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# Corporate governance, groupthink and bullies in the boardroom

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**Rookmin Maharaj** PhD is a graduate of the University of Calgary. Her thesis research integrated the disciplines of Political Science, Education, and Business in the area of corporate governance. Her dissertation topic focused on corporate governance and was entitled 'Corporate Governance and the Board of Directors: Study of the Importance of the Role of the Formal and Informal Systems'. She has developed a unique model that can be used as a compass by companies to build better boards. She is currently consulting with companies in Alberta, Canada on Corporate Governance. She has worked in the energy sector in Alberta, Canada for over 15 years. She has a master's degree in Higher Education and has taught in France, the Caribbean and in Canada at the University of Calgary and Mount Royal College on Environmental Management and Business.

## EXECUTIVE SUMMARY

**KEYWORDS:** corporate governance, board of directors, behavioural characteristics, formal system, informal system, decision-making process

*This research study discusses corporate governance issues from a behavioural viewpoint. It makes a distinction between strict adherence to formal rules and regulations: CEO/Chair separation, independence of board members and board size and informal characteristics of board members: knowledge, values and groupthink.*

*There are three main conclusions:*

1. *This research clearly proves that formal rules and regulations are inadequate; they have little effect upon decision making by board members. Informal charac-*

*teristics must be considered in unison with the formal system when nominating board members in order to restore shareholder confidence and to rebuild trust in board governance.*

2. *Similar values and groupthink can contribute positively to board members' decision making. There is, however, a high possibility for groupthink and values to become redundant, masking board members' knowledge.*
3. *Skills matrices that include questions related to values, knowledge and groupthink and three behavioural characteristics should be considered by boards to ensure the nomination of well-rounded members.*

*Changes to board process, and board decision making, are seminal in preventing future Enron and WorldCom fiascos. It is only by changing the behaviours of the board of directors, through adopting skills matrices, that sweeping changes can occur. In the past, boards have asked: who are our board members? The most important question a board can ask today, however, is: how can the skills and knowledge of our board members be used in service of the strategic direction of the corporation? This can be achieved by recruiting new board members who fill the needs of an organisation, in contrast to nominating 'friends' and continuing the tradition of the old boys club. It should be noted that out of the 100 of the largest economies in the world, 57 of these are corporations and 49 are countries. Corporations are powerful entities in our society, operating in a manner similar to representative governments. Like heads of government, at the top echelon of each corporation is the board of directors; their decisions have enormous ramifications for everyone. Although most citizens have a limited or a passive interest in corporate governance, we each depend on these corporations for jobs, salaries and as investors. Governance of these gargantuan corporations,*



*which wield considerable economic power in the world, concerns each and every citizen. This study draws novel conclusions about the state of governance today, and presents practical solutions for corporations to consider when selecting board members. The detailed discussion about what happens in the boardroom demystifies board process and provides the bases for three critical objectives when selecting new board members or evaluating current board members performance:*

- (1) ascertain and embellish the knowledge base of directors;*
- (2) motivate directors to share and gather information to ensure personal values are congruent with organisational values; and*
- (3) ensure clear and fluent transmission channels exist to reduce the potential of having groupthink on board.*

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## **BACKGROUND**

In recent years, there have been several reasons for concern about board governance. Some boards have not been willing to make governance a high priority or, in other cases, have not been willing to offer shareholders their legitimate rights,<sup>1</sup> such as the right to information and influence.<sup>2</sup> As a result, large shareholders and other investors (eg, suppliers and retail investors) have recently expressed concern regarding the general efficacy of the governance of corporations. The demise of Enron, Tyco, FBI, Cisco and other corporate giants raised concern about corporate governance in general and the board of directors (BOD) in particular. These corporate scandals may be due to lack of intimate knowledge of the internal processes of the corporation by the BOD and CEO of these companies.

‘The Enron era of corporate abuses were of such magnitude that the public demanded concrete structural reforms’ (The Goizueta Directors Institute,<sup>3</sup> p. 4). Increased regulations and guidelines, through the Toronto Stock Exchange (TSX), New York Stock Exchange (NYSE), Ontario Securities Exchange Commission and Securities Exchange Commission

(SEC), pose a new dimension to the dilemma of corporate governance. The 2000s brought major changes, primarily in formal structures, through the Sarbanes–Oxley Act (SOX) and the Canadian Response to SOX (C-SOX) to improve corporate governance. There has been increased apprehension, however, among companies about the cost associated with compliance to SOX and C-SOX. ‘According to a study done by the Financial Executives Institute, companies expect to spend an average of \$3 million to comply with Section 404 of SOX. Companies with revenues in excess of \$5 billion expect to spend an average of \$8 million (0.2% of sales) and companies with sales less than \$100 million think the average cost will be \$550,000 (0.6% of sales)’ (Wayman,<sup>4</sup> p. 1). These guidelines rely heavily on organisational compliance to formal rules and regulations, and corporations are burdened by the high cost of implementing these regulations. Yet, as Hansell<sup>5</sup> suggests, huge corporate scandals such as Enron still occurred even as these boards ‘were supervised by an all-star board [doing all formal things], with qualifications far beyond what any regulator would ever impose’ (Hansell,<sup>5</sup> p. 15). This suggests, therefore, that despite adherence to (the equivalent of) formal regulations, corporate scandals that have highlighted poor corporate governance have occurred.

The irony, however, is that academic research in the area of corporate governance has focused on improving and implementing more formal rules and regulations. Most studies have been driven by the ‘publish-or perish syndrome [where faculty in the tenure system need to produce many publications] and have used easily available [secondary] data and standardized methods... [in which] boards of directors have been treated as a black box between the input and output’ (Gabrielsson and Huse,<sup>6</sup> pp. 12–13; see also Van den Bergh & Levräu<sup>7</sup>).

The usual board measures gathered in these studies are sourced from secondary data and usually examine insider/outsider ratio, board composition, structure and size, CEO/chair duality and the number of board members.

According to Westphal,<sup>8</sup> the focus on the formal system may be attributed to a lack of 'focus on director capabilities [which] may be less effective as a lightning rod to mobilize the governance reform movement...regulators seem more concerned about the impressions that their policies will create than about formulating policies grounded in rational principles and empirical evidence' (p. 10). Additionally, as Thain<sup>9</sup> has noted 'the result is recommendations [for example, the TSX guidelines] that have no systematic base in fact and stated logic' (p. 80).

