The Chairman and the CEO: The Bearing Point or the Odd Couple?

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Synopsis

This paper is the result of over twelve months of research, primarily based on direct interviews with experienced chairmen. Evidence shows that when damaging crises hit companies this is frequently due to directors' "risk blindness", a result of the failure by boards of directors to have governed risk appropriately. Our hypothesis was that the influence of the two key roles, chairman and CEO, and especially the relationship between them, would be a significant factor in how effective boards would be in avoiding risk blindness and successfully governing strategic risk.

As our work progressed we learned much about the relationship between Chairs and CEOs, including how that relationship needs to be built, how it can be destroyed and the impact on boards when that occurs. We discovered that risk, especially strategic risk, the degree of trust between the Chair and CEO and time related issues were all closely interwoven. We learned of the natural lifecycle in this critical relationship that in its development and ending can damage board effectiveness and which poses a paradox for chairmen in fulfilling their critical role.

Finally, we have explored how chairmen can use structured board processes to resolve this paradox and sustain an effective relationship with their CEOs, based on mutual respect and trust, whilst simultaneously avoiding the tendency towards developing strategic risk blindness amongst the board.

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We focus exclusively on helping directors and boards improve their capabilities to govern strategic risk. Our research draws upon the leading edge in understanding the psychology of decision-making, intelligence analysis, forecasting, high-impact and low-frequency risk assessment and tested decision-making processes. Our practice brings these diverse fields together to deliver proven techniques to help boards make tangible gains in their anticipation, assessment, adaptation/mitigation and monitoring of strategic risk.

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Introduction

We undertook this exercise with a relatively simple question in mind – in trying to understand the dynamics of boardroom behaviours and decision making and their influence on the effectiveness of strategic risk governance, was the relationship between the chairman [1] and CEO a determinant factor? Our reasoning was that if failures of strategic risk governance occurred in the boardroom, as evidence suggests they do[2], then it seemed likely that the two most influential people on a board would exert the most influence over the outcomes in this specific respect.

Further, we reasoned that the onus of responsibility would fall most on the shoulders of the chairman. When it comes to existential risk and uncertainty the role of the non-executives on a board is critical and it falls to the chairman to maintain a healthy and effective balance between the perspectives of the executive and non-executive directors.

We initially set about finding what we expected would be a fairly extensive body of research on Chairman/CEO relationships. To our surprise we found very, very little research that was based on the first-hand experiences of chairmen and what they actually did. Should the reader care to enquire they will find an enormous volume of academic speculation about agency theory and (especially in the US) the merits or demerits of separating the role of chairman of the board and CEO, but from-the-field observations are notable by their absence; we found only one paper that attempted to gather any[3], whose author also found a paucity of direct observational evidence.

> ***"Due to the relative poverty of inquiry pin-pointing the chairman/CEO relationship as pivotal to effective board performance, a qualitative study … was undertaken."*** [3]

Consequently we concluded that we had to do our own research. At this point the exercise rapidly became less simple and as it progressed it became apparent that our initial question glossed over many important nuances and complexities – for example, many chairman were themselves previously CEOs: how did their experiences affect their relationship with CEOs when they became chairmen themselves? How was the relationship between chairman and CEO defined? How much was the relationship altered by the passage of time or the influence of events? Were there other factors that were much more determinant of how the board governed strategic risk than we had assumed? How on earth would we persuade busy chairman to discuss these highly sensitive topics?

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[1] For brevity we use the conventional designation without regard to gender

[2] See for example *Roads to Ruin*, 2014, Cass Business School

[3] Kakabadse, Dr. A., Kakabadse, Dr. N., and Barrett, R., (2006) *Chairman and Chief Executive Officer (CEO): That Sacred and Secret Relationship*, Cranfield School of Management, Cranfield

The latter question was non-trivial. We felt that we needed a sample that was large enough to justify at least tentative conclusions, yet small enough that the data gathering would not be interminable. We settled on a minimum of ten board chair interviews as our target; in the event we achieved twelve. Moreover we aimed for very experienced chairmen of typically large or complex organisations. In practice this has meant that our sample represents a much broader set of business sectors and types since every individual has typically had 3 or more chair roles and multiple CEO roles as well.[4]

Since we were explicitly focused on a relationship between two people, it follows that we have sought out only non-executive chairmen of unitary boards, where the role of CEO is not combined, according to the common practice now in the UK. We do not believe that this completely invalidates all relevance of our enquiries for any other governance models which we hope to explore further in the future (e.g. boards with senior independent directors and boards with a combined Chair and CEO role, as are more common in the United States).

We have relied significantly on the goodwill of our interviewees to help us contact other volunteers. We recognise that this carries a risk of selection bias. We were also very fortunate to be able to include male and female chairmen in this sample. Whilst it was not an area of focus in our study, with the benefit of additional research, the impact of gender diversity might also be a relevant consideration regarding the effectiveness of strategic risk governance. However, in the interviews we conducted, we did not find it so. One of our female interviewees expressed the view quite forcefully that she did not consider it to be of any relevance in this context. Consequently we are confident that our observations and conclusions are well founded, based on the data in front of us.

We gratefully acknowledge the goodwill referred to above and the spirit in which every one of our interviewees responded – with candour, with enquiry and with openness to challenge, but most importantly with generosity in offering their perspectives born typically of decades of experience from the highest echelons of corporate governance in practice. We hope we have done justice to their jewels of wisdom, in our cutting and polishing, to allow the deepest insights to be illuminated.

