

**WHY DO INTELLIGENT AND EXPERIENCED BOARDS MAKE POOR
DECISIONS? THE IRISH BANKING CRISIS CASE STUDY.**

Submitted by

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DECLARATION

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ABSTRACT

My thesis focuses on three related research themes. First, to provide academic rigour to the assertions of the Nyberg Report (2011) that the Irish banks were characterised by both groupthink and herding in the lead up to the recent financial crisis. The Nyberg Report was commissioned by the Irish government to provide explanations for the causes of the Irish financial crisis. In particular my thesis explores whether the board of Anglo Irish Bank (Anglo) was characterised by groupthink tendencies and whether the other Irish banks looked to emulate Anglo's strategy.

Second, my thesis will develop a theoretical model which identifies characteristics associated with the increased vulnerability of a board to a poor decision process¹. In particular the model will focus on the interplay between normative and informative influences on decision process and how these can and do interact with director skill levels. Five research questions are developed and my theoretical model of VPDP is applied to the Irish bank case study. Information will be gathered through a process of semi-structured interviews and an analysis of existing literature, official reports and annual financial statements.

Third, a series of recommendations are made which are derived from the model itself and are intended to reduce the likelihood of boards pursuing a poor decision strategy and in increasing the likelihood of a robust boardroom challenge.

¹ For ease of reference the model which I have developed in chapter 6 will be referred to as "my model of VPDP".

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LIST OF ABBREVIATIONS

- AIB: Allied Irish Banks plc
- Anglo: Anglo Irish Bank plc
- BKIR: Bank of Ireland plc
- CEO: Chief Executive Officer
- DDDA: Dublin Docklands Development Authority
- EBS: Educational Building Society
- IFSC: International Financial Services Centre
- ILP: Irish Life and Permanent plc
- INBS: Irish Nationwide Building Society
- VPDP: My model of vulnerabilities to a poor decision process
- NED: Non-executive Director
- PWC: Price Waterhouse Coopers

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Finally I would like to dedicate this thesis to my parents who always wanted a "doctor" in the family (here is hoping!).

Chapter 1: Introduction

Recessions related to financial crises are protracted affairs that have long and deep lasting effects on asset prices, output and employment. Reinhart and Rogoff (2009) analysed eighteen post Second World War financial crises and concluded that on average real house prices decline 35% whilst equity prices collapse by 55%. Ireland's financial crisis which began in 2008 stands out as being particularly severe, and the 7.25% contraction in Irish GDP in 2009 was the largest experienced by a developed country since the Great Depression (Kinsella and Leddin, 2010). The IMF (Laeven and Valencia, 2013) noted that Ireland holds the undesirable position of being the only country that features among the top ten of costliest banking crises across the three measurement criteria it assesses, namely; fiscal cost, increase in debt levels and output loss. The collapse of the domestic Irish banking sector created the greatest challenge to the Irish state since it was founded in 1922 (Houses of the Oireachtas, 2012). The major responsibility for the Irish financial crisis lies with the directors and senior management of the Irish banks themselves (Honohan, 2010).

Given the impact that financial crises have had historically, and the severity of the Irish crisis in particular, my thesis intends to make a contribution by studying the Irish banking crisis with a view towards developing a better understanding of the decision process in boards generally and to make recommendations to reduce the likelihood of poor decision outcomes in corporate boards. The focus of my thesis is, however, not a detailed analysis of the causes of the financial crisis but rather is dedicated to understanding and identifying vulnerabilities to a poor decision process within corporate boards. The recent financial crisis generally, and the Irish case study specifically, provide the lens for which to undertake my research. The intention is that my research can make a contribution in the field of corporate governance and in particular in relation to decision making in corporate boards. The consequence of such a contribution

to corporate decision making will not be limited to financial but relevant for all institutions. I recognise that the recent financial crisis highlights the impact that poor decision making by financial institutions can have on the wider economy and, as such, improving decision making in financial institutions is of particular societal interest. There are, it is submitted, three areas where my research can make a contribution. First in respect of the findings of the Nyberg Report (2011) which attributed the failure of the decision making processes within the Irish banks to groupthink and herding (*ibid*, p. 99)². Groupthink occurs when there is a pre-mature consensus seeking in decision making and the importance of group cohesion and the preservation of the relationship within the group are deemed more important than the decision making process itself. Groupthink results from a series of what has been termed “normative social influences”, where social pressures are put to bear on individual members to conform. Herding between groups relates to “informational influences”, and occurs when a group follows the behaviour of another in the belief that they have superior information, subordinating their own private information in favour of the signals which they receive from others. Herding is therefore not a primary consequence of social pressure to conform, but rather the reaction to signals received from other actors which are seen as having superior information.

Although the Nyberg Report observed groupthink and herding, it does not provide a detailed review of the literature, nor does it provide evidence to back

² The Irish Government set up their own enquiry into their banking crisis which took the form of two scoping reports (Honohan, 2010; Regling and Watson, 2010) followed by the establishment of a Statutory Commission of Investigation (Nyberg, 2011). The purpose of the Commission was to “provide answers on why a number of institutions, both private and public, acted in an imprudent or ineffective manner, thereby contributing to the occurrence of the Irish banking crisis” (*ibid*, p. 1). The report was prepared by Peter Nyberg, a Finnish national with a background in financial regulation and was published in March 2011. A detailed analysis of the findings of the Nyberg Report (2011) can be found in Appendix 1.

up this assertion. This is, of course, understandable. The Nyberg Report is not an academic document and is not expected to provide such a rigorous analysis of the literature³. Moreover Nyberg (2011), when concluding that the Irish banks suffered from groupthink, appeared to reach his conclusion from a more intuitive analysis of the information rather than a more rigorous process of identifying antecedents and symptoms of Janis's groupthink. Nyberg told me in interview: *"I did not go into the details of the elephant [of groupthink]. I just seemed to recognise that it had the essentials ... I never really had the time to go deeper into looking into the exact hypothesis that would fit in. It was not strictly speaking a scientific effort, like the one you are trying to do, it was more trying to structure information and draw conclusions⁴."*

Hart (1994) warns that the concept of groupthink can, and has been, abused and that the term is often used "loosely and indiscriminately as a symbolically powerful pejorative label to stick on any controversial episode of organizational action or public policy-making" (*ibid*, p. ix). In light of this and Nyberg's comments about how he measured groupthink, there is an opportunity for me to provide a more rigorous test of the groupthink construct as it may apply to the Irish banks and to Anglo Irish in particular.

³ As an illustration, the Nyberg Commission only has two references with respect to groupthink, from Janis (1982) and Baron (2005) whilst the review of the literature that follows analyses over fifty different academic papers in this area. It is very possible that a more extensive review was undertaken, but this is not evidence in the report or supporting documentation.

⁴ Although the Nyberg Report does not go through the systematic process of identifying each of the antecedents and symptoms of groupthink, it does provide a number of observations resulting from the data gathered and interviews undertaken which will be used in this chapter to provide supporting evidence to the proposed propositions. Indeed, the Nyberg Commission accessed approximately 200,000 documents from authorities, financial institutions and other sources and conducted 140 interviews with 120 individuals (Nyberg, 2011, p. 10).

My thesis will provide a detailed review of the literature of the phenomena detailed above with a view towards providing a much more robust and thorough analysis of both groupthink and herding. Evidence will be gathered through a process of semi-structured interviews and an analysis of existing literature, official reports and annual financial statements.

Second, the Nyberg Commission observed the existence of both herding and groupthink, but did not develop the concept of how such phenomena might interact and interconnect as described above. Further, the Commission does not discuss alternative explanations to herding and groupthink which may have contributed to the Irish banks' decision processes. My thesis will explore alternative explanations which might account for the behaviour of the Irish banks in the lead up to the financial crisis. The review of the literature related to these alternative possible explanations allowed me to develop a theoretical model which identifies characteristics and vulnerabilities associated with a poor decision process. A poor decision process is defined as a decision which could have been avoided which results in a lower value to the firm in the present or future.

The development of this model is particularly relevant given the failure of many bank boards in the lead up to the crisis, particularly with respect to the lack of adequate boardroom challenge. A number of research questions will be developed and the model will be applied in relation to the poor decision process undertaken by the Irish banks, and Anglo Irish Bank in particular, in the lead up to the crisis. The model will further highlight the vulnerabilities to a poor decision process on three different levels; 1) in respect to vulnerabilities to an initial poor decision process, 2) in respect to the ratification of that decision process by the collective board of directors, and 3) in respect to the risks of emulation of a flawed strategy by competitors increasing systemic risk.

Third, the Nyberg Commission focuses on the causes of the Irish banking crisis, and does not in any way comment, nor does it suggest, possible reforms to

prevent poor decision making processes in the future. This thesis intends to make a contribution to the literature in this area. The global financial crisis has highlighted failures in corporate governance (see for example (Ahrens et al., 2011; Diplock, 2012)). Governance failures have occurred despite a strengthening in governance rules and regulations in the lead up to the crisis. My thesis will argue that there needs to be a much greater implicit awareness of psychology when enacting reforms to combat phenomena such as groupthink in corporate boards. Recommendations are made within my thesis which addresses the behavioural aspects of corporate boards.

Finally, I recognise that there a number of unanswered questions arising from this thesis. Can my model of VPDP be applied more broadly in relation to other case studies? Is groupthink and related phenomena common in the corporate boardroom? How can identified reforms be implemented? As such, my thesis concludes with a summary of areas for further research.

The order of my thesis is as follows: The starting point is the identification of the Irish case study as an opportunity to learn (Stake, 1995) and in particular the comments by Nyberg (2011) that the Irish banks suffered from both herding and groupthink in the lead up to the crisis. Chapter 2 is devoted to the review of the literature on corporate governance, whilst chapter 3 discusses the literature on groupthink, herding and related phenomena which may have contributed to the decision making process of the Irish banks in the lead up to the crisis. Chapter 4 discusses my research methodology and methods. Chapter 5 provides some context to the Irish financial crisis and the background to the Irish banks and Anglo in particular. In chapter 6, drawing from the literature review, I develop my model of VPDP and identify five research questions which I can then apply in the field. Chapter 7 is devoted to my research findings, and the application of the five research questions to the Irish case study. Finally chapter 8 includes my concluding discussions, policy recommendations and areas for further research

Chapter 2: Review of the relevant literature on Corporate Governance

2.1 Introduction

In chapter 1, I identified failures in corporate governance in the lead up to the crisis and positioned my research with respect to making a contribution in the area of corporate governance reform. Although I made the link between corporate governance failures at financial institutions and the cause of the financial crisis, I recognise that the significant body of literature which highlights other primary causes of the financial crisis. Stiglitz (2012) focuses on the rising global inequality between rich and poor in Western economies, Gamble (2009), and Posner (2010) both identify flaws in the Anglo Saxon mode of capitalism, Skidelsky (2010) focuses on what he sees as an intellectual failure of the economics profession, and Rajan (2011) highlights the global saving imbalance particularly between the US and China as being a key cause of the crisis. Other commentators focus more narrowly and identify specific causes of the crisis; Tett (2009) identifies the role that credit default swaps played in the crisis as being critical, Krugman (2008) highlights the role that the shadow banking played in the crisis, Shiller (2008) focuses on the housing bubble, Danielsson (2008) concentrates on the failure of bank risk models, Cairns et. al (2009) highlights regulatory failure, Stein (2013) the role of narcissist leadership, Silver (2012) the failures at the rating agencies and Arnold (2009) on failures related to accounting practices.

All this literature adds to the understanding of the causes of the global financial crisis and is complementary to the research stream which I have identified related to corporate governance failures associated with the crisis. This thesis is not however intended to be a rigorous and in depth analysis of *all* the factors contributing to the causes of the crisis. Rather it focuses on the identified failure

related to governance failures in financial institutions and in particular the poor decisions which many financial institutions made in the lead up to the crisis. Further, the research into corporate decision making in the area of corporate governance is not limited to decision making in respect of the crisis but has wider and broader implications for general decision making in any board context.

This chapter analyses the relevant literature related to corporate governance. It starts by setting the parameters of the research boundaries for this research and in defining the term “corporate governance”. From this follows a discussion on agency theory as a conceptual framework underpinning corporate governance reforms. A review is then made for the rationale for director independence and how governance codes have developed to stress the role of the independent NED. Governance failures related to the financial crisis are then discussed with particular emphasis on the lack of adequate boardroom challenge. The chapter also includes a discussion related to the criticisms levelled at current corporate governance research, a review of existing models which link board attributes to firm performance and a discussion on the literature on diversity and how it relates to corporate boards.

2.2 Research Boundaries

First, it is necessary to provide the research boundaries for this chapter. My thesis is concerned exclusively with the structure and circumstances of Anglo-Saxon corporate governance characterised by the separation of ownership and control and where a single board of directors dominate.

This contrasts to the distinct model which has evolved in Continental Europe and has spread to countries such as Japan. In this model, ownership structure is concentrated rather than dispersed, and responsibilities for management and leadership are arranged into two separate boards. A review of the differences

between these two governance structures is however considered outside the remit of this thesis. The primary focus of my thesis will be on UK corporate governance and the UK Corporate Governance Code. The focus of my research is the Irish bank case study and as such it is important to understand the Irish governance structure. Ireland shares a legal history with the UK and the two countries share almost identical legal framework in both commercial and corporate law (Lynch Fannon, 2011), Furthermore, Ireland had no separate code setting out Corporate Governance conduct in the lead up to the financial crisis. Rather Ireland had adopted the UK Corporate Code of Conduct for all listed Irish Companies. However, in light of governance failures in Irish banks following the financial crisis the, Ireland implemented changes in their governance rules. In 2010, the Irish stock exchange, whilst still recognising that “the UK Corporate Governance Code has set the standard for corporate governance internationally”⁵, introduced six additional supplementary provisions which apply to all listed Irish companies. In addition to this, Ireland introduced its own separate corporate governance code for credit institutions and insurance undertaking⁶.

2.3. Definition of Corporate Governance

There is no one accepted definition of the term “corporate governance”. Daily et al. (2003) define corporate governance as the determination of the broad uses to which organisational resources will be deployed and the resolution of conflicts amongst the myriad of participants in organisations. Solomon (2013) similarly provides a wide definition, defining corporate governance as the

⁵ Refer to the url <http://www.ise.ie/Products-Services/Sponsors-and-Advisors/Irish-Corporate-Governance-Annex.pdf> for a copy of the Irish corporate governance annexure.

⁶ A more detailed analysis of Irish corporate governance codes can be found in chapter 8.

system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible manner in all areas. These two broad definitions have as their basis the principle that companies are accountable to a wide and varied group of actors and as such governance needs to take into consideration factors that affect not only to its direct stakeholders but society as a whole. In other words they assume a socially orientated perspective on governance.

Bainbridge (2012), in contrast, defines corporate governance in a much more narrow sense as the institutional structures, legal rules, and best practices that determine which body within the organisation is empowered to make particular decisions, how the members of that body are chosen, and the norms that should guide decision making. Further, one of the most well recognised, and indeed narrow, definitions of corporate governance is provided by the Cadbury Report (1992) as the system by which companies are directed and control. This definition was adopted when the UK Governance Code was first published in 2003 and remains in the current version of the Combined Code (2014). The narrow definition of corporate governance as identified in the Combined Code complements this thesis which is focussed on micro decision making within the context of corporate boardrooms.

Researchers (for example Sun et al. (2011) and Stanton (2012)) however recognise the interplay between the macro environment and the implementation of effective corporate governance and that factors such as general business ethics, corporate awareness and societal values and the general mind-set and attitudes in a particular culture will influence corporate governance effectiveness. Indeed, this relationship between the micro decisions at board level and the macro level in which boards operate will be discussed in detail in the chapter 3. The emphasis of this research is, as highlighted above, on micro issues and recommendations for effective corporate governance reforms which

will positively affect decision making within individual boards with the resultant knock on effects in the broader macro environment.

Finally, on the issue of why corporate governance matters, the OECD (2004) highlights the importance of effective corporate governance in helping to provide a degree of confidence that is necessary for the functioning of a market economy and will result in a lower cost of capital and encourage firms to use resources more effectively hence underpinning economic growth. The Walker Review (2009) specifically highlights the importance of strong corporate governance in financial institutions and that such failures can impact other parts of the economy in ways which are both interconnected and pervasive and can give rise to public interest externalities and moral hazard of a kind far greater than other types of institutions.

2.4 Why a Board of Directors?

The UK Corporate Governance Code (2014) puts the board of directors right at the forefront of corporate governance when it states: "Every company should be headed by an effective board which is collectively responsible for the long-term success of the company" (*ibid*, section A, p. 5). Corporate governance therefore has as one its core underpinning the belief that group decisions making is superior to that of an individual, and that a corporation should be governed by a board of directors rather than by an individual. This theoretical underpinning is based on the belief that for there to be effective oversight of an organisation, what is required is the collective knowledge and deliberation of a group rather than that of a specific individual (Forbes and Milliken, 1999). Indeed research supports this assumption and has highlighted that overall group decision making is superior to decisions made by individuals and that in particular where evaluation of complex problems is concerned, there is clear evidence that the performance of the group will be superior to that of the average group member

(see for example Hill (1982), Surowiecki (2010) and Bainbridge (2002) and (2012)).

Langevoort (2000) and Marchesani (2005) both identify three distinct roles for a board of directors: First to monitor the company's management on behalf of shareholders, second to support the management in the development of strategies, and third as a resource gathering role with the board acting as a bridge between the board and its external environment. Both these academics recognise that the main role of the board is in the monitoring of management for the benefit of shareholders, therefore reducing agency costs arising from the separation of ownership and control which characterises corporations in the Anglo Saxon model of corporate governance.

2.5 Agency Theory

The recognition of the conflict between management and owners of a firm dates back to the writing of Adam Smith (1863) who observed that managers, as agents for shareholders, will not be as vigilant in pursuing the interests of shareholders as if they were the owners themselves. As Smith wrote in *Wealth of Nations*: "The directors of such [joint stock] companies being the managers rather of other people's money than of their own, it cannot be well expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own ... Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company" (*ibid*, p. 264-265).

Berle and Means (1932) were the first to identify the distinct feature of the separation of ownership and control in US corporations whilst Prais (1976) highlighted that a similar structure of ownership and control operated in the UK. Agency theory was thus developed to provide a framework of how an organisation characterised by such a separation of ownership and control can

be effectively governed (see Jensen and Meckling (1976) and Fama and Jensen (1983)).

Agency theory is thus a control based principle which assumes that managers, by virtue of their understanding and experience within an organisation, are seen to have an advantage over the firm's owners who are largely removed from the day to day operational aspects of the firm. Managers who control the firm, have by virtue of this control the potential to pursue actions which benefit themselves, but not the firm's owners, and this necessitates mechanisms designed to protect shareholders as owners of the firm.

This shareholder protection is achieved initially through the internal mechanism of the board of directors monitoring management performance and decisions for the benefit of the shareholders and, in case such internal mechanisms fail, through the external mechanism of the market for corporate control. The external mechanism of changes in corporate control is typically activated when the internal mechanism for controlling and monitoring management has failed. The role of monitoring of the management for the owners is therefore seen very much as the key criteria of agency theory.

Agency theory has been described as having a "dominant grip" (Huse (2005) and Roberts et al. (2005)) on corporate governance research. Daily et al. (2003) ascribes the popularity of agency theory to two factors. First, it is a simple theory in which large corporations are reduced to two participants – managers and shareholders – and the interests of each are assumed to be both clear and consistent, and second, the notion of humans as self-interested and will put their own interests above all else is well understood and established⁷.

⁷ Agency theory contrasts with stewardship theory which, rather than seeing directors as being self-interested and opportunistic, has as its core the belief that directors interests are often very closely aligned with that of shareholders and that there are often situations where the interests of shareholders and directors are closely correlated. In direct contrast to agency theory, stewardship theory would suggest that control of a corporation should be centralised in the

Just as the UK Code of Conduct (2014) puts the directors right at the heart of corporate governance, agency theory relies very heavily on the board for the efficient functioning of a corporation. Fama and Jensen (1983) describe the board as the “apex of the firms’ decision control system” (*ibid*, p. 311), and it therefore follows that the board of directors are “the ultimate internal monitor whose most important role is to scrutinise the highest decision makers within the firm” (Fama, 1980, p. 294).

In summary, the primary duty of the board of directors is to serve this monitoring function (Dalton et al., 1998). The overwhelming emphasis in governance research has been on the efficacy of the various mechanisms to protect shareholders from the self-interest of management and the dominant theory applied to achieve this has been agency theory (Daily et al., 2003).

2.6 Rationale for Director Independence

To be effective monitors of management, the directors entrusted with such a role need to be sufficiently independent from management to adequately protect the interests of shareholders. The logic being that independent directors will do a better job monitoring management than insiders would do who are closely aligned to the CEO and are therefore more susceptible to the normative social influences (discussed in detail in the next chapter).

Fama and Jensen (1983) argue that the incentive for independent directors to monitor manager is a desire for such directors to build up a reputation as experts monitors: “Our hypothesis is that outside directors have incentives to develop reputations as experts in decision control. Most outside directors of

hands of the firms’ executives. A debate as to the relative merits of agency versus stewardship theory is, it is submitted, outside of the boundaries of this thesis. Rather this thesis has focused on corporate governance initiatives and developments resulting from the accepted agency principle that NEDs are tasked with *inter alia*, the role of monitoring management on behalf of shareholders.

open corporations are either managers of other corporations or important decision agents in other complex organisations. The value of their human capital depends primarily on their performance as internal decision managers in other organizations. They use their directorships to signal to internal and external markets for decision agents that (1) they are decision experts. (2) they fully understand the importance of diffuse and separate decision control, and (3) they can work with such decision control systems. The signals are credible when the direct payments to outside directors are small, but there is substantial devaluation of human capital when internal decision control breaks down and the costly last resort process to an outside takeover is activated.” (*ibid*, p. 315)

Campbell et al. (2009) draw upon the field of neuroscience to rationalise why independence is critical for long term good decision making processes. They argue that decisions are made largely through unconscious means such as pattern recognition and emotional tagging and that these processes make for quick effective decisions, but can be distorted, in particular by self-interest. This unconscious bias to favour decisions which are in our own self-interest, can distort decision making processes by allowing us to make decisions which have self-interest at heart without appreciating the effect that such self-interest has had on the decision process⁸. Campbell et al. (2009) suggest that the way to avoid this unconscious bias is to involve someone else in the decision process that has no appropriate attachments or self-interest and that this person would be well placed to challenge thinking, force a review of logic and possibly even champion a solution that might be contrary to the self-interests of existing group members.

⁸ The argument that Campbell et al. (2009) presents with respect to self-interest creating an unconsciously bias in decision processes is consistent with the theory of ethical fading (Bazeman and Tenbrunsel, 2013) and wilful blindness (Heffernan, 2012) as possible explanations for ethical indiscretions in organisational settings. It follows that if the decision process is affected by unconscious biases that the outcome can lead not only to a poor decision process but also the potential for an unethical decision process.

Langevoort (2000) maintains that managers left to their own devices tend to develop biased constructions of a firm's strategic position and can become overconfident and heavily invested in their own beliefs and therefore disinclined to seek out information that might disprove their existing views. Langevoort emphasises the tendency for overconfidence to develop in a group setting and the introduction of independent directors can dampen this overconfidence.

Overconfidence is common to the normative social influences of groupthink and group polarisation⁹. Independent directors could help to reduce overconfidence and therefore decrease the likelihood of both groupthink and group polarisation occurring. Langevoort concludes that only by giving formal power to a more objective group of outsiders, can the insiders be forced to expose their biases and to take dissonant views more seriously. Again this view is supportive of the role of external or independent directors as important monitors of executive directors.

Finally, Hall (2007) argues that increasing the number of independent directors is about encouraging the psychological attributes of independence of mind. It is the willingness to be open and critical and, as much as possible, an awareness of the biases in thinking that are the qualities that independence can bring.

In summary independent directors can, and should, reduce the cognitive biases associated with group decision making. Specifically independent directors should reduce some of the symptoms associated with poor decision making and reduce group cohesion, group homogeneity and a strong social identity or in-bias of the group all symptoms associated with phenomena such as groupthink, group polarisation, de-individuation, herding and susceptibility to epistemic blind spots.

⁹ A detailed discussion of both phenomena and the common linkage of overconfidence can be found in chapter 3.

2.7 The development of NED independence in the context of UK Corporate Governance reforms

There are two distinct areas in which the roles and responsibilities of directors are set out; first through law and the enactments of the Companies Act, and second through a series of government initiated Reports which has led to creation of a combined Code of Corporate Governance. The UK Companies Act 2006 is enshrined in law and carries both criminal and civil liabilities penalties for non-compliance in certain circumstances (for example for fraudulent or reckless trading by directors as per Section 993 of the Act). In contrast the Combined Code of Corporate Governance (2014) (the “Code”) is “soft” law as there are no legal consequences for non-compliance with the disclosure obligations imposed.

The Companies Act applies to all incorporated entities¹⁰ whereas compliance with the Code is only required for UK and overseas registered companies with a premier listings in the UK¹¹. The Listing rules require such companies to disclose in their annual reports the extent to which they have complied the Code and to give reasons (if any) of any non-compliance; in other words a “comply or explain” model. A company would therefore be in compliance with the listing rules if it has not complied with the Code but had provided reasons for non-compliance. This “comply or explain” model is intended to give corporations flexibility to the extent that the directors feel that the Code is relevant to the corporation’s specific circumstances. However at the same time the

¹⁰ Although there are numerous exemptions applied depending on the size of the company and whether it is a public or private.

¹¹ The intention of the Cadbury Report (1995) was that the Combined Code would apply to all large companies regardless of whether they were listed or not. However, as Davies (2012) notes the restriction to listed companies arose because the listing rules provided a convenient enforcement mechanism and not because this defines the companies for whom such rules are most appropriate.

requirement to explain non-compliance gives the code a greater weight than a recommendation which the company can simply reject without explanation¹².

The Code recognises the importance of the board of directors as the company decision making body. Indeed, the first principle of the Code states that: “Every Company should be headed up by an effective board, which is collectively responsible for the success of the company” (2014, section A1). The Code (2014) goes on to state that “The board should set the company’s strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company’s values and standards and ensure that its obligations to its shareholders and others are understood and met” (*ibid*, section A1).

In contrast, it would be difficult to glean any similar understanding of the importance of the board from a reading of the Companies Act (Davies, 2008). The Companies Act 2006, s. 154, does require all public companies to have two directors and private companies one, but it leaves the determination of the role of the board very largely to the company’s constitution, which is controlled by the shareholders. As such, the Companies Act makes no differentiation between executive and non-executive directors, nor does it define or require NED independence. Indeed the board’s position in company law is deeply ambiguous (Davies, 2008). The reason for this is that the Companies Act covers both corporations with a clear separation between ownership and also smaller organisations where the employees are also the owners¹³. For small companies where there is no such schism between ownership and control many of the corporate governance rules and regulations recommended by the Code,

¹² For a discussion on the effectiveness of the comply or explain approach see Arcot et al. (2010) who find that there is high levels of compliance with the Code, a view shared by Davies (2008) who argues that the comply and explain mechanism has changed corporate behaviour.

¹³ Indeed, the majority of companies governed by the Companies Act are indeed small organisations where no such schism exists between ownership and control.

which have at their core the need for directors to monitor management on behalf of shareholders, are not appropriate¹⁴. Corporate governance reforms and in particular the role of the independent NED are, as a result, focused on the Code not the Companies Act.

If one goes back to the first part of the 20th century the NED was no more than a figurehead, employed to promote the profile of the company and described as a “decoration on a Christmas tree”. Typically NEDs joined the board meeting several times a year in return for a fee (normally one guinea) and a free lunch. Indeed Samuel (1933) referred to such directors as “guinea-pig directors”.

The first attempt, however, to highlight the potential benefits of NEDs came from the report of the Company Affairs Committee of the CBI (otherwise known as The Watkinson Report) which was published in 1973. This was followed by the Cadbury Report (1992) which further strengthened codes with respect to NED dependence. The Hampel was a failed attempt by management to win back some of the ground that had been conceded to the Cadbury Committee (Davies, 2012).

The primary importance of the monitoring role NED was, however, reaffirmed with the publication of “The Review of the role and effectiveness of non-executive directors” in 2003. This report is commonly referred to as the Higgs Report in reference its author Sir Derek Higgs. The Higgs Report was a reaction

¹⁴ This thesis intends to make a contribution to the process of decision making in boards, whether for large or small companies but the focus of this research is on the decision making in large financial institutions characterised by a separation of owners and managers. As such, emphasis is placed on the role that NEDs play in the monitoring of management on behalf of shareholders. This is not to say that many of the recommendations reached in this thesis do not apply to small companies but the focus is on the decision process in large organisations characterised by a schism between ownership and control.

to the Enron fraud and represented the equivalent UK response to the Sarbanes-Oxley Act (2002) which was passed in the US. Most of the members of the Enron board were deemed “independent” directors according to the then standards of the US stock exchange requirements. It was, however, subsequently disclosed that all of the independent directors had financial relationships with the CEO or the company itself – some of them were representatives of charities that received significant donations from Enron or acted as consultants serving the company. As a result, both the New York Stock Exchange and NASDAQ (the two main exchanges in the US) tightened up the definitions of independence. Furthermore the passing of the Sarbanes-Oxley Act (2002) further strengthened the significance of, and reliance on, the independent director and the act was seen as a form of codification with respect to independent outside directors (Zhao, 2011).

In July 2003 the UK Financial Reporting Council approved new draft of the Combined Code which retained almost all of Higgs's recommendations – including those listed above. It was the Combined Code (2003) and then (2006), with the emphasis on independent NEDs monitoring management on behalf of shareholders described above, which underpinned corporate governance in the run up to the financial crisis of 2007/2008.

The Combined Code (2006) included a number of provisions which highlighted the role of the NED director. Section 1 of the 2006 Code highlights the dual role of the NED as one of monitoring and the provisions of resources when it notes that “non-executive directors should constructively challenge and help develop proposals on strategy.” The emphasis in the Combined Code is very much focused on the monitoring function of NEDs. A summary of the relevant codes as they related to NEDs are summarised below¹⁵:

¹⁵ I refer here to the 2006 Code as this was the relevant Code in the run-up to the crisis.

- Code A.3 set outs the need for NEDs to be independent and the criteria recommended to assess independence. Further provision A.3.2 noted that all companies in the FTSE 350 should have a majority of NEDs on the board. The rationale for these provisions being that if the NEDs are independent of executive directors, and in the majority, they are less likely to be dominated by and more likely to challenge the executive directors, A majority of independent NEDs will also in theory reduce the risk of high levels of cohesiveness related to groupthink (discussed in detail in the following chapter).
- Code A4 highlighted that the majority of directors from the nominations committee for board appointments should be independent NEDs. The rationale for this provision is to reduce the likelihood of “an old boys network” prevailing in boards. The benefits of diversity in the context of the corporate board are discussed later in this chapter.
- Codes A.4.4, A.4.5, A.5.1, A.5.2, schedule B (ii) are all codes which emphasised the skills and effort required by an NED to fulfil his/her responsibilities. High levels of functional and firm specific skill levels by NEDS are important as they can reduce informational pressure to conform (herding) and are discussed in detail in the next chapter.
- Code A7.2 focused on the term for which NEDs should serve and that any NED which serves for more than six years should be subject to a particularly rigorous review particularly as to how this relates to NED independence. Again, this provision is concerned with the impact of groupthink tendencies on a board over time. A board which is characterised by high levels of cohesiveness and amiability (which can be associated with longevity) is more vulnerable to groupthink tendencies (discussed in detail in chapter 3).
- Code B.1.3 recommends that remuneration for NEDs should not include share options. This is intended to reduce the likelihood of greater levels of cohesiveness and increase NED independence and perspective as there is less financial aligned with executive directors.

- Codes B.2.1 and C.3.1 highlighted the role that the independent NED should play in the remuneration and audit committees. Again the principle being that these are important decision making committee related to the board and would benefit from the input of independent NEDs who can challenge and monitor the board¹⁶.

In summary, UK corporate governance evolved so as to recognise the importance of NEDs as an effective tool for safeguarding the interests of shareholders in the belief that the presence of such independent directors are an indicator of good governance (Marchesani, 2005)¹⁷. In the UK there was what has been described as a “fetish devotion” (Bainbridge, 2012) to the importance of director independence in corporate governance legislation in the lead up to the financial crisis

2.8 Corporate Governance Research into the link between Director Independence and Board Performance

If independent boards are so desirable then there should be a clear statistical correlation between measures of board independence and corporate

¹⁶ Since the financial crisis the UK Corporate Governance Code has further strengthened further the provisions related to NEDs. The UK Combined Code (2014) includes; provision A.4.2 which states that the chairman should hold meetings with NEDs without executive directors present, A.4.3 is a requirement that should a NED resign he needs to provide a written statement setting out his reasons for resigning which are circulated to all members, B.3.2 which requires greater disclosure on the terms and appointment of NEDs and the expected time commitments

¹⁷ Although there are/were subtle difference in the definitions of independence between the US and UK, fundamentally the two jurisdictions were very much aligned in the lead up to the crisis with respect to the importance of director independence and the role that such directors should play in the monitoring of management on behalf of shareholders.

profitability. The greater independent oversight of management should, in theory, result in better board processes and decisions, translating into better financial performance. Ezzamel and Watson (1997) did find that independent directors were positively associated with profitability amongst a sample of UK firms whilst Baysinger and Butler (1985), in a study of 266 US corporates, found that firms with more outside members realised higher returns on equity concluding that there was a positive relationship between outside directors and firm performance.

However, these findings are the exception rather than the rule. Research studies have failed, in the main, to find a systemically significant relationship between board independence and financial performance. Dalton et al. (1998) conducted a meta-analysis of 54 empirical studies of board composition, and found no meaningful relationship between board composition and financial performance therefore concluding that such finding provides little support for agency theory. Finkelstein et al. (2008) also argue that the benefits of independence are illusory. For the year 2000, they analysed the returns for all S&P 500 firms in the US and compared the results of the upper and lower quartiles in performance in terms of board independence and found that there was no significant differences between the number of independent directors between upper and lower quartile performers. Further, they analysed the “rogues’ gallery” of firms in the index (Enron, WorldCom, Global Crossing, Quest Communication and Tyco) and found that these firms had what they termed “stellar credentials” in terms of director independence.

Bhagat and Black (1999) conducted a comprehensive study of board composition over a ten year period and found “no convincing empirical support for the conventional wisdom that large company boards should consist predominately of independent directors” (ibid, p. 54). Indeed Bhagat and Black even made the case to suggest that there is evidence to suggest that firms with boards with large NED majorities perform worse than other firms whilst Agrawal and Knoeber (1996) identified a negative relationship between corporate

performance and greater outside representation on the board. Other studies have found inconclusive evidence that board composition affected performance (Hermalin and Weisbach (2001) and Fields and Keys (2003)).

Commentators have attempted to explain the lack of such a correlation in a number of ways. One possible explanation is that corporate governance, and board composition in particular, simply does not actually matter (Hermalin and Weisbach (2001)) but this is very much a minority view and, it is submitted, not a credible explanation. How can one assume that there is no correlation between the composition of directors charged with affecting complicated strategic decisions and firm performance? Further, if corporate governance does not matter then why did banks operating in the same geographical area, in the same markets with the same regulator have such very different outcomes in how they performed? This can only be explained in terms of differences in the way that these organisations were run (Walker and Britain, 2009).

Langevoort (1998) argues that measurement problems with how we define independence plagues empirical work in this area, and that if we could truly identify independent directors more precisely then perhaps we could find the correlation between performance and composition. Marchesani (2005) contends that such studies often adopt unsophisticated and different definitions of what constitutes independence which can skew results and make it difficult to make intra study comparisons. This point is shared by Fisch (1997), who argues that many such studies rely on superficial criteria in classifying directors as independent rather than attempting to understand the extensive personal and business relationships which directors hold.

Furthermore, Marchesani (2005) highlights the difficulties that such studies have with respect to endogeneity in that firm performance is influenced by action taken by previous directors and past performance is a factor that influences the choices of subsequent directors. Indeed, research has shown that independent director appointments are more likely following poor

performance firms, see for example Hermalin and Weisbach (2001), Gilson (1989) and Kaplan and Minton (1994). Research results will be adversely affected by corporations that have performed badly and have increased the proportion of independent directors to their boards. Finally, Pettigrew (1992) argues that inherent difficulties in separating out such endogenous factors influencing a company's performance makes it "very difficult to establish" (*ibid*, p. 170) the link between firm performance and board composition.

Another reason why researchers have struggled to find a relationship between board independence and firm performance is that many of the studies were undertaken in periods where the benefits of independent boards, and in particular the ability of NEDs to provide a necessary "brake" to high risk strategies, was not recognised. There is a time lag, and the benefits of independence only became apparent during the crisis of 2007-2008. Indeed, it was the many of the firms who showed exceptionally growth and strong stock performance in the lead up to the financial crisis that suffered the most in the crisis as their high risk and levered strategies unfolded. Two obvious examples of this are The Royal Bank of Scotland and Anglo Irish Bank¹⁸. The benefits of board independence, and in particular the ability of independent NEDs to provide some caution and challenge to an executive board, is greatest in times of high risk and growth. There will, however, be a time lag when the benefits of such independent advice are reflected in firm performance.

In summary, studies have failed to show the link between independence and governance because of a number of issues relating to measurement and timing of the studies undertaken. The results do not however disprove the value of the independent NED. Rather, it is submitted, they raise questions as to the validity of the research undertaken.

¹⁸ For a detailed analysis of this refer to Beltratti and Stulz (2009).

2.9 A review of models which link board attributes to financial performance

The section of chapter 2 is devoted to a review of existing models which look to link board attributes to financial performance. This is of particular relevance as it is an important building block for the development of my model of VPDP which I present in chapter 6. The first step in this review process is the selection of models for such an analysis. Five different models have been identified as relevant. These are the models of Zahra and Pearce (1991), Forbes and Milliken (1999), Hillman and Dalziel (2003), Sundaramurthy and Lewis (2003) and McNulty et al. (2013). These models were selected for the following reasons:

- 1) The first four of the models highlighted above were published in the highly rated journal *The Academy of Management Review*, a 4 star journal, whilst the article by McNulty et al. (2013) was published in the 3 star journal *Corporate Finance: An International Review*¹⁹. Four of these models are extremely well cited; Zahra and Pearce (1991) has 1619, Forbes and Milliken (1999) 1107, Hillman and Dalziel (2003) 1058 and Sundaramurthy and Lewis (2003) 568 citations²⁰.
- 2) The Zahra and Pearce (1991) and Forbes and Milliken (1999) papers are both described as seminal (Huse, 2005; Payne et al., 2009) and form the basis for other models which have been subsequently presented (see for example Minichilli et al., 2012; Payne et al., 2009; Van Ees et al., 2009; Zona and Zattoni, 2007).

¹⁹ The Association of Business Schools in their article "Academic Journal Quality Guide" notes that a 4 star journal is of world elite quality, whilst a 3 star journal is research which is highly regarded. See

<http://www.myscp.org/pdf/ABS%202010%20Combined%20Journal%20Guide.pdf>.

²⁰ Number of citations as at 02/02/2014 per *Google Scholar*. The McNulty et al. paper was only published in 2013 and not surprisingly has only six citations as of 02/02/2014.

- 3) The Hillman and Dalziel (2003) model is of particular interest in that it highlights the assumption that actors always make rational decisions, as presumed by agency theory. In the following chapter I will, however, highlight the literature which argues that decision processes are not always rational and are heavily influenced by powerful psychological forces resulting in.
- 4) The Sundaramurthy and Lewis (2003) model provides an interesting comparison in that it is the only model which I have identified which explicitly recognises, within the graphic of the model itself, the role that groupthink can play in board decision processes and for that reason alone is worthy of review.
- 5) The McNulty et al. (2013) model specifically looks to understand financial risk during the credit crisis. It was the lack of appreciation of financial risk that led to the poor decision processes by the banks during the crisis itself, and as such this model has significant relevance. It is also the only one of the five selected models which has been tested in the field through a questionnaire addressed to CEOs. In contrast, the other four models are purely theoretical.

It is recognised, however, that the selection of these models can be criticised as being self-selected with an inherent researcher's bias given that I will be presenting my own model later in this thesis. These five models are not presented as a panacea of all models linking board characteristics to firm performance and/or a poor decision process. Other models identified which look to link board attributes to financial performance include Judge and Zeithaml (1992), Minichilli et al. (2012), Payne et al. (2009), Van Ees et al. (2009) and Zona and Zattoni (2007). An extensive search of the literature did not, however, reveal any published or available research which would challenge the originality of the model I will present in the chapter 6 of my thesis. These five models are described below in sequential date order with a view to providing the reader with an understanding of how they are constructed.

2.9.1 Zahra and Pearce “Board of Directors and Corporate Financial Performance: A Review and Integrative Model” (1989)

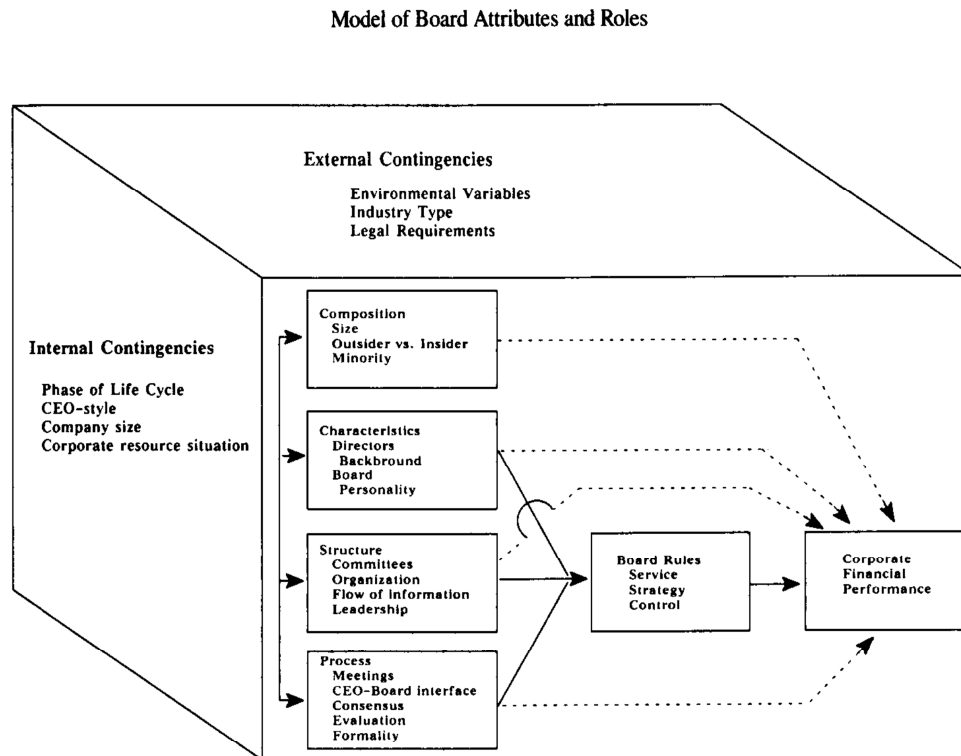
Zahra and Pearce’s model identifies four board attributes which are key to company performance, namely: board composition, characteristics, structure and process. They stress that these four attributes should be viewed as highly interrelated. To illustrate this, the composition of the board, and in particular the mix between executive and NEDs, will impact on the characteristics of the board. By this they refer to the age, educational background, values and experiences of directors. The characteristics of the board will, in turn, impact the board structure, in particular the number and types of committees, committee membership, the flow of information among the various committees, board leadership and patterns of committee membership. Finally this will flow through to the decision process of the board, the formality of board proceedings and the extent to which the board is involved in evaluating itself.

The model recognises the contingent nature of the relationship between board variables and the company’s performance, and that these relationships are influenced by both internal and external contingencies. Zahra and Pearce identified three different types of external contingencies: the environment and industry in which the firm is operating, and the legal requirements of its jurisdiction. Internal considerations identified as affecting the relationship between board variables and firm performance are: the type of ownership, the phase of the company’s life cycle, the complexity of internal operations and the style and preferences of the CEO.

The authors observe that few studies have incorporated these internal and external contextual variables into their research, but that these contextual factors are critical in affecting board performance: “One should not expect the same board committees or organization to exist in different industries, across different phases of the company life cycle, or in different countries. Therefore to understand how board structure relates to performance, scholars should pay

attention to these and other contextual variables” (*ibid*, p. 322). As a result they argue that research results are open to speculation and different interpretation. They conclude that to minimise misleading interpretations, researchers should look to examine the moderating effects of contextual factors.

Figure 2.1: Zara and Pearce’s model



The representation above shows the external and internal contingencies, and the four board attributes linking into the three board roles and then impacting on corporate financial performance. The model highlights that the impact a board of directors can have on a company’s performance can occur either directly or indirectly. Direct impact would be achieved through the association of a direct relationship between board attributes, such as the composition of the board, and company performance. The direct route is depicted in the model through the dashed lines. Most empirical studies have focused on the direct effect of board attributes on company performance primarily through the use of large

archival data sets looking to create a relationship between such inputs and board performance (Gabrielsson and Huse, 2004).

The indirect route reflects the effect of board attributes on the board's performance in its three roles, which in turn influence company performance. These are depicted by the solid lines. The indirect link takes into account the interrelationship between the board variables, the contingencies that influence boards (both internal and external) and the influence that directors exert on senior management initiatives. In effect, the indirect route looks to split the link between the composition of the board and the corporate performance through an intermediate process.

Zahra and Pearce identified four variables (board composition, characteristics, structure and process) but as the figure above reflects, they argue that only three of these (all except board composition) will have an impact on board roles and board performance through the indirect route: "We believe that board characteristics, structure, and process exert a significantly stronger influence on board roles and company performance than board composition. Past research has yielded contradictory findings and suggests at most a modest level of explanatory power. Consequently, the model omits a direct link between composition and board roles" (*ibid*, p. 310)²¹.

Zahra and Pearce favour the indirect route and encourage more research into this area: "The bulk of past empirical research has also been devoted to examining the direct effects of board attributes on corporate *financial* performance. Little attention has been given to the systemic and social components of organizational performance in the model. Future research,

²¹ It does appear slightly contradictory that the authors do not consider that board composition is significant enough to impact board roles and (albeit indirectly) board performance but consider that board composition can however directly impact board performance as the graphic illustration of their model highlights.

therefore, should explore the indirect link among board variables and the systemic and social components of company performance” (*ibid*, p. 308).

2.9.2 Forbes and Milliken “Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups” (1999)

Forbes and Milliken (1999) observe that boards are elite, episodic decision-making groups that face complex tasks relating to strategic decision making. NED board members, in particular, are not involved in the implementation of their decision processes and as such their output is cognitive in nature. These factors, taken together, Forbes and Milliken argue, “suggest that the effectiveness of boards is likely to depend heavily on social-psychological processes, particularly those pertaining to group participation and interaction” (*ibid*, p. 195). The impact that human behaviour can have on firm performance is explicitly recognised in Forbes and Milliken’s model in the identification of the impact that group cohesiveness and cognitive conflict play in affecting board performance.

Further, Forbes and Milliken argue, like Zahra and Pearce, that there is a need to understand the intervening processes which link board characteristics to firm performance, and that the influence of board demography on firm performance may not be as simple and direct as many past studies presume but rather more complex and indirect. Forbes and Milliken criticise research which is based on the argument of parsimony, and which focuses on explaining what the impact of demography is, without necessarily trying to determine why demography operates in an observed way. This is consistent with the approach which I have adopted in this thesis which is concerned with trying to understand the “black box” of board processes and the consequence of intervening processes on decisions.

Forbes and Milliken’s model focuses on two factors which will determine board effectiveness and firm performance. First, board task performance which is

defined as the ability of the board to perform its control and service task effectively²². Second, the authors identify the board's ability to continue working together, as evidenced by the cohesiveness of the board. In effect, Forbes and Milliken identify a "task" and "maintenance" criteria for defining effectiveness²³.

Forbes and Milliken identify three board processes that will influence a board's task performance, namely: effort norms, cognitive conflict and the board's use of its knowledge and skills. Effort norms relate to the level of effort and the amount of time directors devote to their task and as such are an individual-level construct. Forbes and Milliken also highlight that directors must have the necessary skill levels which they see as being a two stage process. First is the requirement of broad functional skills and expertise, and second is the need for firm specific knowledge and skills. In other words, directors will need to have the necessary levels of base expertise going into the job but then also need to acquire firm specific knowledge in order to be effective. However, Forbes and Milliken recognise that individual effort levels are also influenced by group norms and pressure, and that the culture of the collective group will influence the effort norms of individual directors.

²² This is a slightly narrower definition of board effectiveness as provided by Zahra and Pearce (1989) who include strategy in addition to the criteria of service and control noted above. However, this may be a moot point as the function of strategy could conceivably be included in the definition of "service" provided by Forbes and Milliken. Arguably the more fundamental difference in the models relates to the overt inclusion in the Forbes and Milliken model of psychological factors and how they affect decision processes.

²³ Like Zahra and Pearce, Forbes and Milliken identify an intervening construct between board characteristics and firm performance. However, Zahra and Pearce identified the board roles of service, strategy and control as being the intervening construct between board characteristics and firm performance whilst Forbes and Milliken have identified board task performance and maintenance criteria.

Forbes and Milliken define cognitive conflict as task-oriented differences in judgement among group members (*ibid*, p. 494). They recognise that cognitive conflict can have both a positive and a negative impact on firm performance. On the positive side, cognitive conflict will result in the consideration of more alternatives increasing the quality of strategic decision making, particularly in uncertain environments. On the negative side, cognitive conflict can arouse negative emotions reducing the ability of group members to communicate and participate in group decisions, and therefore negatively impacting the decision process.

Forbes and Milliken further note that board cohesiveness can have a direct impact on firm task performance and overall firm performance, and that there is a curvilinear relationship between cohesiveness and a firm's task performance. Both the control and service functions of boards require extensive communication and co-operation between board members which must involve a certain level of trust, and inter-personal relationships all associated with cohesiveness. However, very high levels of cohesiveness can lead to groupthink and to poor decision processes. In other words, cohesiveness can be a positive leading to better communication and co-ordination, but very high levels of cohesiveness can lead to groupthink which will be negatively correlated to firm performance.

Forbes and Milliken draw on the research of Bernthal and Insko (1993), highlighted previously in this thesis. Bernthal and Insko differentiate between two types of cohesion; task orientated and socio-emotional. Task orientated cohesion is cohesion which focuses on the performance of a specific task and is considered to be positive performance. Socio emotional cohesion, on the other hand is the type of cohesion identified by Janis (1972), and relates to the emotional attachment that members have to the group itself and to its preservation. This type of cohesion can, as Janis highlighted, adversely affect firm performance.

Forbes and Milliken argue that cognitive conflict can help to prevent the emergence of groupthink in cohesive groups by fostering an environment characterised by task-oriented focus, and a tolerance of multiple viewpoints and opinions. Cognitive conflict will then allow boards to benefit from the positives associated with cohesiveness (greater levels of trust, communication and coordination) but at the same time reducing the type of cohesiveness associated with groupthink²⁴.

Forbes and Milliken focus on two means of achieving cognitive conflict. First, they argue that diversity within the boardroom can increase cognitive conflict. However at the same time such diversity can reduce communication and the effective collective pooling of directors' knowledge and skill. This reflects the "double edged" sword of diversity which is discussed in detail later in my thesis.

Second, they focus on the proportion of outsiders on the board as a means of increasing cognitive conflict: "The presence of outsiders is also likely to enhance the levels of cognitive conflict on the board, because outsiders share significantly fewer expectations with management and are liable to think more freely with regard to the firm's goals and the range of alternatives available to it" (*ibid*, p. 499). At the same time, Forbes and Milliken recognise that a greater number of outsiders could reduce firm specific knowledge, which could impact on firm performance. This highlights once again the constant trade-offs and counter balances that these models present.

Forbes and Milliken provide three core hypotheses which form the basis of their model. These are summarised below:

Proposition 1: Board effort norms, cognitive conflict and the use of knowledge and skills will be positively related to board task performance.

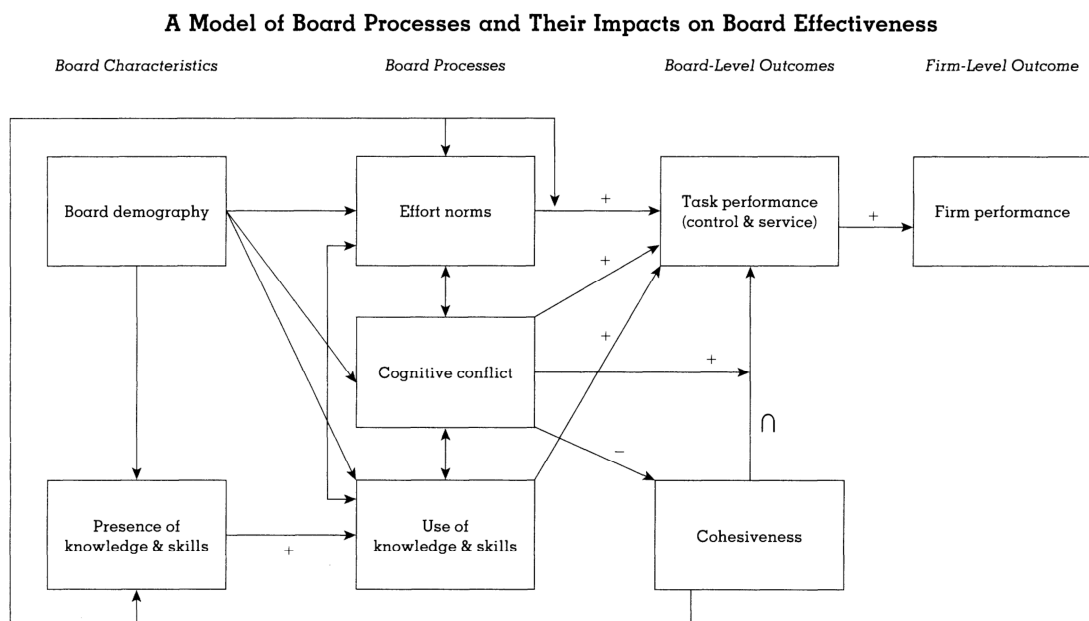
²⁴ Indeed, the title of Bernthal and Insko's (1993) paper was "Cohesiveness without Groupthink The Interactive Effects of Social and Task Cohesion".

Proposition 2: Cognitive conflict will be negatively related to board cohesiveness.

Proposition 3a: Board cohesiveness will be related in a curvilinear manner to board task performance.

Proposition 3b: The relationship between cohesiveness and board task performance will be moderated by cognitive conflict – that is, cohesiveness will be less likely to detract from board task performance when the board has a high level of cognitive conflict.

Figure 2.2: Forbes and Milliken’s model



The illustration of the model clearly shows how board characteristics (including the directors’ skill levels) feed into the three identified board processes, which then impact the performance of the control and service task of directors, and

ultimately the firm performance. The curvilinear impact of cohesiveness is reflected in the model as it relates to cognitive conflict reflecting that greater levels of cohesiveness will reduce cognitive conflict, and impact task board level outcomes. However, at the same time, a cohesive board which communicates effectively can result in greater synergy of ideas and trust, and this can have a positive impact on the task performance of the board. This is reflected by the direct link between cohesiveness and task performance as represented above.

Finally, the processes identified above are interrelated and will affect each other. High effort norms, for example, can lead to more intense participation by board members which can stimulate cognitive conflict which in turn can lead to better decision processes and mitigate the likelihood of groupthink occurring.

2.9.3 Hillman and Dalziel: “Boards of Directors and Firm Performance: Integrating Agency and Resource Dependence Perspectives” (2003)

Hillman and Dalziel’s (2003) model attempts to explain the relationship between boards and performance with reference to agency and resource dependency theories.²⁵ Hillman and Dalziel refer to the concept of “board capital” when describing the contribution of the board. Board capital consists of a) human capital such as experience, expertise and reputation, and b) relational capital which relates to the network of ties to other firms and external contingencies. A company with high levels of board capital will have the necessary experience and expertise to monitor management effectively. Further, high levels of board

²⁵ Agency theory has been described in detail previously in this thesis. Resource Dependency theory is grounded in sociology and organisational doctrine and views boards as “important boundary spanners that make timely information available to executives” (Zahra and Pearce, 1989, p. 297). The board is thus a provider of resources such as advice, counsel and legitimacy.

capital will allow directors to provide the company with the necessary advice, contacts and resources²⁶. Board capital can be seen as an alternative way of expressing the concept of board competence. This leads to the first of the model's propositions which is:

1a) Board capital is positively associated with the provision of resources (resource dependency theory)

1b) Board capital is positively associated with monitoring (agency theory)

The model then explores the incentives that board members have both to monitor and provide resources to the firm. Hillman and Dalziel focus on equity compensation as an incentive that will positively affect the relationship between board capital and increase *both* monitoring and the provision of resources. The argument raised by Hillman and Dalziel is that if directors are incentivised through the payment of equity, this will ensure his/her alignment with shareholders, and also increase the motivation to monitor management on behalf of shareholders. Further, board members who share in the upside of the firm's performance are more likely to make their own connections available to the firm so that equity compensation motivates the board to utilise the important capital they possess. Further building blocks for their model are therefore:

Proposition 2a: Board incentives will moderate the relationship between board capital and monitoring.

Proposition 2b: Board incentives will moderate the relationship between board capital and the provision of resources.

Proposition 3a: Board equity compensation positively affects the relationship between board capital and monitoring.

²⁶ This is consistent with Forbes and Milliken's assertion relating to the importance of the board having the necessary level of functional and firm specific knowledge.

Proposition 3b: Board equity compensation positively affects the relationship between board capital and the provision of resources.

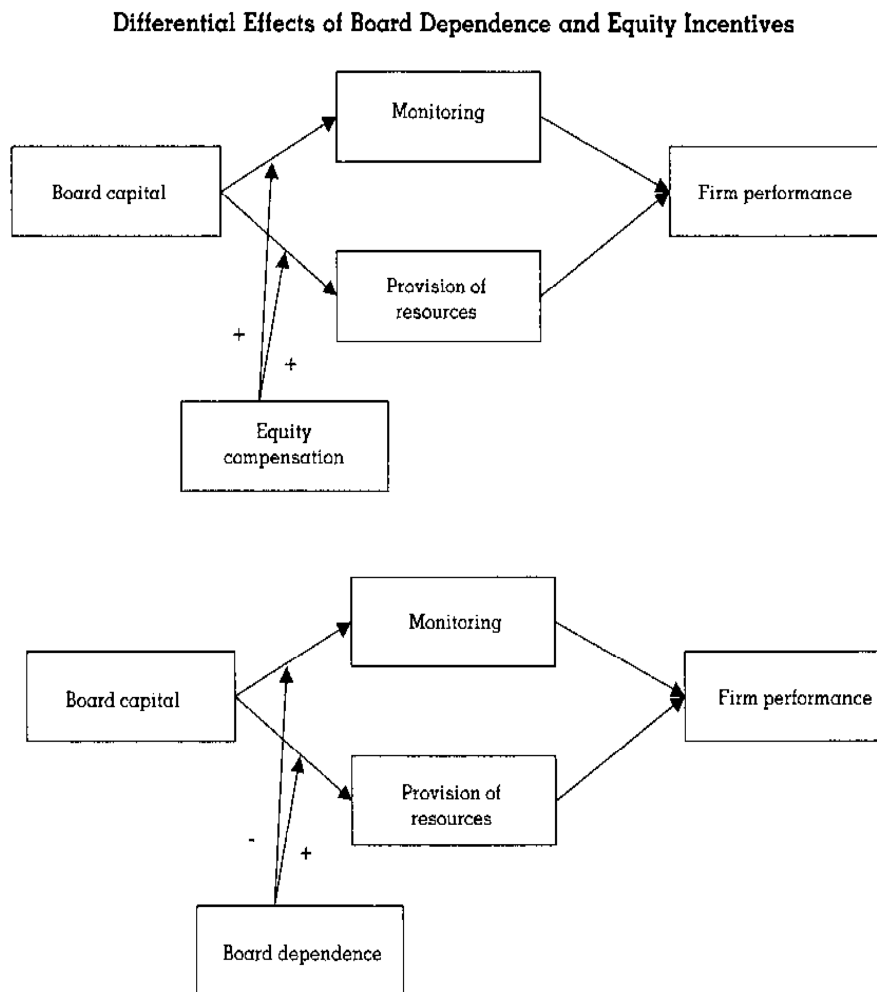
The authors draw on the research of Westphal (1999) to argue that close social ties with directors will increase levels of trust and co-operation and enhance the propensity of management to seek advice from NEDs on strategic issues. The greater the level of trust, the greater the likelihood that management will be comfortable seeking and taking advice from NEDs. Westphal (1999) claims that the primary inhibitor to seeking advice is the perceived effect it could have on the advice seeker's status, and that asking for advice can be seen as an indicator of lack of confidence and ability. Concerns about a loss of status will, therefore, inhibit the propensity for management to seek help. However, as personal relationships increase and trust is built up, this will increase a sense of security amongst NEDs reducing this perceived risk related to status.

At the same time, Hillman and Dalziel recognised that increased trust and closeness between directors could reduce the effectiveness of monitoring, hence creating a trade-off between agency and resource dependency theories. In other words, an over-emphasis on the importance of providing resources and advice to the firm (resource dependency) will result in a weakening of the monitoring of the firm by directors (agency theory). Therefore, their final hypothesis was:

Proposition 4a: Board dependence negatively affects the relationship between board capital and monitoring.

Proposition 4b: Board dependence positively affects the relationship between board capital and the provision of resources.

Figure 2.3: Hillman and Dalziel's model



The illustration of the model above shows clearly that equity compensation has a positive effect on *both* monitoring and the provision of resources, whilst board dependence has a positive impact on the provision of resources but a negative impact on the ability of the board to monitor. Hillman and Dalziel conclude that boards that are highly cohesive with strong friendship and high levels of trust, can result in an increase in a firm's performance. This improved performance is achieved by executives in such an environment being more willing to seek and take advice from NEDs whom they trust. Further, although greater levels of cohesiveness could, in isolation, reduce monitoring, effective monitoring can be achieved through equity incentives. In other words, the counterbalance to

greater levels of cohesiveness and the resulting lack of monitoring, is equity incentives which will provide NEDs with the motivation to fulfil their monitoring responsibilities. The model, therefore, suggests an integration of both resource dependency and agency theory and that “board independence is not the panacea for effectiveness it is thought to be” (*ibid*, p. 393).

In summary, Hillman and Dalziel (1993) argue that director equity compensation will allow the successful integration of both resource and agency theory, and that this will allow the firm to benefit from the resources and contacts that directors bring to the firm. Further, equity incentives will, in the authors’ opinion, ensure that directors will also be effective monitors of management.

The Hillman and Dalziel model assumes that actors will act rationally and that psychology does not play a part in decision processes, and that equity incentivisation is sufficient to ensure adequate monitoring by NEDs of executives. In contrast, providing such incentives could potentially further align NEDs to executives, reduce independence and increase cohesiveness. Cohesiveness is closely associated with groupthink and related phenomena which reduce rather than increase the likelihood of high levels of monitoring. Indeed, I intend to stress the behavioural factors which affect decision making, and that biases, such as confirmation biases leading to epistemic blind spots, are more likely when actors have high financial incentives. The effectiveness of NEDs to monitor management will be affected by a number of powerful psychological factors identified in my literature review, and equity incentivisation will not always be sufficient to counter such forces. This would particularly be the case in a scenario where an entity is characterised by the normative, informative and contextual influences on decision processes highlighted in my model.

Further, Hillman and Dalziel’s model does not take some of the contextual factors particularly associated with speculative bubbles which would affect the monitoring function. Indeed, this thesis will focus on the case study of Anglo

Irish, a bank which undertook a myopic and leverage bet on commercial property with catastrophic results. Both the executive and NEDs of Anglo had high levels of equity ownership (Nyberg, 2011, p. 27), a cohesive board with no/little challenge from the NEDs²⁷.

Hillman and Dalziel's concept of greater equity incentivisation leading to greater levels of monitoring has received no support in the legislature. The Cadbury Report (1992) recommended that NEDs should not take part in share options as this could compromise their independence, although it allowed such NEDs to be paid in shares. This recommendation is reflected in the UK Corporate Governance Code (2014) which notes that remuneration for NEDs should not include share options or other performance-related elements, and that such type of payment could be relevant to ascertaining NED independence (para D.1.3). There are, to my knowledge, no calls for reforms resulting from the crisis itself which are suggesting greater NEDs incentivised through equity compensation.

In conclusion, Hillman and Dalziel's model of alignment of agency and resource dependency theories through equity incentives, assumes that actors are fully rational and fails to take into account the fact that decisions can be made in environments which are characterised by strong normative and informative pressures for conformity, as we saw in the lead up to the financial crisis. Moreover, the model does not recognise the role that context plays in affecting decisions.

²⁷ This statement is discussed and evidenced in great detail later in this chapter.

2.9.4 Sundaramurthy and Lewis: “Control and Collaboration: Paradoxes of Governance” (2003)

Sundaramurthy and Lewis, like Hillman and Dalziel above, recognise that there is a tension between control and collaboration (reflected by agency and resource dependency theories²⁸). They argue that an overreliance on either control or collaboration can create a re-enforcing cycle that will lead to organisational decline.

Sundaramurthy and Lewis provide two separate theoretical models. First, a model which assumes a scenario in which collaboration is stressed over control, and second a model which assumes a reversal of these features so that control is stressed over collaboration. Within these two separate models, the authors then review two scenarios which they term a “high performing” and a “low performing” cycle. In effect the authors consider four different scenarios: 1) collaboration over control in a high performing cycle 2) collaboration over control in a low performing cycle 3) control over collaboration in a high performing cycle and 4) control over collaboration in a low performing cycle. These are described below.

