Valuing corporate governance as a national leadership asset: Focus on behaviours and values not codes and compliance

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- Following the Western Financial Failure of 2008, corporate governance is seen by many as ineffective or as a restrictive compliance tool.
- Increasing the number of compliance codes for further regulation will not solve deep human issues of behaviours and values.
- It is the territory of our directors and managers to develop honest and constructive cultures, emotional temperatures, in their organisations.

'Corporate governance' addresses an irresolvable dilemma for boards — how do we drive our organisation forward to ensure its continuing success whilst also ensuring that it is under prudent control?

The current failures of corporate governance

Boards of directors are ultimately responsible for the answer to both questions. Internationally corporate governance is accepted as crucial in ensuring the leadership effectiveness and efficiency of all of our organisations — private, public and not-for-profit. This is because our organisations are the cement that holds modern societies together. Yet, after twenty-five years of lukewarm promotion by politicians, regulators and some business leaders the current concept of 'corporate governance' is running aground in many of the world's leading countries. It is seen increasingly as merely a compliance tool leading only to risk-aversion and bounded by increasing bureaucratic and costly irrelevancies. Corporate governance in its currently accepted form is ineffective. If it is the cement of our society, why should this be so?

Why in a time of a deep international political and financial leadership crisis should so powerful a concept as corporate governance be discounted by so many directors, managers, politicians and the general public? I find this odd as my view is more positive. I see effective corporate governance rather as Portia saw her small candle — as 'a shining light in a naughtie world'; a counter to the incompetence, ignorance and corruption that is undermining our organisations and societies. Matters are made worse by so few of those affected having any idea or language by which such reforms can be made.

With so many unconvinced of its effectiveness it is time to reconsider the essence of corporate governance and to create a new mind-set to restore its relevance and our long-term survival.

I argue that there is one main cause of the current problem and suggest a very different mind-set to resolve it.

1. Corporate governance being sold by politicians as the silver bullet to an over-expectant, under-educated and gullible public

It is noticeable increasingly just how many times governmental, judicial and international agencies' reports on organisational failures strongly demand better corporate governance. This is true for business, the public sector, government and charities. Yet little effective action is then taken other than public wailing and increasing the number of regulations. This seems odd until one pauses to think about it more. Rather than repeat the increasingly frequent 'something must be done on the governance front' mantra of the politicians, media and the public, deeper analysis reveals that little can be done for the simple reason that those making the most noise know little of what effective corporate governance means in practice. They rely increasingly on prescriptive regulations rather than go deeply into its societal cement function. It is similar to the anti-racism pressure groups who thought that by banning the offensive words this would stop offensive thoughts. This has not proved so in either case. Something deeper is needed. But the players affected retreat to a 'don't blame me' position. Yet the pressures for something to be done continue. So the politicians use the only real weapon that they have and seek public approval by increasing legislation. They move from good intentions and public pressure to pushing the regulators first to produce guidelines then codes, then to increase the codes until they achieve the dogma of 'comply or be found guilty' and ultimately through reducto ad absurdum to a zero sum game.

This is not a learning system as politicians do not increase their understanding of the issues but create a 'them-and-us' culture. Regulators cannot try to solve deep human issues of behaviours and values by increasing the number of compliance codes. It is not just politicians and regulators that fall into this trap but the majority of owners who try to use structural interventions by board and executive changes to solve all too human problems. Sadly, too many directors do not see the societal need to develop consciously their care, skills and diligence to fulfil even their primary legal duties. These are rarely assessed or enforced. It is odd that the very legislators demanding compliance to the Codes are those that passed the more powerful primary laws that they do not then bother to enforce.

Each of the four main parties with responsibilities for effective corporate governance — owners, directors, legislators and regulators — then blames the others. This is unwise. Frustrations abound on all sides. And few actions are taken in a systematic manner by any party to learn how to resolve the erosion of the leadership of our organisations. So the whining, whimpering and buck-passing continues. Yet few can complain as

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they are so ill-educated in the ways of organisational and financial life that they cannot articulate their needs for a future improved system of corporate governance. Is there another way?

2. Towards a future corporate governance system that builds on learning systems, human behaviours and values rather than increasing compliance

'Corporate governance' only arose in the business mind following the UK's 1992 *Cadbury Report on the Financial Aspects of Corporate Governance*.[1] Before that it was more an academic discipline made manifest by the publication of Bob Tricker's *Corporate Governance* in 1984.[2] Since 1992 the Cadbury Report has become the international default document for anyone interested in the direction and control of businesses. It was a radical insight into a world previously hidden from the public, and many directors. It went well beyond its initial 'financial aspects' remit to shed light on the roles of boards of directors and suggested structures and processes by which the outside world could begin to assess the performance and compliance of boards.