The bearing point

We tended more and more as our interviews progressed to mentally hold the label for the chairman and CEO relationship as the “bearing point”. Without, we hope, stretching an analogy too far, the idea is that the chairman and CEO together are the axis around which the rest of the board functions.

[4] See the appendix for analysis of the sample

When a board functions smoothly, the axis is well aligned and easily bears the normal stresses and strains of an effectively functioning board. However whenever challenges arise, whether due to factors outside the company or discord within the board itself, these tensions are always transmitted directly on to the chairman/CEO relationship. This duo bears the brunt of every shock or crisis, every upheaval or confrontation. This is not to say or imply that other relationships, whether amongst the executive team, between the executives and non-executives, or between the non-executive directors themselves cannot also be a source of difficulty. It is just that all of these other conflicts will, we observe, eventually show up as an issue for the "bearing point" partners.

However, the bearing point itself does not function without friction. A theme that emerged consistently from our earliest interviews was how differently the same people had perceived the role of chairman after they became chairmen themselves compared with when they were CEOs previously. Their perceptions of the role of chairmen changed significantly only after they became chairmen.

In the majority of instances these reflections were made by people who, when CEO, were not also chairmen (i.e. it was not a combined role in the same company) and so had had the opportunity to observe first hand and be mentored by effective chairmen. In most instances too, when CEOs they also had non-executive roles in parallel with their CEO roles, so had more than one example chairman to learn from. Despite this, the role of the non-executive chairman was not fully understood, or in some instances necessary in their eyes, until they stepped into that role themselves.

"I was at best agnostic if not sceptical about the value of a non-executive chairman – now I am a zealot!"

Conventional wisdom says that the chairman's job is to make the board effective. It is not our purpose to cover the question of what makes an effective board in any detail. We simply observe for now that in our view and in the views of our respondents the board cannot be effective without an effective relationship between the Chair and CEO. So it is relevant to explore what the chairman's role is in establishing such an effective relationship.

What was abundantly clear in the examples of those who recognised the change in their own perception is that for many, perhaps all, CEOs, one of the prime roles of the chairman is to support the CEO. This support can manifest itself at a purely personal level, for instance in the sense that a chairman is a source of wise and experienced counsel and advice. Yet the expectations of the (pre-chairman experienced) CEOs were also and clearly that the chairman should support them in the sense of being **on their side.** The chairman should, from this perspective, actively work to bring the board into line with the CEO's wishes and expectations. In other words, it was thought that the chairman should, in this respect, be the servant of the CEO.

> ***"I am the leader of your supporters club. I don't come onto the field of play, I stay in the dugout!"***

Hopefully no reader of this paper would expect matters to be so simple and rest there – and they don't. For as much as every Chair recognised the role of being the wise friend to the CEO, the other side of this coin is that every Chair also recognised the essential role of deciding when he or she could no longer support the CEO with the board.

The circumstances that can provoke this fundamental shift in role of the chairman and hence the relationship between the Chair and CEO and between these two and the rest of the board will frequently be one of crisis, when events are not favourable, the news is not good and time is of the essence. In other words the very circumstances when a CEO would most want to have the Chair on their side and keeping the board off their back!

> ***"I say to every CEO, you have my 100% support - unless you don't!"***

This shift in nature and tone of the Chair/CEO relationship can not only be swift, but also dramatic – in fact practically binary, as the quote above illustrates. Thus the role of the chairman is on the one hand to try and establish a successful relationship with their CEOs which is not adversarial or judgemental, but based on mutual respect, and on the other to decide when it might be necessary to test that relationship to destruction.

We asked our interviewees whether a board can ever function successfully when the relationship between the Chair and CEO is dysfunctional. The answer was unanimously "No". One might argue that this is not of primary importance; after all if the CEO is very competent, having an ineffective board might be no great inconvenience to the company's stakeholders. None of our respondents took this view though and neither do we.

Our contention is that, especially as concerns existential threats, an effective board is the **only** mechanism that can potentially protect the future of the company. It follows that if the relationship between the Chair and CEO breaks down, at a time when the company faces crisis and the board most needs to be effective but has that effectiveness compromised, the risk to the company is greatly exacerbated. We do not suggest that the Chair/CEO relationship is the sole determinant of an effective board – far from it – but it is clearly a necessary and important condition for one; a bearing point in fact[5].

In the (considerable) experience of our respondents when the Chair/CEO relationship fails it is hard to fix – though not impossible. The remedy is generally a change of personnel.

> ***"When the relationship fails, either one of the Chairman or the CEO, or both, have to go. Normally it's the CEO"***

This remedy can hardly be considered a panacea. It is perhaps more analogous to surgery – the initial intervention requires considerable post-operative care. Whatever permutation of personnel change is carried out there must inevitably follow the rebuilding of the bearing point relationship and the effectiveness of the board.

Our exploration of the factors that help to build and maintain successful Chair/CEO relationships was necessarily brief and superficial[6]. We asked for a qualitative view of the relative importance of a list[7] of possible factors. As we expected a number of these were interdependent. All those we had identified were acknowledged as relevant but a few were recurring highlights in the view of our respondents. These were:

- The relationship of the CEO with the board (e.g. degree of respect, trust, etc.)
- Communication between board members (e.g. what/how, degree of openness, etc.)
- The Chairman's personality and style
- The Chairman's personal skills and competences
- The CEO's skills and competences

Two issues emerged from our conversations that, in our view, dominate the relationship and moreover have a particularly strong causal influence over the ability of boards to avoid existential risk blindness. In the next two sections we explore these in more depth because of that influence.

