

Influence of Board Mindsets and Behaviours on Effective Non-Financial Risk Oversight

INFLUENCE OF BOARD MINDSETS AND BEHAVIOURS ON EFFECTIVE NON-FINANCIAL RISK OVERSIGHT

In late 2018, ASIC formed a Corporate Governance Taskforce to examine governance practices of large listed entities in Australia. As part of this project, ASIC commissioned Kiel Advisory Group to provide expert advice on the way mindsets and behaviours within Boards might influence their effectiveness. For this purpose, Kiel Advisory undertook an independent review of behavioural norms exhibited by boards of a number of entities selected by ASIC. This report highlights the review's findings.

Given the overall scope of the Taskforce, the review focused on behaviours that may help or hinder effective oversight of non-financial risk and affect decision making relating to variable remuneration; this report focuses on the former. It highlights board behaviours that might affect how clearly non-executive directors see and understand issues, support objective judgement and provide an impetus to address issues.

Key question:

What impact do mindsets and behavioural norms have on board effectiveness?

The methodology was peer reviewed by a range of technical experts including an Organisational Psychologist employed by Kiel Advisory Group, and specialists from three foreign regulators with supervisory programs focused on governance, behaviour and culture. A range of qualitative and quantitative data was collected and triangulated to determine key mindsets and behavioural norms displayed by the boards of six entities, comprising three financial services firms and three non-financial services firms.

This data was further complemented by insights drawn from a survey and a documentation review involving an additional 13 entities across a range of sectors.

35

CONFIDENTIAL DISCUSSIONS

8

MEETING OBSERVATIONS

287

ANONYMOUS SURVEY

Responses

19

DOCUMENTATION REVIEW

Entities

The review noted a range of mindsets and behavioural norms common across boards in the sample. These characteristics created both strengths and barriers to board effectiveness. These findings replicate similar findings on cultural drivers of board effectiveness published internationally¹. Variations in board style were also observed. Boards are encouraged to consider both common challenges, and the inherent risks associated with their own unique style if they wish to address cultural drivers of effectiveness in their firm.

These findings may be read alone or alongside ASIC's broader Corporate Governance Taskforce report.

The report is separated into four sections:

- **Part A** sets out common themes noted across entities in the sample.
- **Part B** describes four varying archetypes and their respective influence on board effectiveness.
- **Part C** highlights implications for better practice.
- **Part D** provides practical considerations for all firms.

1. For example, Raaijmakers, M. (Ed.). Supervision of Behaviour and Culture: foundations and practices. De Nederlandsche Bank. Springer-Verlag Berlin Heidelberg.

PART A (I) COMMON THEMES – HELPFUL MINDSETS AND BEHAVIOURS

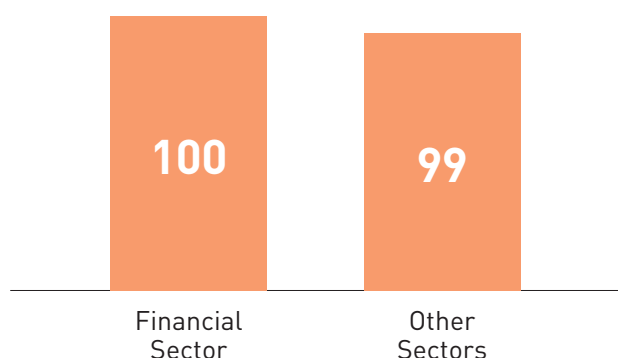
The majority of boards observed in the review exhibited several common characteristics that helped versus hindered their effective oversight of non-financial risk. These themes and implications are described below.

1. Self-concept as ethical role models

Board members that participated in this review displayed a self-concept centred on integrity, both individually and collectively. When asked to choose five words that best described their boards from a list of 96 options, the three most commonly selected words were 'accountability', 'customer-focused' and 'integrity'. In an anonymous survey conducted with board members, 100 per cent of non-executive directors from the financial services sector agreed with the statement 'Integrity and ethics at the board level sets the tone for sound conduct below'.

'Integrity and ethics at the board level sets the tone for sound conduct below.'

Non-executive directors, % agreement



That board members might subscribe to the sentiment of this statement may seem like a given. At a minimum, the fact that so many board members agreed with the statement shows an understanding of the expectations commonly placed on boards.

These expectations are often reinforced in board charters that explicitly articulate the responsibilities of non-executive directors in exhibiting and promoting the highest standards of ethical conduct and decision making.

The review also found a significant emphasis on ethical role modelling in the behaviour of directors. Many executives reported that their boards were highly engaged when ethical issues were on the agenda, and particularly when those issues related to customers (especially in the case of financial services entities), safety and employee wellbeing. One executive noted: "Directors say our number one priority is making sure you remediate customers quickly, our number two priority is making sure you remediate customers quickly, our number three priority is making sure you remediate customers quickly." Boards' self-identity can generate strong alignment of purpose, which is useful in helping them oversee the ethical conduct of their organisation. However, as detailed further in this report, a strong intention to guide the ethical conduct of an organisation is only the first step, and a number of factors may still restrict boards from achieving this goal.

2. Conscious efforts to challenge management

Industry guidance broadly suggests effective boards challenge management thinking. One of the arguments for ensuring diversity on boards is the fact that it increases opportunities to challenge management thinking by considering decisions through a variety of lenses. Diverse perspectives, experience and skills were clearly evident across the boards examined in the review. They employed a range of strategies that demonstrated deliberate effort to test and challenge management. These included light-touch questioning designed to help the board understand management's underlying assumptions, or suggestions for management to consider alternative approaches.