The literature leaves many questions to be answered. Foremost among these questions is the reliance on accounting or market-based measures of firm performance. This is an essential distinction, as critics have argued that accounting-based measures are subject to managerial manipulation (eg, earnings management) and are difficult to interpret across industry contexts. No evidence has been found of a relationship between board composition and firm financial performance across these performance measures.<sup>10</sup>

Additionally, the literature does not provide a comprehensive and consistent set of performance criteria by which to measure board performance. The formal system, which is guided by the rules and regulations (eg, the TSX), has been critiqued for being deficient in addressing the issues surrounding 21st century corporations. As suggested by Thain,<sup>9</sup> the Dey Report is at best a dubious and controversial beginning point for dialogue. Leblanc and Gillies<sup>11</sup> believe that the Dey Report's mandate 'to conduct a comprehensive study' was lost in focusing on the formal rules exclusively, while ignoring the informal system or the spirit in which the formal rules are implemented in organisations. Ultimately, 'the deeply entrenched old board culture and the strong resistance to change in the *status quo*, change in corporate governance, no matter how obviously needed, will be difficult and controversial' (LeBlanc and Gillies,<sup>11</sup> p. 133).

## METHODOLOGY

To shed light on this topic, a list of nine questions (see Appendix A) was developed and 20

interviews with chairs, CEOs, board members and upper management from some of Canada's most influential companies in the pipeline, coal, oil and gas, and chemical industries were conducted in Calgary, Alberta, Canada. These interviews ranged from 2 to 4 h in length. The main purpose was to collect primary data on the informal system, that is, the *process* of *how the* formal systems (TSX and NYSE guidelines) are adhered to within organisations.

It is important to investigate both the formal control elements and the informal control practices to determine the level of importance within organisations. The main purpose of the interviews was to ascertain what these executives consider important with regard to corporate governance and decision making. Other than the criteria used in academic research, executives have their own views on what constitutes a good BOD. These executives spoke about their board experiences, generating a wealth of knowledge about what factors make effective decision making on boards. A content analysis of the interviews was performed. Transcripts were coded as they were reviewed, according to board characteristics. Patterns of board characteristics in the interviews were grouped. A distinctive representation about board process and how decisions are made in the boardroom evolved from the content analysis. Links were then drawn between the board characteristics from the 20 interviews and the literature review. Directors and executives emphasised factors relating to the informal system rather than elements of the formal system such as rules and regulations. From these interviews, a survey questionnaire was developed and sent to 1,200 industry-wide executives across Canada and the United States. Statistical analyses were conducted on the data collected.

## BOARD PROCESS AND THE INFORMAL SYSTEM

The board's decision-making process was analysed to define critical determinants of board effectiveness. The rationale that board behaviour and board process cannot be regulated through rules and regulations or the



formal system alone, although simple, addresses the concern and call for an understanding of board process.<sup>12–22</sup> As one CEO stated during the interview process:

I think the failures were crooks. Regulators have mandated all these rules that imply that boards fail because there is a certain percentage of insiders on the board or because they don't have a certain set of financial expertise. I don't think that the constituency of the board can cause the board to succeed or fail. I think the *behaviour* of the board causes the board to succeed or fail. Formal rules talk about board structure I don't think board structures are going to cause behaviour to change. So you really have to go beyond physical structure and mandating this and that structure (personal communication, 2004).

Board process refers to the way in which the board members interact, lead, develop norms and make decisions.<sup>23</sup> *Board process* is usually neglected when boards are being put together' as suggested by Finkelstein and Mooney<sup>17</sup> and also Johnson *et al.*<sup>24</sup>. The experience, and personal attributes of the individuals comprising the board and the decision-making process of board behaviour, however, affect good corporate governance.<sup>5</sup> In this research, board process is seen to be a crucial element in the informal system. The informal system in this paper focuses on *how* formal systems are embedded and translated within and throughout an organisation. The informal system goes beyond the superficial adherence to the formal system (rules and regulations) and looks at three major board member characteristics used to evaluate board members prior to being nominated and while serving as members of boards.

From the analyses of the interview and survey, a clear picture about the interaction and behaviour of directors emerged. Subsequently, three characteristics that are required for effective decision making were developed:

(1) Knowledge — the actual depth and breadth of knowledge of the directors.

(2) Values — the values of the board members.

(3) Groupthink — board members' ability to interact or the groupthink mentality of board members, and the level of engagement and questioning of board members.<sup>18,25,26</sup>

Two of these characteristics, values and groupthink, make up behavioural characteristics. One tool that can be used to evaluate these characteristics is a skill matrix, which can be used to evaluate the skills of existing and potential board members. The next section introduces three board characteristics, knowledge, values, groupthink and skill matrices, as defined in this research.

## BOARD CHARACTERISTICS

### Knowledge

To understand the board process, an insight into the knowledge base of the board members is important. This knowledge base is a prerequisite for board members if they are to better understand issues and be able to synthesise information coming from multiple sources. All the executives spoke about knowledge development as an important objective of board members. Knowledge, one CEO clarified, does not have to do with populating a board with a series of experts, rather knowledge should encompass directors' ability to critically evaluate what information management brings to the board. Several executives mentioned the ability of board members to apply due diligence to strategic decision-making. This means that directors apply their experience and expertise to better understand issues and bring these to bear upon the decision-making process. Knowledge, as one Chair of the board explained, entails having the right kind of board members who have some knowledge of the various businesses.

The key is having people who have enough experience in all the aspects of the businesses that you are in, who may have all kinds of different views, and who have the right kind of personal relationships with the Chairman

of the board and the CEO. So the big thing that boards have to try to do and work hard at, is have a composition on the board that has some expertise in a number of different areas (personal communication, 2004).

The chair, in this instance, is not speaking about the structure of the board, in terms of the number of board members that serve on the board. Instead, he is relating the knowledge of individual board members to the entire board's ability to successfully operate within the environment in which the firm exists. Knowledge also involves the knowledge base and expertise of individual board members.

In addition to having a stock of knowledge on the board, members must activate that knowledge in the decision-making process. One of the main themes noted by directors throughout the interviews was the ability of directors to analyse and synthesise information in order to make informed decisions. To properly fulfil the BOD responsibilities as outlined by professional bodies and regulatory commissions, the board members must be organised in a manner that allows for learning capabilities (capacity to assimilate existing knowledge) and development of problem-solving skills (capacity to create new knowledge) to render benefits to the corporation.<sup>27</sup>

Moreover, learning capabilities encompass board members' capacity to absorb new knowledge, and synthesise this knowledge. This rationale then prompts inquiry, for example, how do board members learn? Are they resistant to learning? Are they willing to learn? Answers to these questions determine board members' learning capabilities. For example, one executive suggested that by simply having board members with a stock of knowledge, but not permitting these members the motivation and capacity to use this knowledge, is useless.

As a senior person in the management of the company, it is my job to educate the board. I do not think having specific expertise on the board will cause us to manage an issue better. I think subject matter expertise is useful but it

also has to fit within the mandate of what the board is required to do. I have to make certain that there are no surprises, even if they do not ask, I will ensure they have all the information I have (personal communication, 2004).

This suggests that boards must be astute enough to understand the issues that management brings to their attention, and to be able to communicate and engage management in thorough discussion.