²⁸ Hillman and Dalziel (2003) refer to the conflict between resource dependency theory and agency theory whilst Sundaramurthy and Lewis refer to the conflict between agency theory and stewardship theory. It is, however, submitted that resource dependency theory and stewardship theory are “cut from the same cloth” and indeed resource dependency theory is intrinsically linked to stewardship theory. Resource dependency refers “directly to the ability of the board to bring resources to the firm” (Hillman and Dalziel, 2003, p. 385). Stewardship theory has a basic assumption that management and the company are aligned and that managers are seen as stewards of the firm who are working for the best interests of the firm. This theory assumes a collaborative approach which “stresses managers’ tendencies to be collectively oriented and intrinsically motivated. As stewards, managers may identify with the firm and internalise its mission” (Sundaramurthy and Lewis, 2003a, p. 398). A consequence of a collaborative approach is that board members will make their resources and contacts available to the company.

2.9.4.1 Collaboration over Control in a high performing cycle

A high performing cycle is often characterised by the existence of collective efficacy and a strong identity with the firm. This can create an environment of complacency, and expectation, leading to entrenchment of ideas and an inability to adapt. The authors contend that the consequence of a highly collaborative approach is that the group will become more cohesive and that groupthink will occur resulting in a strategic persistence and lack of flexibility that will result in a poor decision process.

An extended period of prosperity can reduce a firm's motivation to comprehend the causes of success, raising the likelihood of faulty attributions (Lindsley et al., 1995; Sundaramurthy and Lewis, 2003). Cohesive teams may attribute their success to their own efforts even if past successes were due to accidents of timing. Taking credit for past successes then creates overconfidence further reducing the incentive to question the cause of performance.

Sundaramurthy and Lewis highlight that such success and confidence build further cohesion, high levels of trust and a strong "in group" bias, all symptoms of groupthink. Members become less receptive to any criticism and members act as mind guards exerting pressure on those whose opinions contradict the majority view: "Over time, the governance team's increasingly rigid mental maps, constricted information flow, and high collective efficacy induce complacency and entrenchment ... Groupthink, along with the related defences it spurs, allows the board and management to bask in past successes and increase their collaboration, rather than recognize the need for change and greater control. This reinforcing cycle fosters strategic persistence or 'the paradox of success'." (Sundaramurthy and Lewis, 2003, pp. 400–402).

In summary, the authors have identified a scenario where a firm is seen to be as very successful and is characterised by an environment where collaboration, cohesiveness and confidence are high, complacency sets in and executives overestimate their abilities. As the group becomes increasingly cohesive, it becomes more susceptible to groupthink, less receptive to feedback and criticism, less flexible and more rigid in the way that it operates. This ultimately leads to poor decisions being made and inevitably to failure.

2.9.4.2 Collaboration over Control in a low performing cycle

In this scenario, Sundaramurthy and Lewis describe a situation which combines high levels of collaboration, cohesiveness and groupthink in a low performance cycle. In such a circumstance, board members remain committed to their failing course of action, and fail to act decisively to change strategy: “Groupthink exacerbates faulty attributions, threat rigidity, and escalating commitment to a failing course of action, eventually resulting in failure” (2003, p. 402). The authors cite research from Cannella and Lubatkin (1993) that in times of poor performance, cohesive teams often exacerbate managerial entrenchment and commitment to a predetermined strategy.

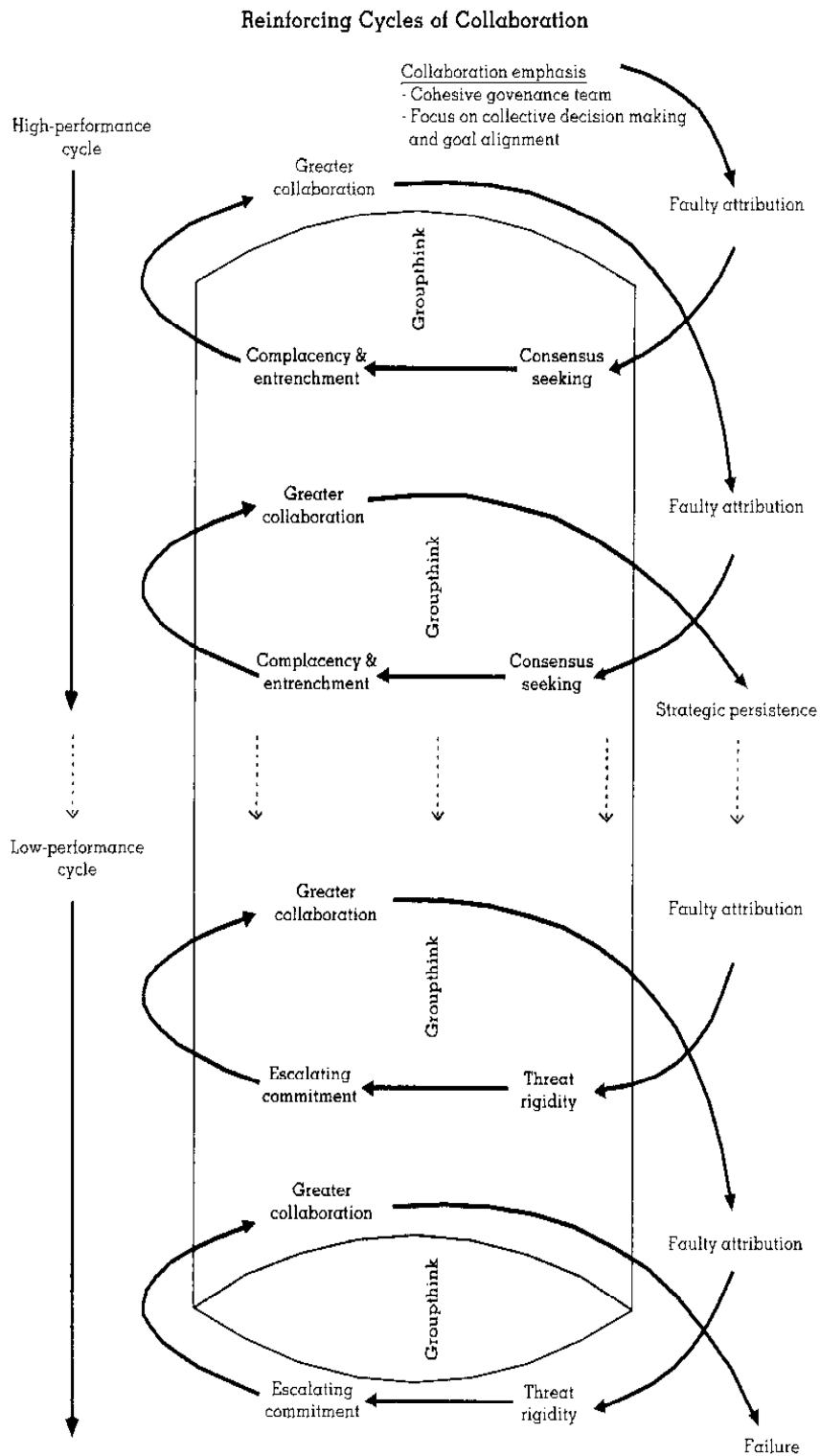
Sundaramurthy and Lewis further cite research from Kahneman and Tversky (1979) in relation to their Prospect Theory which highlights that, if faced with a loss making situation, rather than accept the loss as a sunk cost, actors are more likely to take greater levels of risk given natural tendencies for an aversion to loss. Sundaramurthy and Lewis are highlighting a scenario almost identical to that described by Whyte (1993) with respect to his prospect polarisation theory discussed previously in this thesis.

In summary the authors make two propositions:

Proposition 1a: Firms with a history of high performance and a predominant emphasis on collaboration will experience reinforcing cycles that foster strategic persistence.

Proposition 1b: In a low-performance context, firms with a predominant emphasis on collaboration will experience reinforcing cycles that foster organizational decline.

Figure 2.4: Sundaramurthy and Lewis model of re-enforcing cycles of collaboration



The representation of the model reflects the central part which groupthink and associated high levels of cohesiveness plays in creating an environment which fosters strategic persistence leading ultimately to a poor outcome.

2.9.4.3 Control over Collaboration in a high performing cycle

In this scenario Sundaramurthy and Lewis focus on a board environment in which control (agency theory) dominates. They argue that an overemphasis on the control function will create tension and distrust leading to a suppression of information and a lack of co-operation between board members.

In the high performance cycle, the authors argue that distrust resulting from an overemphasis of control would suppress stewardship, create board polarisation, and encourage myopic behaviour which would result in strategic persistence leading to a downward spiral of performance. The authors argue that the effect of high levels of distrust on high achieving board members would be for board members to reduce their desire to collaborate, and to engage in more self-serving behaviours, and to become increasingly withdrawn and resistant. This then leads to a polarisation and isolation amongst board members: “Managers may attempt to isolate themselves from the source of their frustrations, increasing their emotional distance from the board and external monitors ... polarized groups become immersed in their own activities, fragmenting understanding of outsiders’ demands and insiders’ operations into different ‘thought worlds’ that are difficult to integrate. This challenge intensifies as directors and executives become overconfident in successful times and less likely to seek and consider others’ advice” (2003, p. 405).

Over time, polarisation and isolation of group members will lead to myopic behaviours. This leads to isolation, reduces access to divergent opinions and better quality information leading to a poor decision process: “As directors and executives become more polarised and myopic, the firm will have greater

difficulty responding to environmental changes in a timely and effective manner” (2003a, p. 406).

2.9.4.4 Control over Collaboration in a low performing cycle

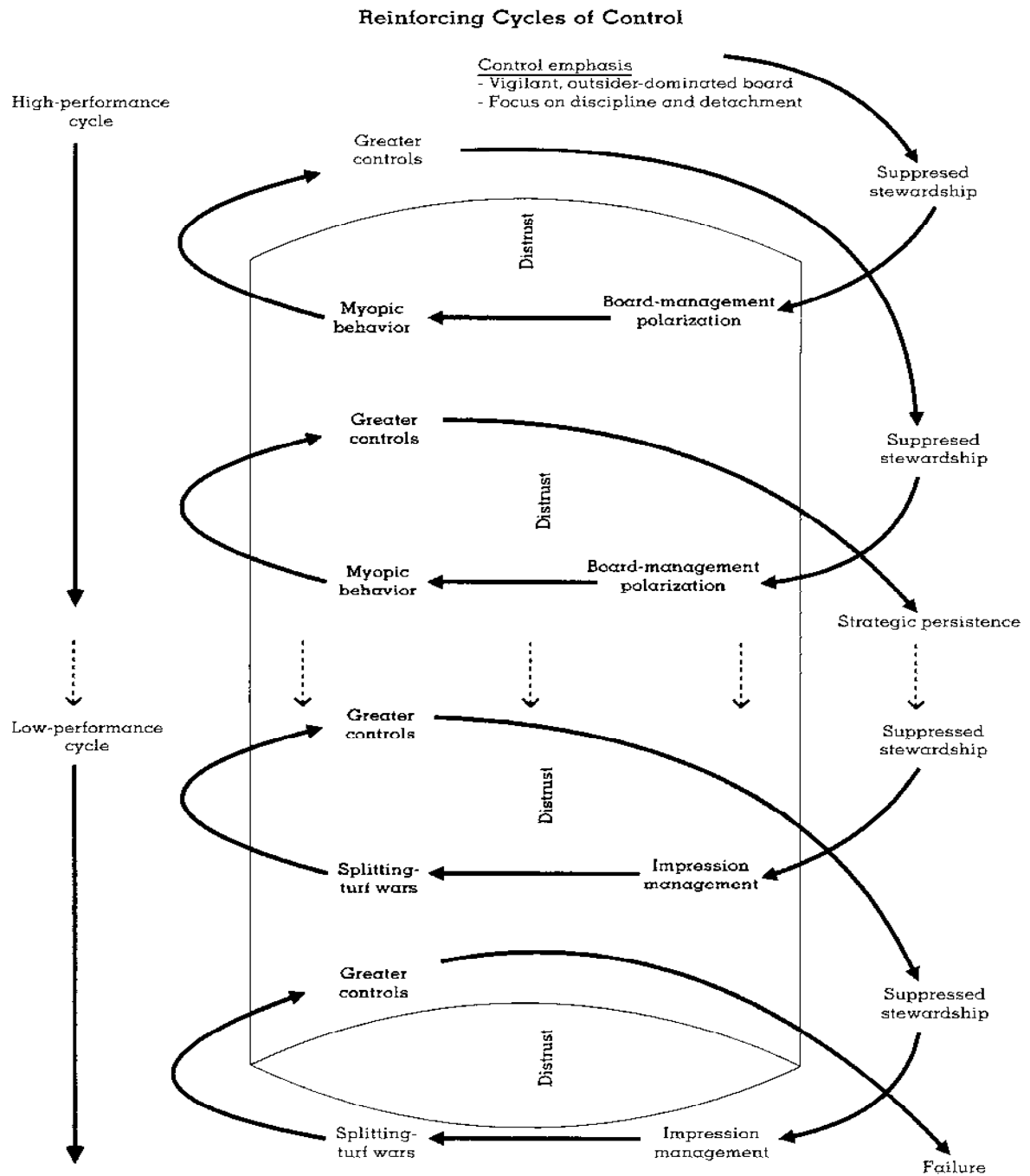
Sundaramurthy and Lewis explain that a low-performance cycle will be characterised by low levels of self-efficacy and close monitoring and distrust which will further exacerbate low confidence levels. This will create an environment in which managers are less likely to discuss problems with other managers as this might be seen as a sign of weakness and a perceived lack of ability (Sundaramurthy and Lewis, 2003; Westphal, 1999). Further, managers are less likely to seek inputs from outside board members for fear of being viewed as incompetent (Jones and George, 1998; Sundaramurthy and Lewis, 2003a). As performance declines, Sundaramurthy and Lewis (2003) argue that further divisions and factions will occur in organisations creating “we/they” distinctions and as the threat of dismissal rises, focus on protection of power and the existence of “political turf wars” (*ibid*, p.406).

Further, Sundaramurthy and Lewis describe a self-fulfilling prophesy where organisations faced with a downward performance cycle and an uncertain/unstable environment manage this risk by increasing and further emphasising the control function, intensifying distrust and exacerbating the situation, creating a “pathological spiralling relationship” (*ibid*, p. 407). In such a downward spiral, management will focus attention on defending their prior actions rather than trying to find alternative solutions.

In summary, Sundaramurthy and Lewis identify a scenario in which the control function is overemphasised in both a high and low performance cycle leading to an environment characterised by distrust. In the high performing cycle environment this leads to group members becoming polarised and can lead to myopic decision processes given asymmetric information and a lack of

collaboration. In the low performing cycle, the lack of trust and low confidence levels leads to poor communication, as directors are concerned that asking questions and sharing information could be seen as a signal of incompetence. A self-fulfilling spiral then occurs when the response to poor performance is an increase in the control function, which then increases levels of mistrust and poor communication. This is depicted below:

Figure 2.5: Sundaramurthy and Lewis' model of re-enforcing cycles of control



2.9.5 McNulty, Florackis and Ormrod “Boards of Directors and Financial Risk during the Credit Crisis” 2013

McNulty et al.'s (2013) model describes the effect of board attributes on financial risk taking into consideration the recent financial crisis. This model is presented in light of evidence gathered from the results of a questionnaire completed by 141 CEOs of companies in the UK. The survey was conducted in 2008 and was undertaken with a focus on companies outside the financial sector. The model presented by McNulty et al. (2013) draws very heavily from earlier work from Zahra and Pearce (1989) and Forbes and Milliken (1999) in identifying four key hypotheses which are noted below:

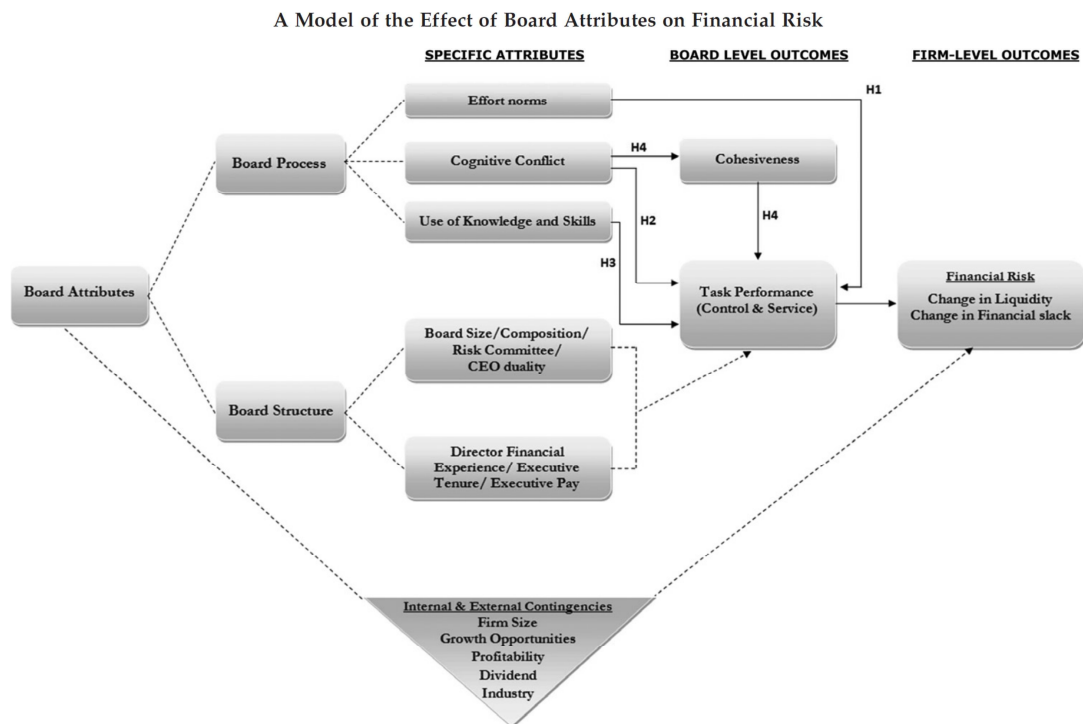
Hypothesis 1: Boards characterised by high effort norms will be less likely to engage in excessive financial risk taking.

Hypothesis 2: Boards characterised by relatively high levels of cognitive conflict will be less likely to engage in excessive financial risk taking.

Hypothesis 3: Boards who use their knowledge and skills to a high degree will be less likely to engage in excessive financial risk taking.

Hypothesis 4: The (negative) impact of cognitive conflict on financial risk is less pronounced in cohesive boards.

Figure 2.6: McNulty et al.'s model



The representation of the model above reflects the strong influences of the Zahra and Pearce (1989) and the Forbes and Milliken (1999) models. The board processes identified above namely: effort norms, cognitive conflict and use of knowledge and skills are identical to those used by Forbes and Milliken, as is the inclusion of both the impact of cognitive conflict and cohesiveness on board processes. Further, the model recognises the importance of context in affecting firm-level outcomes, consistent with Zahra and Pearce (1989) and indeed uses the exact same language “Internal and External Contingencies” as was introduced by Zahra and Pearce.

The McNulty et al. (2013) model is similar to that which I am intending in that it looks to combine the emphasis of context from Zahra and Pearce and the impact of psychology as stressed by Forbes and Milliken. Another similarity is that their model is tested in the field, albeit through a series of questionnaires, whilst I have conducted interviews. What follows below is a discussion of the four hypothesis in light of McNulty et al.'s questionnaire findings:

Hypothesis 1 stated that that if boards were characterised by high effort norms they would be less likely to engage in excessive financial risk taking. The survey results found support for this hypothesis. High effort norms were identified by Forbes and Milliken (1999) as a key attribute affecting board performance, the principle being that if board members do not put in the necessary time and effort, they will be underprepared and unable to contribute effectively. Indeed, the Walker Report (2009) recognised the need to create a minimum effort level amongst NEDs when it recommended that NEDs of FTSE 100 finance companies should dedicate a minimum of 30-35 days each year to each directorship and that the chairman of such entity should dedicate about two thirds of his/her time to the entity (recommendation 3 and 7 of the Report) .

The principle that high effort levels will result in board members who are better prepared, with more relevant information and who are less likely to accede to information pressures to herd, is consistent with the model which I will propose in chapter 6. As my model will highlight, an unprepared director would be more susceptible to informational pressures to conform which could have the knock on effect of making the board more cohesive and confident. This would then increase normative pressures on decision processes. Normative pressures include a greater risk of group polarisation resulting in a more risky decision process²⁹.

Hypothesis 2 above stated that boards characterised by relatively high levels of cognitive conflict will be less likely to engage in excessive financial risk taking. Again, the results from the questionnaire were supportive of this hypothesis.

²⁹ My model does not explicitly mention “high effort levels” but rather will refer to the functional and firm specific knowledge of directors. However, it is submitted that a director’s firm specific knowledge will be a function of the effort level that directors put into the firm and that the concept of “high effort levels” as highlighted by Forbes and Milliken (1999) and McNulty et al. (2013) are recognised (indirectly) in my model.

McNulty et al.'s research finding that boards characterised by high levels of cognitive conflict and higher levels of boardroom challenge are less likely to engage in excessive risk taking (and a poor decision process), is consistent with the conclusions from my review of the literature which identifies observable characteristics, such as high levels of cohesiveness and homogeneity as factors which might reduce cognitive conflict.

Hypothesis 3 stated that boards that use their knowledge and skill to a higher degree will be less likely to engage in excessive risk taking. McNulty et al. (2013) found no support for a correlation between firms who use their knowledge and skills and the level of risk taking by financial boards in the lead up to the crisis³⁰. The authors offer no reason or explanation as to why this might be the case. However, it is submitted that a potential reason for this could relate to the fact that the questionnaires were directed just at CEOs, and their

³⁰ The paper measured the use of knowledge and skill of the firm by the results of a questionnaire answered by the CEO. Relevant questions relating to the use of knowledge and skill in the questionnaire being:

1. NEDs use their skills and knowledge to contribute to board tasks.
2. The executives seek to fully involve the board in any strategic process and decision.
3. The board is appropriately involved in the company's strategy.
4. NEDs actively participate at board meetings to the best of their ability.
5. When an issue is discussed, the most knowledgeable people on that subject generally have the most influence.
6. Tasks on this board are generally delegated in a way that ensures the best fit between assigned task and each director's knowledge.

McNulty et al. (2013) measured change in financial risk by focusing on corporate liquidity in particular cash positions and considered that a firm's financial risk policy was low risk if a relatively high level of liquidity/financial slack was maintained throughout the crisis period.

answers to the relevant questions may also be subject to self-serving biases particularly in relation to CEOs with a directive leadership style. Moreover, CEOs answering the survey might *believe* that they are using their knowledge and skill and yet still be unaware that they are influenced by these powerful psychological forces that impact decision processes. In other words, CEO's answering the questionnaire may not have been consciously aware of how these normative pressures to conform had affected the decision process.

Hypothesis 4 stated that cognitive conflict on financial risk is less pronounced in cohesive boards. McNulty et al. (2013) found support for this hypothesis and concluded that although board cohesiveness alone did not affect financial risk directly, it affected it indirectly through the variable of cognitive conflict. Boards that were cohesive had lower levels of cognitive conflict but greater levels of risk taking, and that cognitive conflict as a result was less pronounced in cohesive boards.

The conclusion that cohesiveness leads to lower levels of cognitive conflict, and that the absence of cognitive conflict can result in greater levels of risk taking, is consistent with the model which I will propose which will highlight the inter-connection of the observable attributes, including cohesiveness that leads to the greatest risk of a poor decision process. In summary, the findings from the CEO questionnaire can be reconciled back to the model of poor decision processes which I will present.

2.9.6 Summary

The purpose of this section of this chapter was to review and analyse existing and well established models that link board characteristics to firm performance. Five separate models were identified for this analysis and the justification for their selection was provided. These models do not represent an exhaustive list of comparable models but rather an excellent cross-section of published

research from which to review the intended model which I will present. Although the selection of these models can be criticised as being self-selective, a comprehensive review of the related literature did not identify an existing model which would challenge the originality of my proposed model which focuses on the way in which normative and informative influences can combine together to affect a board's decision process. My model of VPDP which is presented in chapter 6 will include a discussion of how it can be differentiated from the models identified, and discussed, above.

2.10 The Global Financial Crisis and Corporate Governance

The UK is acknowledged as “a world leader on corporate governance reform” (Solomon, 2013, p. 47) but despite this, many UK and Irish financial institutions failed spectacularly in the crisis. These failures are an enigma in that they occurred despite the strengthening of the concept of director independence since the Cadbury Report in 1992. Independent boards should result in more effective monitoring and better quality decision making and yet widespread failures in such governance occurred failures occurred despite a strengthening of NED independence.

Failures in corporate governance related to the crisis are widely recognised. The Organisation for Economic Cooperation and Development (OECD) commissioned a fact finding study to understand the causes of the financial crisis in 2009 in which it concluded that “the financial crisis can be, to an important extent, attributed to failures and weaknesses in corporate governance arrangements” (Kirkpatrick, 2009, p. 2).

This view is shared by the US Commission into the financial crisis: “We conclude dramatic failures of corporate governance and risk management at many of the systematically important financial institutions were the key causes” (Angelides et al., 2011, p. xviii). The report went on to note that their

examination “revealed stunning instances of governance breakdowns and irresponsibility (*ibid*, p. xviii). The Association of Certified Chartered Accountants concluded that “the credit crunch can be viewed in large part as a failure in corporate governance” (Moxey and Berendt, 2008, p. 1). Further, the International Corporate Governance Network’s statement on the crisis also recognised that failures in corporate governance were at the heart of the crisis and concluded that “enhanced governance structures should therefore be integral to an overall solution aimed at restoring confidence and protecting us from future crises (ICGN, 2008, para 1.2). The World Bank (Ard and Berg, 2010) concluded that: “If there is one lesson from the current crisis it is that corporate governance matters. The central irony of the governance failures in this crisis is that many took place in some of the most sophisticated banks operating in some of the most developed governance environments in the world.

Zhao (2011) links the failure in governance specifically to failures of the independent NED in monitoring management: “The current financial crisis provides strong evidence that our endeavours in decades to promote board independence failed to either stop management from taking too much risk or curb the spiral increasing of executive remuneration” (*ibid*, p. 116).

Indeed, significant emphasis has been placed in both the “popular” press and in academic literature as to the role that “greedy” executives played in the crisis, highlighting the level of remuneration received and their incentive to “keep dancing as long as the music was playing” (see for example Cassidy (2009) and Stiglitz (2010)). Less attention, particularly in popular literature, has been given to the failure of NEDs, who accounted for more than half of the board and whose incentive was not primarily financial but rather, as Fama and Jensen (1985) highlighted, to maintain and build their reputational capital. In other words, independent NEDs failed in their role of monitoring the executives and in providing the necessary “hand-brake” against excessive risk taking by executives.

Sonnenfeld (2002) argues that perhaps the most important determinant of a good board is the capacity for board members to challenge assumptions and beliefs. He observes: “I am always amazed at how common groupthink is in the corporate boardroom. Directors are, almost without expectation, intelligent, accomplished, and comfortable with power. But if you put them in a room that discourages dissent, then they nearly always start to conform” (*ibid*, p. 111). Sonnenfeld argues that boards need to create and foster a culture of open dissent where dissent is not seen as disloyalty and that silent board members should be probed for their opinions and that good boards must even have a “good fight” now and then. Further, Forbes and Milliken (1999) argue that conflict will prevent groupthink by fostering an environment characterised by a tolerance of multiple viewpoints and opinions.

Harrington (2010) in an extensive study of over 1200 investment clubs in the US found that high performing clubs were characterised by significantly more dissent than low performing clubs and that the vast majority of votes in low performing clubs were unanimous when a member’s proposal to buy or sell a stock was voted on. In contrast, members of high performing clubs are more likely to openly debate each other’s ideas so that fewer of their votes pass without dissent. Low performing clubs almost never allowed their member’s proposals to fail whilst high performing clubs did so routinely. Although investment clubs are different in nature to board rooms this research does highlight the importance of dissent to high quality decision making.

This failure of NED’s to monitor management was, however, recognised in the UK Select Committee on Treasury (2009) when it concluded: “The current financial crisis has exposed serious flaws and shortcomings in the system of non-executive oversight of bank executives and senior management in the banking sector. In particular, the evidence shows that many non-executive directors—in many cases eminent and highly-regarded individuals with no shortage of experience in the business and banking worlds—failed to act as an effective check on, and challenge to, executive managers. Too often non-

executive directors in the banking sector have operated as members of a 'cosy club' rather than viewing their role as being that of providing effective checks and balances on executive members of boards (*ibid*, para 151).”

The Walker Report (2009) was set up to review corporate governance in the UK in light of the failures in the lead up to the financial crisis. The Walker Report (*ibid*, p. 12) sets out the process by which board decisions should be implemented, namely:

- 1) presentation by the executive of a proposal,
- 2) a disciplined approach of challenge of the proposal,
- 3) a decision on the policy or strategy to be adopted,
- 4) full empowerment of the executive to implement the agreed strategy.

The report notes that “The essential ‘challenge’ step seems to have been missed in many board situations and needs to be unequivocally clearly recognised and embedded for the future” (*ibid* p. 12). The Report further recognises the pressure to conform within boardrooms and that this can reduce board challenge: “the pressure for conformity on boards can be strong, generating corresponding difficulties for an individual board member who wishes to challenge group thinking. Such challenge on substantive policy issues can be seen as disruptive, non-collegial and even as disloyal. Yet without it, there can be an illusion of unanimity in a board, with silence assumed to be acquiescence.” (para 4.3). An illustration of the lack of a boardroom challenge can be seen in three of the UK’s highest profile bank failures during the crisis, namely Royal Bank of Scotland (RBS), HBOS and Northern Rock.

RBS represents the most costly of UK bank failures with the UK government required in October 2008 to inject £45.5 billion of equity capital into the organisation. In an attempt to understand and learn from the mistakes made at RBS, the Financial Services Act produced in December 2011 a report titled “*The Failure of the Royal Bank of Scotland*”(FSA, 2011). This extensive report covering 450 pages analysis the failures at RBS covering the period from the ill-fated acquisition of Dutch bank ABN AMRO to when the Bank of England was

required to bail out RBS (the “Review Period”). Included in the Report is a chapter on “Management, governance and culture”.

The Report found no evidence of any procedural failures in the governance of the RBS board and indeed the FSA Supervisory team responsible for RBS had formed a positive view of RBS’s high level corporate governance arrangements (para 588). The Report therefore concluded that there was no evidence of a procedural failure of governance at RBS Board level during the Review Period. In other words, the RBS Board had ticked all the necessary boxes with respect to adherence with corporate governance best practice.

However the Report did recognise that, although there was no evidence of formal governance failings, the fact remained that the RBS Board were ultimately responsible for a sequence of decisions and judgements that resulted in its failure. The Report highlighted a few areas where the RBS board failed. These included remunerating, and hence incentivising, the then CEO to focus on increases in revenue and growth rather than on capital, liquidity and asset quality and also a siloed approach to risk management which meant that the bank was slow to assess the overall risks that the bank was running (para 592).

Additionally the Report also stressed the lack of boardroom challenge at RBS (*ibid*, para 592). The Report noted that: “The Review team was able to identify little significant disagreement on major issues during the Review Period in a Board containing tough and experienced individuals with successful track records. Clearly constant disagreement would have been debilitating for a board, but some divergence from consensus would not have been unhealthy” (*ibid*, para 593).

In particular the Report focused on the RBS acquisition of ABN AMRO, identified as a critical strategic error in RBS’s failure (*ibid*, para 227). It highlights that the acquisition was not well thought out, nor were the risks fully assessed and that the due diligence process was inadequate (*ibid*, para 594-600). However in this respect, the Report observed that: “During interviews with

the Chairman and other board members, it was indicated that, while the assumptions and plans were discussed on a regular basis at no stage did any Board member propose that we should not proceed. One former Board member reflected, with hindsight, that there was an element of 'group-think' in the Board's decision to acquire ABN AMRO and that, to his knowledge, no Board member ever said that he or she was worried about the deal. In the opinion of the Review Team, it is very difficult to reconcile this approach with the degree of rigorous testing, questioning and challenge that would be expected in an effective board process dealing with such a large and strategic proposition." (*ibid*, para 599).

Specifically with respect to the lack of RBS NED challenge, the Report noted that: "A number of RBS's non-executive directors told the Review Team during interviews that they had been able and prepared to challenge the executive. However, when asked, they gave few clear examples of proposals from the CEO or executive management during the Review Period which were substantially amended as a result of Board challenge." (*ibid*, para 612)

RBS provides an excellent case study highlighting an organisation which had complied with corporate governance codes and yet its failure was attributed to governance failures including a lack of challenge from its NEDs. Stephen Hester became CEO of RBS once the bank had been rescued by the UK government. Hester, however, provides a very useful insight into the need for dissent and challenge and the role that psychology can play in such a process when he commented: "Helping the company succeed does not always mean saying, yes, to the chief executive, it can mean a challenge, constructive challenge, but I have to tell you, I am not sure this is an issue of process. I think it is, unfortunately, an issue of humans and their behaviour" (House of Commons, 2009, Q. 1977). In other words, good corporate governance is about human behaviour and culture and less about "ticking the boxes" of the Combined Code.

HBOS, like RBS, needed to be rescued during the financial crisis³¹. In 2013 the UK Government published, as part of the Parliamentary Commission on Banking Standards a report on the failure of HBOS, titled: “*An accident waiting to happen*”: *The failure of HBOS* (Parliamentary Commission on Banking Standards, 2013). The report concluded that the board was entirely responsible for the failure of HBOS: “The losses were caused by a flawed strategy, inappropriate culture and inadequate controls. These are matters for which successive Chief Executives and particularly the Chairman and the Board as a whole bear responsibility” (*ibid*, para 134). In preparing the report the Parliamentary Commission interviewed a number of HBOS executives. The lack of a challenge to boardroom was identified as a key weakness in HBOS’s demise.

Sir Ron Garrick was the senior Independent director of HBOS from 2004 until the take-over by Lloyds Banking Group in 2009. In his written evidence to the banking standards he noted that: “Having a full day meeting (away from the office to avoid distractions) to discuss the plans gave the HBOS Board plenty of opportunity to challenge divisional plans and gain a greater understanding of the strategy and risks. In all of the discussions I do not recall any major challenge to the growth strategy from either the Board or senior management.”

Peter Hickman was not a main board director but had the title “Group Director of Risk” at HBOS reporting directly to the then CEO, Andy Hornby. In his written evidence to the Banking Standard Commission he noted that “On the basis of the board meetings I attended and other discussions, I was not aware of any contrary views [with respect to the aggressive asset growth policy] being expressed” (Parliamentary Commission on Banking Standards, 2012a).

³¹ HBOS was taken over by Lloyds Banking Group but the UK government was required to inject capital in the combined group to bolster capital as a result of losses suffered by HBOS in commercial property and exposures to sub-prime assets.

Finally, Peter Cummins was a main board director at HBOS in charge of commercial lending an area which was to experience significant losses in the crisis in relation to lending against over-valued commercial properties. In 2012, the UK Financial Services Authority fined Cummins £500 000 and banned him for life from working in the financial services industry. In his oral evidence before the Treasury Commission the following exchange was recorded between Cummins and Rory Philips QC:

“Rory Phillips: “Was there any point when the board said to you: “No hang on a minute?”

Mr Cummings: No.” (Parliamentary Commission on Banking Standards, 2012b, Q. 1345)

Northern Rock was another UK Bank that failed in the crisis, requiring it to be fully nationalised by the UK government³². The House of Commons Treasury Committee produced a report titled *The Run on the Rock* (House of Commons Treasury Committee, 2008) in January 2008 to report on the cause of the bank’s collapse. As with RBS and HBOS, the report found that the directors were responsible for the bank’s demise with the report highlighting the failures of the Chairman and NEDs in particular: “The non-executive members of the Board, and in particular the Chairman of the Board, the Chairman of the Risk Committee [an NED] and the senior non-executive director, failed in the case of Northern Rock to ensure that it remained liquid as well as solvent, to provide against the risks that it was *taking and to act as an effective restraining force on the strategy of the executive members.*” (*ibid*, para 31) (italics added).

A CEO and a board with low skill levels is more likely to make a poor initial decision/recommendation - the starting point of the model itself. Therefore low

³² Indeed Northern Rock were the first UK bank requiring a bank bailout and also the first retail bank run on retail deposits in the UK for over 150 years when retail depositors queued to take their funds out of the bank in the week beginning September 14, 2007.

functional and firm specific skill level will exacerbate the likelihood of a poor decision process.

A further impact of the lack of skill relates specifically to the gatekeepers in the board, namely the NEDs. If NEDs do not have the necessary knowledge and expertise, they are more likely to rely on, and accede to, the judgement of the executive directors and to herd. Herding is a result of informational pressure when group members squelch their own information in the belief that others have superior information (see for example (S. E. Asch, 1955) or (Robert J Shiller, 2008)). One of the driving forces for such a decision is a belief that there is asymmetry of information and that some board members have superior information. The belief that certain members have superior information comes from a perception of a relative lack of knowledge compared to other actors. This may occur because of a lack of functional and firm specific expertise or a lack of access to relevant information (or indeed a combination of all of the aforementioned).

This point is well illustrated by Finklestein and Mooney (2003). They interviewed thirty two board members for their seminal research paper. One of the respondents highlighted the link between informational asymmetry and the lack of boardroom challenge related specifically to the specific director's lack of timely access to information: "I often get the board packet the night before I leave for the [board] meeting so I don't have enough time to fully understand the issues. As a result, I am less likely to challenge what's going on and more likely to defer to the CFO." (p 104)

A NED who has low firm specific and functional knowledge is more likely to accede to the opinion of the executives on the board. The consequence of this being a board that will be more cohesive, with fewer boardrooms challenges. This lack of dissent can then lead to higher levels of confidence amongst executives who interpret the lack of a challenge as a sign of confidence. Low firm and functional skill levels amongst NEDs will lead to higher levels of

cohesiveness, less board challenge leading to increased levels of confidence. Indeed, the lack of functional and firm specific knowledge of NEDs was highlighted in the Walker Report (2009) as an important contributing factor in explaining governance failures in the UK banking sector in the build up to the financial crisis.

A very similar picture of a failure of NED challenge is revealed in a review of the Irish bank failure. The Nyberg Commission (2011) also highlighted a lack of a challenge from NEDs and in particular with respect to Anglo Irish Bank and Irish Nationwide (para 2.10.2 and 2.5.11 respectively.) Overall the Commission concluded that “On [Irish] Boards there appears to often have existed a collegiate and consensual style with little serious challenge or debate”(para 5.24). Further and related to this lack of challenge the Nyberg Report (2011) specifically highlighted the lack of expertise of the NEDs in the Irish banks as a contributing factor towards their lack of boardroom challenge (ibid, p. 49)³³.

The evidence from the various inquiries into the failures of the UK and Irish banks, as noted above, all highlight the responsibility of the board and in particular NEDs and their inability to challenge management’s strategies. These boardroom failures, however, took place in an environment of increased focus and attention on corporate governance codes.

2.11 Criticisms of corporate governance research

The contradiction as to why improved corporate governance codes, principles and structures could not have prevented the widespread failures in corporate governance has renewed and strengthened calls for a fundamental change in how we approach “the dismal science” (Pitelis, 2004) of corporate governance. Diplock (2012) claims that there is a need for “a paradigm shift in thinking” and

³³ This lack of board expertise is explored in greater detail later in this thesis.

that corporate governance reform is “one of the biggest post-financial crisis the world faces” (*ibid*, p. 239). Ahrens et al. (2011) argues that the recent financial crisis was a huge natural experiment which has “exposed gaps in our knowledge of corporate governance and should lead to a rethink of the central principles of corporate governance”.

Indeed, I have identified widespread criticism of the way in which researchers have approached research into the field of corporate governance. This criticism is levelled in two specific areas. First, those that have questioned the value of existing corporate governance research and in particular the legitimacy of using large data sets to make sweeping conclusions about board effectiveness without understanding the dynamics of individual boards. Second, those researchers that have called for greater recognition and awareness of the psychological and behavioural factors that affects boards when recommending governance reforms. These criticisms are discussed below.

Roberts et al. (2005) have questioned the relevance of trying to assess the impact of director independence on performance through the use of statistics and in particular the use of large sets of publicly available information which are removed from the reality of how individual boards might operate. “Whilst researchers remain wedded to the testing of theoretical models and assumptions against large quantitative data sets, they remain at considerable distance from the objective of their inquiry and, as a result, are inevitably obliged...to make huge inferential leaps. In our view, for theory to ‘go behind the backs’ of practitioners (Giddens, 1984) is to risk irrelevance or worse” (*ibid*, p. 20).

Huse (2005) argues that researchers often default to using large data sets in research as a path of least resistance and that “doctoral students and scholars in tenure track positions have preferred research using easily available data sets and methods that can be evaluated by journal reviewers through well-established validity concepts” (*ibid*, p. 66). However in Huse’s views these

studies tell us very little about what really happens in boardrooms, how relationships between directors are formed, how CEO's engage with external directors and how inter director relationships effect decision making.

Ahrens et al. (2011) observe that "no matter how we put it corporate governance research is not satisfactory" (*ibid*, p. 313). The authors focus on the strong incentives for academics to publish "marginal articles" plagued with unclear and inconsistent measurement problems and performance goals and asks: "What will the next generation of corporate research bring? Will we see another 5-10 000 published papers with as little value added as in the past two decades? Or will corporate governance research mature to generate more useful results?" (*ibid*, p. 322).

Gabrielsson and Huse (2004) observes that archival based studies looking at large sets of data comparing information such as the ratio of inside to outside directors, the number of board members and director share ownership have dominated corporate governance research. Gabrielsson and Huse analysed all the articles on corporate governance between 1990-2002 that had been published in six highly rated journals, namely; *Academy of Management Journal*, *Administrative Science Quarterly*, *Journal of Management*, *Strategic Management Journal*, *Journal of Management and Governance* and *Journal of Management Studies*. In total they review 127 published articles on corporate governance. Their analysis revealed than in 91 of the 127 articles (72%) archival data was primarily used to generate research findings whilst 27 (21%) had collected data from questionnaires and only 5 studies data was collected from direct interviews³⁴.

It is submitted that one possible contributing factor accounting for the paucity of direct interview research is the difficulty in securing access to bank board

³⁴ The balance of the research was a combination of both questionnaires and the use of archival data.

members, and in particular the inability of researchers to observe bank boards in operation. That is, access to the “black box” of bank boardrooms has been restricted.

Furthermore, Gabrielsson and Huse (2004) noted that only 13 articles (5%) focused on the field of behavioural economics. The authors concluded that research into boards was at a crossroad and that: “Frustrated by weak and ambiguous findings, scholars have emphasized the need to critically question the models and theories that so far dominate the field ...However, despite these calls, there have been few alternatives to develop alternative research directions.” (*Ibid p. 23*). Gabrielsson and Huse urge for more research into the behavioural aspects of boards and governance.

Gabrielsson and Huse’s article was written in 2004, and I have been able to find very little evidence of greater emphasis of such research since that date leading up to the financial crisis. A possible explanation for the lack of behavioural focused research is that corporations were perceived to be doing extremely well in the lead up to the crisis and a need to search for a new emphasis in governance research was perhaps considered unnecessary. The crisis itself, however, has highlighted the importance of the field of behavioural economics generally³⁵ and specifically in relation to corporate governance failures as highlighted by the Walker Report (2009). It is anticipated that there will be more research in this area (such as that which I am undertaking) going forward as Ahrens et al (2011) have urged. However interview based research which looks to observe and understand the “black” box of the inter reactions and dynamics of specific boards will, it is submitted, continue be restricted by lack of access to both board directors and to board meetings.

³⁵ For example, Robert Shiller has been jointly awarded the Nobel Prize for Economics in 2013 for his work in the field of behavioural economics and in particular in relation to the relevance of behavioural economics in the context of the credit crisis.

Indeed, Daily et al. (2003) argue that the real challenge facing researchers is gaining access to the type of information that will truly enhance our understanding of the effectiveness of governance mechanism, and that involves a better understanding of how boards operate. Finkelstein et al. (2008) further suggest that the emphasis on empirical data focused research is wrong and that a simple count, using large data sets, of insiders versus outsiders is irrelevant and that the focus should be on the interactions among board members and how this influences their effectiveness in fulfilling the key roles and counsel for monitoring. In their view, one should not look at the effectiveness of board independence in such a one dimensional and sterile way by simply looking at the number of independent directors at various companies and from that, making broad judgements about board effectiveness. Research focus on the number of independent directors as the proxy for board effectiveness is misguided.

In summary, researchers have focused too much on trying to understand board effectiveness by reviewing the inputs (such as number of independent directors) and then trying to make assumptions about outputs (such as financial performance) whilst ignoring the “black box” of what actually happens in the boardroom itself. An alternative approach to corporate governance research must be one focusing on the behavioural aspects of boards and the relative dynamics between the various actors in a specific boardroom setting.

The Walker Report (2009) explicitly recognised the role and understanding of the role that human behaviour plays in more effective corporate governance and that rules and regulations are inadequate: “Improvement in corporate governance will require behavioural change in an array of closely related areas in which prescribed standards and processes play a necessary but insufficient part” (*ibid*, p. 9). The Walker Report includes in Appendix 4 a section on the “Psychological and behavioural elements in board performance” which was prepared for the report by an independent think tank. Interestingly, this “sub-report” made two recommendations to the Walker Report. First that there

should be a full independent psychological assessment of the board focusing on aspects of behaviour, experience, knowledge, and motivation and second, that all NEDs should be trained in the area of group dynamics. Neither of these two suggestions however, forms part of the thirty one suggestions that the Walker Report recommends. This perhaps highlights that legislators are more aware of the need to take psychological factors into consideration when discussing corporate governance, but also that more work is needed to move such recognition from the appendices to core recommendations. A full discussion of recommended reforms is discussed later in this thesis.

Hall (2007) notes that despite the developments in the field of cognitive and social psychology and recent developments in the field of neuroscience, corporate law has made little progress in incorporating behavioural principles into the understanding of corporate decision making. The assumptions underlying corporate law and corporate governance are based on the principle of rationale decision making and do not recognise that psychological factors affect rationale decision processes.

Langevoort (1998) highlights how the rationale actor has come “to dominate predictions about how normal persons and groups will respond to legal incentives” (*ibid*, p. 1499). Langevoort’s observation is linked to the wider debate as to the relevance and applicability of the efficient market hypothesis in economic models and whether economic decisions are made as a result of rationale behaviour alone rather than being influenced by human psychology and that economic decisions are not always rationale.

Sun et al. (2011) argues that corporate governance frameworks and reforms are better addressed by multidisciplinary studies, more holistic thinking and greater levels of contextual understanding: “Many people tend to examine corporate governance issues narrowly in terms of rules, institutions, positions, actors, behaviours and activities within a particular corporate governance framework ..rather than reflexively of understanding what lies behind the

appearance of structure and action constructed by certain beliefs, values, cultures, ideologies and social conventions, and why and how structure and action have been formed in the first place. Thus, although some technical issues might have been addressed and corporate governance improved the fundamental problems indiscernible by traditional static and mechanistic modes of thinking are still there and little touched.” (*ibid*, p. 18)

Cox and Munsinger (1985) highlight how cognitive and psychological factors can impact the effectiveness of legislation when trying to ensure independence of mind in the boardroom. They argue that even if NEDs are economically independent of the firm and are free from any financial conflict of interest, it does not necessarily follow that they will be efficient monitors of management and guardians of corporations’ best interests. NEDs are still susceptible to in group biases.

Cox and Munsinger (1985) stress the social influences on individuals in a group setting and in particular the strength of the attraction of the group and the high value that group members place on membership. It is the enhanced self-esteem which is derived from being a member of a select group contributes toward board cohesion and conformity within a board. A 1995 Korn/Ferry³⁶ study of U.S. board members highlights this fact. In the survey, outside directors were asked “what was the most important factor in deciding whether to join a board?”. The majority of answers received were not the soundness of the balance sheet, or the opportunities for directors to make a contribution, but rather the identity of other board members. It was the attraction to others that was the most important factor in deciding to join a board. As Cox and Munsinger (1995) note: “The reward is non-monetary, prestige, influence, and pleasure associating with other successful people, to work with others that they admire and want to work with and get better acquainted. These preferences are

³⁶ Survey unseen, cited by Dallas (1997).

a manifestation of the inherent drive for affiliation and companionship which motivates people to seek identity with a group” (*ibid*, p. 94).

Further, such cohesion and resulting conformity can become stronger over time as the shared perception of mutual agreement enhances mutual attraction and creates even more conformity. Cox and Munsinger conclude that: “Taken together powerful psychological forces are at work within the boardroom, creating a cohesive, loyal, conforming in-group that will support its membership” (*ibid*, p. 99). Cox and Munsinger (1995) are highlighting the risk of groupthink in group boards and that psychological factors, and in particular the attraction to the group, will affect decision making even if directors are technically “independent”.

Maharaj (2008) argues that attention to the behavioural characteristics of board members has the potential to reduce a groupthink mentality on boards. He argues that it is ironic that academic research in corporate governance has focused on improving and implementing formal rules and regulations whilst the board of directors have been treated as a black box with little understanding of how board actual function. He concludes that “formal rules and regulations are inadequate, they have little effect upon decision making by board members” (*ibid*, p. 72).

Sonnenfeld (2002) similarly argues that we need to focus not only on formal rules and regulations but how we manage the social structure of boards: “We’ll be fighting the wrong war if we simply tighten procedural rules for boards and ignore their more pressing need - to be strong, high functioning work groups whose members trust and challenge one another and engage directly with senior managers on critical issues facing corporations” (*ibid*, p. 104). Dallas (1997) also calls for board reform to recognise the impact of social influences on boards composed of both independent and executive directors and that what is required is “an understanding of the social psychology of groups” (*ibid*, p. 104).

The Group of Thirty (G30) is a private, non-profit body composed of senior representatives of the public and private sector and also academia. In 2012 they published a paper titled “Towards Effective Governance of Financial Institutions” (G30, 2012) as a contribution to the debate of how to achieve effective governance in financial institutions. The steering Committee that produced the paper included a former Board of Governor from the Federal Reserve Bank, a Former US Comptroller, a senior advisor to Citigroup, and the author of the Walker Report (2009) - Sir David Walker a former chairman of Morgan Stanley.

The G30 concluded that governance at financial institutions was not the sole contributor to the global financial crisis, but it was a significant contributing factor and that effective governance can help to prevent future crises from occurring or at least mitigate their impact. The report focused on the need to focus on behavioural aspects of boards and concluded that: “Behavior appears to be key and a focus on the right behaviour means a shift from the ‘hardware’ of governance (structures and processes) to the ‘software’ (people, leadership and values)” (*ibid*, p13). The paper recommends a focus on the culture and values within organisations starting with the board of directors and working its way through the organisational structure. The paper concludes that that good governance is imbedded in the organisational fabric (*ibid*, p. 14) and it encourages regulators to broaden their perspectives to include a review of the people and culture of regulated entities (*ibid*, p. 15).

2.12 Diversity Research

The lack of adequate diversity in the boardroom of financial institutions in the lead up to the crisis has been identified as a contributing factor to the crisis (see for example Lagarde (2010), Rost and Osterloh (2008), Desvaux et al. (2007), Kristof (2010) and The Walker Report (2009)). Given this, a discussion

of the literature on the impact of diversification in the context of the corporate board is considered appropriate.

Williams and O'Reilly (1998) identify three different theories underpinning diversity research; social categorisation, similarity attraction (or homophily) and informational/decision making theory. Social categorisation theory (Turner et al., 1987) argues that individuals have a desire to maintain high levels of self-esteem and to do this they must compare themselves to others. In order to do this effectively, individuals first define themselves and others through a process of self-categorisation and classify actors into "out" and "in" groups. In-groups are considered more trustworthy, and individuals seek to maximise interaction with in-group members and to view out-group members with distrust. Groups then look to drive out or remove individuals who don't conform to the in-group (see for example (Schneider, 1987) and (Bantel and Jackson, 1989)).

Similarly attraction theory argues that individuals who are similar in backgrounds and share common experiences naturally enjoy interacting with each other. Similarity theory is imbedded in the principles of homophily (see for example (McPherson et al., 2001)) and the view that when individuals can chose who to interact with, they will chose those who are similar to themselves. Kanter (1993) refers to a process of "homosexual reproduction" in the workforce whereby top management look to hire others who are similar to themselves. Dissimilarity, however, often results in group processes and performance losses including less positive attitudes of the group, less frequent communication and a higher likelihood of turnover from the group.

Finally, information/decision making theory is based on the concept that individuals in diverse groups may have access to information networks outside their work group and that this added information will enhance group performance. Increased information enhances the ability of the group to generate both more creative and accurate solutions to problems. Further, diverse groups offer more creative solutions and show a greater inclination for

critical thinking and provide a greater variety of perspectives which will help to trigger “kaleidoscope thinking” and combat groupthink (Ramirez, 2000).

Williams and O'Reilly (1988) contend that social categorisation and similarity/attraction theory argue for the benefits of homogeneity in group process but that informational theory, on the other hand, makes the opposite prediction and highlights the benefits of diversity achieved through increased skills and access to more information.

Indeed, diversity has been seen by researchers as being a “double edged sword” (Forbes and Milliken, 1999). Diversity will increase the level of sources and information at the group's disposal (informational diversity) but at the same time diverse groups are more likely to be less integrated, have higher levels of conflict, higher group turnover and lower levels of integration (related to the theories of social categorisation and similarity attraction).

This double edge to diversity is directly related to the curvilinear relationship between cohesiveness and firm performance as discussed earlier in this chapter with respect to Forbes and Milliken's (1999) model. Cohesiveness can improve trust and co-operation leading to better communication and co-ordination of ideas and to better decision processes. However too much cohesion increases the vulnerability to groupthink where the cohesion and collegiality of the group outweighs the quality of the decision process itself. There is, therefore, also an inverse relationship between diversity and cohesiveness. The more diverse a board, the less likely that it will be cohesive. This inverse relationship may however weaken over time and a diverse group can become increasingly cohesive as the group bond strengthens and a sense of group identity develops.

Langevoort (2000) argues that the key to an effective board is maintaining a balance so that the most productive boards are those that have enough diversity to encourage the sharing of information and the active consideration of alternatives, but at the same time are not so diverse that the board struggles to

function effectively and harmoniously. Diversity benefits decision processes by enhancing cognitive conflict and spurring greater debates and varied skills and experiences will increase the range of information and bring different perspectives or mental models to discussions (Sundaramurthy and Lewis, 2003). However boards that are too diverse are often characterised by high levels of socio-emotional conflict and a lack of co-operation and communication between group members (Amason, 1996). The key it seems is balance, getting boards that are cohesive but not too cohesive and boards that are diverse but not too diverse.

However in the context of a corporate boardroom there should be a tendency to emphasise the informational benefits of diversity over the negatives outcomes associated with high levels of diversity. The rationale for highlighting the informational advantage of diversity is that the boardroom is different from a number of other group settings in three areas.

First, unlike many other group settings, executive directors have often worked at the organisation for some time, progressing through the ranks to the position of a board executive. As such, many executives often know each other for a period of time and would have worked together for long hours for a common cause, which would encourage higher levels of cohesion. Indeed, boards that have worked together for long periods are likely to experience lower levels of cognitive conflict³⁷ and reduced diversity as they are more likely to develop a shared understanding of the issues and a stronger in group bias. In contrast, board members who have only served together for a short time period are likely to have more diverse perspectives on issues (Forbes and Milliken, 1999).

³⁷ Horwitz and Horwitz (2007) define cognitive diversity as the degree to which team members differ in terms of expertise, experience and perspective which will achieve true diversity rather than surface level demographic diversity which may not necessarily result in "true" diversity.

Second, the selection of new group members are made by the group itself (through the nominations committee) and as research has highlighted there is a natural homophilic bias to select those that are similar to themselves (Byrne et al., 1966).

Third, there is significant status and prestige associated with board membership (Korn/Ferry International, 22nd Annual Board of Directors' Study 24, 1995 cited by Dallas (1996)). The status and importance of being a part of such a prestigious group can increase cohesiveness and collegiality (Janis, 1972). Group boards are, in summary, characterised by a natural gravitation towards homogeneity and related cohesion.

Research findings which have highlighted the negative impacts of diversity are often the result of laboratory based research which relies on groups of University students often brought together at short notice, in a laboratory controlled and task specific experiment. This is a very different group setting to that of a corporate boardroom emphasising the importance of context.

Van der Walt et al. (2006) and Carpenter and Westphal (2001) highlight that the benefits of diversity need to be viewed in the context of the type of industry in which a firm is operating, and that greater diversity may be appropriate in turbulent environments characterised by strategic complexity³⁸. Diversity and variety of perspectives can contribute when decision processes are complex and where there is no one obvious solution. However, in very stable and less complex environments, the negatives associated with diversity can outweigh the positives. It is when decisions are complex that the group will benefit from diverse opinions, in less complex environments the benefits that diversity provides are not necessary and the decision process itself does not demand

³⁸ The point made by Van der Walt et al (2006) is consistent with the recognition of the industry type as an important external contingency affecting firm performance in the Zahra and Pearce model discussed previously.

diverse viewpoints³⁹. It is submitted that the finance industry is complex, unpredictable and volatile. Banking is therefore an industry which would benefit from a broad perspective of views in the solving of complex problems.

In summary, the risks in corporate boardrooms relate to the propensity for the board to have too little diversity and the associated risks, identified in my model, relating to vulnerabilities to a poor decision outcome. Although Langevoort (2000) highlights that boards should look for a balance between diversity and cohesion, it is extremely difficult to maintain this balance as the propensity in a boardroom will be a natural pull away from diversity and cognitive conflict towards collegiality, groupthink and related phenomena. This implies that managing diversity in the context of the boardroom is not a static process but needs to be reviewed dynamically over time.

In the UK, diversity in the boardroom has been encouraged. The Cadbury Report (1992) made recommendations that there should be a formal selection process for NEDs which would not only re-enforce the independence of NEDs but make it evident that they were appointed on merit and not through any form of patronage (para 4.15). The Higgs Report (2003) further highlighted the lack of diversity of UK directors, a consequence of what it highlighted as inadequacies in the selection process.

The Higgs Report undertook a comprehensive survey of NEDs and observed that almost half of the NEDs surveyed for the review were recruited through personal contacts or friendships. Only four per cent had had a formal interview, and one per cent had obtained their job through answering an advertisement (*ibid*, para 10.5). The Higgs Report recommended improvements to the nomination committee (recommended previously by the Cadbury Report) by

³⁹ Similarly, in a straightforward decision process the risks of groupthink leading to a poor decision process are diminished. That is not to say that groupthink might not occur, but the risk of a poor outcome in a straightforward decision process is diminished.

insisting that the nominations committee should consist of a majority of independent NEDs and also be chaired by a NED. The theory being that if the nominations process is controlled by independent directors, this would reduce the likelihood of a perpetuation of an old boys' network as highlighted by Kanter (1993).

The effectiveness of the recommendation that independent NEDs are in the majority in the nominations committee relies not only on the directors being independent, but also on the NEDs being diverse. If the majority of NEDs on the nomination committee are not diverse, then the selection process is still at risk of homophilic selection. In other word, it may not be sufficient that the nomination committee is dominated by independent NEDs if those NEDs are themselves not diverse or distinct from the executive directors and there is still a risk of homophilic selection.

The Higgs Report, however, highlighted the lack of diversity of NEDs, noting that they are typically white, male, nearing retirement age with previous experience working at a public company. The Report observed that there were less than twenty NEDs on FTSE 100 boards under the age of forty five and that only six per cent of NED posts are held by woman (para 10.21 and 10.22). The Higgs Report called for further work to be done to encourage greater diversity in the boardroom, the result of which was the subsequent Tyson Report (2003).

The Tyson Report noted that many boards lacked a diverse range of skills, experiences and perspectives that could help them address the challenges confronting their companies" (*ibid*, p. 6) and highlighted the benefits of diversity identified above with respect to informational advantages highlighted above. The Report highlighted research by Milliken and Martins (1996) which showed that groups that are more diverse in skill or knowledge have a greater potential to generate more high-quality solutions to problems than less diverse groups. The Report did recognise some of the negative associations relating to diversity, namely lower levels of cohesion, less trust and higher turnover but

concluded that these negatives could be mitigated through training as to the benefits of diversity (*ibid*, p. 7).

The Tyson Report made three recommendations intended to increase diversity amongst NEDs. First, a more rigorous and transparent NED selection process in which companies should broaden their searches to include sources of talent that they have overlooked in the past. Second, more evaluation and training of NEDs which in more diverse boards would encourage a greater sense of trust, cohesion and communication. Third, the encouragement of more research into the benefits of diversity and transparent measurements of diversity, such as the creation of a diversity index highlighting in a transparent way diversity which exists within individual corporations⁴⁰. Further the Tyson Report focused very much on the benefit of cognitive diversity. This represents a change from the Higgs Report which highlighted surface level demographic diversity.

Despite the focus provided by both the Higgs and the Tyson Reports on the need for greater diversity in corporate boardrooms, this lack of diversity was identified as a contributing factor in corporate governance failings leading up to the credit crisis. The UK Treasury Select Committee on the Banking Crisis observed: “If boards consisted of people who read the same newspaper, went to the same universities and schools, and have the same prejudices and views to sit around a board table, you do not get diversity of view and input” (Committee, 2009 para 150). Rost and Osterloh (2008) argue that one of the main reasons for bank failures in the lead up to the financial crisis was the increased homogeneity of boards and the lack of diversity on boards and different viewpoints which led to herding and groupthink. The Association of

⁴⁰ There is, however, no evidence that such a diversity index is being used by UK corporates.

Chartered Accountants also argues that diversity avoids groupthink on boards and specifically encourages greater representation of woman on boards⁴¹.

Perhaps the reason why calls from the Tyson Review went unheeded was the fact that such a call was being made at a time of a significant market bubble where stock market prices continued to rise and where market participants could have pointed at increased profitability, despite a lack of diversity, as evidence that there was no reason to change the status quo of existing and successful boards. Ironically, it is exactly in times of success, and in particular in periods of bubbles, that there is the greatest need for diversity in the boardroom and for alternative views to be put forward and for strategies to be challenged.

One of the issues in the literature in this area is how to define diversity. A common distinction made by researchers is on readily observable attributes such as race, gender, or nationality. Other less observable forms of diversity are less visible underlying attributes and relate to technical abilities such as education, functional backgrounds, tenures and social networks. Most of the research on diversity and its effects on performance are focused on observable diversity (Erhardt et al., 2003)⁴².

It is, however, submitted that it is the unobservable cognitive diversity that will benefit boardroom decision processes through the different perspectives, ideas and knowledge that such cognitive diversity brings to the boardroom.

Different types of diversity are however not mutually exclusive. Ethnic diversity, for example, might be associated with difference in underlying attributes such as education or social networks. One of the questions that needs to be addressed is whether there is a direct relationship between the observable and the non-observable forms of diversity. In other words, does observable diversity

⁴¹ See <http://www2.accaglobal.com/databases/pressandpolicy/unitedkingdom/3421213>.

⁴²This is not surprising as it is much easier for researcher to analyse observable diversity.

lead to cognitive diversity? This discussion is particularly relevant in the debate as to whether gender diversification leads to cognitive diversification in the boardroom.

A number of countries have looked to address diversity in the boardroom by focusing on gender. Norway has introduced a quota system which required the boards of public companies to have at least 40% of women directors. France has introduced legislation in parliament requiring that women constitute 50% of the board of directors of publicly listed companies by 2015. Spain has a requirement that any privately owned company awarded a public contract must have women accounting for at least 40% of its directors. Finally, Iceland has adopted legislation that requires publicly owned companies and public limited companies with more than fifty employees and boards of more than three members to have at least 40% of each gender.

The Walker Report (2009), whilst recognising the need to improve diversity and the gender imbalance on boards, commented that “it would be unrealistic to expect to reduce the present unfortunate gender imbalance by ‘parachuting’ into boardrooms as NEDs women without executive board and senior executive experience elsewhere” (para 3.6). The Walker Report’s observations about the paucity of women directors contributed towards a 2010 government initiative to appoint Lord Davies. Davies’s remit was to look into the reason why there were so few women on boards and to make recommendations as to what the government could do to increase the proportion of women on UK corporate boards. The result was the publication in May 2011 of the report *Women on boards* (Davies, 2011). The report observed that in 2010, women made up only 12.5% of the corporate boards of FTSE 100 companies, up from 9.4% in 2004, a rate of increase considered too slow. The report cited research linking greater levels of women on boards to improved firm performance (Joy et al. (2007), Desvaux et. al (2007)) and that female directors enhance board independence (Fondas and Sasselos, 2000). The report did not, however, mention any of the research which found a negative correlation between gender diversity and firm

performance and did not discuss any of the potential negative implications for gender diversification (discussed below). Rather the Report appeared to take as a given the benefits of gender diversity.

The Davies Report however did not recommend a quota for women directors in the UK citing the results of a survey it undertook in which only 11% of the 2654 respondents were in favour of a gender quota. Rather, the Report recommended that boards develop and encourage boards to disclose a policy concerning diversity and how this policy might be measured. The Report recommended that the Financial Reporting Council amend the Corporate Code of Governance to require listed companies to include their gender policy in their annual accounts. This recommendation has been implemented in the UK Corporate Governance Code (2014). The approach adopted in the UK with respect to addressing gender diversity by ensuring greater disclosure and transparency of gender policies, is very much in line with the underlying philosophy in the UK with respect to governance generally and the underlying “comply or explain” philosophy⁴³.

Rost and Osterloh (2008) make an interesting suggestion to achieve this balance between diversity and cohesion highlighted by Langevoort (2000). They argue that in radically changing environments, such as that experienced in the lead up to the crisis, individuals with no management backgrounds and women were highly underrepresented. The authors argue that in such uncertain environments women and non-experts make far better market forecasters than incumbent male experts. This conclusion as to the relative ability of different

⁴³ Ariely (2013) however argues that the principle of disclosure, albeit in the context of a conflict of interest, can have the opposite of the intended affect. He argues that the act of disclosure can give actors the freedom to do what they liked but at the same time they can do so without a conscious. This argument may question the effectiveness of the “comply or explain” philosophy. However, a further debate on this philosophy is outside the remit of this thesis.

actors to make forecasts was drawn from the results of a survey they undertook at the time that the harbingers of the financial crisis was obvious, but the full extent of the crisis was unknown⁴⁴. The survey sample was 479 students at the University of Zurich from various fields of study (experts were deemed those studying finance whilst non-experts were those studying a totally unrelated subject.) The students were required to make forecasts as to the future stock price of the Swiss Bank, UBS and the study found that both women and non-experts were better at forecasting the stock returns of UBS than expert males.

