

Research series

# The role of trust



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PREPARED BY

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# Contents

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Introduction	3
Research approach	4
What role does trust perform?	5
Differences between the board and executive	6
How does trust work?	9
What can we conclude?	13
References	15

# Introduction

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In 2015, we conducted research for the AICD on the relationship between governance and performance (Kay and Goldspink, 2015). This involved interviewing 100 Chairs from private and listed companies, as well as from not-for-profits and public sector organisations. The research identified three key factors that the Chairs said impacted the quality of board decision-making and, as such, their organisation's ability to achieve successful outcomes. These were:

- Perspective — an ability to question and debate the assumptions informing the board's assessment of the organisation's situation, given its complexity and ambiguity;
- Scale — the ability to appropriately frame or understand the implications of decisions across time and different levels of organisational scale, i.e. decisions taken at the level of the team may have unintended consequences at the divisional or organisational and vice versa;
- Prediction — the ability of the team to use information and experience as a basis for predicting plausible future circumstances and their implications for the organisation.

The Chairs argued that the attributes needed to support these three key factors were:

At the individual level:

- Independence of mind (as distinct from structural independence); and
- Openness to alternatives;

And at the collective level:

- Diversity of views and experiences; and
- Trust.

Achieving and maintaining these attributes, they argued, came down to the selection, development and maintenance of an effective team, comprising both the board and the executive. Importantly, the Chairs also discussed the fact that it was a challenge to bring these attributes together, and even more difficult to maintain them over time. Of these attributes, trust - both between members of the board and between the board and the executive - was seen as the most important factor as it enabled the other attributes. Significantly, in a study we conducted in 2012 involving interviews with 50 CEOs of critical infrastructure organisations, (Kay & Goldspink, 2012), trust was also found to be critical to organisational resilience.

In this paper, we will explore the role of trust in more detail, comparing the views of the CEOs from the 2012 study<sup>1</sup> with those of the Chairs from the 2015 study. We will also consider broader research, which provides insights into trust dependent processes linked to effective governance and effective group decision-making more generally.

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<sup>1</sup> We would like to thank Commonwealth Attorney General's Department for making the data set from the 2012 study available to use for re-analysis.

## Research approach

In this paper, we have relied on two pre-existing data sets. This included (i) 50 qualitative interviews with CEOs of large critical infrastructure organisations, focused primarily on the factors supporting organisational resilience in their businesses; and (ii) 100 qualitative interviews with Chairs from a wide range of organisations – including listed, public sector, private and not-for-profit organisations – focused on the relationship between governance and performance.

In both cases, the interviews were semi-structured, recorded and transcribed for subsequent analysis. The results described in this paper were the product of a detailed recoding of those transcripts specifically focused on the subject of trust. It is important to note that trust was not the focus of either research project. Instead, it emerged as an important explanatory variable for understanding organisational resilience in the case of the CEO study, and the relationship between good governance and performance in the AICD Chairs study. Consequently, while questions about trust were asked in the interviews, they were usually in response to comments made by interviewees.

In terms of gaining a deeper insight into the role of trust, our methodology is both a strength and a weakness. It is a strength in that we made no prior assumptions about any potential role for trust and, accordingly, did not adopt one definition or assumption in favour of another.

This means the results direct attention to those aspects of trust that the respondents valued, rather than imposing the assumptions of the researchers. The weakness is that the research methodology was not framed so as to separate the ways in which trust may operate (i.e. cognitive, affective or dispositional). As such, care is needed when considering the findings; as while the findings highlight some interesting patterns, they should not be over interpreted.

Ultimately, this paper is designed to stimulate debate about the various roles that trust may play in the relationship between good governance and performance, and to help guide further research into trust that supports the effectiveness of boards.



# What role does trust perform?

The topic of trust has received considerable attention in the academic literature since the late 1950s. Despite this, it remains an elusive and complex topic. Webster's dictionary lists no fewer than 17 different definitions of trust, with the way the topic is viewed often dependent on the context or situation in which trust is being observed. For this paper we are concerned with understanding trust in the context of governance and, more particularly, the role that trust might play in the relationship between good governance and performance.

In the 2015 AICD study, it was found that trust underpinned or enabled the decision-making team (comprising the board and executive) to maintain:

- Diversity of views and experiences;
- Independence of mind; and
- Openness to alternatives.