The knowledge base of each director should be congruent with the needs of the organisation and directors should be willing to share their knowledge and expertise with both internal and external stakeholders to ensure effective decision making. As one board member noted:

Getting out of your comfort zone is a very useful thing for most people. It is stimulating and challenging, boards thrive on bringing new experience and diverse opinions in, so everyone in the business community not just the company gets this experience. People are learning, and, you get to understand how other people look at things. It is a very effective way to transfer knowledge (personal communication, 2004).

In summary, the individual director's depth and breadth of knowledge about the organisation's business and strategy is critical in ensuring effective corporate governance. The director's role, then, is to ask tough questions of management if they are not clear about an issue. The learning capabilities of board members ensure that once this information has been gathered, board members are able to analyse and synthesise this information to make better decisions. With regard to knowledge transfer, not only is it important to identify gaps in knowledge, but to be able to share that knowledge with other board members and management.

### Values

The company's code of ethics reflects the organisation's vision and values and should be reflected upon when facing tough decisions.



Values, both personal (such as beliefs, education and social status) and corporate (as expressed in a corporation's code of ethic, vision and mission statements), may elicit more valuable insight about board members. Monks<sup>28</sup> comments that although values and governance are recognisable words, we do not often specifically consider the meaning of these words within a specific context. He believes that values are difficult to define and may be easier to be defined as a negative such as 'governance can prevent value destruction' (p. 118).

Johnson and Macy,<sup>29</sup> Knight *et al.*<sup>30</sup> and Markoczy<sup>31</sup> point out that there is a need for re-examination by top management of the values and principles that underline the firm's relationship and motivations towards nature, the market and key stakeholders. Starbuck<sup>32</sup> defines corporate ideology as the beliefs and values that provide a reference frame to members of an organisation, and he believes that top executives play a key role in developing and maintaining a firm's key ideology. Through the combination of disclosure and transparency an organisation's ideology is created by both the CEO and the BOD. Although the extent of communication, disclosure and transparency are implemented by the CEO, it is the BOD's job to champion and encourage this culture both internally and externally, formally and informally. This can be accomplished by ensuring that key personnel supporting this ideology are placed in departments such as Environmental Health and Safety, Corporate Social Responsibility or Internal Audit. Board members should be informed and educated about the industry and issues pertaining to the organisation's operations. Through these oversight duties, the company's ideology is filtered throughout the organisation by the BOD.

Weaver *et al.*<sup>33</sup> found that when ethics programmes are used as control systems, management commitment was a strong determinant of either compliance or a values-based orientation. Essentially, this refers to how the corporate ideology is enacted within any organisation. As organisations' resource allocations reflect their ideologies, and individuals within an organisation

may adopt ideologies that match and justify their statuses and experiences, it is important to understand how corporate ideology is transferred between and among both internal and external stakeholders.

Mackenzie<sup>34</sup> holds that ethical norms can give rise to moral sanctions. He suggests that ethical norms provide powerful incentives for board members to exercise self-restraint and calls for development of a more complete 'norms theory' of corporate governance and corporate responsibility as the basis for more effective remedies to governance problems in the future. As one executive noted:

So when it comes to risks and systems it is basically how well you know the company's values. How well the company is saying here is what we are doing. There are some companies that say there are no problems. In our company's culture people are encouraged to say everything is NOT all right. If we have a problem we bring it to the table. It is not acceptable to surprise anybody or [BOD and management] would get hung up by the neck. I think the tone of the board at our company shows maturity by standing by their values. I say our board is as good as any board I sit on, in terms of capabilities and skill set (personal communication, 2005).

In summary, corporate values are important as they determine the choices the executives make and so influence corporate strategy. It is important that managers are aware of their personal influence in the decision-making process. This fact begs the question as to how do values, both the individual director values and corporate values of executives, affect behaviour, and, in essence the strategic decision-making process? The decision-makers' eventual perception of a situation and his/her values provide the basis for strategic choice. Therefore, values are treated as something that can affect perception<sup>35</sup> and subsequently enter into strategic choice based on the decision-makers' values. Therefore, values may in fact define how executives behave. Sikula<sup>36</sup> maintains that values are important

determinants of individual, group and organisational behaviour (p. 17).

### **Groupthink**

When receiving information, board members may succumb to the persuasive power of their peers in their thinking patterns and opinions. This is called groupthink. 'Groupthink refers to a deterioration of mental efficiency, reality testing, and moral judgement that results from in-group pressures' (Janis,<sup>37</sup> p. 9). In other words, groupthink occurs when a person's thought process and decision-making capabilities become heavily influenced by peer pressure. One director cited groupthink as a major detriment to board process:

I think it's interesting at a board, often the big failure is if you have this homogeneity of thinking and culture (personal communication, 2005).

It is by ensuring that there is sharing of information that board members are not adversely affected by groupthink; there must be effective interconnections and communication among all board members. Therefore, it is imperative that management and CEO are open and truthful to the board so that the board can do their job by independently evaluating management's strategic direction. Groupthink occurs when a person's thought process and decision-making capabilities become marred by peer pressure. This may cause the group to overestimate their power and morality, causing the members to ignore the ethical or moral consequences of their decisions. This behaviour can encourage an illusion of invulnerability, creating excessive optimism, and may encourage the group to take extreme risks.<sup>38</sup>

Closed mindedness may cause the group members to discount warnings or other information without conducting due diligence and pressure the group toward uniformity; these board members may be viewed as 'bullies'. This pressure may cause the group members to withhold their opinions for fear of having an opinion different from that of the group. This silence may

create a domino effect where silence may be considered consent among the group members. If a member expresses a strong argument against the majority of the group, however, direct pressure may be exerted on that member to ensure that he/she understands that dissent is contrary to what is expected of loyal members. The result is that the group inadequately surveys alternatives and objectives. They fail to examine the risks attached to preferred choice. The group may fail to reappraise initially rejected alternatives, resulting in poor information search, selective bias in processing information at hand or even failure to work out contingency plans. The level of participation among board members at board meetings can be used to reduce the negative effects of groupthink.

Leaders who understand the negative ramifications of groupthink are able to engage intelligently and effectively in the decision-making process with all group members. Groupthink as a concept can guide executives and policy makers in their strategic decision-making process.

Lorsch and Donaldson<sup>39</sup> argue, however, that corporate managers grapple with complex organisational problems, and that their decision making is limited by the objective constraints of the financial goals system, constituency demands and psychological constraints of their own beliefs. These interrelated beliefs act as a filter through which management perceives the realities facing the organisation. Corporate managers have a deep emotional commitment to their belief. This commitment gives them the right and the correct way to view the external environment and their organisation. These emotional convictions shape the pattern of decisions (which can in fact encourage groupthink), and may be labelled corporate strategy. Hence, it is not altogether surprising that beliefs and corporate strategy are closely intertwined. Beliefs serve two critical functions: (1) they act to simplify, or to translate the world from complex to comprehensible and familiar terms and (2) they provide stability when change threatens to undermine the lessons of experience. 'The key issue for corporate



managers is their ability to balance psychological constraints of the belief system with the more objective pressures they face' (Lorsch and Donaldson,<sup>39</sup> p. 80).