Some boards made more active requests for management to supply additional information or analysis. Others showed more robust disagreement with management's ideas, or expressed concern about the status of controls or other risk management improvement initiatives.

This expectation to challenge was also noted in formal guidelines captured by board charters, including statements such as '[Directors have an obligation to]... discuss, debate, challenge...at board meetings.'

Many chairs also discussed deliberate techniques they employed to facilitate open challenge – for example, waiting until the end of a meeting to put forward their viewpoint, to avoid undue influence on the group's decision making. Two-thirds of boards stated that board dinners were used as a deliberate mechanism for facilitating frank discussion between the board and the CEO.

This clear attempt to challenge is acknowledged by management. When members of management teams were asked to select five words that best reflected their board, the second most commonly selected word (after 'accountability') was 'challenge'.

However, the effectiveness of board challenges varied. While the act of challenging was quite common, the extent of deep challenge to the whole group's assumptions, logic and institutional performance was less clear. Some barriers to this are explored in the next section.

'The board doesn't make many decisions really, they endorse management decisions. But they challenge: How do we get to that? What are the options?... This happened at [Company XYZ], what are we doing on that? Or from experiences I was discussing on my other board, what are we doing about it?'

– Executive describing challenge by their board

PART A (II) COMMON THEMES – UNHELPFUL MINDSETS AND BEHAVIOURS

1. Difficulty engaging in deep reflection that might result in genuine self-challenge

The review noted several mindsets and behavioural norms that appeared to restrict opportunities for boards to self-reflect and identify blind-spots, especially those related to ethics or other risks with a subjective dimension. These characteristics included:

Limited time for unstructured discussion	Notwithstanding additional opportunities for discussion (such as board dinners), the formal meetings observed as part of the review kept to a tight schedule in order to cover mandatory items. As a result, time for reflective thinking was very limited.
Framing	Board papers and presentations often framed choices through a functional prism, directing the board's focus towards logical business trade-offs rather than to other considerations such as ethics.
Limitations to psychological safety	Here's what one non-executive director said about relationships with other board members: "We aren't 'friends', we don't spend time together outside board meetings, but there is a lot of mutual respect." The propensity to ask truly confronting questions relies on deep trust, positive regard and empathy between people – a type of relationship that is difficult to achieve through typical board interactions, which take place a limited number of times each year.
Unconscious bias	The review noted that a number of board members had such a strong belief in the board's role and the business's moral compass that it was difficult for them to accept evidence of lapses – even unintended ones.
Euphemisms and polite language	In a number of instances, language was used (probably unconsciously) to subtly placate and avoid follow-up on uncomfortable issues. Words were carefully chosen to offer reassurance rather than concerns.

Implications for supervision and monitoring of non-financial risks

These norms may inhibit the capacity of boards to:

- Identify ethical ramifications that management and the board may have overlooked at the time a strategy was formulated
- Evaluate changes in the materiality of non-financial risk due to changes in the external environment (including changing expectations)
- Decide how to address new concerns regarding non-financial risk, which relies on giving sufficient time and attention to debating issues, achieving consensus and agreeing on appropriate mitigating actions

2. Attempts to resolve conflicting agendas

Many non-executive directors emphasised that the work of a board is multifaceted, and that supervision and monitoring of non-financial risk is one key consideration among a range of others. The boards studied for this review were explicit in their attempts to balance multiple priorities – including some priorities that undermined the goals related to non-financial risk. The purpose of this review was not to judge the appropriateness of such trade-offs, but rather to highlight their existence and consider their impact on the specific aims of supervising and monitoring non-financial risk. Two commonly discussed tensions are described below.

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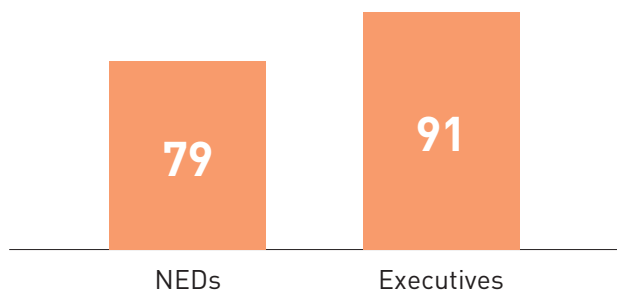
Perceived (mis)trust versus transparency

Boards may recognise their role in challenging executives and holding them accountable, but many non-executive directors are also aware of the unintended side effects when attempts to do so go poorly, such as decreases in mutual trust and transparency. As one executive noted, “The biggest challenge is making sure it does not become a negative blame culture that stifles openness and learning.”

The survey results highlighted this tension.

‘Building a culture of transparency between the board and management is more important than penalising executives for issues that may have been outside their control.’

Financial sector, % agreement



Empowerment versus accountability

For a variety of reasons, boards expressed sensitivity to their role in relation to management. Among other concerns, a number of non-executive directors were aware that overstepping into management’s domain – especially into the sphere of the CEO’s delegated authority – could reduce management’s motivation, sense of ownership and, ultimately, accountability. This could be a difficult dynamic to navigate, as illustrated by this comment from a non-executive director: “The most challenging thing is to justify myself as a director that I’m not hands-off, not strong ... actually this [is] what makes people more accountable ... you trust people until they let you down, and then you don’t trust them.”

Implications for supervision and monitoring of non-financial risks

- In an attempt to avoid a ‘blame culture’, non-executive directors may end up with insufficient debate and challenge.
- Sensitivity to the concept of empowerment can reduce a board’s impetus to take strong steps to influence management, even when it is objectively warranted.