Yet it had two major limitations. Its main sponsors were the Institute of Accountants of England and Wales, and the International Stock Exchange of London. Its major foci were, therefore, financial accountancy and audit, and only companies listing on the London Stock Exchange. Although these are powerful in the national economy they are only a fraction of the registered organisations that exist in the private, public and not-for-profit worlds. Subsequent unthinking acceptance of the Cadbury Code and its renewals by the majority of organisations in these sectors has led to many organisations trying to fit into increasingly inappropriate, onerous and complex compliance rules. It is always easy to grab at pre-digested food but it is rarely appropriate for specific dietary needs. At a time when the politicians are out to get the bankers and big business it is especially dangerous for other organisations to follow slavishly anything but the basic principles.

Conduct, codes and national cultures

Easy acceptance of inappropriate structure and processes is nonsense for two reasons. First, the Cadbury Code was posited as a very British response in part to counter the development of US legal 'extraterritoriality' imperialism — the worry was of the global imposition of US law and its fixation with rules and draconian penalties. The worry was that corporate governance could become globally a US lawyers' paradise with much litigation and an ever-increasing set of rules. It was, and is, a route to corporate bureaucracy and risk aversion with no guarantee of company success. The US system does not encourage, discretion, explanation or risk-taking with the agreement of the owners. It is anti-liberal capitalism.

The UK argued for a more flexible *principles-based* code than rigid US *rules-based* compliance. This reflected national cultures. The UK argued for the use of discretion by a board to suit its particular circumstances. If its actions were seen to be outside the governing code yet within the primary law, then the board must set this before the owners at an AGM or EGM and seek approval. This also had immediate attractions for non-listed companies in the UK and Commonwealth cultures. However, the UK Codes are moving dangerously into areas of management rather than directing, becoming increasingly prescriptive and rules-based egged on by politicians ignorant of corporate governance and organisational leadership. Worryingly they are being pushed into areas such as remuneration, HR policies and culture where their prescriptions are against the very nature of a principles-based approach.

This is a consequence of the continuing pubic fury at the Western Economic Failure of 2008. Yet most directors are neither venal nor bankers and do not work in listed companies. We need a broader and more diversity-embracing approach towards effective corporate governance to restore public trust in corporate governance and organisational leadership as a national asset. This must involve human values and behaviours. It is beyond the world of accountants.

Corporate governance and culture

It is worth noting that in the two nations, the UK and South Africa, seen to be most effectively advocating effective corporate governance the innovators focus on developing two distinct areas; *stewardship* between the board and the owners, and *culture* as a learning system. Much has been said about stewardship recently[3] so I want to focus on 'culture' here. I argue strongly that this is not the territory of the regulators. It is the territory of our directors and managers to develop constructive and honest cultures, emotional temperatures, in their organisations. This requires consistent internal organisational rewards and behaviours, not external regulation.

In the 2014 *Developments in Corporate Governance and Stewardship*, published by the UK's Financial Reporting Council[4], the new chairman, Sir Win Bischoff, comments, 'The governance of individual companies depends crucially on culture. Unfortunately we still see examples of governance failings. Boards have responsibility for shaping the culture, both within the boardroom and across the organisation as a whole and that requires constant vigilance. This is not an easy task. Our recent guidance on risk management highlighted the need for boards to think hard about assessing whether the culture practised within the company is in line with what they espouse. Boards should consider what assurance they have around culture. Are performance drivers and values consistent? How can culture be maintained under pressure and through change? Is the culture consistent throughout the business? We will be working to promote best practice in these areas during 2015'.

I think that asking such questions and asking individual organisations to respond is as far as a regulator can go. These are impossible areas to assess using most current business tools. Any attempt by regulators to specify and measure an organisation's culture will likely lead to more rules, risk-aversion and ineffective compliance. This is happening already in the risk assessment areas. Rather organisations need to develop transparent systems of assessment, rapid feedback for the owners' scrutiny, and have processes for both development and sanctions to grow their unique culture.

Do such tools exist? Yes, but they are not considered 'normal' business tools. We have to look to 'soft' and 'wimpish' areas like social psychology, board dynamics and anthropology to get help. Many directors and managers see themselves as 'hard' and macho and so have an inbuilt aversion to such disciplines. More fool them. If they dipped a toe in the water they would see quickly that the concepts of the short-term 'emotional climate' of an organisation and the subsequent development of its long-term 'culture' are key measures of organisational health and continuing success. So we need to track their trends over time by the board. This is invaluable information for directors and managers. Yet they rarely have it. So they often pontificate on the necessity of developing and changing culture without have any experience of so doing.

