

Abstract

This webinar offered participants a deep and thorough examination of the intricate layers embedded within boardroom decision-making protocols and the multifaceted landscape of corporate governance. Leveraging the wealth of insights encapsulated in the seminal work 'Inside the Boardroom: How Behaviour Trumps Rationality', the conversation navigated through the fundamental principles expounded within its pages.

Immersing themselves in a rich tapestry of real-world scenarios, the authors skillfully painted a vivid picture of the subtle nuances pervading governance structures and the dynamic interplay within boardroom settings. From the delicate balance between rationality and human behavior to the intricate mechanisms shaping organizational dynamics, the discussion traversed a spectrum of themes, providing participants with a holistic understanding of the challenges and opportunities inherent in governing corporate entities.

Fireside Chat with Authors of the Book "Inside the Boardroom: How Behaviour Trumps Rationality"



Mr. R. Gopalakrishnan



Dr. Tulsi Jayakumar

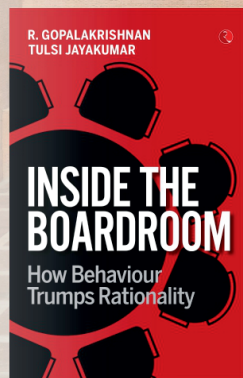
Authors



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Prof. Chitra Singla
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Moderators

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About the Speakers



Mr. R. Gopalakrishnan

This is R. Gopalakrishnan's eighteenth book. Gopal has played every type of board role on more than twenty-five company boards over thirty-five years. In India and abroad. As CEO, executive director, non-executive director, board chairman, and as independent director. His board experience is rich and has provided him a ring-side view of corporate governance, as it has evolved since its nascent stirrings in the 1990s to its more exhaustive (and exhausting) avatar, now. Governance tends to be obsessed with the technicalities and rules. Gopal believes governance—corporate or public—has as much to do with human behavior as it is about rules and procedures; it is about neeti (conduct) and neeyat (intent), as much as about niyam (rules)!