3. Difficulty understanding the business in enough depth to identify gaps in management's perspective

Diversity and independence were commonly espoused standards of the boards in the review sample. While these characteristics have benefits, the combination of independence and diversity does present a risk that the board may have a restricted understanding of the business. As one executive commented:

“There is a risk of detachment for non-executive directors, who know the business less deeply ... The risk is that boards don't know what's going on. The way to counteract this is to have more directors on the board from the sector ... I'm not convinced by the value of 'dumb questions'.”

– Executive

On the task of overseeing non-financial risks, respondents highlighted that non-executive directors' ability to anticipate, identify, evaluate and judge the materiality and impact of potential risks through the information they receive is constrained. This is especially true of directors who have never worked in the industry on a day-to-day basis. Even for non-executive directors with previous experience, the increasing complexity and rapidly evolving nature of many industries presents considerable challenges. Free-text comments by respondents provided particular insights into the salience of these challenges. Comments from 20 per cent of non-executive directors and executives from the financial services sector contained the word 'complex' when describing the challenges boards face in effectively overseeing non-financial risk.

Non-executive directors and executives shared various strategies for seeking to verify information provided by management. These included 'joining the dots' across multiple reports, carefully reviewing internal and external audit reports, visiting operational facilities, speaking directly to front-line staff, and engaging with customers and suppliers. Most of these techniques were evident in all the organisations we studied. However, the overall evidence from this review suggests that in spite of these efforts, (appropriate) detachment from day-to-day operations, limited direct industry experience, and increasingly complex and evolving environments combine to undermine non-executive directors' understanding of the businesses they oversee. Of the financial services non-executive directors surveyed, two-thirds agreed with the statement 'It is difficult for boards to identify conduct-related risks and issues that are not contained in any information provided to them.'² Many non-executive directors expressed the belief that boards simply needed to trust management's judgement. "In a lot of areas, often their experience is better than yours, you cannot second guess," one non-executive director said of management.

Implication for supervision and monitoring of non-financial risks

While non-executive directors may not see a clear solution to the problem they face in achieving deeper insights into the business, this issue reveals a clear tension: effective monitoring of non-financial risks does require a strong grasp of operational issues. Unless this tension is addressed, a gap may exist between regulatory expectation and practical reality.

2. Note: due to prioritisation of other items, this question was not included in the survey for NEDs in other sectors.

PART B

DIFFERENCES OBSERVED ACROSS BOARDS: FOUR ARCHETYPES

In addition to common strengths and challenges, several different board archetypes were observed in the deep-dive sample and indirectly supported by our broader analysis. These archetypes are described here as Advisory, Collaborative, Sceptical and Director styles, referring to different patterns of problem solving, decision making and leadership approach. Each style was also associated with certain strengths and challenges relevant to boards' effective oversight of non-financial risk. The following factors tended to define these variations in style.

The primary source of influence: CEO or chair

The informal source of influence in most boards was distinct: some leant towards the CEO, and others towards the chair. This was observed in subtle and symbolic ways, including which of them spoke first and most often at board meetings. Neither model prevailed in terms of effectiveness, but in both models, effectiveness did depend on mutual respect.

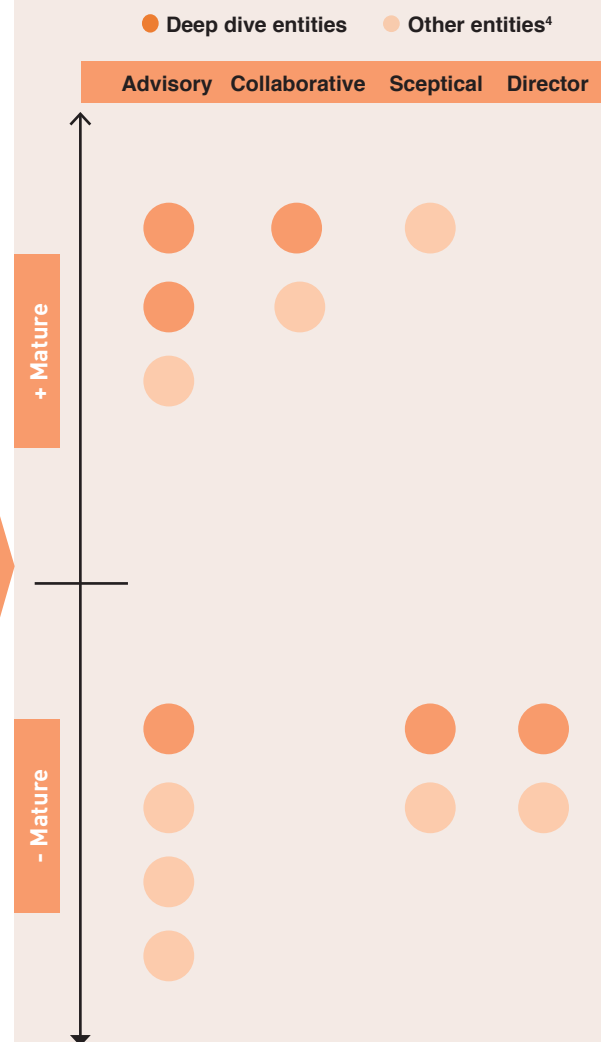
Task-oriented versus relationship-oriented

Boards tended to reflect the leadership style of the chair. Task-oriented boards displayed a high level of conscientiousness and attention to best-practice processes and guidelines. Relationship-oriented boards were more adept at building trust and transparency, putting emphasis on supporting, motivating and developing the board and management as an indirect means of achieving high performance. This was a dimension where one end of the spectrum did seem to prevail: relationship-oriented styles appeared to provide a more effective foundation for gathering insights and achieving influence.