It's about trust

The fact that our interviewees emphasised the role of trust in the Chair/CEO relationship seems, at first glance, to be almost banal. Trust (like risk) is inherent

[5] The Kakabadse, Kakabadse & Barrett paper (ibid) concluded that the relationship was the prime determinant of an effective board. We do not go quite that far.
[6] The Kakabadse, Kakabadse & Barrett paper (ibid) was focused on the relationship in general terms. We were interested in how the relationship affected risk governance in particular.
[7] See appendix

in virtually all business relationships (or indeed all relationships). What is so special about this one?

Firstly we observe that the stakes are high – as we have seen, when the relationship fails it is damaging for the board, for the company and one or both of the individuals. Secondly it is not obvious that the terms of engagement for the relationship are balanced. In other words the stakes are high for both participants but the interests are not perfectly aligned.

Consider the interests of the CEO. He or she might place their trust in the Chair to support them, help manage the board, to actively work in the CEO's interests and future success. The latter is a potentially very powerful motivator given the already short and seemingly ever shorter terms in office of CEOs. On the other hand the CEO might be wary of placing their trust in the Chair due to the risk that being open and honest might work to the their disadvantage, be seen as a sign of weakness or due to the fear that the Chair will want to interfere and micro-manage.

From the viewpoint of the chairman they have an interest in the success of the board and the company and hence in the success of the CEO. However can they trust the CEO to tell them what they or the board need to know? Can the CEO be trusted to tell the chairman what they don't want to be known, which in the context of risk governance may be the most critical of information?

This asymmetry of interest and information (the executive and CEO will always know much more about the true state of affairs than the board, especially non-executives and the chairman) makes the establishment of a trusting relationship between the chairman and CEO much more difficult whilst still essential, an odd couple perhaps.

> ***"The Chair is the champion of challenge to the Executive"***

We speculate that this is one reason that many US corporations remain wedded to the model of the combined chair and CEO roles. Why bother trying to make a difficult and essential relationship work between two people if you can combine their roles into one? We also remain doubtful that the combined role, even as it makes for smoother sailing and possibly faster decision making when the winds are fair, can ever be relied upon to govern existential risk effectively when the storm clouds gather.

However this must remain a topic for further enquiry with US corporations. (We note that many US corporations are adopting a lead independent director model that has parallels with the UK recommended practice – see the box below – but we have not yet explored whether this role has the same relationship challenges with the CEO in US corporations).

Independent Board Leadership in the USA
"In the past decade, institutional pressure to adapt either an independent chair or a lead director has reached the tipping point." ("CEO Duality: A Review and Research Agenda" by Krause, Semadeni, and Cannella). By 2014, 47% of S&P 1500 companies had a lead director, and 35% had an independent board chair.

"The rise of the lead director, elected by the independent directors, is contributing to a better separation of governance from management. To make the position work effectively, it is essential that this role have a separate job description that is publicly available and respected by the chair and CEO. The most effective lead directors view themselves as 'first among equals' and can coordinate the opinions of all directors and facilitate open discussion among them." (McKinsey "Board Governance Depends on Where You Sit")
"In practice in the US, the roles of lead director and chairman have converged…Core responsibilities include involvement in agenda setting, chairing executive sessions, providing feedback to the CEO after executive sessions, and helping to shape boardroom dynamics." ("Chairman or Lead Director: What's in a Name?" FT 4April11)

"Effective strategic risk oversight depends on carefully crafted agendas, engaging executive sessions, constant dialogue between the lead director andother directors, and dialogue between the lead director and the CEO." (Lead Director Network Viewpoints, May 2012)

For now our focus is on the split role model, where trust is essential. We are reminded of the "trust equation" (see box)[8]. While it is clearly not a true equation, we nonetheless suggest it offers some insights into the nature and dynamics of the chairman/CEO relationship.

The "Trust Equation"

Trust = fn. (Intimacy x Credibility) / Risk

Trust in a business relationship is a function of the product of the degree of intimacy and the degree of credibility and inversely proportional to the degree of risk

Start with intimacy – how well do you know the individual? We suggest that one of the principle determinants of this factor is simply the time spent with

[8] Though we have no empirical support for this model, our subjective experience has demonstrated its usefulness – it seems to be helpful in a diagnostic sense. We first came across this model at Gemini Consulting. We have no other source, though a number of alternatives and variations can be found – for example: http://trustedadvisor.com/why-trust-matters/understanding-trust/understanding-the-trust-equation

them – about which more later. Next is credibility – how much do you think the individual's skills and capabilities can be relied upon? As we have seen some of the most important factors in the relationship were identified as the respective skills and capabilities of the chairman and CEO and mutual respect, both of which impact directly upon the degree of credibility with which each party regards the other.

Finally there is the degree of risk in the relationship, for either party. Of course, risk cannot be avoided in business and thus in business relationships. But in the context of this vital relationship there are two components of risk that are of particular importance. The risk that the company is perceived to be facing is one, the personal risk that the parties perceive themselves to be facing is the other.

An anecdote from one of the chairman to whom we spoke most starkly illustrates the latter component. The chairman related how the relationship with a CEO (let's call him John), irretrievably broke down following a discussion about performance related bonus. Both John and his chairman agreed that the results achieved did not meet the criteria that had been set for the bonus payment to become due. However John argued that the reasons for not achieving the target results were beyond his control and insisted that the bonus should be paid. It emerged that the real reason John wanted the payment was that he feared that if the bonus was not paid it would become apparent to other executives and his credibility among his peers would be damaged – he would face humiliation. When the chairman refused to be persuaded by this argument, the relationship between them was destroyed, with John subsequently refusing to hold other than the most formal of conversations and ultimately choosing to leave.