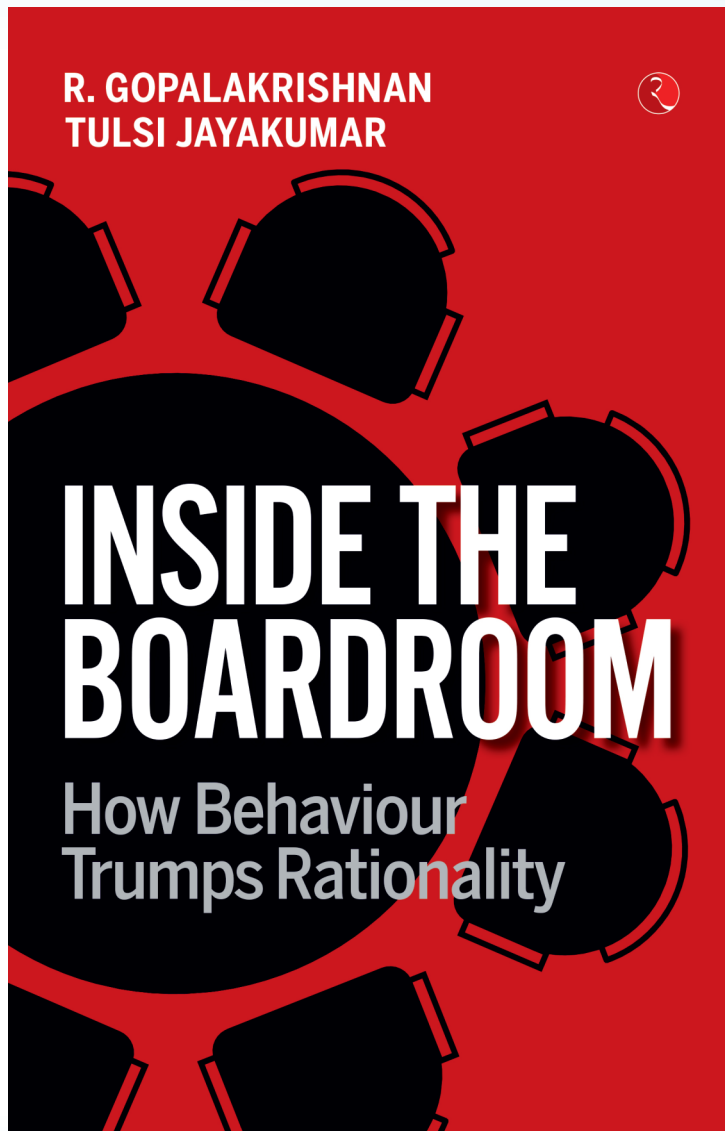


Dr. Tulsi Jayakumar

Dr Tulsi Jayakumar is Professor of Finance & Economics and Executive Director, Centre for Family Business & Entrepreneurship at Bhavan's S.P. Jain Institute of Management & Research (SPJIMR), Mumbai. Her research interests span various areas with special focus on behavioral economics and family business. She works extensively with family businesses and is a member of several industrial bodies. She is a thought leader and writes extensively in the media. She believes that most decisions are driven by either the subconscious or the unconscious, and a knowledge of the same can make all the difference in the boardroom, and indeed guide any management decision. This is her third book.

About the Book

The largest private airline in India went bankrupt, as did the bank that could not say no to its borrowers who defaulted on huge loans. Could these disasters have been foreseen, if not averted? Would it have helped if the directors on the board had spoken up before the corporate failure?



Inside the Boardroom explores the downfall of these companies and many more in the light of directors' behavior and its impact on corporate governance. R. Gopalakrishnan and Tulsi Jayakumar believe that corporate success goes beyond having significant knowledge of accounting rules and governance regulations. They boldly assert that directors' behavior in the boardroom is less rational than may be widely believed! Being human, directors' decisions are naturally subjective and prone to behavioral bias, especially when confronted with manifestations of power, passion and authority in the boardroom, or even a secret desire to be accepted by others. Hence, successful directors and boards need to be deep observers of human behavior and boardroom dynamics because behavioral and cultural nuances are significant aspects in most incidents of mismanagement leading to governance failure.

Lucidly described with a plethora of real events and insightful instances, Inside the Boardroom showcases the authors' experience with governance and boardroom behavior. It brings to light misbehaviours in the boardroom, early warning signs of failing governance in companies and some magical mantras for CEOs and independent directors to prevent failures.

The Moderators



Prof. Chitra Singla
Faculty, Strategy
IIMA



Prof. Sunil Sharma
Faculty, Strategy
IIMA



Mr. Rohit Goel
Partner
PwC in India

Fireside Chat

Note to Readers: The following section of this report stem from a fireside chat featuring two prominent authors engaged in dialogue with three interviewers. While the questions and responses presented herein strive to accurately encapsulate the essence of the conversation, they have undergone paraphrasing to enhance clarity and readability. This paraphrasing approach aims to distill the core points and overarching themes discussed during the event while ensuring the flow and coherence of the dialogue.

It's important to note that while every effort has been made to faithfully represent the original conversation, some minor adjustments and rephrasing have been applied for the sake of brevity and comprehension. Rest assured, the integrity of the discourse remains intact, and the report endeavors to convey the substance and spirit of the fireside chat as authentically as possible.

Prof. Chitra Singla (Q)

What was the motivation behind writing “Inside The Boardroom”?

Mr. R. Gopalakrishnan

What prompted me to contemplate this subject was the realization that, despite spending thirty-five years serving on twenty-five boards across various countries, I still found the path ahead rather unclear. The quest to navigate this ambiguity served as a strong motivator. This book endeavors to illuminate that path. Furthermore, the fusion of practical experience with an academic approach yields a unique outcome within these pages. At the very least, it offers a fresh perspective, if not a definitive one. To consider this book the ultimate authority on governance would be unrealistic.

Throughout my extensive tenure on various boards, I've come to view board governance as having two facets, akin to the two sides of the moon. We often focus on one aspect of governance: the rules and regulations, referred to as "niyam" and "neeti." However, another crucial concept emerges: "neeyat," which pertains to our intentions and behavior. Through my experiences, I've had the privilege of serving on imperfect boards, from which I've gleaned invaluable lessons. Imperfection is inherent in any board structure, as long as human nature is at play. I aim to shed light on this unseen aspect of boards: behavior. When changes occur in governance methodologies, directors should remain vigilant. My experiences in this regard have been overwhelmingly positive; I've encountered no adverse outcomes. While India has made commendable strides in corporate governance, perfection remains elusive.