Centralised versus diffused interactions

Some models attempt to foster multiple direct relationships across members of the board and management, while others prefer a 'funnel' approach where the CEO is the primary conduit for information flow between management and the board. Each model appeared to have inherent benefits and risks. Centralised models aid alignment of purpose and direction, and clarity of accountability, whereas diffused models strengthen transparency, opportunities for broader support and influence. Neither model seemed to prevail in terms of its impact on effectiveness.

Archetypes observed in sample³



3. Only entities with a minimum reportable sample size for the survey of both board and executives were included

4. Indicative only due to more limited data (survey and document review).

1. Advisory model

“I view [the board] as the best advisors you could have. They are there to appoint the CEO and make sure appropriate governance is followed, a strategy pressure-cooker, and representative of shareholders.”

– Executive

This style was characterised by clear role boundaries, and maintained a certain distance from the rest of the organisation, often using the CEO as a conduit for connecting to the broader management team and business. Respect was a critical driver of effectiveness within these boards.

Strengths of this style

- Independent perspectives ensures these boards avoid becoming ‘too close’ to management. This may make it easier for them to view issues through an alternative lens and challenge management blind spots.
- An emphasis on collective performance increases the group’s potential for generating insights.
- A high degree of respect from the executive team means relatively subtle direction from the board can translate into significant influence on management.

Inherent risks with this style

- Insufficient respect for the board by management can limit their influence.
- Information asymmetry between management and the board is a risk of this style, even when there is mutual respect. A side effect of independence can be disconnection from operational reality.
- Advisor boards need to pay particular attention to their methods for verifying the information they receive from management, to ensure their fact base is adequate to challenge management effectively. This is especially important in models where the CEO acts as an information funnel between the two groups.

Less effective advisory boards displayed these characteristics

- Management view members of the board as adding limited value – for example due to insufficient industry experience. Questioning that lacks operational understanding may be one driver of this dynamic.
- The chief executive officer views the board as a source of advice, but with an option to dismiss if desired. This diminishes the board’s influence.
- Members of the board express doubts about the capability or experience of one or several of their peers.

More effective advisory boards displayed these characteristics

- Executives and non-executive directors describe the board as a high performing team.
- Management respect for the board is visible through active engagement and advice seeking, genuine listening and openness to being persuaded, especially by the CEO.
- Mutual respect is manifested in active listening between non-executive directors, openness to considering differing viewpoints, and appreciation for the effort and insight of fellow board members.

2. Collaborative model

“The [XYZ Board] is an extremely competent and caring board and enjoys a strong and transparent relationship with the management team, who feel empowered to raise issues as they arise.”

– Executive

This model put considerable emphasis on constructive group interactions, sometimes more than on formal corporate governance structures. It was characterised by a relatively equal distribution of authority between the board and management, facilitated by a strong CEO, and a chair who ‘leads from behind’.

Strengths of this style

- A strong degree of transparency and trust between the board and management increases the likelihood that any issues or concerns at the management level will be shared with the board.
- The board is more likely to participate in decision making regarding perceived materiality of risks, and remediation plans.
- Constant discussion and genuine co-creation of strategy engenders high levels of buy-in and a shared commitment to the group’s purpose.

Inherent risks with this style

- High levels of engagement and participation between the board and management can increase the risk of ‘group think’ (shared cognitive errors in perception or logic which undermine the validity of decisions).
- The highly consensus-oriented nature of this model can increase the time required to reach decisions and take action. And once a position is agreed, it can be quite rigid and difficult to shift – even when external information suggests that change might be justified.

Less effective collaborative boards displayed these characteristics

- The board avoids asserting necessary influence in order to avoid disrupting the relationship with management.
- An overwhelming striving for consensus leads to participation by all members of the group on all decisions, negatively impacting both efficiency and effectiveness of decisions.
- Individuals with different perspectives (especially those who are newer to the group) experience strong feedback to align to the group’s existing views.

More effective collaborative boards displayed these characteristics

- The board avoids ‘micro-managing’ the executive, but rather coaches and supports them, ensuring they are ‘brought along’ when necessary.
- Investment in extensive dialogue ensures genuine alignment exists on all key issues. Skilled facilitation by the chair ensures individual perspectives are raised and fully explored.
- Trust and mutual respect allow members of the group to delegate certain issues to a sub-set of the board (for example committees) who have expertise and time to devote to them.

3. Sceptical model

“The issues we bring to the board tend to be prosecuted more than years ago ... When interrogating something they break it down to component pieces to analyse ... They can all be testing and challenging – they don’t stick only to their areas. There are lots of questions.” – Executive

This model put a high value on meeting perceived external expectations. It was characterised by a high degree of conscientiousness and a focus on completing set tasks. Particular emphasis was placed on challenging information provided by management to test its accuracy and completeness.

Strengths of this style

- This model involves a committed and serious attitude towards the board’s responsibilities.
- The board sets clear expectations of management, which reinforces a sense of ownership and accountability.
- Management decisions are robustly tested, and information provided to the board is examined in detail.

Inherent risks with this style

The overwhelming challenge for this style of board is that a strong commitment to challenging management – often in conjunction with a heightened emphasis on penalising executives for poorly managing non-financial risks – may create a perception of mistrust between the board and management. Such a perception may be associated with a more careful approach by executives when sharing concerns with the board (for example, by waiting until more information is available). It also may encourage more defensive responses to questioning from the board – in turn inhibiting the board’s ability to understand and constructively influence via effective exploration of issues and management’s guidance on possible actions.