These factors were found to support the capacity of the board to make effective decisions and, in this sense, it could be argued that the board provides a reflective capacity for the executive as its distinctive role in the broader team.

This view is distinctive from the vast majority of academic research on governance, as it focuses on processes of collective sense-making, and is therefore talking to the strategic role of the board rather than to the control-related i.e. regulatory and compliance roles (Roberts, McNulty et al. 2005). It also begs the question that if trust is critical to the collective sense-making of those with governance responsibilities, is it viewed the same way by both the board and executive and if so, what role does it play?



# Differences between the board and executive

Having extensively re-coded both the CEO and Chair data sets, Figure 1 clearly illustrates differences in emphasis between the board and executive in relation to the role of trust. While the 2012 CEO study was concerned to

identify what helps build an organisations’ resilience to uncertainty in the environment, we feel it is legitimate to compare these two data sets as the Chairs considered similar themes in describing the role of the board.

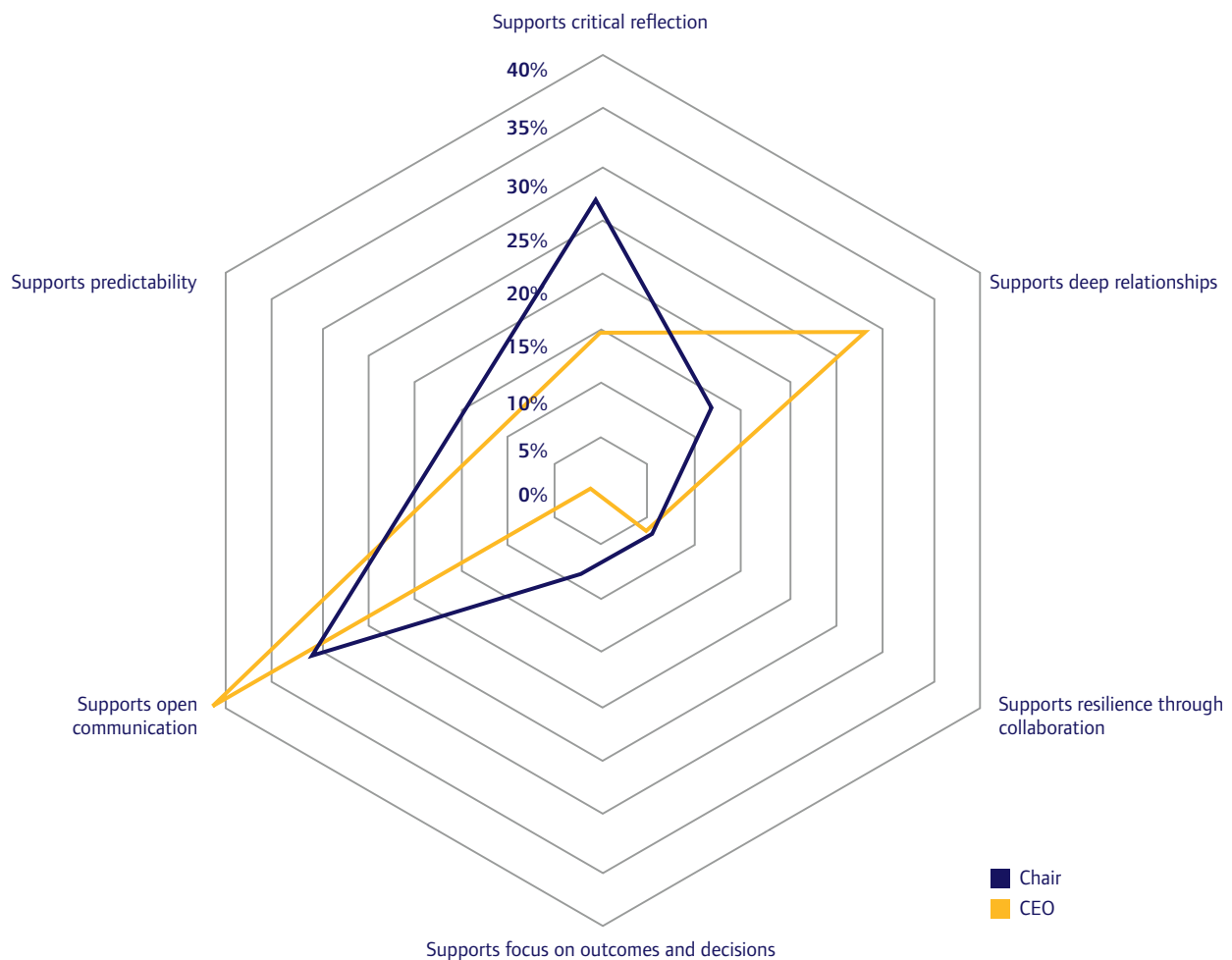


Figure 1 Role of Trust by Chairs and CEO

The key difference between the way the CEOs and Chairs discussed how trust was valued related to the role of trust in ‘supporting deep relationships’, which was favoured by the CEOs, and its role in ‘supporting critical reflection’, which was favoured by the Chairs. For the CEOs, ‘deep relationships’ encouraged mutual support between parties when the organisation found itself in times of need, while ‘critical reflection’ (emphasised more by the Chairs) referred to the quality of debate that could be achieved in the pursuit of superior decision-making outcomes.

In our view, as both factors received considerable attention from both groups, this difference reflects role differences between the Chairs and the executive, rather than a fundamental difference in the way that trust was conceived. Significantly, both CEOs and Chairs placed a high emphasis on the role of trust in supporting open communication.

It is also worth noting that when discussing the role of trust, the interviewees primarily referred to trust between internal stakeholders, i.e. between the board and its own members as well as between the board and the executive. Although trust with external parties, e.g. suppliers, was also raised this was mostly by the CEOs. The importance of high levels of trust between the board and executive may raise alarm bells as board independence is typically concerned with the perceived need for the board to operate at-arms-length from the executive in order to fulfil its control function. This is derived from, or reflected in, the assumptions of agency theory (Eisenhardt, 1989) which has tended to dominate thinking about the role of the board and good governance (Pye and Pettigrew, 2005). It is argued from this perspective, that without effective control, management will seek to maximise its own interests at the expense of the owners of the business. The role of the board, therefore is to ensure that the remote or fragmented (in the case of publicly listed companies) owners’ interests are protected from the assumed risk of managerial opportunism. It is also assumed that the board’s capacity to perform this role is derived through structural