Dr. Tulsi Jayakumar

We had previously worked on a series of six books that serve as foundational pillars for institutions. I view this book as a natural extension of that series. It delves into the intricacies of institution-building and explores the qualities of leaders who not only lead but also shape these institutions. Leadership is not solely about individual leaders; it encompasses the entire governance framework, particularly within corporate entities.

This book holds significant importance for me personally because it addresses governance beyond large corporations. As emphasized in the book, a substantial portion of the country's market capitalization and wealth generation stems from family businesses and promoter-led companies. Where does governance fit into this landscape? When examining the shapers and institutions, governance emerges as a vital component of the puzzle. Drawing from my research interests in behavioral economics and family businesses, a conversation with Mr. R. Gopalakrishnan sparked the idea of integrating these areas, leading to the creation of this book.

Prof. Chitra Singla (Q)

I wholeheartedly concur with your sentiments regarding the behavioral aspect of governance. Upon reading the book, one comes to understand that the challenges depicted are not unique to oneself; they resonate with others as well. Perhaps these dilemmas are common to every director. Could you offer a brief overview of the book? Highlighting some key insights could entice our attendees to delve into its pages. In my view, it's highly accessible and written in clear, straightforward language.

Dr. Tulsi Jayakumar

We've aimed to explore why corporate governance, despite being seemingly straightforward, often leads to corporate scandals and failures. Why do boards falter? Drawing on examples from both Indian and international corporate landscapes, we endeavor to identify: (a) the biases that contribute to these challenges; (b) the early warning signs, which we term as Prodromal Signals, that precede disasters; and (c) the essential qualities required of leaders, including CEOs and directors. We're not prescribing solutions; rather, we're engaging in a learning process. Our objective is to identify potential signals and guide directors on how to recognize and address emerging issues effectively. The book delves into these themes and provides insights on how directors can navigate such situations.

Mr. R. Gopalakrishnan

Once we transition from rationality to behavior, things tend to become somewhat chaotic and subject to debate. However, based on my experiences, I've identified three basic tools. The first tool is what we refer to as the Prodromal Test. Over the past two decades, I've personally applied this test to numerous boards. It functions akin to a compass, indicating the general direction rather than pinpoint accuracy, yet proving immensely valuable. Another frequent challenge I've encountered is how to handle disagreements. Some individuals opt to seek public attention, aiming for headlines in the next newspaper, while others choose to remain silent.

Lastly, I propose a speculative idea that I hope will stimulate further research. This concept emerged around three years ago: every leader, regardless of their sector, runs the risk of becoming somewhat self-absorbed. To explore this notion further, I conducted a "*fly on the wall*" assignment with two companies. While I cannot claim these companies underwent radical transformations, I believe it nudged the needle forward in terms of progress.

Prof. Sunil Sharma (Q)

While delving into the book, I found myself captivated by its use of the Mahabharata metaphor, which held my attention throughout. As someone who teaches Strategy professionally, I couldn't help but relate it to a well-known framework in the field: Structure-Conduct-Performance. This framework suggests that an organization's behavior is shaped by the industry structure, and in turn, the behavior of players can alter that structure. The metaphor resonated with me, illustrating how human thinking is influenced by the company they keep or the environment they inhabit.

This led me to ponder: Are we perhaps placing unrealistic expectations on our board of directors? Reflecting on the evolution of the Yugas, from Ram's era of Maryada in Treta Yuga to Krishna's adept blending of purpose and pragmatism in Dvapara Yuga, I question whether today's board members need extraordinary capabilities to navigate the fine line between pragmatism and principle. So, in this somewhat hypothetical scenario, I pose the question: "In Kalyuga, who would make a better board member, Ram or Krishna?"

Mr. R. Gopalakrishnan

I believe both of them would excel as directors. Ram, as a board member, would embody unwavering integrity and communicate directly. He would demonstrate immense compassion when addressing human concerns at the board level. Conversely, Krishna would bring worldly wisdom to the table. He would speak in cryptic language, requiring others to engage their intellect to decipher his intentions. Both sets of skills are indispensable. It's not a matter of one being superior to the other. In my experience, every board benefits from having both a Ram and a Krishna.

