The Human Face of Corporate Governance

By Lynn McGregor (2000)

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Summary by Graham Wilson

A quick overview – why I have summarised this book

Anyone who knows me will be well aware that I am very sceptical about 'systems' and 'procedures'. My experience of the quality management movement in the 1980's was that a very well intentioned and laudable aim was completely unfulfilled. We still have just as shoddy quality in our goods and services as we did in 1979. What's more, as many managers today pay lip service to the needs of the customer as they did then. There's a wonderful graph, produced by the DTI in their literature promoting ISO9000, in which it is shown that as the number of quality management systems implemented in a country increases so the national wealth, measured in *per capita* GDP, declines – exponentially!

Despite this, there were some good messages in the quality movement – one of which was that policing quality into something – by inspecting it and chucking out the rejects – is a VERY inefficient way of doing things. Sadly, most books and reports on corporate governance seem to encourage a policing mindset. They reinforce formal procedures or systems, 'independence' of the inspectors, or create a hierarchy of overseers.

The reason why rules and regulations don't work is that people don't follow them. I can't put that more simply. And the worst offenders are the managers in organisations – the very people meant to be implementing and managing these governance practices. Managers have a strong disregard for the law. It is said that managers incur more speeding tickets and parking fines in this country than any other group. When you take away the social weightings that favour this (managers tend to have more powerful cars and drive longer distances) they still come out on top as the worst class of offenders. Put bluntly, POLICING AND PROCEDURES DON'T WORK.

The phrase, the 'human face of corporate governance' will mean different things to different people. But to me it promises a real world answer to the fundamental problem – how do we

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ensure that the people at all levels within organisations behave legally, ethically, and responsibly?

In his preface to this book, Sir Christopher Hogg explains; "Governance brings power; and power corrupts. The antidotes to that power are transparency, objectivity and accountability. All three require a steadfast and clear appreciation of oneself as seen by others."

As some of you know, I was recently invited to be an advisor to a body established by Lord Paul, the World Council for Corporate Governance. This organisation seeks to encourage organisations from the smallest business to whole governments to adopt 'good' governance. The reason I was invited (well one reason any way) is because of my interest in how human beings (as Mayor Koch of New York used to say, PEEPUL) behave at work. In May 2003, I gave one of the papers at the 4th World Congress on Corporate Governance, being held in Westminster, on the topic – "People and Corporate Governance", so it seemed logical to summarise this book as part of my monthly 'book summary' series.

I found this book frustrating in some ways. It is actually four separate tomes in one. McGregor has some very powerful messages and spells them out superbly – but each section stands on its own to some extent. In some sections she has given a lot of detail but unfortunately it is based on only one model – especially in the area of personality and self-development. In others her analysis is very detailed and helpful – such as her breakdown of formal roles on boards and the problems that beset them. In the end, I decided to focus on the first section and then give an overview of the remainder.

The Meaning of Governance

What is being governed?

McGregor's perspective is that on the one hand, what is being governed is the corporation, but on the other (equally important) hand, governance is about how the decisions made in governing a corporation <u>affect</u> people. At present, we live in a society that values materialism, technology, and competition. This social context is under increasing criticism, not only through the high profile demonstrations against the City, but also among individuals who question the impact of this materialism on their own lives. As George Carlin, the US comedian, put it:

These are times of tall men and short character; steep profits and shallow relationships. These are times of world peace, but domestic warfare; more leisure but less fun; more kinds of food but less nutrition … these are the times of fancier houses but broken homes.

The system is not only under attack from 'cranks' and others on the fringe. Eminent business leaders and international bodies like the World Trade Organisation and the United Nations, have all challenged the very model on which the Western society is based. Any system evolves to favour those who are successful within it – this is the hub of Darwinian theory and creates a self-perpetuating model. So the large corporations who routinely abuse poorly developed economies, through their environmentally damaging actions, implicit acceptance of child labour, and support of corrupt regimes, have the wealth that works in this system to defend themselves legally whenever they are challenged.

While the propensity for corruption is built into our western market model, as our eyes are opened to the need for appropriate governance, so the nature of the organisations that we seek to have operate in a fair and just manner is also changing.

Globalisation was a term that applied only to very large corporations. Today, the changed nature of commerce means that even quite small firms can have a global presence. This further undermines the power of governments to influence and ultimately control them and hence the onus of responsibility weighs even more heavily on the people within the companies concerned.