In summary, it is management's role to ensure that the organisational environment is conducive to sharing information. This can be accomplished by management being completely honest and open with the board about information they may have about the strategic direction of the organisation. Generally, board members hold their position in high esteem and this prestige can therefore act as motivation to share and gather information. It is difficult to question when there is homogeneity of thinking among board members. Board members, however, need to be able to think independently and not conform to in-group pressures.

#### DISCUSSION OF STATISTICAL ANALYSIS

Regulations such as SOX or C-SOX are meant to affect the decision-making capabilities of the BOD. There have been two streams of thought about this in the literature. One stream views new regulations as opportunities. As noted by SEC Chairman William H. Donaldson 'if companies view the new laws as opportunities — opportunities to improve internal controls, improve the performance of the board, and improve their public reporting — they will ultimately be better run, more transparent, and therefore, more attractive to investors' (Hoffman,<sup>40</sup> p. 26). This explanation, however, refers to the ideal organisation where board members are engaged in discussion with management. The second stream views regulations as thoroughly ineffective at improving board governance or the decision-making process of the BOD. 'The majority of corporations do not have their directors involved in the decision-making process; rather the directors review and approve the strategic decisions when they are presented to them' (Scherrer,<sup>16</sup> p. 87). This view of the BOD places management at the forefront of decision making — directors are solely responsible for oversight of strategic decisions. This view regards regulations as

neglecting the actual work of directors. While these two views dominate the literature, they present a highly polarised view of the BOD. Actual board behaviour *vis-à-vis* regulations are more complex than these two divergent views allow. Several studies<sup>41–43</sup> have examined elements of the formal rules and regulations such as board size, CEO/Chair duality, and ratio of insiders/outside against firm performance, which was used as a proxy for decision making. There are no conclusive data, however, that indicate that companies view the new laws as opportunities or that they help the board and management in their decision-making process.

Most prior research<sup>44,45</sup> used proxies such as firm financial performance for decision making. While this is a convenient method, it ignores the process of decision making and supplants cognitive and social factors with external factors. As Markoczy<sup>31</sup> notes, 'researchers should determine what it is that they want to measure and continue to develop and refine tools for doing so instead of relying on convenient substitutes that may turn out to be neither particularly good substitutes nor extremely convenient ones' (p. 1240). According to the executives interviewed in this study, there seems to be a nonrelationship between increased formal rules and decision making. Any change in the decision-making process was attributed to the board's behaviour, not increased rules. As noted by one executive in the interview stage of this research:

You want ethical behaviours, you want honest people, people working hard to get the best outcomes. So how do you do that? You know they [regulators] stayed away from that because they cannot mandate that, they cannot audit behaviours! (personal communication, 2005).

This implies that executives ascribe board effectiveness to factors other than rules and regulations, and these factors constitute the informal system. This is consistent with White.<sup>46</sup> According to White,<sup>46</sup> a major concern is that many

companies, because of either the intent or the effect of regulation, can demonstrate either a very high or a low effectiveness factor in the short term, with no significant improvement in actual sustainable effectiveness in the long term.<sup>46</sup> This means that rules and regulations are driving these organisations to make changes; however, they are not making significant improvements in their informal systems. They are following rules and regulations with a compliance mindset. This may result in high effectiveness or 'worse, accompanying this shift may be an increase in control- costs and a decline in spontaneity, creativity and risk taking as well as in the experienced quality of work life' (White,<sup>46</sup> p. 344). Thus, White<sup>46</sup> proposes that increased regulations can engender either high or low effectiveness, without changing behaviour. Indeed, a compliance mindset does not change behaviour but encourages a checklist approach. For meaningful change to occur, boards must go beyond simple adherence to rules and regulations. This idea was further endorsed in the interview stage as there was a clear indication from board members that regulations may not be the only factor in altering perceived decision making. Another executive noted:

You talk about governance; you talk about the change since SOX. I am concerned that a few bad actors have caused huge changes, where we are proscribing solutions. I do not think they generate better outcomes and it is almost like the innocent being punished while the guilty are free. I think that this is a real challenge in the world today (personal communication, 2005).

The executive, therefore, believed that rules and regulations, while important, can become a burden to the organisation, particularly the board. This is consistent with Gillies,<sup>47</sup> who notes that 'while it is possible to make a case for [increased regulations], it is unlikely that legislation...would substantially change board performance' (p. 216).

Based on statistical analysis, the results indicated no statistical relationship between TSX

formal (rules and regulations) and decision making. These results most likely occurred because many executives feel that increased regulations do not by themselves improve decision making (see Appendix C). Although boards and CEOs have a heightened awareness of the formal rules like SOX and C-SOX, it does not mean that these rules will automatically improve decision making. A practical implication of this is that the executives believe that many other factors besides rules and regulations affect decision making. The way in which new board members are sometimes actually recruited, however, may not help in the decision-making process. As one board member noted during the interview stage:

There are way too many cases where other members say there is Joe who just retired and so let us see if he wants to do this [join the board] (personal communication, 2004).

A statistical analysis of the relationship between values, groupthink and knowledge and decision-making showed that values and groupthink have a dominating effect on knowledge in predicting decision-making. This indicates that values and groupthink account for a significant amount of decision-making variability (see Appendix C). These findings are significant and warrants asking the question: why would values and groupthink override knowledge? One director during my interview stage cited groupthink as a major detriment to board process. Therefore, companies should be cautious that values and groupthink are not so strong that they override the essential knowledge base of directors. Hambrick and Mason<sup>48</sup> suggest that 'organizational outcomes — both strategies and effectiveness—are viewed as reflections of the values and cognitive bases of the [BOD] in the organization' (p. 193). This is consistent with previous research that has shown that 'weighing against the benefits that strong ties create is another dynamic; relationships can get so strong that the community becomes complacent and insulated from outside information and challenges' (Florida *et al.*,<sup>49</sup> p. 20).



When board members are so focused on their own dialogue (groupthink) they may ignore the whole picture — that is, that the corporation exists within society. In this situation, their narrow focus may prevent them from using their knowledge gained from their environment (society) to make better decisions. This finding is significant and invites further research in this area, and poses the question: ‘How can companies nominate board members who do not have a groupthink mentality?’ One way to ensure that companies do not nominate board members with a groupthink mentality may be accomplished by formulating a well-developed skill matrices that encompasses the knowledge, experience and the behavioural characteristics/patterns of potential and existing board members.