independence from the executive and its fiduciary obligations in law. For some external stakeholders, signals of an overly close (i.e. open and trust-based) relationship between the board and the executive would therefore be a red flag.

In contrast to the above, both the CEOs and Chairs advocated the importance of trust, between the board and executive, as an enabler of improved decision-making. Indeed, accounts of organisational dysfunction in the interviews often involved distrust as both a cause and result of the problems experienced. This gives rise to a possible tension between the needs of some external stakeholders (regulators, the general public and remote shareholders) and internal stakeholders. External stakeholders may trust the company as a whole where they perceive an arms-length relationship between the board and executive management – seeing it as key to avoiding downside risks (such as opportunism, rent seeking and malfeasance). By comparison, internal stakeholders may value closer collaboration and coordination between the board and executive.





Significantly, the Chairs in the AICD study were both conscious of and concerned to achieve a balance between these competing aspects.

*[Chair 10] Well it's interesting, the whole thing about trust. I mean, you know, what does that mean, really? They want you to bring up fresh questions and make sure that money's, you know, being used properly and ... I mean trust can be a bit passive, can't it? I mean you want to trust people are going to do a good job and be professional, but you, don't want them to sort of all be the same.*

This need for balance links directly to the direction of governance reform, which, having responded primarily to governance failures, has tended to be preoccupied with the need for control, potentially at the expense of the strategic role of the board. This has been challenged in the wider research literature. McNulty and Styles have argued, for example, that the board '... should be 'engaged but non-executive', 'challenging but supportive' and 'independent but involved' (Roberts, McNulty et al. 2005: S6). They go on to state that:

*'... in practice, such accountability is realized through a wide range of behaviours – challenging, questioning, probing, discussing, testing, informing, debating and exploring – that draws upon non-executive experience in support of executive performance.'* (Roberts McNulty and Styles: S12)

This strongly aligns with the view of the Chairs and supports the argument that independence of mind is more critical than structural independence, however, to sustain this robust challenge, within both the board environment and in relation to dealing with the executive, the need for a trust-based collegiality was crucial. Trust then is essential to provide openness of communication, allowing multiple perspectives to be voiced and heard – including that of the executive. In the absence of trust, there is naturally a greater likelihood of defensive behaviours, and a tendency to withhold information and/or hide evidence of poor organisational performance.