It is submitted that it is difficult to read too much into the actual results of this study. A student studying finance at University is not necessarily an “expert” in the field of finance⁴⁵ and predicting a bank’s stock price does not equate to the type and complexity of decisions that boards of financial institutions are often required to make. Despite these reservations, the authors make some very interesting observations about how “criss-cross” theory may be applied to achieve balance in the boardroom and second why experts made poor decisions in the lead up to the crisis.

Rost and Osterloh (2008) recognise the importance of balance in the composition of boards. Boards that are too diverse can suffer from poor communication and lack of co-operation between actors, whilst boards that are not diverse enough, are vulnerable to groupthink and a one dimensional approach to seeking solutions to problems. To create a balance in the composition of boards, they suggest that boards should include what they refer to as “criss-cross individuals”, that is, individuals who can be classified as both part of a majority *and* a minorities according to different identified classifications.

⁴⁴ The survey was conducted in 2008.

⁴⁵ There is an old saying that may be appropriate in this circumstance which is that “a little bit of knowledge is a dangerous thing”.

The authors focus on gender and expert knowledge as two key factors in shaping board compositions and then identify four different possible permutations; 1) men who are experts, 2) men who are non-experts, 3) women who are experts and, 4) women who are non-experts. Rost and Osterloh then argue that the majority of boards are both men and experts and that the greatest conflict to such a board will be the inclusion of women who are non-experts, a combination which reflects the greatest potential conflict on both the basis of gender and level of expertise. In contrast, they argue that the potential to provide a balance between conflict and cohesiveness is achieved by including in the board either a male that is a non-expert or a female who is an expert. In their view, a balance is in effect achieved through including actors that both conform and conflict with the boardroom norm of men who are experts.

Rost and Osterloh's solution to achieving a balance between diversity and cohesiveness is an interesting one. It might be that classifying individuals into distinct categories of experts and non-experts and male and female, and then deciding the composition of the board on that basis, is too simplistic and one dimensional. What this research does, however, highlight is the need for boards to consider the composition of their board with a view towards achieving a balance between cohesiveness and diversity. Further, it highlights that gender diversification, in isolation, may be insufficient to achieve true cognitive diversity. This is a point discussed in greater detail later in this chapter and in chapter 8.

Rost and Osterloh draw on behavioural economics, and in particular the works of Kahneman and Tversky (1986) and (1981), to argue that experts are prone to make mistakes due to bounded rationality. For example behaviour is affected by representativeness, or availability, and that in order to render complex problems manageable humans have an inclination to predict uncertain events in the future by looking at a small portion of data and from those inferring

conclusions⁴⁶. Experts faced with making a decision in the future are therefore at risk of relying unduly on past experiences and do not consider other alternatives widely enough. Further, behaviour is affected by anchoring adjustments where individuals use a past event or trend as a reference point to influence upcoming decisions. Experts given their experience are more at risk of being influenced by anchors which, in a market characterised by high levels of growth and new era thinking, might result in future decisions being anchored, or influenced, by an environment in which asset prices were inflated. The consequence being an increased risk of future decisions being poorly made.

The counter argument to this presented by Rost and Osterloh above is that experts will have extensive experiences often spanning long periods of time and different environments. Experts are therefore, it is argued, less likely to take current market conditions into account as an anchor when making future decisions. Rather, non-experts are more vulnerable to biases such as anchoring and availability biases, given the wider and broader set of data and experiences available to them.

It is submitted that the important point in this debate is not whether experts are more susceptible to such biases than non-experts, but rather that both sets of actors are vulnerable to inherent biases but given their different experiences will be affected in different ways. This highlights two important points. First, it reconfirms the importance of diversity in a group setting and that different actors will be influenced by different past experiences and that this will ensure that there is a diversity of experiences and ideas combining to make decisions. Second, it highlights the importance of psychology and behavioural economics in decision processes - a point central to my thesis.

A research stream looking at gender differences has focused on behavioural differences between men and women. Ricciardi (2008), for example, observes

⁴⁶ This is commonly known as an “availability bias”.

that women worry more than men and that this impacts their decision process. Individuals that worry show a higher intolerance to uncertainty and a lower tolerance to risk resulting in underperformance in good times and outperformance in bad times⁴⁷.

The link between greater levels of worrying and lower risk tolerance has also been made by Shiv et al. (2005) who undertook a series of experiments with individuals incapable of feeling emotions due to brain lesions. The results showed that those that had this form of brain damage took more risks than those in the “normal” control group. The conclusion drawn was that as the brain injured subjects were incapable of experiencing worry, anxiety and fear, this resulted in them being more inclined to accept risks and less likely to exhibit loss averse behaviour.

Further, Jionakopolos and Bernasek (1998) concluded from a 1989 study in the US that single women show more risk aversion in financial decisions than single men. Other studies that have concluded that men take more risks than women in the field of finance include Karabenick and Addy (1979) and Sorrentino et al. (1992). Rost and Osterloh (2008) also highlight how gender differences in worrying will effect risk decision processes and that the reason why women worry more than men is unclear, and that it might be a result of different socialisation processes or it might be inbuilt, that is “nature versus nurture”.

Another behavioural difference related to gender that researchers have highlighted is in relation to confidence levels. Overconfidence has been highlighted as an important characteristic associated with poor decision process. Barber and Odeon (2001) found that in areas of finance, men are more confident than women. This conclusion was drawn from analysing trading data from over 35000 households from a large US brokerage firm over a five year

⁴⁷ Indeed as highlighted previously, banks that outperformed in the lead up to the crash were the hardest hit in the crash itself (Beltratti and Stulz, 2009).

period. The authors used trading as a proxy for confidence with the theory being that the more confident an individual is the more likely he/she is to trade. The study found that the average turnover rate for men was one and a half times higher than it was for women. Interestingly higher trading levels by men actually resulted in lower performance levels. This highlights the point that we are generally overconfident about our abilities and that we tend to overestimate the precision of our knowledge and abilities (Alpert and Raiffa, 1982).

Other research which focused on gender differences highlighted that overconfidence can be task related and that differences in confidence are greatest in tasks perceived as being in the male domain. Finance has historically been a male dominated industry (Beyer and Bowden, 1997). Men are therefore more likely to feel confident than women do in financial matters (Prince, 1993). Overconfident investors believe more strongly in their own beliefs and valuations and concern themselves less about the beliefs of others (Barber and Odean, 2001). If men are more confident than women in financial matters, then this overconfidence can, as highlighted previously, be a significant contributing factor in a poor decision processes particularly in difficult tasks with low levels of predictability. The behavioural differences related to gender which academics have highlighted with respect to risk taking and overconfidence provide strong arguments for the inclusion of more women in boards to provide more balance in the risk profile of boards, something which was clearly absent in many financial institutions in the lead up to the crisis.

In addition to the research highlighted above, there is a strong body of research which highlights the benefits of gender diversity (see for example Burke (1997), Bantel and Jackson (1989), Huse and Solberg (2006) and Pearce and Zahra (1991)). However, there are also research findings which question the benefit of gender diversity. Tannen (2001) found that women feel intimidated and uncomfortable in groups and are thus less willing to offer ideas. Further men

can get impatient with such reluctance and that this can further reduce group effectiveness⁴⁸.

Research by Kanter (1993), Kent and McGrath (1969), Clement and Schierneck (1973) have all shown that single sex groups outperform mixed sex groups. Alagna et al. (1982) in a study of all male versus mixed medical students, found that mixed sex groups reported higher levels of conflict, interpersonal tension, and lower levels of cohesion, findings consistent with the theories of social categorisation and similarity attraction highlighted above. O'Reilly et al. (1989) found no significant direct or indirect relationship between gender diversity and group performance. Shrader et al. (1997) investigated the relationship between the percentage of female board members and two accounting measures of financial value (return on assets and return on equity) and found a significant negative relationship between the percentage of woman on the board and firm value. In contrast, however, Carter *et al.* (2003) found a positive relationship between woman and minorities on the board and firm value⁴⁹.

This is quite clearly a difficult subject without a clear definitive answer. The solution perhaps lies in a discussion of nature versus nurture. Are woman different because of inbuilt or genetic differences or is this a result of experiences which have shaped views? Are woman, for example, inherently more risk averse than men or this a function of the role in which they have historically had in society? Are woman that have had just as much exposure to the field of finance as men going to be as confident as men in their decision

⁴⁸ Related to this finding is the research by Konrad et al. (2008) who found that it takes a critical mass of at least three woman on a board to affect change. The presence of three or more woman not only improves their own board experiences but also enhances the contributions that woman will make on boards as they are not isolated and are not treated as outsiders.

⁴⁹ The lack of consensus in finding a direct relationship between demographics (in this case gender) and firm performance amongst academics has been discussed earlier in this chapter.

process? Does gender diversity automatically provide an organisation with greater cognitive diversity? Or is the answer to the nature versus nurture question that it is a combination of both nature and nurture which determines attributes (Shenk, 2010)? This is an ongoing academic debate which is beyond the scope of this thesis.

Indeed it could be argued that the emphasis on gender for the purposes of boardroom diversity is misleading and misguided. Instead, perhaps the focus should be on cognitive diversity looking to highlight individuals that can bring diverse perspective and different information bases into discussions. Gender is often used as a proxy for cognitive diversity and gender and cognitive diversity are often correlated. Hillman et al. (2002) for example found that female (and Afro-American) directors are more likely to come from non-business backgrounds and are more likely to hold advanced degrees than white males in a 1997 study of Fortune 100 boards.

The argument, however, could be made that gender will not always provide cognitive diversity and just because a board candidate is a woman, it does not *automatically* follow that she provides the necessary cognitive diversity that a board desires. A woman NED that has the same educational and work background as existing directors may not provide cognitive diversity just because of her gender. Rather than focusing on gender, directors should be seen as a “bundle of attributes” (Ruigrok et al., 2007) and more sophisticated measures aimed at highlighting cognitive differences in board members should be employed in the search for boardroom diversity rather than relying solely on crude and easily identifiable measures such as gender or nationality.

It is however submitted that on balance the arguments favour a focus on gender diversification as a means of achieving cognitive diversity in the corporate boardroom. The positives to such an approach point to the *possibility* of inherent inbuilt gender differences which will bring different attributes to boardroom discussions, such as a natural risk aversion in women. Women are

also less likely to be part of the “old boys” network often associated with all male boards and as such gender is a good proxy for less observable but important types of diversity.

A sole focus on gender diversification may however lull boards into the false sense of security that boards they have achieved true cognitive diversity when in reality they may have just appointed a woman to the board that provides little/no cognitive diversity compared to existing board members. This would occur when a women board member has identical networks, skills and work experiences as that of existing members. Finally the emphasis on appointing women may pressurise boards into gender tokenism. If female directors are chosen merely because of tokenism, their impact is likely to be minimal (Adams and Ferreira, 2004). Overall, however, the conclusions drawn in this thesis are that greater gender diversity should be encouraged but not seen as the panacea for achieving true cognitive diversity (as highlighted by Rost and Osteloh (2008)).

In summary, cognitive diversification is an important characteristic that should be encouraged in the composition of corporate boardrooms. Such diversity can improve the quality and creativity of decision making and reduce the possibilities of groupthink, group polarisation and de-individuation from occurring. There is a natural gravitation towards homogeneity on group boards and a prestige associated with being a board member that accentuates the need for diversity in this particular group setting. Diversity will reduce cohesion of the type associated with highly homogenous and cohesive boards, increase cognitive conflict and boardroom challenge and, improve the quality of information and decision making processes. Increasing the number of women on boards should improve such diversity but this should not be the only criteria in which boards define true diversity.

2.13 Conclusion

In summary, many of the developments in corporate governance, although partially reactionary in nature, have helped to set out structural guidelines for corporations. Recommendations such as independent directors along other reforms related to audit and remuneration committees and the separation of CEO and chairman⁵⁰ are building blocks which can help to prevent poor decision making but they clearly are not a panacea. As the financial crisis has highlighted, good governance guidelines such as that set out in the Code doesn't necessarily result in effective decision making and the existence of a robust board challenge. What is missing is an appreciation of the dynamics of individual boardrooms and in addressing the psychological aspects of how individuals interact within groups. The key to good reforms are therefore social rather than structural. As Sonnenfeld (2002) notes: "As important as implementation and rules and regulations are the human dynamics of boards as social systems where leadership character, individual values, decision-making processes, conflict management, and strategic thinking will truly differentiate a firm's governance" (*ibid*, p. 112).

The next chapter of this thesis focuses on examining the literature which explores the normative and informative influences on board decision making processes.

⁵⁰ See paragraphs C3, D1 and A.2.1 respectively of the UK Corporate Governance Code (2014).

Chapter 3: Groupthink; Herding, Group Polarisation, De-individuation, Epistemic Blind Spots and Economic Bubble Theories

3.1 Introduction

This chapter will examine the literature on the normative and informative influences on board decision processes. The starting point for this review related to the phenomena of groupthink and herding, both specifically identified by the Nyberg Commission (2011) as being a significant contributing factor in the poor decision process undertaken by the Irish banks in the lead up to the crisis. This chapter will not limit itself to just a discussion of just groupthink and herding literature but will also examine the literature related to group polarisation, epistemic blind spots and economic bubble theory. These phenomena have been identified in the review of the literature as being potentially relevant in enhancing the understanding of the decision processes of the Irish banks in the lead up to the crisis.

3.2 Groupthink

It was a school history project on the failed United States invasion of Cuba which was the catalyst for the concept of “groupthink”. Irving Janis was helping his daughter with her assignment when he began to wonder how John F. Kennedy and his advisors had agreed to the poorly thought out and ill-advised Cuban invasion. Janis questioned whether “some kind of psychological contagion, similar to social conformity phenomena observed in studies of small groups” (Janis, 1972, p. viii) had affected the decision making process. This question, and his subsequent search for the answer, was the catalyst for publication of his seminal book *Groupthink* in 1972. In this book, Janis studied a set of four policy decisions by four separate US presidents which resulted in fiascos; Roosevelt and his failure to foresee the attack on Pearl Harbour,

Truman and his invasion of North Korea, Kennedy and the aforementioned Bay of Pigs invasion and Johnson on the escalation of the Vietnam war. Janis looked to contrast the decisions made in these scenarios against two historical cases which produced good policy decisions; the development of the Marshall Plan to avert economic collapse in post war Europe and Kennedy's handling of the Cuban Missile crisis. In the second edition of his book, published in 1982, Janis refined his theory and included the series of decisions by Nixon with respect to the Watergate scandal as a further example of groupthink⁵¹.

Janis groupthink model legitimised the importance of previous academic research on social influences and group process and drew on work from pioneers in the field of conformity research, in particular Lewin (1947), Festinger (1954), Back (1951), and Schachter (1951).

Janis's groupthink model highlights the pressure for conformity in cohesive groups, the desire to reconcile one's opinions with that of a selected "in-group", and the relationship between conformity and group attractiveness. Janis defined groupthink as a "quick and easy way to refer to a mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when the members striving for unanimity override their motivation to realistically appraise alternative courses of action" (Janis, 1972, p. 9)

Janis' interpretation and definition of the term groupthink was significant for two reasons. First, Janis made the link between the pressure for conformity in cohesive groups and the increased risk of a defective decision making process. Until Janis's research, academics had thought that tightly knit groups came to quicker and more, not less, effective decisions (Aldag and Fuller, 1993). The idea was "impressive in its counterintuitive power: the realisation that, depending upon the content of group norms, harmonious, cooperative, team-like entities may be a liability rather than an asset in producing high-quality

⁵¹ Janis considered the Watergate cover up as his best example of groupthink.

decisions” (Hart, 1994, p. 253). Second, the analysis of political decision making had long been dominated by rational choice perspective and Janis was the first to try to interpret such decisions in a psychological sense⁵² (Hart, 1994).

Janis’ groupthink is an excessive form of concurrence seeking amongst members of high prestige, tightly knit groups. It occurs when the group members come to value the group, and their membership of the group, higher than other factors. The result of this is that group members strive for a quick unanimity on the issues that the group has to confront. Agreement between members will generally occur very quickly through a strong tendency for concurrence seeking to maintain the atmosphere in the group. To preserve the clubby atmosphere and the unity in the group, members suppress personal doubts, silence dissenters and have a strong belief in the morality of the group and a poor view of those outside the group. The result is a distorted view of reality, excessive optimism and hastily thought out policies. These flawed policies then lead to inadequate and premature solutions, that in hindsight, surprise those outside the group by the hubris of the members, the absence of insight and lack of concern for the consequences of failure (Baron, 2005).

Many sources and types of errors can produce defective decision making. There is widespread recognition in numerous studies that show conformity in group settings, see, for example Deutsch and Gerard (1955) and Asch (1952). It is however Janis’s argument that the cohesiveness of the group promotes this conformity because group members want to remain in the group given the status and prestige that such membership offers, that differentiates the theory of groupthink. According to Janis, it is the strong cohesion and the desire to commitment to the group itself, that the pressure for conformity increases,

⁵² The essence of this debate continues today in the field of finance between those that argue that the markets are on the whole rational and efficient with those that argue that most decisions are not made rationally but are very often rooted in psychological responses which are not at all rational. See, for example, Skidelsky (2010) and Akerlof and Shiller (2009).

resulting often in premature consensus before a thorough decision making process is undertaken. Janis' contribution lies in the counter-intuitive realisation that group cohesiveness might be a liability rather than a positive for high quality decision making.

3.2.1 Group cohesiveness and group homogeneity in relation to Janis' groupthink construct

Group cohesiveness is the crucial "linchpin" in Janis's depiction of the dynamics of groupthink (Hart, 1994, p. 251) and is the primary and necessary antecedent condition for groupthink to occur. It is therefore difficult to overstate the importance of group cohesiveness to the theory of groupthink and for Janis, groupthink cannot exist without cohesion: "Only when a group of policy makers is moderately or highly cohesive can we expect the groupthink syndrome to emerge as the members are working collectively on one or another of their important policy decisions (Janis, 1982, p. 176)."

Janis himself does not provide a clear cut definition of cohesiveness although he does refer to cohesiveness in the context of members' positive valuation of the group and their motivation to continue to belong to it. Janis's cohesiveness is one of a comfortable and "clubby" solidarity as is illustrated by his statement: "When group cohesiveness is high, all the members express solidarity, mutual liking, and positive feelings about attending meetings and carrying out the routine tasks of the group" (Janis, 1982, p. 5).

Festinger (1950) however defined group cohesiveness as "the resultant forces which are acting on the members to stay in a group" (*ibid*, p. 274). Longley and Pruitt (1980) on the other hand, summarise Janis' definition of cohesiveness to mean "the degree to which members find their group attractive (*Ibid*, p. 81)".

Although Janis does not provide a precise definition of cohesiveness, he does suggest several explanations as to how cohesiveness contributes towards

groupthink. One is that cohesiveness and the sense of security from that unity, encourages a strong sense of confidence perhaps even euphoria and an illusion of invulnerability that curtails examination of the positive or negative consequences of a specific decision. "The various devices to enhance confidence and self-esteem require an illusion of unanimity about important judgements. Without it, the sense of group unity would be lost, gnawing doubts would start to grow ... preserving the sense of unity can do more than keep anxiety, shame, and guilt to a minimum; it can induce pleasant feelings of elation" (Janis, 1982, p. 258).

A second explanation is that members of cohesive groups are motivated to maintain the spirit and unity in the organisation that they so cherish, and that the preservation of this unity takes preference over a dissenting view: "The more amiability and spirit de corps among the members of a policy-making group, the greater is the danger that independent critical thinking will be replaced by groupthink" (Janis, 1982, p. 13).

Finally, in drawing on the conclusions of Schachter (1951) and Festinger (1954), Janis notes that cohesive groups put pressure on dissenters to alter their views and conform to the group norm. "When groupthink dominates, suppression of deviant thoughts takes the form of each person's deciding that his misgivings are not relevant, that the benefit of any doubt should be given to the group consensus" (Janis, 1982, p. 247).

Janis recognised the distinction between task-oriented cohesion and social-emotional cohesion. Janis's model is therefore limited to those contexts in which social-emotional cohesion is dominant. This observation is consistent with research done by Bernthal and Insko (1993) who found that higher socio-emotional cohesion were more likely to experience groupthink than groups high in task-orientated cohesion.

Cohesiveness is a necessary condition in Janis's model of groupthink but it does not follow that every cohesive group will fall victim to groupthink. A point

recognised by Janis: “It follows that the positive relationship between cohesiveness and groupthink cannot be regarded as iron law of executive behaviour that dooms the members of every cohesive group to become victims of groupthink every time they make a collective decision. If the group encouraged individual dissent and alternative strategies to problem solving, it is likely that groupthink will be avoided even in high cohesive groups”⁵³ (Janis, 1982, p. 245).

Closely related to the concept of cohesiveness is homogeneity. Groups that are characterised by high levels of homogeneity are more likely to be cohesive as they are more likely to share common values and ideas. Group homogeneity was not, however, initially included as an antecedent by Janis in his original analysis of six antecedent (Janis, 1972) but was added in the 1982 version of the book which included a discussion of the Watergate cover-up with President Nixon – his best example of groupthink. “Lack of disparity in social background and ideology among the members of a cohesive group makes it easier for them to concur on whatever proposals are put forward by the leader to deal with the policy problems they are confronting” (Janis, 1982, p. 250).

All of the literature reviewed for this thesis identified group homogeneity as an important antecedent for groupthink. Baron (1995), Whyte (1998) and Hart (1994) all included group homogeneity as an antecedent in their versions of groupthink. Further, Shafer and Crichlow (1996) and McCauley (1989) both specifically highlight group homogeneity as a key antecedent in their research findings. Unlike group cohesiveness which has engendered much discussion and disagreement as to its role in the groupthink process, the homogeneity of group members’ social backgrounds and ideologies, as identified by Janis, has been undisputed by researchers.

⁵³ A fuller discussion on the ways to prevent groupthink are found later in this thesis.

There is, as Janis notes, a natural tendency for human beings to gravitate towards those that are similar to themselves. This is well recognised in academic literature; Heffernan (2012) argues that the most important criteria in selecting a life partner is homogeneity and that we are attracted to those that are most similar to ourselves. In a business context, Moore (1962) notes that managers tend to promote those that are similar to themselves on the basis of a kinship based on which predominantly men reproduce themselves in their own image.

3.2.2 The constructs of Janis' groupthink model

Janis identified four structural conditions (represented by Box B1 in Figure 1) that, in addition to cohesiveness, play an important role in groupthink. They are: 1) group insulation from outside sources of information and opinion that could challenge group beliefs; 2) a lack of tradition of impartial leadership 3) lack of norms requiring methodical decision-making procedures for considering evidence and alternative options; and 4) homogeneity of members' social backgrounds and ideologies. These conditions increase the likelihood of groupthink because they do not provide an organizational structure that would prevent members from developing the premature concurrence seeking associated with groupthink.

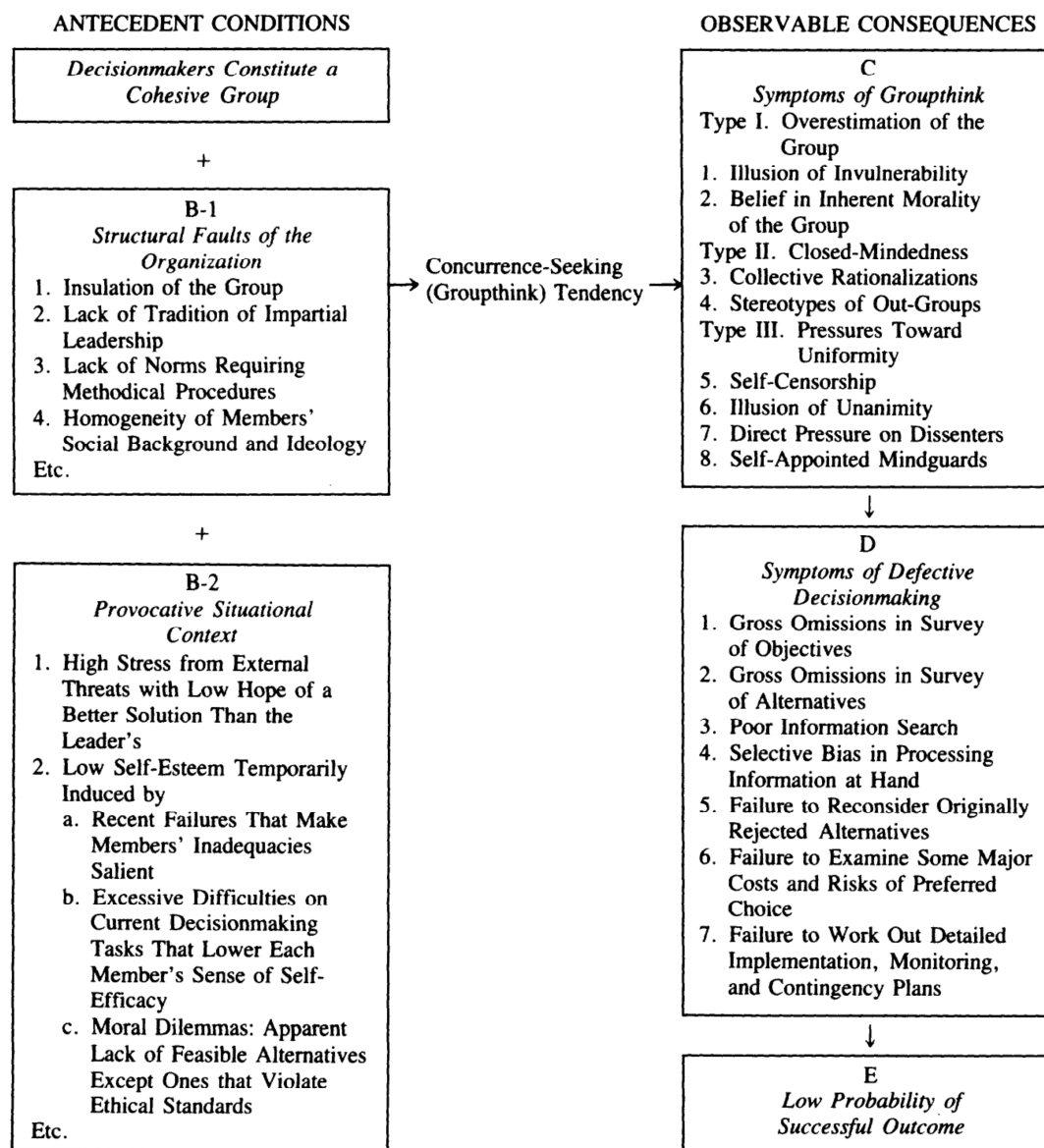
Janis further identifies what he terms a "provocative situational context" related primarily to stress which also contributes towards groupthink (represented by Box B2 in Figure 1). These are 1) high stress from external threats, and 2) low self-esteem induced by recent failures, excessive difficulty on current decision making tasks and moral dilemmas relating to lack of feasible alternatives except ones that violate ethical norms.

Not all of the antecedents noted above need to be present, but the more of those that are observed, the greater the chances of defective decision making

as a result of groupthink (*Ibid*, p. 245). After identifying the antecedents of groupthink, Janis then identifies eight observable symptoms of groupthink (represented by Box C in Figure 1) and the symptoms of defective decision making of which Janis has identified seven types (represented in Box D in Figure 1). The result of this being a low probability of a successful outcome (represented by Box E in Figure 1). In summary the groupthink process involves a causal link connecting the structural antecedent conditions with the concurrence seeking tendencies, indications of defective decision making and a decision outcome with a low probability of success.

The model does not suggest that groupthink is inevitable, but rather that in the presence of the antecedents increased risk of defective decision making exists. This is reflected in the model itself as the end result of groupthink reflected in “Box E” in Figure 1 refers to a “low probability of a successful outcome”. Groupthink is thus a process not an outcome, and it does not necessarily follow that it will always result in poor outcomes but the chances are much higher that this will be the case. In other words, the link between groupthink and failure is probabilistic rather than deterministic (Yetiv, 2003).

Figure 3.1: Janis' Groupthink Model



Although Janis focused his research with respect to high level foreign policy fiascos, the groupthink concept has had a wide and interdisciplinary impact and is mentioned in literature in diverse fields including political science, communications, business organisations, social psychology, management, healthcare and academia. Groupthink has been mentioned as either the primary or a contributing cause of a huge range of defective decisions in a wide array of

decisions. This includes Ford's decision to build the Edsel car (Huseman and Driver, 1979), the Challenger Space Shuttle Disaster (Esser and Lindoerfer, 1989), the US decision to invade Iran (Yetiv, 2003), and the failures of WorldCom (Scharff, 2005), Enron (O'Connor, 2002) and SwissAir (Hermann and Rammal, 2010).

Groupthink has also been explored in a religious context. Schnall and Greenberg (2012) discuss the vulnerability of the ancient court of Israel to groupthink antecedents and provide a wide range of reasons why they believe the courts avoided groupthink. Rost et al. (2010) noted that the structure of the Benedictine Abbeys made them vulnerable to groupthink. Klein et al. (2009) highlighted the risk of groupthink in academia. Mitchell and Eckstein (2009) reviewed the applicability of groupthink in relation to jury decisions and concluded that juries are at risk of groupthink. In the area of corporate governance, Maharaj (2008) urged greater attention to the behavioural characteristics of board members in order to reduce the likelihood of a groupthink mentality being created which would impede overall board effectiveness.

Not surprisingly given the breadth of the examples noted above, groupthink theory has been described as the dominant theory used to explain decision fiascos and as a conceptual "tour de force" (Whyte, 1998, p. 186). Paulus (1998) describes the theory as an "influential and highly cited construct" (*ibid*, p. 362). These views are shared by numerous other academic researchers (see for example Hart (1994), Esser and Lindoerfer (1989), McCauley (1998), Baron (2005), Yetiv (2003), Wei Choo (2007) and O'Connor (2002)).

3.2.3 Laboratory and Case Study application of groupthink

Janis's theory has created significant interest in academic circles and subsequent research into the groupthink theory can be divided into three broad

categories. First, laboratory studies which have looked to test and isolate some of the antecedents of groupthink identified by Janis. Second, and following Janis's lead, research applying the groupthink concept in a retrospective case study analysis. Third, researchers that have suggested either modifications or revisions to Janis's model, or in the extreme example of Aldag and Fuller (1993), a total rejection of the groupthink concept. These areas of groupthink research are discussed below.

Laboratory research into groupthink has provided little support for Janis's groupthink and in particular his core antecedent of group cohesiveness being a necessary antecedent for groupthink to occur (see for example Flowers (1977), Leana (1985), Fodor and Smith (1982), Callaway and Esser (1984) and Courtright (1978)). There are two possible explanations for this. First, this lack of support may be partly accounted for by the difficulty in testing the groupthink concept in laboratory settings. One of the limitations of laboratory tests relates to the complexity of the linear groupthink model with its seven antecedents, eight symptoms of groupthink and seven symptoms of defective decision making. Academics have found it impossible to do a comprehensive study with manipulation of *all* the variables. The reason being is that this would require a very large sample and the inevitable statistical problem of multicollinearity and high correlation between the independent variables. A point recognised by both Park (1990) and Flippen (1999).

As a result, laboratory studies have tested a few of the antecedents in isolation (see for example Turner et al. (1992) that tested three of Janis's antecedents or Moorhead and Montanari (1986) who tested just two). Partial tests can be misleading because the effects of two or three of the antecedent factors might be different from those of the full array considered simultaneously due to the way in which the antecedents might interact with each other (Park, 1990). This is consistent with Janis's thinking, as he predicted interaction effects between the antecedents in his model. Indeed, Baron (1995) argues that the specific experiments relating to the link between group cohesiveness and groupthink is

more a test of a specific hypothesis within the broader framework of groupthink than it is a test of the theory of groupthink as a whole.

Second, it is extremely difficult for laboratory tests to induce genuinely high levels of group cohesiveness such as that envisaged by Janis in mature groups working in “real life” situations. A comparison of “strangers” versus “mere acquaintances” as manipulated by Flowers (1977) is very different from the type of cohesion which exists in long standing and intense groups where the members have a deep emotional tie to the group and are making decisions in real life scenarios. This was recognised by Leana (1985) when she noted that her manipulation of cohesiveness may not have been powerful enough to produce the effects postulated by Janis (*ibid*, p. 15). All these experiments cited above were conducted using University students and generalising from this small sample of students to the entire population may not be valid. Moreover Posner-Weber (1987) pose the question as to whether students behave differently in a laboratory setting.

In summary laboratory tests have reflected, at best, mixed support linking cohesiveness to a poor decision process. However, as discussed above, these result need to be seen in light of the limitations of replicating potential groupthink scenarios in a laboratory setting and may reveal more about the limitations of the tests themselves than the applicability of Janis’ groupthink theory.

Researchers that have applied the groupthink concept to retrospective case studies of poor decision making scenarios have been more successful in evidencing groupthink (see for example Manz and Sims (1982), Hensley and Griffin (1986), Eaton (2001), O’Connor (2002), Yetiv (2003), Scharff (2005), Ahlstrom and Wang (2009) and McConnell (2012)). There are, however, epistemological hurdles relating to the application of retrospective case studies to the groupthink concept that need to be taken into consideration.

First such approach has, as a starting point, a series of poor decisions and then looks to apply a theory to those decisions, making an assumption of the cause and effect relationship between poor decision making and groupthink. In other words, a self-selected solution is applied to a self-selected problem without considering whether there are other potential causes of the poor decision making process. Indeed Paulus (1988) even argues that case studies can be used as evidence for almost any theory one wishes, whilst Yetiv (2003) warns of what he sees as the risk of a “suspicious fit” when applying the theory to a retrospective case study.

Second, there is the risk that that unconscious biases will result in selective interpretation of the events to match the theory of groupthink with the poor decision making processes. If one has a starting point a potential solution, it will require significant academic rigour and discipline to avoid looking for the evidence that connects the cause and effect, particularly if one applies a looser more generic version of the concept of groupthink. The debate as how to define groupthink is discussed in detail later in this chapter.

3.2.4 Research suggesting modifications to Janis’ theory

The results of groupthink research in both the laboratory and through case studies has resulted in a number of suggestions and modifications to the original theory espoused by Janis. Such developments and suggestions are to be expected. Aldag and Fuller (1993), Baron (1995), McCauley (1998), Hart (1994) and Whyte (1998) all argue that the conceptual basis of the model needs to be broadened in light of the research results. Paulus (1988) recognised that Janis model “represents a brilliant construction” (*ibid*, p. 371), but argues that “theories are temporary guides to understanding reality on the way to discovering the truth” (*ibid*, p. 367) and that all theories require some modification subsequent to presentation. He cites Festinger (1987): “No theory is going to be inviolate. Let me put it clearly. The only kind of theory that can be

proposed and ever will be proposed that absolutely will remain inviolate for decades, certainly centuries, is a theory that is not testable. If a theory is at all testable, it will not remain unchanged. It has to change. All theories are wrong. One doesn't ask about theories, can I show that they are wrong or can I show that they are right, but rather one asks, how much of the empirical realm can it handle and how must it be modified and changed as it matures." (original paper unseen).

In summary, what these academics are arguing is that the groupthink model must be adapted to take into account the years of research which have followed Janis's initial findings in the early 1970's. What follows below is a review of the research of Baron (2005), Whyte (1998, 1989, 1993), Hart (1994) and Turner and Pratkanis (1998) suggesting modifications to Janis' groupthink theory⁵⁴.

Baron (2005) argues that Janis was correct about the symptoms of groupthink but incorrect when it came to identifying the antecedents of groupthink. "I contend that not only are these conditions [Janis's antecedents to groupthink] not necessary to provoke the symptoms of groupthink, but they often will not even amplify such symptoms given the high likelihood that such symptoms will develop in the complete absence of intense cohesion, crisis, group insulation, etc." (*ibid*, p. 13).

Baron's therefore suggests his ubiquity model of groupthink model representing a revision rather than a rejection of Janis's model by re-defining the antecedents of groupthink. Baron identifies three as opposed to the seven antecedents to groupthink suggested by Janis. Baron's first antecedent is that individuals must feel a sense of social identity with the collection of individuals they are among. If one is part of a group with a clear social identity, the theory

⁵⁴ This is by no means an exhaustive list of the literature in this area (see for example (McCauley, 1998; Raven, 1998; Schafer and Crichlow, 1996). However for the purposes of my thesis and in the interests of pragmatism a discussion was limited to the four views above which are representative of the types of modifications recommended to Janis's groupthink.

being that this will evoke feelings of allegiances and social identity. Baron's second antecedent condition is that group interaction must produce, or reveal, an emerging or dominant norm if the symptoms of groupthink are to occur. Lastly, Baron identified situational low self-efficacy as an antecedent to his ubiquity model of groupthink. Baron refers here to a situation where group members lack confidence in their ability to reach satisfactory resolution for the issues facing them in a decision process.

A review of Baron's antecedents reveal many similarities to that suggested by Janis, but not surprisingly the antecedents are less restrictive and allow for groupthink to develop in a much broader group setting than that envisaged by Janis. Excluded from his model are the requirements for intense cohesion, strong external threat in a crisis situation in which few feasible solutions are available, and the insularity of the group. Janis's other antecedents such as homogeneity of the group, directive group membership and low self-esteem are indirectly included in Baron's ubiquity model. Given the relaxation of the antecedent conditions proposed by Baron, it is not difficult to extrapolate from this that his theory that groupthink is much more common and pervasive than Janis had envisaged and therefore are not limited to high level, complex decision processes.

Baron does reconcile his model to Janis's when discussing the weak or strong version of his ubiquity model. The strong version of his theory holds that the three antecedent conditions Baron identified, were not only necessary for groupthink but also exhaustive. Baron however favours a weaker version of his model which implies that other antecedent factors, identified by Janis but rejected by Baron, as being causes of groupthink may still affect the groupthink process: "This moderate version of the ubiquity model leaves open the possibility that any of the antecedent conditions specified by Janis might still, under certain circumstances, heighten the likelihood or intensity of groupthink" (*ibid*, p. 37). In other words, Baron is less formulaic or prescriptive in identifying

specific antecedents of groupthink but rather that the impact of specific antecedent will be dependent on contextual circumstances.

Whyte (1998, 1989, 1993), offers an alternative groupthink model to that proposed by Janis and Baron. Whyte, like Baron above, does not challenge the concept of groupthink and predicts the same outcomes, decision making defects and symptoms of groupthink as defined by Janis but relies on different explanations for the antecedent conditions. Whyte draws on the research of Longley and Pruitt (1980), Fodor and Smith (1982), Leana (1985) and, in particular, Tetlock et al. (1992) to argue that group cohesiveness and the antecedents associated with provocative situations (high stress and low self-esteem) are dropped from the groupthink model. Whyte suggests replacing these antecedents with the concept of collective efficacy.

Whyte (1998) defines collective efficacy as “a collective belief about the group’s ability to successfully perform some task” (*ibid*, p. 189). Whyte derives this term from the notion of self-efficacy and draws on the definition provided by Bandura (1986) who describes self-efficacy as “people’s judgement of their capabilities to organise and execute course of action required to attain designated types of performances. It is concerned not with the skill one has, but with the judgements of what one can do with whatever skills one possesses” (*ibid*, p. 319).

In Whyte’s view, perceived collective efficacy can become problematic when it becomes too high resulting in overconfidence and ultimately poor performance. Whyte (1989) makes a clear differentiation between overconfidence which he sees as “probably doing more good than harm” (*ibid*, p. 203) and what he sees as a very extreme form of collective overconfidence: “It is only when beliefs of collective capability become unrealistically exaggerated, unduly disparate from what is realistically possible, and assume the quality and hubris that high collective efficacy should be eradicated because it leads to groupthink” (*ibid*, p203).

Whyte noted that past successes of the group would heighten levels of collective efficacy which would then have an impact on other antecedent factors exacerbating the likelihood of groupthink occurring. As leaders make decisions that at least in the short term are vindicated by events that unfold, they can become intolerant to opposing views and more likely to show signs of impartial leadership. Further, success can make groups less concerned with the needs to maintain methodical procedures, another antecedent of groupthink. Whyte also suggests that the length of the track record of success might also determine how quickly efficacy perceptions decline in the face of negative feedback. In other words, the longer the group is successful, the less likely that the self-efficacy will diminish when faced with a challenging situation. Historically successful groups are therefore more vulnerable to groupthink.

Whyte argued that Janis had confused high collective efficacy and cohesiveness and that Janis's approach is "infused with the notion of collective efficacy, although he does not use this term directly and attributes the formation of this attitude to cohesiveness as opposed to assigning it a role as the primary antecedent to groupthink" (*ibid*, p.203). Whyte refers to four case studies to illustrate this point, three of which relate to case studies cited by Janis himself.

Whyte (1998) links his core antecedent of collective efficacy to the symptoms of groupthink identified by Janis. He notes that illusion of invulnerability and the belief in the inherent morality of the group relate to excessive optimism (collective self-efficacy) and increased likelihood of risk taking without considering the consequences of such action. Further Whyte argues that the other symptoms of groupthink, namely self-censorship, an illusion of unanimity, direct pressure on dissidents and reliance on self-appointed mind-guards are all related to high collective self-efficacy.

Although Whyte recommends replacing high cohesiveness and provocative situational context with collective efficacy, he accepts Janis's antecedents relating to the structural faults of the organisation, namely insulation of the

group, lack of tradition of an impartial leader, lack of norms requiring methodical procedures and homogeneity of group members. Whyte therefore accepts the symptoms of groupthink, the antecedents related to the structural faults of the organisation but his contribution in the groupthink debate lies in his argument for the replacement of group cohesiveness and stress related antecedents with the concept of collective efficacy.

A comparison between Baron's ubiquity theory of groupthink and Whyte's collective efficacy theory highlights many similarities. Both theories are modification not repudiations of Janis's original concept. Both accept the symptoms of groupthink identified by Janis and many of his antecedents as well. Both theories have as antecedents the lack of the tradition of an impartial leader, lack of norms requiring methodical procedures and homogeneity of group members⁵⁵. Both theories rejected Janis's claim that high cohesion based on a strong attraction of group members was a necessary antecedent for groupthink and both theories dismissed Janis's antecedent related to decisions being made under high stress as an antecedent.

The difference between the two alternative theories being that Baron suggests the situational low self-efficacy is an antecedent for groupthink whilst Whyte argues that collective efficacy of group members is a necessary antecedent for groupthink. At first glance, these researchers appear to have diametrically opposing views; Baron is arguing that lack of confidence and belief of individual group members are unlikely to challenge the group norm and to go with what they see as the majority view. Whyte, in contrast, argues that the collective overconfidence of the group will lead to a poor decision making process. Both researchers provide cogent and convincing arguments and reconcile their finding back to the research findings of Janis. Koerber and Neck (2003) test the

⁵⁵ Baron did not consider insulation of the group a core antecedent whilst Whyte accepted all of Janis's antecedents which fell under the category of "structural faults of the organisation" which included insulation of the group.

application of Whyte's model in the sports arena and conclude that using Whyte's model that there was evidence of groupthink in the case studies. There is no external verification of Baron's groupthink model in a case study analysis but this does not in any way make the research any less meaningful⁵⁶.

The different research findings, described above, highlight the possibility that there is more than one path towards groupthink. Janis studies a series of political scenarios which involved cohesive groups in high stress and threat situations and concluded that the poor decision making was a function of premature concurrence seeking from members that valued the cohesiveness of the group above all else and named the process groupthink. Research from Baron and Whyte identify alternative paths to achieving the same outcome as that envisaged by Janis, and is consistent with Baron's assertion, that groupthink is more common than the limited scenarios studies by Janis. Indeed the number of different scenarios in which groupthink has been noted to have occurred as reflected in Table 1 in this chapter does highlight the pervasiveness of groupthink.

This multi-path approach has been adopted by Hart (1994) who identified two different types of groupthink; collective avoidance and collective over-optimism. Collective avoidance has similarities with both Baron and Janis's groupthink in that it has as an assumption a lack of confidence of group members in the decision process and the fear of failure. Hart argues that if members of a group perceive that there is the chance of failure individuals will try to avoid being held accountable for that and will do one of three things. Either they will exit the group, express their dissent for the record or, hide within the group in an

⁵⁶ Baron (2005) research is cited in 1201 articles and in the Nyberg Commission Whyte (1989) has 209 citations (source *Google Scholar* date 23/2/2015). Whyte's research was published 6 years prior to Baron's paper. Clearly the number of citations of a research paper is not an indicator of the quality of the research undertaken but they do provide some limited indication as to the impact of the research undertaken. Both papers are it is submitted impactful.

attempt to spread responsibility to the collective group (the groupthink scenario).

In contrast, groupthink associated with collective optimism assumes that group members perceive that the issues facing them are an opportunity for success and as a result are strongly motivated to co-operate with each other in achieving the expected rewards for success. Members susceptible to this form of groupthink are characterised by high self-esteem and confidence. Hart notes that this type of groupthink affects “high confidence groups working on high prestige projects, expecting major policy successes and career advancement as a result of their efforts” (*ibid*, p. 192). Whyte cites the research of Hart and aligns his groupthink theory closely to the “collective optimism” version of groupthink identified by Hart.

Hart adds that the distinction between these two types of groupthink can help to explain the symptoms of groupthink “illusions of invulnerability” which is difficult to envisage in the “pessimistic” variant but very possible in the “optimistic version”. Hart identifies both the Bay of Pigs and the Watergate cover up as examples of the “optimistic” version of groupthink, a view which Whyte (1998) agreed with when he presented his theory a few years later.

Hart therefore identifies between “pessimistic” and “optimistic” variants of groupthink thus highlighting that there may be more than one path to groupthink, and that Janis’s groupthink is not exclusive and that there are other antecedents which can affect the symptoms of groupthink resulting in a low probability of a successful outcome.

Hart (1994) identifies situations of intense intergroup competition and conflict between other groups as being an important factor in groupthink which had been largely ignored by Janis. He cites research from Blake and Mouton (1961) which shows that the presence of a threatening out-group increased intra-group solidarity and that the existence of such out-groups resulted in an increased tendency for group members to favour their own in group, consistently over-

estimating in-group products and achievements versus the out-groups. Hart then links four of the groupthink symptoms; namely illusions of invulnerability, belief in the inherent morality of the group, collective rationalisation and stereotyping of out-groups as symptoms that are exacerbated in situations of intense competition between other groups. Although this theory is not developed further by Hart, the role of out-groups in the groupthink process is another facet of the groupthink debate. This discussion will be developed further in the discussion of herding later in this chapter.

3.2.4. Is Groupthink a valid construct?

Given the clear lack of consensus surrounding the groupthink model, is the theory itself robust or should it be discounted as a potential explanation, either partially or wholly for the poor decision process of the Irish banks in the lead up to the crisis?

A review of the literature has revealed over one hundred articles and numerous textbooks covering the subject of groupthink. Articles have been identified through a research of the various academic databases at the University of Exeter, through article reference lists and in the identification of a collection of articles that appeared in a number of journals published in recognition of the theory's twenty fifth anniversary in 1998⁵⁷. The literature review revealed a lack of consensus around some of the aspects of the theory itself but only Aldag and Fuller (1998) recommend abandoning the model completely.

Aldag and Fuller argue that there has been little empirical support for the theory and that the theory has become legitimized because of its heuristic value and despite research which has highlighted weaknesses in the theory: "The quarter-

⁵⁷ Indeed, only in 2014, Sunstein and Hastie, eminent academics from the Universities of Harvard and Chicago Booth Business School respectively, published a book titled *Wiser: getting beyond groupthink to make groups smarter*".

century experience with groupthink represents an unfortunate episode in the history of group problem solving research. In view of the fact that there has been remarkably little empirical support for the groupthink phenomenon, that the phenomenon rests on arguable assumptions, that published critiques of groupthink have been ignored by groupthink researchers, and that groupthink is presented as fact in journal articles and textbooks, we see the continued advocacy of groupthink as a form of organizational Tonyandy, in which knowledgeable individuals fail to speak out against widely accepted but erroneous beliefs” (*ibid*, p. 163).

Aldag and Fuller’s article was published in 1998 and the authors did not have access to the research which has been undertaken since their article was written – including the works of Baron (2005), Hart (1994) and Whyte (1998) referred to above. Since Aldag and Fuller criticised the groupthink concept for its lack of empirical evidence, there have been a number of further research articles which have concluded that the theory is indeed valid. Further, Aldag and Fuller criticise the theory on the basis on the “strong” version of the theory arguing that, as there is a lack of consensus about the applicability of some of Janis’s antecedents and group cohesiveness in particular, that the whole basis of the theory is questionable. Other researcher have taken a much broader view of Janis’s concept of extreme premature consensus and extreme pressure for consensus seeking in a group setting, have accepted that this can be ascribed to the term “groupthink” and have then added to the literature on the subject with their own specific recommendations or observations.

Finally, Aldag and Fuller’s article and their rejection of the groupthink concept must be seen in context in which it was written. The article was written as part of a series of articles for the journal *Organizational Behavior and Human Decision Processes* in recognition of the twenty fifth anniversary since Janis presented his theory of groupthink. Other articles in the same series had praised the theory, for example Paulus (1998) described groupthink as a “brilliant construct” (*ibid*, p. 371). Aldag and Fuller presented a research

argument which balanced out these views; “we adopt the role of the devil’s advocate” (*ibid*, p. 163) which they saw very much in keeping with the spirit of what Janis would have wanted: “While it may seem ironic, or even unseemly, that we should take such a strong stand against groupthink in this volume, we see our position as entirely consistent with Janis’s call for the open airing of dissent. That is, in the face of an illusion of unanimity, where disconfirming information is regularly ignored or distorted and insiders struggle to present their preferred alternative in a favourable light, dissonant perspectives are essential” (*ibid*, p. 180).

Despite Aldag and Fuller’s concerns noted above, there is, however, support for the concept of groupthink. At the same time my thesis will recognise the literature which has been developed since the groupthink concept was formulated by Janis in 1972. A critical understanding of the literature with respect to herding, group polarisation, de-individuation, epistemic blind spots and economic bubble theory, builds on the findings of Janis, and enhances the overall understanding of the phenomena which can affect decision making processes in the context of corporate boards.

3.2.6 How to define groupthink for the purposes of my research

The literature review has identified many versions of groupthink and therefore great flexibility for the researcher in deciding how to define groupthink. Should the research focus exclusively on Janis’s (1972) version which has as a core antecedent high levels of group cohesiveness coupled with high stress and low self-esteem? In contrast, Baron’s (2005) version of groupthink stresses low self-efficacy but de-emphasises Janis’s core antecedent of group cohesiveness and anticipates that groupthink will occur in a much wider range of group settings than those envisaged by Janis. Whyte (1998, 1989) also deemphasises cohesion and stress but identifies collective efficacy as a key antecedent whilst Hart recognises different types or paths to groupthink. Finally, researchers such

as Eaton (2001) take a very liberal view of the groupthink term, ascribing the theory with limited evidence. Which groupthink version should my thesis adopt?

In answering this question, a researcher must first decide whether to accept either the “weak” or “strong” version of groupthink. The strong version relates to an integrated set of characteristics with deterministic linkages as set out by Janis whilst the weak version is used generically to explain poor decision making in a group setting that is vulnerable to conformity pressures.

Esser and Lindoerfer (1989) in their analyses of the Challenge Space Shuttle disaster argue for a weaker version of groupthink and that it is a syndrome which can be identified when a majority but not necessarily all of the symptoms of groupthink are present. They contend that there might be cases where not all the groupthink symptoms are relevant. For example, not all situations involve an “enemy” out-group and therefore stereotyping the out-group may not always be relevant. In summary, the absence of a particular symptom should be seen in context and not necessarily lead to the conclusion that groupthink has not occurred.

Hart (1994) is a strong critic of the weak form of groupthink and the use of the term in a more generic and colloquial manner as a broad reference to explain poor decision making in a group setting. Quick characterisation of a poor decision process as being the result of groupthink, without any academic rigour or thorough investigation can, he argues, create the illusion that groupthink is an all-purpose label that can be used to explain any number of unsatisfactory outcomes. He warns that if the weak version becomes widely accepted then the concept will “become a kind of analytical garbage can for commentators and analysts in need of a powerful metaphor when they seek to blame policymakers or managers for a variety of ills and evils of governance” (*Ibid* p. ix).

Paulus (1988) backs up this view and notes that the misuse of the term groupthink can be dangerous and that inaccurate use of the term can compromise overall group effectiveness. Aldag and Fuller (1993) further

maintain that the weak interpretation of the model is sometimes used in response to the failure of empirical examinations to provide results wholly consistent with groupthink.

Janis (1982) appears to support a stronger version of the theory: “it does not suffice merely to see if a few of the eight tell-tale symptoms of groupthink can be detected. Rather, it is necessary to see if practically all of the symptoms were manifested and also to see if the antecedent conditions and the expected immediate consequences – the symptoms of defective decision-making – are also present” (*Ibid*, p. 60).

In contrast Turner and Pratkanis (1998) and Esser and Lindoefer (1989) argue that only a limited number of the antecedents need to be present. Baron (2005) and Whyte (1989) even question the validity of some of Janis’s antecedent as highlighted in chapter 2.

Further another challenge relates to the relative depth of observations and the implications for the groupthink construct. For example, one might observe socio-emotional cohesiveness in two separate case studies but the level and depth of such cohesiveness might be significantly greater in one of the case studies. As an illustration, if one was reviewing two case studies, (case “A” and “B”) and observed more of the symptoms and antecedents of groupthink in case “A”, but in case “B” the depth of the observations were much more profound, how would you compare the two cases? This lack of certainty reflects the subjective nature of the groupthink construct itself and the reliance on the judgement of the researcher and, it is submitted, is an identified shortcoming in any research in this area. Further, it highlights the epistemological challenge of defining groupthink.

In order to provide some context to the debate on the groupthink definition, a comparative study focusing on five case studies was undertaken. These case studies were chosen for review based on two criteria. First, three of the five case studies refer to corporate examples of groupthink with respect to Marks &

Spencer and BA (Eaton, 2001), Enron (O'Connor, 2002), and WorldCom (Scharff, 2005). As such they provide direct comparisons for the Anglo case study. Second, the remaining two case studies selected are more recent cases of groupthink and reflect the most recent thinking in this specific area of research. These studies relate to President Bush's decision to invade Iraq (Yetiv, 2003) and the defeat of the French to Germany in the Second World War (Ahlstrom and Wang, 2009). These five case studies are not meant to be an exhaustive list for comparative purposes but rather to provide some context to explore the aforementioned research questions. A detailed comparative analysis of the five case studies is found in Appendix 4.

The analysis of these case studies provides two broad observations relevant to the discussion on the groupthink definition. First, when analysing groupthink, research by O'Connor (2002), Yetiv (2003) and Ahlstrom (2010) have remained faithful to the original conceptualisation of Janis's model. They have carefully analysed Janis's antecedent and symptoms and rigorously looked for evidence of each antecedent and symptom before concluding the existence of groupthink. These academics observed supporting evidence for nearly all the antecedents and symptoms of groupthink (a full analysis of their findings is found in Appendix 5). In contrast, Scharff (2005) and Eaton (2001) self-selected the antecedents of groupthink. Eaton in particular has taken a very loose interpretation of Janis's groupthink concept. Eaton does not, for example, consider nor discuss cohesion as a necessary antecedent condition for groupthink and redefines groupthink as "dogmatic decision-making strategy in conditions of general management stress, inducing tendencies to search for strong leaders, resulting in conformity and compliance" (*Ibid* p. 184). In this comment Eaton has totally redefined and reconceptualised Janis's groupthink into a much more generic and wider form of concurrence seeking in group settings and has then labelled this as groupthink.

Further, two of the researchers (O'Connor and Yetiv) focused on providing evidence for both the antecedents and symptoms of groupthink whilst the other three research papers focused only on the symptoms of groupthink.

My research will follow the lead of O'Connor and Yetiv, and focuses on *both* the antecedents and symptoms of groupthink and will focus on the “strong” form of Janis’s original groupthink construct. The perceived advantage of this approach is two-fold. First, it reduces the risk of self-selection of the antecedents and symptoms of groupthink related and mitigates the risk of a confirmation bias in the research. Second, by measuring groupthink against the strong form of groupthink my analysis will be testing the groupthink construct in the most rigorous and systematic way.

The disadvantage of this approach is that by following Janis’ construct, the research does not directly reflect the developments and suggested modifications to the groupthink construct which have been suggested and discussed above. Baron (1995) for example argues that groupthink is ubiquitous and is far more widespread than anticipated by Janis. Baron identifies just three rather than Janis’ seven antecedents of groupthink. Further Whyte (1998) and Hart (1994) both suggest alternative antecedents to groupthink which focus on high levels of confidence, an attribute that it is submitted will be easier to observe in the Anglo case study which focuses on a period characterised by high levels of confidence associated with a property bubble. In other words, applying Janis’ groupthink is a more difficult task for the researcher with reference to the identified Irish case study.

However, difficulty in evidencing a construct should not be primary reason for choosing a specific definition. Rather the decision on which version of groupthink to apply must be based on a strong epistemological foundation. It is submitted that, as highlighted in the literature review in chapter 2, that there are different but equally acceptable paths to groupthink. Janis’ construct represents one such path. An “advantage” to Janis’ version of groupthink is that it has at is

core high levels of socio-emotional cohesiveness where the attraction and prestige to the group is high. This type of cohesiveness and attraction to the group is an attribute that can be associated with corporate boards and as such, it is submitted that Janis' path to groupthink is particularly relevant. This is not to say that groupthink cannot be achieved through other routes, rather that Janis' groupthink resonates in the context of corporate boards⁵⁸.

In summary, the research will follow Janis' antecedents and symptoms of groupthink but will reflect where appropriate with the findings of subsequent research identified and discussed in this literature review⁵⁹.

The observation above identified a method of how groupthink can be measured. The second observation from the review of the five case studies relates to the identification of the sources of information that will be used to test the construct. Researchers in the aforementioned case studies relied on a number of sources for the analysis of their data including formal SEC investigations, press reports, and published articles. O'Connor (2002) additionally relied on a body of literature which defined general boardroom norms and then looked to apply these to the Enron case. In Ireland, and specifically with reference to Anglo, there are a number of comparable sources of information that are available for review. The three official inquiries into the Irish banking crisis (Honohan, 2010; Nyberg, 2011; Regling and Watson, 2010) provide an excellent insight into the Irish banking sector and Anglo in particular. A number of academic articles have been written on the Irish banking crisis and more generally on corporate governance in Ireland (Donovan and Murphy, 2013; Kelly, 2009; Kinsella and

⁵⁸ It could be argued that I have self-selected a variant of groupthink increasing the likelihood of a suspicious fit. Whilst I recognise this criticism, as highlighted above Janis' strong version of groupthink is actually more stringent than other "looser" variants of groupthink.

⁵⁹ How this will "work" in practice will become evident in the chapter of the analysis of groupthink at Anglo in the lead up to the crisis. In particular refer to the discussion of research question 2g) as an illustration of this.

Leddin, 2010b; Mac Canna et al., 1998; O'Sullivan and Kinsella, 2011). Although none of these articles focus exclusively on Anglo, they do provide information which can, and will be used, when assessing this research question.

Further, there have been a number of books which have been written on the banking crisis and three that focus exclusively on Anglo (Carswell, 2011; Kelly, 2010; Lyons and Carey, 2011). These books include a number of interviews with decision makers at Anglo. Lyons and Carey's (2011) book in particular is based on a series of interviews undertaken with Sean Fitzpatrick (who was both CEO and then Chairman of Anglo). Finally, the literature review that was undertaken earlier in this thesis with respect to both groupthink and corporate governance norms and regulations provides a number of applicable academic references.

3.2.7 Groupthink and unethical behaviour

An additional stream of research relates to the linkage between groupthink and unethical behaviour. Indeed, O'Connor (2002) and Scharff (2005) observed groupthink behaviour at WorldCom and Enron respectively both organisations in which unethical (and illegal) behaviour occurred. What follows below is a discussion of why there is such a linkages and why boards which are vulnerable to groupthink tendencies are also vulnerable to acting unethically.

Sims (1992) identifies organisations that have highly cohesive management boards that value loyalty as being more likely to have a culture that diffuses individual responsibilities for the consequences of unethical behaviour. In effect,

a process of de-individuation occurs that diffuses responsibility of an individual with respect to an ethical indiscretions undertaken in a group setting⁶⁰.

Sims highlights the risks that highly cohesive groups, that value the preservation of the group itself above all else, (as identified by Janis in groupthink theory) can result in situations where ethical indiscretions will be ignored should they conflict with a preferred option: "The group is likely to perceive few ethical alternatives and to ignore potential problems with the preferred alternative. The group may reject any opinion that does not support the preferred alternative, and it is unlikely to reconsider an alternative previously dismissed by the group, even in light of new evidence. Decisions made through such a process are not always unethical, but there is a higher probability of the occurrence of unethical behaviour". (*ibid*, p. 654)

Ford and Price (1996) also link groupthink to corporate dishonesty and in particular the potential for individual self-deception to evolve into group self-deception when they commented: "Arguably, groupthink represents a dangerous form of self-deception. To meet social needs an individual suspends his or her independent critical facilities and yields to the demands of the group ...The more powerful and influential individuals sway the group, often deceiving themselves that the decision was correct because group unanimity was

Hall (2007) highlights the risks that high levels of confidence and high self-esteem can lead to dishonest behaviour. This can occur when over-confident people take on too much, or set goals too high for themselves, and are then faced with the possibility of failure impacting on their self-esteem. In such circumstances, subjects are at risk of engaging in unethical behaviour in an attempt to prevent failure. Hall highlights the management of Enron as an

⁶⁰ The process of de-individuation and the linkage to groupthink is discussed in detail later in this chapter.

example of this, where there existed a “superstar” culture and executives believed that they could do no wrong.

Langevoort (1995) argues that group dynamics can affect and bind individuals together and blind them to their ethical indiscretions and that the process of dishonesty are compounded at group level as a process of de-individuation occurs and the collective ego of the group takes over: “the organisation develops a collective ego that serves much the same function (and dysfunction) as the individual one. The collective egocentric bias is compounded by the diffusion of responsibility characteristic of large organisations, which encourages self-protective inference” (*ibid*, p. 874) . A number of the characteristic highlighted above as being synonymous with unethical behaviour are consistent with the symptoms of groupthink identified by Janis.

The symptom of groupthink “illusions of invulnerability” can be related to Hall’s (2006) observation above regarding the “superstar” culture within the management of Enron.

Tenbrunsel and Messick (2004) highlighted that the greater the perceived benefit of a specific course of action, the more likely we are to morally disengage and become wilfully blind. An environment in which a group is highly cohesive and maintenance of the group “esprit des corps” is highly valued by group members (a precondition for Janis’s groupthink) would provide a strong motivation for group members to ignore ethical considerations in decision processes.

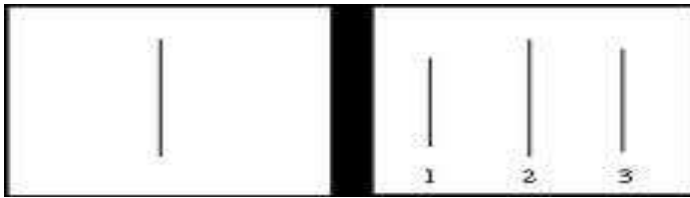
Indeed, Janis’s “best example” of groupthink was the Watergate cover up (Janis, 1982), whilst groupthink has been evidenced at both Enron (O’Connor 2002) and WorldCom (Scharff, 2010), and Hall (2007) links the failure and the fraudulent actions of the directors’ of Australian insurance company HIH to groupthink. All of these companies have been characterised by unethical behaviour by management. It does not necessarily follow groups that are

susceptible to groupthink will commit ethical indiscretions, however, it is argued that such groups are more vulnerable to the risks of making unethical decisions.

3.3 Herding

Herding literature can be traced back to the writing of Keynes (1937) when he used the metaphor of voting in a beauty contest to describe the actions by rational actors in a market. At that time, beauty competitions were popular in newspapers, who would print one hundred photographs of women inviting contestants to write in with their views as to the faces they liked most. Contestants who picked the most popular face would then be entered into a raffle where they could win a prize. Keynes used this example as a metaphor to explain stock valuations and that pricing shares was not based on market fundamentals but rather on the views of what others thought the value of stock might be: “It is not a case of choosing those [faces] which, to the best of one’s judgement, are really the prettiest, nor even those which average opinion genuinely thinks the prettiest. We have reached the third degree where we devote our intelligences to anticipating what average opinion expects the average opinion to be”. (Keynes 1937 chapter 12)

One of the most famous social experiments in the area of social conformity was undertaken by Asch (1952). Asch gathered a group of seven to nine college students in a classroom. These students were then asked to compare the length of lines shown on two large white cards. On one card was a single vertical black line and on another card were three vertical lines of various lengths. The subjects were then asked to match the single vertical line to the line of the same size of the other card. The experiment was designed so that it was obvious which lines matched. An illustration of this is reflected below with the line on the left matching with line “2” on the right:



The subjects, all University students, were asked to give their answers sequentially and the experiment was manipulated so that all participants, bar one, were confederates instructed to give incorrect answers before the answer of the true participant. Asch found that individuals matching the lines made mistakes less than one per cent of the time when asked to complete the experiment on their own, whilst in a group setting, the minority subjects swung to acceptances of the misleading majority judgements in 36.8% of the selections.

Asch interpreted the results as showing the social pressure brought to bear by others on individual judgement as subjects “desperately tried to merge with the majority” concluding that the “social process is polluted ... we have found a tendency to conformity in our society so strong that reasonably intelligent people are willing to call white black is a matter of concern” (Asch (1952) p. 21 cited by Sunstein (2000a)). Asch’s findings were widely cited as providing a scientific basis for claims that people do not have fully independent judgement and is still cited today⁶¹, despite the doubts which have been raised in the interpretation of his results as noted below.