Less effective sceptical boards displayed these characteristics

- Relationships within the board, and between the board and management, receive relatively less attention than the task of challenging management, sometimes leading to interactions that are experienced as confrontational and antagonistic rather than supportively probing.
- Very high expectations of management and low tolerance for failure are expressed by the board, creating some fear of raising issues.
- A mindset of defensiveness exists within the management team, possibly developing in response to perceptions of criticism or doubt.

More effective sceptical boards displayed these characteristics

- A strong degree of compliance with guidelines and recommendations is displayed, with an emphasis on effective outcomes, not just best practice processes.
- Rather than individual competence, emphasis is placed on the group’s collective performance, including challenging not only management, but also the board’s own blindspots.

4. Director model

“I have strong views ... everyone knows my vision. The board has good relationships with the executive, but would like us to step back.”

– Chair

This model was characterised by a highly influential chair who exhibited vision and passion for the firm. These groups tended to perceive success and failure as attributable to individual talent rather than group effectiveness. A clear sense of long-term purpose was also a feature of this model.

Strengths of this style

- A strong alignment around a common purpose encourages the board and management to develop the same expectations for the business's goals, performance and strategy, reducing the conflicts and misunderstandings that can come from misaligned intentions. This, combined with a high degree of respect for the chair, reinforces the board's ability to influence management constructively.
- The board is more likely to understand the operational dimensions of the business, which can provide helpful data for evaluating the existence and materiality of non-financial risks.

Inherent risks with this style

- Concentration of perspective is the most significant risk of this style. Because the chair is highly respected, their views may end up prevailing whether or not they take steps to avoid undue influence. This is particularly problematic when issues arise that are outside the chair's area of expertise.
- This style can be disempowering to management, which ultimately affects motivation and ownership.

Less effective director boards displayed these characteristics

- The competence of the full group tends to be under-utilised, with the chair's influence dominating.
- The strong emphasis on individual talent can make board members feel self-conscious about asking questions that reveal a lack of knowledge.
- When incidents occur, they are often attributed to individual failure, rather than considering how the group could operate more effectively as a team to mitigate capability gaps.

More effective director boards displayed these characteristics

- The chair strategically applies the director model as necessary – for example, during periods of transformation or crisis – but reduces directive behaviours once the phase has passed.
- The chair is highly cognisant of gaps in their skills and style, and takes deliberate steps to compensate for them – for example, by ensuring others play a 'supporting role' in relevant areas.

PART C IMPLICATIONS FOR BETTER PRACTICE

Individual conscientiousness is necessary but not sufficient

The conscientiousness of individual non-executive directors was often observed during the review process. Most non-executive directors displayed sound awareness of their obligations. They took actions designed to ensure their input added value: preparing for meetings, taking steps to understand the business and issues well, readily contributing their insights and asking thoughtful questions. However, individual capability, while necessary, did not seem sufficient to differentiate effective boards from ineffective boards, possibly because board supervision and monitoring is an activity involving multiple groups.

Skilled navigation of the group dynamic is a key differentiator of effective boards

- **Aligned purpose to reinforce effort towards a common goal.** Clear articulation of and genuine joint commitment to the firm's noble purpose helped boards and management form a common base to evaluate materiality, investment priorities and conflicting stakeholder preferences.
- **Perceived trust to reinforce insight.** When executives felt mistrusted by their boards, their reaction was more likely to be defensiveness, anxiety and fear – the antithesis of the open, transparent environment boards desired from their management teams in which to escalate issues and constructively respond to challenges. Higher levels of trust and vulnerability between board members facilitated openness, including admitting a lack of knowledge and ethical doubts. Trust by itself might not strengthen oversight of non-financial risk, but mistrust undermines it in multiple ways.
- **Mutual respect to reinforce influence.** Participants noted that the consequences of a board exerting excessive authority to gain control can undermine the sense of accountability it intends to achieve. Relying on authority also has limitations as a source of action. Management teams with high levels of respect for the board were inclined to offer more candid information to help the board provide appropriate guidance. And these boards could respond with far more energy and commitment than those lacking respect from management.

CHARACTERISTICS OBSERVED THAT REINFORCE EFFECTIVENESS

Individual conscientiousness
(basic requirement)



Aligned purpose

Perceived trust

Mutual respect



More effective oversight of non-financial risk

- Collective effort towards a common goal
- Board insight
- Board influence

PART D

CONSIDERATIONS FOR FIRMS

1. Boards can strengthen their effectiveness by addressing three factors

Improving ownership of their role in creating the conditions that underpin effective risk oversight

- Evidence collected in the review suggests that many non-executive directors feel a sense of helplessness regarding the expectations of certain stakeholders. For example, there is a common view that boards must simply trust management because they will never be able to guess what is missing from information presented to them. While this statement may be partly true, there is an onus on boards to take responsibility for maximising the likelihood of well-founded trust in management – that is, for creating an environment of transparency, accountability and collective insight. This conclusion suggests the following:
- Boards should spend more time considering the drivers of their own blind spots, including how their interactions with management may perpetuate them.
- Individual directors should reflect on and explicitly discuss the impact of their own mindsets and beliefs on decision making – for example, concerns that revisiting board decisions may increase personal liability.
- Non-executive directors should be aware of the risk that conscientious efforts may produce unintended side effects, and that risks can be bi-directional. For example, fear and excessive politeness can both be risks to transparency and challenge.