## BOARD TOOL

### Skill matrices

In order to fulfil the TSX Guidelines 1A 1B 1D and 1E (see Appendix B), many boards use a skill matrix to outline the experience and knowledge required by the board member based on industry trends and the corporation’s specific needs. This exercise ensures that there is congruence between the corporation’s needs and the board members’ capabilities. It also helps to ensure that the board member has sufficient depth of knowledge to make an adequate contribution. This matrix should serve to highlight board members who have the knowledge and experience required by the board.

The skill matrices then acts as the screening process in determining whether the BOD as individuals and collectively have the appropriate competencies to fulfil their responsibilities. Skill matrices do not have to be a sophisticated form or document, but should reflect the communication among the board and management about what type of board they want to be. ‘The most important predictor of director effectiveness is not independence, but strategic experience that matches the company’s needs’ (Westphal,<sup>8</sup> p. 3). In this research,

two board characteristics found to affect decision making of the board are values and groupthink. Therefore, skill matrices would identify board members who are knowledgeable not only about the company’s area of business but also identify the behavioural characteristics of board members.

This can be accomplished through discussions among the chair of the nominating committee, the chair of the board, other directors and CEO in formulating a director’s competency [skill] matrix analysis.<sup>50</sup> This skill matrix will facilitate the board members being organised in a manner that allows for learning capabilities (capacity to assimilate existing knowledge) and development of problem-solving skills (capacity to create new knowledge) to render benefits to the corporation.<sup>27</sup> ‘Use of a director skills matrix can be beneficial on this count. Such a matrix delineates those critical skill sets that are currently captured by board members and those skill sets that are wanting. Any addition to the board should, ideally, fill an area of weakness, thereby enhancing the overall board profile’ (Dalton and Dalton,<sup>10</sup> p. 96; see also Sherwin<sup>51</sup>). Skill matrices, therefore, serve as an objective criterion for nominating new board members, CEO and the board chair and the ‘boards’ role with regard to Corporate social responsibility.

### The directors behavioral types

Skill matrices can also be expanded to include other characteristics that would ensure that board members are well rounded. According to Leblanc and Gillies,<sup>11</sup> the search for directors with various behavioural characteristics is driven by the belief that a combination of directors with different behavioural characteristics will lead to a more effective decision-making process by the board. These behavioural characteristics will be dealt with in the following section.

Skill matrices need to identify gaps in both knowledge and behavioural patterns of existing and potential board members to match them to the strategy of the company’s needs. Identifying

gaps in board member's knowledge base is a straightforward exercise; the knowledge, and technical experience can be easily ascertained. The behavioural patterns, however, involve a more complex skill matrix.

Leblanc and Gillies<sup>11</sup> offer a model in selecting the right mix of directors and outline ten behavioural types that can be attributed to chairs and directors. These fall into two categories of functional or dysfunctional board members.

## BOARD MEMBERS

### Change Agents versus Controllers

Change Agents are the catalysts for bringing about fundamental change and are functional board members. Controllers are very dissatisfied and are incapable of accepting any position that is presented to the board without any reason and without suggesting an alternative; they are the dysfunctional aspect of Change Agents.<sup>11</sup> One means of breaking the complacency that may arise due to groupthink and shared values is engagement. Engagement can be brought about by Change Agents, who, according to Leblanc and Gillies<sup>11</sup> 'are to ensure that change is not simply talked about but takes place, they provide the leadership and make tough decisions, unpopular as they may be with management and other directors, to get the change made' (p. 174). Perhaps the most useful definition of engagement through the role of Change Agents came from the interview stage of this research. As one board member in the interview stage noted:

If you are management, you know if you have got an engaged board or not — you know from the quality of the meetings and what you get out of them. Management has to always be challenged [by the board] they can only challenge each other so much. After all, they are a management team. Management is basically run by consensus. If they coalesce, this is when they need to be challenged. This is where a board of directors

can get engaged. Engagement by the board is invaluable to management. How can you let one CEO who is responsible for operating the company do what he likes? He has six other CEOs from different experiences. Board members need to say: I think what you are doing is crazy. Why don't you do this? Why have you not done that? Have you thought about this? Have you thought about that? We [the board] do not agree because we think you have not done this kind of work. This sort of engagement is a great advantage you get from a board and is another way to ensure that you will not fail. I do not know one great truthful CEO who would not say I deserve the credit, but boy my board was really helpful (personal communication, 2004).

Board members must be alert to the fact that 'social ties in CEO-board relationship'<sup>52</sup> have the propensity to be (diminish the involvement and effectiveness of directors by reducing their tendency to control management decision making) and adversely affect decision making.

It is imperative that management and CEO are open and truthful to the board so that the board can do their job by independently evaluating management's strategic direction. Engagement, therefore, may reactivate board members' knowledge base in situations where groupthink and values have become strong. One executive related:

There was not enough creative tension before [at our company], because you can rationalize why incremental change is fine... The model we find for driving change that really works is one where you have the current state plus the desired future and the tension to get there (personal communication, 2004).

This executive is suggesting that engagement (change) can only occur in organisations that have identified their values (desired future) and that both management and the board have ensured that this culture is translated throughout the organisation. Within an organisation values



and groupthink can be positive and are necessary for cohesiveness. They can also, however, lead to complacency. It rests with the board to strive for creative tension when they believe change is necessary.

According to Finkelstein and Mooney, 'one of the biggest areas where directors find themselves at a disadvantage relative to the CEO is their knowledge of the company' (2003, p.110). In the interview sessions, several directors suggested that board members should communicate directly with people who are responsible for making decisions, without the presence of the CEO or management. As one executive noted:

If management has an issue and they want to talk to a board member or a committee chair, they can phone them and have a discussion. The board members will do the same thing. They will phone into the company if they have a question, and they will go to whomever they think is best able to answer the question. I want the board to be fully informed about the issues and I want the board to be fully aware of those issues — no surprises. My view is I am going to make sure the board has all the information because I am never going to get accused of having managed what they know (personal communication, 2004).

Nonetheless, knowing that their responsibility is to govern and not manage, board members need to leave the running of operations to the operational heads. At the same time, if they have any concerns about what information management has presented to them, they need to investigate further by asking tough questions.

### **Challengers versus Critics**

The second type of functional board members are Challengers. The Challenger's role is to ask tough questions and represent the functional aspect of board behaviour. Whereas Critics criticize and complain in a manipulative way, they lack 'the constructive component of being constructively critical'.<sup>11</sup> Board members who

are not open minded may not be able to think objectively even when their individual commitment is high. Argyris<sup>53</sup> suggests that open mindedness is not simply a function of how people feel but of how they think and whether they listen only to themselves. One senior management executive related how change occurs in his organisation.

Adopting this new program at our company prompted a tremendous dialogue. Whereas the philosophy before was just get a little better than what you did last year, now there is a stake in the ground and you get engaged with creative tension. That is the part driving the change (personal communication, 2004).