Deutsch and Gerard (1955) tested Asch’s conclusions with a controlled experiment identical to that undertaken by Asch, with one important difference: subjects were placed anonymously into groups of people they never saw (they

⁶¹ Asch’s findings were published at a time of widespread concern over what was seen in the Western world as the threat of communist propaganda and brainwashing and continued bemusement relating to the German people obedience to the Nazi persecutions.

were separated by a partition and communicated only using a simple light system) and were told they would never see the other participants again⁶². Deutsch and Gerard found that subjects gave nearly as many wrong answers as when tested in Asch's original experiment, and suggested that wrong answers had been given not because participants have been afraid to express a contrary view, but rather they were reacting to the information that when the vast majority of people share a view then that view must be correct. Deutsch and Gerard therefore interpreted Asch's finding as being information based rather than due to normative social influences.

Another widely cited experiment relevant to herd behaviour was performed by Milgram (1963). In his experiment, subjects on an individual basis were asked by an "expert" scientist to administer a series of electric shocks to an individual who, unbeknown to the subject was a confederate. The confederate was not actually being shocked, but was feigning great distress and pain to the subject and requesting for the shocks to be stopped. However, when the experimenter told the subjects that the shocks would cause no lasting damage and urged them to continue administering the shocks, many did so.

These results were widely interpreted as demonstrating the enormous power of authority and the willingness to accede to authority. Another interpretation is that people learn that when experts tell them something is correct, it probably is, even if it does not seem to be the case (Shiller, 2005). In other words, the experiment can be interpreted at least partly as an information based interpretation of the results. This view is backed up by a variation to Milgram's initial experiment in which he found that when the shocks were not being controlled by an "expert", there was a much diminished tendency for the subjects to continue to take orders to continue giving electric shocks.

⁶² There was no "group" behind the partition only the experimenter manipulating the signals simulating the actions of a group member.

This informational based conformity is the basis for the “seminal” theory (Chamley, 2004) of informational cascades developed by Bikhchandani, Hirshleifer and Welch⁶³ (Bikhchandani et al., 1992) based on models of Bayesian learning⁶⁴. The theory maintains that an information cascade occurs when information secured from predecessors’ actions is so conclusive that a rational follower will unconditionally follow the choices made by those before him and ignore his own private information. BHW define an informational cascade as an occurrence “when it is optimal for an individual, having observed the actions of those ahead of him, to follow the behaviour of the preceding individual without regard to his own information” (Bikhchandani et al., 1992, p. 992).

Decisions in these circumstances are, therefore, not based on a coercive pressure to conform, but a rational act based on the information that has accumulated which overrides her private information even if this points to a different decision. Once this point is reached, her decision becomes uninformative for later choosers so her decisions does not reflect any further learning and the individual that follows is in the same position and will also join the cascade. The term “cascades” and “herding” are used interchangeably by researchers (see for example Shiller (2005) or Easley and Kleinberg (2010)) and for the purposes of this thesis will be used to describe a normative influence on decision processes which is a result of a belief by an actor that others have an informational advantage, suppress their own information and follow the herd.

⁶³ Bikhchandani, Hirshleifer and Welch will be shortened to “BHW”.

⁶⁴ The Bayes model is a model of decision making under uncertainty and works with probabilities given information you possess and information you have observed models the decision that a rational actor should make.

Informational cascades have been proven to occur in laboratory settings (Anderson and Holt, 1997, 1996) and Easley and Kleinberg (2010)) by using a simple urn with different colour marbles. In one version of this controlled experiment, the experimenter tells the subjects there is a 50% chance that the urn contains marbles in the ratio of two red for every one blue and a 50% chance that the ratio is reversed; two red for every one blue marble. Subjects are invited to draw a marble from the urn, observe its colour and place it back into the urn without showing it to the other subjects. The subject then has to guess whether the urn is majority blue or majority red. Individuals can therefore observe the actions not the signals of their predecessors – so that they do not see the colour of the marble drawn but are informed as to the choice; majority red or blue. Each individual therefore starts with some private information, obtains some information from predecessors, and then decides on a particular action.

The first subject has an easy decision to make; if she draws a red marble then the rational decision is to guess majority red. This guess conveys perfect information about what (s)he has observed. If the second subject sees the same colour as the first logically she would guess the same colour as well. If however, the subject sees the opposite colour, she should be indifferent as to what guess to make (one red and one blue marble drawn). It is the scenario when the first two subjects have announced the same colour, blue, and the third subject draws red that an information cascade can develop. When the first two guesses are the same the third subject should rationally (and in accordance with bayesian theory⁶⁵) guess blue regardless of the colour which she draws from the urn, and hence regardless of her own private information. The fourth subject is faced with a similar choice to the third, she knows that the third subject would guess blue regardless if her own information so this guess

⁶⁵ Easley and Kleinberg (2010) provide a full analysis of the working of the model and the decision process applying the model to this simple example.

conveys no information. So the fourth student is in effect in the same situation as the third subject and whatever colour she draws is outweighed by the first two draws of blue and, like the third subject, should guess blue. What can be inferred from this controlled experiment, is that over time and as the number of people guessing trends towards infinity the probability of a cascade begins to converge to one ((BKW (Bikhchandani et al., 1992) and (Easley and Kleinberg, 2010)). Indeed Anderson and Holt (1995, 1996) found that in ninety four cases when an individual was confronted with a situation in which it was optimal to follow the guesses of her immediate predecessor in seventy nine of these the individual acted against their own signal and followed the cascade.

From this simple model a number of inferences can be made. First, an information cascade can lead to a non-optimal outcome. For example, in a blue majority urn, there is a $1/3$ chance of the first student drawing a red ball and a $1/3$ chance of the second student also drawing a red ball, and a $1/9^{\text{th}}$ chance that both the first and second student draw a red ball. There is therefore a $1/9^{\text{th}}$ chance that a red cascade is incorrectly created. Further, this error will not be corrected by subsequent guesses of the urn, as all subjects should guess red and disregard their own information if the first two guesses are red⁶⁶.

Second, informational cascades can be based on very little information - in the example above on just the observations of two subjects - and as a result this can make a cascade easy to start but if new information is made available it can also be rapidly reversed. Cascades can therefore be fragile (as is often demonstrated with fashion fads). The attached cartoon from *The Economist*⁶⁷ light heartedly illustrates the fragile nature of cascades:

⁶⁶ This is what is known as a "reverse" cascade.

⁶⁷ Found on <http://www.flickr.com/photos/60433209@N00/2867609321/> on 26/1/13.



Third, informational cascade are, as demonstrated above, all pervasive and as such are an attractive means of explaining mass behaviour in areas such as consumer behaviour, politics, business strategy and crime enforcement and even academic publications (Bikhchandani et al., 1998). In the area of crime enforcement, there is evidence that the decisions to commit crimes is influenced by observing the behaviour of others and that when individuals see crimes going unpunished they interpret that the rewards from crime outweigh the costs. Shefrin and Triest (1991) showed that news stories about tax evasion led to greater number of people evading tax. In an academic environment if a journal's referee is aware that a paper had been previously rejected, this would provide information to the referee about a signal from a previous referee and increase the chances that the referee also rejected the paper.

The information cascade model presented by BKW is an extremely simple model of decision making in a controlled environment. It has many assumptions such as sequential decision making, and it may well be that subjects don't see all the decisions made but only a few. Further, it assumes that all the signals convey equal information and does not account for differences in influence

amongst actors. Easley and Kleinberg (2010), whilst recognising these factors as potential limitations, argue that the basic principle of the model holds true: “When people can see what others do but not what they know, there is an initial period when people rely on their own private information; but as time goes on, the population can tip into a situation where people – still behaving rationally – begin ignoring their own information and following the crowd” (*ibid*, p. 442).

Information cascades are more likely in areas where information is more readily communicated and disseminated. Shiller (2005) notes that certain type of information flows more freely than others, especially if the topics are imbedded in the psyche of a society or are important to the basic instinct of survival: “These topics resemble the kinds of things that our ancestors have talked about since time immemorial. But conversation seems to flow less well about abstract topics, such as the mathematics of finance, or statistics about asset returns, or optimal levels of saving for retirement. Transmission of such knowledge is of course effortful, infrequent, and imperfect” (Shiller, 2005 p. 161).

The Irish obsession with property ownership and the property bubble which developed in Ireland in the build up to the financial crisis of 2007, would be a good example of information which would potentially be susceptible to a formation of a cascade given that it is very much imbedded in the Irish psyche. This is discussed in greater detail in the literature relating to epistemic blind spots discussed later in this chapter.

A cascade will depend on the subjects subordinating their own private information in favour of the signals which they have received from others. There is no social learning or exchange of ideas taking place. If, however, subjects come from diverse backgrounds, they are more likely to have access to different sources of information and to have the confidence to act on their own private signals, and therefore less likely to allow the signals of others to dominate. In revealing their information to the group, diverse subjects would increase social

learning and could facilitate the breaking of cascades. Group diversity could, therefore, reduce the likelihood of information cascades occurring.

Related to this argument is research by Easley and Kleinberg (2010), who found that the spread of an information cascade will stall when it tries to break into a tightly-knit community within the network. Easley and Kleinberg refer to this as a “blocking cluster”, and argue that this blocking cluster is the only thing that will cause an information cascade from developing further.

The model which they applied is based on the assumption that each node in a social network has a choice between two behaviours “A” and “B” and assumes that if two nodes are linked, then there is an incentive for the nodes to have their behaviours linked⁶⁸. Using an algebraic equation the authors create a decision rule for each actor, ascribe a value of “2” and “3” for behaviour “A” and “B” respectively, and then model the impact of diffusion on a specified network. What their research highlights, is that the process becomes a chain reaction of the adoption of behaviour “A” until the network comes across a tightly knit network which blocks the spread of adoption.

Although the model has very limited practical application, it does provide some evidence to illustrate that an information cascade will spread in a closely connected network. Further homophily can create a barrier by making it harder for information to be disseminated from outside a densely connected community. Therefore, a closely knit community is both more susceptible to the spread of an information cascade within the dense network, but is also less susceptible to the spread of cascade originating from outside the network to infiltrate the closed network itself⁶⁹.

⁶⁸ This may be relevant if perhaps they are sharing a common technology.

⁶⁹ The implication has been in this paper that informational cascades are a negative, and result in a lack of social learning and can lead for example to asset bubbles. Information cascades

Information cascades can be applied not only to understanding mass behavioural movements such as why the Irish population became so hugely overexposed to property during the financial crisis, but also to understand how it might affect decisions making within small group settings, specifically within boardrooms. In particular, a scenario in which a board discusses a strategy and board members are asked to opine in sequence to express a view on a particular issue, can result in an information cascade. In this scenario, a cascade could occur if board members assume that early contributors to the debate have information which is comparable or even greater in quality than their own and will suppress his/her own information.

3.3.1 Herding and Groupthink

BHW recognise that there are other explanations for conformity which are based on peer pressure rather than the rational decision making process of the informational cascades model. They suggest combining the impact of informational effects with psychological effects to ensure a better understanding of the decision process: “We believe that the integration of learning/cascades effects with other factors will lead us to better theories about the process by which society locks into technologies, or customs” (Bikhchandani et al., 1998). Indeed, it is the intention of this thesis to do just what BHW are suggesting, and to integrate the literature relating to both normative and informative influences on decision processes.

Although they are coming at it from different perspectives, groupthink and herding have in common a suppression of individual thoughts in favour of others’ views. Herding arise as subjects suppress their own information and rely

could, however, have positive externalities if the information being disseminated is for example a type of innovation or health benefit.

on the informational signals they have received. Similarly with respect to groupthink, Janis notes that “when groupthink dominates, suppression of deviant thoughts take the form of each person’s deciding that his misgivings are not relevant, that the benefit of the doubt should be given to group consensus” (Janis, 1972, p. 201).

Given this common thread of a suppression of individual thought, it is not surprising that groupthink and herding share common attributes. One common attribute is the existence of an influential directive leader. Janis (1972) identifies the existence of a directive leader as an antecedent of groupthink. The leader of an organisation should be impartial instead of stating preferences and expectations at the outset of any deliberation process as a means of helping to prevent groupthink. BHW warn of the risk that early disclosure by more prominent individuals (perceived as having better quality information) can exacerbate the likelihood of a cascade forming as subsequent subjects are more likely to suppress their own information should it be different to that which is already disclosed. For this reason, BHW suggest that it is social desirable that information in a group is communicated in reverse order of seniority, a recommendation shared by Janis and indeed practiced in the Ancient Israeli Courts (Schnall and Greenberg, 2012).

Another linkage between the two processes is homogeneity. Herding and groupthink are both potentially heightened in homogenous groups with no/little diversity. Homogeneity was identified by Janis as being an antecedent of groupthink and the link between group homogeneity and groupthink has been widely accepted by other researchers; see for example Baron (2005), Whyte (1998), Hart (1994) and Schafer and Crichlow (1996). Further as highlighted above, homogeneity plays a role in group herding; see for example Easley and Kleinberg (2010).

Information cascades are more likely to be broken if subjects rely on their own private information rather than suppress this in favour of signals received from

preceding others. Subjects who have information from diverse sources are more likely to have the confidence to rely on their own information than those from homogenous sources.

Another common thread between herding and groupthink is that both processes are exacerbated through high levels of competition. Hart (1994) and Turner and Pratkanis (1998) identified competition between groups as an important contributing factor contributing towards groupthink, as the threat from out-groups increases both intra-group solidarity and the tendency for group members to favour their own group. Competition between groups also increases the likelihood of herding in an effort to maintain market share relative to competitors, as identified above. Therefore, the threat of competition affects both groupthink and herding tendencies⁷⁰.

There is also a complex interplay between the phenomena of groupthink and herding. Herding is often related to the motivation of an organisation to compete and maintain market position and is viewed as a process which occurs *between* different organisations. Herding can also be viewed from within an organisation where individual actors assume others have superior information and are suppress their own information and herd. This risk is particularly highlighted in boards of directors and in relation to NEDs with low functional and firm specific knowledge that are more likely to follow what they perceive as an informational advantage of the executive directors and herd.

The likelihood of such NEDs herding is, it is submitted, exacerbated in groups which exhibit the symptoms of groupthink. NEDs that are looking to preserve the unity of the group, and are suffering from the symptoms of groupthink, are more susceptible to reduce their challenge. This lack of challenge will be

⁷⁰ The impact of competition on both normative and informative influences on decision processes is discussed in detail later in this thesis.

exacerbated if such NEDs *also* believe that executive directors have an informational advantage. In other words, the normative and informative pressures combine together to reduce challenge and increase the likelihood of a poor decision processes being undertaken. Therefore, a director faced with both the social pressure and the informational pressure to conform is less likely to challenge and more likely to go along with the status quo. The risk of these influences combining together is heightened if such a firm is characterised by common attributes such as homogeneity, directive leadership and high levels of competition.

Furthermore herding and groupthink can combine on another dimension. An organisation which has made a poor internal decision related to groupthink, and possibly “internal” herding, provides an opportunity for other firms to emulate this behaviour by herding. Groupthink creates a situation whereby a firm makes a poor decision, whilst herding amplifies the situation when other firms embark on the same strategy. Groupthink (and possibly herding) within an individual firm can create a situation which increases the risk of a firm making a poor decision, whilst herding can amplify the situation when other firms embark on the same strategy, increasing systemic risk. This identified interplay between groupthink and herding is developed further in the building of my model of poor decision processes in chapter 6.

3.3.2 Conclusion

The review of the literature has identified common trends between groupthink and herding and that both phenomena related to a suppression of individual thoughts in favour of the views of others. The motivation for this suppression of thoughts is different for these phenomena. In groupthink, the suppression related to the normative influences relating to the desire to preserve group unity, whilst for herding, the informative influences relate to a belief that others have superior information. However, both phenomena share common attributes,

namely; that they are exacerbated by the existence of a directive leader, homogeneity and high levels of competition.

Finally this chapter has identified that herding and groupthink can interact with each other in different ways, both internally within a firm and between firms, increasing systemic risks of a poor decision process occurring.

3.4. Group Polarisation

The concept of group polarisation can be traced to James Stoner's unpublished Master's thesis (1961). Stoner asked business school students to respond to a series of fictitious dilemmas using a choice dilemma questionnaire in which they had to decide between a cautious course of action with a small benefit, and a risky option with a large potential payoff. Stoner found that when people worked together in groups on this kind of problem, they opted for the more risky action than when they made decisions alone. Stoner termed this phenomena a "risky shift" and it sparked a flurry of research to test this assertion; so much so that Cartwright (1971) commented that "rarely in the field of social psychology has a single study stimulated as much research as the master's thesis by Stoner" (*ibid*, p. 361).

Subsequent research disproved Stoner's "risky shift" phenomena. In Stoner's research, students had an initial predisposition towards a risky position and this accounted for the shift towards a more risky outcome. However what researchers subsequently found, was that the direction of the shift depended on the original disposition. In other words, if individuals that care about loss interact with each other, they make more conservative decisions whilst those that had a great appetite for risk make riskier decisions when they interacted (Levine et al., 2000). The risk shift that Stoner had observed was not a tendency towards a risky outcome but rather a tendency to polarize. The question that researcher then focused on was not why do group decisions cause risky shifts, but rather

why do group decisions cause more extreme choice shifts either to a more conservative or riskier position than individuals.

It was Moscovici and Zavalloni (1969) that clarified this process and coined the term “group polarization” as a means of explaining that groups tend to be more extreme in the direction in which they were already tending. The concept of group polarisation has become widely accepted and recognised in the literature and has been found to occur in a wide range of countries using a wide range of participants in both laboratory and natural settings (see for example Dion et al. (1970) and Lamm and Myers (1976)).

Three theories have developed to try to explain why groups have a tendency to polarise; social comparison, persuasive argument and social identification theories. These are explained below:

3.4.1 Social Comparison Theory

Social comparison theory is based on the work of Leon Festinger (Festinger, 1954) and asserts that actors espouse opinions which are less extreme than their true opinions because of a fear as being seen as an outlier. However, if group discussions reveal that others have similar or even more extreme positions, actors shift their positions towards their true values and may even be encouraged through competition to become more extreme. Advocates of the social comparison theory include Sanders and Baron (1977) and Goethals and Zanna (1979).

Sanders and Baron (1977) sum up the theory as follows: “People often value opinions more extreme than those they personally espouse. People fail to adopt these (extreme) positions as their own due to fear of being labelled an extremist or deviant ... However during a group discussion, in which members may compare their positions, relatively moderate members may realise that relatively extreme members hold opinions closer to their most admired positions. This

realization either “releases” the moderate members from their fear of appearing extreme, or motivates to “compete” with the extreme members to see who can come closest to espousing the most admired position. In either case, the moderates are motivated to adopt more extreme positions, while there is no corresponding pressure on extreme members to moderate their opinions (although of course, simple conformity pressure may lead to some small amount of moderation by extreme members). The net result is an overall polarization of opinions.” (*ibid*, p. 304)

Friedkin (1999) explains the social comparison theory as a process of de-inhibition followed by a status competition that brings about polarisation (*ibid*, p. 859). The social comparison theory of group polarisation relies on knowledge of what other group members’ position is, and therefore requires that their positions are revealed or communicated. Research has found that mere exposure to other actors’ opinions without actual verbal communication was enough to produce group polarisation. For example Blascovich et al. (1975) found that people playing blackjack in groups made riskier bets than when playing on their own when actors could observe other players bets but could not discuss them.

3.4.2 Persuasive Argument Theory

The persuasive argument theory was put forward by Burnstein and Vinokur (1977) and has at its core the assumption that on any issue under deliberation, it is unlikely that there is a precisely equal balance of arguments for and against a specific issue but rather that there will be leaning in a specific direction. Before any group discussion takes place, individuals would not have access to all the arguments. However once the discussion gets under way, each actor becomes acquainted with more of the arguments supporting the dominant view and group members respond to the additional information and evidence supporting the initially favoured view by shifting their opinion further in that

direction. The group shift, or polarisation, is therefore dependent on actual or implicit arguments that result from group discussions. As Burnstein and Vinokur (1977) note: "When a preponderance of arguments in the pool favors a particular alternative, the average prior attitude reflects the direction and magnitude of this preponderance. Further thought or discussion leads to polarization toward the alternative that initially elicits more and/or better arguments" (Burnstein and Vinokur (1977 p. 316) cited by Friedkin (1999)).

3.4.3 Social Identification Theory

Social identification theory is based on Turner's (1985) self-categorization theory and argues that polarisation is a result of group members attempting to conform to a shared in-group norm as what they see as prototypical for their in-group. Turner describes the prototype as "the position that best defines what the group has in common compared with other relevant out-groups. A person becomes more prototypical as he or she differs less from in-group members and more from out-group members "(Turner, 1991, p. 77).

Spears et al.'s (1990) findings in their laboratory experiment was supportive of the social identity theory. Groups of students were divided into groups with some groups emphasising the importance of group structures and in others the role of groups was de-emphasised. Results found that polarisation occurred across the board, but that it was significantly greater when group identity was emphasised. The conclusion being that polarisation is more likely and more extreme when group membership is made salient.

Sunstein (2000, 2009) is also supportive of the social identity theory of group polarisation. He argues that if members of a group think that they have a shared identity, there will be heightening polarisation. Further, if individual members tend to perceive others as friendly, likeable and similar to themselves, the size and likelihood of the shift will increase.

Social identity theory therefore suggests that group polarisation is due to a member's desire to be seen as loyal and a solid group member. Group polarisation can be seen as a form of conformity to a group norm as a means of showing status in the in-group and distance from out-groups. This theory therefore challenges the persuasive argument theory which assumes that actors will be persuaded of a particular argument regardless of who makes the arguments. Social identity theory argues that we are more receptive to arguments from our friends (in-group) as we are from our enemies (out-group). See for example Mackie and Cooper (1984) and Abrams et al. (1990).

In summary, there has been much debate amongst academics as to the merits of the three theories discussed above. The theories themselves, however, do not need to be mutually exclusive and can combine together to achieve polarisation. For example, there will be a greater tendency to polarize when one hears a lot of persuasive arguments during for example a discussion of in-group members that supports a dominant view.

The different theories will also be more or less appropriate depending on specific group settings. The persuasive argument theory is perhaps stronger when one knows very little about ones fellow actors' positions going into the discussion so that the arguments are new and persuasive. If all the actors are aware of other actors' positions in advance of the discussion then it is more difficult to see how they can be persuaded. Group members will have knowledge of their groups' main attributes, characteristics and will shift towards them as their group membership becomes more important. The social identity theory is perhaps the most relevant to cohesive, closely knit groups such as board of directors and in identifying vulnerabilities towards polarisation in group decision processes.

3.4.4 Social Influence Network Theory

The three theories discussed above provide alternative (and arguably complementary) ways of explaining why polarisations occur. Social influence network theory was developed by Noah Friedkin together with Eugene Johnsen (Friedkin, 1999; Friedkin and Johnsen, 1999). Friedkin and Johnsen's (1999) model attempts to bring network theory and its sociological influences to bear in the field of group polarisation a domain previous exclusive to the field of psychology.

Friedkin (1999) recognises what he sees as a clear delineation between research in the fields of sociology and psychology and his theory attempt to bridge the gap between these two disciplines in the area of group dynamics. He wrote: "As an area of study within psychology ... the field group dynamics has declined, and although the concepts of group membership and group effects have been retained, psychologist now rarely grapple with the network structure of groups, the social processes that unfold in these networks, and the contributions of these network structures and processes to individual and collective outcomes⁷¹. It is sociologists – concerned with the origins of influence networks and status structures, the effects of social exchange networks on actors' bargaining behavior, and the effects of social networks on information flows, consensus formation, and collective action – who continue to grapple with these matters (*ibid* p. 856)."

Friedkin and Johnsen's intention is not to dispute existing group polarisation literature but rather to complement it: "A network theory does not overturn extant work on group dynamics but instead envelops and enhances this extant work by attending to the structure in which interpersonal processes unfold in a group" (Friedkin, 1999, p. 858).

⁷¹ Friedkin's paper was written in December 1999. However my experiences in the literature I have reviewed is that this observation still holds true today

Friedkin and Johnsen (1999) make a distinction between group polarisation and what they term a “choice shift” – a distinction not readily made by psychologists. A choice shift is said to occur when after a group’s interaction on an issue, the mean final opinion of group member differs from the members’ mean initial position. Group polarisation, on the other hand, is said to occur when the choice shift *is in the same direction* as the mean initial opinion. According to Friedkin and Johnsen group polarisation always involved a choice shift but that a choice shift can occur in the *opposite* direction of the initial mean position. This would occur because of the higher influence network of a particular member of the deliberating group.

It is the process of recognising the different influence network of various actors within a group and their resulting ability to alter the choice shift, that distinguishes the model developed by Friedkin and Johnsen (2011). They argue that the choice shift is a product of the group’s social structure in which certain members have more influence than others during the deliberation process and that the inequalities of influence within the network must be taken into account when modelling or predicting a choice shift. They wrote: “The crucial ingredients are the network of interpersonal influences and the process by which these interpersonal influences modify person’s attitudes. Choice shifts are the by-products (the aggregate level consequences) of these individual attitude changes” (Friedkin and Johnsen, 2011, p. 231).

Friedkin and Johnsen’s model includes actors’ pre group deliberation opinions and a relative measure of the interpersonal influence of each actor on another. The relative interpersonal influence of each actor is measured by subjective means by asking actors to divide tokens into piles and to allocate these according to the extent that they thought other group members influenced their decision. The subjective nature of the measure brings with it issues concerning members potentially underestimating the relative influence of other actors and the judgement of actors to assess the relative influence that actors may have

had on their decision process particularly when there is no single strong or obvious influence. Further, the model has very limited applicability when measuring group decision making outside of a controlled experiment environment given the practical problems of securing pre-deliberation opinions and asking actors to measure the relative influence of others actors on their decision process.

Despite these clear limitations in the model described above, the core principle is sound; that inequalities of personal influence within a group network play an important role in the choice shift phenomena process. Indeed the relative influence of different actors was recognised by Sunstein (2000) in his analysis when he commented that “many examples of group polarisation require an appreciation of the role of leaders, whose views count for far more than those of other group members” (*ibid*, p. 87). Friedkin and Johnsen do not however limit themselves to focusing on the leader of a group but rather look at the influence network of the group more widely. An actor might not be a designated leader but at the same time could hold significant influence over other members in the decision process. In summary, Friedkin and Johnsen highlight the importance of the influence of an actor’s network on a choice shift.

3.4.5 Group Polarisation and Homogeneity

Sunstein’s (Sunstein, 2009, 2000b) research focuses on the consequences of group polarisation for group decision making across a wide range of areas including social, political and business settings. This is a subject which he believes has been widely ignored across the disciplines: “I have been unable to find sustained discussions on the literature [on group polarisation] in economics, sociology, philosophy, law or political science, and there appears to be no

treatment of the implications of group polarization for social behaviour or the theory of democracy”⁷² (Sunstein, 2000, p. 74).

In particular Sunstein has highlighted the link between homophily⁷³ and group polarisation as an area which has been largely ignored by academics, a view shared by Turner (1991). Sunstein noted that: “Existing work on homophily has not been brought into contact with the phenomena of group polarization. This is a serious gap” (*ibid*, p. 84). Indeed, he noted that the question of whether homogeneity increases polarisation has been “little pursued” (*ibid*, p. 49).

Sunstein (2000) stresses the risk of group polarisation with respect to homogenous group settings and that in his view “social homogeneity can be quite damaging to good deliberations” (Sunstein, 2000, p. 76). Sunstein argues that cohesive groups of like-minded people whose members are connected by close social ties often suppress dissent and can as a result reach inferior decisions compared to non-homogenous groups where dissent is encouraged. He concluded that “widespread error and social fragmentation are likely to result when like-minded people, insulated from each other, move in extreme directions simply because of limited argument pool and parochial influences” (*ibid*, p. 105).

There is research supporting Sunstein’s link between polarisation and homogeneity. Goethals and Zanna’s (1979) concluded that homogeneity increased polarisation and that there was a greater level of polarisation in a study amongst actors when the actors established that they had a homogenous attitude related to risk prior to the group discussion. Further, Schkade et al. (2007) conducted an experiment as to the views amongst like-minded people

⁷² Indeed I have found no mention of group polarization or its consequences in any of the literature on corporate governance and the consequences for board room decisions.

⁷³ Homophily refers to the tendency of individuals to associate with others that are similar to themselves (McPherson et al., 2001) and is an explanation for homogeneity. The terms are inextricably linked and are used interchangeably in this thesis.

from three cities in the US whilst discussing three politically charged subjects, namely; global warming, affirmative action and civil unions for same sex marriages. They concluded that deliberation between actors increased consensus and significantly reduced diversity within the groups.

Finally, Sagerman (2011) found that as group members preparing for an act of terror a process of natural selection took place whereby less radical members of the group left until only extreme members remained as a cohesive group with dangerous consequences. What this study shows is that polarisation can be exacerbated by members leaving the in-group because they are unhappy with the direction the group was taking. The end result is that actors are exposed to “softer and louder echoes of their own voices” (Sunstein, 2000, p. 119). In other words the group became more homogenous over time.

Sunstein (2000, 2009) highlights the risks with respect to poor quality decision making and the increased likelihood of increased polarisation in group settings. The one mitigating factor about homogenous groups is that as a consequence of their homogeneity, members will have similar opinions so that the pre-deliberation mean should be narrower and polarisation should be less extreme (but more frequent) than that which exists in diverse group settings. However as Sunstein notes the risk is that the group itself becomes more extreme in views through a process of self-selection so that although the extent of polarisation might be less severe in homogenous groups the pre-deliberation perspective of the group will have, as a starting point, a more extreme point of view.

3.4.6 Group Polarisation and Geographical Isolation

Sunstein (2009) argues that group polarisation is more likely in situations where actors are constrained in a geographical area and are physically separated with their own “free space” (ibid, p. 100). The term “free spaces” is referred to as a “degree of separation” related to a group’s physical separation (ibid, p100).

Sunstein cites research by Groch (2001) in support of this assertion. Groch researched various categories of physical disabled groups and concluded that their likelihood of polarisation depended on the extent to which the group was in physical close proximity and isolated from other groupings.

3.4.7 Whyte's (1993) Prospect Polarisation Theory

Janis recognised the concept of group polarisation in his writings (Janis, 1972, p. 5 and p. 300) but made no attempt to incorporate it into his groupthink model of defective decision making process. Perhaps, one of the reasons why Janis did not try and link this into his model of groupthink, is that his groupthink theory is based on an ex post analysis of case studies relating to political disasters. In order to ascertain whether group polarisation has occurred requires knowledge of actors' pre-deliberation and this was not, of course, possible for Janis studying these case studies post event. Further, Turner's (1985) social identity theory in relation to group polarisation was only developed in 1987, well after Janis' groupthink. This theory has the most in common with Janis groupthink construct, but it was arguably "too late" for Janis.

Whyte (1993), however, has developed a model of group polarisation which complements and reacts with groupthink. Whyte (1998, 1989) as highlighted previously, developed his own model for groupthink with a core antecedent of collective efficacy, replacing Janis' requirement for group cohesiveness and antecedents related to provocative situations. Whyte, in addition to developing this model, also argued that groupthink was not sufficient in itself to explain poor decision making processes associated with fiascos but also developed a theory of what he termed "prospect polarisation" which would combine with groupthink to create an environment which would result in a poor decision outcome.

Prospect polarisation combines the work of Kahneman and Tversky (1979) and their prospect theory and work with respect to decision framing together with

existing literature on group polarisation. Prospect theory is based on the observation that as individuals we are loss averse, but also have an aversion to loss. Kahneman and Tversky explain this through experiments in which they offered subjects two problems. In the first scenario, subjects were asked for their preference between a certain £900 and a 90% chance of receiving £1000, and the great majority of subjects choose the certainty of the £900, indicating a natural conservatism and risk aversion. In the second scenario, the question to subjects is framed differently; asking whether they would choose between a sure loss of £900 and a 90% chance of losing £1000, and the vast majority of subjects chose the latter option, reflecting an aversion to loss. In other words, we move from being risk averse when our options are positive and become risk seeking when our options are bad. Tversky and Kahneman explained why we are both risk averse and at the same time have an aversion to risk by the fact that intrinsically losses loom larger than gains (Kahneman, 2011, p. 284) and that our decisions are made according to the specific reference point and how the question is framed and it is the framing of the question itself which determines our decision process.

Whyte incorporates this theory into his model by arguing that if the notion of choice is framed in the domain of a loss (as illustrated in the second example) this framing elicits amongst members a preference for risk. This aversion for risk will then combine with the effects of polarisation and increase the extent to which the group has a preference for the riskier option as their opinions become more polarised.

Whyte then links his theory of prospect polarisation into his own theory of groupthink centred on the concept of high group efficacy and confidence. Whyte observes that groups with high efficacy and high confidence will have high expectations of success. If, for example, they have an expectation of a profit for the year of \$10 million, but there is a possibility that instead the group is more likely to make only \$7 million, then given high expectations and confidence that this will be framed as a loss of \$3 million rather than being viewed as an overall

profit to the group of \$7 million. As a result of this framing, groups will have an aversion to loss, will take the riskier options available to them, and expose themselves to even greater losses in exchange for the chance to avoid the sure loss. Therefore groupthink combines with prospect polarisation to produce a scenario in which high risk and poorly thought out decisions are made resulting in poor outcomes.

Whyte (1989) argues that the explanation advanced above “is equally applicable to business decision making, and it is consistent with the view the previously advanced that firms that are performing below target or reference levels are more likely to pursue risky options than those that are not” (*ibid*, p. 53-54). Whyte then refers to previous research which concluded that poorly performing firms have a greater propensity to adopt riskier strategies in an attempt to make up for lost ground on competitors. Singh (1986) and Fiegenbaum and Thomas (1988), both cited by Whyte (1989), provide research which backs up this assertion.

In summary, Whyte argues that groupthink can combine with group polarisation and that high levels of confidence can create an environment in which both groupthink and group polarisation occur, so that a poor and risky decision process is undertaken. This assertion is backed up in the research findings of Gerard and Orive (1987) and Baron et al. (1996) who showed that confidence contributes to heightening opinion extremity. If an individual learns that others share his/her stance then the individual will feel greater confidence regarding the stance and will as a result be more willing to endorse more extreme views.

3.4.8 Groupthink and Group Polarisation

Whyte (1993), as discussed above, has linked what he terms “prospect polarisation” to his version of groupthink. Sunstein also recognises the close relationship and similarities between groupthink and group polarisation in

particular with respect to the conditions of homogeneity, cohesion, group solidarity and affection. Indeed, Sunstein argues that many of Janis's case study examples can be seen as case studies in group polarisation, as groups move to more extreme points in line with their original tendencies (Sunstein, 2009, p. 87).

Sunstein "favours" group polarisation over groupthink as an explanation as to why groups make poor decisions. He argues that the groupthink model is too complicated and involved with its seven antecedents and eight symptoms that has made the theory unwieldy and difficult to test or prove whilst the concept of group polarisation has been proven and uncontroversial⁷⁴. He notes that: "group polarisation offers a simple and clear prediction: As a statistical regularity, deliberating groups will end up in a more extreme point in line with their pre-deliberation tendencies. The idea of groupthink is far more complex and unruly, without any simple predictions" (*ibid*, p. 89).

The complexity of the groupthink construct has been discussed in detail. . The conclusion drawn was that, despite Sunstein's reservations, it was a valid construct and worthy of consideration. Sunstein's argument does highlight the commonalities between groupthink and group polarisation, in particular with respect to the social identity theory of group polarisation.

Friedkin and Johnsen (2011) compare their social influence network theory to Janis's groupthink theory emphasising the similarities. They highlight Janis's suggestion that one of the antecedents of groupthink is a directive leadership style and that this can, and will, contribute towards groupthink. This antecedent

⁷⁴ Refer to the section of this chapter on Groupthink for an analysis of the criticism of the groupthink theory

is consistency with their views about how interpersonal influences within networks affect the decision process⁷⁵.

On the issue of group cohesion, a key antecedent for Janis's groupthink theory, Friedkin and Johnsen argue that if groups are cohesive and homogenous then group members are likely to be more susceptible to change their opinion in line with more influential group members, hence increasing the likelihood of poor decision making in line with that envisaged by Janis.

Friedkin and Johnsen (2011) further highlight the importance of cohesion in group polarisation when he noted: "If cohesion has the effect of increasing members' susceptibilities to interpersonal influence, then group members with high susceptibilities may quickly abandon their initial positions in favour of the positions of members who, for whatever reason are both intransient and influential. In short if cohesion fosters a homogenous group membership and an efficient influence network, and if the groups social structure is stable across issue domains, then, as Janis suggests, a *structural* basis exists for low quality decisions" (*ibid*, p. 257). In other words, Friedkin and Johnsen highlight characteristics which are common to both groupthink and group polarisation which creates a vulnerability to a group undergoing a poor decision processes⁷⁶.

Sunstein (2000) highlighted that group polarisation is more likely when groups are isolated and Janis (1972) includes the insulation of the group from outside

⁷⁵ A subtle distinction perhaps is that Janis limited his influence structure to the leader of the group whilst according to social influence network theory it may not necessarily be the designated leader that has the most influence within the network structure itself (although one might envisage that this is the case in the vast majority of times).

⁷⁶ This approach of identifying common traits across identified phenomena to identify "red flags" with respect to decision processes is consistent with the approach which will be developed later in this thesis.

experts as one of his antecedents of groupthink. Finally Whyte (1998, 1999, and 2003) argues that high levels of confidence, an antecedent of groupthink, can increase management expectations, and if expectations are not met, then this can result in the framing of a loss and a greater likelihood of higher risk taking. In other words, Whyte links groupthink and group polarisation through high levels of confidence.

In summary, both groupthink and group polarisation have in common a strong sense of belonging and identification. Both phenomena are affected by high levels of homogeneity associated with cohesion, directive leadership, isolation from outside experts, and in terms of Whyte's version of groupthink and polarisation by high levels of confidence. Given these strong links it is therefore possible that a group that suffers from groupthink would also be affected by group polarisation; so not only is a decision making process defective but it also results in a more extreme decision.

The study of group polarisation, however, provides some epistemological hurdles for the purpose of this thesis in that it is extremely difficult to apply in a retrospective case study. To "prove" that group polarisation had occurred in the Irish bank setting would require knowledge of the pre-deliberation views of individual board members and to then be able to compare those views with the outcome of the group itself. This is practically impossible especially given the time differences between the research undertaken and the decision making processes and the lack of access to pre-deliberation views.

Not surprisingly therefore the literature review did not reveal any research into group polarisation based on a retrospective case study. O'Connor (2002) did consider polarisation as possible explanations in her analysis, but concluded that "groupthink, which is related but distinct from polarization and cascades, provides a more descriptive account of the Enron Boards' role in Enron's collapse" (*ibid*, p. 1257) . O'Connor (2002) provides no explanation as to why groupthink provides a more descriptive account, but it is submitted, that it is

easier for any researcher to measure groupthink than it is to measure group polarisation.

The difficulty in measuring the concept of group polarisation directly to the proposed Irish case study does not in any way diminish the importance of the phenomena in understanding poor decision making processes in group board settings. The antecedents for group polarisation can be evidenced in a case study though it might not be possible to “prove” given the inability to determine pre-deliberation views. If the structural conditions which are necessary to group polarisation are observed, and the decisions undertaken are highlighted as being particularly extreme and risky then certain inferences and predictions can be made that there is a greater risk or likelihood that group polarisation did occur. Recommendations can then be made to highlight the risks associated with this phenomenon. This is discussed in greater detail in chapter 8.

3.5 De-individuation

This section of this chapter examines the concept of de-individuation and whether this is relevant to trying to understand the behaviour and poor decision characterised by boardrooms in Ireland in the lead up to the financial crisis. De-individuation is a psychological state of decreased self-evaluation and disinhibition which looks to explain a variety of anti-social behaviours such as violence in crowds or mobs but may also be extended to include a possible explanation for reckless behaviour within the board room setting. In a de-individuated state, individuals become so consumed by their collectively so that the group becomes the reference point, substituting individual goals and standards of behaviour for those perceived to be of the group.

The origin of the concept of de-individuation can be traced back to the early crowd theorist, French social psychologist Gustave Le Bon. Le Bon (1960) had an altogether negative view of groups or crowds which in his opinion “displayed

a singularly inferior mentality” (*ibid*, p. 6). Le Bon argued that when individuals gathered in crowds they became anonymous, lose their personal responsibility and become dominated by a collective unconscious. This collective unconsciousness represents a primitive state of evolution in which atavistic emotions dominate, and as a result group behaviour lacks civilised attributes. Moreover, as individuals become part of a group or crowd, their behaviour becomes significant as a collective response and the salience and relevance of the group becomes more important resulting in greater levels of conformity to group norms: “In a crowd every sentiment and act is contagious to such a degree that an individual readily sacrifices his personal interest. This is an aptitude very contrary to his nature, and of which a man is scarcely capable, except when he makes part of a crowd” (*ibid*, p. 18).

Festinger et al. (1952) defined the term “de-individuation”, and in doing so, recognised the influences of Le Bon in their work⁷⁷. Festinger et al. suggested that when group members were not seen as individuals, a state of de-individuation may result, with a consequent lowering of restraints. Festinger et al. (1952) concluded that when individuals became immersed in the group and their own individual identifications reduced, subjects were more likely to engage in behaviour usually considered unacceptable.

Arguably the most well-known example of de-individuation research was the Stanford Prison Experiment undertaken by a team of academics led by Zimbardo (Haney et al., 1972). In this experiment, eighteen Stanford University students were to be enrolled in what was meant to be a two week experiment simulating prison life. Nine students were randomly assigned as guards with the remaining nine assigned as prisoners. The “inmates” were arrested by local police who agreed to co-operate in the experiment and were subject to the

⁷⁷ Pepitone acknowledged that the idea had come “straight from the pages of Le Bon” (cited by Reicher (1984, p. 341).

normal procedures for arrested prisoners (handcuffs, finger printing, strip searching and the issuing of prisoner uniforms) before they were put into three men prisoner cells. The care of the prisoners was then handed over to student guards.

Within a few days both sets of students became totally immersed in their respective roles. The guards started to inflict cruel punishments on the prisoners, and the prisoners started to address each other by prisoner number not name. As the guards became crueller and more vindictive, the prisoners became more demoralised. The experiment had to be abandoned after just six days as the prisoners started to show extreme signs of stress, hysteria and depression.

Haney et al. (1972) explained the behaviour of the guards using the process of de-individuation and that individuals had become submerged into their clearly defined groups. They concluded that anonymity of the group members was the principal cause of the de-individuation process and that when individuals act in a large group, the group provides them with anonymity and diffuse their own personal responsibility for their actions. This leads to a loss of identity and reduced concern for social evaluation on a personal basis and is referred to as a psychological state of de-individuation (Brown, 2001).

Subsequent research by Diener (1979) and Turner (1985) in particular, however, lessened the emphasis of anonymity as a primal factor in de-individuation. These findings are summarised in the meta-analysis of the relationship between anonymity and de-individuation undertaken by Postmes and Spears (1998) in which they concluded that there was little evidence to support the relationship between de-individuation and anonymity as it pertained to socially unacceptable behaviour.

Research undertaken by Johnson and Downing (1979) found that when they dressed up subjects in Klu Klux Klan type outfits this increased aggressive behaviour in subjects however when subjects were dressed up as nurses there

was a reduction in aggressive behaviour in the subjects. In other words, de-individuation can also result in pro-social behaviour and is not as one sided and negative as the likes of Zimbardo or Le Bon had argued. The conclusion drawn from this research being that anonymity increased the responsiveness to what were the normative cues present in the environment. The environment in which the group operates is critical in determining the behaviour of de-individuated individuals, and being in a group will not itself lead people to act in a destructive fashion; rather they will behave depending on the norms which are salient to the group situation.

Diener (1979), Turner and Killian (1987) and Brown (2001) all observed that there is a linkage between high levels of group unity and cohesion and the occurrence of de-individuation and that being in a cohesive group tends to cause people to make the group their main point of reference rather than their own individual perceptions, and that as such group cohesiveness is an underlying antecedent for de-individuation.

This assumption is consistent with the findings of Reicher (1984) found that de-individuation, and an individual's immersion within the group, increased the salience of the group identity and increases adherence to group norms and that de-individuation leads to greater levels of group conformity. Furthermore should de-individuation take place in a boardroom setting, the norms salient to the group setting are more likely to be potentially destructive given the value system inherent in the banking culture. Evidence of the value system in banking can be seen in the literature (see for example Admati and Hellwig (2014), Stiglitz (2010), Carswell (2006)) and in the number of ethical indiscretions associated banking. Recent examples of such behaviour being the manipulation of the LIBOR setting, the fixing of foreign exchange rates and the miss-selling of interest rate swaps by banks to smaller and medium size enterprises.

3.5.1 De-individuation and Groupthink

There are clear linkages between the processes of groupthink and de-individuation and the behaviour of de-individuated persons and victims of groupthink (Hart, 1994). Both are group phenomena in which individuals forego their own independent thought process in favour of an emerging group norm or behaviour. Both phenomena are explanations for failures in group settings and both have at their core group cohesiveness and homogeneity.

Hart (1994) hypothesised that in groups where the underlying cause of cohesion lies in the “prestige and rituals of the group, as well as the mutual liking of its members, de-individuation is more likely to occur and serve as a kind of intermediate state towards groupthink” (*ibid*, p. 124). Mutual liking of members is much more likely to occur in homogenous group settings (see for example Heffernan (2012) or McPherson et al. (2001)) and as such from this one can infer that de-individuation is more likely to occur in homogenous group settings.

Further, both groupthink and de-individuation group processes are affected by the norms salient to the group itself. Turner and Pratkanis (1998) and Neck and Moorhead (1992) concluded that certain types of groups are more susceptible to groupthink by definition of their social identity. The social identity and value system of bankers has come under a lot of scrutiny since the onset of the crises with numerous commentators pointing towards a denigration of moral and ethical standards in the banking community as being a significant contributing factor towards the crisis (see for example Stiglitz (2010), Admati and Helwig (2014) and Mason (2010) as illustrations of this.) There is therefore an argument that can be made that bankers, by definition of their social identity and focus on profitability, are much more susceptible to groupthink and de-individuation than perhaps groups such as scientists and jurors. Scientists and jurors, in contrast to bankers, have social identities that by definition would encourage greater levels of vigilance and questioning of an existing status quo.

De-individuation and groupthink can be linked in a cause and effect relationship. De-individuation is a process whereby the individual subordinates his own feelings and standards in favour of those of the group setting. Groupthink is a process which can occur in a group setting where de-individuation has occurred and individuals prioritise the group over and above their own thought processes. This connection is recognised by Hart (1994) who links the two processes as follows: "There is sufficient evidence to make plausible the idea that given the similar antecedents and effects of both concepts, there might be a link in terms of processes: the concurrence-seeking tendency of groupthink can be seen as a manifestation of de-individuation. De-individuation posits the development of a group mind, groupthink occurs during its maintenance and preservation ... groupthink is enhanced by a state of de-individuation among group members. In other words, de-individuation is one of the group level mechanisms bringing about groupthink, conceived of as a premature and excessive concurrence seeking" (*ibid*, p. 72). Hart therefore links de-individuation to groupthink as a process or stage in groupthink.

Despite these similarities, Janis makes no mention of the process of de-individuation in his research other than indirectly, when he noted that other causal psychological factors may also have occurred in the case studies in which he observed groupthink (Janis, 1989). One of the reasons why Janis did not make the link between these two phenomena was perhaps that at the time of formulating the groupthink concept, there was little research into de-individuation. Further the research that existed, emphasised anonymity as a key antecedent for de-individuation (Festinger et al., 1952; Zimbardo, 1969) which was a clear differentiating factor between de-individuation and groupthink. As noted above, anonymity has been de-emphasised in more recent research and replaced with a greater accent on cohesiveness and conformity which align groupthink and de-individuation more closely.

In summary, de-individuation emphasises the attributes of cohesiveness and homogeneity and the importance of the salient norms of the group setting.

Certain groups are more vulnerable to destructive behaviour when affected by groupthink and de-individuation than other given salient norms. This is particularly relevant given that banking has been identified as an industry where salient norms have, at times, resulted in socially destructive behaviour.

If however one relates this back to the research question of whether de-individuation alone is a process that can be seen as a possible means to understand some of the decision making processes within the Irish banks, then the answer to this question is simply no. De-individuation is not a process by itself that can do this, rather it is inextricably linked to the groupthink phenomenon which is a possible explanation for the poor decision making processes by Irish boards.

3.6 Epistemic Blind Spots

Epistemic blind spots occur because humans process information selectively and favour information which confirms their beliefs; rather than consider how they might need to adjust their beliefs to fit the information. Wei Choo (2007) notes that such blind spots occur when a “stream of warning signals is not heeded because the information does not fit existing beliefs, or because there is no frame of reference for the warnings to be recognised” (*ibid*, p. 34). Moreover Wei Choo notes that some organisations follow a “justification” approach in their decision processes whereby the organisation holds its beliefs as being incontestable and during the decision process looks for evidence that supports its beliefs and decisions. A justifications organisation will stay firm to its beliefs and rarely abandon or change them. What Wei Choo describes above as an epistemic blind spot, represents in effect an extreme confirmation bias⁷⁸.

⁷⁸ A confirmation bias occurs when an actor looks to process information selectively and favours information that confirms a pre-existing belief (Kahneman, 2011; Nickerson, 1998).

Bazerman and Tenbrunsel (2013) introduce the concept of bounded awareness to explain the tendency to exclude important and relevant information from the decision process by placing “arbitrary and dysfunctional bounds on our definition of a problem” (*ibid*, p. 7). These arbitrary boundaries are affected by what they term “motivated blindness” which exists when there is a vested interest regarding an outcome or situation. Subconsciously individuals create biases and boundaries that shape the decision making process in a way that achieves a result consistent with their initial vested interest. Despite an obvious bias in the decision process, investors still persuade themselves that the process was fairly undertaken.

Heffernan (2012) refers to the term “wilful blindness” in her research and refers to the transcript of the trial of the CEO and Chairman of Enron as to the genesis of the concept. Heffernan quotes the presiding Judge in the trial when instructing the jury: “You may find that a defendant had knowledge of a fact if you find that the defendant deliberately closed his eyes to what would otherwise have been obvious to him. Knowledge can be inferred if the defendant deliberately blinded himself to the existence of a fact” (*ibid*, p. 2, original document unseen).

Heffernan argues that we do not make a conscious decision to become “wilfully blind” but that it develops over a period of time as a result of a “skein of decision that slowly but surely restrict our view” (*ibid*, p. 27). This is consistent with the ideas formulated by Bazerman and Tenbrunsel (2013) who note that ethical indiscretions often occur as a result of small, and what are seen at the time as being inconsequential changes over a long period of time.

Heffernan observes the tendency for like-minded people to group together and provides numerous example to illustrate the natural tendency for homophily to develop. Heffernan links the propensity to develop blind spots to the tendency towards homophily. She argues that by seeking out those that are similar in

views and ideologies, individuals become more confident in the correctness of their views and blind to alternative views. As a result, we develop blind spots and fail to see arguments and ideas outside of the homogenous grouping we belong to. Heffernan thus provides another link between homogeneity and poor group decision processes.

Regling and Watson (2010), in their scoping report for the Nyberg Commission (2011), recognise the importance of property ownership imbedded in the Irish culture and that this had become a blind spot in the run up to the financial crisis. They note that the crisis in part “reflected an uncritical enthusiasm for property acquisition that became something of a national blind spot” and that “some of the underlying misjudgements about debt and property were so embedded in collective psychology that this can be imagined, perhaps, to mitigate institutional failures to some degree” (*ibid*, p. 35).

Regling and Watson do not develop the concept of an epistemic blind spot further in their report, and neither is the theory discussed by Nyberg in the final Commission⁷⁹. Regling and Watson do observe that Ireland had never had a property crash before the crisis (*ibid* p. 5). Wei Choo (2007) asserted that such blind spots were likely when “there is no frame of reference for the warnings to be recognised” (*ibid*, p. 34). In effect what these academics are describing is how an availability⁸⁰ and confirmation bias can combine together to affect a decision process. The fact that Ireland had never experienced a property crash (an availability bias) is information that investors in the Irish property market relied upon as evidence in relation to a confirmation bias that the Irish property market would continue to prosper. The significance of property investment to

⁷⁹ Nyberg did however recognise the socio-economic and emotional attachment that the Irish had towards property as an asset class in his report.

⁸⁰ An availability bias refers to a situation where an actor in making a decision places greater emphasis on information which is more readily available to them (see for example Kahneman et al. (1982)).

the Irish psyche⁸¹ may have resulted in an extreme version of these biases occurring, and the creation of an epistemic blind spot in relation to property. A detailed discussion of whether there was an epistemic blind spot to property in Ireland is found in chapter 7.

In summary, there are common themes that can link the literature on epistemic blind spots to groupthink. Janis (1972) observed that group members in the groupthink case studies he examined “showed interest in facts and opinions that supported their initial preferred policy and take up time in their meetings to discuss them, but they tend to ignore facts and opinions that do not support their initial preferred policy” (*ibid*, p. 10). What Janis is describing is a situation where group members are affected by a confirmation bias in their decision processes. Indeed, Janis included “collective rationalisation” as one of his symptoms of groupthink.

An epistemic blind spot can therefore be intrinsic to the groupthink process itself. If a group suffers from an epistemic blind spot with respect to a specific asset or investment and suffers from groupthink symptoms, the group will not actively challenge the investment decision. In other words, groupthink prevents an organisation “seeing” the epistemic blind spot.

Finally, the review of the literature on epistemic blind spots provides further evidence of a consistent theme in this literature review; the importance of homogeneity and cohesion, as the tendency to develop blind spots has been linked to homophily (Heffernan, 2012).

⁸¹ The Irish relationship with property is explored in detail later in this thesis.

3.7 Economic Bubble Theories

This section of this chapter explores the body of literature which looks to explain why speculative bubbles occur. This area of research focuses on the role that the underlying culture of a society plays in influencing the environment in which board decisions are made. It recognises the importance of the wider zeitgeist of a society and argues that understanding the wider environment in which corporations operate, will provide some answers as to why financial crisis occur generally, and specifically why banks made such poor decisions in the lead up to the crisis. This literature review also provides a direct link to the observation made previously that both groupthink and de-individuation are influenced by the salient features of the group and that the behaviour of the group will be influenced by the environment in which it is operating.

3.7.1 The importance of the underlying environment and societal values

Market commentators have consistently emphasised the importance of understanding the cultural environment in which financial bubbles occur. Chancellor (2000), when analysing the Tulip bubble in Holland in the 1630s, observes that “conditions were propitious for the outburst for a speculative euphoria” (*ibid*, p. 14). He cites the Dutch republic loss of Calvinistic austerity as the nation “became a nation of consumer” (*ibid*, p. 15) as an important contributing factor towards why the Tulip bubble occurred.

Galbraith (2009) when detailing the causes of the Great Depression of 1929, recognised the technical factors relating to leverage, and the poor regulatory and accommodative interest rate environment which existed leading up to the crash. Galbraith, however, concluded that the zeitgeist of the time was far more significant than underlying technical factors: “Far more important than rate of interest and the supply of capital is the mood. Speculation on a large scale

requires a pervasive sense of confidence and optimism and conviction that ordinary people were meant to be rich.” (*ibid.* p. 187)

Akerlof and Shiller (2010) argue that a society’s value system plays an important role in creating the environment in which speculative bubbles can develop. Like Galbraith, they focus on the Great Depression of 1929, and observe that in the United States in the 1920s “disrespect for the law was widely accepted and the failure of prohibition and that people both drank and gambled in flagrant violation of the law” (*ibid.*, p. 39). In their view, it became common practice and acceptable to disregard and disrespect laws. They highlight literature such as *The Great Gatsby*, published in 1925, which celebrated economic predation, as an illustration of the mood and belief system at that time.

Akerlof and Shiller (2010) use the metaphor of the demise of the card game contract bridge and the growth of poker as an indicator of a fundamental value shift in the build up to the crash of 2007. The authors observed the reduction in popularity in the United States of contact bridge, a game they observe which is played cooperatively and not for money, and the huge growth in popularity of poker in recent times, a game played individually, where bluffing (lying) is an important attribute to being successful. They conclude: “Of course we know there may be no link between what is taking place at the card table and what is taking place in the economy. But if card games played by millions of people shift the role of deception, wouldn’t we be naïve simply to assume that such shifts do not also occur in the world of commerce?” (*ibid.*, p. 40)

Shiller has focused much of his research on understanding the internet bubble which occurred around the start of the millennium and more recently the property market bubble in the US (see for example (Shiller; 2008, 2005, 1995)). For Shiller, a good part of what drives people’s thinking is purely social in nature, and central to Shiller’s thesis of understanding why speculative bubbles occur relates to the creation of an information cascade leading to herd

behaviour and the lack of independent thought. Shiller (2008) uses the metaphor of a virus to explain the social contagion of thought. He explains that every disease has a contagion rate, the rate at which the disease is spread from person to person, and a removal rate (the rate at which individuals are no longer contagious). If the contagion rate exceeds the removal rate by a necessary amount, an epidemic occurs. Shiller notes that the contagion rate will vary according to environmental factors, for example contagion rate for influenza are higher in winter. The contagion of thought patterns will soon gather momentum and a tipping point will be reached when the epidemic becomes endemic.

3.7.2 Homogeneity and Information Cascades

Shiller (2008) refers specifically to the findings of BHW (1992) and the literature on cascades and argues that an information cascade occurs when individuals rely on the information of others because they believe that they must have an informational advantage. In doing so they “disregard their own information, and act instead on general information as they perceive it, they squelch their own information. It is no longer available to the group and so does not figure in further collective judgements. Thus, over time, the quality of group information declines” (*ibid*, p. 47). Shiller (1995) further argues that information cascades are more likely to occur when groups are characterised by homogeneity. This link between homogeneity and the increased risk of informational cascades developing is consistent with the research finding highlighted in the chapter on herding (Easley and Kleinberg, 2010).

Swarup (2014) explores the reasons behind the tulip bubble in Holland in the 1630s and highlighted that at that time travel was limited. He observed that: “People gathered together locally to drink, and social conversation gave way to

economic posturing. It created a fertile environment for groupthink⁸² and for the words of an expert to carry a crowd that had little place else to go and more limited choices for speculation” (*ibid*, p. 177). In other words, Swarup (2014) argues that the environment, and in particular the isolation of the group, made it easier for an information cascade to develop.

Swarup moreover observed that many of the participants in the bubble belonged to heterodox religious groups, most notably the Mennonites⁸³ and that a consequence of this “market participants were more susceptible to the influences of their peers” (*ibid*, p. 177). Swarup, in this comment, is identifying homogeneity as a factor which contributed to the Tulip bubble itself.

3.7.3 Confidence and Speculative Bubbles

Minsky (Minsky, 1992; Minsky and Kaufman, 2008; Minsky and Minsky, 1982) observes that events leading up to a crisis always start with a “displacement”, an exogenous, outside shock to the macroeconomic system. This displacement might be a technological advance or a change in the interest rate environment but it leads to a period of sustained growth. The risks are that in an economy which has seen sustained growth without sufficient regulation, a mood of “explosive euphoria” (or overconfidence) can occur which leads to an asset price bubble. This excessive and unfounded optimism means that increasing number of participants take advantage of the perceived strength of the market

⁸² Swarup provides no evidence to back up the comment that groupthink may have characterised the behaviour of the actors in the Tulip bubble. However he observes both homogeneity and isolation of the group, both characteristics associated with Janis’s groupthink.

⁸³ The Mennonites are a Christian group.

with little thought of the potential for any subsequent correction⁸⁴. This somewhat irrational action is the beginning of the creation of an asset bubble.

Reinhart and Rogoff (2009) detailed empirical analysis of financial crises covering sixty six countries over eight centuries and provide extensive evidence to show that financial crises over times share many commonalities. The title of Reinhart and Rogoff's book, *This Time Is Different*, refers to its underlying message and the concept of "new era" thinking which precedes a financial crisis. The authors refer to this phenomenon as the "this-time-is-different syndrome" and note that this syndrome is: "rooted in the firm held belief that financial crises are things that happen to other people in other countries at other times; crises do not happen to us, here and now. We are doing things better, we are smarter, we have learnt from past mistakes. The old rules of valuation no longer apply. The current boom, unlike the many booms that preceded catastrophic collapses in the past is built on sound fundamentals, structural reforms, technological innovation, and good policy. Or so the story goes" (*ibid*, p. 15).

Reinhart and Rogoff (2009) maintain that this overconfidence is misguided and that overconfidence and associated new era thinking is, in their view, more likely in countries which have experienced rapid growth over a period of time: "The greatest policy insight is that premature self-congratulations may lead to complacency and demotion to a lower grade. Several debt crises involving default or near default occurred on the heels of countries' rating upgrades, joining the OECD, and generally being portrayed as the poster children of the international community" (*ibid*, p. 290)⁸⁵.

⁸⁴ Minsky's views are very similar to those expressed by Kindleberger (2000).

⁸⁵ The relevance of this observation with respect to Ireland is discussed later in this chapter.

The concept of confidence, and in particular over-confidence, is a key theme in the research by Akerlof and Shiller (2010). Like Reinhart and Rogoff (2009), the title of their book, *Animal Spirits*, is at the very heart of the message they wish to deliver. “Animal Spirits” is a direct quote from Keynes and refers to man’s “spontaneous urge to action” meaning that decisions are not as rational as some economic theory would dictate but rather are often made as a result of human emotions such as fairness, confidence, and money illusion. The authors argue that emotions play a key role in the decision making process and that economic decision cannot be explained by looking at pure “rational” (efficient market) economic theory alone.

With respect to the emotion of over or under confidence, Akerlof and Shiller (2010) note that: “The very term confidence – implying behavior that goes beyond a rational approach to decision making – indicates why it plays a major role in macroeconomics. When people are confident they go out and buy; when they are unconfident they withdraw, and they sell. Economic history is full of such cycles of confidence followed by a withdrawal”. (*ibid*, p. 13)

The authors argue that the Keynesian notion of a multiplier, developed by Hicks which focuses on the multiplier effect of consumption, ignores the impact of confidence: “We usually think about multipliers only with respect to conventional variables that can be easily measured. But the concept applies equally well to variables that are not conventional and that cannot be easily measured. Thus there is not only a consumption multiplier, an investment multiplier, and a government multiplier, which represents the change in income that occurs when there is, respectively, a \$1 change in consumption, investment, or government consumption. There is also a confidence multiplier.” (*ibid*, p. 16)

The role of confidence, highlighted as being important in the creation of speculative bubbles, has also been recognised as being an important contributing factor for the psychological phenomena of both groupthink and group polarisation. Janis, in developing his theory of groupthink, recognised

overestimation of the group as the key symptom of the groupthink phenomena. For example, in Janis's analysis of the poor decisions made by then President Kennedy and his advisors, referred to the "unlimited confidence" that the team had when planning the invasion and that this centred on the promise of new and bold ideas and the "euphoria of the new day" (Janis (1972) cited by O'Connor (O'Connor, 2002)). Furthermore, Whyte (1998) argued that collective efficacy was a key antecedent for his version of groupthink, whilst Hart (2004) identified a version of groupthink related to excessive optimism.

Overconfidence is also intimately connected to group polarisation as Sunstein (2000) observes: "Part of the reason for group polarisation appears to that as a class, extreme positions tend to be more confidently held" (*ibid*, p. 92). Indeed this confidence is further exacerbated if members of a group decide to leave because they are uncomfortable with the direction with which the group is heading so that the group becomes more confident and extreme in its opinions.

Further, O' Connor (2002) in her case study of Enron, makes the link between groupthink and overconfidence associated with new era thinking. She observed that the internet boom that preceded the collapse of Enron affected the Enron board's decision making and that a financial bubble "may lull boards into a false sense of security" (*ibid*, p. 1240).

3.8 Conclusion

This chapter reflects a broadening of the literature review beyond groupthink and herding and group polarisation, epistemic blind spots, de-individuation, and the overall environment in which the banks operated. These have all been discussed and the key elements of each explanation highlighted.

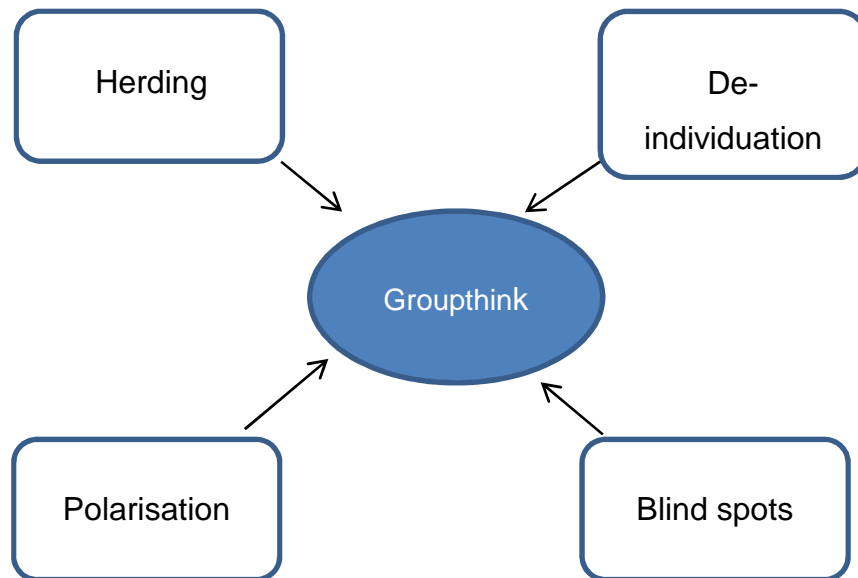
A review of the literature highlighted the interconnectivity of the related phenomena. First, there is interplay between herding and groupthink. Within a group setting, NEDs that believe that executive directors have an informational

advantage (pressure to herd) and also want to preserve the unanimity of the cohesive in-group (pressure for groupthink) are less likely to challenge an existing strategy which might be flawed. In other words, groupthink and herding tendencies can combine within a group to increase vulnerabilities of a poor decision processes occurring. Further, a leading entity that has pursued a flawed strategy could place informational pressure on competitors to herd. This is particularly the case when the ultimately flawed strategy is initially perceived as a success, as was the case with the leveraged property play in the lead up to the crisis. Groupthink and herding can therefore combine in a systemically important way.