Smaller firms are more agile, they usually trade in knowledge and information, and they rely less on physical production. This suits a world that is progressively aging, depends increasingly on IT, and wants to be more mobile. Governance in this setting is different to that in a very large multinational. However, established organisations and their 'governors' are going to have to respond to these trends and confront the need to change their approaches to governance.

Furthermore, these are largely predictable influences and their effects. More dramatic are the unpredictable ones, such as natural disasters, political instability and human behaviour.

The human face of corporate governance

Lynn McGregor sees the function of corporate governance as directly ruling, leading, creating and maintaining structures and systems and then monitoring performance. How people govern depends on their values and beliefs, their ability to make decisions, and their capacity to implement those decisions.

Decisions taken by those in power affect the destiny of and quality of lives of many people. To do so responsibly calls for more than just expertise, knowledge and skills. To her, the key qualities are not about codes of practice, know-how, or past experience, they are about whether those in power acknowledge the power they have, understand how they wield it, and do so with full responsibility.

Acknowledgement of Power

Business leaders have always had the power to directly and indirectly affect the quality of life of large populations. They choose whether to charge a fair price for their goods or services or whatever the market will bear. They choose whether to source from the cheapest suppliers regardless of their business practices and employment standards. They choose whether the manner in which they treat their own staff allows them to lead fulfilled lives outside work or not. There have always been slave traders and there always will be exemplary employers, benefactors like the many Quaker-inspired business leaders of the 19th Century (Barclay, Cadbury, Fry and others). These are not simply things that affect multi-national corporations – they are equally true for the small one-or-two person enterprises that make up the vast majority of businesses.

The potential exists for us to end starvation across the globe. It is the conscious choice of powerful people not to do so, but instead to make other people's lives diminished and miserable. As McGregor says: "It is no longer enough for a business leader, be they a board member or a shareholder, to say that their sole purpose is to make money or to generate profits."

Understanding how they wield their power

The choice not to use their power effectively and responsibly is "the result of unconscious, short-term action and the failure to recognize our own and others' shortcomings in time. It is also the result of lack of foresight about the implications of our decisions or actions on others."

"Many corporate leaders who are adept at managing the material aspects of governance prove to be underdeveloped in other areas, such as, for example, the spiritual and emotional sides. Those who are interested in the so-called 'soft' side of life are often not as good at generating material wealth or as interested in the financial aspects of life. However there are enough examples to indicate that the marriage of 'soft' and 'hard' can produce a quality of life that is at once materially, spiritually, and emotionally, superior to that produced by one side on its own."

"We have a greater understanding of human nature than ever before. This understanding has mainly been used in crude ways by the business world. Lists of competencies and categorizing people in boxes help directors to understand the standards expected of them at any one time. Listing people by category is useful in understanding individual differences and

indicating whether there is balance in a group. However, there is more to human nature than these approaches can reveal. When people govern, they apply their talents and perceptions, ways of making decisions, wisdom, understanding and creativity. They also live either consciously or unconsciously according to their values and beliefs about themselves and their perception of reality."

Who governs?

The conventional idea is that corporate governance takes place at board level. This is one aspect but not the whole story. McGregor presents a four-fold model of governance.

1 The most pervasive form of governance is the **SYSTEMIC** form, operating through institutions and the social system. This kind was implied earlier. Decisions made in organisations may reflect current practice but they are still taken and the wisdom of them can still be challenged. For example, in the late 1990's money purchase scheme pensions were heavily promoted. Companies placed too great a reliance on them and as the stock market declined have seen a whole generation of retirees left with depleted incomes. A similar phenomenon in which financial advisors over promoted endowment mortgages left thousands of home owners with negative equity and intolerable levels of debt. The decision to heavily promote these schemes was at best ill-informed and at worst deliberately driven by greed. At this systemic level, most decision making is statistically based.

2 Within the 'system' there are many different groups with specific interests; corporations, regulatory bodies, pressure groups, and the media to name a few. The way in which they operate is largely based on power. Their strength depends on their negotiating skill determined by how well they make deals and play power games.

This **INTERGROUP** governance is also played out within companies between the board, the investors, the executive, and the workforce. When they relate well together people are happy and get on with the process of generating appropriate wealth. If they do not relate well, lack of understanding, trust and respect, inadequate information, and hidden agendas undermine the potential of the organisation.