This statement implies that the board members were willing to be more open minded about enacting change within the organisation through constructive dialogue. This parallels Argyris and Schon's<sup>54</sup> idea of double-loop learning, where errors, once detected, are corrected through changes in organisations' norms, policies and objectives. This is because, as Argyris and Schon's<sup>54</sup> believe, decisions for corrective action within an organisation involve changes to norms, objectives and policies (values and groupthink), not changes to knowledge. When the board is making a decision for change, based on their assessment of past errors, they opt to correct organisational values, and groupthink mentality. As 'learning agents are scattered in space and each possesses a bit of knowledge',<sup>55</sup> it is much more difficult to decide to make changes to knowledge. One example of double-loop learning may involve the chair of the board and board members having to make the tough decision to fire a CEO because the CEO refused to take corrective action after the board identified serious concerns. One board chair related:

At some point you have to make very tough decisions. The board may have to fire the Chief Executive Officer which I have been involved in a number of times, either because of a lack of trust or more importantly because

of a lack of knowledge, stupid decisions, or the CEO trying to gloss things over the board when they have not given the board all the facts. I have been involved in this type of situation about six times. That is the role of the board of directors. In every case the board made a decision too little too late. You know the board is just reluctant to take that action. In every case we made the right decision, but we were a year or two too late (personal communication, 2004).

This was double-loop learning because there was a complete change of management and company focus with the new CEO. A change in CEO at an organisation has a rippling effect on the entire organisational structure and culture. For example, the difference in the management and strategic direction of an organisation between a CEO who is a lawyer as compared to a CEO who is an engineer or an accountant is significant. When the BOD sheepishly acquiesces to the CEO, they are not considering the underlying norm and belief of the organisation (the vision and mission statements).

Alternatively, 'managers must weigh the benefits of seeking advice against serious potential costs: when managers reveal information necessary for the board to advise them, they face the uncertainty that that information could affect the board's opinion of them enough so that the board fires them'.<sup>56</sup> Therefore, it is imperative that both the management and the board are open minded, the boards' responsibility being to advise management when their advice is sought, or if they perceive that there are problems. Management must be confident in their ability to perform all required due diligence before making presentations to the board. Additionally, board members must be open minded to incorporate other views and ideas so that their decision-making process is guided by a balanced, informed base.

### **Counsellors versus Cheerleaders**

The third type of functional board members are Counsellors. 'Counsellors have strong

persuasive skills, high credibility and have the ability to work individually with a variety of people, both inside and outside the company'.<sup>11</sup> Alternatively, the dysfunctional Cheerleaders praise all executives on the board continuously; however, they do not prepare or participate in board meetings.

'The *expertise hypothesis* suggests that a longer-term director engagement is associated with greater experience, commitment, and competence, because it provides a director with important knowledge about the firm and its business environment'.<sup>57</sup> These Counsellors as one CEO recounted:

We in management say: Here are the concerns about the issue so the [board member] has some breadth of knowledge. Then they start by reading the newspaper or they visit their colleagues or they may sit on other boards and they listen for things and so their knowledge is building all the time. There is a cost, an exchange of information both micro as it relates to the company and macro as it relates to the industry and the environment broadly (personal communication, 2004).

This sharing of information in an honest and timely manner ensures that these boards have full trust in the CEO and, therefore, are motivated to serve on the board. One board member during the interview stage elucidated the importance of creating a healthy motivating environment:

I think the best board meetings you ever have are when everybody comes out and says, 'We had a hell of a meeting, we argued and fought and we just did it'. I mean that was a real good meeting. On the other hand, if you get a report and are asked a few questions and it is approved, then, you just get on with things and then have dinner an hour early. That is not the kind of board you want, and so I think the real good management teams want board of directors' engagement. It is invaluable to them. (personal communication, 2004).



Therefore, there must be continuous effective communication among all board members and management.

According to Leblanc and Gillies<sup>11</sup>, Counselors act as coaches to other board members, and they serve as external connectors; they have a good understanding of policy issues that are not routine, for example, social change or political developments and may also play the role of advisers or mentors. These board members should balance the values of the organisation with the ability to discern whether there is pressure from other members for them to conform to a particular decision. The board member may not necessarily agree with their colleagues, but may refrain from voicing their opinion for fear of creating conflict, which can adversely affect the decision-making process.

#### **Consensus-builders versus Conformists**

The fourth type of functional board members are Consensus-Builders. Consensus-Builders are directors who use their superior conflict-resolution skills to ensure that there is sharing of information; board members as a team need to be motivated to serve as members, in the best interest of the shareholders. By learning about the needs, expectations and motivation of directors, organisations can ascertain whether the values of directors are congruent with the organisation's strategic direction. Motivational theory suggests that identifying 'needs' is the first step in being able to fulfil those needs. Thus, by identifying directors' needs, organisations can then differentiate between directors who are merely decorative features from directors who are on the board to add value. The dysfunctional opposite of Consensus-Builders are Conformists. Conformists are nonperforming, cooperating directors who support the status quo, and retain their seat due to past successes or relationships.<sup>11</sup>

Consensus-Builders are considered 'resourceful',<sup>58-60</sup> suggesting that these board members serve as boundary spanners and resource extractors, making information and resources avail-

able to executives; thus, these board members serve to enhance organisational legitimacy.<sup>26</sup> When the board acts in this capacity, they are able to extract resources and knowledge from their environment to the company's advantage. During the interview stage, one executive noted that:

[The stakeholders in the community] were the experts in this case, because they lived near the energy plants and were able to observe that our thousand dollar lighting system was useless after 6.00 p.m., so we saved millions of dollars annually on electricity because we listened to our stakeholders (personal communication 2004).

#### **Chairs**

Additionally, Chairs are special board members who have the job of overseeing the entire board's activity. According to Leblanc and Gillies,<sup>11</sup> there are two types of chairs Conductors or Caretakers. 'Conductor-Chairs have a good relationship with management; keen interest in good governance and are engaged in all important board activity. Caretaker-Chair are ineffective and have Cheerleaders, Critics, Conformists or Controller characteristics therefore, they lack leadership ability'.

Nominating board members with a solid knowledge base of the company's business is important. This research indicated, however, that this knowledge may be suppressed in the presence of groupthink. Therefore, it is essential to identify board members' behavioural characteristics before they come on board to screen potential board members who demonstrate dysfunctional tendencies as discussed above.

#### **CONCLUSION**

The lead finding of this study is that corporate leaders in Canada are unanimous in their view that the usual board measures such as CEO duality, insider and outsider ratio, number of board members and directors' share ownership may not be the only critical determinants of

board effectiveness. The informal elements of corporate governance that have long been neglected by regulatory bodies, research and literature can provide crucial information about effective decision making. From the interview sessions and survey analysis of data, an inside view of board process and what occurs inside the boardroom was revealed.