The literature review further identified the connection between group polarisation and groupthink and that groups can be affected by the symptoms of both groupthink and group polarisation. Therefore, not only is there a greater risk that a group makes a poor decision, but that there is also the risk of a polarisation in the decision processes itself. The consequence is that the flawed decision is exacerbated by polarisation.

A review of the literature on de-individuation reflected that the process of de-individuation itself, whereby the group member foregoes their own sense of independence in favour of an emerging group norm or behaviour, can be seen as a stage of groupthink. Groupthink and de-individuation are therefore inextricably linked. An epistemic blind spot is an extreme form of confirmation bias where actors pursue a strategy without recognises the risks or flaws associated with that strategy. This occurs because actors, for a variety of reasons and often related to a strong self-interest, persuade themselves through self-rationalisation, that the strategy is a good one. This process of self-rationalisation is a symptom of groupthink. In other words, if a group has a epistemic blind spot and suffers from the symptoms of groupthink then it does not “see” the blind spot.

In summary, groupthink is linked to herding, group polarisation, de-individuation and epistemic blind spots and appears to play a central role in the identification of vulnerabilities with respect to poor decision processes. This is reflected below:



The link into groupthink is not surprising given the complexity and richness of the groupthink construct with its wide range of antecedents and symptoms. Groupthink is however very specific in that it intends to explain a premature concurrence seeking within a socio-emotional cohesive group. Group polarisation, de-individuation and epistemic blind spots are not dependent on, and can occur independently of groupthink, and can therefore offer stand-alone explanation for vulnerabilities in decision processes.

What the literature review does highlight is that a combination of these phenomena may be more powerful than when identified in isolation. Cox and Munsinger (1985) recognise that a combination of factors, such as those highlighted above, can contribute towards a group bias and that when they combine together the sum of their parts is greater than the individual

components in what is referred to as a synergism or wholeness: “When several compatible psychological factors come together as a *whole system*, they jointly enhance total in-group bias, so that the effect is greater than we would expect on the basis of a simple additive model alone. This synergetic whole system has been observed frequently in the psychological literature. It is as if a coherent attitudinal system takes on a life of its own, and the wholeness enhances the influences of each individual factor ... this synergism creates compelling psychological forces towards in-group biases within the board” (*ibid*, p. 104). On the same theme, Brafman and Brafman (2008) refer to these psychological forces as “streams” that converge together to become even more powerful.

Given the linkage between the phenomena it is not surprisingly that they share common characteristics. A summary of common features identified in the literature review are highlighted in the table below:

Table 3.1: Common characteristics of identified phenomena

Characteristic	Identified in:
Homogeneity (linked to cohesiveness) ⁸⁶	Groupthink, herding, group polarisation and de-individuation
Influential or directive leader	Groupthink, herding, group polarisation
Isolation of the group	Groupthink, de-individuation
High levels of confidence	Groupthink, group polarisation

⁸⁶ As noted previously, groups which are homogenous and share common values and ideas are more likely to be cohesive.

Furthermore the threat of competition was seen as exacerbating the likelihood of groupthink and herding and of accentuates the in-out group bias related to groupthink and increases the pressure of firms to emulate the strategy of competitors. A review of the general literature related to bubbles highlighted the importance of confidence in creating a speculative environment associated with poor decision processes. This review highlighted the importance of the social identity of the group and the value system of the industry in which firms are operating and that macro and industry specific factors will affect the environment in which organisations make decisions.

The identification of common themes or linkages identified above form the basis for the development of the theoretical model describing poor decision processes discussed in detail in chapter 6. The intention of the model is to identify potential “red flags” which might alert management and regulators of the vulnerabilities of a poor and potentially systemically significant decision processes. This contribution focuses primarily on the internal decision processes within boards and in improving the governance mechanisms of all corporations.

Chapter 4: Research Methodology

4.1 Qualitative v Quantitative Research

Research can be categorised as being either qualitative, quantitative or of a mixed design. Easterby-Smith et al. (2012) and Bryman and Bell (2015) observe that qualitative methods of research involve the collection of data that is mainly in the form of words, whilst quantitative methods involves data which is either in the form of, or can be expressed as, numbers. Similarly, Stake (2005) observes that quantitative researchers represent happenings with scales and measures (numbers) whilst qualitative researchers are concerned what is happening with key episodes and represent this by means of their own interpretations and stories (narratives).

Quantitative research makes the ontological assumption that reality is objective and external to the subject and that subjects can be studied through objective categories and verified by empirical methods (Ahrens and Chapman, 2006). As such, in quantitative research there is a desire to limit the personal interpretation of the researcher from the period the research design is set, to the time the data is collected and analysed statistically.

In contrast, qualitative research designs calls for the researcher to be in the field, making observations and exercising subjective judgements. Qualitative research emphasises the interpretation of the researcher and attempts to view events through the eyes of the subject which they are studying: "The social world must be interpreted from the perspective of the people being studied, rather than as though those subjects were incapable of their own reflections on the social world" (Bryman and Bell, 2015, p. 405). Erickson (1986) argues that the most distinctive characteristic of qualitative inquiry is its emphasis on interpretation.

The approach which I have taken in my research is qualitative in nature. This decision was taken after considering how best to address the research questions which I have identified in my thesis. My research is focused on understanding the factors that affected the decision making process of the Irish banks in the lead up to the crisis, and seeks to gain a deeper understanding of what had happened through the subjective interpretation of the social actors that were involved. I am not seeking for definitive “yes” and “no” answers, or to prove or disprove a particular hypothesis, but rather to gather information and build theories. My research is intended to be “richly descriptive” (Merriam, 2002) providing the subjects with a voice and authenticity to the varying human experience (Silverman, 2010). The choice of qualitative methods was also attractive to me as it allowed me to engage and interact with the relevant actors and to increase my own understanding of the causes of the Irish crisis.

There are many different languages within the context of qualitative research (Silverman, 2010). My research methodology has been described above as qualitative and I have adopted an interpretivist approach as my overall research framework. Interpretivism seeks to provide an understanding of social reality which comes from the subjective interpretation of the researcher. This contrast with positivism, normally associated with quantitative research, which incorporates the assumption that there are true answers, and that the objective of the researcher is to start with a hypothesis and then seek data that will prove or disprove this. The aim of positivist research is therefore to search for a correct answer and the elimination of other plausible explanations (Bryman and Bell, 2015; Easterby-Smith et al. 2013).

Interpretivism is grounded in inducted reasoning, and does not provide hard and fast explanations from which causal relationships are identified and predictions made (McKerchar, 2010). Inductive reasoning seeks to supply strong evidence for, but not absolute proof, and this is consistent with the approach in my thesis. I am not testing theories or trying to identify the “correct” reason as to why the Irish banks made the decisions they did (i.e. positivism). Rather I am trying to

understand and interpret the views of the actors in the field and increase the comprehension of the decision making process of the Irish banks. I have posed “research questions” to be applied with reference to the identified case study, rather than hypothesis that will be proved or disproved.

The style in which I have interpreted the data can be described as being based in the hermeneutic tradition. Hermeneutics is concerned with the nature of the understanding and interpretation of human behaviour and traditions (Greetham, 2006). Hermeneutics provides insights into the ways in which the researcher interprets both written text and interviews. The underlying philosophy being that the researcher needs to understand the culture and the environment in the field in order to interpret the meaning of the data gathered (Easterby-Smith et al. 2013). My research emphasises the importance of culture and the environment which is particularly relevant when trying to understand the Irish obsession with property as an asset class. In summary, my research is qualitative, based in the hermeneutic tradition and my approach is interpretive.

4.2 Research Subjectivity

One of the key characteristics of qualitative research is that there is an element of subjectivity in the researcher’s interpretation of the data. A discussion on subjectivity is particularly relevant in the context of my own research and background. The geneses for this research are my own experiences working in an investment bank in the lead up to the financial crisis of 2008. Between 1994 and 2008, I worked in the debt capital markets department of UBS Investment Bank, responsible for structuring and marketing the sale of debt and capital securities for financial institutions in Northern Europe including the Irish Banks. In that time, I executed over forty different bond transactions for five of the six domestically owned Irish banks. I had access to senior management of these organisations on numerous occasions, in particular when hosting investor

meetings where management presented and discussed their credit with investors.

When the Irish banks failed so spectacularly, I reflected on my own experiences with the Irish bank management in the lead up to the crises. My casual observations included:

- 1) The extreme confidence of Irish bank management in their own banks' credit story and more generally in the strength and sustainability of the Irish property market. At no stage did any Irish bank executive ever express, either publicly or privately, any reservations that the Irish property market was over-priced. This confidence and belief appeared excessive compared to that which I evidenced in my dealing with other Northern European financial institutions.
- 2) Very low levels of tolerance for contrary opinions on the sustainability of the Irish economy. As an illustration of this, at a meeting with the management of one of the largest Irish Banks in Munich in 2006, an investor referred to a critical research paper by Professor Morgan Kelly of University College Dublin (Kelly, 2007) in which he highlighted a bubble in the Irish property market and forecasted a 60% fall in Irish property prices. This research was dismissed by management of the Irish bank as being attention seeking, with Kelly portrayed to the investor as being out of touch with commercial reality and described as a "nutty professor". On another occasion, I received a call from the management of an Irish bank threatening to take away a bond mandate as a result of a research paper which had been written by our independent equity analyst in which the analyst had challenged the strategy of the bank⁸⁷.

⁸⁷ These personal anecdotes are examples consistent with the symptoms of groupthink relating to "stereotyping out-group's and "direct pressure on dissenters" identified by Janis in his groupthink model.

- 3) High levels of homogeneity and cohesiveness in the management of each bank. All of my dealings at board and executive level in Ireland where with Irish nationals, and, perhaps not surprisingly given the geographical size of Ireland and the concentration of the banking industry in Dublin, there were numerous examples of individuals who were well connected to each other. Further many managers and board members had been at the banks for their whole careers and bank management appeared to me to be extremely cohesive.
- 4) High levels of competition between banks. In particular, the management of AIB and Bank of Ireland often discussed the success of Anglo Irish Bank and ways in which they could compete with, and regain, market share.
- 5) Significant interest in property as an asset class in Ireland and an extreme confidence in property as an asset class. Property investment pervaded almost every conversation that I had in Ireland, whether this was in the taxi on the way to a meeting or over lunch with senior bank managers. Without exception, every person I spoke to was resolute in the belief that property prices would continue to rise.

These are, of course, my own casual observations and have no academic substance. These personal anecdotes are, however, consistent with a number of the antecedents and symptoms of groupthink and herding. The conclusions of the Nyberg Commission and in particular the role that the Commission ascribed to both groupthink and herding in the Irish Financial crisis, provided further impetus to my thought process in developing a framework which identifies poor decision processes in a group setting.

My own personal experiences meant that I began this research project with what can be described as a natural bias, highlighting an interesting epistemological debate. Silver (2012) uses Bayesian theory to argue that a

predisposition, such as the one I describe above, is central to making accurate predictions. Bayesian theory is concerned with conditional probability and looks to determine if an event or hypothesis is true given that an existing event has already happened. This depends on three variables; first the need to estimate the probability that the hypothesis or event is true, second the estimate of the probability that the event is false and thirdly (and most importantly), a prior probability. A prior probability refers to what the likelihood of the event occurring is, before exploring the event. In other words, prior beliefs should combine with the diagnosticity of the evidence.

Kahneman (2011) refers to this prior belief as “the base rate” and provides a number of examples of how errors in forecasting are made by actors who ignore the base rate⁸⁸. Kahneman argues that the importance of Bayesian reasoning can be summarised in two statements. First, the need to anchor your judgement of the probability of an outcome on a plausible base rate, and second, the need to question the diagnosticity of your evidence. In effect this research has as its anchor my own casual observation coupled with the findings of Nyberg (2011). Kahneman, like Silver (2012) is supportive of the idea of anchoring decision processes with a credible base.

⁸⁸ An example provided by Kahneman (2012) relates to an experiment when the actors were given a description of a fictitious student, “Tom W.”, and then asked to rank in order of likelihood which field “Tom W.” is studying. The description provided emphasises a stereotype which appears more suitable to someone from a computer science, engineering or library science background and as such actors in the experiment ranked those fields as most likely over fields such as the humanities, education and business studies. The point of this experiment was that the actors made their predictions whilst totally ignoring the base rate, and the fact that there were materially more students enrolled in the humanities, education and business studies as there were in the smaller esoteric fields they selected (and indeed “library science” was not even offered at the University). The point being that predictions are often made without reference back to the base rate, and it is this base rate which is intrinsic to any Bayesian calculation of probability.

Silver (2012) recognises that such an approach to prediction assumes subjectivity in the application of the prior probability in contrast to the frequentist approach as developed by Ronald Fisher as a method of making predictions which are not contaminated by researcher's bias. The frequentist method defines an events probability of its occurrence in a large number of events. The underpinning philosophy behind frequentism is that the more data one collects, the less likely the error and probabilities are fundamentally related to frequencies of events.

Silver however highlights what he sees as a fundamental weakness in the frequentist approach when he notes that it: "discourages the researcher from considering the underlying context or plausibility of his hypothesis, something that the Bayesian method demands in the form of a prior probability. Thus you will see apparently serious papers published on how toads can predict earthquakes⁸⁹, or how big box-stores like Target beget racial hate groups⁹⁰ which apply frequentist test to produce statistically significant' (but manifestly ridiculous) findings" (p. 252). Although Bayesian theory is normally associated with quantitative rather than qualitative research, it is submitted that the principle of the argument noted above, applies to my research, and that approaching research with a subjective bias can be a positive to research finding.

Furthermore, Merriam (2002) notes that researchers, rather than trying to eliminate such biases or subjectivity, should identify, recognise and monitor them. Stake (1995) argues that subjectivity should not be seen as a failing that needs to be eliminated, but rather as an essential element of understanding. Yin (2013) argues that the researcher should strive for "high quality analysis" and that a researcher "should use your prior, expert knowledge and experience in

⁸⁹ The citation for this article being Grant and Halliday (2010).

⁹⁰ The link for this article is <http://www.sciencenewsline.com/summary/2012041121000031.html>

your case study” (*ibid*, p. 137). Pesckin (1988) goes further in arguing that a researcher’s subjectivity “can be seen as a virtuous, for it is the basis of researchers making a distinctive contribution, one that results from the unique configuration of their personal qualities joined to the data they have collected” (*ibid*, p. 18). In summary, my subjective position and knowledge of the field in which I am researching can be harnessed as a significant positive, but needs to be tempered with an appreciation of the risks of unconscious bias that are associated with my own unique circumstances.

4.3 Case Study Approach

Case studies are rich, empirical descriptions of particular instances of a phenomena that are typically based on a variety of sources (Eisenhardt and Graebner, 2007; Yin, 2013). The case study approach is a popular and widely used research design particularly with respect to qualitative research (Easterby-Smith et al., 2012; Eisenhardt and Graebner, 2007). The selection of cases should be based first and foremost on the opportunity to learn and researchers should chose cases where they expect learning to be the greatest (Pettigrew, 1990; Stake, 1995). The choice of case study and the opportunity to learn is particularly important given qualitative case study research is normally limited to a single or limited number of cases. In my research I have identified the Irish case study and specifically Anglo Irish bank which, in my view, provide an excellent opportunity for learning⁹¹.

Stake (1995) differentiates between two types of case study research; instrumental and intrinsic. In an instrumental case study, the case is looked at in depth because of its potential to help the researcher to understand an external interest and to provide insights into an issue. In contrast, an intrinsic case study

⁹¹ See chapter 5 for a detailed discussion of the history of the Irish bank case study and the background to Anglo Irish.

is researched to understand the unique features of the case with no emphasis on whether the case represents a particular trait or problem, rather the case is studied because of its own intrinsic interest. The case study research which I am undertaking is instrumental and has a broad focus relating to increasing the understanding of the decision making process in corporate boards.

Laboratory experiments, typical in quantitative research, isolate the phenomena from their context, whilst case studies emphasise the real world context in which the phenomena occur (Eisenhardt and Graebner, 2007). Flyvbjerg (2006) argues that case study research, where the researcher is intimately involved in the research subject, can increase the learning process when compared to research where the researcher is removed from the study matter: "Great distance to the object of study and lack of feedback easily lead to a stultified learning process, which in research can lead to ritual blind alleys, where the effect and usefulness of research becomes unclear and untested. As a research method, the case study can be an effective remedy against this tendency" (*ibid*, p. 223). Finally on this point, Flyvbjerg (2006) cites research from Beveridge (1950) in which he concludes that there are more discoveries stemming from the intense and rich observations from a case study than there are from statistics applied to large groups⁹².

Eisenhardt (1989) notes that case study research can be used for three main aims; to provide descriptions, to test theory or to generate theory. My research falls into the category of testing theory given that I develop a model which looks to identify vulnerabilities to a poor decision process and then to apply the case study to the model. The approach that I have adopted is consistent with that suggested by Silverman (2013) who argues that a researcher's case study

⁹² It is not, however, an intention to debate the relative merits of quantitative and qualitative research methods, and I fully accept that both approaches have their merits. My view, expressed above, is that a qualitative case study approach is best suited to addressing my specific identified research questions.

selection should not be based on statistical grounds but rather derived from a particular theory that the researcher wants to examine.

Case study research is better placed with respect to research questions related to “how” and “why” and are not suitable to address research questions such as “how often” and “how many” (Eisenhardt and Graebner, 2007). My research is very much focused on the research questions related to “how the Irish banks made their decisions” and “why they made the decisions in relation to property investment”. This provides me with further comfort as to the applicability of the case study method in my research.

A criticisms levelled at case study research is that one cannot generalise from the findings and it can be argued that this is “considered to be devastating to the case study” (Flyvbjerg, 2006, p. 224). Flyvbjerg however disputes this and contends that case study research is ideal for generalising using the principle of “falsification” developed by Popper (1959). Flyvbjerg refers to Popper’s example relating to the assumption that “all swans are white”, and there is just one observation of a “black swan”, this sighting would falsify the initial proposition. Flyvbjerg concludes that: “The case study is well suited for identifying ‘black swans’ because of its in-depth approach: What appears to be ‘white’ often turns out on closer examination to be ‘black’” (*ibid*, p. 228). In other words, even a single case study research can provide generalisability if the observations from the case study contrast with a pre-existing belief.

Yin (2013) further highlights that the validity of extrapolation from a case study depends not on the representatives of such a case in a statistical sense (as would be the case in research of a positivist nature) but rather on the plausibility, depth of analysis and cogency of the reasoning used to describe the results from them.

My research focuses on a single case study⁹³. The decision to focus in a single case study, rather than a multiple case study, was made given my desire to provide as rich and deep a description of my chosen subject. A single case study review was the only realistic means of achieving this given the time constraints of my research. Single case studies can richly describe the existence of a single phenomenon (Siggelkow, 2007) but multiple cases can create more robust theory because the propositions are more rigorously grounded given the variety of evidence gathered. Further multiple case study analysis allows for broader exploration of identified research questions and theoretical elaboration (Eisenhardt and Graebner, 2007). I recognise the limitation of my research with respect to issues of generalisability of a single case study analysis.

4.4 Interviews

The use of interviews in case study research is a widely accepted and effective means of gaining a rich understanding, and in portraying the multiple views of the case (Stake, 2005). There are three types of interviews that can be undertaken; structured, semi-structured and unstructured. Easterby et al. (2012) highlight that structured interviews contain a set of predetermined questions and as a result, allow for very little interaction with the interviewee. Structured interviews are typically more suited to quantitative research where the aim is to maximise the consistency of measurement of key concepts. Unstructured interviews are on the other extreme of the spectrum, and are more akin to a general conversation. Unstructured interviews are more suited to an exploratory type of research and where, for example, the case study is used to generate

⁹³ I refer to my study as a single case study as it looks at the Irish banks and Anglo in particular. I consider this to be a single case study rather than a multiple case study (even though I do consider all six of the Irish banks in my analysis) because of unique context in which the Irish banks operate and that as a result my work should be seen as a collective and single case study review.

theory. The semi-structured interview represents the “middle ground”, and will allow me to impose some structure on the interview but at the same time provide me with the flexibility for inter-reaction with the interviewee and to allow the interviewees “a degree of freedom to explain their thoughts” (Horton et al., 2004, p. 340). For this reason I chose a semi-structured interview approach.

Although interviews are an extremely prominent method of gathering data in the qualitative researcher’s armoury (Bryman and Bell, 2015), four of the five comparative case studies which I analysed in chapter 3 did not use interviews as part of their research gathering process. It is submitted that the reason that these researchers did not undertake interviews does not relate to a methodological objection to the interview process itself, but rather through a lack of access to the decision makers (highlighted by LeBlanc and Schwartz (2007)).

Of the five groupthink case studies I reviewed, only Yetiv (2003) relied partly on information sourced from interviews. Yetiv warned that “while interviews can be useful, especially for a data-demanding theory like groupthink, they can also pose risks” (*ibid*, p. 422). Yetiv highlights that these risks relate to decision makers not recollecting events accurately or providing self-serving and bias accounts of the events. To mitigate this risk, Yetiv backed up information secured from interview against one or more source by means of data triangulation. Statements that were deemed to be self-serving were explored in follow up interviews or ignored.

The risk of a self-serving bias is exacerbated given that the research subject concerns understanding a poor decision process and there is an increased motivation for actors to justify their actions and to abdicate responsibilities for failures. Eisenhardt and Graebner (2007) suggested that researchers gather interview data from actors “who view the focal phenomena from diverse perspectives. These informants can include organizational actors from different hierarchical levels, functional areas, groups, and geographies, as well as actors

from other relevant organizations and other observers such as market analysts” (*ibid*, p. 28). Park (1990) noted that it would be better to interview outsiders rather than group members given group members’ inherent biases and lack of objectivity when assessing the group decision process. To mitigate the risk of self-serving bias, and taking into account the comments above, a wide set of actors were interviewed so that a broad and more balanced perspective was obtained.

The list of actors interviewed, (summarised in chapter 7) is consistent with the mix of interviewees recommended by Eisenhardt and Graebner above. Moreover, the identification of biases in the account of events when compared with data from other sources may provide useful information for the research itself. Janis (1972), for example, identified collective rationalisation as a symptom of groupthink and the communication of such biases by interviewees may be suggestive of such biases.

In any interview process there is the risk that the interviewees do not recollect events accurately. This is particularly relevant as this research was conducted in 2014, six years since the start of the Irish banking crisis. It is submitted that the time period which has lapsed between the events leading up to the crisis and the interviews itself are not so distant so that interviewees will be unable to recall most events. Interviewees’ memories of specific events were, on occasion, prompted by my recall of specific factual events⁹⁴. It is, however, recognised that despite these prompts, there may still be errors in the recall of events and that this is a natural limitation of the interview process.

A practical issue related to any interview process is the lack of access to the relevant actors (Leblanc and Schwartz, 2007). The reluctance of actors to agree to be interviewed is exacerbated in Ireland given existing and potential litigation related to the banks and the announcement of a further banking inquiry into in

⁹⁴ A timeline of events was drawn up which assisted interviewee recall when necessary.

Ireland⁹⁵. This point is highlighted in the following e-mail exchange with an actor who had been an executive director at one of the Irish banks finance before the crisis:

“Hi Gary

As I believe the saga of the financial meltdown is not yet finished and may be the subject of some formal investigations here in Ireland, I would prefer not to participate in your study”

Due to a number of litigation claims, particularly around Anglo Irish bank, certain actors were reluctant to be interviewed – even if it is for academic research purposes⁹⁶. This point is well illustrated again in an e-mail exchange with a former (well connected) employer at Anglo:

“Overall, it will be very hard to talk to my contacts as they are all facing court cases over the coming months. Even if they weren't I am not sure

⁹⁵A Committee of Inquiry into the Banking Crisis has been set up by the Irish Government and evidence is currently been taken by the Commission (March, 2015). A number of bankers are due to give evidence before the Inquiry but these are scheduled for April/May of 2015. See <https://inquiries.oireachtas.ie/banking/hearings/>. .

⁹⁶ Anglo Irish Banks auditors are being sued by Anglo Irish bank for their part in the bank's demise. There is also the possibility that the directors of Anglo might be sued in relation to the window-dressing of Fitzpatrick's loans to directors (see for example <http://www.aclsolicitors.ie/news-events/current-news/anglo-irish-bank-scandal-the-possibility-of-legal-actions-seeking-compensation/>). Furthermore executive from IL&P and Anglo have been charged with conspiracy to defraud with respect to a loan between IL&P and Anglo intended to boost Anglo's reported deposit numbers (see <http://www.litigationreview.info/articles/share/1310874/>). Further there are a number of litigation claims or potential claims with respect to INBS. These include a potential claim against INBS auditors KPMG, and existing litigation claims against the directors of INBS with respect to their stewardship of INBS in the lead up to the crisis.

how they would feel about commenting on the crisis. They have been through the mill both personally and publicly.”

Finally, a further logistical problem was contacting the ex-directors of the Irish banks to request interviews. In the lead up to the crisis the directors of the Irish banks suffered significant personal damage to their reputations and as a result many are no longer working in industry and are difficult to contact. Those currently working in industry were contacted by letter at their place of work. However, not a single director of Anglo agreed to be interviewed. The closest I have to an interview with an Anglo director is the interview I conducted with Actor P, a close friend of Tom Browne (a director of Anglo in the lead up to the crisis)⁹⁷. However, my research can draw on *The Fitzpatrick Tapes* (Lyons and Carey, 2011), a series of interviews which were conducted by Lyons and Carey with Fitzpatrick and proved very useful in this research. Other indirect access to directors of Anglo was obtained through other media sources and books and newspapers and is reflected in the analysis of my findings in chapter 7.

In summary, there are a number of challenges in the interview process. There are natural limitations to any interview process relating to the accurate recall of events and self-serving biases by interviewees. It is submitted that these identified limitations are in essence no different to that undertaken by many other researcher projects which are interview based. Furthermore, the practical challenges with respect to access to relevant actors are also not unique to this research project - although the difficulties of access in Ireland are exacerbated given the specific circumstances in described above. These are not, however,

⁹⁷ The only evidence I have that Actor P is a “close friend” of Tom Browne, a former Anglo director, was that I was told this not only by O’Connor himself but also by both Actor Q and another former business associate of mine (individuals I had known and trusted when working in Ireland). I tried to contact Browne for a direct interview and, although for legal reasons he was uncomfortable doing this, I also understood from Actor P that he was aware and comfortable with me talking to Actor P.

insurmountable epistemological obstacles and does not mean that an interview process is not useful to the research process. The interview process was, it is submitted, additive to the information which had already been gathered and was conducted with a full appreciation of the potential limitations noted above.

In total I interviewed twenty individuals and conducted twenty one interviews each lasting between 30 minutes and 1.5 hours⁹⁸. These semi-structured interviews began with me asking the interviewee if they could describe what they did at their organisation in the lead up to the crisis. This was then followed up with a broad question often asking if they could describe the culture at their own organisation or at Anglo. I would then try and pick up on relevant themes that came out of their answers and try to develop those further with probing questions. I made a conscious effort not to ask any “leading questions” but rather to try very hard to listen, be patient and “steer” the interviewee. Of course, the more interviews one does the more accomplished one becomes as an interviewer and later interviews were arguably richer in content than some of the earlier interviews conducted. No two interviews were the same or followed the same format but rather developed in line with their answers⁹⁹.

The interviewees reflect a wide range of actors including those that worked inside Anglo, competitors of Anglo, service providers to Anglo as well as external participants. As highlighted previously, the one limitation in the mix of

⁹⁸ I conducted two separate interviews with Actor B.

⁹⁹ My supervisors kindly provided me with advice in the interview process and I shared the first few interviews with them and took their feedback. I learnt that a good interview is one in which the interviewee did the talking.

interviewees is that I did not gain access to a main board director at Anglo¹⁰⁰. A full list of the interviewees can be found in chapter 7.

All the interviews were conducted in person with the exception of the interviews with Nyberg, Actor P and Carswell which were conducted telephonically. All the interviews were recorded with the express permission of the interviewees. The only exception being Actor H, who gave permission for me to take notes only.

The process of selecting interviewees was also to some extent arbitrary due to the fact that my starting point was past contacts that I knew from when I worked with the Irish banks. Past contacts included Actor N (who was a competitor at a rival bank), Actor A and Actor B from Anglo, Actor F and Actor K from BKIR, Actor M and Actor J from AIB, Actor G from Ulster Bank and Actor Q from Davy. Some of these interviewees provided leads and introductions which led to further interviews. For example, three separate interviewees had mentioned that Actor E would be a good person to interview and provided me with an e-mail and introduction to him. Some interviews were the result of unsolicited e-mails and responses (for example Peter Nyberg, Actor O and Actor I).

In summary, there is an accepted arbitrariness to the list of interviewees and a (frustrating) absence of Anglo directors. However, the interview process was just one part of the evidence gathering process and additional evidence was gathered from an extremely wide and diverse range of sources. It is submitted that the interview process complemented the information gathered from other sources and indeed provided an additional richness to the analysis undertaken in this chapter.

4.5 Data Analysis; validity, reliability and generalisability

¹⁰⁰ This lack of access was not a result of a lack of effort on my behalf. I attempted to contact all of Anglo's past directors from the start of the millennium, all without success.

Easterby-Smith et al. (2012) highlights that a researcher needs to answer three questions with respect to research validity, reliability and generalisability: Does the study clearly gain access to the experiences of those in the research setting? Is there transparency about how the researcher made sense of the raw data? Do the concepts and constructs derived from the study have any relevance to other settings? These three questions are discussed below.

4.5.1 Research validity

Yin (2013) observes that a major strength of case study collection is the opportunity to use many different sources of information and this allows the researcher “to address a broader range of historical, attitudinal and behavioural issues” (*ibid*, p. 97). He notes that through a process of data triangulation, findings are much more likely to be accurate if they are based on several sources of information all triangulated on the same set of research questions. This is very much in line with the approach which I have taken and reflected in chapter 7¹⁰¹. For the purposes of my research I was able to draw on a wide variety of data sources covering both direct and indirect interviews, annual reports and accounts, public inquiry documents, newspaper and television articles, academic articles and books written on the subject. The depth and variety of the observations are reflected in chapter 7.

Easterby-Smith et al. (2012) highlight what they see as three important factors which will affect the quality of the data gathered in interview. These relate to; 1) building trust with interviewee, 2) using the appropriate language in interview and 3) making sure that the research has relevance to the respondents. On the issue of trust, Easterby-Smith et al. warn that failure to develop trust may result

¹⁰¹ For an example of this please refer to Table 7.6 where I summarise all the observations I have made, categorising them by different data sources. Further in the appendix I provide some context to the number of variety of data sources by providing a comparative analysis with reference to other relevant studies.

in the interviewee responding to telling the researcher what they want to know or to hold back from telling their true version of events. I was very fortunate to have built up trust with a number of the actors that I interviewed over a sustained period of time during my years as an investment banker. Even with the actors that I did not know before interview, we could make a connection based on common business acquaintances and friends and this helped to build up a level of trust. Second, given my knowledge and experience in banking I was able to communicate effectively with the interviewees and to understand the more technical banking terms that came up in interview. This further helped to develop a bond of trust and my knowledge of the field allowed me to probe more incisively in interview. Third, all the interviewees were engaged in the interview process and in making a contribution to research which would improve the decision making in bank boards, especially in light of the severity of the crisis which they had experienced.

4.5.2 Data reliability

There were a number of challenges I faced when analysing the data. First, related to the risk of data asphyxiation (Pettigrew, 1990) given the large volume of information at my disposal. I tried to deal with this by being as organised as I could in the categorisation of the data into pre-agreed themes or codes. The approach which I adopted in the analysis of the data was broadly consistent with framework analysis (Rapley, 2011). This process involved first familiarising myself with the data, generating themes and sub-themes from the data, coding the data, developing descriptive accounts and explanatory accounts before then writing up the information. The development of codes for which to categorise information was driven by the theoretical model which I developed. As an illustration of this, Janis' groupthink has seven antecedents and eight symptoms which provided me with categories in which to categorise information.

Eisenhardt (1989) highlighted that the researcher should ensure that the theory is not too rich or complex and that the hallmark of good theory is parsimony but accepted that “given the staggering volume of rich data there is a temptation to build theory which is very rich in detail but lacks the simplicity of overall perspective” (*ibid*, p. 547). Langley (1999) further noted that the aim for a researcher in data collection is to “move from a shapeless data spaghetti towards some kind of theoretical understanding that does not betray the richness, dynamism and complexity of the data but that is understandable and potentially useful to others” (*ibid*, p. 695)

I found the challenge, identified by both Eisenhardt and Langley above, particularly difficult. I was faced with a balance between not wanting to overwhelm the reader with the depth of information, but at the same time trying to show the richness of my analysis. Further, I felt that by illustrating to the reader that the data supporting a specific research question was comprehensive, and from a number of different sources, this would partly mitigate any criticism of a “suspicious fit”. I accept that at times that I may have erred on the side of overwhelming the reader, and that my finding reflected in chapter 7 may be “heavy going” at times for the reader.

Another issue which I faced, in common with all other researchers, is the acceptances that humans are poor processors of information and are susceptible to a number of inherent biases in the processing of information (see for example (Kahneman et al., 1982; Tversky et al., 1981; Tversky and Kahneman, 1986). To reduce the tendency to process information selectively and to only look for evidence which confirmed by existing view (confirmation bias), I took heed of the advice of both Yin (2013) and Eisenhardt (1989). These academics encourage the researcher to consider literature which conflicts with the theory you are developing. As Eisenhardt (1984) noted, a review of conflicting literature “represents an opportunity” and that the “juxtaposition of conflicting results forces researchers into a more creative, frame breaking mode of thinking that they might otherwise have been able to achieve” (*ibid*, p. 544). I

found that this advice was particularly useful when reviewing the five existing models which linked board attributed to financial performance (refer to chapter 2). In particular the model of Sundaramurthy and Lewis (2003) provided a challenge and identified a limitation in my model as discussed in chapter 6. Other conflicting research which I found useful in shaping my thoughts includes Sunstein (2009), Stein (2014), Hart (1994), Aldag and Fuller (1993) and Kerr and Robinson (2011).

4.5.3 Generalisability

Langley (1999) observes that it is the “thick description” that will allow the reader to judge the transferability of ideas to other situations and that good research “will often produce a sense of déjà vu among experienced readers” (*ibid*, p.695). It is hoped that the narrative of the Anglo case study, described in chapter 7, will provide the reader with such a sense of déjà vu in relation to other similar cases. Finally Colville et al. (2013) argue that although it is difficult to generalise from single case studies they cite note that single case studies “are not only necessary ingredients for developing more general theories of behaviour but they also provide rich resources bridging empirical evidence and theory building” (*ibid*, p. 1206). I do, however, recognise the limitations of over-generalising from my single case study and that an identified area of further research, is to apply my model of VPDP in a different context¹⁰².

¹⁰² Please refer to chapter 8, and in particular the discussion on the limitations of my research and identified areas for further research.

4.6 Research ethics

Saunders et al. (2011) defines business ethics as “the appropriateness of your behaviour in relation to the rights of those who become the subject of your work, or are affected by it” (*ibid*, p. 129). This definition of research ethics, which puts those affected by the research right at the right of any ethical considerations, is consistent with the view expressed by Bryman and Bell (2015), Easterby-Smith (2012) and Silverman (2012). Silverman further highlights that as qualitative research inevitably involves contact with human subjects in the field, ethical considerations are of particular concern.

Bryman and Bell (2015), Easterby-Smith (2012) and Silverman (2012) highlighted a number of issues that I needed to take into account to protect the interests of research subjects, in particular the interviewees.

- 1) To make sure interviewees were fully informed about the research and that they gave their consent to be interviewed. For each of the twenty interviewees I engaged with, I explained that I was studying towards a PHD, that my chosen field was the Irish banks case study with particular emphasis on Anglo, and that the intention of my research was to increase the understanding of the decision making process if the Irish banks in the lead up to the crisis. All the interviewees gave their consent.
- 2) For all twenty interviewees I offered them fully anonymity. Five of the interviewees requested that they be anonymised for the purposes of my research whilst the remaining fifteen actors all gave their permission for their names to be used. Despite this permission, a decision was made to anonymise all the actors other than Peter Nyberg and Simon Carswell. This decision was taken, in consideration of the comments from my external examiners, to protect the actors given the sensitive nature of the inquiry and the potential for harm to the interviewees. It was deemed unnecessary to protect the identity of Nyberg and Carswell whose views

are already in the public domain (Nyberg through his Commission, and Carswell in respect of his two books and numerous press articles). Further, I made this judgement given that neither interviewee made comments to me in interviewee that was inconsistent with what they have said in public or which would be considered harmful to them.

- 3) Easterby-Smith (2012) highlights that participants privacy must be respected at all times. This was particularly relevant in the interview which I conducted with Actor B. Actor B expressed concerns over privacy and we agreed to conduct the interview in the privacy of his home. For all the other interviews, interviewees were given the option of where they would like the interview to take place. Only two of the interviews were conducted in public places, both venues chosen by the interviewee.
- 4) All interviewees were offered a copy of the interview transcription, thus ensuring that any deception and issue of data has been minimised (Easterby-Smith, 2012). Only one interviewee requested a copy of the notes and made no corrections or alterations.

4.7 Summary

This chapter reviewed and justified my choice of research methodology and methods. It includes a discussion on the use of case study design for my research, the rationale for choosing the single case study approach and the use of semi-structured interviews as part of the data gathering process. I have justified the validity and reliability of my data, explained how I processes the data and discussed research ethics and the implications of this for my own research. Finally I have recognised the limitations of my research. These relate to the subjectivity in the interpretation of my research findings, the inherent biases which exist in the collection of data, the limitations with respect to generalisability of my finding from a single case study, and the difficulty in getting access to participants to interview. Despite the acceptance of the

limitations above, I am confident that my research findings, reflected in my thesis, have a contribution to make to the literature in my field.

Chapter 5: Background to the Irish case study

This chapter provides the background to the identified Irish bank case study. What follows below is, 1) an analysis of the economic backdrop to the Irish financial crisis, 2) a study of the environment in which the Irish banks were operating and, 3) a granular review of all six of the Irish domestic banks.

5.1 Background to the Irish Crisis

When Ireland joined the European Union in 1973 it did so as its poorest member and as the “economic laggard” of Europe (Kirby and Kirby, 2010, p. 31). From the late 1980’s, Ireland was however to undertake a period of unprecedented growth which was to become known as the era of the “Celtic Tiger”¹⁰³. Indeed, in the 1990’s the Irish economy grew at an average rate of 7.5% which was more than three times the average of Europe rivalling the growth of China (Kirby, 2010, p. 2).

This growth is linked to the election of Fianna Fáil, in February 1987, which signalled a new direction for the economy and the ideological underpinnings instituting a policy of expansionary fiscal contraction (McCann, 2011). The government tackled over-indebtedness and negotiated a series of centralised social partnership agreements with trade union which traded in wage moderation in return for income tax concessions.

¹⁰³ The term “Celtic Tiger” was first used by Kevin Gardner an economist at Morgan Stanley in a research report. The use of the word “tiger” being a direct comparison with the Asian tiger economies such as Taiwan, Malaysia, Singapore and Indonesia which had witnessed high levels of growth in the 1980s and an increase in standards of living from a base level way below that of OECD average, as they caught up with the economies of the “First World”.

Ireland benefited from steady improvements in its educational standards¹⁰⁴, improved infrastructure connected to favourable EU subsidies and grants, liberal labour markets and the strong growth in the UK - its largest trading partner. Favourable employment demographics were additional important contributing factors towards growth. In 1989, only 31% of Ireland's population was in work, the lowest in the OECD. Ireland's baby boom, which started in the 1970's and peaked in the 1980's, meant however that by the end of the late 1990s Ireland had a higher fraction of the working age population than either the US or the UK (Mulholland and Bradley, 2009).

Lane (2011) points to the increase of the "weightless economy" during this important phase of growth in which high value but low weight sectors such as the computer and pharmaceutical industries were increasingly important. This meant that Ireland's peripheral geographical status became less of a barrier to export-oriented production. Investment came particularly from the United States due to Ireland's historical links, attractive corporate tax rate of 12.5% and its proximity to Europe.

The improvement in Ireland was such that by the end of the 20th Century, Ireland's GDP was at European average. Ireland had effectively caught up with the rest of Europe. The two decades of sustainable and competitive growth which had preceded this growth phase however created expectations of a continuing rise in living standards and asset values and an environment in which lenders, borrowers and regulators became accustomed to economic growth in the region of 7%. This created an expectation of success in Ireland, and "new era thinking".

¹⁰⁴ Honohan and Walsh (2002) note that education standards in Ireland rapidly increased as a result of the introduction of free secondary education in Ireland in 1967.

Instead of growth stabilising around European averages, the start of the 21st century saw Ireland move into the next phase of growth; shifting from that based on solid fundamentals and export demand to one based on domestic, debt fuelled and bank funded demand focused on the construction industry and related property investment. The expectations for such high growth levels masked the risks associated with this second phase of growth.

Donovan and Murphy (2013) argue that it was the slight weakening of the Irish property market in 2001 which was the catalyst for the start of the housing and construction boom in Ireland. In 2001, Irish property was beginning to show signs of slowing, related to weakness primarily in the US following the collapse in share prices of high growth internet companies (the “dot.com” bust), the weakness in Irish agricultural imports related to the foot and mouth outbreak, and the events of September 2011. Faced with the possibility of a slowdown in growth, Irish policy makers took a range of steps to reignite the property market and ensure that Ireland continued to enjoy the high levels of growth for which it had become accustomed.

The rejuvenation of the Irish economy took the form of tax incentives to encourage building and the investment in property. The Irish political party Fianna Fáil were the dominant coalition partner when such tax incentives were introduced and in the lead up to the crisis itself. Commentators have pointed to a very close relationship between Fianna Fáil and those in the building and construction industry as a potential reason to explain why such favourable tax incentives were introduced to encourage construction (Donovan and Murphy, 2013; O’Toole, 2009; Ross, 2010,).

From January 2002, interest accrued on borrowed money employed in the purchase, improvement or repair of rented residential property was allowed as a tax deduction against all rental income when calculating rental income. Ireland was, at that time, one of only four OECD countries that allowed income tax deductibility for mortgages, whilst not taxing imputed rental income or capital

gains for owner occupied homes (Honohan, 2010). Finland, Portugal and Spain also allowed a tax deduction for mortgage interest payments, but did not tax imputed rent or capital gains on principal owned dwellings. However, unlike Ireland, all three aforementioned countries had municipal taxes on property taxes ranging from 0.1% to 1% (Rae and van den Noord, 2006). Research has shown that there is a strong positive association between the volatility of house prices generosity of the tax system towards housing (van den Noord 2004).

Tax deductibility for mortgage income was not the only property related tax deduction. Section 23 of the Irish Corporation Tax Act was first introduced in 1981 for the purpose of stimulating the then flagging construction industry. It allowed investors to write off all but the site costs of an apartment against their total rental income for the first year including rental income from other properties whilst any unused tax relief was carried forward indefinitely. Further tax reliefs were made for multi-story car parks, holiday homes, hotels and student accommodation. Builders took advantage of these tax reliefs and used them, not to meet specific demand, but rather ostensibly to receive the tax subsidies. During the period that tax relief was available for hotels, the number of hotel rooms increased 150% whilst tourists in Ireland only increased 70%. As O'Toole (2009) observed: "Developers were building hotels, not to meet demand, but simply to get subsidies from the government" (*ibid*, p. 118).

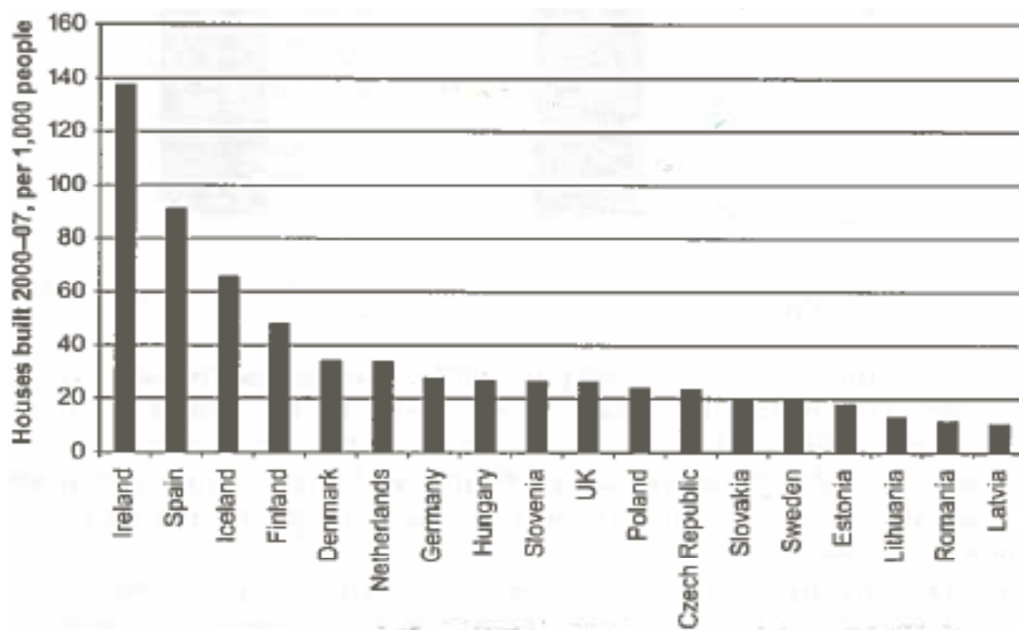
The extent to which Irish growth focused, in this second phase, on the construction industry can be seen in a number of economic statistics. By 2006 residential construction, which had been 4-6% of GDP in the 1990s, reached 13% and at this level was more than twice the GDP average and higher than any OECD country including Spain. The proportion of Ireland's economy derived from the construction industry Ireland's "became excessive" (Regling and Watson, 2010, p. 22).

The construction boom resulted in a significant increase in the number of new houses built. In 2005, house completions in Ireland were 80,000 compared to a

population of 4 million. In contrast in 2005 in the UK, housing completions were 209,000 relative to a population of 60 million (Nyberg, 2011). By 2006, at the height of the construction boom, the number of new houses being built per 1000 people in Ireland was 22 compared with 3.5 in the UK and 3 in Germany. Many of the houses were built speculatively and to take advantage of tax incentives¹⁰⁵. Ryan (2011) cites the example of Leitrim, the smallest county in Ireland with a population of just 29,000. Leitrim built 3,000 houses in the boom whilst the estimate was that fewer than 600 were needed given population trends.

The increase in the number of houses built in Ireland relative to its peers is well illustrated by the following graph highlighted by the following graph (Kinsella and Leddin, 2010, p. 93).

Figure 5.1: Number of New Homes Built per 1,000 people, 2000-2007



¹⁰⁵ O'Doherty writing in the *Irish Independent* in 2006, at the height of the housing boom, vividly describes new housing estates built speculatively, and on the back of tax incentives, sitting desolate and unoccupied.

Despite the increase in supply of houses relative to real demand as noted above, house prices continued to rise. Ireland experienced a threefold increase in the average price of property from 1994 to 2006 (Honohan, 2010). Irish house price inflation was the highest amongst OECD countries between the mid-1990s and 2006, with the United Kingdom and Spain second and third respectively (Malzubris, 2008). Krugman (2009), when comparing the US and Irish property boom in the lead up to the crisis, remarked that Ireland was Florida without the snakes.

At the peak of the Irish property bubble, the average first time buyer mortgage had risen to eight times average earnings, and the average second-hand house cost seventeen times average earnings. The positive wealth effect from rising property prices led to a strong growth in private consumption. Furthermore, tax revenues from property related sources were very high in this growth period, and funded an increase in government expenditure.

The IMF ("World Economic Outlook Housing and the Business Cycle," 2008) provides further evidence of the extent to which property prices in Ireland had become divorced from fundamentals. The research included a comparison of house price valuations across 17 different markets. Prices were modelled as a function of seven fundamental factors, namely affordability, disposable income, long term interest rates, credit growth, stock market performance and demographic factors such as the size of the population by working age. The portion of the actual house price increase that could not be explained by these factors was termed the house price "gap" or overvaluation. The study covered the 10 year period from 1997 to 2007 with Ireland topping the house price gap with a 33% house price gap.

The construction boom significantly impacted Irish government revenues from tax receipts. The structure of Ireland's tax revenues changed dramatically from the early 1990s to 2006-2007. Previously Ireland had been reliant on relatively stable taxes such as personal income tax and VAT, but in the construction

boom tax revenues became much more reliant on cyclical taxes such as corporation tax, stamp duty and capital gains taxes. These cyclical taxes accounted for 30 per cent of tax revenue in 2006 compared with just 8% in the late 1980's (Regling and Watson, 2010, p. 26).

In summary, Ireland had become increasingly reliant on a narrowed and cyclical tax base dependent on a buoyant property market and when the property market collapsed it quickly created a very large public deficit which Ireland is now struggling to come to terms with.

5.2 Euro membership and its impact on Irish banking growth

When the Euro came into force in January 2002, Euro interest rates were set at a level inappropriate to the Irish economy. Euro monetary policy was set with countries like Germany and France in mind; countries with mature economies, low growth rates and very moderate price and house inflation. This represented a complete contrast to the economic cycle in Ireland.

Estimates suggest that the ECB policy rate was on average almost one percentage point lower than a standard Taylor rule¹⁰⁶ would suggest for Ireland over the period 2001 to 2006 (OECD, 2009). Kinsella estimates that had it the opportunity, the Irish Central Bank would have raised interest rates around 2003, and that real interest rates were close to -4% in the early 2000s and that “this free money and the expansion of credit goes a long way to explaining the boom in the domestic economy” (Kinsella and Leddin, 2010, p. 14). Further, most mortgages in Ireland are floating or variable rate so that low Euro interest rates made mortgages more affordable further boosting the demand for housing

¹⁰⁶ The Taylor Rule is a monetary policy rule which looks to provide central banks with an indication as to how much they should adjust nominal interest rates in response to changes in the rate of inflation, and output and other economic indicators.

(Rae and van den Noord, 2006). Artificially low interest rates would have also contributed towards Irish consumer indebtedness.

Another consequence of EMU membership was the elimination of exchange risk which gave the Irish bank's "virtually unfettered access to funding from European and other capital markets" (Nyberg, 2011, p. 3). Dellepiane and Hardiman (2010) sum it up when they commented: "Among the perverse and unintended consequences of the Euro was the fact that an institutional design intended to bring about economic stability by ending currency volatility, ended up creating incentives for much greater instability in the form of very uneven growth, asset price inflation, and unsustainable credit expansion. Ireland, like other European peripheral economies, fell victim to the politics of market-led indiscipline" (*ibid*, p. 488).

The Irish property boom was effectively funded by the Irish domestic banks. The three years ending in 2006 saw compound growth in the Irish banks loan assets at 28% and the Irish banks went from lending 60% of GNP in 1997 to 200% in 2008 (Kelly, 2009). Irish banks increasing dependency on wholesale funding was also very evident. The Irish banks which had been more or less completely deposit funded in 1997, drew on interbank deposits for over 40% of their funds in 2007 (OECD, 2009). Net indebtedness of the Irish banks to the rest of the world was just 10% of GDP at the end of 2003 but by 2006 this had risen to 60% of GDP (Honohan 2009). Irish bank wholesale funding was focused on short term markets. This overdependence on short term funding was not of course unique to the Irish banks and was prevalent in banks worldwide (in particular in the US and the UK). The primary attraction of borrowing in the short term wholesale markets was of course lower costs

5.3 The bursting of the Irish property bubble

The global reduction in bank liquidity was a catalyst for the collapse of the Irish housing bubble but it was not its cause. Nyberg (2011) observed that “the problems causing the crisis as well as the scale of it were the result of domestic Irish decisions and actions” (*ibid*, p. ii). Honohan (2010) refers to the characteristics of the Irish crisis as being both “domestic and classic”. He observed that the Irish banks had no meaningful exposure to the US sub-prime market, nor had they been involved in aggressive international acquisitions but instead “had been fatally weakened by a deep involvement in a world-beating property bubble which took off on the eve of Euro area membership and swelled” (*ibid*, p. 19). Regling and Watson (2010) refers to the causes of the Irish crisis as “home-made” relating to a “plain vanilla” property bubble in Ireland (*ibid*, p. 5-6). Finally, Kelly (2009) agrees that the collapse in Ireland was precipitated by the world crisis but concludes that “the Irish property boom would have collapsed anyway” (*ibid*, p. 59).

When the Irish housing cycle started to turn in 2007 in line with a weakening of the global economic outlook, the Irish banks found themselves overexposed to an asset class that was hugely overvalued, and at the same time their access to funding limited given developments in international markets. The Irish government’s flexibility and ability to act was also limited by its overreliance on revenue from the very asset class which was struggling - property. The consequence of this was the collapse of the Irish economy and the IMF bailout which subsequently followed.

The change in Irish fortunes appeared sudden and dramatic. In 2006 the Irish stock exchange, buoyed in particular by the bank stocks, had risen 28% outperforming the Eurostoxx 50, the FTSE and the Dow Jones Industrial Average. In 2007, Ireland’s GDP per capita had ranked behind only Norway, the US and Luxembourg (Ross, 2010). In contrast by 2008, Ireland’s economy contracted by 11% in real terms and 16% in nominal terms, and house prices

fell by 36%. Figures from the Irish Central Office Statistics in July 2011 reflected that house prices had fallen for 42 consecutive months down 42% off their 2007 peak. Ireland has experienced the deepest and fastest contraction by any Western Economy post Second World War (Kelly, 2009). So dire was Ireland economic contraction that in 2010 Ireland requested, and was granted, a €85bn bailout by the International Monetary Fund (IMF)¹⁰⁷. The open letter written by the Irish Finance Minister and head of the Irish Central Bank in 2010 requesting the IMF bailout noted that Ireland “faced an economic crisis without parallel in recent times” and that “at the root of the problem is a domestic banking system, which at its peak was 5 times the size of the economy, and is now under severe pressure¹⁰⁸.”

In summary, the tangible causes of the crisis were artificially low interest rates in Ireland which made borrowing artificially low and encouraged housing related lending, whilst at the same time the Irish banks had access to a deep pool of cheap and short term commercial funding which they then on-lent to both individuals and property developers. Favourable tax incentives added more fuel to the property fire, resulting in the creation of a significant property bubble in Ireland. The consequence of the bubble was a loss in competitiveness and a tax system and government too reliant on the dependence of the continuation of the boom itself. The significant reduction in bank liquidity relating to the

¹⁰⁷ The €85bn is broken up as follows: €22.5bn from the IMF Extended Fund Facility, €45bn from the European Financial Stability Facility including bi-lateral loans from UK, Sweden and Denmark and €17.5bn from Ireland’s own resources from the Irish Treasury cash buffer investments of their National Pension Reserve Fund

¹⁰⁸ The open letter was written by Brian Lenihan (then Irish finance Minister) and Patrick Honohan (Governor of the Central Bank of Ireland) to Mr Dominic Strauss-Kahn dated December 3, 2010 and can be found on this link <http://www.imf.org/external/np/loi/2010/irl/120310.pdf>

international credit crisis was the catalyst for the collapse of the Irish economy and the resulting request for an IMF bailout in 2010.

5.4 The environment in which the Irish banks were operating

Research into the causes of speculative crises has highlighted the importance of the macro environment in shaping attitudes and ideologies and in fostering an environment of overconfidence and new era thinking¹⁰⁹. Specifically relating to Ireland, McWilliams (2007) observes the change in Irish attitudes and values from Hibernian Catholic Ireland to the transformation into “Europe’s hedonists” and the “most decadent Irish generation ever” (*ibid*, p. 4). Hibernian Catholic Ireland represented to McWilliams the concept of a conservative, insular and understated Ireland. McWilliams provides many facts and anecdotes backing up his claims of Irish decadence, consumption and the change in core moral values in Ireland. As an illustration he observes changes in Irish consumption trends and that by 2007, Ireland spent more on gambling than on newspapers, more on chips than the British and more on chocolate than the Belgians (McWilliams, 2007, p. 9).

McWilliams traces this change in Irish attitudes back to 1979 after Ireland joined the European Monetary System and the Pope visited Ireland. He argued that rather than the Pope’s visit being the highpoint of Hibernian Ireland, it served instead to underline that the church had started to become less important, and had been replaced with more outward looking and consumer orientated attitudes. McWilliams observes that the baby boom in Ireland peaking in June 1980, exactly nine months after the Pope’s visit, and that it is was this generation, with its new set of values, that fuelled the Irish consumer boom. Whether one can actually trace a tipping point in Irish values back to a specific

¹⁰⁹ Refer to chapter 3 for a review on economic bubble theory.

historical point is debatable. However McWilliams makes a strong argument for the change in Irish values and attitudes as Ireland embraced European Union and the neo liberalism values and (ultimately debt driven) consumerism which reflected a move away from Ireland's traditional roots

McWilliams was not the only commentator to notice the change in Irish attitudes to spending. Murphy and Devlin (2009) paint a picture of an Irish society obsessed with consumerism. Murphy and Devlin (2009) observed that in Ireland: "Sales of high tech gadgets, fancy furniture, and exotic holidays skyrocketed. Prestigious designer names from Tiffany to Dolce & Gabbana, from Versace to Jimmy Choo, set up camp to cash in. Smart gyms, spas and golf clubs had a membership glut. Hair and Beauty salons were extending their hours and opening new branches as fast as they could raise signs over the doors. Whether opting for teeth whitening or cosmetic surgery, buying state of the art Gaggia coffee machines or installing electronic security gates, people were routinely living beyond their means. Money, and what it could buy, was worshipped. By the crest of the boom, personal credit reached one and half times that of disposable income¹¹⁰" (*ibid*, p. 41).

Further, Ireland had seen a huge period of growth that preceded the onset of the financial crisis. In the 1990s the Irish economy grew at an average rate of 7.5% which was more than three times the average of Europe and rivalled the growth of China (Kirby, 2010). Ireland, and the miracle of the Celtic Tiger, rapidly converged towards Western European standards of living, and it was often referred to as a model for other emerging and open economies to emulate. Ireland was no longer the "economic laggard" of Western Europe (Kirby, 2010 p. 31). In 2005, *The Economist* magazine produced a global quality of life index ranking in which Ireland was classified as the country with the

¹¹⁰ Murphy and Devlin observe that in 2006, Ireland had the highest personal credit card debt of any European country (*ibid*, p. 41).

highest quality of life in the world and in 2007 Ireland's GDP per capita ranked behind only Norway, the US and Luxembourg.

This strong level of growth resulted in greater levels of overconfidence and perception that Ireland had entered a new paradigm of growth. Nyberg (2011) recognised that Ireland was more vulnerable to overconfidence associated with "new era" thinking given its track record of growth over recent years. Nyberg (2011) noted that "traditional values and practices were seen as less relevant in the new financial order" (*ibid*, para 5.4.3) and that long period of strong and benign growth in Ireland "played a substantial role in convincing observers that developments were stable (*ibid*, para 5.4.5)." The high levels of growth that Ireland achieved in the two decades leading up to the start of the 21st century created an expectation of further growth and masked some of the warning signals associated with the divergent growth, path Ireland took leading as it did to an economic crisis. This observation is consistent with the risks, identified by Reinhart and Reinhart (2009) that countries which had been previously successful and portrayed as "poster children" of the international community are more vulnerable to new era thinking (*ibid*, p. 290).

This point is further developed by Brawn (2009) who argued that the term "Celtic Tiger" came to represent Irish expectations and were imbedded in the Irish psyche and new era thinking: "Unfortunately the term 'Celtic Tiger' took on a whole new meaning among the general population: it morphed into an idea and became part of the zeitgeist. It had seeped deep into the Irish psyche, especially among the younger 'Generation Y', those born since 1980 and who were too young to remember the bad old times. In 21st-century Ireland there are Celtic Tiger people (Celtic Cubs¹¹¹), clothes (Abercrombie and Fitch) television programmes (e.g. Xpose¹¹²), homes, cars, and so on. Incredibly it appears to

¹¹¹ Celtic Cubs is a term relating to children that were born during the Celtic Tiger period.

¹¹² Xpose is a popular Irish celebrity gossip programme.

have become fixed in the outlook of many people as a way of life” (*ibid*, p. 40-41).

McWilliams (2007), Murphy and Devlin (2009) and Brawn (2009) all focus on changes in underlying values within Irish society as a whole. Other commentators focus specifically on the culture within the Irish banks when looking to understand the crisis. Clifford and Coleman (2012) argue that the banking crisis should not have come as a surprise in Ireland, and was systematic of the lack of respect for laws and also a poor political leadership and the overly close relationships between politician and business. They cite a number of examples to back up their assertions. Many of these are purely political in nature; for example a passport for sale scandal, a businessman who had made personal donations to politicians in return for favours, an illegal lottery to fund the hospital system and a case of “jobs for friends”. In all of these examples according to the authors little or no action was taken against the perpetrators.

Carswell (2006) provides thirteen different examples of banking related aspersions beginning in 1976. These include the removal of the Chairman of Irish Permanent for payments made to him for improvements to his personal dwelling, overcharging of customers by National Irish Bank, a foreign exchange fraud at AIB and the decision by AIB to write off debts owing from two former Prime Minister. Carswell argues that these examples reflect the moral state of the Irish banking sector. Books covering similar themes of banking and political scandals in Ireland covering the period of the past years include *Banana Republic* (Sweeney, 2009) and *Bust* (McDonald, 2011).

The Deposit Interest Retention Tax (DIRT) scandal in Ireland is an excellent illustration of the environment in which the Irish banks were operating. This tax was first introduced in 1986, obliging banks to withhold tax at source from the interest paid to borrowers and pay this directly to the Revenue (simply an interest withholding tax). Irish non-residents however could fill out a form

declaring that they did not live in Ireland, which allowed them to receive their interest gross before the DIRT deduction.

The consequence of this legislation was that a number of people claimed non-resident status. O'Toole (2009) notes that by the end of 1998, 17% of all Irish held deposits were in theory held by non-residents, a number totally out of kilter with the number of true non Irish residents. The Irish banks were widely seen as turning a blind eye to customers who were filling in the forms and in some cases were actually helping customers to complete forms (Clifford and Coleman, 2010). The scale of the practice was such, that according to Carswell (2006) "some banks even advertised for non-resident deposits in the window of their branches" (*ibid*, p. 35).

Bank of Ireland initially adopted a policy of complying with DIRT, but in the first year of the tax had €120 million of deposits withdrawn from its branches, and quickly "got the message and joined the other banks in facilitating their customers' crimes" (O'Toole, 2010 p. 50). This race to the bottom and emulation of competitors in Ireland was an important part of the lowering of credit standards by the banks competing to secure property lending business during the property boom and a theme that will be discussed in chapter 7. This further highlights an example of bank herding identified by Nyberg (2011) as being a factor in the credit crisis as well as the role that competition played in affecting bank board behaviour. These are both themes identified in this chapter.

Eventually the DIRT scam was brought to a head,¹¹³ resulting in a government report by the Dails Committee of Public Accounts. The report concluded that the

¹¹³ It was an internal auditor at AIB, Tony Spollen who was the whistle blower. His internal audit report to his superiors at AIB was leaked to the press in 1991. This report prompted the Comptroller & Auditor General to investigate the scale of the tax owned from these false non-resident accounts ultimately leading to the above mentioned enquiry.

problem of DIRT evasion was an industry wide phenomenon and that the evasion of DIRT was practiced in a wider culture of more generalised tax evasion.

Importantly although the banks were fined,¹¹⁴ no one bank executive was deemed responsible nor held to account for the scam. Ross (2010) makes a comparison between the fines levied by the FSA in the UK – another regulator body famed for its light touch regulation - to those levied by the Irish regulator to illustrate the lack of action taken in Ireland. Between 2002 and 2007 he calculated that the UK FSA fined banks and building societies £14 million and then £27 million between January 2008 and June 2009. In Ireland the banks received no fines at all between 2002 and 2007 and the only fines meted out by the Irish regulator between January 2008 and June 2009 were €10, 000 and €5,000 to the *Irish Times* and the *Phoenix* magazine respectively.

The Ansbacher banking scandal, which broke in 1997, was another banking scandal which perhaps helped to set the tone for future bank behaviour. This was a relatively simple circular fraud. Investors gave the Irish bank, Guinness and Mahon, money which was deposited in Ansbacher Bank in the Cayman Islands but unrecorded for Irish tax reasons. This same money was then lent back to the participants as a loan allowing them to record the interest which they were receiving as a tax deduction. As with the DIRT enquiry, there was no prosecution which followed the unveiling of this scam, leading O'Toole (2010) to conclude that “Irish banking did nothing to create a collective ethic, a set of common standards that would ensure that nothing like the DIRT and Ansbacher scandals could ever happen again” (*ibid*, p. 69).

The lack of accountability for these failures amongst the Irish banks may have affected the attitudes of bank boards. It is possible that the banks suffered from

¹¹⁴ In total IR225 million was recovered from 25 different institutions including IR133 million in fines

what Wilson and Kelling (1982) call a “broken window syndrome”. This syndrome has its roots in criminology but has application for understanding the causes of financial crises generally, and specifically in Ireland. Wilson and Kelling were concerned about why crime and vandalism were higher in some areas of the US than others. They concluded that vandalism can occur once the sense of mutual regard and the obligations of civility are lowered by actions that seem to signal that no-one cares, and that street crime flourishes in areas in which disorderly behaviour goes unpunished: “Social psychologists and police officers tend to agree that if a window in a building is broken and is left unrepaired all the rest of the windows will soon be broken. This is as true in nice neighbourhoods as in run down ones. Window breaking does not necessarily occur on a large scale because some areas are inhabited by determined window breakers whereas others are populated by window-lovers, rather, one unrepaired broken window is a signal that no-one cares, and so breaking more windows costs nothing (*ibid*, p. 3).”