This example illustrates very powerfully how, when the risk to his personal reputation became overwhelming, John's trust in his chairman dissolved. In all other respects John was a successful CEO and the company was not itself in mortal danger. (Several other Chairs mentioned remuneration as a potentially toxic issue in the relationship, though some suggested that if an issue of remuneration arose it was normally a symptom of a deeper malaise.)

There are times though when the company is facing a serious threat and, whether this is due to exogenous factors or not, this amplified sense of risk places stress on the degree of trust in the relationship between chairman and CEO. A further factor here is time, in the sense that **the rate of change in the magnitude of the risk** will also influence the degree of trust. Clearly trust in the Chair/CEO relationship is not static and while it can only be established over time it can be diminished much more rapidly.

Here, then, is the paradox concerning the relationship between the Chair and CEO, its foundation in trust and its impact on how boards govern strategic risk. When all is going apparently well, the perceived risk in the relationship is low and trust is high. When a crisis emerges, the perceived risk in the relationship grows very rapidly and trust is eroded – at the very point when the board needs to be at its most effective and the bearing point of the chairman and CEO relationship is carrying its heaviest load. Small wonder that this is often the point when the relationship fails and the consequences for the company are severe.

We will return to this dynamic in the discussion about the lifecycle of the relationship below. Now we turn to issues of time.

It's about time

The issue of time arose frequently in our conversations with three areas where it was cited as a vital factor; time invested in informal conversation between the chairman and CEO, time within board conversation invested in exploring the future and the time when the Chair/CEO relationship needs to come to an end.

> ***"When my first chairman told me he wanted to speak to me every week I thought – 'what an earth are we going to talk about?' "***

We were initially surprised at the degree of interaction with their CEOs that almost all our respondent chairmen considered necessary. Our assumption had been that if the relationship was well founded and effective, the intensity of communication would be less than when the relationship was rocky or the company itself was under major threat. It is fair to say that some respondents did tend to this view. The majority, and it was a majority from the larger organisations represented, were quite adamant that very frequent dialogue was essential. Several reasons were put forward to explain this.

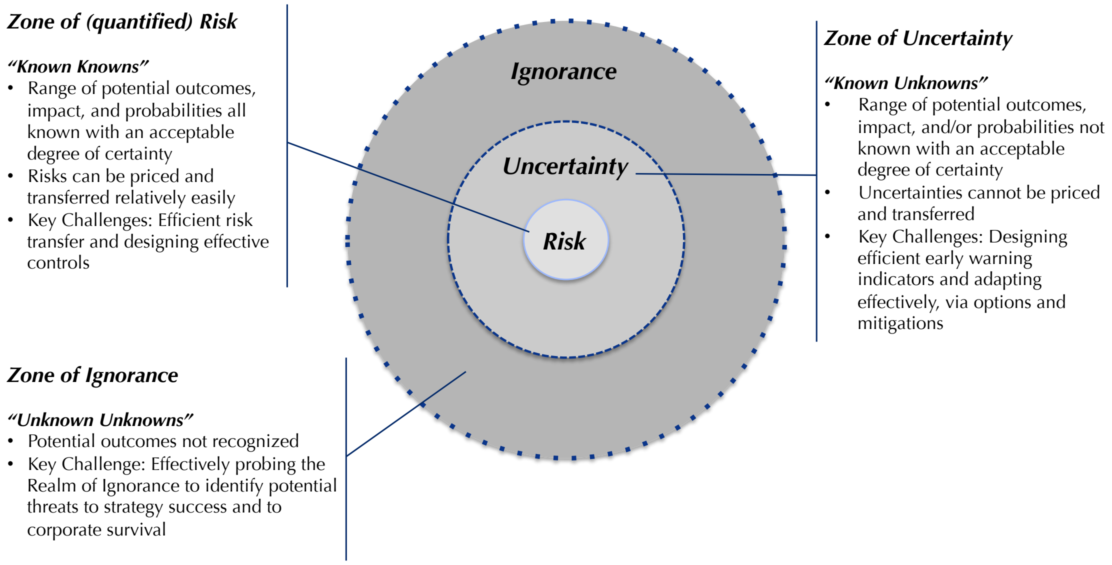
Unsurprisingly, when the relationship is new, it is expected that time needs to be invested to better understand the personality and style of a new partner (this can sound unnervingly like dating and maybe the parallels are illuminating). Establishing a degree of intimacy, our "equation" suggests, is effective at helping to establish trust. Then a different purpose emerges. The dialogue becomes one of exploration – what is it that is on the CEO's mind that she may not have recognised even to herself? What has she recently learned that the board should be made aware of?

> ***"I make sure I speak to my CEO every week, whether we have something to talk about or not"***

From our research into the root causes of risk governance failure we identify three zones of risk and uncertainty (see diagram below). These correspond to three quadrants of the famous (or infamous) "knowns and unknowns" matrix[9].

Most risk management effort is directed towards known-knowns; these comprise the contents of the typical risk register. This zone is of least interest to boards other than to be assured that it is properly understood and well managed, like any other aspect of business operation. The experienced chairmen we spoke to recognise that their focus is on the known-unknowns – what does the CEO know that we don't but should? – and, potentially the most threatening, what is in the zone of ignorance, the unknown-unknowns, that may materialise as an existential threat? If we don't know what we don't know, how can we find out?