In this sense, trust provides the social 'glue' that supports robust challenge while conserving the integrity and quality of the interpersonal relationships. Again, there is support for this in the literature. Peterson and Behfar have established empirically, for example, that intra-group trust moderates the impact of increased task-related conflict (2003:10). All of which leads us to consider how it is that the Chairs and CEOs believe that trust works.





## How does trust work?

One of the few areas where there is broad agreement is that trust involves a willingness on the part of someone to accept vulnerability or to take a social risk (Bigley and Pearce 1998). Clearly, to speak one's mind and to challenge others' assumptions, in the way suggested by the Chairs, involves taking such a risk. People are only likely to take such risks to the extent that they hold positive expectations about another's intentions or behaviours in relation to them (Mayer, Davis et al. 1995).

Social similarity has been shown to support more trusting interpersonal relationships (Newcomb 1956). People with similar backgrounds and experiences are more likely to share similar values, beliefs and assumptions. This will be conducive to more open exchanges and sharing of views and, therefore, collegiate relationships. However, this pathway to collegiality may come at the expense of diversity. The Chairs interviewed for the AICD study saw diversity of views as fundamental to better decision-making and therefore performance. They were conscious of the need to maintain and encourage diversity of views on their boards by recruiting directors with different backgrounds or perspectives.

*[Chair 10] ...there's a sort of natural tendency to sort of go with people that are like you ... it sort of takes discipline to say, "We're going to look for, you know, diverse thinking," and know that that's going to probably be a bit harder. But in the end, hopefully we'll get some better decisions.*

Within the wider push for greater diversity on boards, it has been argued that women bring different views and styles to men (Huse 2006). For the 2015 AICD study, we purposefully oversampled for women in the hope we could identify differences in perspectives between genders. Analysis of the data in terms of overall

thinking about the relationship between governance and performance – the primary focus of the study – identified no significant differences between male and female directors. However, in recoding the data set specifically for considerations of trust, some interesting differences emerged.

Figure 2, shows differences between male and female directors in relation to the emphasis they placed on trust and its role in governance. Whilst more than 20 roles were identified in the transcripts, this was reduced down to the 6 that were most frequently discussed and which showed differentiation by gender. It is important to note that the differences presented in Figure 2 are a function of the frequency with which these dimensions were discussed by interviewees. The assumption is that the more often the concept came up in interviews, the more important it was to the Chairs.

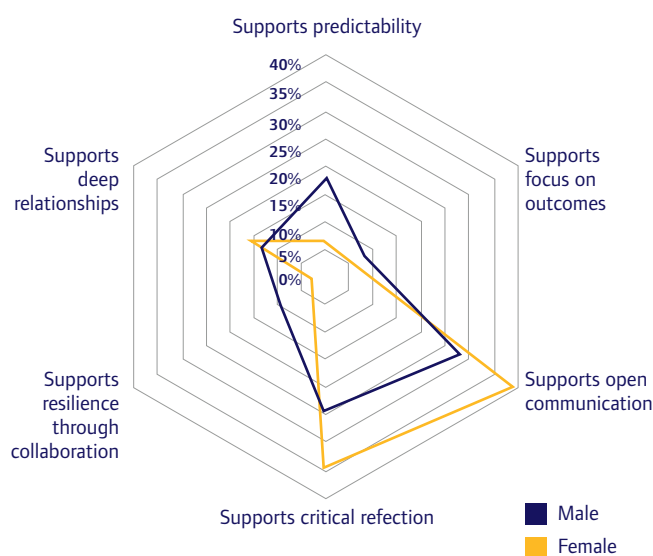


Figure 2 Role of Trust by Gender

For the male Chairs, there was a slightly greater emphasis on the role of trust in ‘supporting predictability’; indeed, this was also the case in the CEO sample<sup>2</sup>. The role of trust, from this perspective, is reducing behavioural uncertainty. A person is trusted when the person granting the trust has (based on experience) formed a judgment that he or she can rely on that person to respond in a predictable way (under certain conditions). In this sense, trust is an expectation or prediction of an outcome based on knowledge of the people and processes involved. In the context of organisational resilience this was important as it reduced one area of uncertainty in a crisis and emerged as the primary theme around trust in the CEO study.