To illustrate the point that vandalism can occur in “nice neighbourhoods” the authors cite an experiment undertaken by Zimbardo (1969) where he left a vehicle in a salubrious area. The car was untouched for a week. He then went back and smashed part of the car with a sledgehammer and within a few hours, the car had been turned upside down and totally destroyed.

Carswell (2006), Sweeney (2009), McDonald (2011), Ross (2010) and O’Toole (2009) highlight the claims that financial corruption and tax evasion are “imbedded” in the Irish culture and in 2005 *The New York Times* in 2005 described Ireland as the “Wild West” of International Finance. O’Toole (2010) noted that: “For more than thirty years before the Irish banking system collapsed, it had been colluding on a massive scale with fraud, tax evasion and routine breaches of exchange control” (*ibid*, p. 46).

Tenbrunsel and Messick (2004) refer in their research to an “ethical fade” where over time the ethical aspects of decision making fade into the background. One

of the factors that Tenbrunsel and Messick cite as a factor which contributes towards an ethical fade is “ethical numbing”. This occurs when an unethical act is repeated a number of times so that participants come to accept unethical behaviour as being mainstream and acceptable. Examples such as the DIRT enquiry, the Ansbacher back to back frauds and the numerous other smaller, (and perhaps in isolation trivial) misdemeanours set the tone for the environment in which the Irish banks plied their trade.

None of the three official reports into the Irish financial crisis, however, discuss the history of ethical indiscretions, lack of accountability and a perceived change in value system in Ireland in the run up to the crisis. Perhaps the reason for this is the subjective and intangible nature of the discussion and the risk of any comments being interpreted as being moralistic, judgemental and of a socio-political context. These are, however, important factors in identifying the environment in which corporations operate and are indeed intended to be captured in the model which was developed in chapter 6 as important “contextual factors”.

5.5 Background to the Irish Banks

The discussion above focuses on the macro economic backdrop and the environment in which the which the Irish banks operated in the lead up to the crisis. What follows below is a more granular review of the Irish banking sector itself.

There were four domestic banks and two domestic building societies in Ireland in the lead up to the crisis¹¹⁵. Allied Irish Banks (AIB) and Bank of Ireland

¹¹⁵ Throughout this thesis I have used the term “bank” to include both banks and building societies. Although these are technically different due to the structure of their ownership, I have done this in the interests of pragmatism.

(BKIR) were Ireland's largest banks and were considered full service banks. Anglo Irish Bank (Anglo) concentrated almost entirely on business banking and in providing finance to commercial property assets whilst Irish Life and Permanent (ILP) concentrated on providing residential mortgage financing and insurance products through its insurance arm. In addition to the four banks, there were two domestic building societies, Irish Nationwide Building Society (INBS) and Educational Building Society (EBS). In addition to the six Irish banks noted above, three British banks competed in the Irish domestic banking market; HBOS, Northern Rock and Royal Bank of Scotland (RBS)¹¹⁶. Northern Rock competed almost exclusively for retail deposits. As a result Northern Rock did not suffer any material impairment in Ireland but rather from a reduction in the retail deposits from Irish customers. HBOS and RBS, in contrast, competed primarily in the Irish domestic mortgage and commercial property market and suffered material losses in Ireland. HBOS suffered impairments on its Irish mortgage portfolio of £10.9 billion which was the equivalent to 36% of its loan book as at end of 2008. The percentage of impairments as a proportion to loans at HBOS was higher than that of AIB, BKIR and RBS but less than that of Anglo (Standards, 2013). RBS recorded a cumulative impairment charge of £6.45 billion on its Irish loan book, more than that recorded in both its UK retail banking and UK corporate banking over the same period (FSA, 2011).

In addition to the six domestic Irish banks and three UK banks there were thirty two international banks based in Ireland. The rationale for these international banks basing themselves in Ireland dates back to a decision in 1987 by the Irish government to set up the International Financial Centre (IFSC) in a designated area of the Dublin Docklands by the river Liffey. The idea was to attract foreign bank investment in Ireland with the incentive being a low tax rate of 10%, but which was increased to 12.5% in 2005. Under Irish tax law, a corporation can

¹¹⁶ RBS acted through a combination of Ulster Bank in Northern Ireland and First Active in Southern Ireland.

pay its entire tax bill in Ireland if its central control and management are located in the state even if its core businesses are undertaken elsewhere. This encouraged banks to create the façade that their businesses were being managed out of the IFSC whilst in reality the businesses were being run elsewhere in Europe (O'Toole, 2009).

The international banks played little or no role in the domestic Irish market and held only 7% of Irish household deposits and only provided 5% of the total credit outstanding in the Irish market (Honohan, 2010). Given this, my thesis will focus on the six Irish domestic banks and HBOS and RBS when focusing on the decision process of the banks' board and their over-investment in property in the lead up to the crisis.

The three official Irish reports into the crisis (Honohan, 2010; Nyberg, 2011; Regling and Watson, 2010) focus exclusively on the six domestic banks and their decision processes. This is, however understandable given that the inquiry focused on the Irish crisis, and the Irish government guaranteed the debts of the Irish banks whilst HBOS and RBS received support from the UK government.

5.6 A review of the strategies of the Irish Banks

5.6.1 Bank of Ireland and AIB

The 1960s was a period of consolidation in the Irish banking sector with the emergence of two core banks, AIB and BKIR¹¹⁷. This consolidation was borne from a desire to remain competitive and to reduce the threat from an overseas banking entering the Irish banking domain. AIB and BKIR had, however, very

¹¹⁷ AIB was formed in 1966 a result of a merger between the Provincial Bank of Ireland, Royal Bank of Ireland and the Munster and Leinster Bank. Bank of Ireland took over Hibernian Bank in 1958 and National Bank in 1965

different cultures. BKIR was predominantly a Protestant Bank¹¹⁸. It had a court rather than a board of Directors with the bank's charter being awarded in 1783. AIB, in contrast, had strong Catholic roots and was seen as a more abrasive and aggressive competitor¹¹⁹. These two banks, despite the difference in their cultures, dominated the domestic Irish retail market. O'Sullivan and Kennedy (2010) noted that in 2006, AIB and BKIR controlled 80% of all Irish current accounts and 40% of all loans and deposits.

Nyberg (2011) highlighted that one of the core strategies of both AIB and BKIR was to maintain independence and that strong growth and share price performance protected them from a potential take-over. Further, despite their dominance in the Irish retail market, Nyberg also notes that both these banks viewed Anglo as a threat and that Anglo was "highly regarded and greatly admired by many market commentators and advisors both domestically and abroad" (*ibid*, p. 24). The threat which Anglo presented to AIB and BKIR is explored in detail later in chapter 7.

5.6.2 INBS, EBS and IL&P

INBS business model was "unique" (Nyberg, 2011) in that they provided 100% finance to developers to acquire sites that were zoned but had not as yet acquired planning permission. When planning permission was acquired, the loan was typically repaid to INBS and the property was financed by a competitor

¹¹⁸ Indeed it was only in 1991 that Patrick Molloy became the first Catholic CEO of Bank of Ireland.

¹¹⁹ Ross (2010) explained the differences between the cultures of the two banks when he observed that when chasing a client Bank of Ireland would politely knock on the door and wait for an answer while AIB would head straight for the back door with a crowbar (*ibid*, p. 27). Certainly my own impression of the two banks was that AIB was significantly more aggressive than BKIR when dealing with banking counterparties.

bank. INBS would often enter into profit share arrangements with the developer and receive a percentage of the profits when the project was completed. The business model was more like that of a venture capitalist financier than a traditional bank. It was hugely exposed to a decline in the Irish property markets and in particular commercial property and it was also over-reliant on the wholesale market for its funding.

INBS key strategy was a demutualisation and sale which would have resulted in a significant windfall for its members. INBS most significant growth spurt was accordingly in the years leading up to the expected demutualisation. The credit crisis of 2007/2008 however made such a demutualisation impossible and INBS was rescued alongside the other Irish banks.

In contrast, EBS was committed to mutuality and its business model was that of a traditional building society taking deposits from members and lending these out as mortgages. EBS core strategy did however change in 2006 when the made the strategic decision to enter into the market for financing commercial properties.

ILP was a converted building society which kept close to its historical roots focusing on the Irish mortgage market and combining this with its insurance business. Residential mortgages accounted for 84% of ILPs total loan portfolio in December 2008 (Nyberg, 2011).

5.6.3 Anglo Irish Bank

Anglo classified itself as being “a relationship based business bank with a centralised business model operating in three core areas – Business Banking, Treasury and Wealth Management” (Anglo AFS; 2006). In essence, however, Anglo was a single focused commercial property growth model characterised by a centralised decision making process with a very limited branch network. Anglo’s lent on a secured basis on commercial property primarily in Ireland but

also in the UK and in the Boston area of the United States. Business and personal banking accounted for just 5% of their business. Anglo was described by O'Toole (2009) as the "quintessential developers' bank" (*ibid*, p. 199).

Leverage was an intricate part of Anglo's business, and often they would finance not only the investment syndicate, but the individual members of the syndicate themselves. For a particular development, Anglo would put a limit on the amount it would lend to the property syndicate, and would require the syndicate members to provide the rest of the capital for the development upfront. In theory therefore Anglo would prudently limit its exposure to the development to a defined percentage of the loan to value. However, Anglo also financed the individual members of the syndicate through its private bank. The security which Anglo's private bank would take being existing property (which given the buoyant property market would have almost certainly increased in value since it had been initially encumbered) or equity which might include Anglo shares. Thus, in practice, Anglo was highly leveraged and exposed to the success of specific property developments and was very sensitive to falls in the Irish property market.

Anglo was also very sensitive to maintaining relationships with its key commercial property clients. Anglo's loan book was extremely concentrated on a few large lending relationships and its exposure to its top twenty customers as at May 2008 accounted to half of its total loan book of €41.7 billion (Nyberg, 2011). As a result of the desire to maintain its core relationship and in light of the strong competition, Anglo felt pressurised to approve loans for fear of losing customers. This point is highlighted by Kelly (2010), a property developer who was a customer of Anglo's: "The [credit committee] meeting was for getting deals approved, and they rarely came back with a no. If a deal looked tricky, the bank would put up the price of money, but lent it anyway" (*ibid*, p. 39). The extent to which competition influenced the decision process of Anglo and competitor banks will be explored in detail in chapter 7.

Anglo saw significant growth in both its profitability and market capitalisation in the lead up to the crisis. In July 2007, its share price peaked at €17.53 and its market capitalisation €17.53 billion. This represented an 80% increase in share value and 103% increase in market capitalisation over a two year period, significantly outperforming all the other Irish banks (O’Sullivan and Kennedy, 2010). In 2007, management consultants Mercer Oliver Wyman named Anglo Irish Bank as the best rated bank of the 170 banks over US\$10 billion that they had surveyed globally, whilst *Investor Relations Magazine* in 2008 named Anglo as “Best Overall Investor Relations” (Murphy and Devlin, 2009).

In 2007, Anglo became only the fourth ever Irish company¹²⁰ to disclose profits in excess of €1 billion when it reported its twenty second consecutive year of uninterrupted growth, with profits up 44% to €1.221 billion. Beltratti and Stulz (2009) concluded that banks that had performed best before the crisis and were rewarded with the largest stock increases before the crisis were the banks that suffered the most during the crisis. Anglo is an excellent example of this research.

In December 2008, two and a half years after its market capitalisation had peaked at €17.53 billion, Anglo was nationalised by the Irish government, its shares worthless. In March 2011, as a fully nationalised entity, Anglo recorded an annual financial loss of €17.7 billion breaking its own record corporate loss in Ireland losses incurred in 2010 at €12.7 bn. The total cost of the government bailout of Anglo is estimated to exceed €34 billion the largest of the Irish banks¹²¹. The IMF (2010), in their report setting out the details of their bailout, specifically mentioned Anglo noting that “Although the bank [Anglo] was

¹²⁰ Two of the other three being Bank of Ireland and AIB.

¹²¹ The precise cost to the Irish government of Anglo is difficult to quantify as it was first split into two entities, a “good” and a “bad” bank in September 2010 and then merged with Irish Nationwide in July 2011.

nationalized almost two years ago, it has sucked in ever-increasing public funds, and has served as a nagging reminder of the severe banking supervision deficiencies in Ireland and the poor state of the Irish banks” (*ibid*, p. 13).

Lyons and Carey (2011) noted that: “The collapse of Anglo Irish Bank is the central drama in a series of events that has culminated in the Irish state requiring a bailout from the International Monetary Fund and the European Union – an extraordinarily dramatic downfall.” Kelly (2009) described Anglo as a “genuinely rogue bank” (*ibid*, p. 82) whilst Lewis (2011) cites a comment from a hedge fund manager that “Anglo Irish was probably the world’s worst bank” (*ibid*, p. 84).

Three significant governance indiscretions have been identified with respect to Anglo in the lead up to the financial crisis. These relate to the warehousing of the chairman Sean Fitzpatrick’s loans over year end at a competitor institution, the back to back arrangement with ILP to booster year end deposits, and the “Golden Circle” transaction where Anglo provided financial assistance for the purchase of its shares from a distressed holder. These are discussed briefly below.

During the period 2001-2007 loans from Anglo to Fitzpatrick were transferred to INBS so that the full extent of his borrowings would not be disclosed in the Anglo AFS. After year end, on the 3rd or 4th of November, these loans were then transferred back to Anglo. By 2007 Fitzpatrick had loans of €127 million outstanding from Anglo whilst only disclosing €7 million in the annual financial statements (Lyons and Carey, 2011, p. 220)¹²². The exposure of this

¹²² Fitzpatrick justified his decision to conceal the loans in the series of interviews that made up the book *The Fitzpatrick Tapes* (Lyons and Carey, 2011). Fitzpatrick rationalised the decision to warehouse the loans on the basis that he had invested in a number of tax driven partnerships which meant for legal reasons relating to partnership law that he would need to disclose the full amount of the loan in the accounts and not just his partnership share. He felt that this would have created a false impression of the magnitude of his loans. This argument is, it is submitted,

governance failure in late 2008 led to the resignation of Fitzpatrick, CEO Drumm and NED Bradshaw¹²³.

The back to back arrangement with ILP was another indiscretion which involved the manipulation of Anglo's balance sheet. Anglo was perceived internationally as the most vulnerable of the Irish banks to a reduction in wholesale funding. Anglo's mono-line business strategy described above, lower debt credit rating¹²⁴ and its reliance on wholesale funding, made for obvious comparisons with Northern Rock. Northern Rock had received UK government emergency funding in September 2007 and had been bought under UK government ownership in February 2008 as a result of short term liquidity failures.

In Anglo's September 2007 year end accounts it had disclosed as a balance sheet item customer deposits of €53 billion. and in the run up to the September 2008 year Anglo would have potentially had to report customer deposits of around €46 billion – reflecting a reduction of 13% on 2007. Customer deposits were an important indicator of the health of Anglo's funding profile as customer deposits were perceived by the investor community as being reliable and less liable to flight risk. Interbank deposits in contrast were perceived to be as being extremely vulnerable to the drying up of wholesale markets associated with ongoing concerns relating to the banking crisis.

flawed. Fitzpatrick warehoused not only partnership loans but other loans not linked to partnerships. Moreover any loan exposures related to his partnership liability could have been easily explained by means of a note to the Anglo annual report and accounts.

¹²³ Bradshaw's loans had inadvertently also been warehoused by Fitzpatrick as one of the partnerships related to an exposure to a partnership which Bradshaw was a partner.

¹²⁴ Anglo had a single "A" credit rating from the rating agencies whilst both AIB and BKIR had a "split" AA/A rating. The lower rating meant that it was both more expensive to secure wholesale funds and also more difficult given the perceived higher risk.

Anglo's management believed that any disclosure of a reduction in corporate deposits would be a signal to the market that Anglo was struggling to secure stable funding. Indeed, Cooper (2009) highlighted that in the run up to the announcement of Anglo's 2008 year end results that Anglo had been struggling to raise anything more than overnight money. O'Toole (2009) further highlights the stress that Anglo was under when he noted that in the last week of Anglo's year end, €5.4 billion in corporate and retail deposits was withdrawn from Anglo. On the 29th September the day before the year end Anglo's shares had dropped 46% in the market (*ibid*, p. 206)¹²⁵.

ILP was a bank-assurer with a separate life assurance company Irish Life and as such was uniquely positioned to aid Anglo. Any deposit made from ILP's insurance arm Irish Life would technically be classified as a customer deposit rather than as an inter-bank. Anglo approached, and executed, with ILP a back to back transaction whereby Anglo deposited €7.45bn with ILP (disclosed as an inter-bank loan) and ILP, through its insurance arm Irish Life, deposited the money back with Anglo who then disclosed the deposit as a "customer deposit" in its September 2008 year end accounts. This allowed Anglo to falsely boost its customer deposit numbers and to create the perception amongst users of financial statements that Anglo was not as reliant on inter-bank deposits than in reality it was¹²⁶.

¹²⁵ This drop in Anglo's share price was not of course in isolation. September 2008 was the most volatile month in the crisis. Indeed in September 2008, Lehman Brothers had gone into liquidation, Merrill Lynch had been saved from a similar fate and had been bought by Bank of America, Fortis Bank had been part nationalised whilst German bank Depfa Bank was amongst others struggling for funding.

¹²⁶ In effect the € 7. 45 billion received from ILP allowed Anglo to reflect customer deposits in its 2008 accounts as just over €53 billion therefore showing no deterioration in the number from that disclosed in 2007. The effect of this false disclosure on the Anglo share price performance is, however, impossible to quantify. The Irish Government, on the date of Anglo's year end 30

The “Golden Circle” transaction related to the arrangement by the board of directors to fund the purchase of Anglo’s shares by ten large customers of Anglo from the distressed investor Sean Quinn¹²⁷. From late 2005 until September 2007, Quinn built up a position in Anglo shares which at its peak was 28.5% in Anglo, 28% synthetically through derivative contracts and 0.5% through a direct holding (Lyons and Carey, 2011, p. 117).

Anglo had lent Sean Quinn either directly or indirectly €2.8 billion of which €574 million related directly to loans with respect to his share purchases (Lyons and Carey, 2011, p. 134 and 142). Quinn bought the rights to his shares between the prices of €13.25 and €17 (Cooper, 2009, p. 190) and as Anglo’s share price fell, Quinn came under significant pressure. Speculation built up as to the extent of Quinn’s exposure to Anglo. The board of Anglo became concerned that if the full extent of his exposure to Anglo became known, it would put further downward pressure on the Anglo share price.

Anglo put together a list of ten close banking relationships, which was to become known as the “Maple 10” or the “Golden Circle” who would each take 1% of Quinn’s share positions with the remaining to be taken up by Quinn himself or sold down in the marketplace. All ten clients were given financial assistance by Anglo to purchase the shares. Three quarters of the sums being lent to buy their shares were secured against the shares itself, whilst the bank

September 2008, took the decision to guarantee all the dated liabilities of the six Irish domestic banks. This provided a huge (albeit short term) boost in confidence in the Irish banking sector. The guarantee covered €440 billion of liabilities approximately twice the country’s GNP. As part of the guarantee the Government employed Price Waterhouse Coopers (PWC) to review the accounts of Anglo. It was as a result of this enquiry undertaken started in November 2008 that the details of the guarantee became known.

¹²⁷ In 2008, Quinn was Ireland’s richest man with *Forbes* magazine placing him in their top 200 in the world list (Lyons and Carey, 2011, p. 99). Quinn invested heavily in Irish bank shares and in particular in Anglo.

had recourse to the borrower's other assets for just 25% of the purchase price. In effect, 75% of the loans were secured against shares which were to become worthless leading to huge losses to the state via its ownership of Anglo. Two of Anglo's executive directors, McAteer and Whelan have been found guilty of breaching Companies Act regulations with respect to providing financial assistance for the purchase of Anglo shares.

As highlighted in chapter 4, case study selection should be influenced by the case which gives the researcher the greatest opportunity to learn (Eisenhardt, 1989; Stake, 1995b). These three governance failures described above, coupled with the central role that Anglo played in the Irish crisis highlight Anglo as an interesting case study for further analysis.

5. 7 Conclusion

The level of severity of the Irish crisis and the central role that the banks played make this an excellent case study to test my theoretical model of poor decision outcomes. In particular, Anglo has been identified as a bank which was central to understanding the Irish crisis itself, and in assessing whether the model can assist in understanding systemic risks associated with a poor decision outcome at a leading bank leading to emulation of that strategy by competitors.

Chapter 6: A multi-theoretical approach to the development of my model of VPDP

6.1 Introduction

In this chapter I will develop a model which provided an alternative lens to identify vulnerabilities within a board to a poor decision process. My model of VPDP will then be compared and contrasted to the five recognised models which link board attributes to financial performance discussed in chapter 2. Finally from the model itself, five research questions will be identified which will then be applied with reference to the identified Irish bank case study.

The proposed model will lean heavily on both behavioural and institutional theory¹²⁸ and is in keeping with the call to bring multi-dimensional and different approaches to research into the field of corporate governance (Daily et al., 2003; Filatotchev and Boyd, 2009; Payne et al., 2009; Roberts et al., 2005).

The model will also be consistent with Huse's (2005) recommended conceptual framework for behavioural research in the field of corporate governance. Huse's (2005) conceptual framework for exploring behavioural aspects of boards is characterised by three factors. First, a greater understanding of the intermediate processes such as board cohesiveness and cognitive conflict which sit between board attributes and firm performance. Second, Huse recommends applying theories from group and cognitive psychology to understand boards and decision making groups. Third, Huse urges researchers to adopt a pluralistic approach to board theories and that various approaches are needed to meet

¹²⁸ Institutional theorists argue that the institutional environment can strongly influence the behaviour of individual firms that operate within such environment. The discussions regarding the macro environment and the impact which this has on the decision process highlighted above all fall within the broad tenets of institutional theory.

the various research questions in this field. All three of these factors identified above by Huse are included in my proposed model.

The model draws from the extensive literature review undertaken earlier in my thesis. First, from the literature detailing the normative and informative influences on group decision processes, and the inherent biases in our decision processes through the identified phenomena of groupthink, herding, group polarisation, de-individuation and epistemic blind-spots. The review of the literature in this area identified that these phenomena were closely related, and can combine together to create a more powerful force than when looked at in isolation (Cox and Munsinger, 1985).

Second, the model draws on the literature review which discusses the importance of context, the interplay between broader macro and micro factors, and how this might affect decision processes. This review concluded that context is critical in understanding processes and that it should be explicitly embedded in models of human behaviour (see for example Johns (2006), Ocasio (1999), Westphal and Zajac (2001) and Pye and Pettigrew (2005)). Further, recognition is made of Powell and DiMaggio's (1983) research, which argues that institutional pressures within a specific domain increase the homogeneity of corporations transacting within that field. Once a set of organisations emerge through a combination of coercive, mimetic and normative pressure, corporate leaders make their organisations increasingly similar to those around them.

The model further recognises the literature which highlights the environment in which speculative bubbles occur (see for example Shiller (2008; 2005), Swarup (2014) Galbraith (2009, 1994) and Kindleberger (2000)). This is of particular relevance as the economic backdrop to the collapse in the Irish banks, described earlier, represents a classic example of a speculative property bubble which burst resulting in the IMF bailout of Ireland in 2010. A review of this literature highlighted the importance of behavioural factors in explaining

irrational behaviour associated with bubbles, and identified high levels of confidence and a belief that “this time is different” as important factors common to financial bubbles.

Third, the model recognises the role that directors’ low skill levels affect board decision processes generally, and also increases the vulnerability of normative and informative pressures on decision making (Zahra and Pearce (1989), Walker Report (2009)).

The model will capture three layers of decision processes and the vulnerabilities with respect to a poor decision process at each of these levels. First, with respect to an initial decision recommendation (normally made by a CEO). Second in respect to the ratification of such a decision by the board of directors. Third, with respect to implications for a systemically poor decision process relating to herding by competitors.

In summary, the proposed model is in keeping with the call for a multi-theoretical approach. It draws on a wide and extensive review of literature covering behavioural and contextual factors and functional skill levels and covers three levels of decision processes.

6.2 Building blocks for the model of poor decision processes

The model has as a starting point an initial poor decision or strategy suggestion in the context of a corporate boardroom. A poor decision process has been defined previously as a decision which could have been avoided, and which results in a lower value to the firm in the present or future. Such a poor recommendation may simply be poorly thought out, inadequately researched and made by an actor with low levels of knowledge and experience. Such a recommendation may, however, be affected by inherent inbuilt biases in the decision processes itself. Literature related to behavioural economics argues that our decision processes are not always rational but rather are affected by a

number of identified biases (see for example Akerlof and Shiller, 2010; Ariely, 2009; Kahneman and Tversky, 1979; Kahneman, 2011; Kahneman et al., 1982).

Examples of such biases relate to bounded rationality with respect to overconfidence, availability and confirmation. With respect to overconfidence, research findings have found that actors are overconfident and overestimate the precision of their forecasts (Daniel et al., 1998). Moreover, if investors experience gains in their holdings of an asset, this gives them some comfort that they have a cushion against a potential loss and they become even less risk averse and purchase more of the same asset (Thaler and Johnson, 1990). Overconfidence can, therefore, negatively impact decision processes.

An availability bias relates to when actors make decisions and place greater emphasis on information which they have available to them (see for Kahneman et al., 1982; Wänke et al., 1995). For example, the fact that Ireland had never experienced a national property crash, might affect decision processes whether to invest in property. Again, the existence of such a bias could lead to a poor decision process.

A confirmation bias exists when actors favour information which confirms their existing beliefs, whilst ignoring other information which contradicts this (Nickerson, 1998). Confirmation biases exist when humans process information selectively and favour data which confirms an existing belief, rather than considering how they might adjust their beliefs given the information (Wei Choo, 2007). The greater the vested interest, the greater the likelihood that actors will be vulnerable to such a bias. Bazerman and Tenbrunsel (2013) refer to the process in which actors deceive themselves into thinking that a decision is fair, even though the reality is that such a decision is skewed in favour of their vested interests, as motivated blindness. An extreme version of a confirmation bias has been referred to as an epistemic blind spot (Wei Choo, 2007).

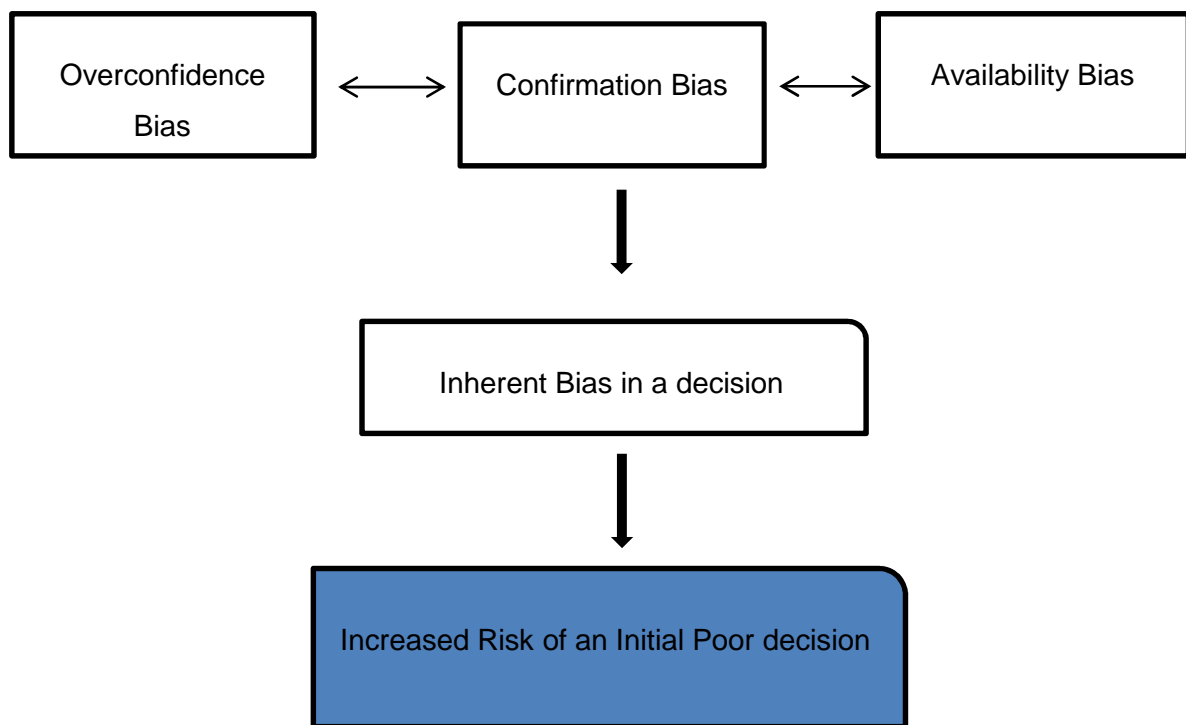
Heffernan (2012) highlights that actors looking to convince themselves about a specific course of action are likely to surround themselves with other actors who have similar views to them, who will reinforce these beliefs rather than challenge them. Further, as such homophily develops, so does confidence in the correctness of their views, and the greater the blindness towards alternatives. In other words, epistemic blind spots are associated with homogeneity and will exacerbate confidence.

To illustrate this, assume a scenario where an actor with a vested interest and a strong confirmation belief that property is a good investment, relies on the availability of information which shows that property has performed well in the recent past and that there is no history of a property crash. In this scenario, a confirmation bias has combined with an availability bias. Further, this confirmation bias will be exacerbated if the actor is confident in his decision processes, a confidence which might be a function of past recent successes. A confirmation bias here combines with an overconfidence bias. In this way, these biases can combine together to affect an initial decision process.

The model recognises that our decision process has a number of inherent biases and potential flaws. Further when faced with a vested interest in a specific outcome, actors look to justify or rationalise a choice. Such rationalisation often involves a form of self-deception and a tendency towards homophily, actively seeking others who have similar views. Such homogeneity then exacerbates confidence in the (often flawed) decision process. In summary, the starting point for the model is a poor decision or strategy recommendation. This decision may simply be no more than a “poor choice” made from a position of low levels of knowledge, but could also have been affected by inherent biases in the decision process itself.

This is reflected below:

Figure 6.1: First building block of my model of VPDP



6.3 Normative influences and how they affect decision processes

The first building blocks of the model are concerned with the vulnerabilities of a poor decision by an individual actor. My model is concerned with understanding how decisions are made in the context of a corporate boardroom. Material decisions or recommendations by a CEO (or another member of the board), need to be agreed by the collective board of directors. The primary role of the independent NED is to monitor management and to provide a robust challenge when necessary.

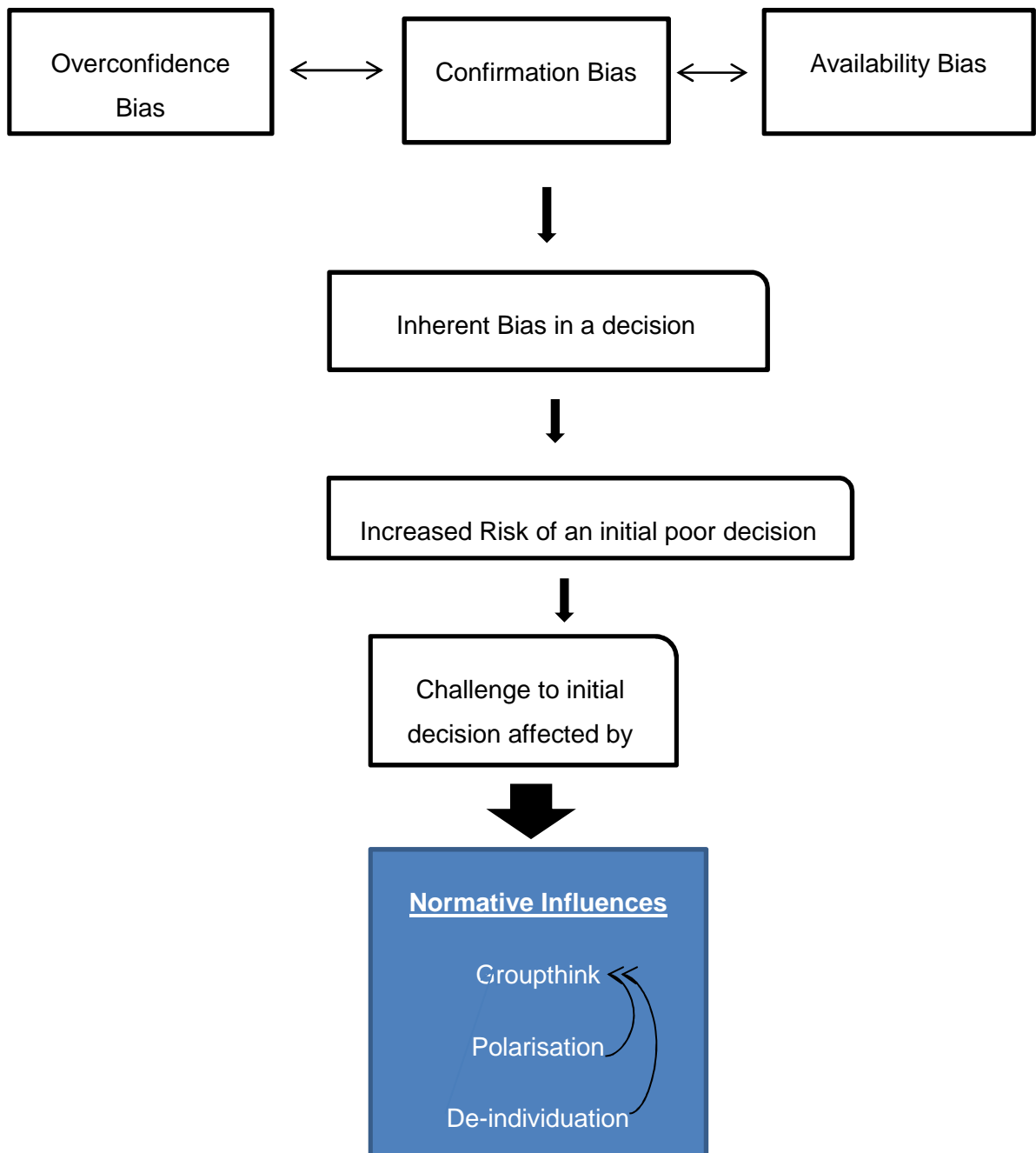
The effectiveness of NEDs to challenge management is, however, affected by a number of factors. The first of these relate to normative pressures on decision processes. The literature review identified three normative influences on

decision processes, namely groupthink, de-individuation and group polarisation. Groupthink was defined by Janis (1972) as “a mode of thinking that people engage in when they are deeply involved in a cohesive in-group when the members strive for unanimity override their motivation to realistically appraise alternative courses of action” (*ibid*, p. 9). Group polarisation refers to the phenomenon where a group tends to be more extreme in the direction in which it was already trending (Moscovici and Zavalloni, 1969). De-individuation is a psychological state of decreased self-evaluation and disinhibition, where de-individuated individuals become so consumed by their collectivity that the group becomes the reference point, substituting individual goals for those perceived to be of the group (Festinger et al., 1952).

As highlighted in the literature review, these three phenomena are inextricably linked. Groups that suffer from polarisation are also most likely to be suffering from groupthink. Moreover, a de-individuated individual will subordinate his/her feelings in favour of those of the group, and as such a de-individuated individual is, therefore, more susceptible to groupthink. These phenomena share common characteristics of cohesiveness, homogeneity, directive leadership, and are exacerbated in situations of high confidence. Groupthink, group polarisation and de-individuation can combine together to create an environment in which the risks of a poor decision outcome are heightened. Cox and Munsinger (1985) highlight, when phenomena combine together, a form of synergism occurs so that the combination of the effect is more powerful as a force than if phenomena are looked at in isolation. Further, Rousseau and Fried (Rousseau and Fried, 2001) observed that a set of factors when considered together can sometimes yield a more interpretable and theoretically interesting pattern than any of the factors would show in isolation.

This additional building block to the development of the model is reflected below:

Figure 6.2: Second building block of my model of VPDP



The figure above reflects that group decision processes are affected by normative influences on decision making which can reduce the likelihood that an initial poor decision will be challenged, and increases the risk that such a decision will become more polarised. The arrows above, connecting the

normative influences, reflect the interconnectivity of the identified normative influences, and that de-individuation and group polarisation are closely connected to groupthink.

6.4 Informational pressures to conform

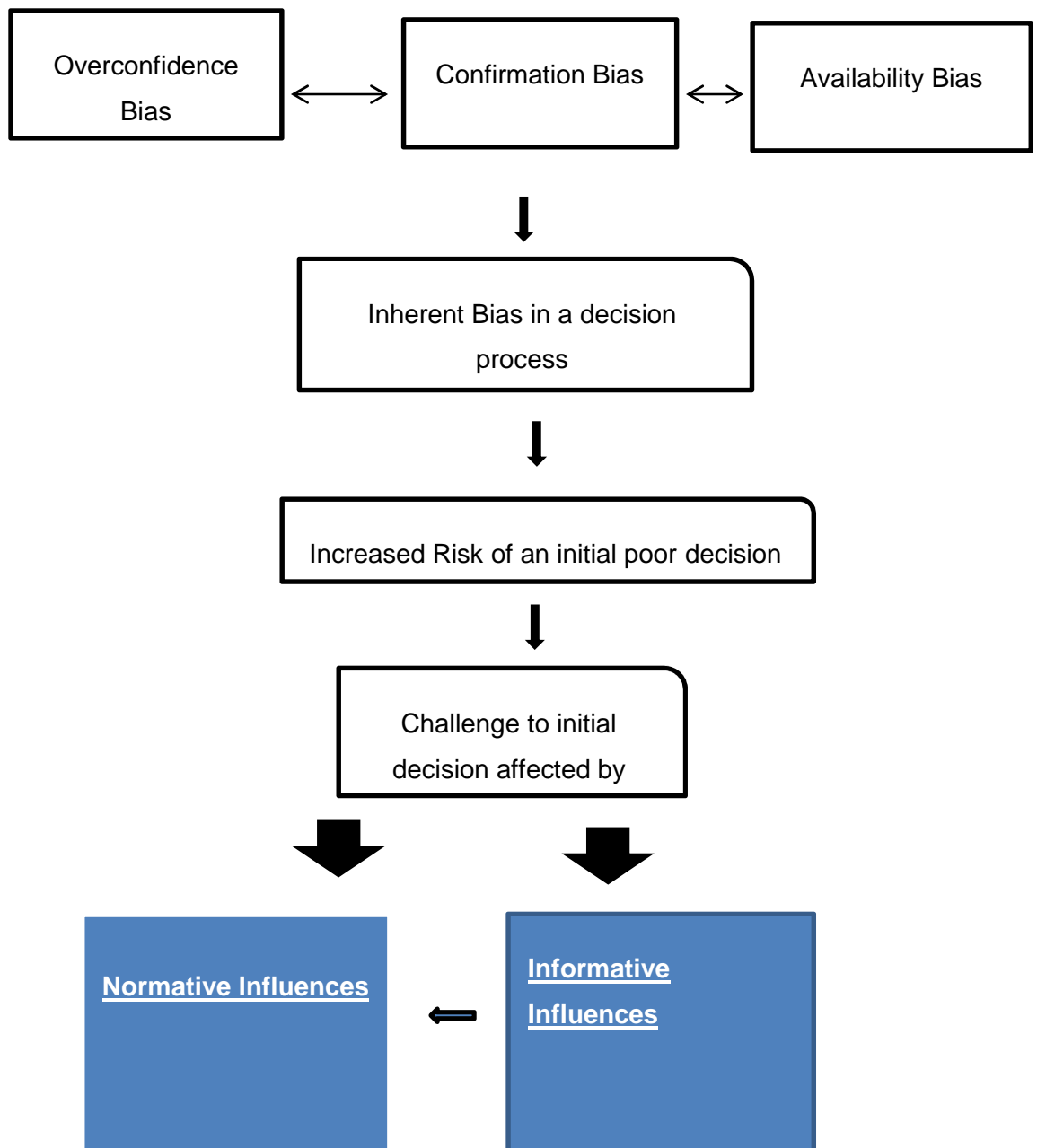
A further building block of the model relates to the informative pressures to conform leading to herding. This pressure is not coercive, but rather the result of a rational act based on the accumulation of information which is perceived to be superior to that of an actor's own information. As such, the actor will follow the choices made by others and ignore her own information. This informational based conformity has strong support in the literature, see for example Bikhchandani et al. (1992), Anderson and Holt (1996) and Easley and Kleinberg (2010). A distinction can be made between normative pressures which are rooted in psychology, and informative pressures which are rooted in traditional financial theories based on the rational assessment of information.

A review of the literature related to informative influences on decision processes revealed that herding is more likely to occur in homogenous groups (Easley and Kleinberg, 2010). The propensity to herd is greater if the signals or information which actors rely on, come from others which are considered influential. In other words we are more likely to herd when the informational signals are from other actors whose signals are valued (Friedkin and Johnsen, 1999).

High levels of competition can lead to herding as market participants look to maintain market share (Donovan and Murphy, 2013; Nyberg, 2011). Shiller (1995) further highlights that herding is more likely to occur where information about an asset class is more readily communicated and disseminated, especially if the topics are imbedded in the psyche of a society or are important to the basic instinct of survival. Shiller (2008) specifically highlights property as an example of such an asset class which is more susceptible to herd behaviour.

The literature review further identified a linkage between normative and informative pressures on a decision process. Both normative and informative pressures have in common a suppression of individual thoughts in favour of others' views. Not surprisingly there are common threads, namely: directive leadership, homogeneity, isolation of the group and are both exacerbated in environments associated with high levels of competition. Further, there is a complex interplay between normative and informative influences which can exist internally within a firm, and also between firms. Within a firm, normative and informative pressures can combine together, and a NED who believes that an executive director has better information, is more likely to herd. Herding can increase cohesion and confidence within a group. Both of these are characteristics associated with normative pressures to conform. Herding can, therefore, increase the likelihood and vulnerability of a group to groupthink, group polarisation and de-individuation. The relationship between informative and normative pressures described above illustrates that the sum of the whole can be more powerful than the individual components (Cox and Munsinger (1985) and Rousseau and Fried (2001)). This additional building block to the model is reflected below:

Figure 6.3: Third building block of my model of VPDP



The arrow in the diagram above connecting informative and normative influences reflects the interconnectivity between these influences and that

informative pressures can impact normative influences and can combine to reduce the likelihood of a robust challenge.

6.5 The importance of context to the model itself

As noted previously, a model of decision processes needs to consider the contextual factors which impact on both normative and informative influences in decision processes. The industry type is an example of such a contextual factor. Turner and Pratkanis (1998) argue that certain types of groups are more susceptible to groupthink than others and that jurors and scientists, by definition of their group social identity, are more likely to appraise critically a situation before making a specific decision. They note that a scientist is more likely “to bend over backwards to prove himself wrong rather than right on matters of scientific investigations” (*ibid*, p. 230). Related to this, Neck and Moorhead (1992) found that although many of the antecedents were present, groupthink was avoided by the jury in the case against DeLorean. The responsibility and expectation associated with the role meant that jurors were able to resist groupthink.

Finally, further evidence of this point is found in the research of Johnson and Downing (1979) into the process of de-individuation. These researchers found that when subjects were dressed up in Klu Klux Klan type outfits this led to an increase in aggressive behaviour whilst those subjects who were dressed up as nurses, there was a significant reduction in violence. None of this research was related specifically to banking but the high number of ethical indiscretions which have been associated with the industry would indicate that banking was a higher risk industry in this respect. Bankers, if they were to “dress up”, are more likely to do so in Klu Klux Klan outfits than nurses!

The industry type, therefore, impacts the salient norms of an industry, and certain industries are more vulnerable to groupthink (Neck and Moorhead,

1992; Turner and Pratkanis, 1998) and to related ethical indiscretions (see (Ford and Price, 1996; Hall, 2007; Langevoort, 1995; Sims, 1992)¹²⁹. This risk is reflected in the model above by the inclusion of “industry type” in the contextual factors.

The threat of competition is another contextual factor that will impact the decision process. The impact on inter-group competition on groupthink is highlighted by Turner et al. (1987) and Hart (1994). Hart (1994) highlights that intense competition between different groups, and the existence of a threatening out-group, can increase intra-group solidarity, increasing cohesiveness and the likelihood of groupthink. Hart argues that the four symptoms of groupthink identified by Janis, namely illusions of invulnerability, belief in the inherent morality of the group, collective rationalisation and stereotyping of out-groups, will be impacted by competition from external groups. Janis (1972) identified high stress from external sources as an antecedent in his groupthink model, and the threat of competition is an example of such stress¹³⁰.

¹²⁹ For a fuller discussion of this please, refer to chapter 3 on groupthink, and in particular the sector titled “groupthink and unethical behaviour”.

¹³⁰ Banking is an industry which has been associated with high levels of competition and high confidence. Both of these observables are characteristics associated with normative and informative influences on decision processes. This further highlights the vulnerability of banking as an industry to a lack of adequate boardroom challenge.

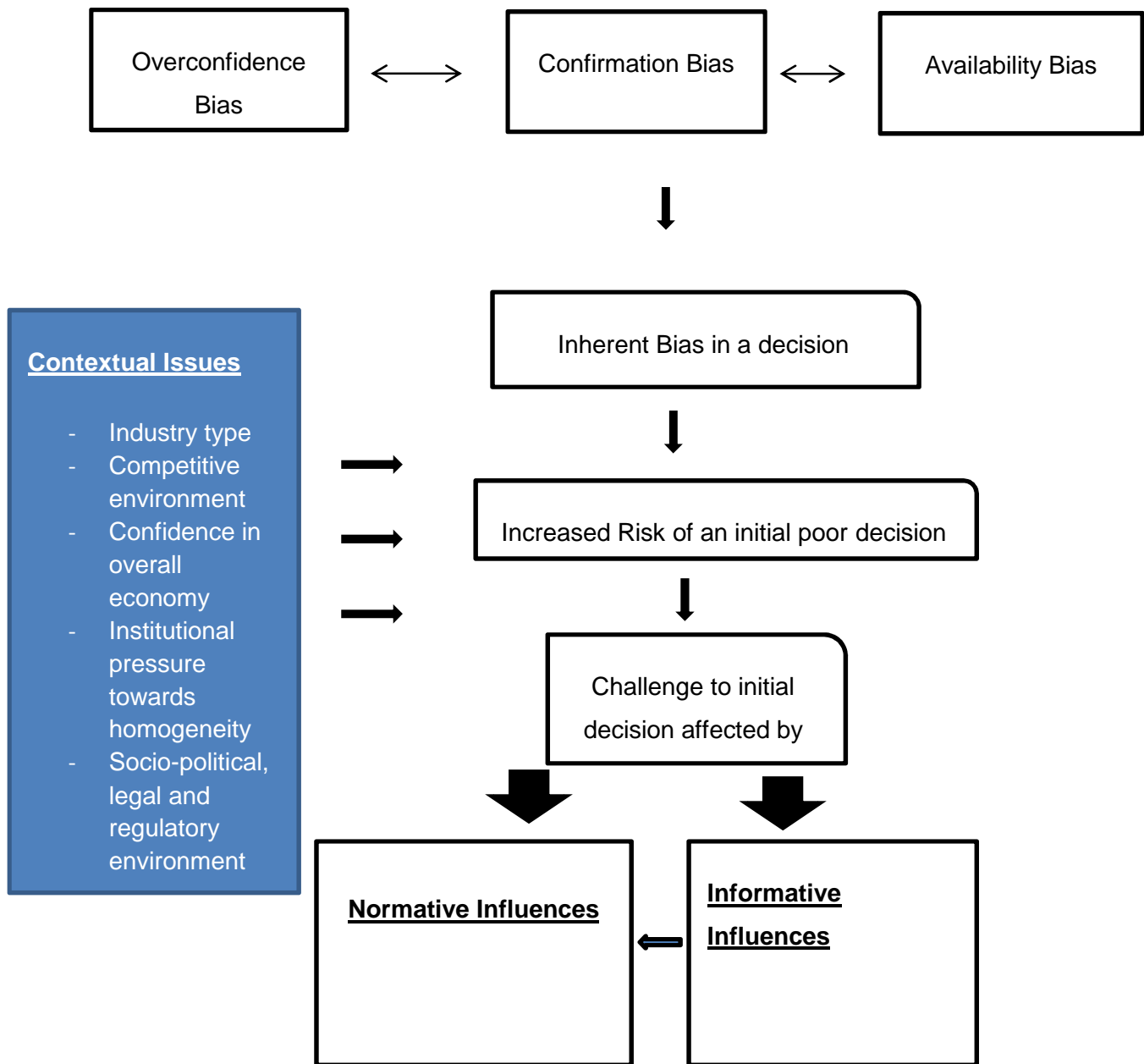
Furthermore, high levels of competition, particularly amongst a small number of dominant players, was a feature of the environment in which Arthur Andersen went into liquidation, and was a key feature of the backdrop in which the credit rating agencies made poor decisions with respect to the rating of structured products in the lead up to the financial crisis (Alcubilla and del Pozo, 2012). A review of the decision processes related to the accountancy firms and the credit rating agencies is, however, outside the remit of this thesis.

The life cycle of the company, both with respect to the company itself and the longevity of its directors, is another contextual factor which will impact on the cohesiveness of the group. A company which has experienced high levels of growth and success, is likely to be characterised by high levels of confidence. Further, a board which is more mature, and where the directors have worked together for a long period of time, is more likely to be characterised by high levels of cohesiveness.

The overall confidence at a macro level will feed into the confidence at a micro bank board level. High levels of confidence associated with a “this time it is different” attitude has been identified as being a key factor common to speculative bubbles (Chancellor, 2000; Galbraith, 2009, 1994; Kindleberger and Aliber, 2011; Mackay, 2004; Reinhart and Rogoff, 2009; Shiller, 2008). The institutional pressure for homogeneity, identified by Powell and DiMaggio (1983) will affect the homogeneity at a firm level. Again, this illustrates how contextual factors affect the decision making process. Finally, the socio-political, legal and regulatory environment and zeitgeist in which firms operate, as discussed in chapter 3, will affect the environment in which individual firms will make decisions.

In summary, a number of specific contextual factors will impact on the observable attributes associated with both normative and informative influences on decision processes. These contextual factors can, it is submitted, exacerbate the likelihood of normative and informative pressures on decision processes, reducing the likelihood of a challenge and increasing the risk that a poor decision strategy goes unchallenged. These contextual factors are added to the model below:

Figure 6.4: Fourth building block of my model of VPDP



The diagram reflects the potential amplifying effects that context can have on decision processes. The impact of context is seen in different “parts” of the model. For example, high levels of confidence in an economy, often associated with speculative bubbles, can affect actors confidence biases in initial decision

making. Further high confidence levels are associated with normative influences on decision making so that, not only can high confidence in an economy affect an initial decision, but it can also increase the vulnerability to groupthink and group polarisation and the effectiveness of the challenge of the decision itself.

High levels of competition have been associated with *both* normative and informative influences on decision processes both of which can reduce challenge. Finally, the institutional pressure towards homogeneity within a society can also manifest itself within an organisation, increasing the vulnerability to both normative and informative influences on a decision process. Homogeneity has been identified in the literature review as being a characteristic associated with both normative and informative pressures on decision processes. In summary, contextual factors will amplify or exacerbate the factors identified as potential vulnerabilities to a challenge of an initial poor decision process.

6.6 The impact of the functional and firm specific skill level of Directors

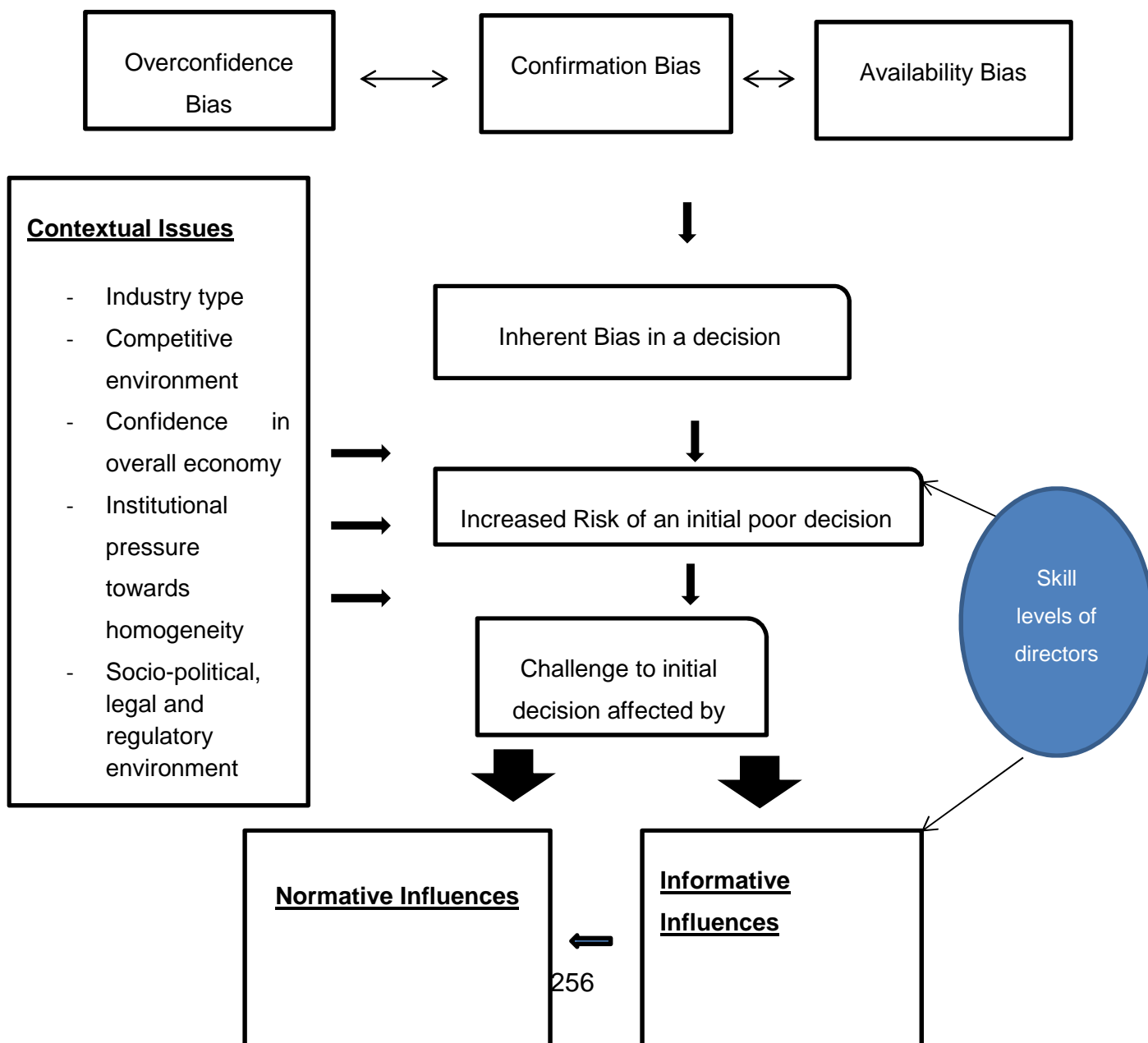
Low functional and firm specific skill levels with respect to the board of directors will impact the likelihood of a poor decision process at two levels. First, the starting point of the model itself was an initially poor decision recommendation, or strategy suggestion, being made. There is an increased risk of a poor decision being made initially if the skill level of the initial decision maker (normally the CEO) is low.

Second, if the skill level of the directors, and in particular the NEDs, are low, they are more likely to herd and accede to the superior knowledge of the CEO and other executive directors. This lack of dissent can then lead to higher levels of confidence amongst executives who interpret the lack of a challenge as a sign of confidence. Low firm and functional skill levels amongst NEDs will, therefore, lead to both higher levels of cohesiveness and increased levels of

confidence. The consequence of this will be to increase the risks of normative pressures on decision making with a greater likelihood of fewer boardroom challenges. In other words, lack of directors' skill leads to greater likelihood of informative pressures on directors to herd, which in turn can increase confidence and cohesion and the increased risk of normative pressures on the decision process. The net effect of this is the increased likelihood of a lack of robust challenge.

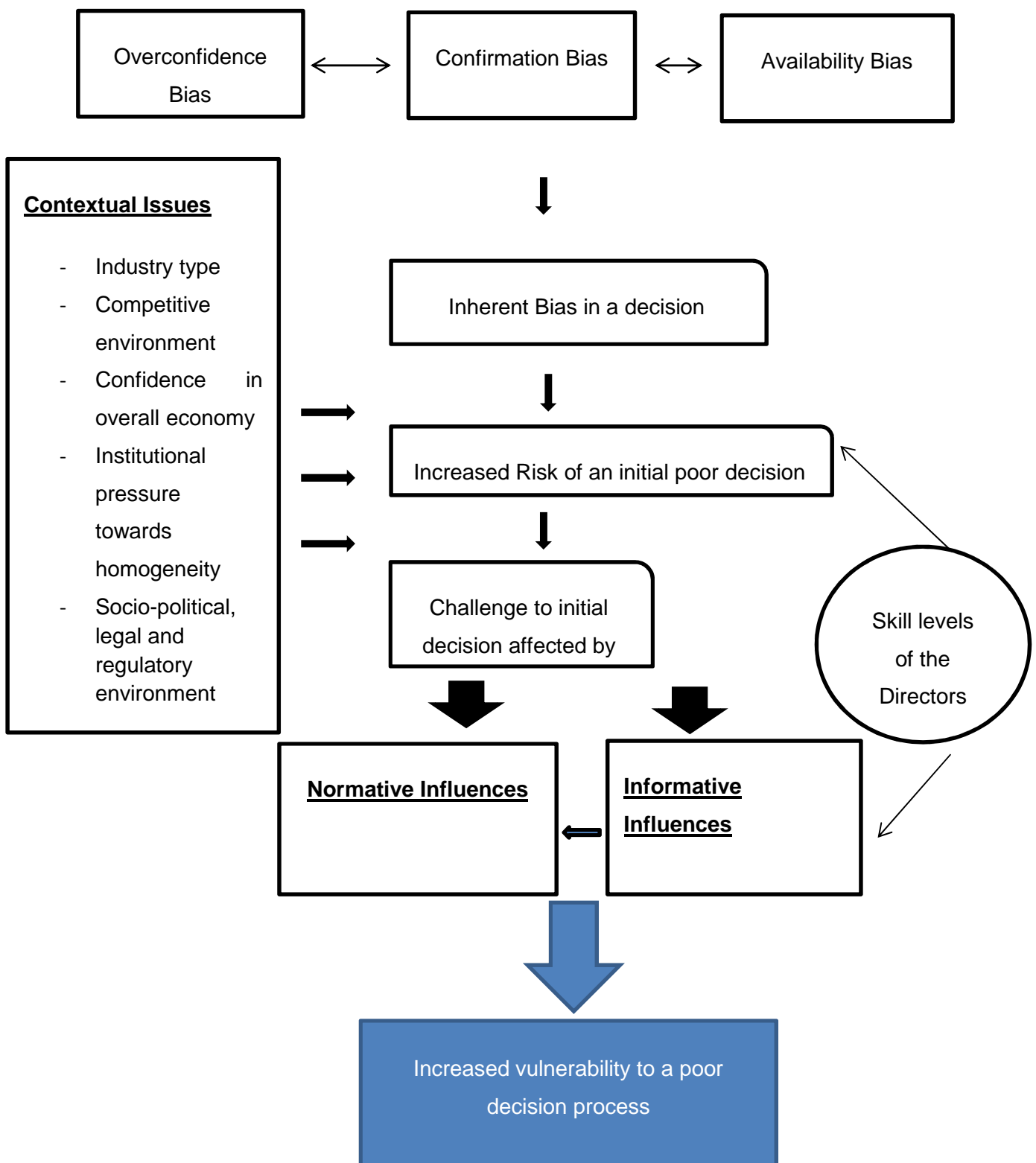
This highlights once again the interconnectivity of all the attributes of the model and that they "feed" off each other. This final building block in relation to the model is reflected below:

Figure 6.5: Fifth building block of my model of VPDP



As the diagram illustrates, low functional and skill levels can affect the initial decision process itself. Further low skill levels can increase the risk of herding and increase cohesiveness within a group, thus affecting both normative and informative pressures and reducing the likelihood of an effective board challenge. In summary a complete illustration of the model is presented below:

Figure 6.6: My completed model of VPDP (firm specific)



6.7 Systemic risk of a poor decision process

The model above has described an internal process within an organisation and identifies the vulnerabilities of a poor decision process being undertaken internally within a firm. This reflects two levels of decision making; first with respect to the initial policy recommendation, and second with respect to the challenge of such a strategy by the collective board. A further nuance of the model is the impact that a poor decision process at an individual firm can have on other firms in the same industry. This is best illustrated though a theoretical scenario:

As a starting point, a poor decision is suggested by the CEO of a specific firm. The decision is one which is made as a result of a decision process which is affected by any one of a number of inherent biases in the decision process. A possible scenario is that the CEO recommends that the firm lend more aggressively in the property market. This decision may be affected by an availability bias (such as there has never been a property crash) or a confirmation bias (the CEO has a personal vested interest in the property market and is looking to confirm his vested beliefs) or the CEO might be affected by a historical belief in the security associated with property as an asset class, something which is deep seated in the culture of the environment in which he is operating (an epistemic blind spot). The board in which the CEO is sitting is characterised by all the antecedents of groupthink; high cohesion, high levels of homogeneity, an influential CEO and a board which is not overly concerned with compliance to detailed rules and regulations.

The environment in which the bank is operating is highly competitive, increasing the feeling of cohesion within the board under threat from competition. The overall business environment is characterised by high growth, an expectation of further growth, and a belief that “this time it’s different”. The board of the company is longstanding, and the company has a track record of success increasing confidence within the board itself. These assumed contextual factors

amplify the observable attributes associated with normative and informative influences on group decision processes.

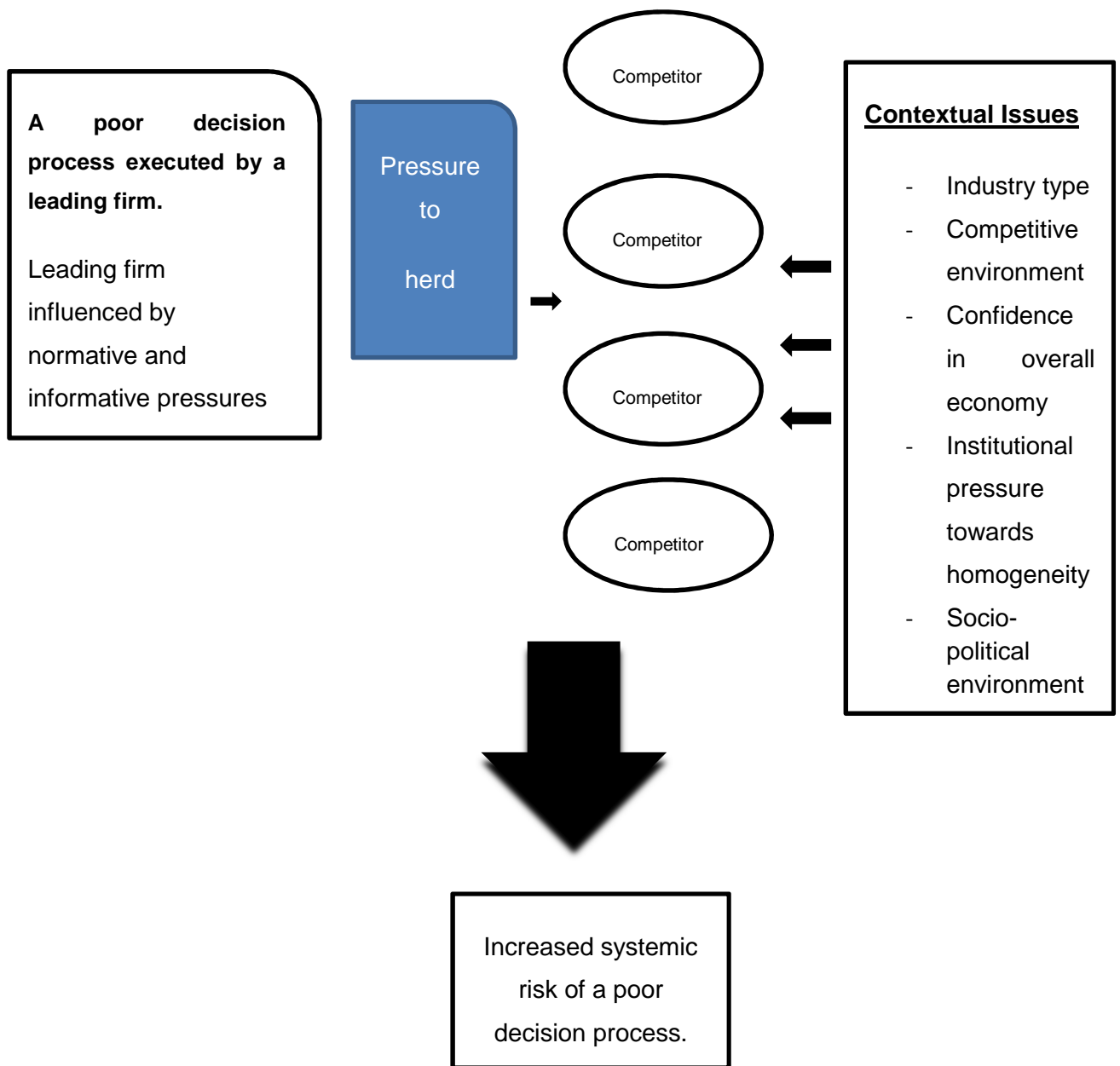
The NEDs of such a company are, inter alia, the internal gatekeepers in the boardroom. In line with agency theory (Jensen and Meckling, 1976) they represent the “solution” to the conflict of interest between management and the shareholders. In this theoretical example, the NEDs are characterised by high levels of cohesiveness and homogeneity with management and are themselves susceptible to groupthink. Further, such NEDs have low functional and firm specific knowledge of the firm and are even less likely to challenge management, but rather to accede to the perception of superior knowledge and information of the firm’s executives. In other words, the NEDs herd, suppressing their own information in favour of that of the CEO. The propensity to herd will be exacerbated in situations where there are high levels of homogeneity between executive and NEDs.