The Three Zones of Risk Governance



(For convenience we refer to "Strategic risk" as the combination of threats from all three zones, which pose an existential threat to the company. The Zone of Ignorance is orders of magnitude greater in size than the Zone of Uncertainty, which is orders of magnitude greater in size than the Zone of Risk.)

> ***"I took two huge hits [existential threats] in my career – neither were identified on the risk register. "***

> ***"When something really goes wrong it is not on that list [the risk register]. "***

Through the discipline of spending frequent time in unstructured conversation with their CEOs these chairmen are improving their chances of reducing the risk

[9] Made infamous by being quoted by Donald Rumsfeld, US Secretary of Defense and held up by some sections of the press as humorous.

from the zone of uncertainty and improving their chances of discovering something of vital importance from the zone of ignorance. We doubt that this practice has developed as a consequence of reflection on the logic that we describe here, rather that the experience of being in such a regular conversation with their own chairmen when they were CEOs has strongly influenced their actions when they became chairmen themselves. Or, wishing to build a strong, trusting relationship in the early stages of the working partnership the frequent dialogue became a habit and valued process worth continuing with. In any case the way in which our respondents spoke about this investment of time very clearly articulated the importance attached to it, even if on occasions they seemed to surprise themselves by the acknowledgment.

> ***"If two weeks go by and I haven't spoken [to the CEO] I feel vaguely negligent – and I'm almost surprised when I say that!"***

> ***"The regular dialogue creates in the CEO's sub-conscious mind the view that you are someone that needs to be consulted"***

> ***"CEO's probably think [conversations] are too frequent, but when they get used to it they are the ones who think out loud, they talk for 80% of the time – frequency is important"***

The next very important observation made by our interviewees was the need for boards to spend sufficient time thinking about the future.

In the *Roads to Ruin*[10] report one of the key conclusions was that, when faced with existential strategic risk, boards and directors too often suffered from "risk blindness". One of our favourite thinkers and researchers into the psychology of judgement and decision-making, Daniel Kahneman[11]observes that risk blindness is the result of "familiarity with inferior information". The challenge for all boards is to be constantly wary of familiarity. The paradox here is that the closer the alignment between chairman and CEO, the "cosier" that relationship, the greater the risk that the board will also slip into a comfortable feeling that all is well.

Many of our chairmen interviewees acknowledged this paradox. They recognise that a constant questioning of their CEOs would fracture their relationship and damage trust and respect. Notwithstanding this, they still sought a balance between detachment and engagement in the relationship. A degree of

[10] Ibid

[11] Nobel prize winning behavioural economist and Emeritus Professor of Public Affairs, Woodrow Wilson School of Public and International Affairs, Princeton University and author of *Thinking, Fast and Slow*, 2011, Penguin Books, London.

detachment was viewed as having the benefit of not interfering in the proper role of the executive but it also allowed them to ensure that the board is always ready to re-examine a strategy or an issue to avoid the trap of familiarity and be able to constantly improve the quality of information on which their decisions are based.

> ***"[A chairman] has to have the ability and willingness to come at the issue afresh and allow sufficient time – you need the 'grit in the oyster'."***

Interviewees described a range of approaches they used to ensure that the balance of time in board discussion was appropriately future-focused. Interestingly a number were simple techniques to manage the flow of information (e.g. rules on the size of board papers) or using technology to support board members ability to access more detailed information behind board papers (e.g. a secure web site). These techniques, together with a well-planned agenda programme, are used to create the time for thoughtful, reflective, future-focused board conversations.

The third issue of time that featured prominently was the evolution of the Chair/CEO relationship, and its eventual dissolution. As discussed above, events can bring the partnership to an abrupt, unplanned end. There can also be a planned departure of either the chairman or CEO resulting from a realisation that new or different skills are needed. In the case of a board decision to replace the CEO this might well not be the preferred option of the CEO, but it is still viewed in practice by the Chairs we talked to as a proactive, rather than reactive process. There is also the question of whether, and if so why, there is a natural ending point to the Chair/CEO relationship – a point at which the very familiarity between two people becomes, of itself, a source of risk.

> ***"Experience is an asset, but can also become a risk. Confronting similar issues invites falling back on familiar solutions."***

> ***"It's very hard to be a CEO – hard to maintain the tempo for years. The best process I have learned is to talk about succession [with the CEO] on day 1."***

> ***"You become too wedded to the current answers to strategic questions if you stay too long in the chair."***