A hierarchy of culture

What is the framework within which it is possible to develop such measures? I argue that it is necessary for any leader to understand a simple, five-level hierarchy that ranges from instantly observable behaviours to deeply held, often unconscious, beliefs:

- behaviours
- opinions
- attitudes
- values
- beliefs.

Social psychology, especially group dynamics and its analytical tools, is helpful in understanding the more visible levels of behaviours, opinions and attitudes. Anthropology — *the study of man, his origins, institutions, religious beliefs and social relationships* — analyses the less visible values and beliefs at an intensely personal level. They are the anchors of an individual's life. And that is why if held unconsciously they are so difficult to change. Aggregated they form the organisation's culture.

We know this in day-to-day organisational life. 'Culture' is often flippantly described as 'the way we do things around here' or, more alarmingly for board members, 'what we do when no-one is looking'. Most boards only discover the latter when there is a crisis, by which time it is often too late. There are many tools available, particularly rigorous and well-designed emotional climate surveys which can be tracked over time by boards and top management to warn of visible and invisible trends. Yet they rarely form part of a board's dashboard. So insidious behaviours and values often erode the organisation's espoused values. A 'value' is a belief in action. It defines a moral principle in which a person believes. Reward systems are rarely created with the emotional climate and values in mind. Indeed in most businesses 'value' has a primarily financial meaning rather than as a moral belief. In many organisations 'value' tends to be much more closely related to accountancy practice rather than anthropological analysis. Yet the tools to avert this reductionist stand-

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off exist and should be part of any future director's kitbag.

I argue that from the board's viewpoint a more anthropological understanding is needed by directors that focuses on values and beliefs to improve their leadership. This will be resisted by the macho many. It amazes me still how many directors see their organisations as purely impersonal and mechanical with simple and guaranteed command-and-obey processes. This defies reality. I have worked with so many organisations of all types where both the chairman and chief executive have admitted privately that 'when I pull the levers of power I have no idea if they are connected'. Feedback mechanisms are slow. Learning is slower. Messages passing upwards are modified to protect the guilty and organisational learning is either non-existent or negative. The rate of organisational learning is not equal to, or greater than, the rate of environmental change to ensure the continuing success of the organisation.

As the board has oversight and leadership of the total organisation it is crucial for the directors to transcend their inbuilt managerial/operational mind-set to understand the positive and negative dynamics of 'culture'. When working with a board I have found that a quotation from Clifford Geertz[5] immensely powerful to study and then work with, even though they often find the words hard initially:

> Culture is an historically transmitted pattern of meaning embodied in symbols; a series of inherited conceptions expressed in symbolic forms by means of which men communicate, perpetuate, and develop their knowledge about and attitudes towards life… Man is an animal suspended in webs of signification he himself has spun. I take culture to be those webs, and the analysis of it to be therefore not an experimental science in search of law, but an interpretive one in search of meaning.

This is very practical, if taken in bite-sized chunks. And if you don't like the intellectual language then just go to any reception area, look and listen. The way in which you are greeted, the colours and shapes of the space and the general posture of those employed tells you all you need to know about the emotional climate of that organisation. When this is repeated constantly throughout the organisation it becomes their symbolic values which over time determine their behaviours and inevitably shape their culture. It tells you what you can, and cannot, do in this organisation, who gets rewarded and who punished, who stays and who goes.

The value of values

I was taught that the basic moral values of effective leadership, and so of corporate governance, are accountability, probity and transparency. These are the building blocks of leadership and corporate governance. These are measurable in both personal and organisational terms. So trends can be tracked over time to see the emergent patterns and dimensions of an organisation's developing culture. The Abrahamic religions of Judaism. Christianity and Islam may dispute many things but their underlying moral values have been clear for millennia. Starting with, '*thou shalt not kill*' these are made manifest in the Seven Deadly Sins and their opposite, the Seven Virtues:

- greed vs charity
- lust vs chastity
- gluttony vs temperance
- sloth vs diligence
- wrath vs patience
- fury vs kindness
- pride vs humility.

My worry is that as regulators try and extend their territory into 'culture' they have not read Geertz or anyone like him and will ask some soulless bureaucrats to create a code that specifies the clauses and subsets by which moral values can be beaten into a compliance code. I argue that as we already have millennia-tested values we do not need a code, just ways of using them fully.

We even have them built into our primary law but few seem to know this, including the regulators. The UK's 2006 Companies Act listed the seven basic duties of a director.

1. To act within their powers (constitution)
2. To promote the success of their company
3. To exercise independent judgment
4. To exercise reasonable care, skill and diligence
5. To avoid conflicts of interest

6. Not to accept benefits from third parties
7. To declare interests in proposed transactions.

If the politicians and regulators ensured a climate of self-enforcement of these well-tested behaviours and values we would not need increasingly dense codes that battle against human nature.