Whilst the CEO study had a smaller percentage of female respondents than the AICD study, it is significant that the greater emphasis on prediction from male respondents remained present with the Chairs. One Chair used an analogy to team sports to explain that it is like:

*[Chair 09]: ...where you expect the individual in a team sport to really perform well when they are required to. You know, if it's football, when they're going for the ball, they're expected to perform well. When the team's defending, they're expected to perform as a team, you know, and it's not unlike that when a board operates.*

Within the literature on trust, the making of judgements about another's intentions can be based on rational assessment and prior experience (as reflected more strongly in the male responses), or on gut feel. This

suggests two ways in which trust may work – rationally or emotionally. These two possible sources of trust are, respectively, referred to as cognitive and affective.

For McAllister (1995), the ‘cognitive’ refers to an assumption that, at least in part, we choose whom we trust and why for rational reasons. In these circumstances we should be able to explain why, based on experience, we choose to trust someone. This is an important assumption in the context of governance as it suggests that we consciously make trust-based decisions rather than sub-consciously. The second of McAllister's categories, the ‘affective’ foundations for trust, relate more to the emotional bonds between people (Lewis and Weigert, 1985), where an emotional investment in a relationship supports a belief in the virtue of the other person and that those sentiments will be reciprocated. In contrast to the cognitive perspective, ‘affective’ trust is not necessarily conscious.

Some have argued that these two aspects of trust can be integrated, with cognitive trust being more dispositional (and hence innate) and affective trust more cultural. Either way the judgment will inevitably be made on limited information or experience, as a ‘rule of thumb’. As such it may be subject to systematic preferences and biases.

Trust, in this sense, serves to reduce the cognitive load; if I do not have to focus on how others are doing and can assume they will do their best to support the organisational outcomes, I am free to focus more on the other challenges at hand. For example:

*‘... trust enhances the predictability of others’ actions (Gulati, 1995). This enhanced predictability allows exchange partners to anticipate others’ actions and*

<sup>2</sup> Of the 100 Chairs interviewed for the 2015 study, 30% were woman. All sectors were sampled this way. This compares with an average of approximately 22% female representation on ASX 200 boards. (AICD statistics)

<sup>3</sup> The number of female CEOs in the resilience study was 9 out of 50, or 18%. Gender was not a consideration in the sampling for that study.

*to adjust their own accordingly when the need for such adjustment arises. Hence, trust also enhances adaptive capacity.’ (Puranam & Vanneste, 2009: 15)*

This may apply to intra- as well as inter-group dynamics, including between the board and the executive. To the extent that these two key groups have confidence in one another to do what needs to be done, they can concentrate on adding distinctive value befitting their roles, rather than attempting to second guess one another. This, of course, opens up the possibility of the ‘dark side’ of trust, in that the assumption of trust may be misplaced and the trustor may be blind-sided by betrayal.

It is of concern and somewhat paradoxical then that ‘... settings where trust is most needed – situations of interdependence, potential conflict, and risk... are those where betrayals of trust are known to be more prevalent’ (McAllister 1997: 96). Trust as a basis for future prediction may therefore be valuable in a crisis but may not be something which could or should be relied upon as a normal mode of operation.

Interestingly, female Chairs placed greater emphasis on the role of trust in ‘supporting open communications’ and ‘supporting critical reflection’ rather than its role in reducing uncertainty. These are closer to what Roberts refers to as ‘socialising’ in nature.