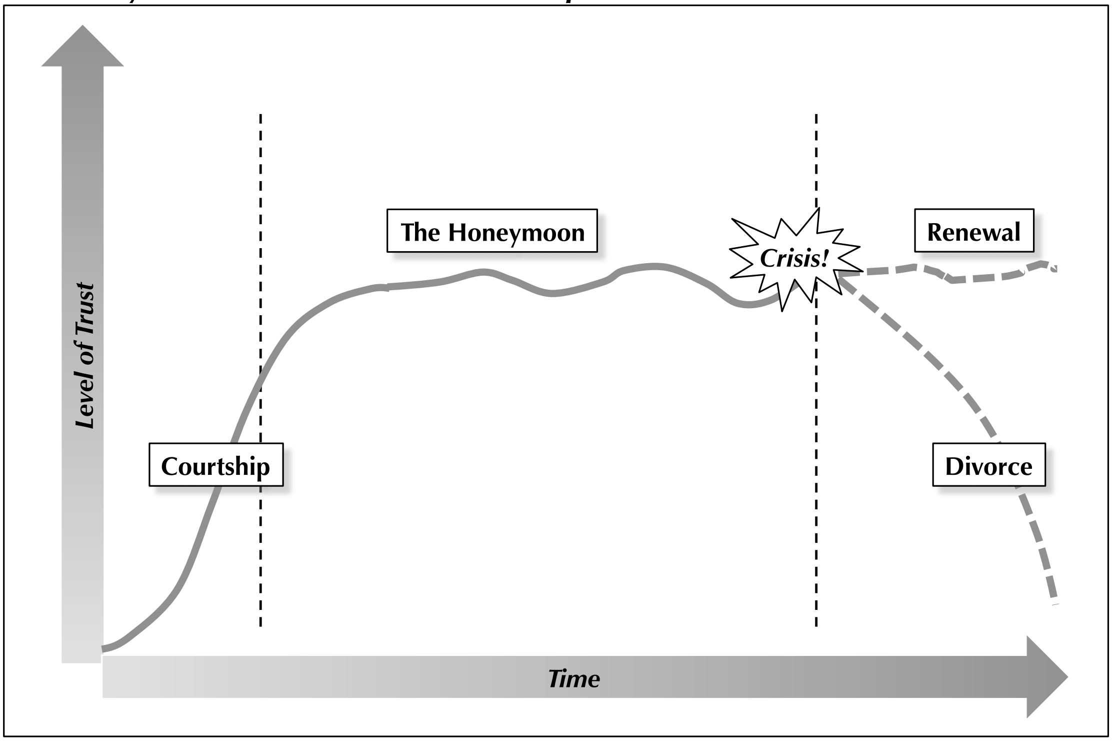
The broad consensus appears to be that if either the Chair or the CEO has been in the role for between six and ten years, then the time for change is fast approaching if not overdue. There is a natural lifecycle to the relationship that will bring its inevitable end.

The lifecycle of a Chair/CEO relationship

One (highly experienced) Chair with whom we spoke described this concept[12]. We reproduce it since it seems to us to offer some acute insights into the challenges that chairmen and boards face in effectively governing strategic risk.

The narrative starts with the appointment of a new CEO or chairman. Trust needs to be established – intimacy and credibility built and tested and the risks in the relationship evaluated. Over the initial one to two years, if all goes well, a successful relationship is developed. The new CEO demonstrates their success or the new chairman establishes themselves with the board. The board and other internal and external stakeholders become confident in the capabilities of their leadership.

The Lifecycle of a Chair/CEO relationship



With luck, there follows a sustained period of success – a "honeymoon" period of growth in market share, acceptable returns and an enviable share price. The CEO appreciates the supportive yet challenging relationship with the chairman, the chairman appreciates the depth and breadth of experience on the board and the directors are pleased that their board evaluations pass without incident.

[12] We would be happy to acknowledge the source but they prefer anonymity.

This story can end without trauma, with either or both of the principal players eventually moving on in a well-managed transition. Or unanticipated calamity can strike, with two possible outcomes. The crisis might be averted or survived and mutual trust renewed, or the pressure of events in a rapidly developing crisis can explode the risk in the Chair/CEO relationship, causing trust to falter, the relationship to crack, the board to become unnerved and someone soon to be leaving.

One of the most interesting questions for us is whether the development of the relationship itself is a factor in creating the very risk blindness that ultimately leads to surprise and crisis?

"It's easy to be a supportive chair and board. But if they are too laid back they risk walking, while applauding, over a cliff!"

The odd couple and strategic risk governance

Remember that our working definition of strategic risk is an uncertainty (especially from the zones of uncertainty or ignorance) that if manifested would pose sufficient threat to cause the failure of the company's strategy or significant damage and/or the death of the company itself. Experience teaches us that when companies succumb to existential threat the root cause of failure is board "risk blindness" which we define as familiarity with inferior information (about the relevant strategic risk).

If the chairman is accountable for the effectiveness of the board and the board is susceptible to risk blindness, it is the chairman's responsibility to help the board avoid it. This may seem obvious (in a way we hope it is). The snag for the chairman is the development of the relationship with the CEO over the lifecycle. We suggested to the chairman who described the lifecycle concept that the challenge is to avoid being so comfortable in the "honeymoon" phase that the signs of an impending crisis are missed. Risk blindness develops over the time when all seems to be well, as inferior information – be it wrong assumptions, missed warning signs, or simply not having relevant data – becomes familiar and thus acceptable and accepted. The Chair quite forcefully agreed. He was clear that the chairman has the key role in keeping the board's strategic risk vision acute.

Yet there are two significant challenges. Firstly the cognitive biases of all humans, individually and as groups, make the chairman's task extremely difficult and secondly it is exactly when the CEO relationship is at its "best" that the Chair should arguably be most nervous. When it comes to strategic risk, when the relationship between Chair and CEO is good, it is bad! The relationship has established high levels of trust, based on intimacy, credibility and low perceived personal and business risk and hopefully the CEO trusts the

Chair sufficiently to be open and share information. Yet this does not address, and in fact may contribute to the issue of inferior information, as a high degree of comfort in the boardroom tends to reinforce directors' reluctance to challenge the inevitably biased (e.g. over-optimistic and overconfident) and possibly fatally flawed information they receive from management, or to question the absence of important information they do not receive.

At the same time it would simply not be realistic or practical for the Chair to personally subject the CEO to continuous, harsh or sceptical rigorous scrutiny. In theory this is the role of the rest of the board, particularly non-executives, but they also are most likely to rely on their perception that "all is well – don't rock the boat"[13].