Prof. Sunil Sharma (Q)

To follow that up, does it mean that board members would be individually ineffective but collectively effective?

Mr. R. Gopalakrishnan

Correct. That is spot on. A failure, just like success, is a collective one, although we tend to attribute success to one hero. For me, there are two very strong signals that are red herrings. Many Indian companies have a web of companies, akin to a spider's web that cannot be disentangled. The second thing is, related party transactions. The moment I encounter these two, I get my antennae up.

Mr. Rohit Goel (Q)

Based on your experience, what do you think are some of the common behavioral biases that affect a director's decisions in the boardroom? How can they be overcome or mitigated?

Dr. Tulsi Jayakumar

Let's delve into the reasons behind biases. The precursor to bias is a heuristic, mental shortcut humans often employ when making decisions. Heuristics are essentially quick decision-making aids, utilizing System 1 thinking¹ which relies more on gut instinct. The reliance on these shortcuts can result in biases.

Among the biases prevalent in most boards is the authority bias, where individuals defer not only to the CEO but to any board member perceived as having greater authority. It's crucial for new directors to recognize that blindly following authority isn't always advisable. Similarly, there's the groupthink bias, where individuals avoid expressing dissent to maintain harmony.

Other behavioral biases include individual confirmatory bias, where individuals seek signals that affirm their preconceptions, and group confirmation bias, where the group's consensus is unquestioningly accepted. The status quo bias manifests as resistance to change, while the escalation and commitment bias mirrors the sunk cost fallacy.

In our exploration within the book, we've encountered various biases in different scenarios.

To illustrate better: *The Milgram experiment, conducted by psychologist Stanley Milgram, explored human obedience. Subjects recruited through newspaper ads were paid to administer electric shocks to a person in a chair, under the instruction of an experimenter posing as an authority figure. Despite the obvious distress of the person (believed to be a paid actor) receiving the shocks, subjects continued to comply. Stanley Milgram replicated this experiment in multiple countries except Germany where he chose not to conduct it, and everywhere, the experiment revealed consistent results.*

The point is, the presence of another authority figure alongside the original experimenter, dressed in a similar way, instructing the subject to not administer the electric shocks would have led to higher chances of the subject listening to the former and not administering those shocks.

The significance lies in having board members who ask, "What could we be doing?" rather than simply following directives. Boards benefit from individuals who question and consider non-conforming evidence. However, it remains uncertain if boards are willing to embrace such perspectives.

Prof. Chitra Singla (Q)

The book features a table outlining recommendations for diversity on boards, activism, and other related aspects. This raises the question of who should be responsible for implementing the suggestions outlined in the table. While we acknowledge that board members may engage in malpractices/misbehaviors, they are also expected to recognize biases in the boardroom and be willing to pose pertinent questions. Are you proposing the concept of a self-governing board?

Dr. Tulsi Jayakumar

In my view, when the question of responsibility arises, I believe that I would take it upon myself if I were a board member. I wouldn't want to find myself on the wrong board; rather, I would actively assess whether things are aligned or otherwise. Personally, I am content with the current board I serve on because there isn't one dominant voice overshadowing others all the time.

1. System 1 thinking refers to the brain's fast, automatic, intuitive approach. (<https://news.harvard.edu/gazette/story/2014/02/layers-of-choice/>)

Prof. Chitra Singla (Q)

I understand your perspective. Expanding on the previous point, it's evident that one person alone cannot alter board behavior. However, the absence of dissenting voices within a board raises the question of how to foster effectiveness. Who will take the initiative to implement the aforementioned mitigation mechanisms?

Dr. Tulsi Jayakumar

First and foremost, CEOs must shift their perspective on corporate governance. It shouldn't be perceived as something imposed upon them or merely obligatory. They need to grasp the purpose of a board and the value it adds. Providing some level of education for CEOs is imperative. Additionally, it's incumbent upon every director to recognize that biases can cloud judgment, leading individuals to view a position on a company board as a singular opportunity while overlooking potential drawbacks. Hence, educating both CEOs and directors is essential.

