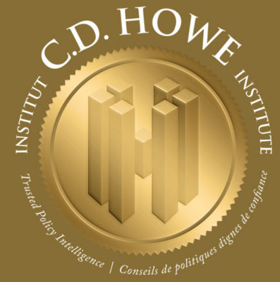
Intelligence MEMOS



From: Edward Waitzer

To: Corporate Governance Observers

Date: March 5, 2024

Re: **Zombie Thinking is Not Helping Effective Corporate Governance**

Corporate governance and leadership best practices are typically based on intuition, self-serving opinion and rhetoric, and not often enough on real best practices and evidence.

This has led zombie thinking based on "dead ideas that still walk among us," in the words of John Quiggin in his book *Zombie Economics that focused on* the 2008-09 financial crisis.

Such thinking has been elevated – mandated by regulators and advanced by a burgeoning class of governance experts for whom such standards become the end unto itself. The same is true with the prevalent ideas about leadership – the sanctum of the top-flight business schools, consulting firms and those who have made it into the C-suite.

Current "best practices" for corporate board structures appear to have little to no impact on performance. Similarly, there is little supporting evidence that board practices contribute to effectiveness.

Consider the following examples.

While independence of directors is defined and regulated, research finds little or no relationship between those definitions and corporate outcomes. A deeper understanding of what truly fosters independence of thought among board members might advance thinking about board quality. Delaware courts have recently begun to consider social relationships in evaluating director independence – something regulatory requirements do not address but is a welcome acknowledgement of how the world really works.

Meanwhile, executive compensation would benefit from a clearer understanding and communication of how best to align pay and performance. Regulation encourages reliance on executive compensation experts who tend to benchmark against peer groups and are rewarded for coming up with ever more complicated arrangements. The result is often a mechanical ratcheting up of compensation and proliferation of obtuse disclosure. This confuses investors, rather than improving outcomes or clarifying how pay and performance are aligned.

Consider the 55-percent pay increase awarded to the CEO of Loblaw Cos. Ltd. in 2022 (with advice from two compensation consultants – neither independent). The justification was based on comparison to a peer group skewed to high CEO pay and the fact that a large portion of the increase was long-term payouts – arguably of limited relevance in motivating a controlling family shareholder.

Likewise, our ideas about leadership are often based on untested narratives. For example, the assumption that there are universal attributes to leadership tends to put the cart before the horse – focusing on who has these idealized exceptional qualities before determining what qualities are required. A study of "presidential greatness" demonstrated that 86 percent of the variance in the rankings of US presidents could be accounted for by knowing how long they served in office, for how much of their term the country was at war, whether there was any scandal associated with their presidency, and whether they were assassinated or was the face of a war. Only the last has much to do with the leader's character (and it's hard to be a war hero if your country isn't at war).

Presenting leadership as an essential and universal set of qualities serves existing leaders and those who train them. Such stereotyping reinforces alienating notions of hierarchy.

A recent PricewaterhouseCooper **paper** examined behavioural factors that lead to bad board decision-making. They are susceptible to rigid group dynamics that degrade decision-making in the face of crisis situations. They often double down on bad decisions to avoid admitting failure. Boards fail to take advantage of the collective intelligence that diversity is intended to foster by failing to create a culture that encourages dissent. We need better research on how such group dynamics can frustrate high-level boards.

Corporate governance is social science. The factors that determine effectiveness are contextual and complex, but can still be measured and analyzed. It's not hard to study the interactions among board members to better understand how they contribute to effective governance.

Good governance matters. Rather than fixating on how to manage governance ratings, it is time for more on evidence-based analysis. The challenge, in part, is overcoming an inertia fuelled by those individuals who currently control the narrative and are heavily invested in it, despite its well-understood inadequacies.

In response to the recession in the early 1990s, the Toronto Stock Exchange jumped on the "best practices" bandwagon, adopting guidelines outlined in a report titled *Where Were the Directors?* Thinking about the role of the corporation and importance of good governance has evolved substantially, but critical thinking about best practices remains deficient. Perhaps the time has come to focus on "where is the research and analysis?"

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