*‘...the opportunity to challenge, elaborate, clarify and question – has the potential to engage more fully the person and thereby offer a fuller sense of personal recognition and identity. At the same time, such open communication draws people into a deeper sense of their relatedness to each other. Indeed, in the absence of hierarchy it is only through such processes of dialogue that individual differences and interdependencies can be articulated. [these] have the potential to be an alternative source of identity at work, to build an immediate sense of the interdependence of self and other, as well as to generate shared, credible and possibly alternative understandings of organizational reality.’ (Roberts 2001: 1554)*



The two factors, ‘Supports Open Communication’ and ‘Supports Critical Reflection’, were dynamically related in that, for the Chairs, trust was both enabled by and an enabler of these factors – suggesting the existence of virtuous and vicious cycles of trust building. Typically, the focus of discussion for the Chairs in describing these relationships was the dynamics between the board and the executive. For example

*[Chair 02]...it's a very important thing to have a shared relationship of trust between the board and the CEO in particular. That needs to be a trusted and shared relationship, very important, ... Because if you expect a CEO to come to the board with his concerns, or her concerns, or with doubts, that requires a safe environment for the CEO to do that. So, that's important for the Chairman in particular, to manage, to make sure that the Directors don't judge the CEO for coming with those uncertainties, or incomplete ideas.*

In this quote, the respondent is noting the role of trust in creating or reflecting an environment of psychological safety (Edmondson 2003 ). Schein (1985: 298) argued that psychological safety helps people overcome the defensiveness (Argyris, 1990) or “learning anxiety” that occurs when people are presented with data that does not conform with their expectations or hopes. This can thwart productive learning behaviours. Psychological safety therefore opens up a capacity to learn and change thinking, as well as to hear alternative perspectives (Edmondson, 2003 : 5).

Importantly psychological safety has also been shown to support greater task conflict (which is positively related to group capacity to solve complex problems), without giving rise to interpersonal conflict (which is negatively associated with effective problem solving). Forbes and Milliken (1999) argue, for example, that the most effective boards will be characterised by high levels of interpersonal cohesiveness while at the same time encouraging task-oriented disagreement. This was a view strongly reflected by the Chairs:

*[Chair 32]: ... it's the personal qualities and it's this being able to operate in a collegiate process but independently thinking at the same time. And it's getting that balance. You can be a very independent thinker who just wants to think your way and never, ever listen to what anybody else says, which is going to be pretty disruptive on a board. Or you can be the other way where you just accept everything that's said and don't think independently about an issue.*

For women, then, the emphasis was more on the role of trust in enabling effective group functioning – in expanding the group's capacity to respond to complex problems and high uncertainty by harnessing the diversity of views within the board and between the board and the executive. This is a more relational focus. These differences were, however, very much around the margins and, overall, both males and females placed emphasis on the same aspects; that is, those that provided the ‘social glue’ to hold relationships together while, at the same time, supporting robust challenge and questioning in the interests of the organisation.

## What can we conclude?

From the above discussion we can conclude that the role of trust in governance, to a large degree, depends upon the starting position for the discussion and, indeed, the stakeholder perspective being adopted. Puranam and Vanneste (2009) argue that the approach chosen in relation to governance typically corresponds to whether the concern is framed as one of ‘minimising risk’ or ‘maximising performance’. The former tends to place emphasis on how trust supports or undermines the role of the board in exercising its control function, while the latter is concerned with the role of trust in advancing the strategic function of the board.

Given that the sociological research suggests that trust is more readily lost than gained (Lewicki and Bunker, 1996; Elangovan and Shapiro, 1998), it is perhaps unsurprising that, in the face of persistent governance failures, regulators have, to a degree, assumed a negative role for trust in attempting to address instances of managerial opportunism, devaluing the effective and legitimate role trust plays in supporting organisational performance. This is an excessively myopic view and runs the risk of becoming an ‘own goal’ (Roberts, McNulty et al. 2005).

This paper has focused more on the role of trust in relation to the boards’ strategic role (Pugliese, Bezemer et al. 2009). From this perspective, based on the interviews and organisational research, the conclusion is that,

*‘... board effectiveness and ultimately, firm performance may be enhanced by close, trusting CEO–board relationships... (Westphal, 1999: 19).*

The Chairs’ approach emphasised that trust forms part of a ‘socialising’ approach to accountability, rather than a ‘policing’ one. Roberts (2001; 1567) has argued that this approach has a greater impact on accountability due to its immediate face-to-face nature:

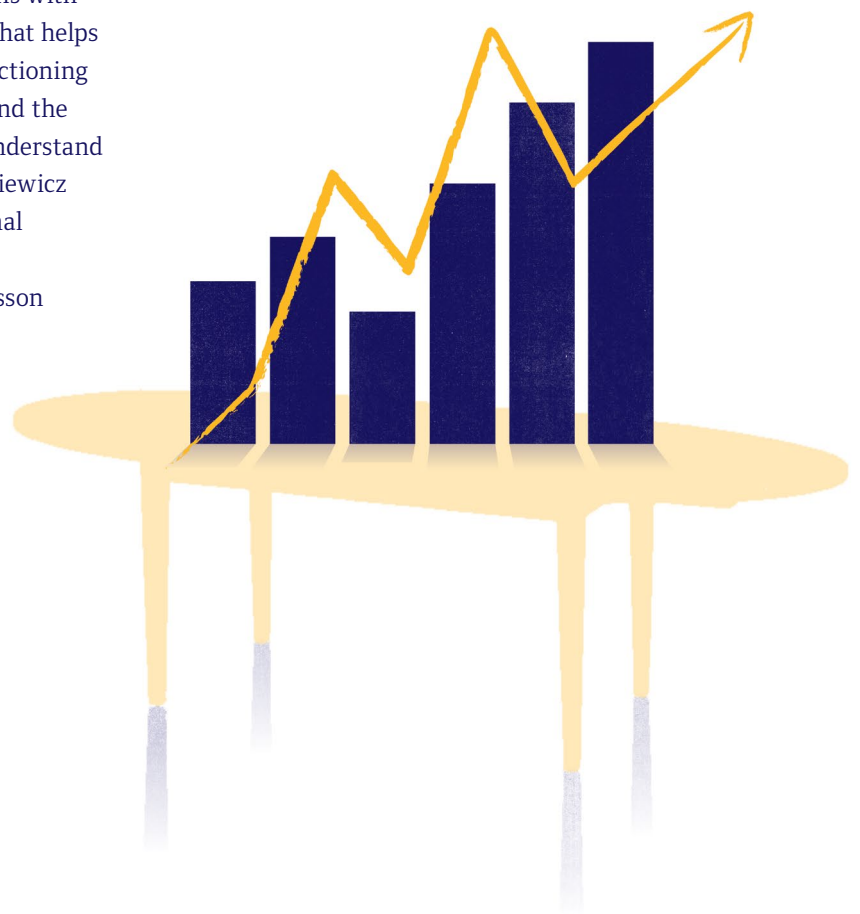
*‘One of the vital benefits of face-to-face accountability between relative equals is that it allows us to test and challenge our own and others’ assumptions through dialogue. On occasions, such testing may only reinforce our concerns, but it may also allow the other to overwhelm our assumptions in a way that deepens and refines our reciprocal understanding. Over time, such face-to-face accountability is a vital source of learning and can produce complex relationships of respect, trust and felt reciprocal obligation, which far exceed the purely instrumental orientation to action that agency theory assumes.’*

Assuming mistrust, rather than trust, shuts down scope for learning by denying participants the psychological safety that is needed to support robust relationships, which can remain viable in the face of questioning and challenge. It is this quality of relationship which the Chairs argue is at the heart of good governance, and which balances the needs of both the control and strategic roles.

Trust provides the level of social cohesion necessary for effective decision-making under uncertainty by allowing the diversity of views and experiences of the board to be harnessed. Trust is built up gradually and incrementally, reinforced by previous trusting behaviours and previous positive experiences (McAllister 1995; Lewicki and Bunker 1996).

The balance that the Chairs argued for can be slow to build and all too easily lost. For this reason, it was unsurprising that many Chairs described it as a sought after 'sweet-spot' that was rarely experienced but, when attained, was powerfully advantageous. It is of concern, therefore, that while the regulatory focus remains with the control function, too little is known about what helps achieve, stabilise and sustain this quality of functioning within the board itself and between the board and the executive. There is therefore a need to better understand how the behavioural dynamics of trust (Paliszkievicz 2011), patterns of interaction, formal and informal leadership, and organisational context influence the quality of decision making (van Ees, Gabrielsson et al. 2009).

If the Chairs we interviewed are right, and as Styles et al have argued, 'Actual board effectiveness... depends upon the behavioural dynamics of a board, and how the web of interpersonal and group relationships between executive and non-executives is developed in a particular company context' (Roberts, McNulty et al. 2005: S11), then the near absence of empirical research in this area is an issue requiring urgent attention. Research with this focus is far more likely to provide the sought after link to organisational performance, than the current dominant concern with the control function alone.





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