Mr. R. Gopalakrishnan

I prefer the term "constructive dissonance" over "dissent" as they convey different nuances. Constructive dissonance necessitates a skill set that can be imparted by behavioral experts. (Shares a personal anecdote to illustrate it's an art to disagree without being disagreeable)²

Mr. Rohit Goel (Q)

According to a PwC survey, 45% of respondents reported a general lack of understanding about ESG. Additionally, 42% expressed a lack of ownership over ESG within their organizations. Furthermore, a global investor survey revealed that 87% of respondents believe sustainability reporting by corporations constitutes greenwashing. Now, considering the intricate dynamics of behavior, as outlined in your books, do you believe that existing company boards are adequately prepared from an ESG governance standpoint, or is there a risk of a greenwashing bubble ready to burst?

Mr. R. Gopalakrishnan

I assume the respondents you're referring to are directors and managers. However, I view the problem from a different angle. Why focus solely on directors when the entire world is grappling with the same dilemma? When faced with a fuzzy problem, expecting clarity is unrealistic. It's part of an evolutionary process; we'll likely circle back to certain points. While I acknowledge your perspective, resolving a complex issue isn't straightforward. Our journey towards ESG may take a winding path.

Dr. Tulsi Jayakumar

Board directors are often constrained because many of them view ESG through the lens of short-termism, believing their role is solely about maximizing shareholder wealth. However, there's a growing realization that their responsibilities extend far beyond this, encompassing stakeholders and ESG considerations. It's an ongoing journey. I recall an anecdote from a meeting where a senior industrialist labeled ESG as a 'western conspiracy' to undermine competitiveness. If industries perceive ESG as a cost-increasing measure, integrating it into agendas will indeed be a challenge. Owners, particularly those leading promoter-led companies, must view sustainability as an investment rather than an expense.

Mr. R. Gopalakrishnan

I have a slightly different perspective compared to Dr. Tulsi. Initially, I wasn't entirely convinced about the concept of ESG, but I took the initiative to educate myself. Now, after many years, my viewpoint has shifted. It's been a gradual process, akin to a drunken man trying to reach a lamppost. We'll eventually get there, and I hope that nations will pave the way.

2. https://www.youtube.com/watch?v=etFxE_R3VOQ&list=PLe79_ltxE9532J6Y9gKpEw4ZaBdeuJVsx&index=10&t=428s (36:48 – 40:44)

Prof. Sunil Sharma (Q)

When it comes to enhancing board effectiveness, there's much to be done to achieve the highest level of excellence. Progress is spurred by innovation, necessitating the exploration of unconventional solutions. Currently, the board appointment process resembles a "collegium system," wherein new members are appointed internally by the organization, often for reasons of convenience. In such a flawed selection process, it's unrealistic to expect individuals to consistently uphold integrity. Board situations can typically be classified into two categories: benign and crisis situations. In benign scenarios, it's generally acceptable for individuals to express their opinions. However, the true test arises during crises when the involvement of other stakeholders becomes crucial. Unfortunately, the high (sitting fees) remuneration of board members can sometimes lead to greed overshadowing integrity in such situations. What innovative measures have been implemented to prevent this occurrence?

Mr. R. Gopalakrishnan

I respectfully disagree, based on my thirty-five years of observing boards. The sentiment you mentioned was indeed prevalent in the late 80s and early 90s, particularly when promoters perceived themselves as owners of the company. However, it's inaccurate to claim ownership when public funds are involved. While there remains a sizeable portion of individuals who adhere to this outdated mindset, societal change is gradual, and not everyone adopts new perspectives immediately.

One of the motivations behind writing this book was to shed light on such evolving aspects of innovation. For instance, the inclusion of women on boards represents a progressive innovation. Initially, I myself harbored reservations, but now I wholeheartedly support it, recognizing women as valuable contributors due to their unique perspectives.

Ultimately, I believe we are making strides in the right direction, but progress requires patience.

Prof. Sunil Sharma (Q)

It's often said that knowledge without integrity can be perilous. While there's no shortage of knowledgeable individuals, the presence of people with high integrity is less certain. Even knowledgeable individuals can succumb to irrational behavior. Ultimately, when a company collapses, it's imperative to conduct an honest assessment, given the immense repercussions. The real question is whether we're witnessing any genuine innovation and earnest engagement in the pursuit of enhancing board effectiveness, or if it's merely paying lip service.