What do Alan Greenspan and Gillian Tett have in common?

In this essay I have argued that the four major players of corporate governance — the boards, owners, regulators and legislators do not act as an integrated system of learning on behalf of the nation. There is little oversight of each of them and none see themselves as a key to developing effective national leadership as an asset to stabilise and grow our society. The solutions to designing such a learning system would need another essay to espouse.

Here I want to look at the current continuing failures of moral purpose and values seen following the Western Financial Failure of 2008. In so many nations there are many examples of leadership inadequacies in the media, courts, politicians, boards, the police, health managers, local government and charities.

And those are only examples that I have taken from the previous two day's UK newspapers.

What on earth went so wrong that the social revolution of the Swinging Sixties gave way to the Corrupt Noughties leading to the Austerity Era and the rise of public fear, growing authoritarianism and terrorism? I argue strongly that it was a lack of understanding of the moral purpose of organisations combined with a lack of personal courage to say ‘no’ to corrupting pressures which allowed two attitudes to affect our western world. First, that it is wrong to query any action on moral grounds. So challenges ranging from the support of the Paedophile Exchange to the IRA or ISIS were made socially non-discussable. This eroded the social cement, the explicit values and behaviours, which held our organisations, family and personal mental health together. Second, such international dynamics as the financial ‘big bang’ changed our perceptions of what were acceptable behaviours and values in our organisations. Many employees and some managers saw them already as impersonal machines or psychic prisons. Now they were free to see them as personal financial aggrandisement vehicles where you took what you could grab and devil take the hindmost. Effective corporate governance went out of the window. Executive remuneration soared despite rewarding most for mediocre performance at best. Such thinking was backed by the rise of impersonal digital technology so that ‘players’ could ‘game’ the system instantly and without concern for the effect on others. This is the realm of psychopaths.

I had not realised quite how bad things were until I read *The Map and the Territory*[6], the memoir of Alan Greenspan, previously the chairman of the US Federal Bank and so one of the most powerful people in the world — the master of the masters of the universe.

It makes you weep that such power was wielded in such a narrow and inhuman way. In the book and subsequent interviews when asked why such a global financial crash happened his answer is ‘our models did not work. We had 250 PhDs working on them and they were tuned to the neo-classical economic concept that markets will always return to equilibrium given time’. When they did not, and with the global financial system crashing around them, no-one really knew what to do because we had not factored in two powers which were then spooking the markets. First, was the nature and speed of market dynamics (sic) and second was ‘people’ and their unpredictable emotions (even siccer). It is mind boggling that the human and emotional aspects of our wealth and existence had not been seriously considered important enough to be in the model. They did not consider seriously the powerful driving emotions of greed and fear in people. When this was then transmitted through instantaneous global communication systems we all suffered and continue to suffer the results. We are now poorer but not much wiser as our leaders have not yet shown the contrition to the public that they need to gain their forgiveness to be able to create the new emotional climate in which to learn. Reputations were rubbished and neo-classical economics, especially macro-economics, has suffered a continuing nervous breakdown. Behavioural economics is the new hot trend.

What has this to do with Gillian Tett, US editor of the *Financial Times*? She is a trained anthropologist and her regular writings demonstrate this rigorously. She is very helpful on organisational and moral purpose. She wrote a devastatingly insightful interview of Alan Greenspan and his book.[7] He was marginally contrite but did admit that he now needed in retirement to study a discipline the importance of which had previously eluded him — anthropology! He needed to know much more about people and their values and has enrolled to do so. Is this a way forward for leadership and effective corporate governance where we all spend less time on codes and more on understanding human nature, beliefs and their effects on the dynamics of markets? I hope so.

Professor R Bob Garratt is best known for his long-selling book The Fish Rots from the Head: Developing Effective Board Directors. *In March 2015 he was awarded the 2015 Outstanding Achievement Award by The Global Forum for Leadership, Organisational Development and Business-driven Action Learning. Bob Garratt can be contacted at www.garrattlearningservices.com.*

Notes

1 *The Financial Aspects of Corporate Governance*; The Cadbury Committee Report, Gee & Co, London, 1992.

2 Tricker R I, *Corporate Governance*, Oxford University Press, 1984.

3 *Why Stewardship Matters*; Tomorrow's Company, London, 2011.

4 UK Financial Reporting Council, London, 2014.

5 *The Interpretation of Cultures*; Clifford Geertz, Basic Books, New York, 1973.

6 Greenspan A, Lane A, *The Map and the Territory: Risk, Human Nature and the Future of Forecasting*; New York, 2013.

7 Tett G article, *The Financial Times Weekend Magazine*, 23 October 2013.