Nowhere is this more visible than at the time of merger. Even perfect 'marriages' may crumble on account of differences in management philosophy, corporate culture and differences of approach.

3 As any serious boardroom member knows actual decisions are ratified there but are negotiated off-line. This is a process between individuals and their personalities. **INTERPERSONAL** governance is a powerful factor in deciding positive outcomes. Dysfunctional groups end up competing inappropriately, waste time backbiting, engaging in internal politics or merely putting each other down. They sabotage meetings and cause the group to go round and round before committing to a decision.

4 And finally, **PERSONAL** governance reflects the uniqueness of each individual.

"In reality, people are complex and have both strengths and weaknesses as well as different attitudes, values and beliefs. Everyone is unique with a different background and style. They bring their own ways of thinking, experience and expertise. Everyone has specific talents and blind spots. They also have different needs and ways of relating to others. Those who are not fully aware of their strengths and talents act out of instinct and may not be exploiting what they have to the fullest. Powerful people who are not aware of their weaknesses, or how they might be abusing their power are less likely to find ways of compensating for their shortcomings."

Sadly, "many board members do not really believe in self-development." There is though, a substantial body of evidence that great leaders throughout history have had very high levels of self-awareness not superficially but of a deep and profound nature.

Personal Governance

Essentially there are three factors that shape the way we experience the world and how we try to influence it. They are our core genetic nature, the experiences we have in life (and how we respond to them), and the values and beliefs that we develop over time. They are all inter-related and different theorists place the emphasis on different components.

The way in which we experience and influence the world can be broken down into several aspects too:

- Personality traits

- Decision-making styles – qualitative, quantitative, intuitive

- 'Intelligence' – the way we relate things together: physically, emotionally, spiritually

- Talents – what we do with those relationships

- Blind spots – things that we suppress unconsciously

- Weaknesses – things that prevent us from influencing as we might like to

It is only by understanding the impact of each of these elements for themselves that a 'governor' can be appropriately effective in their governance. Comprehensive self-awareness together with a continuously open mind is key.

Interpersonal Governance

When people come together to work, they obviously bring with them all their individual characteristics. These don't always interact in the same way and the interaction that they have is dynamic – changing with individual moods, as a result of their interaction and because of things that are happening elsewhere.

Approaches to governance that are rigid, inflexible, rule based or performed at arm's length are very unlikely to address the complexities that this scenario creates.

McGregor gives a simple illustration that highlights this. It is of a firm owned by a father, who acts as Chairman, and who makes his eldest son the Managing Director. The younger son has lived in awe of his elder brother throughout his childhood and has, unconsciously, tried to prove himself to his parents and his brother through his academic prowess. While the elder brother goes straight into the family firm, the younger one is now very successful in the school environment and ends up getting a place at Harvard. On joining the family firm, he brings many strengths and ideas yet his implementation of them is thwarted by his brothers' attitude to him.

Decision Making

McGregor believes that one of the main functions of a Board is to take collective decisions. Her model of interpersonal governance is based on this activity.

One of the founding fathers of organisation development, Ed Schein, developed a straightforward model for looking at group activities and McGregor follows this in her approach as she weaves human factors into the decision making activity.

To begin with, we look at the **content** of the decisions. Regardless of what the subject is, there is almost always going to be a human element – whether the topic directly involves people or has an impact on them. For example, she points out the number of boards that will gladly discuss relocation without considering and debating the impact on the individuals who work for them.

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She misses one human component of content that Schein expected – namely who are the people involved in the debate. While they bring with them their personalities and so on that will affect the outcomes, there is also a powerful dynamic that will evolve between them – this is part of the decision making process – which I'll pick up below, but simply including certain individuals or groups of people will affect the outcome of the decision too. How many management teams could have avoided major conflict if only they had invited representatives of the workforce to their discussions? They'll have lots of reasons why not to do so, but these don't always stand close scrutiny nor do they often make sense in the longer term.

The next aspect to consider is the **process** by which the decision is made. There are again two aspects to this, the mechanical process that is followed and then the human dynamics that are going on behind the scenes. For instance, some boards will simply ratify the decision presented to them by their executive colleagues. Others will engage in lengthy debate. Some will insist on preparatory briefing notes and others do not. This is what Schein refers to as **task process**. While it doesn't directly affect people, the method of choice does reflect certain norms that the individuals have made - consciously or unconsciously.