Clarifying and focusing on outcomes rather than on processes associated with the board's role

Considerable guidance is available to boards regarding the formal structure, processes, procedures and systems that should allow it to fulfil its obligations. This guidance is often well grounded, but it is not an end in itself. Instead, observations gathered in the review suggest boards should focus their attention on the outcomes they seek to achieve through the processes of supervision and monitoring. In practice, this suggests the following:

- Chairs should look beyond superficial actions to achieve the level of trust, transparency and respect required to achieve effective oversight. Asking quieter members of the board for a perspective or waiting until others have spoken before presenting a viewpoint is good practice but does not define the fundamental relationships of the board–management dynamic.
- Process-focused solutions can undermine outcomes – for example, it may be easier for the board to digest shorter board papers that focus on management's opinion, but this may also perpetuate blind spots and limit the board's ability to genuinely grasp operational issues.
- Time spent together should be protected primarily for activities that reinforce the drivers of effectiveness – which may mean less time for management presentations, and more for joint reflection, debate and discussion. One practice observed in the review was an unstructured, 'stream of consciousness' style update from the CEO (rather than a presentation of a pre-prepared paper), designed to generate less filtered insights into the CEO's mindset, perspectives, concerns and motivations.

1. Boards can strengthen their effectiveness by addressing three factors (continued)

Increasing their commitment to collective rather than individual performance.

The review highlighted that while important, individual factors are not sufficient to overcome deficiencies in group dynamics. This insight implies:

- Assessments of a board's effectiveness should focus on collective functioning (at least as much as the performance of individual directors) and factors that underpin it, such as transparency, influence, and team reflection and self-challenge.
- Excessive focus on individual diligence may distract and potentially undermine collective performance.
- Poor group dynamics must be addressed. Boards were far more likely to recount past examples of 'toxic' group dynamics causing ineffective governance than issues relating to individual capability.

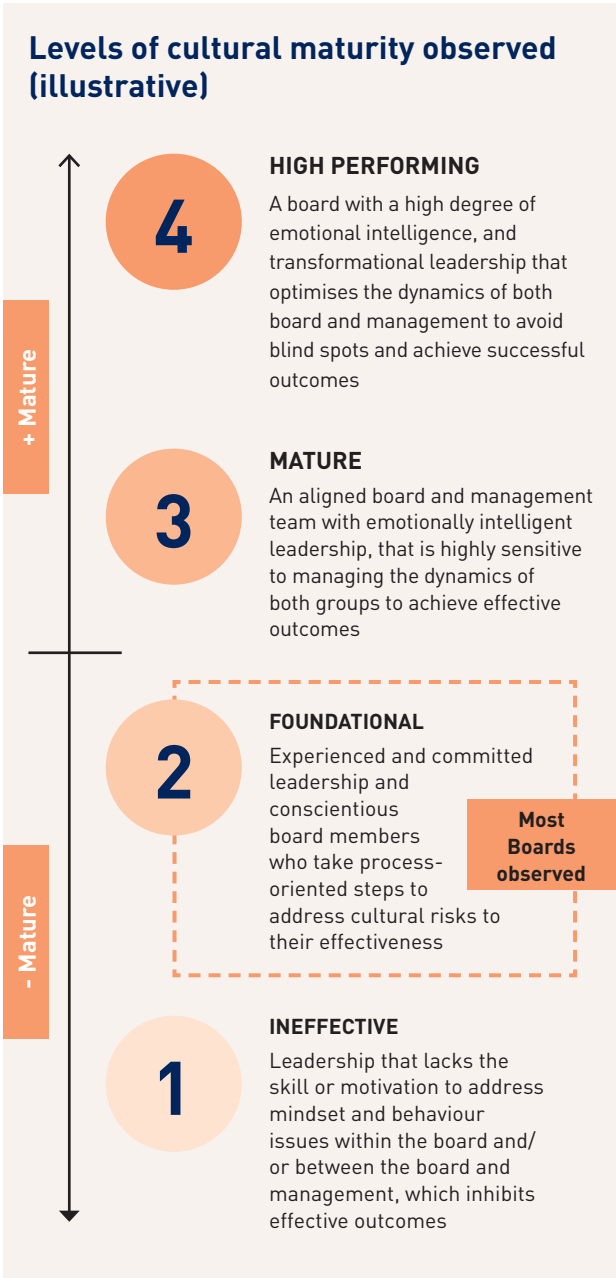
2. Chairs should take steps to mitigate risks inherent in their board's particular style

The boards examined in the review had a range of cultural styles. None of these styles were definitively effective or ineffective, but they each presented certain strengths and challenges specific to overseeing non-financial risk. A board's style can influence internal relationships and those with management, which in turn can help or hinder insight (for example, through transparent information flow), influence (such as through the speed of action) and judgement (for example, via collective self-challenge). True accountability for the Board's oversight duties requires self-awareness and proactive steps to mitigate inherent tendencies that are likely to undermine effectiveness.

This report discusses four styles – based on Advisory, Collaborative, Sceptical and Director models – and provides examples of the key strengths and challenges each presents in relation to board oversight of non-financial risk. These are intended as examples only. Boards should take their own steps to understand their culture and its impact on effectiveness in various domains.

3. A greater focus on informal drivers of effectiveness can help boards move beyond a foundational level of cultural maturity and strengthen their risk oversight.

While the review observed boards at high and low levels of cultural maturity, most exhibited opportunities for improving self-awareness and development. We observed a solid foundation, with many board members perceiving themselves as ethical role models, and displaying a serious and attentive attitude towards fulfilling the expectations of their role, such as by challenging management with a range of questions. And while these basic characteristics of individual conscientiousness are necessary, they are not sufficient to achieve distinctive collective performance, which relies on far deeper group dynamics involving alignment of purpose, trust and respect between board members and with management. Understanding how to overcome natural interpersonal responses and challenges within a group – such as fear, defensiveness, avoidance of conflict, blind spots and unconscious bias – may come naturally to some, but usually requires dedicated investment of time and attention. It is likely that such commitment will go a long way to strengthening the mindset and behaviour challenges outlined in this report.