In summary, what has been described above is a theoretical scenario of a company in which the recommendation of a poor decision is not challenged through a combination of both groupthink and herding. All this occurs within a specific organisation and results in the execution of a poor decision process by that individual firm.

Developing our theoretical example further, and assuming that the broad environment in which the banks operate is characterised by high levels of competition, homogeneity and high confidence levels. The likelihood of other firms herding and following the decision and informational signal by the leading firm is, therefore, intensified. A poor decision process from an individual firm can influence the behaviour of others, creating systemic risk.

This interplay is reflected below:

Figure 6.7: My completed model of VPDP (systemic risk)



6.8 Comparison of my model of VPDP to the five existing models highlighted in chapter 2.

In chapter 2, I identified and analysed five models which looked to link board attributes to financial performances (Forbes and Milliken, 1999; Hillman and Dalziel, 2003; McNulty et al., 2013; Sundaramurthy and Lewis, 2003; Zahra and Pearce, 1989). What follows below is an analysis of how my own model can be differentiated from these established models.

6.8.1 What can I add to the Zahra and Pearce (1989) model?

The Zahra and Pearce model described in chapter 2, represents an integrated model linking four board attributes both directly and indirectly to board financial performance. The model explicitly recognises the importance that context plays in influencing the identified attributes and board roles and how this links to firm performance. In that sense their model is aligned with the conclusions I have drawn from my literature review which also stresses the importance of taking into consideration how contextual issues affect the environment in which board decisions are made. Other similarities relate to the recognition of the leadership style of the CEO and the structure of the board.

My model of VPDP can be differentiated from Zahra and Pearce's in that it recognises the role that human psychology plays in decision processes and ultimately in financial performance. One of the core assumptions for the model of VPDP is the role that human behaviour plays in affecting board processes and, it is submitted, this is an important differentiating factor between my model of VPDP and that of Zahra and Pearce (1989).

6.8.2 What can I add to the Forbes and Milliken (1999) model?

The Forbes and Milliken model recognise the importance that psychological factors play in affecting governance effectiveness which is consistent with the approach I adopted in the development of my own model. My model of VPDP focuses primarily on understanding the factors which affect a robust boardroom challenge. Forbes and Milliken identify the importance of cognitive conflict in ensuring that such a challenge exists.

Forbes and Milliken focus specifically on cohesiveness and the role that it can play in affecting firm performance. High levels of task orientated cohesion can lead to high levels of firm performance whilst high levels of socio-emotional cohesiveness can lead to groupthink and reduce performance. The suggested antidote to high levels of socio-emotional cohesiveness associated with groupthink is to promote cognitive conflict through diversification, and by increasing the number of outsiders to the board.

Cohesiveness has been identified in my literature review as a key factor associated with poor decision processes. Forbes and Milliken focus on the impact on cohesiveness with respect to groupthink, whilst the conclusions from my literature review are that high levels of cohesiveness and related homogeneity will increase the vulnerability, not only to groupthink, but also to group polarisation and de-individuation. Further, I intend to consider the impact that internal herding can have in affecting firm performance. This is only indirectly recognised by Forbes and Milliken in that the use of knowledge and skills of the directors is reflected as having a direct input on cognitive conflict, increasing the likelihood of board challenge.

Moreover, I highlight explicitly that group homogeneity is an important factor contributing towards the risk of a poor decision process and is associated with both normative and informative pressures on decision processes. Forbes and Milliken only indirectly recognise the importance of group homogeneity when

they note that diversity in the boardroom can increase cognitive conflict and boardroom challenge resulting in a better decision process.

Forbes and Milliken identify increasing the number of outsiders in the board as a means of enhancing cognitive conflict and boardroom challenge. The conclusions from the literature review are, however, that an increase in the number of NEDs will not necessarily enhance cognitive conflict. Rather, the effectiveness of NEDs challenge will be impacted by three important factors: namely, normative and informative pressures and the skill level of directors. These three factors do, as described previously, combine together to affect the impact of NEDs to increase the cognitive conflict associated with a robust boardroom challenge.

The significant difference between my model of VPDP and the model presented by Forbes and Milliken (1999) is, however, that Forbes and Milliken do not take context into account whilst my model of VPDP assumes that context is critical to shaping decision processes. My model therefore captures elements of the models of both Zahra and Pearce and Forbes and Milliken; It includes the contextual considerations emphasised in the Zahra and Pearce model and the psychological factors stressed by the Forbes and Milliken model. However, it can also be differentiated from these two models in that it highlights how factors such as groupthink, group polarisation, herding, de-individuation and blind spots can combine together to increase the risk of poor decision processes in a way that is not, it is submitted, envisaged by either Zahra and Pearce (1989) or Forbes and Milliken (1999).

6.8.3 What can I add to the Hillman and Dalziel (2003) model?

The Hillman and Dalziel model discussed in chapter 2 was criticised in that it assumes that actors will act rationally and that psychology does not play a part in decision processes, and in that sense is the antithesis of the model which I

have developed which assumes that decision making is affected by both normative and informative influences and is often not rational. I argue that the effectiveness of NEDs to monitor management will be affected by a number of powerful psychological factors identified in my literature review, and equity incentivisation will not always be sufficient to counter such forces. This would particularly be the case in a scenario where an entity is characterised by the normative, informative and contextual influences on decision processes highlighted in my model. This

Further, Hillman and Dalziel's model does not take some of the contextual factors particularly associated with speculative bubbles which would affect the monitoring function. The case study of Anglo Irish, analysed in chapter 7, describes a bank which undertook a myopic and leverage bet on commercial property with catastrophic results. Both the executive and NEDs of Anglo had high levels of equity ownership (Nyberg, 2011, p. 27), a cohesive board with no/little challenge from the NEDs¹³¹.

Hillman and Dalziel's concept of greater equity incentivisation leading to greater levels of monitoring has received no support in the legislature. The Cadbury Report (1992) recommended that NEDs should not take part in share options as this could compromise their independence, although it allowed such NEDs to be paid in shares. This recommendation is reflected in the UK Corporate Governance Code (2014) which notes that remuneration for NEDs should not include share options or other performance-related elements, and that such type of payment could be relevant to ascertaining NED independence (para D.1.3). There are, to my knowledge, no calls for reforms resulting from the crisis itself which are suggesting greater NEDs incentivised through equity compensation.

¹³¹ This statement is discussed and evidenced in great detail in chapter 7.

Hillman and Dalziel's model of alignment of agency and resource dependency theories through equity incentives, assumes that actors are fully rational and fails to take into account the fact that decisions can be made in environments which are characterised by strong normative and informative pressures for conformity, as we saw in the lead up to the financial crisis. Moreover, the model does not recognise the role that context plays in affecting decisions. In summary, it is submitted that my model of VPDP is in direct contrast with the basis of rationality of human behaviour which the Hillman and Dalziel model is based.

6.8.4 What can I add to the Sundaramurthy and Lewis (2003) model?

The Sundaramurthy and Lewis four part model described in chapter two provides an interesting "challenge" to my proposed model. The two parts of their model which overemphasises collaboration over control in both a high and low performing cycle is very much in keeping with the conclusions I have drawn from the literature review. In these scenarios, Sundaramurthy and Lewis emphasise the importance of high levels of cohesiveness and confidence and argue that groupthink is core to creating a decision process which leads to failure.

There are, however, three notable areas that my model can be differentiated from Sundaramurthy and Lewis's "collaboration over control" model. First, the literature review identified that groupthink can, and will, combine with other identified normative influences, and informative influences, and is also affected by the skill levels of the directors themselves. In this sense, my model reflects a more complex interplay of forces than that suggested by Sundaramurthy and Lewis. Second, the conclusion I drew from the literature review was the importance of recognising the significance of context, and how this can and will affect process. Sundaramurthy and Lewis consider context in the sense that they look at firms in both high and low performance cycles but arguably do not

consider context as broadly as I do¹³². Third, the model which I will present only suggests vulnerabilities which might lead to a poor decision process, whilst Sundaramurthy and Lewis appear less cautious and more definitive that the emphasis of collaboration over control will ultimately lead to failure. However, despite these difference, Sundaramurthy and Lewis's model of collaboration over control is closely aligned to what I intend to present, albeit through a different lens.

It is, however, the second of Sundaramurthy and Lewis's models that provides the greatest challenge to my model of VPDP. Sundaramurthy and Lewis present a model which assumes an overemphasis of control over collaboration, and has at its core a lack of trust. This lack of trust leads to a polarisation of board members and low confidence levels, all associated with an over-emphasis of the control function associated with agency theory. This represents the antithesis of the conclusions drawn from the literature review with respect to the causes of a poor decision process, which has at its core high confidence levels and high levels of cohesion associated with the identified phenomena of groupthink, herding, group polarisation, de-individuation and inherent biases in decision. These phenomena have been associated, and indeed influenced, by the literature associated with speculative booms such as that experienced in Ireland before the financial crisis.

Sundaramurthy and Lewis therefore present an alternative explanation for a poor decision process which my literature review has not explored highlighting that the model which I intend to present is not a complete explanation for all scenarios in which poor decision processes might occur.

¹³² My model of VPDP highlights a broad range of contextual factors which will have a bearing on decision processes which includes: the industry type, level of competition, confidence in the overall economy, the industry type and the life cycle of the company.

It is, however, submitted that the scenario that Sundaramurthy and Lewis present of high levels of monitoring and distrust being associated with a high performance cycle is unlikely. A firm which is performing well with high levels of confidence is unlikely to experience increased levels of monitoring and mistrust but rather is more likely to be characterised by complacency, high levels of cohesion with vulnerabilities to overconfidence, and availability biases which will lead to less, rather than more, rigorous monitoring.

Distrust is more likely to occur in an organisation which is in a poor performance cycle, where confidence is low and the reaction to poor performance is an increase in monitoring. In this scenario, Sundaramurthy and Lewis have described a very plausible explanation for a poor decision process not contemplated in my model.

My model of poor decision processes is one which will have as its core features such as cohesiveness, homogeneity, and cohesiveness combining together to create a combination which can greatly increase the risk of a poor decision process. Sundaramurthy and Lewis' model of high levels of monitoring and distrust in a low performing cycle is based on the concept of distrust, which can be associated with high levels of diversity, low confidence levels and low levels of cohesiveness leading to a poor decision process.

Although this scenario is plausible, the literature review highlighted that there is a natural pull towards homogeneity and cohesiveness in boards. This relates to the prestige associated with belonging to bank boards (Dallas, 1996) and the homophilic tendency of self-selection in boards which would increase the risks of homogeneity and cohesion. In other words, it is submitted that, as highlighted in the literature review, the greater risks in boards relates to scenarios where collaboration overrides control, rather than when control dominates over collaboration. Indeed, the reason why agency theory rather than resource dependency theory has dominated corporate governance reforms is because

legislators are more concerned with the need to enforce the control function of boards.

Having said this, the Sundaramurthy and Lewis model which emphasises control over collaboration, and the characteristics of low confidence and distrust does highlight that my model of VPDP will not be a complete explanation of why corporations make poor decisions. My model of VPDP may present a plausible lens to view poor decision processes in a scenario where collaboration overrides control. This, it is argued, given the nature of the make-up of corporate boards, is a greater risk, and a more likely scenario. It is, however, accepted that my model will not be all encompassing and will not explain all the circumstances leading to a poor decision process. In other words, there is another path to a poor decision processes which will not be explained by my model.

This does not, it is submitted, mean that the model which I present has no contribution to make. It highlights in particular how phenomena can combine together to produce poor decision processes. This can have important systemic implications, as the combination of groupthink and herding will result in the poor decision process of a leading firm being multiplied across the industry. There is no systemic risk associated with the Sundaramurthy and Lewis model related to reinforcing cycles of control. In other words, such a scenario of a company which is characterised by distrust is unlikely to affect the decision processes of other unrelated organisations. Another specific contribution I can make is in the identification of observable characteristics of a poor decision process which can act as red flags for both management and regulators in identifying risks and recommending reforms to counter risks.

6.8.5 What can I add to the McNulty et al. (2013) model?

McNulty et al.'s (2013) research provides support for the approach which I have adopted in this thesis. The authors conclude that "an analytical approach that studies the inner behaviour of boards (i.e., the intervening processes) is widely regarded as an important direction towards progress in corporate governance and board research" (*ibid*, p. 73). Further they conclude that "corporate governance regulators are justified in their attempts to go beyond structure and identify behavioural issues that are integral to improving board governance" (*ibid*, p. 74). This is consistent with the approach which I have adopted. My proposed model of VPDP, however, can be differentiated from that of McNulty et al (2013) in that it recognises the implicit interplay between normative and informative influences on decision processes and how this can affect board performance. In other words, my model of VPDP explains how normative and informative influences can and do combine together to influence decision processes in a manner which differentiates it from the McNulty et al. model, and indeed all other models which I have reviewed.

6.8.6 Summary of my model of VPDP

My model of VPDP above highlights the attributes which increase the likelihood or vulnerability of an individual firm pursuing a poor decision process and the increased risk of emulation by competitors. However, the link between the identification of the attributes associated with poor decision processes and organisations that are characterised by poor decision processes, is probabilistic rather than deterministic. In other words, the research above does not *prove* that if a poor decision process is observed that it was a result of the characteristics identified in the model. Other explanations not identified in the model or the literature review may provide a more complete explanation for the

same decision process¹³³. Indeed my model of VPDP does not capture a poor decision process in a situation where there is distrust and low levels of confidence, as discussed previously and highlighted by Sundaramurthy and Lewis (2003).

Further, it is possible that one may observe all the characteristics noted above in an organisation that is predisposed to a poor decision process, but that organisation avoids, or appears to avoid, a poor decision process. There are, it is submitted, three possible reasons why this might occur. First, relates to the timing of the observation. If I had undertaken my research of, for example, RBS, HBOS or Anglo Irish Bank in 2006, I may have observed all the characteristics identified above, but also organisations that were perceived to be very successful. It was only in 2007/2008 that their earlier poor decision processes unravelled.

Second, it is feasible that a board might make a decision which fails to consider the alternatives, where there is a lack of boardroom challenge, and where the board is characterised by attributes associated with groupthink, group polarisation and high confidence levels, but that the decision path that the board takes turns out to be a successful one. In other words, the characteristics associated with a poor decision process, which I have identified above, increase the risk of a poor decision process being taken because they increase the risk of a one dimensional decision process being taken where alternatives are not considered and there is a lack of challenge. However, it is possible that such a decision process leads to a positive outcome. The chances of this happening

¹³³ For example, Stein (2014) draws on psychoanalytical theory to argue that the closeness of organisational identities in twin organisations may lead to increased rivalry, narcissism a greater tendency for greater-risk taking and vulnerability. Stein focuses on the case studies of HBOS and RBS and Fannie Mae and Freddie Mac, but notes that his findings may be applicable for understanding the decision processes of AIB and BKIR in the lead up to the crisis (*ibid*, p.12).

are, it is submitted, higher if the skill levels of the directors, and in particular of a strong directional leader are very high.

Having said this, any organisation which is one dimensional and does not actively consider alternatives is, however, susceptible to a poor decision process at some stage in the future. In other words, a decision process might be correct now, but in the future there is a risk that at some stage a poor decision is made and that this is not corrected or challenged.

The third argument relates to the role that the external gatekeepers play in affecting the decision processes. This is particularly relevant in the case of highly regulated industries such as banking where the regulator has a meaningful role in modifying or adjusting the entities decision process. It is possible that two banks from different jurisdictions will both have very similar attributes identified in the model as being associated with a poor decision process but only one of the banks will go down a poor decision path. A bank might be “saved” from a poor decision process by a vigilant and forceful regulator who identifies the bank’s high risk strategy and forces the bank to modify its strategy¹³⁴.

The Irish banking sector was characterised by light touch regulation, a deferential regulator (Honohan, 2010) adopting what Nyberg (2011) described as a naïve interpretation of the efficient market hypothesis. The Irish banks were not “saved” or forced to modify their decision processes by the regulator. In contrast for example, the Bank of Spain required the Spanish banks to maintain high and counter cyclical loan loss provisioning in the lead up to the crisis which acted as a buffer when the cycle changed and helped to reduce the impact of the losses on the Spanish banking (Nyberg, 2011, p. 44).

¹³⁴ The impact that the gatekeepers could have on a corporation’s internal decision process would be a “contextual factor” that affects internal decision processes and, it could be argued, is therefore, captured in my model of VMPD.

The model which I have presented is, however, generic and is not specific to the banking sector and as such has relevance to other sectors that are not regulated. Furthermore, even for those sectors which are regulated, the model could be used by regulators to help identify entities which are more susceptible to poor decision processes and to be more vigilant in their supervision.

Finally, the model does not measure, nor attempt to measure, the extent to which an entity might suffer from some of the characteristics identified as being associated with a poor decision process. In other words, two entities might be characterised by cohesiveness and homogeneity, but to very different extremes. It is submitted that, all things being equal, the entity which is more cohesive and more homogenous is more vulnerable to a poor decision process. What is important is not only the identification of the observables, but also the depth of the observation itself.

The model of VPDP reflects the interconnectivity of a number of related phenomena but the way in which these interact with each other is extremely complex with many different variables. It is, therefore, very difficult to predict with any certainty the sensitivities of the model to any specific changes in the variables. These observations are discussed in greater detail later in the chapter dedicated to potential reforms.

In summary, the model is probabilistic rather than deterministic, and it does not follow that entities that have the characteristics associated with a model of poor decision process will all make poor decisions for the reasons described above. The model has a number of limitations as highlighted above but does, it is submitted, provide a useful starting point to identify potential vulnerabilities in decision processes and from them to recommend reforms. Indeed, from this model two streams of research follow. First, the need to test this theoretical model with reference to a relevant case study. Second, the identification of potential reforms which might mitigate the likelihood and severity of poor

decision processes going unchallenged in the future. These are discussed later in my thesis.

6.9 Applying the model to generate the research questions

Below is a table which identifies relevant research questions derived from a review of my model of VPDP which can be applied to the Irish case study:

Research question	Relevance to the model
<i>The Anglo board was affected by an epistemic blind spot towards property as an asset class and also displayed other inherent biases in their decision processes.</i>	The starting point for the model is an initial poor decision process. Over-investment in an inflated property bubble has been identified as being the primary cause of the Irish financial crisis (Donovan and Murphy, 2013; Kinsella and Leddin, 2010; Nyberg, 2011)
<i>The Anglo Board was affected by the antecedents and symptoms of groupthink in the lead up to the financial crisis.</i>	This proposition will not only address the core normative influence identified in my model, but will also confront one of the key identified contributions that this thesis can make; namely to provide academic rigour to Nyberg's (2011) assertion that the Irish banks suffered from groupthink in the lead up to the crisis.

<p><i>The Anglo board's decision process in the lead up to the crisis was affected by group polarisation.</i></p>	<p>This proposition will address the identified normative influence of group polarisation.</p>
<p><i>The directors, and in particular the NEDs of Anglo, had limited banking knowledge and experience.</i></p>	<p>This proposition addresses the importance of director knowledge and experience plays in the model itself.</p>

I recognise that these four research questions do not represent a complete review of my model. First, there is no research question which addresses the internal informative pressures to herd amongst Anglo board members. The primary reason for this admission is that the lack of access to Anglo board directors meant that there was no way of directly testing this research question. However, the analyses of the identified proposition can potentially observe high levels of homogeneity, strong directional leader and low levels of direct skill levels. If these observables are evidenced then this can highlight the vulnerability of the Anglo board to normative pressures. However, a more direct observation is not possible without access to the main board directors.

Second, there are no identified research questions which specifically address the contextual issues highlighted by my model of VPDP. The industry type was identified as creating a social identity within which firms operate and banking was identified as an industry which has a history of failures associated with poor judgements and ethical indiscretions. Anglo was of course operating in the context of a banking environment and as such there is no reason to identify and discuss a specific research question in relation to this. Chapter 3 detailed the socio-political environment in which the Irish banks were operating and in

particular the history of poor governance of the Irish banks which had largely gone unpunished.

Further, high levels of confidence in the overall Irish economy have been identified by a number of commentators, specifically in relation to the success of the Irish Tiger and the associated new era thinking (see for example Donovan and Murphy (2013), Honohan (2010), Kelly (2009) Kirby and Kirby (2010) and Nyberg (2011). High levels of confidence in the Irish economy are not surprising given that this has been identified in the literature review as being a key feature associated with speculative bubbles, such as the property bubble which Anglo was operating (see for example (Akerlof and Shiller, 2010; Kindleberger and Aliber, 2011; Shiller, 2008). As such it was deemed unnecessary to devote a specific proposition to this contextual issue. High levels of competition, identified as another contextual factor in my model, will be discussed and addressed in respect of the research question with respect to whether the Irish banks herded and emulated the strategy of Anglo. This is discussed below.

The four research questions developed above related to the application of the model to a firm specific case study, in this case Anglo. The model however also has application on a wider systemic basis as is highlighted by the model itself in figure 6.7.

The second level to the model reflects the risks that an informational signal from a leading actor can lead to herding by competitors who assume that the leading bank has an informational advantage. Further, the lower the level of experience and skill amongst the directors in competing banks, the more likely these banks will herd and follow what is perceived to be the leading bank. This gives rise to one additional research question and to a minor alteration of an existing established proposition.

Research question	Relevance to the model
<i>The Irish banks herded in the lead up to the crisis and in particular emulated the strategy of Anglo.</i>	This proposition addresses the third level to the model and the vulnerabilities of a poor decision process within an individual firm resulting in a wider systemic risk.
<i>The directors of the Irish banks had limited banking knowledge and experience.</i>	This represents a very slight modification of the research question developed with respect to Anglo by widening the hypothesis to look wider at the skill level of the directors of the Irish banks in general. This widening of the identified research question allows me to explore whether there was low skill levels in all of the Irish banks which may be connected to their propensity to herd and follow Anglo.

In summary therefore I have identified five research questions which will be tested with respect to the Irish bank case study. These are summarised below:

Research question One: The Anglo board was affected by an epistemic blind spot towards property as an asset class and also displayed other inherent biases in their decision processes.

Research question Two: The Anglo Board was affected by the antecedents and symptoms of groupthink in the lead up to the financial crisis.

Research question Three: The Anglo board's decision process in the lead up to the crisis was affected by group polarisation.

Research question Four: The directors of the Irish banks had limited banking knowledge and experience.

Research question Five: The Irish banks herded in the lead up to the crisis and in particular emulated the strategy of Anglo.

Chapter 7: Application of the research questions to the Irish case study

7.1 Introduction

The objective of this chapter is to apply the five research questions identified in chapter 6 to the Irish case study.

In reviewing these five research questions, data was gathered from a wide range of reports, books, newspaper articles and annual report and accounts, the extent of which is reflected in the bibliography. Semi-structured interviews were, as discussed, also conducted. A list of the anonymised actors who were interviewed are noted and categorised below:

Table 7:1 List of actors interviewed

Anglo Employees	Note all Anglo employees have been designated with the letter (A) after their name to help the reader identify the context of their comments.
Actor A	Senior executive at Anglo, direct access to Anglo board
Actor B	Senior executive at Anglo, head of investor relations, direct access to board members on a regular basis.
Actor C	Mid-ranking executive at Anglo but had direct contact with board members at Anglo.
Actor D	Senior executive at Anglo, direct report into board member.
Actor E	Senior member at Anglo, direct report into Anglo CEO.
Anglo competitors	All Anglo competitors are designated with a (C) after their name.
Actor F – BKIR	Senior executive at BKIR, direct report into BKIR board member.
Actor G – Ulster Bank	NED at Ulster Bank.
Actor H – ILP	NED at ILP in the lead up to the crisis.
Actor I – EBS	NED at EBS in the lead up to the crisis.

Actor J – AIB	Senior executive at AIB, direct report into board member.
Actor K – BKIR	Senior executive at BKIR, direct report into board member.
Actor L – AIB	Senior executive at AIB, direct report into board member.
Actor M – AIB	Senior executive at AIB, direct report into AIB executive committee member (one level below board).
Anglo Service Providers	Anglo service providers have an (S) after their name
Actor N – Merrill Lynch (ML)	Managing Director at ML, head of Irish debt capital markets. Part of the ML team that advised both the Irish government and prior to that Anglo Irish Bank.
Actor O – Davy Stockbrokers	Equity analyst at Davy Stockbrokers, Ireland’s largest broker.
Actor P – Davy Stockbrokers	Bond salesman Davy. Closely connected to Tom Browne, a former director of Anglo.
Actor Q – Davy Stockbrokers	Chief Executive at Davy Stockbrokers.
Actor R	Fund manager at Banquo Capital (fund manager).
Others	
Peter Nyberg	Author of the Nyberg Commission.
Simon Carswell	Journalist and author of two books on the Irish banks.

For ease of reference, the five research questions are repeated below:

Research question One: The Anglo board was affected by an epistemic blind spot towards property as an asset class and also displayed other inherent biases in their decision processes.

Research question Two: The Anglo Board was affected by the antecedents and symptoms of groupthink in the lead up to the financial crisis.

Research question Three: The Anglo board’s decision process in the lead up to the crisis was affected by group polarisation.

Research question Four: The directors of the Irish banks had limited banking knowledge and experience.

Research question Five: The Irish banks herded in the lead up to the crisis and in particular emulated the strategy of Anglo.

What follows below is a systematic review of the five identified research questions.

7.2 Research question 1: The Anglo board was affected by an epistemic blind spot towards property as an asset class and also displayed other inherent biases in their decision processes.

Inherent biases in our decision processes relate to inbuilt preferences which consistently violate the rules of rational choice (Kahneman, 2011) and form the basis of the field of research referred to as “behavioural economics”. There are a number of inherent and psychological biases which can be identified as being influential in the decision process of the Irish banks to invest in property. These related to biases related to representativeness, availability and confirmation.

The representative bias reflects that people tend to over-extrapolate the past when making forecasts about the future. As a result, actors place too great an emphasis on past performance when making predictions about the expected direction of future events (Barberis, 2013).

The availability bias reflects that decisions are made with reference to ease with which relevant instances come to mind (Tversky and Kahneman, 1973). An illustration of this bias would be if there had never been a property crash and property prices had only increased in value, then the availability of this information would affect decision processes.

A confirmation bias occurs when actors seek information which will confirm their previously held conviction and avoid confrontation with facts that might contradict their existing opinion or position (Szyszka, 2010). If actors believed that the property market was a good investment and only likely to increase in value, they would only seek information which confirmed that belief and would dismiss, or look to ignore, contrary information. Further, the greater such actors are financially committed to a specific course of action, the greater the risk of this bias occurring (Bazerman and Tenbrunsel, 2013; Heffernan, 2012). In other words, actors who have a personal financial commitment to the property market and benefit from its increase, are more susceptible to be influenced by a confirmation bias and to seek information which will confirm that their decision to invest in property is sensible. Bazerman and Tenbrunsel (2013) refer to this as a form of “motivated blindness” which can exist when there is a vested interest regarding an outcome or situation so that actors process information selectively.

Epistemic blind spots have been identified as occurring when we process information selectively and favour information which confirms our beliefs, rather than consider how our beliefs might need to be adjusted to take into account the facts of a specific situation (Wei Choo, 2007). In effect, an epistemic blind spot is an extreme form of confirmation bias

Evidence

Regling and Watson (2010) and Nyberg (2011) recognise and identify examples of the biases identified above. Regling and Watson, when explaining the strong preference for property as an asset class in Ireland, highlighted that Ireland “had never experienced a property crash” (*ibid*, p. 5). Nyberg added that: “Great comfort seems to have been taken from the specific Irish experience from earlier years; previous slowdowns had not resulted in property crashes and price declines, if any, were relatively modest” (*ibid*, p. 21). Finally, Actor L (C)

noted that: *"People became more and more accustomed to the idea that property prices could only go in one direction."* These observations reflect that both by availability and representativeness biases may have affected decision processes related to property investment.

The high levels of growth which Ireland experienced from the late 1980's to the start of the millennium created an expectation of growth and further success going forward (Honohan, 2010; Kelly, 2009). This level of expectation may have contributed towards a confirmation bias amongst actors who looked for information which would confirm their beliefs, created from such expectations, that the Irish property market was to continue to increase in value. Further, the existence of a motivated self interest in the property market would have increased the likelihood of actors being influenced by such a bias.

Such motivated blindness may have occurred at Anglo, an organisation in which the directors were identified as having significant holdings in the bank's equity in the lead up to the crisis (Nyberg, 2011). As will be highlighted in research question 2a), the directors of Anglo had significant shareholdings in Anglo, and there was a material financial incentive to believe in the sustainability of the property market¹³⁵. As noted above, Bazerman and Tenbrunsel (2013) observe that the greater the financial interest, the greater the propensity for an actor to be susceptible to confirmation biases and to persuade herself that the course of action she has taken is the correct one. Therefore, the directors of Anglo may be particularly vulnerable to look for information which would confirm their view that the property market would continue to increase in value.

¹³⁵ In addition to exposures to Anglo shares (and indirectly to the property market) Lyons and Carey (2011) highlight a number of investment in both commercial and residential property that Anglo's Fitzpatrick had made in the lead up to the crisis.

Actor F (C) observed that the Irish “*got caught up with the thoughts that things could continue to grow*”. Actor A (A) observed that at Anglo “*there was a sense building that we could not get things wrong, we were always getting things right*”. Actor B (A) highlighted that: “*Anglo had nineteen years of growth and that this created an expectation of future growth*”. Actor E (A) noted that “*it was all about self-interest and conflict and they [Anglo management] did not want to hear an outsider tell them it was risky*”. All these comments could be interpreted as reflecting inherent biases in decision processes relating to representativeness, availability and confirmation.

A number of commentators and interviewees referred to the possibility of a blind spot in Ireland with respect to property as an asset class. Nyberg (2011) referred to the existence of a “national speculative mania in Ireland during the Period¹³⁶, centred on the sale and acquisition of property” (*ibid*, p. 94). Regling and Watson (2010) observed in Ireland an “uncritical enthusiasm for property acquisition that became something of a national blind-spot” (*ibid*, p 34-35).

Social commentators have explained the Irish relationship with property from a historical perspective related back to the history of the Irish as landless tenants during English occupation. Murphy and Devlin (2009) note that: “The history of the Irish people gives them an unusual attachment to home ownership. Pre-independence, the bulk of land was owned by outsiders who were often absentee landlords. Tenants had sparse legal protection and were rarely sure of the roof over their heads. Race memory – indeed, family memory – meant that, given the opportunity, an Irishman or woman would always seek the security of owning the land on which they lived” (*ibid*, p. 32).

¹³⁶ Nyberg defines “The Period” as the dates between 1 January 2003 and 15 January 2009. The 1 January 2003 is identified in the Commission as the period when Ireland entered its second and dangerous phase of growth focused on the construction industry whilst, 15 January 2009 is the date that the Irish banks were taken under government ownership.

Kelly (2010) stresses the historical and emotional relationship that the Irish have with property as an asset class: “Property was the rock on which Irish society was built and economic life seemed to revolve around it. This is, at least in part, a consequence of our previous existence as landless tenant farmers. To own land was to live and survive, so the importance of ownership has been drilled into our minds” (*ibid*, p. 208). Other commentators who have highlighted the importance of property in Irish society include Lee (1989) and Brawn (2009)¹³⁷.

Twelve interviewees made mention of the Irish attachment towards property. All of them emphasised the historical links and emotional ties that the Irish have towards property. A selection of these comments is noted below:

- Actor E (A): *“The Irish have an absolute obsession with property. Land ownership and property ownership, it is a sign of social status in Ireland.”*
- Actor Q (S): *“Our attachment to property is rooted in history. Ireland is a peasant society, you never sell land.”*
- Actor G (C): *“Property is in our molecules, it is deeply, deeply, deeply rooted in our culture to own property because there was a time when we were kicked off our land and we were not allowed to own property.”*
- Actor D (A): *“There is an Irish attitude towards property, the best time to buy is now, and the best time to sell is never.” People will not sell, when they buy they won’t sell, perhaps they are saying they are not making any more of it.”*
- Actor F (C): *“That fascination with property is in many respects an inferiority thing, it’s about the need to own things, it’s due to the fact that a lot of the Irish come from an agricultural background and during the*

¹³⁷ This observation ties in with my own anecdotal experience when working in Ireland. Property ownership and speculation was a constant topic of conversation both in business and social situations.

19th Century Irish people did not own the land because it was owned by the landlords and therefore when you got your hands on land you held onto it. That sometimes drives mad behaviour.”

- Actor J (C): *“People in Ireland like to have possession. I have heard many times the saying in Ireland “they are not making any more land””.*
- Actor K (C): *“My father in law is cash poor, really cash poor but land rich. He has 90 acres near the Irish Sea and he will never sell that land. No way. It’s a useless piece of land like literally from that side of my office to the other that he cannot do anything with and instead of selling it to me has given me an easement which is ridiculous because I would give him €20 000 for it which is ridiculous because he can never do anything with it.”*

In summary, a review of this research question has identified in Ireland the historical and emotional attachment to property. There is evidence to suggest that the decision processes of the boards of the Irish banks, and Anglo’s in particular, may have been affected by inherent biases relating to representativeness, availability and confirmation.

7.2 Research question Two: The board of Anglo was affected by the antecedents and symptoms of groupthink.

Janis (1972) defined groupthink as “a mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when the members’ strivings for unanimity override their motivation to realistically appraise alternative courses of action” (*ibid*, p. 9). Chapter 3 provides a detailed analysis of the concept of groupthink. The conclusion drawn from this chapter was that groupthink was a valid construct and one which has been widely accepted in the literature as a contributing factor to poor decision processes across a number of different decision making scenarios.

One of the challenges identified and discussed in the groupthink discussion in chapter 3 related to the challenges of defining groupthink. Five case studies of groupthink were reviewed in this respect. The conclusion drawn was that my research, consistent with the approach of Yetiv (2003) and O’Connor (2002), would follow Janis’s original groupthink construct and focus on *both* the antecedents and symptoms of groupthink. The perceived advantage of this approach was deemed to be two-fold. First, it reduces the risk of self-selection of the antecedents and symptoms of groupthink that “fit” the case study. Second, by measuring groupthink against the strong form of groupthink my analysis will test the groupthink construct in the most rigorous and systematic way¹³⁸.

¹³⁸ However, as highlighted in the literature review, researchers such as Whyte (1998), Hart (1994) and Baron (2005) present modifications of Janis’s interpretation of groupthink. In particular they identified an alternative path to groupthink which emphasised a form of collective optimism and high self-efficacy as an alternative antecedent to the high stress/low self-esteem identified by Janis. The intention is to follow Janis interpretation of groupthink but will take into consideration the alternative routes to groupthink identified above.

Moreover Nyberg (2011), when concluding that the Irish banks suffered from groupthink, appeared to reach his conclusion from a more intuitive analysis of the information rather than a more rigorous process of identifying antecedents and symptoms of Janis's groupthink. He told me in interview:

"I did not go into the details of the elephant [of groupthink]. I just seemed to recognise that it had the essentials ... I never really had the time to go deeper into looking into the exact hypothesis that would fit in. It was not strictly speaking a scientific effort, like the one you are trying to do, it was more trying to structure information and draw conclusions".

Nyberg's approach is completely understandable in the context of his commission, and his absence of rigour in the measurement of groupthink does not detract from his commission. Further, although the Nyberg Report does not go through the systematic process of identifying each of the antecedents and symptoms of groupthink, it does provide a number of observations resulting from the data gathered and interviews undertaken which will be used in this chapter in respect to the discussion of the identified research questions. Indeed, the Nyberg Commission accessed approximately 200,000 documents from authorities, financial institutions and other sources and conducted 140 interviews with 120 individuals (Nyberg, 2011, p. 10).

Hart (1994) does, however, warn that the concept of groupthink can, and has been abused, and that the term is often used "loosely and indiscriminately as a symbolically powerful pejorative label to stick on any controversial episode of organizational action or public policy-making" (*ibid*, p. ix). In light of this and Nyberg's comments about how he measured groupthink, there is an opportunity for me to provide a more rigorous test of the groupthink construct as it may apply to the Irish banks and to Anglo Irish in particular.

As noted above, Yetiv (2003) highlighted the risks to researchers of being vulnerable to confirmation biases and of seeking for evidence which confirms a predetermined theory. Janis was aware of the risk of assuming that a poor

decision process will automatically lead to groupthink and that researchers could overestimate the predictability of past events in analysing case studies leading them to conclude that the poor decision process must have been groupthink (Janis, 1972 p. 194). Janis recommended that researchers go through a comprehensive and rigorous process of structuring any groupthink inquiry. To achieve this, Janis suggested examining four questions when assessing whether groupthink could have been a contributing factor in a poor decision process: 1) Researchers should ask who made the policy decision, was it the leader alone or did group members participate to a significant degree. If the members did participate, were they a cohesive group? 2) To what extent was the policy a result of a defective decision making procedure? 3) Can the symptoms of groupthink be discerned in the group's deliberations? 4) Were the antecedents that foster groupthink syndrome present?

In the case of Anglo, I can answer Janis's first two questions in the affirmative. First, Anglo had a board of directors, held regular board meetings and noted, in its accounts: "That the Board is responsible for the leadership, direction and control of the Bank (Anglo, AFS, 2006, p.35)." The extent to which Fitzpatrick, as leader, influenced boardroom decisions and the level of cohesiveness of the Anglo board are discussed in detail in relation to research question 2. Second, the policy or decision to finance commercial property to the extent that Anglo did, was clearly flawed given the need for the Irish government to bailout Anglo at a cost estimated to be in excess of €50 billion to the Irish state. Questions three and four above relate to the symptoms and antecedents of groupthink that Janis raised and are reviewed in the analysis of the research questions. Furthermore, Janis recommended that researchers analysing retrospective case studies in relation to groupthink consider both the symptoms and antecedents of groupthink in their analysis. This, it is submitted, provides further support for the decision noted above to focus on analysing *both* the symptoms and the antecedents of groupthink.

What follows below is a number of propositions related to both the antecedents and symptoms of groupthink as set out by Janis (1972). Each sub-hypothesis includes a discussion on how it might be defined and any evidence which might support or contradict the proposition from the source materials and interviews conducted.

A summary of the antecedents and symptoms of groupthink and the related propositions are:

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

Research question 2a)

The board of Anglo Irish in the lead up to the crisis constituted a cohesive group.

Group cohesiveness is the core underpinning to Janis's theory and indeed groupthink cannot exist unless the antecedent of cohesiveness exists. The concept of cohesiveness has been described as "one of the most interesting, and most elusive constructs in the study of small group behaviour" (Mullen et al., 1994, pp. 189–190). There are a number of different types, definitions and

means of measuring cohesiveness. Janis' concept of cohesiveness was very much focused on the interpersonal nature of cohesiveness rather than on any type of task oriented cohesion. Janis focused on a cohesiveness characterised by "amiability" and "spirit des corps" and noted that: "Concurrence seeking tendencies probably are stronger when cohesiveness is based primarily on the rewards of being in a pleasant 'clubby' atmosphere or of gaining prestige from being a member of an elite than when it is based primarily on the opportunity to function completely on work tasks with effective co-workers" (Janis, 1972, p. 201)¹³⁹. The focus on establishing whether the board of Anglo was cohesive will, therefore, focus on identifying this socio-emotional cohesiveness based on an attraction to the group itself.

Evidence

The starting point for evidencing cohesion within the Anglo board is the natural tendency towards cohesiveness which exists in corporate boards. Chapter 2 which focused on the governance literature referred to a 1995 Korn/Ferry study (cited by Dallas, 1997) of U.S. boards where directors were asked "what is the most important factor in deciding to join a board?" The majority of answers received were not the soundness of the balance sheet, or the opportunities for directors to make a contribution, but rather the identity of other board members.

¹³⁹ Janis's observation about socio-economic versus task oriented cohesion are back up by a meta-analysis undertaken by Mullen et al. (1994) that concluded that cohesion associated with an interpersonal attraction impaired decision making whilst task focused cohesion enhanced group decision processes.

In other words, it was the attraction and prestige of other board members that was the most important factor in deciding to join a board¹⁴⁰.

Cox and Munsinger (1985) provide further support for the results of the aforementioned survey: “The reward [of board membership] is non-monetary, prestige, influence, and pleasure associating with other successful people, to work with others that they admire and want to work with and get better acquainted. These preferences are a manifestation of the inherent drive for affiliation and companionship which motivates people to seek identity with a group” (*ibid*, p. 94).

It therefore follows that the starting point in assessing socio-emotional cohesiveness in the context of a board room is that there is a natural tendency for this type of cohesiveness to exist in any boardroom. Indeed, O'Connor (2002) relied on what she saw as being boardroom norms with respect to the natural pull towards cohesiveness when providing evidence that the Enron board was most likely cohesive¹⁴¹.

Nyberg (2011) highlighted the cohesive nature of the Irish bank boards in his report: “All bank boards appear to have operated on a collegiate and consensual basis ... In some cases there were explicit references to both the good atmosphere of the board and the wish to avoid fractious or consistently contrarian behaviour” (*ibid*, p. 49). Nyberg does not mention Anglo specifically in his report but he did tell me in interview that “*the strength of Anglo for so long was that they did have a very catching and **cohesive** internal culture*” (bold added). Thus Nyberg specifically identifies the cohesive culture at Anglo.

¹⁴⁰ Although this is a US study, there is no reason why the results would be different in comparable jurisdictions such as Ireland and the UK.

¹⁴¹ O'Connor cited the research of Cox and Munsinger (1985) in support of this assertion.

Fitzpatrick highlighted specifically the collegiate atmosphere within the Anglo board in an interview cited by Lyons and Carey (2011) when he observed: "Anglo was forged from a unique culture, rooted in humble beginnings and *fostered by a collegiate spirit*, hard work, self-belief and a fair dollop of 'us against the world'" (*ibid*, p. 72 italics added). Actor A (A) described the culture of cohesiveness when he told me:

"It was not like we were the Moonies but there was a collegiate feeling among the staff and there was a pride in where we were and what we were doing."

Actor E (A) in describing the Anglo credit committees as "*a cross between a Nuremberg rally and a pep talk at an American football game*". These descriptions above reflect a sense of cohesiveness at Anglo.

O'Connor (2002) identified strong financial incentives through the Enron director's share ownership and share options as a factor that contributed towards the high level of cohesiveness in the Enron board. Similarly, the board of Anglo were bound together by their shared exposure to the Anglo share price. As already highlighted, the board of Anglo had significant financial interests in the success of Anglo. All the directors and NEDS had interests in ordinary shares of Anglo whilst five of the directors had both ordinary shares and options. The largest personal interest as at the 30 September 2006 year end was Sean Fitzpatrick who had 4,473,869 shares at a market value at year end of €57,936,603. The directors with the smallest exposure to Anglo's shares were Anne Heraty (25,000 shares at €323,750) and Fintan Drury (53,796 shares at €696,658). All other directors had exposure to Anglo exceeding €1,5 million. This shared interest in the performance of Anglo may have contributed towards a greater level of cohesiveness amongst the board.

A comparison of stock ownership and options at the other three listed Irish banks, BKIR, AIB and ILP, provides context as to the relative exposure of Anglo

directors to their company is provided in the table below. All exposures were calculated as at their 2006 year ends and data was taken from their respective annual reports and accounts.

Table 7.2 Analysis of the Irish bank directors share exposures (2006)

	Anglo	BKIR	AIB	ILP
Highest director exposure to shares and share options	€57, 9 million Fitzpatrick Chairman	€7,1 million Goggins CEO	€5, 1 million Sheehey CEO	€3,0 million Went CEO
Smallest director exposure to shares	€323 750 (Heraty)	€16 940 8 out of 14 directors (57%) at BKIR had exposures less than Heraty	€10 800 9 out of 15 directors (60%) at AIB had exposures less than Heraty	No exposure 5 of the 9 directors (55%) at ILP had exposures less than Heraty.

Source: Annual Financial Statements for Anglo, BKIR, AIB and ILP for year ending 2006.

The table above highlights a significant difference between the exposures of Fitzpatrick compared to the CEOs of the other three listed banks. Fitzpatrick is eight times more exposed to Anglo than the second highest in the table, Goggin at BKIR. Further, the table highlights that all of the directors at Anglo, including NEDs, had material exposures to the share price of their organisation whilst this was not the case at BKIR, AIB and ILP¹⁴².

¹⁴² My thesis recognises that the existence of observables in itself does not necessarily tell the whole story and that one also needs to understand the depth or intensity of the observables.

Further, high levels of stock ownership at Anglo was not exclusive to their board, but pervaded the entire organisation. Actor B (A) noted that:

“Virtually every member of the staff owned stock in the bank. They [the staff] all had a direct interest and involvement in the future direction of the bank. People would have had a very active interest in the share price, where the share price was. If a particular piece of research came out, a strong piece of research, a “buy” recommendation on Anglo that would give people a gee up. When I describe the culture at Anglo it was very much a hands on and ownership culture so people were very much encourage to buy into that, it was their company and they were part of the future success of the business and by their hard efforts that success was going to continue. And what we did every year, and it probably was in contravention of every rule in the book, was that the first people that got the results were the staff and on the night before the results were announced to the market, after the close of business in this part of the world in Dublin we told the staff what the figures were. The Finance Director, CEO or whoever stood up and addressed them and said this is what your efforts have generated this year this is where we are compared to last year compared to the last half year end. So there was a real spirit of ‘this is your company and this is what your efforts have built and this is going to contribute towards your own sense of well-being; financial well-being as well’.”

Actor D (A), mirrored this sentiment when he observed that the culture was *“very much that you own this bank, we own this bank, this is our bank.”* The sense of “this is your company” linked to share ownership described by the interviewee above highlights cohesiveness at Anglo.

Higher levels of stock ownership at Anglo might be one indicator that the board of Anglo was *more* cohesive than that of its rival banks. However a comparative analysis of relative levels of board cohesiveness between the Irish banks is beyond the remit of this thesis.

Actor A (A) identified the strong sense of loyalty that employees felt to Anglo and that, in his view, selling stock would have been a signal of disloyalty to the company:

“I can tell you for a fact that I did not sell my shares, and I had shares that I was not locked into that I never sold, and I absolutely believed the story right up very close to the end and even at that point when I knew things were in trouble but through some frankly misguided sense of duty I felt it would be inappropriate for me to sell them and if I was seen to be selling them, even though I was allowed to sell them would that had hurt the broader effort. That’s naivety and cost me a lot of money.”

Again in this comment the interviewee Actor A (A) highlights the connectedness between high levels of loyalty, share ownership and cohesiveness at Anglo.

Staff were encouraged to buy stock and indeed offered loans to do so. Actor C (A) in his interview noted that he was offered a €50,000 loan to buy stock to buy equity in the bank. Carswell (2011) further noted that executive director Willie McAteer had taken out a €8.25 million loan to purchase shares in Anglo. Actor G (C) highlighted that Anglo board members were *“ferociously pressurised into buying the Anglo shares”*. Actor G (C) presented this pressure as a means of locking them into the Anglo business model:

“The way it locked them in was to get them to borrow so that they were no longer independent and you get them to borrow shares in the company, so that the borrowing makes them incapable of extricating themselves from the company. So the description I heard was of a darker side than just a simple side of everyone getting into the bubble mentality”.

When asked who was driving this darker side, she noted that it was from CEO and Chairman level (Drumm and Fitzpatrick). There is however to my knowledge no way for me to verify this claim, and indeed this is the only time I

heard such a claim. However there was a consistent message communicated to me in the interviews that this was an organisation with a high level of share ownership and a strong pervading culture of “this is our bank” which contributed towards cohesiveness within Anglo.

Another factor which would affect cohesiveness is the existence of friendship between group members. The principle that working groups which are made up of friends are more likely to be cohesive and collegiate was recognised by Janis (1972): “People with strong affiliative needs prefer their work colleagues to be good friends, even if those friends are not very competent. Such people give priority to preserving a friendly relationship, at the expense of achieving success in the group’s work tasks” (*ibid*, p. 242).

The analysis of the Anglo NEDs as at the end of the financial year 2006 at the height of the property bubble, highlights a number of strong friendship and connections amongst the NEDs. NEDs are particularly important in the context of a group setting given their role in monitoring and challenging management as highlighted in the chapter dedicated to corporate governance (Jensen and Meckling, 1976). An analysis of the NEDS is provided below:

Table 7.3: Analysis of the connections between the Anglo NEDs (2006)

NED	Connection
Sean Fitzpatrick – Chairman (previous CEO)	Fitzpatrick connected to all the NEDs as highlighted below.
Fintan Drury Drury connected to Fitzpatrick; social and shared directorships.	A close friend of Fitzpatrick (Lyons and Carey, 2011 p. 62). Fitzpatrick sat on the board of Drury Communications, a corporation set up by Drury.
Ned Sullivan Sullivan connected to Fitzpatrick; social and shared directorships.	A close friend of Fitzpatrick (Lyons and Carey, 2011 p. 125). Sullivan was chairman of the board of Greencore. Fitzpatrick sat on the board of Greencore

<p>Lars Bradshaw</p> <p>Bradshaw connected to Fitzpatrick; social and shared directorships.</p>	<p>Close friend and business associate of the chairman, Fitzpatrick (Ross, 2009 p. 54). Murphy and Devlin (2009) describe Bradshaw and Fitzpatrick as “bosom buddies” (<i>ibid</i>, p. 86). Lyons and Carey (2011) detail the significant business investments that Bradshaw and Fitzpatrick undertook in partnership.</p> <p>Bradshaw was the chairman of DDDA, a board which Fitzpatrick sat on.</p>
<p>Patrick Wright</p> <p>Wright connected to Fitzpatrick; past shared directorship.</p>	<p>Fitzpatrick and Wright had sat on the board of Aer Lingus together.</p>
<p>Anne Heraty</p> <p>Heraty connected (indirectly) to Fitzpatrick.</p>	<p>Heraty sat on a common board (Further Education and Training Awards Council) with Fitzpatrick’s sister Joyce O’Connor.</p>
<p>Gary McGann</p> <p>McGann connected to Wright (social) Fitzpatrick (shared directorships)</p>	<p>McGann was a “close pal” of fellow director Patrick Wright (Ross, 2009 p. 55). Fitzpatrick was Chairman on the board of Smurfit where Fitzpatrick was a director.</p>
<p>Michael Jacob</p> <p>Jacob connected to Fitzpatrick through a long standing friendship</p>	<p>Michael Jacob who was described by both Lyons and Carey (2011) and Carswell (2011) as one of Fitzpatrick’s closest friends.</p>

Furthermore, as is highlighted below in the discussion of research question 2c), Fitzpatrick was also strongly linked to the executive board of Anglo. This connection existed, because Fitzpatrick had previously been the CEO and had worked closely with the existing executive directors and second, through his influence in appointing David Drumm as his successor as CEO. The strong social and business connections between the NEDs of Anglo point towards the likelihood of a board that was cohesive and one in which a collegiate atmosphere existed.

The analysis above was consistent with what was said in interview.

Actor E (A) noted that: “A lot of the board were golfing buddies and friends of his [Fitzpatrick].” Actor A (A) observed that “there was a definite sense that all of the non-executives were picked by Sean [Fitzpatrick]. Sean was a very gregarious, charming, street smart CEO and he was no fool and I think he certainly did try and put people around him that were loyal”.

Actor D (A) told me that Fitzpatrick “did have his people alongside him who, in my opinion, would not have necessarily been the best or the smartest but they were his people... He had his fixers, he had his men, he had his people. Michael Jacob was one of them. I mean people who had a respect for Sean and possibly let that respect override logical thought from time to time. Look we believe you, we trust you.”

Another factor which could affect cohesiveness identified previously is the longevity of its directors. A board which is more mature and where the directors have worked together for a long period of time is more likely to be characterised by high levels of cohesiveness. A review of the longevity of the Anglo Board as at the end of the 2006 financial year reveals:

Table 7.4: Analysis of the Anglo board tenor (2006)

Director Name	Duration (in years)
NEDs	
Sean Fitzpatrick	20
Michael Jacob	18
Lars Bradshaw	2
Ned Sullivan	5
Anne Heraty	Less than 1 year
Gary McGann	2
Patrick Wright	6
Fintan Drury	4
Executive Directors	
David Drumm	2
William McAteer	14
Pat Whelan	Less than 1 year
Tom Browne	2
Declan Quilligan	Less than 1 year

This analysis highlights that Fitzpatrick, McAteer and Jacob had been directors for significant periods of time. Executive directors Drumm, Whelan and Quilligan were all newly appointed to the board in 2006, but all had been working at Anglo for long periods before their board appointments. Drumm had been at Anglo for 13 years, Whelan 17 years and Quilligan 16 years (source Anglo 2006 AFS). During that time period, these three relatively new board members would have worked their way up the firm and most likely worked closely with existing long standing board members. This point was highlighted by Actor B (A) who commented:

“The people that were there from the very beginning or the very early stages of Anglo who had grown up with the organisation in every sense of the word, they had grown professionally in terms of their working life they really felt a sense of ownership of the company.”

In contrast, the NEDs of Anglo, with the exception of Jacob, were relatively new appointments although as highlighted previously they are closely connected in particular to Sean Fitzpatrick. Therefore, although the NEDs may not have worked together for long periods of time at Anglo, there is longevity through other personal and business connections which precede Anglo and may be seen as potential evidence of cohesiveness. A closer analysis therefore reflects that the executive board of Anglo was characterised by longevity.

Another potential indicator of the likelihood of cohesiveness is the existence of homogeneity amongst board members. There is a natural tendency for human beings to gravitate towards, and be close to, those who are similar to themselves. Therefore, it follows that if a board is characterised by high levels of homogeneity, it is more likely that such a board will be cohesive. The natural pull towards homogeneity in a group setting is well recognised in academic literature. Heffernan (2012) argues that the most important criteria in selecting a life partner is homogeneity; we are attracted to those who are most similar to ourselves. In a business context, Moore (1975) notes that managers tend to

promote those who are similar to themselves on the basis of a kinship in which predominantly men reproduce themselves in their own image.

Janis recognised the importance of homogeneity to his groupthink model and includes “homogeneity of members’ social backgrounds and ideologies” as a stand-alone antecedent to groupthink. Janis argued that homogenous group members will lack a diversity of thoughts and ideas, and given their similar backgrounds are more likely to view problems from the same perspective and as such less likely to challenge a poor decision process. Group homogeneity is important for two reasons; first because it is associated with cohesiveness and second because it is associated with a lack of diversity of cognitive thought processes.

The approach adopted in this chapter is to take each of the symptoms and antecedents of groupthink systematically and in the order presented by Janis. Group homogeneity is discussed below with reference to research question 2e). Any evidence of homogeneity observed however will provide further indication that the board of Anglo was cohesive in the lead up to the crisis.

In summary, there is a natural gravitation in a corporate boardroom setting towards homogeneity given the prestige and status associated with board membership. With regard to the Anglo board, there is evidence to suggest that the board was cohesive in the lead up to the crisis. The Anglo board was characterised by the existence of friendships and business connections, shared interest in the share price performance of Anglo, longevity of membership or connections and homogeneity (see research question 2e) below). All of these are associated with the type of socio emotional cohesiveness associated with groupthink.

Research question 2b)

The board of Anglo Irish was insulated from outside experts.

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

Outside experts could challenge or correct a board's opinion by introducing new information that might generate an examination of the initial decision process. Outsiders therefore provide a diversity of thought process associated with a better decision process (Forbes and Milliken, 1999; Milliken and Martins, 1996; Williams and O'Reilly, 1998). Further, outsiders to the group are less likely to value membership of the group so highly and will be less vulnerable to the premature concurrence seeking pressure associated with groupthink.

The principle of the independent NED is very much in keeping with the thinking highlighted above. Independent NED directors will provide alternative views and opinions that can bring a fresh dimension and challenge the executive board. The effectiveness of the independent NED to challenge the executive directors and provide diversity of thought can be reduced due to a number of factors as

highlighted in the model of poor decision processes. These pressures relate to vulnerabilities to normative social influences, of which groupthink is the most pervasive, and also the informative pressures associated with herding. Normative pressures are deemed to be higher when NEDs have low levels of functional or firm specific skill levels which increase the likelihood that they will not challenge an existing decision process. In summary, the effectiveness of NEDs as outside experts to challenge management can be greatly reduced, as was the case in many banks in the lead up to the financial crisis.

NEDs are, however, just one example of outside experts that boards might be exposed to. Other examples include the regulator, the firm's auditors, the Central bank, bank analysts, the rating agencies and investment bankers. The board of Anglo would have been exposed either directly or indirectly to a wide number of outside experts¹⁴³. It is submitted that given this there is no evidence to support research question 2b).

This poses the question as to whether a) outside experts did warn the board of Anglo about the risks of property investment and the board, vulnerable to normative and informative pressures and caught up in new era thinking, ignored such a warning or b) whether such outsider experts did not identify or warn the board of the risks associated with their aggressive growth strategy.

It is submitted that the answer to this question does not lie in an "either/or" solution. Rather there will be examples of outside experts who warned management at Anglo but were ignored, and also examples of experts that did not warn Anglo of the risks associated with their strategy because they

¹⁴³ From my own experience as an investment banker I had exposure to the board of Anglo and indeed facilitated on numerous occasions meetings between board members at Anglo and credit analysts at potential investors. Further, Anglo had credit ratings from both Moody's Investor Services and Fitch Ratings. These agencies will not, as a matter of course, provide solicited ratings without meeting with executive directors. Further, it is difficult to envisage that the Regulator and the auditors did not have access to the board of Anglo.

themselves did not recognise the risks. Indeed, the groupthink model identifies examples of management ignoring the warnings of outsiders (stereotyping of out-groups and direct pressure on dissenters). These relate to symptoms of a board that does not take heed of warnings but rather, as a consequence of groupthink, ploughs ahead with a pre-existing strategy. These symptoms will be discussed when analysing the symptoms of groupthink later in this chapter.

Discussed below is the second of these possibilities, namely that outside experts did not warn Anglo because they themselves did not recognise the risks. O'Connor (2002) in her analysis of Enron described what she termed "collective groupthink" as a reason why Enron's gatekeepers failed to detect the problems at Enron. O'Connor noted further that "a circular form of social learning took place whereby each of these groups discounted the negative information it possessed because the other groups failed to show apprehension" (*ibid*, p. 1265).

Janis (1972) touched on the concept of collective groupthink in case study of Pearl Harbour when he observed that three interlocking groups, the Navy, the Army and the War Council, responsible for the defence of Pearl Harbour "reciprocally indulge in groupthink" (*ibid*, p. 95) and that these groups mutually reinforced each other's lack of vigilance. However, Janis did not develop the concept of collective groupthink further (it is mentioned in one paragraph on just one page of his book). O'Connor (2003) also does not investigate this concept in any detail, and dedicates only one paragraph of her eighty seven page report to the concept of collective groupthink.

Nyberg (2011) highlights the possibility of groupthink existing between organisations: "The Commission is of the view that there also was pressure for 'group think' within the institutions, *and possibly, between them as well*" (*ibid*, p. 86, italics added). The Commission further noted the failure of the gatekeepers to challenge the Irish bank's expansion strategies and that: "Bank leadership and staff also appear to have taken comfort from the fact that neither the FR

[financial regulator] nor the Central Bank, apparently saw any problem worthy of a policy change with either the very rapid growth of balance sheets or the related concentration of exposures to property” (*ibid*, p. 50).

There is, to my knowledge, no other research other than that highlighted above, which attempts to explain the collective failure of a wide range of actors to prevent a poor decision process being enacted as being ascribed to a form of “collective groupthink”. Rather explanations focus on the psychology of new era thinking, and information cascades (Akerlof and Shiller, 2010; Galbraith, 1994; Kindleberger and Aliber, 2011; Robert J Shiller, 2008). An information cascade occurs as a result of herding where actors squelch their own information believing that others must be better informed so that over time the quality of information declines (Shiller, 2008). What then occurs is a social contagion of thought processes, described by Shiller as being similar to that which happens when a biological virus spreads. Indeed, O’Connor’s (2002) comment noted above relating to a “circular form of social learning” appears to be a reference to an information cascade rather than a process of collective groupthink.

It is submitted that perhaps one of the reasons why the concept of collective groupthink has not been explored is that researchers have seen groupthink as an internal process, something which happens within cohesive in-groups rather than something which happens collectively in a wider environment. Indeed, Janis’s version of groupthink is predicated on the existence of a socio-emotional cohesiveness based on mutual attraction and the prestige of the in-group. This type of cohesiveness is difficult to envisage in the larger business environment. Evidence from the interview process was that the Irish bank boards did not socialise and that there was, if anything, distrust and suspicion between the Irish banks. The absence of a cross board socio-emotional cohesiveness was highlighted by Actor Q (S):

“The banks knew each other but they did not cross over. They generally played their cards close to their chest. They were a bit like us and the

other brokers, we knew them but we would not socialise with them, it is competitive. The CEOs would meet each other but they would not socialise with each other.”

Actor N (S) commented that Anglo:

“regarded them with ‘we are going to give you a poke in the eye’ and when I am talking about them I am talking about AIB and BKIR. Each of those institutions would have had a very strong culture, and were different and did not like each other and considered Anglo a whippersnapper.”

Actor H (C) and Actor I (C), both NEDs at Irish banks confirmed that the only contact they had with the management of the other Irish banks was in capacities unrelated to their banking roles.

In summary, given the geographical closeness of the banks and bankers to each other, it is submitted that the directors of the Irish banks most likely knew each other but there was no sense from any of the interviews and indeed the literature¹⁴⁴ that the bankers formed a close and cohesive bond across bank boards. Socio-emotional cohesiveness is a pre-requisite for Janis’s groupthink and in the absence of this antecedent it is difficult to progress the concept of the existence of an intra-group groupthink in the Irish bank boards.

It is however possible that a number of institutions could have suffered from groupthink at the same time and that a number of the Irish banks, and their gatekeepers all suffered from the symptoms and antecedents of groupthink. Indeed, if Anglo Irish is shown to have many of the antecedents and symptoms

¹⁴⁴Some of the literature (Cooper, 2009; O’Toole, 2009; Ross, 2010) however highlighted a close relationship between the banks and the regulator and between some bankers (in particular Fingleton and Fitzpatrick from INBS and Anglo respectively) and politicians but not between the banks themselves.

of groupthink and flourished in the Irish banking context, it is likely that other Irish institutions would be similar. This is the argument put forward by Powell and DiMaggio (1983), who argue that once a set of organisations emerge in a field (such as an established banking environment in Ireland) corporate leaders make their organisations increasingly similar to others around them. That is, the institutional pressures within a specific domain increase the homogeneity of corporations transacting within that domain. All six of the Irish banks had headquarters in Dublin increasing the susceptibility towards homogeneity and cohesiveness.

As highlighted in the theoretical model of poor decision making, it is the combination of both normative and informative influences on decision processes that combine together to create the risks of collective environment in which speculative bubbles can develop. Further, when these phenomena combine together they become even more powerful than when considered in isolation (Brafman and Brafman, 2008; Cox and Munsinger, 1985).

This thesis has focused on the central question of groupthink in Anglo and herding by other market participants. However, it is very possible that groupthink existed at all or some of the Irish banks and gatekeepers, and that this groupthink exacerbated the collective poor decision process and a form of collective social learning (O'Connor, 2002) took place. Indeed, as highlighted above, this was the very conclusion that Nyberg (2011) came to.

The interview process focused primarily on those who had been associated with Anglo, and the interviews undertaken with participants from the Irish banking institutions focused on their interactions with Anglo and the competitive landscape and whether there was pressure to emulate Anglo. In other words, the interview process did not specifically explore whether all six domestic Irish banks were characterised by the symptoms and antecedents of groupthink more broadly in the Irish banking sector. The interview process did, however, highlight some antecedents and symptoms associated with groupthink in

relation to the domestic Irish banks. For example, Barbara Patton (C) highlighted pressures towards uniformity, stereotyping of out-groups and pressure towards uniformity at EBS. Actor J (C) similarly evidenced stereotyping of out-groups and pressure towards uniformity at AIB. Actor F (C) identified illusions of invulnerability at BKIR whilst Actor H (C) noted homogeneity in the selection process of directors at ILP. Indeed, an analysis of the educational backgrounds of the board directors as of year-end 2006 of the four listed banks (AIB, Anglo, ILP and BKIR) reflected very high levels of homogeneity. Of the 57 directors across the 4 banks, 22 or (38.5%) attended UCD and 7 (12%) Trinity College (so that over half attended just two Universities) and 28% of these were qualified Irish accountants.

However, practically for the purpose of this thesis, it is not possible to undergo the same rigorous analysis of groupthink in each of the six Irish banks and the gatekeepers. There is to my knowledge only two groupthink studies which have looked at multiple cases of groupthink. Janis (1972) analysed seven different political case studies whilst Eaton (2001) looked at two companies BA and Marks and Spencer. As discussed previously, Eaton did not undertake a comprehensive review of the antecedents and symptoms of groupthink. Further, Janis's seminal book, of which there are three editions, focused exclusively on introducing the concept of groupthink whilst this thesis attempts to include groupthink in the context of a model of poor decisions processes. In other words, it is beyond the scope of this thesis to undertake a comprehensive and detailed analysis of the antecedents and symptoms of groupthink for all six Irish banks and the gatekeepers.

Research question 2c)

Anglo Irish Bank was characterised by the lack of tradition of an impartial leader

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

Janis (1972) noted that impartial leaders were those who strongly stated their own views and actively discouraged dissent. In the case of Enron, O'Connor (2002) focused on the CEO Ken Lay as the leader when concluding that Enron's leader was impartial: "Congressional hearings indicated that the Enron Board lacked impartial leadership. As with most boards, the CEO, Ken Lay, appointed many of the Enron directors, and served as chairperson of the Enron board" (*ibid*, p. 1267).