The detailed discussion about what happens in the boardroom demystifies the board process and provides the bases for three critical objectives when selecting new board members or evaluating current board members' performance:

- (1) ascertain and embellish the knowledge base of directors;
- (2) motivate directors to share and gather information to ensure that personal values are congruent with organisational values; and
- (3) ensure that clear and fluent transmission channels exist to reduce the potential of having groupthink on board.

The knowledge base, depth and breadth of knowledge and learning capabilities are all important factors that contribute to directors' informed decision making. Learning capabilities presuppose that board members, upon receiving information, are able to analyse and synthesise this information to make empowered decisions. Further, board members' knowledge and expertise are valuable resources that should be used to the benefit of the organisation. One of the important roles of the board is to ask tough questions of management if they are not clear about an issue. Therefore, it is essential that board members facilitate knowledge transfer with other board members and with management.

Most board members regard their board position in high esteem. The prestige associated with being a director can therefore motivate members to share and gather information. Information is at the heart of board process; however, information needs to be accurate,

clear, reliable and timely. Thus, it is necessary that board members question each other and management to preserve the integrity of the information and avoid groupthink. It is often difficult to assess and understand the repercussions of homogeneity of thinking among board members, or groupthink. If board members are not able to think independently, clear from group pressures, then this may adversely affect the decision-making process.

For the knowledge and motivation of directors to be functional, there must be clear and fluent transmission channels; Leblanc and Gillies<sup>11</sup> call these directors' functional directors. When fluent transmission channels exist, board members are able to communicate among themselves, management and outside consultants, and are thus less likely to involve personal agendas or political status. When putting a board together, it is essential to choose functional directors who have the behavioural characteristics that promote good decision making. Therefore, the behavioural patterns of board members are of significance to board effectiveness. It is essential for boards are able to recognise early warning signs of dysfunctional behavioural patterns that may present significant risks to the organisation. A well-developed skill matrix that inquires about the prospective board members and CEO's knowledge and behavioural characteristics (values and groupthink) may indeed improve the decision making of the board.

There are three main conclusions:

1. This research clearly proves that formal rules and regulations are inadequate; they have little effect on decision making by board members. Informal characteristics must be considered in unison with the formal system when nominating board members in order to restore shareholder confidence and to rebuild trust in board governance.
2. Similar values and groupthink can contribute positively to board members' decision making. There is a high possibility, however,



- for groupthink and values to become redundant, masking board members' knowledge.
3. Skills matrices that include questions related to values, knowledge and groupthink and three behavioural characteristics should be considered by boards to ensure the nomination of well-rounded members.

A model was developed (see Appendix C) that provides a visual conception of the relationship or nonrelationship among the formal and informal system. This research suggests that effective corporate governance may be associated with more than the reparation of internal controls or following the checklist approach to rules and regulations. Sound values and philosophical statements that are diligently translated throughout an organisation may also be an effective means of governance and may enhance a corporation's overall viability.

Composition should not simply refer to 'who' the board members are, but to the calibre and knowledge base of each member, their learning capabilities and how they interact with each other, with management and with other stakeholders. Structure should not focus solely on the number of directors and size of the board but should be reflective of how knowledge is used on the board, how board members are chosen and what competencies they possess.

This can be accomplished by formulating detailed skill matrices that comprise knowledge, values and behavioural characteristics of the potential and existing board members. Attention to the behavioural characteristics of board members has the potential to reduce the propensity of having board members who have a groupthink mentality that can impede a board's overall effectiveness.

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- shift to either end of the continuum poses a problem. As noted later in the paper a critic may stimulate argument by criticising and complaining, which may reduce the potential for groupthink on the board. However, this behaviour has the potential to side track board members. The question remains, is it worth having a critic on board to avoid groupthink?
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## Appendix A

### **QUESTIONS USED IN INTERVIEWS**

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Questions will centre around these topics and how they relate to the environmental responsibility committee and corporate governance of the Board of Directors (BOD):

- Q.1. How does the BODs go about their duty of overseeing development of the overall strategic direction and policy framework for the company?
  - Q.2. What is the process that the BOD goes through to approve or disprove the opportunities and risks of the company's business?
  - Q.3. How does the board go about identifying the principal risks of the company's business and ensure there are systems in place to effectively monitor and manage them?
  - Q.4. How does the environmental responsibility committee (or its alternative) work with management to design compliance policies that meet and anticipate environmental regulations?
  - Q.5. What percentage of the BOD would you consider to be environmentally knowledgeable?
  - Q.6. How does your company ensure that the BOD understands environmental risks and liabilities; for example, the changes to liability reporting requirements for asset retirement obligations?
  - Q.7. How does the BOD ask senior management the right questions when environmental position is not clear or actions and goals seem mismatched?
  - Q.8. Have any of the boards on which you have served assessed the risks of climate change to their firms?
  - Q.9. There has been suggestion from a number of reports about corporate governance that members of the board who have full-time jobs sit on no more than four boards and that retired members sit on no more than seven boards. What do you think about this suggestion?
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**Appendix B**

**LIST OF TORONTO STOCK EXCHANGE GUIDELINES AND SHELL CANADA'S<sup>61</sup> PROXY STATEMENT (2004)**

<i>TSX Guidelines with cross-references to the CSA Proposals</i>	<i>Does Shell Canada meet the guidelines?</i>	<i>Shell Canada's corporate governance practices</i>
<p>1. The board should explicitly assume responsibility for <i>stewardship of the corporation</i> and, as part of the overall stewardship responsibility, the board should assume responsibility for the following matters: (The Canadian Securities Administrators (CSA) Proposals require disclosure of the board's written mandate.)</p>	<p>√</p>	<p>The mandate of the Board is to supervise the management of the business and affairs of the Corporation. The Board's authority is exercised in accordance with:</p> <ul style="list-style-type: none"> <li>• the <i>Canada Business Corporations Act</i>;</li> <li>• the Corporation's articles of incorporation and by-laws;</li> <li>• the Corporation's Statement of General Business Principles and Code of Ethics;</li> <li>• the charters of the Board and the Board committees; and</li> <li>• other applicable laws and regulations including those imposed on the Corporation by CSA, the TSX (on which the Corporations Common Shares are listed) and the US. Securities and Exchange Commission ('SEC').</li> </ul> <p>The Board approves all material decisions that affect the Corporation and its subsidiaries before they are implemented. The Board delegates to management the authority and responsibility for the day-to-day affairs of the Corporation and reviews managements performance. The Board expects management to manage the Corporation in a manner that enhances shareholder value, is consistent with the highest level of integrity and within the law.</p>
<p>(a) Adoption of a strategic planning process</p>	<p>√</p>	<p>Copies of the Corporation's Statement of General Business Principles, Code of Ethics and the charters of the Board and its committees can be found on its website at <a href="http://www.shell.ca">www.shell.ca</a>. Printed versions of these documents are also available upon request to the Corporation's Secretary.</p> <p>The Board oversees the Corporation's strategic direction and is involved in the Corporation's strategic planning process. During the course of the year the Board will review with management the individual business plans for each of the business units. The Board is responsible for reviewing and supporting the overall five-year strategic plan, including risks and opportunities. Throughout the year, the Board reviews business, segment and project-level strategies, as appropriate. At its last meeting of the year, the Board approves the capital and operating budget for the following year. The Board reviews the Corporations performance against the strategic plan at least quarterly. Management must seek the Board's approval for any transaction that would have a significant impact on the strategic plan.</p>