APPENDICES



Method

The methodology designed for this review reflected a range of considerations:

1. The approach aligns to established methods for assessing or examining group behaviour and culture, drawing on organisational and social psychology theory and research techniques, and supervisory approaches used around the world.
2. The introductory nature of this work within ASIC suggested a more exploratory stance would be preferable. Therefore, the review took an inductive approach, with a neutral starting point, rather than seeking to confirm pre-existing hypotheses about particular models or organisations.
3. As ASIC selected 20 institutions for review⁵, it was not feasible to apply the same 'deep-dive' mindset and behaviour assessment techniques across the whole sample. Instead, a combination of methods was used to balance breadth and depth of analysis.
4. A desire to share findings with a broad audience – to maximise learning, reflection and refinement opportunities – created a need to modify some traditional techniques in order to manage concerns regarding the impact of findings being made public. For example, interviews that would normally have been conducted on a completely anonymous, one-to-one basis often included a note-taker from the entity.

Based on these considerations, three financial services firms and three non-financial services firms were examined using the deep-dive methodology. Insights arising from this analysis were supplemented with indicative data collected via surveys and targeted documentation reviews in an additional 13 entities from a range of sectors, including financial services. This helped to develop some perspective on the breadth of cultural characteristics in a larger sample of institutions. It also provided the opportunity to compare the nature of the findings through a more traditional mindset and behaviour assessment method, with the kind of insight that would be achievable via less resource-intensive and scalable methods, such as a survey. Finally, this approach offered immediate data to suggest when a deeper dive might be of value.

Data was collected from the deep-dive sample via all of the following methods:

- Confidential discussions
- Meeting observations
- Anonymous survey
- Documentation review

Other institutions were surveyed and underwent a lighter-touch documentation review.

The data from these sources was triangulated in several ways. First, a systematic, bottom-up analysis was conducted using quantitative interrogation of survey data, as well as thematic content analysis of interview notes and free-text comments. Second, top-down synthesis of key observations was achieved by applying expert judgement to arrive at relevant and meaningful conclusions from the data. Third, insights emerging from the process were challenged via internal discussion with ASIC leadership and governance experts.

There are certain limits to the conclusions that can be drawn from this review. As noted elsewhere, the findings in this report are based only on observations from boards in this sample. The selection of entities for inclusion in the review was guided by ASIC, and was not intended to form a representative cross-section of the boards of all listed Australian companies. Therefore, findings may or may not apply to other boards. Further, the field-based and inductive nature of the methodology means conclusions are well evidenced, but cannot be completely definitive (as might be possible in a hypothesis-driven and controlled laboratory experiment, for example). The voluntary nature of both entity and individual participation may have also influenced the results.

5. One entity was included in ASIC's broader corporate governance review but excluded from this review of mindsets and behavioural norms for conflict management purposes.

Confidential discussions

35

Confidential discussions were held with six members of each board and executive committee (including the chair, CEO and those in other key roles). Conversations were aimed at surfacing common behavioural norms across these two groups, and how they might ultimately help or hinder the board's ability to monitor and supervise non-financial risks to the entity. The discussions were semi-structured – they did not involve a list of pre-prepared questions. So, specific topics varied, but examples included the way individual knowledge within the group is leveraged, common ways of resolving opposing viewpoints, and mindsets or attitudes the group may share regarding their role and challenges. The goal of these discussions was to identify shared rather than individual perspectives and experiences.

Meeting observations

8

One or two board and/or committee meetings were attended for each entity in the deep-dive sample to observe the group's behaviour in situ. Meetings were selected on the basis of full board and executive attendance, relevance to the topics of non-financial risk and remuneration (as applicable), and scheduling considerations. The exercise was focused on gathering information about the way board members interact with each other and with members of the management team, rather than evaluating the content of discussions. As much as possible, the observer stayed for the entire meeting (which was not possible in some instances, due to legal or other reasons), to help them adjust to and understand factors such as the effect on meeting participants of being observed, the time of day and the length of agenda items.

Anonymous survey

287
responses

A short online survey was completed by board and executive team members from 19 entities in the sample (one entity declined to participate). Response rates for individual entities varied from 53% to 100%. As with other components of the analysis, questions focused on respondents' experiences of behavioural norms across the board and executive that may influence how the groups function. The survey focused on behaviours related to overseeing non-financial risk, as well as underlying drivers of behavioural norms, including a group's shared values, beliefs and assumptions. Survey results were aggregated for financial services versus non-financial services entities, and for board members versus executive team members.

Documentation review

19
entities

A series of documents provided by entities for the purposes of this review were examined by Kiel Advisory to further validate and provide insights on other components of the analysis. The type of documents reviewed for an individual entity depended on the characteristics that emerged through the analysis process. Examples included board and committee meeting agendas and minutes, board and committee charters, and formal board communications such as the chair's report in annual reports.