Dr. Tulsi Jayakumar

I believe the issue you're referring to, regarding lip service, stems partly from a lack of understanding about the necessity of a board. Even some of my family business students, who are transitioning their businesses to large companies, contemplate the type of individuals they should appoint to their boards. It's conceivable for companies evolving from SMEs³ to large corporations to maintain the SME mindset. If the perception of "the company is mine" persists, it's likely that only compliant individuals will be brought on board, resembling mere puppets. Hence, the problem isn't merely lip service, but rather a lack of awareness among these companies regarding the role and purpose of a board. It's crucial for companies undergoing transformation to undergo a structured process of comprehending the need for governance and eliminating superficial compliance.

Mr. R. Gopalakrishnan

Companies typically pursue two types of transformation. It's important to acknowledge that complete reform of human nature is unrealistic. Transactional transformations can occur relatively quickly, but cultural change requires time. For instance, consider the case of family planning in India, which took approximately 40-50 years to significantly reduce the population replacement rate. Similarly, the integration of women into the workforce is another example of a transformational process that unfolds gradually.

Prof. Chitra Singla (Q)

What do you think is an actionable item which can make Indian Boards more effective, and which the government and policy makers should look into?

Mr. R. Gopalakrishnan

I highly recommend conducting the Prodromal Test. While it's not a flawless questionnaire, it can be adapted and improved upon. Though it's a basic measure, it can offer valuable insights. It's essential to approach it pragmatically. (Shares a personal anecdote to illustrate its effectiveness)⁴

Dr. Tulsi Jayakumar

When a listing is underway, promoters or family business entrepreneurs should undergo a training process. The board of directors' training should encompass the behavioral aspects we've discussed. Additionally, mandatory training for owners is essential, as they bear responsibility for shareholder wealth.

Prof. Chitra Singla (Q)

I wholeheartedly agree. In my personal experience, when the family owner or promoter is open-minded and receptive to change, they are more receptive to the insights and contributions of the board. Conversely, if they are closed-minded, it significantly affects the dynamics.

Dr. Tulsi Jayakumar

Absolutely! This is where the promoter's willingness to learn becomes crucial. I encountered a family-owned business that had expanded its operations and functions to resemble that of a large corporation, yet it retained a small-business mindset. This is a common scenario among family-owned businesses. Therefore, it's essential to provide training that encourages them to embrace challenges and view them as opportunities for growth, rather than as burdensome costs.

4. https://www.youtube.com/watch?v=etFxE_R3VOQ&list=PLe79_ltxE9552J6Y9gKpEw4ZaBdeuJVvX&index=10&t=428s (1:01:33 – 1:02:55)

Q&A Session

Q1

Based on your experience, do you observe that women members on boards are often perceived as tokens solely in family businesses, or does this also occur in non-family businesses? Do you notice any distinctions between the two?

Dr. Tulsi Jayakumar

I'll share one statistic from our book: some of the world's largest companies lack female representation on their boards. However, India has made significant strides in this regard, with more women serving on boards. Personally, I don't think women on boards are perceived as mere tokens in many companies. While this perception may exist in some family businesses, I believe women still have meaningful roles to play and aren't merely puppets. So, I wouldn't entirely agree that women on boards are viewed as tokens.

Mr. R. Gopalakrishnan

In my opinion, it's related to the male psyche rather than company boards specifically. This mindset will require time to change, if not disappear entirely.

Q2

Introducing the concept of "Niyat," does an individual or a board member believe that their subconscious influences their behavior more profoundly than their conscious and superconscious mind?

Mr. R. Gopalakrishnan

Indeed, I think the subconscious manifests in a person's behavior. I believe that "neeyat" is reflected in a person's aspirations. Some individuals strive to achieve unicorn status hastily, and then the principles ("niyam") and other elements fall into place accordingly.

Q3

In discussions concerning sustainability and ESG within corporations and boards, do you believe that *people, planet, and profit* are given equal priority? Or is it a hierarchy with *people* first, *planet* second, and *profit* third?

Mr. R. Gopalakrishnan

I can recall two personal anecdotes³ where people and the planet were prioritized over profits, with profits coming in third. While some might argue that such examples are rare, everyone should strive to emulate them.

Dr. Tulsi Jayakumar

In my experience with evolved family businesses, they don't perceive these three Ps as mutually exclusive. In fact, philanthropy and societal impact have consistently been significant priorities for many family (evolved) businesses in India.

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