If the crisis strikes and the strategic risk manifests itself as a genuine threat then of course all bets are off. Unfortunately the typical crisis context of extreme time pressure, huge stakes and also imperfect information does nothing to enhance the bearing point Chair/CEO relationship or the board's effectiveness and ability to exercise good judgement. An exponential increase in the degree and rate of increase of business risk combined with a loss of credibility usually destroys trust between a Chair and CEO, and without this trust the relationship falters, causing the board to become less effective, which further worsens the crisis. When it comes to strategic risk, when the relationship is bad, it's no good!

Apparently, even with the best of motives and deftest of skill and judgement, a chairman can be damned if they do challenge a CEO too much in the honeymoon period and damned later on if they don't. The irony is that if the board can "buy" time ahead of any crisis, it is the best chance to avoid its worst effects.

Many commentators on the subject of strategic risk governance exhort boards to do a better job without offering much in the way of helpful counsel as to what exactly they are supposed to do differently. In our view existential threats to organizational survival are most likely to develop when external factors, such as changes in technology, shifts in market competition, innovations in the dominant industry business model and/or regulatory changes combine with internal failures by management teams and boards to anticipate, properly assess and adapt or mitigate the potential impacts of these changes. To avoid these failures, we conclude that boards need specific processes to counterbalance the unavoidable cognitive biases that individually and collectively can lead their judgement and decision making astray. These processes are the solution to the chairman's conundrum.

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[13] Daniel Kahneman (ibid) observes that the question most often asked about cognitive illusions is whether they can be overcome. He concludes that often the answer is "No" since the individual or group may have no clue as to the error. He also concludes that it would be impossibly tedious and impractical to be constantly questioning one's own judgements. We infer that the same can be said of constantly questioning someone else's!

The role of process in strategic risk governance

Not every chairman we spoke to saw board processes in this helpful light. Some tended to see process as a bureaucratic or procedural tool – useful perhaps in the sense of having a well planned agenda, good board papers and effective minutes, but otherwise of limited effect on the serious business of judgement and decision making.

> ***"Process is not so important, even strategy is over-valued. Culture and values are much more important"***

One very experienced chair in particular was quite dismissive. However he then went on to describe what his particular concern was – what he felt was the most significant strategic risk faced by the company – and what he tried to do to counter it. Ironically, although he did not see it in those terms, he was describing a structured way, a method or process, for anticipating, assessing and adapting to the key strategic risk he perceived!

There are at least three reasons why chairman should consider structured processes as part of their strategic risk governance armoury. Firstly some processes do work to make the board effective. Otherwise why would the "procedural" approaches to meeting planning, agendas, minutes etc. be so widespread? If there was a much better way surely it would have proved itself and been adopted as an improvement on these routine processes.

The second reason is that there are processes than can help address the challenges of cognitive bias and board risk blindness. In his ground-breaking book, *Thinking, Fast and Slow*, Daniel Kahneman[14] describes his conclusions about the way humans make decisions, based on his nearly fifty-years of work in the area. He shows how failures in judgment and decision making result from systemic errors – known as biases – which everyone is prone to and about which everyone tends to be sublimely unaware. Kahneman presents a view of how the human mind works that he describes as System 1 and System 2 thinking. To summarise very briefly, System 1 is the fast, intuitive, reflexive, effortless mind and System 2 is the slow, analytical, directed, effortful mind. Kahneman observes how this view draws upon " … recent developments in cognitive and social psychology …" where "one of the most important […] is that we now understand the marvels as well as the flaws in intuitive thought".

In addition to the powerful insights that this model of thinking offers to understand the decision-making strengths and flaws of individuals and groups, such as directors and boards, we suggest that there is another relevant perspective. This is that, by analogy, the board can be considered as the "System 2 mind" of the company. For people, System 2 is meant to be the safety

[14] Ibid

mechanism that checks whether System 1 judgements are to be relied upon. The board is meant to be the locus of governance, of thoughtful, measured and careful decision-making that balances the power, ambition and possibly risk-taking of the executive. Boards typically employ a range of approaches to fulfil this duty – strategic reviews, risk appetite, risk registers, financial controls, audits, budgets, performance reporting – all of which are manifestations of the oversight and checking function of the board, just like System 2 thinking. Yet there remains a fundamental problem.

However much as individual directors and boards might pride themselves on their experience and judgement, the lesson from Kahneman's research is that System 1 is far more influential than they would like to admit. It naturally influences boards, **even when they are trying their hardest to be a System 2 influence on the decision-making for the company.** This may not be a major concern for much of the board's work. System 1 intuitive judgement may not always be wrong. In fact when it is based on profound expertise and experience it can often be quite right. The issue is that when a System 1 intuitive judgement is wrong, the "System 2 mind" is mostly unaware of it. When boards become familiar with incorrect information, the company's "System 2 mind" is compromised and risk blindness results. When the risk is strategic the consequences can be catastrophic.

As Kahneman writes " … when cues to likely [System 1] errors are available, errors can only be prevented by the enhanced monitoring and effortful activity of System 2". To paraphrase – when cues to existential risk are available they can only be effectively governed by the effortful activity of the board – a board moreover that is also consciously mindful of it shortcomings due to the influences of System 1 thinking on its members' own judgements. Kahneman goes on " … constantly questioning our own thinking would be impossibly tedious …". To paraphrase again – individual directors and the board cannot provide constant vigilance nor constantly question their own or the executive's thinking. They can, however, use structured methods that help counterbalance the likely negative effects of their own biases to offset their own risk blindness. Specifically, they can use processes that are proven to help avoid the unwitting errors of System 1 in their own thinking, which may then contribute to the institutional failure of the board as the "System 2 mind" of the company.