## Appendix B: Continued

<i>TSX Guidelines with cross-references to the CSA Proposals</i>	<i>Does Shell Canada meet the guidelines?</i>	<i>Shell Canada's corporate governance practices</i>
<p>(b) Identification of the <i>principal risks</i> of the corporation's business and ensuring implementation of appropriate systems to manage those risks (The CSA Proposals require disclosure on the subject of ethical business conduct, the adoption of a code of business conduct and compliance monitoring.)</p>	√	<p>The Board is responsible for identifying the principal risks of the Corporation and ensuring that risk management systems are implemented. The systems for identifying and managing these risks include:</p> <ul style="list-style-type: none"> <li>• a risk based control assessment process to identify significant risks that the Board reviews annually;</li> <li>• risk assessments for all new projects on cost, schedule, technology, economics and the sustainable development aspects of the project;</li> <li>• peer reviews on major projects;</li> <li>• reviews of capital expenditures, economic premises, earnings projections and sensitivities, and the financing capabilities of the Corporation in the strategic planning process;</li> <li>• a management system for Health, Safety and Environment ('HSE');</li> <li>• ISO 14001 registration of Environmental Management for all key operating facilities;</li> <li>• audits on HSE and asset integrity;</li> <li>• an 'Assurance Committee' comprising the President and CEO and senior management that oversees a range of appraisal mechanisms including business control audits, HSE audits, asset integrity reviews, value assurance reviews and self-assessments;</li> <li>• financial controls, business processes and management information systems monitored by internal audit, the external auditor and the Audit Committee;</li> <li>• quarterly reports to the Board on HSE;</li> <li>• reports to the Board on interest rate, currency risk and other risk management activities; and</li> <li>• annual assurance letters on HSE, the Statement of General Business Principles and Code of Ethics and a wide range of business procedures, policies and practices provided to the Board by the President and CEO.</li> </ul> <p>The Audit Committee meets regularly to review reports and discuss significant risk areas with the internal and external auditors. The Board, through the Audit Committee, ensures that the Corporation adopts appropriate risk management policies.</p> <p>The Corporation has adopted a Statement of General Business Principles and a Code of Ethics for its directors, officers and employees which includes commentary and direction in the areas of business integrity and conflicts of interest. Copies of the Corporation's Statement of General Business Principles, Code of Ethics and the charters of the Board and its committees can be found on its website at <a href="http://www.shell.ca">www.shell.ca</a>. Printed versions of these documents are also available upon request to the Corporation's Secretary.</p>



**Appendix B: Continued**

<p><i>TSX Guidelines with cross-references to the CSA Proposals</i></p>	<p><i>Does Shell Canada meet the guidelines?</i></p>	<p><i>Shell Canada's corporate governance practices</i></p>
<p>(c) <i>Succession planning, including appointing, training and monitoring senior management</i></p>	<p>√</p>	<p>In the ordinary course of business, the Corporation and its subsidiaries enter into transactions with which a director may have a relationship. It any such transactions are brought before the Board for discussion or approval, the director declares a conflict of interest and withdraws from any discussion or vote on the transaction.</p> <p>The Board is responsible for appointing the President and CEO and senior management. The Board, through the Management Resources and Compensation Committee:</p> <ul style="list-style-type: none"> <li>• approves the President and CEO's annual objectives and compensation and terms of employment;</li> <li>• assesses at least annually the performance of the President and CEO;</li> <li>• determines compensation and terms of employment for senior executives; and</li> <li>• approves pension and benefit plans of the Corporation.</li> </ul> <p>The Management Resources and Compensation Committee, in consultation with the President and CEO, recommends candidates to the Board for appointment as officers. This committee ensures that processes are in place to recruit senior managers with the highest standards of integrity and competence, and to train, develop and retain them. It also oversees the implementation of succession and management development plans and reports to the Board at least annually. The Board supports management's commitment to training and developing all employees.</p>
<p>(d) <i>Communications policy for the corporation</i></p>	<p>√</p>	<p>The Board has adopted a corporate disclosure policy based on the CSA's National Policy 51-201 <i>Disclosure Standards</i> and the TSX's <i>Policy Statement on Timely Disclosure</i> and <i>Electronic Communications Disclosure Guidelines</i>. The policy provides direction on the accurate and timely disclosure of material information, confidentiality, equal dissemination of information to investors and analysts, electronic communications and employee trading. The policy is administered by a committee of senior management and is reviewed at least annually. A copy of the Corporation's policy can be found on its website at <a href="http://www.shell.ca">www.shell.ca</a>.</p> <p>The Board approves all major communications by the Corporation, including annual and quarterly financial reports to shareholders and reviews press releases involving financial information. The Corporation communicates with its stakeholders through a number of channels including its website. Shareholder communications are available in English and French. Inquiries from investors, media or the public are responded to by Investor Relations, Public Affairs, the Corporation's Secretary or the appropriate members of senior management. The Corporation has a toll free number for customers and public inquiries.</p>

**Appendix B: Continued**

<i>TSX Guidelines with cross-references to the CSA Proposals</i>	<i>Does Shell Canada meet the guidelines?</i>	<i>Shell Canada's corporate governance practices</i>
(e) <i>Integrity of internal control and management information systems</i>	√	The Board, through its Audit Committee, examines the effectiveness of the Corporation's internal control processes and management information systems. The Committee meets at least quarterly to receive reports and review the integrity of the systems with management and, independently of management, with the internal and external auditors. The internal auditor submits quarterly reports to the Audit Committee on the quality of the Corporation's internal control processes and management information systems. The annual assurance letter to the Board from the President and CEO and the CFO includes a statement on the integrity of the internal control and management systems. The President and CEO and the CFO provide certificates prescribed by the Sarbanes-Oxley Act of 2002 and the CSA.
2. A majority of directors should be 'unrelated'	√	Of the ten directors standing for election in 2005, only C. Mather, the President and CEO of the Corporation, is an inside director. All other directors and nominee directors are 'unrelated directors' (as defined below). The Corporation has a significant shareholder and one unrelated director and one unrelated nominee director are related to the significant shareholder.

Appendix C

CORPORATE GOVERNANCE DECISION-MAKING MODEL