It is McGregor's view that boards should overtly agree a process by which they will take decisions that reflects their personal circumstances. If the group don't then follow this mechanism, then it is a legitimate topic for discussion as to why not.

But there is also a set of dynamics going on between the people – for example, Fred regards Joe as a personal friend as well as a colleague so he tends to favour his proposals rather than challenge the friendship. Then there's Tim and Tina who spar off each other in almost every meeting or Ranjani who has just got engaged and her fellow board members suspect she wants to leave but hasn't said anything yet. There are an infinite number of elements in these dynamics and they can all influence decisions – in Schein's terms, this is **people process**.

The shadow side of corporate governance

The abuse of power does not have to grab the headlines – indeed, it is the more subtle forms that are the most worrying. Obvious examples of headline grabbing abuse include the obscenely spectacular profits generated by some utility companies, the revelation that a multinational manufacturer has systematically ignored anti-pollution regulations on a local basis for years and has only just been caught, or that the MD of a company has insisted on sexual favours before he would agree to employ a woman in his office. But these are the tip of the iceberg.

Far subtler are the bosses who slowly undermine the confidence of their direct reports, the directors who manipulate employees for their own good, the cartels that just stay inside the law and the manufacturers who deliberately sell to third world despots even though they know that public opinion would be against them.

Anyone who is familiar with the hierarchy of needs proposed by Maslow, will be aware of the idea of 'basic needs'. The mistake we make is to assume that these are to do with food and water and that once someone has sufficient income to pay for these they have been fulfilled. Instead, we have to look at a person's psychological needs. In the 80s and 90s, most boards were dominated by men who had been born during the second world war. Their fathers were absent and for many they never returned. This had many impacts. For example, such boys got little recognition for day-to-day activities – it was only the highlights that were communicated. They soon discovered that if they were to get their father's attention they had to excel at something – be it sports, entrepreneurship, exams or whatever. In the grown up world, they still find themselves trying to seek recognition or approval. Their basic need is not for food or water but for attention from a parent figure and the way to get that is to be ever more outrageous in their achievements.

It is important to remember too, that it is not the real need that is the issue but the perceived one.

Sadly though, it is not the need so much as the method found to satisfy it that provokes shock. So, the individual will stop at nothing to satisfy their own needs, and they will do so at the cost of other people, and then they will create a series of personal defence mechanisms to justify (to themselves and, naively, to their peers) their outrageous behaviour.

The most obvious examples of the abuse of power are bullying, delusions of grandeur, obsessive drives for something, and overt internal competition. Often colleagues don't recognise the symptoms because they are so wrapped up in the organisation themselves. One business that I had the privilege of observing close-up highlighted how invidious this can be:

- There were lots of examples of bullying but the simplest was far too much dogmatism on the part of one individual around business discussions – "We need/must/should do X"

- The delusion of grandeur was laughable when the person concerned (a partner in a three-person business) decided, of his own accord, to call himself 'Chairman'

- His obsessive drive to make money led him to assess everything in terms of the immediate £ worth – even tentative networking meetings provoked the catch phrase, "Are they going to give us any work?"

- And then he applied his own scales of performance to everyone else, regardless of what they were doing, and ignoring the fact that they performed different tasks to him, so that he could ridicule them for their failure to match him.

Other more covert forms of abuse of power include deceit, secrecy, manipulation, and 'playing politics'.

McGregor makes the point that many of the most talented leaders display some form of psychological illness or neurosis. The problem with people suffering from these illnesses is that they may have a distorted view of reality which is difficult to detect and can be dangerous. There is a well-established set of defences used by people to limit the impact of their psychological neuroses. McGregor illustrates each of these with clues to spot in someone when they are relying on them. The set includes; isolation, intellectualisation, rationalisation, doubt and indecision, denial, projection, regression, displacement, reaction and repression.

The Human Face of Formal Roles

The final section of the book consists of a detailed breakdown of the various roles on a board (Chair, CEO, Non-executive Directors and Executive Members). It looks at the overall responsibilities of the board, and its members and some of the personal and interpersonal dynamics associated with them.

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