The third and also compelling reason to use structured board processes in the governance of strategic risk is that it removes personality from the conversation. The chairman has a legitimate reason to use tools that the board can apply on a periodic basis during the "honeymoon" period of the lifecycle that avoids putting the relationship with the CEO at risk whilst simultaneously improving the chances of better anticipation and assessment of the potential existential risks and gaining time to adapt or implement mitigation tactics before it becomes too late to do so. Moreover if (or when) a crisis strikes, the fact that the chairman and CEO have both had the opportunity to anticipate it and to plan how to react to it, should reduce the loss in credibility and the dramatic escalation in the personal risk and decline in mutual trust in the relationship that can lead to its breakdown at the very point at which it is most needed to help bear the pressures on the board and keep it functioning effectively.

As our interviews progressed we explored the topic of process in more depth, though not exhaustively. We posit that as the research and thinking in the area of human judgement and decision-making is still relatively new it has yet to be seen in the widespread practice of effective boards. We suspect that this will change once early adopters realise the potential of this approach to substantially improve strategic risk governance.

> ***"Now we are talking about [processes], I might try that."***

What next?

As much as this research project felt quite intensive and lengthy, objectively we have yet to fully explore many of the issues we encountered. For us, the research has raised at least as many questions as it has resolved. For example, does the experience in the US fundamentally challenge or strengthen the conclusions drawn here? Would the experience of Chairs of European supervisory boards be fundamentally different? Is it really more important to find a good CEO than a good chairman? Or, as one interviewee put it, does a good CEO help the company succeed while a good Chair helps it survive – both of which are equally vital?

Who develops the chairman in this critical role? Many of our interviewees paid tribute to the role models from whom they learned their craft, when they were CEOs themselves, but if there is no good role model does this condemn good CEOs to be bad chairmen?

For these and other questions to be answered requires more work. For that reason and simply to continue to examine and understand the real work of chairman and boards in practice we will continue to add to this body of knowledge over time.

Conclusion

So are the chairman and CEO the bearing point, the strong axis upon which the effective board rests or the odd couple, a marriage of unequal partners with conflicting interests, founded in trust that must be constantly tested and doomed in most cases to separation? Maybe it's both.

Maybe it should not be a surprise that we have more questions than answers at this stage of our enquiry. We conclude nonetheless that the enquiry is very much worthwhile and we hope to continue it. We believe that the work of Kahneman and others over the last four decades is yet to be fully understood and applied in the context of boards and the work they do, particularly with respect to their critical duty to govern strategic risk and existential threats to the survival of the company.

We hope that the lessons from experience and observations from our work to date will be of value to all chairmen and CEOs who are committed to their own development and the success of their organisations, or whatever type or size. Both roles are complex and demanding and the stakes are high both for these individuals and the many people whose fates rely on their actions and decisions. We think they well deserve all the help they can get!

Appendices

Profile of our interviewees

We interviewed 12 people with significant experience as board chairs – male and female.

Collectively and cumulatively they have held just over 100 positions as board level executive (mostly CEO) and non-executive directors and chairs. On average they have held 3+ posts each as chair; the fewest was 2 posts, the greatest 9.

They represent well over 400 years' of collective experience at board level (on average >30 years per person), mostly of large and very large organisations with international scope. As chairs our interviewees hold >150 years' experience (on average >10 years per person).

Their sector experience as board members covers over 20 sectors, including:

Aerospace/Defence	Automotive
Consumer Goods	Data analytics
Electronics	Energy
Engineering services	Manufacturing
Food and Drink	Financial Services
Government/Regulatory	Infrastructure
Marketing Services	Media
Mining	Non-profit (including education, professional and trade associations)
Pharmaceuticals	Professional Services
Retail	Technology
Utilities	

Of the 46 organisations that our interviewees had chaired or served as directors of, for which there was a reported revenue, 19 had annual revenues in excess of £10bn, 16 had annual revenues greater than £1bn and less than £10bn and 11 had revenues below £1bn. (Just above 100 for-profit and non-profit organisations were represented but not all had available data. Some organisations have since been merged or demerged, others were privately held and non-profit organisations have not been included in the revenue analysis. The latest available turnover data was used, but this is not necessarily all from the same year. Foreign currency data was converted to GB£ at current rates.)

The geographical scope of the companies they have served as directors and chairs includes the UK, USA, Europe and Asia. Some of the companies represented by our interviewees' experience have a truly global footprint. Approximately 60% of the companies were headquartered in the UK, 20% each in the US and rest of the world.

Possible factors influencing the Chairman/CEO relationship

- The context (e.g. external pressures, crises, shareholder relationships)
- The composition of the board (mix of skills and experience)
- The definition of the chairman's role vis-à-vis the CEO
- The definition of the board's role vis-à-vis the CEO
- The Chairman's personal skills and competences
- The CEO's skills and competences
- The processes that the board employs in doing its work
- Communication between board members (e.g. what/how, degree of openness, etc.)
- The Chairman's personality and style
- The CEO's personal personality and style
- The relationship of the CEO with the board (e.g. degree of respect, trust, etc.)
- Other (as described):
    - Facilitate informal discussion
    - Putting in sufficient time
    - Values, e.g. Not criticising management for missed opportunities