Definition of 'effective'

To ensure an accurate interpretation of the review's conclusions, it is important to provide some additional clarity on how we defined 'board effectiveness' – that is, if behavioural norms influence the effective functioning of a board, how is 'effective functioning' defined? Board effectiveness is a broad topic and therefore many different dimensions may have been examined. However, given the focus of ASIC's Corporate Governance Taskforce on oversight of non-financial risk, and decision making related to remuneration, particular emphasis was placed on behavioural norms that would help support these aspects of the board's role. These included, but were not limited to:

- Understanding non-financial risks facing the business
- When applicable, understanding circumstances in which the business might operate outside its risk appetite
- When necessary, ensuring timely action is taken to reduce risk to acceptable levels

Some assumptions were made about important mechanisms for facilitating the dimensions above:

- **Challenge.** The process of challenge facilitates all of the dimensions above. For the board to fully understand all key risks and issues facing the business, challenge involves them stretching management's thinking by providing alternative perspectives and considerations they may have overlooked. For example, in determining what level of risk is considered acceptable, the process of challenge may test management's assumptions regarding practical constraints and market practices. In return, management insight may be an important input into the board's ultimate view of what is feasible and appropriate. For a board to determine that issues are being appropriately managed (and when or how to take action if they are not), the process of challenge is again designed to arrive at a collective view that incorporates all relevant and critical information for effective decision making.

- **Transparency.** The board's ability to supervise and monitor risk effectively is fundamentally dependent on its access to valid information about the business's operations. As management generally controls the majority of such information, this requires a dynamic of openness and candour in providing all relevant data and insights to the board. Although it might seem the onus rests with management to willingly share information upwards in a timely and complete manner, the board also plays a key role in creating the conditions for this transparency – for example, through its reaction to the information it receives (especially 'bad news'). Consequently, in this study we assumed transparency was an important requirement for effectiveness, and we sought to identify factors that either facilitated or undermined it.
- **Influence.** Although it may seem self-evident by virtue of the board's positional authority, the board's ability to genuinely affect the actions of management can't be taken for granted. As a mechanism that underpins effective oversight, influence plays a role in both obvious and subtle ways. When risks are identified outside appetite, the board must successfully influence management to take action to bring them back inside appetite. Influence also plays a role in encouraging the sharing of information, and managing dynamics within the board to facilitate effective debate and decision making (especially by the chair).

Definition of culture

This review could be described as examining the cultural characteristics within boards that help or hinder them from achieving the outcomes described above.

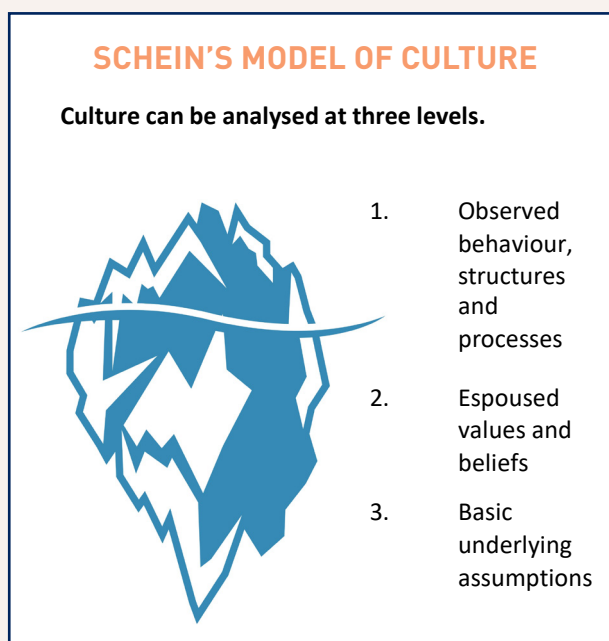
In relating the work and its findings, we have attempted to use more specific terminology, rather than relying on the word 'culture' which has a range of interpretations in the general business community. However it is worth briefly describing how the concept of culture may apply to the content of this report.

According to Schein (2004)⁶, culture exists at three levels:

1. Observed behaviour, structures and processes
2. Espoused values and beliefs
3. Basic underlying assumptions

Behavioural norms are the typical ways people within a group tend to respond in a particular situation. These norms involve some form of observable action, discussion or decision, and have the most direct link to company-level outcomes (such as risk management). Artefacts are also an observable aspect of culture. These are the formal mechanisms that leaders implement to help them manage the business – including policies, processes, structures and procedures. Behavioural norms and artefacts develop as the result of shared values, beliefs and assumptions held by leaders and other members of a group. Shared beliefs tend to be more logic-based, while values tend to be based on emotion. Assumptions can be rational or irrational, and are often unconscious until surfacing upon specific reflection.

This method placed particular emphasis on behavioural norms associated with group dynamics, as opposed to individual behaviour. Specifically, the review sought to examine group dynamics within the board, and between the board and management.



In the context of this work, we sought to understand the following dimensions.

- **Behavioural norms.** The primary focus of this work was identifying behavioural norms that support or inhibit a board's effectiveness. An example of a relevant behavioural norm might be a tendency for management to respond defensively when questioned by the board.
- **Formal mechanisms.** The review also noted formal mechanisms within the system that reflected attributes of the organisation's culture. Such mechanisms are often accepted by the board and/or management due to their alignment with underlying values, beliefs and assumptions – and may be designed with that alignment in mind. An example of an artefact might be the invitee list for board meetings, which may or may not include the chief risk officer.
- **Espoused values and beliefs.** The review examined the underlying values and beliefs that are typically associated with certain behavioural patterns, especially those that might be problematic. For example, board members may believe that important decisions must have unanimous rather than just majority board agreement.
- **Assumptions.** With the time available, we also sought to identify commonly held mindsets that might be unconscious impediments to desirable group norms. One assumption might be that the CEO's judgement should always be trusted because the company's past performance 'proves' that the CEO's capability is sound.

6. Schein, E. (2004). Organizational culture and leadership (3rd ed.). San Francisco, CA: Jossey-Bass.