Evidence

In the case of Anglo, the leader was widely recognised to be Sean Fitzpatrick (Carswell, 2011; Lyons and Carey, 2011; Ross, 2010). Fitzpatrick was CEO of

Anglo between 1986 until 2005 when he moved from CEO to Chairman. His successor, David Drumm was widely seen as a surprise appointment (Carswell, 2011; O'Toole, 2009; Ross, 2010). Fitzpatrick was not on the nominations committee but Lyons and Carey (2011) argue that Fitzpatrick was hugely influential in the appointment of Drumm. This is a viewpoint shared by Drumm himself. Drumm commented in a newspaper interview in the *Irish Times*: "Sean [Fitzpatrick] left nothing to chance, and particularly not the appointment of his successor as CEO. I would not have allowed my name to go forward for the position if Sean had not pushed me into it; Sean usually got what he wanted. I most certainly would not have been appointed CEO if Sean didn't want that. He had total control of the board (Simon Carswell 2011)".

Drumm further highlighted the role that he believed Fitzpatrick played once Drumm had been appointed as CEO in a separate interview with *The Daily Business Post*. "Sean was a very, very powerful person. He was a controlling person not just of the executives, but of the non-executives. He ran the board, in a highly premeditated, controlled manner. There were meetings before board meetings to make sure he got what he wanted and so on. Sean was like that before I became CEO, he was 18 years as CEO and he wasn't planning on changing. So as chairman, he was an executive chairman for all intents and purposes and a highly controlling one, there is no doubt in that. Anyone that knows him knows that is true" (O'Dowd, 2011).

Lyons and Carey (2011) noted that in one of the interviews they conducted with Fitzpatrick he admitted that he "controlled the board" (*ibid*, p. 74). Other commentators who stressed the control which Fitzpatrick had over the board include Carswell (2011), Murphy and Devlin (2009), Cooper (2009) and Ross (2010). Carswell (2011) cited an (unnamed) former director of the bank: "He [Fitzpatrick] wanted semi-yes men around him. He didn't mind having an argument but he always wanted to win. If he didn't win an argument, he would think very badly of you. Sean Fitzpatrick felt that it was Sean Fitzpatrick plc and not Anglo Irish plc – he felt it was his bank, that he should call the shots to the

board and the management ... He didn't want a board at all" (*ibid*, p. 38). Lyons and Carey (2011) referred to a quote from an (unnamed) employee at Anglo: "You didn't question Sean. No-one can tell him what to do or not to do" (*ibid*, p. 86).

A number of the quotes in both Carswell (2011) and Lyons and Carey (2011) accounts are from unnamed sources. Carswell (2011), however, does include quotes from two named former directors of Anglo; Adam Stanzel who had been an Anglo NED from 2001-2005 and Tony O'Brien who had been the chairman of Anglo before Fitzpatrick replaced him. Stanzel, on the issue of Drumm's appointment as CEO noted: "I always had the feeling that Sean Fitzpatrick would have liked to have [Drumm] in that position. Sean said he was neutral in the appointment but my impression was that he wanted him as chief executive" (*ibid*, p. 65).

Tony O'Brien observed the leadership style of Fitzpatrick when he stated: "[Fitzpatrick] was very good at putting his case and if it was not accepted, there would be a lot of aggro¹⁴⁵" (*ibid*, p. 38). Carswell further argues that Fitzpatrick was hugely influential in the selection of the Anglo board: "As the senior member of the appointment committee, Fitzpatrick selected the people he wanted to sit on the board ... the interview process was also led by Fitzpatrick" (*ibid*, p. 41)

These provide further evidence to back up the assertion made earlier that Fitzpatrick in effect controlled the board and was the effective leader of Anglo. Further evidence of Fitzpatrick's influence in the boardroom is reflected in the aforementioned analysis of the NEDs in Anglo in which Fitzpatrick is shown to be closely linked to all other Anglo NEDs.

¹⁴⁵ The term "aggro" above being slang for aggression.

The evidence above which points towards Fitzpatrick as an influential and directive leaders was substantiated in the interview process. Actor B (A) noted that:

“There probably was a feeling amongst a number of us that Sean was trying to control or manage the board, that he did not want too many people disagreeing or taking a very different or opposite view to what his own was.”

Actor A (A) commented that Fitzpatrick tried to: *“put people around him that were loyal and would do what he asked them to do”* and that he had been told that *“the game was to have David [Drumm] as a puppet for Sean.”* Actor D (A) commented: *“The bank [Anglo] was driven by Sean Fitzpatrick, there is no question of that”*. Finally Actor Q (S) commented that: *“The culture of Anglo was very much driven by Sean Fitzpatrick. David Drumm was definitely Sean’s pick and no-one else.”*

Actor P’s (S) version of events around the appointment of David Drumm as CEO in 2005 is consistent with that highlighted above; that Drumm was appointed at Fitzpatrick’s behest. O’Connor told me:

“When David Drumm got the job, and I firmly believe that Drumm got the job through Sean’s manipulation, he got the job for the very simple reason that Sean thought he was malleable. He was very malleable and once or twice he did try to kick out but by in large Seanie [Sean Fitzpatrick] was the puppet master and he was doing as he was told. How can I prove it, I can’t prove anything, I am giving you opinions. I would know David Drumm, I would know Pat Whelan [a former director of Anglo], I would know Tom [Tom Browne, one of the contenders for the CEO job when Drumm was appointed] very well I would know Tiernan [Tiernan O’Mahoney, a former executive director of the bank] the general feeling and I would have heard evidence about the interview process. Tom clocked at one stage during the process, at an early stage when he

was one of the favourites, he said to me 'I think the whole thing is a set up and that he [Fitzpatrick] doesn't want me'. Tom would not have been malleable. Tom identified during his interviews that the biggest single threat to the bank going forward was Sean Fitzpatrick and over interference by a chairman. That was in the presentation he did, it was very much seen as a negative."

Actor B (A) and Actor D (A) in interview both suggested an explanation which would explain the rationale for Fitzpatrick's directive leadership style. Both interviewees pointed to the failed 1999 merger between Anglo and First Active. First Active was a converted building society that had been an attractive partner for Anglo given its access to retail funds through its branch network and its excess capital. Anglo had been in advanced merger negotiations with First Active but negotiations broke down over the make-up of the merged board (Carswell, 2011; Lyons and Carey, 2011)¹⁴⁶. Fitzpatrick had wanted to be the CEO of the combined bank and O'Brien, the then Anglo chairman, wanted to be the chairman of the combined bank, a position which the management of First Active found unpalatable. O'Brien and Fitzpatrick both refused to back down and the deal fell through.

Both Actor B (A) and Actor D (A) argued that the conflict between Fitzpatrick and his then Chairman O'Brien shaped his view of how he wanted the future boards at Anglo to operate. Actor B noted that:

"The [First Active/Anglo] deal never got consummated because of egos. So that probably marked Sean's card or set Sean's thought process down a very particular path that he needed to be very wary of who and what was on the board with him and what the respected positions of those board members would be. I would say that probably a life lesson for him in so far that Tony O'Brien was a tough hard-nosed business

¹⁴⁶ First Active was subsequently taken over by RBS.

man, probably to be fair to him but he wasn't going to be rolled over he wasn't going to be anybody's lap dog and he dug his heels in and Sean realised there was no way he was going to manoeuvre and that taught Sean a big lesson."

Actor D (A) commented that the failed First Active deal:

"bit Sean in the bum [the failed take-over of First Active] , it really did when he was taking over First Active. Subsequent to that, in my opinion, the board NED that came in would have been known to Sean"

Carswell (2011) in support of these comments quotes an unnamed Anglo insider as saying "there was no way that Seanie was going to let O'Brien serve another term as chairman after the First Active deal collapsed" (*ibid*, p. 40).

In summary, evidence suggests that Fitzpatrick had significant influence over the Anglo board, that he liked to exert his influence on the decision process and that this desire for control may have been shaped from a past experience when Fitzpatrick may have believed that he lacked the necessary control over the board during a critical process.

Research question 2d)

The Anglo board was characterised by a lack of norms requiring methodical procedures.

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

Janis (1972) notes that if an organisation has sufficient rules and standards that this would help to prevent members of a cohesive group “indulging in uncritical conformity” (*ibid*, p. 249). In other words, the lack of such norms will result in cohesive groups being more vulnerable to premature concurrence seeking associated with groupthink.

Evidence

Anglo was a listed Irish company and subject to the formal rules related to Irish Company Law, the Irish Listing requirements and the “comply or explain” model of the UK Corporate Governance Code¹⁴⁷. A review of the Anglo Annual

¹⁴⁷ The UK Corporate Governance Code was known as the “Combined Code” up until 2008 and in 2010 this was changed to the UK Corporate Governance Code. For practical purposes it has

Accounts from 2002 to 2007 reveals that in every year Anglo received an unqualified audit report and also reported that it had been in compliance with the Corporate Governance Code.

There are, however, a number of examples of corporate governance failures that have been identified at Anglo. The first of these relates to when Fitzpatrick moved from CEO to Chairman of Anglo in 2005. The UK Corporate Governance Code provision 2.2 notes that a chief executive should not go on to become a chairman. The rationale for this being that a previous CEO would have undue influence on the board itself in his/her new role as Chairman. The UK Corporate Governance Code does, however allow such a move to take place as long as the board has consulted major shareholders in advance - setting out its rationale for the move.

The board of Anglo did consult with the Irish Association of Investment Managers before Fitzpatrick's appointment as Chairman in 2005. They agreed to the appointment, but requested that Anglo appoint a senior independent director to the board. No such senior independent director was appointed.

Another such indiscretion relates to the warehousing of Fitzpatrick's director loans at INBS. As described previously, this related to the warehousing of Fitzpatrick's loans over reporting periods with INBS so that such loans were not disclosed in the Anglo report and accounts. Immediately after financial year end, these loans were then transferred back from INBS to Anglo. Fitzpatrick noted that the annual warehousing of the loans with INBS "had escaped attention within the bank because there had been no specific process to monitor it" (Lyons and Carey, 2011, p. 220). Further, Anglo did not keep a registry of directors' loans at the bank (Lyon and Carey, 2011).

been referred to throughout this thesis as the UK Corporate Governance Code although technically it could be referred to as the Combined Code up until 2008.

Carswell (2011) highlights that Anglo consistently overrode its own credit procedures particularly during the period 2005-2007 as the pace of lending increased. Lenders orchestrated what he referred to as “corridor credits” (*ibid*, p. 52) whereby loans were informally approved outside the credit committee to get deals done before they were formally rubber stamped later. Loans which had been rejected in the London credit committee were subsequently resubmitted to the Irish committee and then approved. Carswell quotes an (unnamed) director at Anglo: “We kidded ourselves that the system really worked – we just didn’t have the time” (*ibid* p. 52).

Carswell (2011) further quotes from an unnamed former banker of Anglo that worked out of their US office (which accounted for about 13% of Anglo’s loans). The former director noted that the Anglo credit committee meetings “were not like those at other banks and it was more like a committee of peers and that loans were then rubber stamped back in Dublin” (*ibid*, p. 100).

A further illustration of the lack of methodical procedures in place was that Anglo had a well-publicised lending rule of limiting lending no more than one per cent of its total loan book to a specific customer¹⁴⁸. A review of the Anglo loan book carried out by Price Waterhouse Coopers after Anglo was nationalised revealed that Anglo had breached that rule in the case of its top eight customers (Carswell, 2011; Lyons and Carey, 2011; Nyberg, 2011).

Nyberg (2011) highlights inadequacies in Anglo’s lending policies noting that exceptions to lending policies were very common and that loans that were not supported by strong or sufficient cash flows or collateral were supplemented by personal guarantees. However such personal guarantees were already encumbered or supported by equity in other property which had already been

¹⁴⁸ I heard this mentioned by senior Anglo representatives a number of times at investor meetings as an internal rule which was used to illustrate to investors that Anglo was not over-exposed to any single counterparty.

pledged to Anglo (*ibid*, p. 32). Further, Nyberg noted that the credit reporting procedures were inadequate and the quality of information presented to the Risk and Compliance Committee and the Board of Anglo “was not of the highest standard” (*ibid*, p. 30). Not only were credit policies inadequate, Nyberg observed that these policies were relaxed in the years leading up to the crisis and that cases of further exception to even relaxed credit policy was a frequent occurrence (*ibid*, p. 31).

Further evidence of the lack of norms at Anglo can however be seen in 2007 when the responsibilities of the Chief Risk Officer at Anglo were assumed by that of the Finance Director. As Nyberg (2011) notes: “At this time, Anglo’s property-related exposure in Ireland, the UK and the US had grown very significantly, and the need to monitor and manage the attendant complexities and risks had grown proportionately. This decision would suggest that risk management was not appropriately prioritised within the bank” (*ibid*, p. 27).

Furthermore Nyberg highlighted to me in interview a general observation about Irish attitudes towards rules when he said:

“There are some features which I am not sure about but seemed reasonable at the time that seemed typically Irish, for example not really liking rules and so forth. I agree that it is not necessarily only Irish, but I am comparing with Finland, where it is very important that rules are followed and if one wants to change stuff one changes the rules and that was not true in Ireland at all. However, as regards other countries I can’t say, it is just an impression I have.

I got this impression from, I did not only get it only from the interviews and the data, and it was also something I observed from the daily life, from reading the papers, reading the debates from the papers, and of course I did read about the previous inquiries (e.g. Dirt) but it did seem to me. I like Ireland a lot and the Irish but it seems a lot more tribal as a

nation, and if you are a tribe you just care about the rules of the tribe not the rules of the nation. This is just me speaking.”

These comments from Nyberg provide a contextual explanation for the background in which Anglo was operating but are, as he highlights above, casual observation. The Irish banking environment has been historically characterised by a number of banking scandals in the years before the onset of the crisis itself such as the DIRT inquiry, the Ansbacher affair, the government bailout of ICI, and the Farrell “affair¹⁴⁹”, all of which are detailed by Carswell (2006). These banking “scandals” provide some support for Nyberg’s assertion although there was no supporting evidence for this in any of the interviews.

Fitzpatrick has been described above as an influential and directive leader and his attitude towards the adherence of norms would have influenced the general culture in that respect at Anglo. In an interview with *The Irish Independent* he was asked if he was a details person, to which he replied “I wouldn’t be well organised and would be fearful of those who are”. (“5 min with Sean Fitzpatrick,” n.d.).

Moreover, Fitzpatrick appeared to be resistant to governance reforms. In 2005, Fitzpatrick gave a speech at the Irish Times Property Awards in which he was reported to have attacked the increase in governance and regulation. He noted that the pronounced moves towards greater control and regulation could squeeze the life out of an economy that has thrived on institution, imagination and a spirit of adventure” (“Media should spare us the polemics and give us balanced business news,” 2005). This was not an isolated example. Actor G (C) highlighted in her interview that she had shared a platform with Fitzpatrick in 2007 at a business event and that Fitzpatrick had been anti corporate governance:

¹⁴⁹ The Farrell scandal related to the forced resignation of the former CEO of Irish Permanent for misuse of company expenses.

“He said the “F” word as part of his diatribe on corporate governance.”

Fitzpatrick’s influential views on governance may have affected the culture at Anglo and the attitude towards adherence to norms.

The interview process identified a number of examples which reflected the lack of adherence to strict and rigorous procedures and norms and that, on occasion, the “can do” culture at Anglo overrode the need for adherence to rules and procedures. Anglo had been Actor A’s (A) and Actor C’s (A) first employer and it was only in hindsight, and having worked elsewhere, that they recognised the lack of conformity to norms at Anglo. Actor C (A) told me:

“My experience now in this organisation [his current employer] is there are a lot more checks and balances that would not have been in Anglo. If there was a good idea, pull together a paper, there wasn’t a committee that you needed to go to, there was a credit committee but these ideas got ‘approved’ and you did not need to go through a lot of layers of bureaucracy or checks and balances at the same time.”

Actor A (A) added that:

“There were a lot of us that grew up in the organisation and we did not know anything was going on was wrong but having worked now and seen what governance looks like in a proper bank there is just a world of a difference, the challenge, the second line oversight which people pull their hair out over that happens for a reason and that wasn’t there, we had challenges but we did not have anything like the challenges we should have.”

Comments by both interviewees should be taken in context. Both of them currently work in banking in the post financial crisis banking environment which is much more compliance and procedure driven. However, their general comments about the lack of controls at Anglo do provide good supporting evidence with respect to the lack of such norms.

Actor E (A) further highlighted that even when there were suitable controls and procedures in place, that in reality these were often ignored:

“So they had all the structures and the committees but actually what was happening was that Drumm would speak to Quilligan [an executive director and head of lending in the UK] and Quilligan would speak to Campbell [head of lending in the US] and the deal would be approved then 10 days or two weeks later the deal would come to credit committee. You know. It was how it was evolving and I found it disturbing.”

In summary, the examples highlighted above from a wide variety of sources and situations provide significant evidence for research question 2d) above, and that there appeared to be a lack of enforceable norms and procedures at Anglo compared to expected basic industry norms in the conduct of its business in the years leading up to the financial crisis.

Research question 2e)

The Anglo board was characterised by the homogeneity of members' social background and ideologies.

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

Janis (1972) reasoned that diversity in group members' backgrounds and ideologies would reduce the chances of a member giving into the pressure for consensus. A lack of diversity in social backgrounds would, therefore, increase the likelihood for group members to concur with the proposal put forward.

Cohen (1977) identified three possible sources of homogeneity; the pressure towards conformity (S. Asch, 1955; Sherif et al., 1961), the selective elimination of the most disparate group members (Schachter 1952) and homophilic selection. Cohen (1977) defined homophilic selection as "the tendency to over-choose as clique mates others who are similar to one's self" (*ibid*, p. 227). Cohen concluded from his study that homophilic selection accounted for much of the groups' homogeneity. In other words, according to Cohen, homogeneity

manifests itself primarily through a self-selection process. This finding is of particular relevance for groups such as board of directors who are self-selecting, so that there is a natural pull towards such homophilic selection and hence homogeneity. Specifically with respect to Anglo, the evidence suggests that the board, and the NEDs in particular, were closely connected through friendships and business connections.

McPherson et al. (2001) distinguished between two different types of homophily; baseline and inbred. Baseline homophily is created through demographic reasons whilst inbred homophily is induced through social preferences. The two types of homophily can and do combine together and ethnic/racial homophily (baseline) leads to the highest levels of inbreeding homophily. "Inbreeding homophily often complements baseline, such that smaller categories of individuals who would otherwise have networks dominated by the majority group actually have associates that are much more similar to them than we would predict" (*ibid*, p. 429). McPherson et al. goes on to argue that the most basic source of homophily is space and that we are more likely to have contact with those who are closer to us in geographical location than those who are distant.

This is of particular relevance in Ireland, which is characterised by high levels of baseline homophily given the geographic isolation and the domination of Irish nationals in the boards of the Irish banks and more generally the Irish property market. This is highlighted by Kelly (2010): "I cannot remember a single instance during the twenty years in the business when I encountered a foreign investor in the Irish property market. We built it ourselves, and the collapse was because of us" (*ibid*, p. 202).

Further, Marsden (1987) highlighted that personal networks were highly homophilous on education. Again this has specific relevance for boards of directors which tend to be dominated by those with secondary educations, with a strong emphasis on business. Ireland is characterised by a few large

Universities, University College Dublin (UCD) and Trinity College, so that many of the board members have shared the same education (Clancy et al., 2010).

Yetiv (2003) measured homogeneity by emphasising friendship and shared experiences within the Bush inner circle. He noted that Bush had been friends with and played tennis doubles with a member of his inner group, and that the members of the group had all had the shared experiences of being parliamentarians together. O'Connor (2002) noted that the board members of Enron had similar social educational and career backgrounds and were members of the power elite in the US.

Evidence

Ireland is a relatively small geographically isolated island with a population of around six million. Therefore, it would not be unexpected to find high levels of homogeneity and director overlaps in the boards of Irish companies. Mac Canna et al. (1998) reviewed the networks of interlocking directors of the top 250 Irish companies with a view to comparing these findings with a previous comparative study of ten countries undertaken by Stokman and Wasseur in 1976. Data gathered by Mac Canna et al. of the network of Irish companies in 1994 was compared to data gathered by Stokman and Wasseur in 1976. The comparison revealed that overall the Irish boards were found to have looser connected network structures which were sparser and less dense than those of the countries tested by Stokman and Wasseur. These results, at first glance, contradict the expectation that the Irish board network would be denser and more interconnected.

Mac Canna et al. (1988) however recognised that these results were significantly affected by the sample of companies selected and that a disproportionate number of the companies selected were Irish subsidiaries of foreign multinationals with no independent boards. Further, an additional sizeable tranche of the 250 companies selected consisted of family and private companies and are less likely to have high levels of board linkages. Mac Cann

et al. concluded that intense linkage *did* exist in “relatively large indigenous significant plcs. This fact, along with scarcity and peripherality of women in the Irish network, leads to the conclusion that, within the relative limitations and constraints of Irish business, the ‘old boys’ club flourishes where it can” (*ibid*, p. 375).

O’Higgins (2002) interviewed twenty six NEDs and chairmen of Irish listed companies. This included board members of eight of the ten largest quoted companies which included AIB, BKIR and Anglo. O’Higgins noted that a number of interviewees asserted that NEDs should be “acceptable” within the boardroom culture and included quotes from interviewees: ‘You pick people with a similar value system, philosophy, attitude towards economic behaviour and compatibility’; ‘congenial, clubbable’; ‘the old school’; ‘the old boys’ network, in a way” (*ibid*, p. 24).

O’Higgins (2002) concluded that there were high levels of homogeneity and a lack of diversity amongst the NEDs interviewed: “The homogeneity among the study participants is striking, in terms of their occupational backgrounds and their way of thinking. This again strengthens the notion that a lack of diversity exists in Irish boardrooms. This situation is reinforced by the fact that the Irish subsidiaries of foreign multinationals, arguably the most dynamic sector in the country, tend not to be interlinked into the mainstream of indigenous companies’ networks though non-executive directors interlocks” (*ibid*, p. 28).

Clancy et al. (2010) undertook a study of the directors of twenty six private and fourteen state owned bodies between 2005-2007 identified by the researchers as being important to the Irish economy. The list included four of the Irish banks; AIB, BKIR, Anglo and IL&P. The report concluded that there was a significant lack of diversity among members of the director network which they studied, and highlighted the gender imbalance with only one in nine directors being a woman. They concluded that: “Severe gender imbalance and similarities in world views and experiences may lead to persistent ‘groupthink’;

that is decision-making that ignores alternative evidence as a result of a group's desire to reach consensus. One major contributing factor to this is where the group members all come from similar backgrounds" (*ibid*, p. iv).

Clancy et al. recognise that the lack of diversity of directors could be due to the relatively small population in Ireland. The study focused on a director network of thirty nine directors who were identified as holding two or more directorships within the forty identified companies. This included directors from AIB, Anglo, BKIR and IL&P. The report highlights that these directors were typically based on the south side of Dublin and that all but six of the thirty nine directors whom they studied, lived in either Dublin or its neighbouring counties. They note that many have attended private schools and detail three such schools in particular; Gonzaga, Blackrock and Belvedere¹⁵⁰. Further they note that many would have trained as either accountants or barristers and that University College Dublin "appears to be the third level institution of choice" (*ibid*, p. 24). Finally Clancy et al. highlight that many of the directors were over fifty and that the youngest director of the thirty nine whom they analysed was forty six.

In summary, Clancy et al. argue that the directors of the companies which they analysed were characterised by high levels of homogeneity and a lack of diversity which contributed towards the crisis in Ireland. The report recommends a number of governance reforms which might look to reduce homogeneity, increase diversity and to reduce what they see as economic inequality in Ireland. Reforms recommended include limiting the number of directorships that can be held simultaneously, introducing a quota system for woman directors

¹⁵⁰ The report did not provide a breakdown of the schools and Universities attended, professional qualifications or ages of the identified Director network.

and a debate on the introduction of a cap on the remuneration packages of senior management in both public and government enterprises¹⁵¹.

Focusing specifically on Anglo, its board has already been highlighted above as one characterised by long standing friendships, and shared experiences. Friendships are more likely to develop amongst those who share similar ideologies and backgrounds. Homogeneity and socio-emotional cohesiveness are often very closely linked. We are more likely to be cohesive with those who we are similar to (Heffernan, 2012; McPherson et al., 2001).

The culture at Anglo appeared to be one which encouraged homogeneity. This is reflected in an interview Fitzpatrick gave in 2001: “The whole thing here [at Anglo] was about belief – *we wanted like-minded people* to whom we could give a platform from which they could develop. If they were not capable or committed, we got rid of them” (Kenny, 2001, p. 81 italics added). Fitzpatrick further noted that: “unlike some others, we never employed people to tell us we shouldn’t lend” (Carswell, 2011 p. 16).

A review of the Anglo Board as at year end 2006 identifies the nationality, education, age and sex of the Anglo directors:

¹⁵¹ Chapter 8 of this thesis is devoted to discussing potential reforms in corporate governance.

Table 7.5: Analysis of the Anglo board education, age and nationality (2006)

Name	Nationality	Education	Age (in 2006)
Sean Fitzpatrick	Irish	University College Dublin Chartered Accountant	58
Lars Bradshaw	Irish	MBA (International Institute of Management Development) Prior education unknown	46
Michael Jacob	Irish	Fellow of the Chartered Institute of Management Accountants Education unknown	61
Pat Whelan	Irish	Member of the Institute of Bankers Education unknown	44
Tom Browne	Irish	Member of the Institute of Bankers Education unknown	44
Gary McGann	Irish	University College Dublin Fellow of the Institute of Chartered Accountants	56
David Drumm	Irish	Chartered Accountant No formal education, joined Deloitte Touch accounting firm straight from school	40
Fintan Drury	Irish	University College Dublin	48
Decal Quilligan	Irish	Trinity College	43
Willie McAteer	Irish	Chartered Accountant Education unknown	56
Patrick Wright	Irish	Fellow of the Irish Management Institute Education unknown	65
Anne Heraty	Irish	University College Dublin	46
Ned Sullivan	Irish	University College Dublin	58

Source: Anglo AFS 2006. Where the accounts have not provided details of education attempts have been made to find this through internet search engines.

The table above does highlights some homogenous tendencies in the Anglo directors:

- 1) All of the directors were Irish nationals.

- 2) Five of the thirteen directors were educated at the same University, University College Dublin.
- 3) Three of the directors were chartered accountants and two were members of the same affiliation, the Institute of Bankers.
- 4) Six of the thirteen directors were over 55 years old whilst the other seven directors were in the age bracket 40-49
- 5) All but one member of the board, Anne Heraty, were male.

These homogeneous traits identified above are not unsurprising given the linkages between board members already identified and that actors are more likely to socialise and connect with those who are similar to themselves.

Furthermore evidence from the interview process strengthened the argument highlighting homogeneity in the Anglo board. Actor B (A), Actor D (A), Actor E (A) and Actor A (A) all identified high levels of functional homogeneity among the Anglo executive directors as a factor contributing towards the poor decisions made by Anglo. Executive directors Whelan, Drumm, Quilligan, Wright, Browne and Campbell¹⁵² all came from the lending side of Anglo's business and had similar experiences relating to lending in the commercial property sector. McAteer was the only exception to this¹⁵³.

Actor D commented:

¹⁵² Tony Campbell was not an appointed executive director of Anglo but in charge of Anglo's US lending operations. However it was explained to me by White (A) that he was to all intents and purposes a board member and attended all the board meetings, but the only reason he was not nominated as a board member was due to the regulatory structure of Anglo in the US which was set up as a branch rather than a fully owned subsidiary, and for that reason it precluded official representation at the board.

¹⁵³ McAteer had an accounting background, having worked previously at PWC. However his effectiveness as an executive director is discussed in detail in research question 4.

“They [the executive board] were all commercial lenders. Put them in a field and ask them how much it would cost to develop the field, brilliant. Ask them what was going on in the financial world, what was in the financial times that day, about commercial mortgage securitisation, how treasury are managing their risk, not a clue”.

Actor E (A) noted that Drumm had surrounded himself with fellow lenders and that he *“had a cabana around him, he had put these people Campbell, Quilligan and Whelan and their idea of banking was just lending money”*. These comments highlight the homogeneity of the functional backgrounds of the Anglo executives but are also relevant to the discussion relating to a lack of functional skill level of the directors and are discussed again later in this chapter.

Actor I (C) highlighted her perception of the homogeneity of the Anglo executives when she commented:

“I was on the board of a charity, and we were looking for support from Anglo and I met some of them. It was the management team. I was really struck by how they all seem to be cut-outs of the CEO. They all looked like Drumm, they talked like Drumm, they dressed like Drumm, it was remarkable.”

Actor H1 (C) observed that Fitzpatrick was attracted to appointing self-made business people as NEDs to the Anglo board and that this was very much in keeping with how he saw himself, as someone who had taken over a small bank and had transformed it into the fourth largest company in Ireland. Specifically Actor H noted that three of the Anglo NEDs; Heraty, Drury and McGann were all “self-made” and had developed large and successful businesses from scratch. He noted that Fitzpatrick would have been very resistant in his view to appoint what he termed a “West of England” board member. What he meant by that is someone who had a strong English/British heritage coming from a privileged background but wanted to appoint directors who were similar in make-up to how Fitzpatrick saw himself. This observation,

relating to the homophilic desire to surround oneself with individuals who are similar to yourself is well recognised in the literature (McPherson et al., 2001) and is another potential indicator reflecting homogeneity within the Anglo board.

In summary there is a tendency towards homophily in boards in general and this pull is exacerbated given the specific Irish contextual circumstances highlighted above. Further, a review of the Anglo board revealed a board where all the members were Irish, with strong educational similarities, strong friendships particularly amongst the NEDs, and almost no functional diversity amongst the executive board.

Research question 2f)

The board of Anglo was characterised by high levels of stress from an external threat.

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

Janis's rationale for this antecedent being that the threat from an external source threatens the existence of the cohesive in-group and can create an "us versus them" mentality. The group then becomes even more cohesive and the importance of the maintenance of the group above all else exacerbated. Janis (1972) identified a situation where the group was being threatened by losses from an external source and believed that there was no hope of finding a better solution to the problem than the one favoured by the leader (*ibid*, p. 250).

Janis (1972) did however recognise that stress from an external or internal source was neither a necessary nor a sufficient condition for groupthink. Indeed, Janis cites examples when stress led to a decrease in cohesiveness and an increase in the group's problem solving abilities. In this antecedent, Janis

focuses on the specific circumstances when the levels of stress leads group members to become more dependent on the group itself for social support. Stress in this situation will then lead to greater levels of socio-emotional cohesion and a greater desire to maintain the positive feeling in the group above all else. Groupthink therefore becomes a form of “defensive mode” (O’Connor, 2002, p. 1268) for coping with the stressful situation

Evidence

The board of Anglo was put under considerable stress with the onset of the crisis in 2007 and in particular the deterioration in wholesale funding associated with the sub-prime crisis. This liquidity freeze was the catalyst for the dramatic deleverage in the financial system and the bursting of the Irish property boom. The Anglo board was faced with the constant pressure of securing sufficient wholesale funds to fund its operations. Further, this situation was exacerbated by the large synthetic share position that a speculative and distressed investor, Quinn, had taken in Anglo’s shares which he became unable to honour.

Two notable ethical indiscretions occurred during this time. The first of these related to the back to back funding arrangement with IL&P which artificially boosted Anglo’s year end funding disclosures so that it looked to outside investors that Anglo was in a more comfortable funding position than it really was. The second ethical indiscretion was the arrangement to assist ten of Anglo’s customers to purchase Quinn’s shares in Anglo. The board of Anglo contravened the rules set out in the Companies Act by providing financial assistance to these shareholders to allow them to purchase these shares¹⁵⁴.

¹⁵⁴ Two of Anglo’s directors , Pat Whelan and Willie McAteer have been found guilty in the Irish courts of providing financial assistance for the purchase of such shares and in effect artificially increasing the price of Anglo’s shares.

Both of these decision processes were made under severe external pressure where the future of Anglo was under threat.

The focus of this research, however, is on the period in the lead up to the crisis before the beginning of the financial crisis. During the period from early 2000s to mid-2007, confidence was high, property prices continued to rise, and liquidity was readily available. It was during this time frame that the Irish banks collectively over-invested in property as an asset class.

The research questions which are to be explored set out in this thesis focuses on this specific period and whether the decision process of the Anglo board to invest in property was affected by groupthink, and that the other Irish banks emulated Anglo's lead. The ethical indiscretion related to decisions made by the Anglo board once the financial crisis had begun, as described above, may well be examples of decision process affected by groupthink but are not the focus of this research¹⁵⁵.

In the period before the start of the crisis there was an identifiable external threat to Anglo in the form of the competitive pressures from both domestic and UK based banks looking to make inroads into Anglo's market share, and to emulate its perceived growth in share price performance. One of the research questions discussed later in this chapter is that competition from Anglo affected the behaviour and performance of the other domestic Irish banks.

¹⁵⁵ The Anglo board in the period after the financial crisis had started was, in effect, the same board that governed Anglo during the crisis with all of the same characteristics. Therefore, it follows that a board which had groupthink tendencies before the start of the crisis is most likely going to suffer from the same tendencies after the crisis had begun, particularly faced with the additional stress associated with the specific external threat which the financial crisis posed to the very existence of Anglo and the board itself. However, this research is focused on the period before the onset of the crisis and in particular the systemic risk that groupthink can potentially have across an industry in times of speculative bubbles.

The threat of competition also affected Anglo. Anglo's business model was very much built on the strength of its client relationships, and Anglo looked to differentiate itself from its competitors not on the basis of price, but by being able to make quick and favourable decisions on loans¹⁵⁶.

This point is illustrated by Kelly (2010), who was a property developer and a client of Anglo's. Kelly describes the competitive pressure on Anglo to maintain clients by agreeing to lend in the fear that if Anglo refused other banks would: "There was a lot of competition from banks to lend money to the big developers on the big deals, and I think Anglo's biggest fear was that they would lose clients and deals to the other banks who charged less. Anglo had always charged more for their money, but they won and kept clients by lending this money more easily than their competitors. As developers, we talked about the 'Anglo premium' all the time, and some chose to go elsewhere for lower interest rates and fees, but not many and certainly not us. We valued Anglo's flexibility and didn't mind paying for it. The Anglo premium was easily outweighed by the benefit of being able to do more deals" (*ibid*, p.36). Anglo was initially more expensive but whilst the developers were making money in a rising market Anglo provided freer access to credit and this was one of the cornerstones on which Anglo built their business model.

Anglo's concern with maintaining its core relationship meant that they were very reluctant not to lend to their relationship clients for fear that they would go elsewhere. Lending decisions were nearly always favourable to the lender. As Kelly (2010) noted "Once numbers on the deal stacked up, Anglo was there – and sometimes Anglo was there even if the numbers didn't stack up" (*ibid*, p. 37).

¹⁵⁶ At a debt investor meeting which I attended, Fitzpatrick boasted that decisions on loan approvals were made with a 24 hour turnaround.

Anglo's desire to maintain its competitive position in light of the increased competition inevitably led to a reduction in the margins that Anglo could charge. This is highlighted by Nyberg (2011) when he noted that "as competition increased in Anglo's core lending markets, margins declined and greater risks were taken to retain customers. This is evidenced by material changes made to Credit Policy in 2005, 2006 and 2007 which relaxed key elements of lending criteria" (*ibid*, p.31).

There is evidence to support a culture at Anglo of an "us versus them" mentality at Anglo. Fitzpatrick noted in an interview in 2005 that the difference between Anglo and its competitors was "a collegiate spirit, hard work, self-belief and a fair dollop of '*us against the world*'" (italics added) (Brian, n.d.). Actor Q (S) noted that Anglo "had the kind of attitude we are the runt of the litter and we are going to take on AIB and BKIR and eat their lunch, that was their culture". Actor P (S) noted that: "There was a huge culture of insularity. As in we are Anglo and everyone hates us." Actor N (S) further described Anglo as "the sharp elbowed, ugly kid" comparing the culture to that of Lehman Brothers and Bear Stearns in that they were challenging the establishment.

In summary, the external threat of competition has been identified as a potential example of stress which could have been a contributing factor towards groupthink. Furthermore, interviewees have highlighted their perception of an "us versus them" attitude at Anglo related in Anglo's case to the competitive pressures, which would have exacerbated cohesiveness. As Janis highlights above, a determinant of groupthink is when such a threat increases the in-group bias and cohesion of the group.

Research question 2g)

The board of Anglo suffered from low self-esteem induced by recent failures, excessive difficulties in current decision processes and the existence of moral dilemmas.

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

Antecedent 2g) above referred to an external threat to the group. This antecedent relates to internal sources of stress identified by Janis as being evident in the case studies he examined. Janis (1982) saw the interplay between internal and external stress as a potential "either-or" scenario: "Even when the members are not particularly concerned about risks of material losses for themselves or their organizations, *so that the level of external stress is low*, they may nevertheless be subject to internal sources of stress" (*ibid*, p. 255, italics added). Janis concluded that high levels of internal stress can make the group members more dependent on the group to maintain morale and to deal collectively with stress levels in the same way that external stress can.

Evidence

There is no evidence from the literature that the board of Anglo were suffering from high levels of internal stress related to low esteem in the build-up to the financial crisis. In the decision processes related to the back to back funding arrangement with ILP and the financial assistance provided to boost the Anglo share price, then it is possible that Anglo directors were suffering from low self-esteem and recent failures related to the constant pressure that the bank was under. However, as discussed previously these potential examples of decision processes affected by groupthink are outside the remit of this thesis. In the period before the crisis broke there is evidence, which will be presented when discussing the symptoms of groupthink, that the board was highly confident and characterised by high levels of self-efficacy¹⁵⁷.

Hart (1994) and Whyte (1998) both present an alternative route to groupthink which does not rely on low self-esteem and stress but rather focuses on a form of collective optimism as an antecedent for groupthink. In this version of groupthink, group members see opportunities for success and as a result are strongly motivated to work together as a close team to reap the expected rewards for success. Members susceptible to this form of groupthink are characterised by high self-esteem and confidence.

Indeed, Hart (1994) highlights that this alternative, but optimistic form of groupthink, is much easier to reconcile to the symptom of groupthink identified by Janis relating to “illusions of invulnerability”. It is difficult to envisage a group

¹⁵⁷ The observation with respect to high confidence levels of Anglo board will be explored with respect to the symptoms of groupthink, specifically the research question related to the illusions of invulnerability.

that is characterised by low self-esteem induced by recent failures also as having as a symptom of groupthink the illusions of invulnerability.

In summary Janis has presented antecedents related to both internal and external levels of stress, which have been discussed above with respect to proposition 2f) and 2g) . There is some evidence pointing to high levels of external stress relating to the competitive environment in which Anglo was operating. There is no initial evidence of high levels of internal stress relating to low self-esteem. Janis did highlight that stress could be from either internal or external sources and that it is the reaction of the group to the stress that is important. Janis argues that a group can react to stress (whether it is external or internal) by becoming closer and more bonded and therefore more susceptible to groupthink. Further, other academics have presented an alternative version to Janis's antecedent related to low levels of self-esteem which is related to high levels of optimism which are explored later in this paragraph. Given this, the absence of evidence relating to this research question does not, it is submitted, detract from the possibilities that the Anglo board suffered from groupthink.

Antecedents and Symptoms of groupthink

Research questions 2a)-g) examined Janis' seven antecedents of groupthink. High levels of socio-emotional cohesiveness are a necessary antecedent for Janis' groupthink construct. It is submitted that there was strong evidence from a broad range of sources which would support this necessary antecedent. Further, there is a strong linkage between socio-emotional cohesiveness and homogeneity and the analysis highlighted high levels of homogeneity which further re-enforces this necessary pre-requisite. Further support was found in the analysis for the antecedents related to directive leadership, lack of norms and high stress through the threat of competition. There was no support for the antecedent related to the insulation of the group from outside experts. However,

access to outside experts can be a countenance to groupthink only if such outside experts provide a contrary opinion which acts as a challenge to a board's decision process. However, as highlighted above, this may not be the case if there is a process of circular learning occurring relating to an information cascade. Finally, the lack of evidence related to the existence of low self-esteem related to a recent failure is discussed above in relation to different interpretations of groupthink and, it is submitted, is not critical to the development of the construct itself. Indeed Janis (1972 p. 245) did highlight that not all the antecedents of groupthink need to be present.

The observation of antecedents related to groupthink only tell a partial story. As Janis (1972) noted: "The first step in developing a theory about the consequences of groupthink is to anchor the concept of groupthink in observables by describing the symptoms to which it refers" (*ibid*, p. 174). Proposition 2h) - 2o) analyse all eight of Janis' identified symptoms of groupthink. After these research questions are reviewed, it will allow me to make a much more rigorous assessment on the groupthink construct given the examination of *both* the antecedents and symptoms of groupthink. What follows below is an analysis of the symptoms of groupthink.

Research question 2h)

The board of Anglo was characterised by illusions of invulnerability.

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability ¹⁵⁸	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

Janis noted that illusions of invulnerability can be manifested in expressing overoptimistic views about the group's power and by ignoring warnings that call attention to the dangers of continuing a set course of action (Janis, 1972, p. 220). Janis highlighted the thought that "nothing can stop us" and the concept of group members believing that they belong to a "super group" as being indicative of this symptom (*ibid*, p. 36). Janis further stresses the role of the leader in creating an environment in which this sense of confidence pervades the group.

¹⁵⁸ I have interpreted Janis's symptom of the "illusion" of invulnerability to refer to the symptom of extreme confidence. This interpretation is consistent with how all other academics have understood this terminology.

Janis argued that the confidence and euphoria associated with belonging to an invincible group would create an even greater sense of socio-emotional cohesiveness amongst group members.

Scharff (2005) referred to the strong stock price performance of WorldCom and the awards and favourable press which the organisation had received as indicative of the existence of the illusion of invulnerability within the WorldCom board. O'Connor (2002) also highlighted past successes at Enron as a contributing factor towards creating the illusion of invulnerability.

Evidence

When Anglo was first listed on the Irish stock exchange in 1987 it was valued at a market capitalisation of £1.6 million, whilst at its peak twenty years later, its market capitalisation was €17.53 billion, making it Ireland's fourth largest company. Anglo experienced an 80% increase in its share value during the height of the property boom in Ireland covering the two years 2005-2007. Anglo significantly outperformed both AIB and BKIR in terms of profitability and share price performance, particularly in the years leading up to the crisis (Nyberg, 2011).

Anglo had also received a number of awards including being rated as best bank globally by Mercer Oliver and Wyman in 2007. In 2003, a Sunday newspaper in Ireland ran a poll of analysts asking who was the best CEO in Ireland, Fitzpatrick accounted for 71% of the vote (Lyons and Carey, 2011).

There are a number of comments in the literature which highlight the extreme confidence at Anglo. Carswell (2011) quotes an unnamed former employee of Anglo who commented that: "It was thought that Anglo had found a new way of doing banking ... it was like an Apple computers [sic] or Microsoft in software" (p. 56). Ross (2010) further quotes from an unnamed executive at Anglo: "As the business grew, so did Sean's [Fitzpatrick] ego. He began to think he could walk on water" (*ibid*, p. 52). Carswell (2011) quotes an unnamed senior Anglo

executive as saying: “There was an arrogance in Anglo – we thought we were masters of the universe” (*ibid*, p. 122).

Fitzpatrick has made a number of quotes that highlight the belief and confidence as to the Anglo business model. A selection of his comments being:

- “I was determined this was not going to be another bank. We were going to be a different bank, with a different culture and a different way of doing business.” (Kenny, 2001, p. 81)
- “They [the employees of Anglo] are able to spend their money, send their kids to the best schools, live in nice houses, buy big cars. They are held up as role models because it is possible for younger people to achieve that.” (Carswell, 2011, p. 67)
- “We had ideas and we had balls ... as we worked the scene and maximised the moment, the world watched with astonishment. That is no exaggeration.” (O’Toole, 2009, p. 169)

A further illustration in support of this proposition can be seen once the crisis had started. In September 2008, just three months before Anglo was to be nationalised, Fitzpatrick, Bradshaw, Drumm and Whelan all bought additional shares in Anglo (Carswell, 2011; Lyons and Carey, 2011). September 2008 was the height of the global financial crisis (this was the month when Lehman Brothers went into liquidation and AIG needed to be rescued by the US government and Lloyds rescued HBOS in the UK). The decision by the directors of Anglo to invest in Anglo shares at this point in time could be seen as a signal of the illusions of invulnerability of the Anglo directors.

There was a strong sense from the interviewees that backed up the assertion relating to Anglo’s illusions of invulnerability. This was evidenced from both interview comments from those who worked within Anglo and also those who interacted with Anglo as service providers or competitors.

A summary of relevant interview comments being:

Comment from Anglo Insiders	
Actor A (A):	<i>"There was a sense that we couldn't get things wrong". In theory they [the Anglo board] believed in the end they were infallible."</i>
Actor D (A):	<i>"As Anglo grew, the confidence and the swagger grew, so that if we walked into AIB if we were part of syndication we would not be hiding behind a bushel anymore. We were actually saying: 'look lads we are a senior partner in this, 'F' off AIB, you might have been able to tell us what to do 10 years ago'."</i>
Actor B (A):	<i>"It was the way the phone was answered, there was this belief we what we were trying to do was unique, it was just better than our competitors ... we believed that our model was better, our approach was better, the way we did business, the way we underwrote credit, the way we interacted with customers, the way we knew our customers inside out, by virtue of the fact that we had sight of customer cash flows, the value of their securities, their personal guarantees. These guys had known and grown up with us. We didn't just inherent these customers overnight, we had grown up over twenty years. There was a real belief that our strategy was completely different to the others."</i>
Comments from Anglo outsiders	
Actor O (S):	<i>"They thought they were doing the right thing, they were winning market share, people were trying to replicate them, they were gods, they were told they were great in the newspapers every time and every day every week, all the awards, best CEO, best investor relations, best CFO, company of the year."</i>

Actor Q (S):	<i>"It was an extremely confident culture [Anglo]; they were masters of the universe."</i>
Simon Carswell:	<i>"He [Fitzpatrick] was a very forceful individual he had no doubt about himself or his model. He had been around for so long and been in charge for so long that it gave him this sense that the bank was invincible and that compounded their problems when the crisis hit."</i>
Actor G (C)	<i>"So there was a kind of a bit of a flash harry, a seat of the pants, all the rest of you are fuddy duddys, we are quick we are on our feet, we are sharp."</i>
Actor H (C)	<i>"Anglo thought they were 'masters of the Universe' and were 'cocky;". Actor H also highlighted that Fitzpatrick was "flashy" commenting on his haircut (long hair) and dress sense (his style of suit and diamond cufflinks) and that this was an outward reflection of his confidence.</i>
Actor F (C)	<i>"There was an arrogant invincibility about a lot of people in Anglo. It came with the enormous success, with the growth of the balance sheet, it looked like they could do no wrong."</i>
Actor N (S)	<i>"They had a real self-belief in what they were doing, they were evangelical I would say in the belief of their business model."</i>
Richard Curran:	<i>"There was a feeling of invincibility and a feeling that we [Anglo] can do no wrong. We have found a new way of doing this and it works"</i> <i>(Lynch, Adrian, 2010).</i>

Finally, Actor G (C) noted a story about a social interaction which she had with Fitzpatrick in which a story about an ethical indiscretion relating to Lord Browne

(who had been the CEO of BP) was discussed. Actor G noted that Fitzpatrick was strongly of the view that in time Browne would be able to resume his business career and that the indiscretion would be soon forgotten. Actor G interpreted this stance as being reflective of Fitzpatrick's own views on himself, and noted that she:

“found it a very interesting revelation on his part because he thought that even if he [Fitzpatrick] got caught [contravening governance procedures], he could resuscitate himself afterwards, and as it turned out, it did not happen to him.”

If Actor G is correct in her interpretation then this view can be seen as a further demonstration of Fitzpatrick's belief in his sense of invulnerability and that he could recover from any set back.

In summary, there is significant evidence which would point towards high levels of confidence and illusions of invulnerability amongst the directors of Anglo. Anglo had an extremely strong track record of growth and exceptional share price performance in the years preceding the onset of the crisis. The company and its leader had been recognised externally for their successes. Fitzpatrick had made a number of comments that reflected his strong belief in the group and what they had achieved. The decision by the directors to invest in Anglo shares just three months before Anglo was nationalised reflects a board that must have had a very strong belief in the group itself. Finally, the interview process identified further strong support for this proposition from a number of actors as highlighted above.

Research question 2i)

There was a strong belief in the inherent morality of the Anglo board.

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

Janis groups together the symptoms of groupthink related to a) the illusions of invulnerability and b) the belief in the inherent morality of the group, under the same heading "overestimation of the group". Janis (1972) identified group member's inherent belief in the morality of the group, and the principle that the group was "good and wise", as a means of allowing the group to minimise decision conflicts between ethical values and expediency (*ibid*, p. 256). If there was a core belief in the inherent morality of the group this would allow the group to get comfortable with the ethical stance of any policy under discussion.

The concept that actors tend to overestimate their own abilities and the impact which they have had on positive outcomes is well recognised in the literature (Kahneman, 2011; Thaler, 2012). Such over-optimism and belief can lead to a "can do" mentality and in groups can increase the socio-emotional

cohesiveness of a group. This strong in-group cohesiveness increases members' desires to maintain the good atmosphere in the group above everything else leading as it can to groupthink.

This specific symptom which focuses on the inherent morality of the group is perhaps more relevant in the context of the political group settings which Janis analysed. All of Janis's case studies involved decision processes which had broad ideological and moral ramifications. For example, the support given to attempt the overthrow of the Castro administration, or the North Korea conflict, are decisions where ideologies and morality would have been right at the heart of the decision process. These types of decision processes are different to a pure business decision such as the choice as to whether to invest in property as an asset class. In a business scenario it is submitted that such a belief in the morality of the board will be less pervasive.

Both Scharff (2005) and Eaton (Eaton, 2001) do not specifically deal with the symptom related to the inherent morality of the group in their research, but rather group this together with the symptom related to the illusions of invulnerability and discuss in broad terms any evidence which highlights an overestimation of the group itself. O'Connor (2002), in contrast, reviewed and evidenced a belief in the inherent morality of the Enron board by referencing a comment by the then CEO Skilling noting that "We're the good guys" and "We're on the side of the angels" (*ibid*, p. 1274-5) and that board members of Enron were strong proponents of deregulation and the belief in the self-regulating abilities of the market. Deregulation underpins a philosophy that business can effectively self-regulate and such self-regulation implies an inherent belief in the morality, or self-righteousness, of the leaders of such boards. Further O'Connor (2002) notes that the American culture of the time portrayed Enron management as "modern day heroes" (*ibid*, p. 1276) and that such leaders were given iconic status as part of the elite corporate royalty (*ibid*, p. 1277).

Evidence

Fitzpatrick was, in common with the Enron board, a strong advocate of deregulation. Fitzpatrick noted: "Having developed this marvellous entrepreneurial culture, which is delivering so many benefits in terms of employment and wealth to the country, we must ask ourselves if there is now a danger that our regulatory environment has gone too far. Are we starting to shackle, instead of encouraging, the entrepreneurs who in turn generate more wealth, not just for themselves but for the country as a whole" (Cooper, 2009, p. 208). This statement by Fitzpatrick and in particular the comment that the entrepreneurial culture, of which he was clearly a part, had "*delivered so many benefits in terms of wealth and employment to the country*" does point towards an inherent belief in the morality and usefulness of his industry.

Another example which might highlight Fitzpatrick's belief in the inherent morality of Anglo's business can be seen in the comments he made in a radio interview following the Irish government decision to guarantee all the liabilities of the Irish banks (including Anglo Irish) in September 2008. When asked by the interviewers whether Fitzpatrick was sorry and wanted to apologies for the need for the Irish government to support Anglo, he replied; "It would be easy for me to say sorry. The cause of our problems was global so I can't say with any degree of sincerity and decency but I do say thank you" (Cooper, 2009, p. 210). Fitzpatrick's interpretation of the events as being of a global nature and not as a result of poor decisions made by Anglo itself could be seen as another example of his belief in his and Anglo's morality.

Fitzpatrick's reaction when it was disclosed that he had been warehousing his loans with INBS so that they would not be disclosed in the Anglo accounts, provides further evidence which suggests that Fitzpatrick believed in the inherent morality of his actions. He noted that the arrangement "appeared to be the best and simplest way of dealing with the [accounting] problem so as to not

give an exaggerated figure of my indebtedness” (Lyons and Carey, 2011, p. 81). Further, in his resignation statement when the extent of his loans was discovered, Fitzpatrick noted that: “The transfer of the loans between banks did not in any way breach banking or legal regulations¹⁵⁹”. Once again this comment may be seen as reflecting Fitzpatrick’s belief that his actions were justified implying a sense of morality on his behalf.

Finally, the interview process with those that had worked at Anglo highlighted a belief within Anglo that they had a unique and different business model and that they were better than their competitors. Actor B (A) noted that:

“We believed our model was better, our approach was better ... I am not beating my own trumpet but we were told by people that we were way ahead of our competitors, way ahead of our competitors [comment repeated by interviewee], we punched way above our weight.”

Actor A (A) observed that *“we were always getting things right”*. Actor D (A) noted that *“we became the place to go to for staff at the other banks, people wanted to work at Anglo”*. These statements appear to indicate a sense of confidence, invincibility and arguably a sense of inherent morality as well which pervaded the culture at Anglo.

In summary there is evidence that Fitzpatrick, as leader of the Anglo board, believed in the inherent morality of the board and his own actions. Further the awards that Anglo and Fitzpatrick had received in the lead up to the crisis might have added to the perception within the Anglo board that they were part of corporate elite in Ireland, working for the good of the people and the country with a sense of morality. This strong sense of confidence associated with a

¹⁵⁹ Refer to <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/3850245/Anglo-Irish-chairman-Sean-FitzPatrick-resigns-over-inappropriate-loan.html> for Fitzpatrick’s statement.

sense of inherent morality was mirrored by the comments with Anglo interviewees as noted above.

Research question 2j)

The board of Anglo suffered from collective rationalisation in explaining away potential warning signals that would suggest the need for a change in strategy.

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

O'Connor (2002) explains this symptom as groups demonstrating a mind-set of "hear no evil, see no evil, speak no evil" and that groups interpret negative data in a way that supports the maintenance of the status quo (*ibid*, p. 1278). Group members go through a process of cognitive dissonance and self-persuasion to persuade them that the policies which they have adopted are sound. The group interpret negative data in a way that supports the maintenance of previously

agreed policies and actually increases the level of commitment to the agreed strategy.

Langevoort (2000) highlights that there is a natural pull in boardrooms towards a process of self-rationalisation, particularly in the case of an NED. He argues that NEDs place trust and their reputational capital in the executive board and the CEO when deciding to accept a board role. If NEDs are then faced with a situation when this trust might be misplaced, they undergo a process of cognitive dissonance and persuade themselves that they were correct to place their trust in the executive board in the first place. Langevoort explains that this desire for self-rationalisation is greater when a director is placed in a position of having to question the judgement or integrity of a friend on the board.

Evidence

Anglo's business strategy was very much based on the bank's close relationship with leading property developers. As the market for lending got more competitive, Anglo felt pressurised to continue to lend to their customers believing if they did not provide the funds, their competitors would go elsewhere (Kelly, 2010; Nyberg, 2011). Thus, the board of Anglo could have used the threat of losing their relationship clients as a form of self-rationalisation for why they continued on their aggressive lending strategy. This appears to be implied from this statement by Anglo's CEO Drumm: "One thing that goes around and around in my mind is that we made a decision in 2004 to reduce our land and development exposures, particularly in Ireland, because at that time we saw intense competition coming in from other banks, we saw land prices going up at a ridiculous rate and we made a conscious decision to pull back from it. We failed to execute on our own plans, and we never pulled back. That was because of the strength of the relationship, we just had very strong, long standing relationships with our borrowers and we couldn't stand back from them" (Carswell, 2011, p. 71). This statement could be interpreted as implying

that it was the strength of Anglo's longstanding relationships with existing customers that justified or self-rationalised their decision to continue to lend.

Another potential interpretation of a process of self-rationalisation is a comment made by Fitzpatrick when defending his actions in the lead up to the crisis: "I had a duty. To whom? Investors. What was it? It was to make money. How do we make more money? We made it doing what we did. We were admired for doing that and doing it well" (Lyons and Carey, 2011, p. 264). In this statement Fitzpatrick appears to be rationalising the decisions to take the risks that Anglo did on the basis that it was in the best interests of shareholders to pursue such strategies. Further the comment that Anglo was "admired for doing that and for doing that well" refers back to both the symptoms of the illusion of invulnerability and the belief in the inherent morality of the group highlighted previously.

Actor N (S) indicated that at investor roadshows he attended representatives of Anglo used to:

"point out that Irish people did not have credit card debt, they were not short term borrowers on an unsecured basis to go out and buy consumer goods, they were more thrifty prudent, they bought property and, therefore, overall they were not more indebted on the rest of the world they spend it on different things, they spent it on property".

Again this could possibly be interpreted as a form of self-rationalisation based on the importance that was placed in Irish society with regard to property ownership.

In summary, as Langevoort (2000) observes there is a natural pull towards self-rationalisation in the boardroom context which is exacerbated in situations when boardroom friendships exists (as was the case at Anglo). Further, there is some initial evidence that the directors of Anglo rationalised their decision to invest heavily in property on the basis that not doing so would mean that they would jeopardise the relationships they had with their client base. The decision to

invest appears also to have been justified on the basis that it was “the duty” of the board to take such risks and make money for shareholders. Finally, as highlighted above, high levels of debt financing were justified on the basis that debt was being used to finance property and that property was an extremely valuable and important asset class.

Research question 2k)

The Anglo board negatively stereotyped both outsiders that threatened Anglo as well as insiders that did not conform to group consensus.

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

Janis (1972) argued that members of a concurrence seeking group vulnerable to groupthink tendencies, tended to view any out-group who they were up against as “weak and stupid” and that such “wishful beliefs” dominate their thinking until an unequivocal defeat proves otherwise (*ibid*, p. 37). Raymond (1978) cited by Scharff (2005) noted that organisations suffering from groupthink viewed out-groups as “generally incompetent, and incapable of countering effectively any action by the group, no matter how risky the decision or how high the odds are against the plan of action succeeding” (*ibid*, p. 46). O'Connor (2002) highlighted that Enron board members conveyed an attitude of

“we are smarter than you” when dealing with equity analysts and got offended by certain questions.

This stereotyping can also occur internally within the group itself with respect to group members who do not go along with consensus. Within a cohesive group, a value system of “you are either with us or against us” can develop and those internally who oppose the in-group can become outcasts and excluded from the group itself. O’Connor (2002) noted that within Enron employees who did not conform were quickly dismissed, quoting an Enron employee as saying: “You either got with the system or you were out of the door” (*ibid*, p. 1285).

Finally, competition between in group and out group members has been shown to be an important factor which can contribute towards such negative stereotyping and intergroup discrimination. Competition has been shown to exacerbate the distinctiveness of one’s membership in a group so that in-group bias becomes more pronounced (Cox and Munsinger, 1985; Sherif et al., 1961).

Evidence

Competition has been highlighted above as exacerbating in-out group biases and intergroup discrimination. The Irish banking environment was characterised by extreme levels of inter-bank competition (Honohan, 2010; Nyberg, 2011; Regling and Watson, 2010). This competition might have exacerbated the in-out group biases with respect to Anglo.

Indeed, Carswell (2011) highlights that the Irish stockbroker Davy had a number of private clients for which it had arranged property investments, and turned down a number of property investments which were subsequently taken up by Anglo. A row developed between Davy and Anglo, with Davy personnel questioning the sustainability of the Anglo business model. Carswell quotes an unnamed senior executive of Anglo when commenting about this disagreement: “There was a sense that we felt these people [Davy] didn’t know what they were

talking about because we believed our own press” (*ibid*, p. 122). The comment that “these people did not know what they were talking about” implies a stereotyping of outgroups.

Comments by Fitzpatrick also highlight potential external and internal out-group stereotyping. Fitzpatrick noted that if employees “were not capable or committed, we got rid of them” (Kenny, 2001, p. 81). Moreover in relation to external out-group stereotyping Fitzpatrick noted; “Sometimes I am asked why I don’t talk about my competitors. My response is ‘What do I want to talk about them for’” (*ibid*, p. 84).

Another potential illustration of the isolation of contrarian views related to the stereotyping of out-groups relates to comments made by a former NED of Anglo, Anton Stanzel. Stanzel was a NED at Anglo from April 2001 to January 2005 and was the only non-Irish national on the Anglo board¹⁶⁰. Carswell (2011) noted that Stanzel regularly warned the bank to diversify out of property lending. Carswell quotes Stanzel: “They listened but the focus was just on property because it was so successful. It is difficult to tell people that an area of lending is very, very dangerous when you have such success” (*ibid*, p. 69). Stanzel’s contrarian views may have resulted in him becoming isolated and stereotyped as a board member and may have been a factor in him leaving the board in 2005.

Actor C (A) reflected in interview a story which illustrates an example of negative stereotyping of an insider that did not conform to consensus:

“When we set up the US MTN programme [this is a legal programme which allows borrowers to issue debt into the US market] I did not appreciate the pressure that Niall was under. He was in charge of

¹⁶⁰ Stanzel’s board appointment relates to the purchase of a small private banking operation in Switzerland/Austria by Anglo in April of 2001.

setting the sectorial view of our lending and the guys did not like what it looked like and they kept on having him go back to change it but Niall was trying to do a rational for it. I remember flippantly joking about moving something from one side of development to the other, to being Greenfields to being something else, and I keep coming back to Matt Moran [Anglo CFO] and I had a lot of interaction with him, but Matt and Pat Whelan [board member] were, 'no we can't show that' we had better show it this way. So basically it was a fictitious mix, we never issued off it thank god, but the story wasn't right. Niall was given a hard time. Niall, we were saying, 'just get the figures', we want to do a deal we need to get on with things why are you prevaricating. He was considered like he wasn't top draw because he wasn't 'on the programme', at Anglo we get on with it, we do it and where he was more of an analytical person and trying to reconcile things which is the right thing he should have been doing but it wasn't given the right answer on it."

The comments by Actor C above, reflecting that his co-worker Niall was “not considered top draw” and “he wasn’t” on the programme” because he would not produce the results that Anglo management wanted, provides an example of negative stereotyping.

Carswell in interview provided another example relevant to research question with respect to the finance director Willie McAteer: “*There was one voice that spoke out more than others and that was Willie McAteer at credit committee level. They would make fun of Willie because he was older and more conservative*”. When Carswell notes that senior Anglo employees would make fun of McAteer, and the reference with respect to his age, provide examples of negative stereotyping.

Another example of negative stereotyping of an Anglo employee is the case related to ex-Anglo employee Actor E (A). During the course of my interviews four interviewees, Actor N (S), Actor B (A), Carswell and O'Connor (S),

highlighted his case as an example of an Anglo employee who was marginalised and forced out of Anglo because he challenged management.

Actor E (A) described in interview how he believed he was forced out of Anglo:

“I exited in late May 2006, but it was the end of a very nasty process where I was marginalised and I can trace that process back to late October 2005. Drumm had been in his position for about 10 months as he had taken over in January 2005.

I arranged to see David Drumm and at that meeting I said to him David believe me I have run a bank albeit a smaller one than this but I understand both sides of the balance sheet. And I said do you understand there is nobody, and I mean nobody on the board at Anglo who has any clue of what I do, there is nobody that understands market risk, there is nobody who understands gap risk, liquidity risk, operational risk in treasury. I said ‘are you not concerned about that?’ Now I would have thought that an intelligent guy with not a huge amount experience but intelligent would have said ‘Jeez [actor E], you are 10 years older than me I should be listening to you’. But instead what he did he physically came across the table from me and he almost hit me. I thought he was actually going to strike me and his first six words to me were ‘FUCK YOU, FUCK YOU, FUCK YOU’.

He said you are just talking your own book, you just want to be on the board of Anglo. And I said to him it doesn’t matter if I am on the board or not, I was on the executive board, and in fact I preferred not be on the main board, it was a matter of supreme indifference to me. But that was his response, and after that I was in the naughty corner with the dunce’s hat on. It was very subtle but it was obvious and I then always knew I was in the departure lounge after that.

I was circulated with the notes of credit committee and I used to really read it through to look what was happening but I noticed in the last 6 months that stopped and I was not getting the notes. And I would ask for it, and get it but then it would stop again and that might have been part of the process of softening me up for departure. To keep me a little in the dark as to what was happening on the credit side.”

In this exchange, Actor E highlights how he was seen as “being in the naughty corner with a dunce’s hat on” and that he was denied access to notes of minutes provides another example of negative stereotyping and isolation of a contrarian. Further, it also provides an example of the way in which Anglo management treated dissent, which is discussed fully in relation to research question 3n) below.

This exchange reflects Actor E’s subjective view in relation to his departure from Anglo. However, there is further evidence which is supportive of his claims. Actor B (A) highlighted that Actor E was seen as an outsider that had a different perspective on the bank that was not welcomed:

“I think Actor E was perhaps regarded with some suspicion by some of our senior executives at Anglo, particularly guys those that had been there for a long period of time. Brian was more an investment banker, treasurer type a different animal altogether than a lender than had grown up through the ranks in Anglo.”

Actor N (S) noted that Actor E:

“did not last very long because I think he did not get into the culture you had to get in and fit the Anglo way, whatever that was, and from the outside I am not saying that I knew but you had to be on message.”

Actor P (S) noted that;

“Actor E (A) was very badly dealt with by Anglo. Tom [Browne, an executive director at Anglo] would have expressed regrets to me. Drumm and Moran, were involved in that. I think there was an article where Moran spoke about them in public. It was nasty and Tom thought he was very badly shafted at the time as did Tony Campbell [shadow board member], but none of them did anything about it at the time.”

Actor P (S) above is referring to comments in an article which appeared in *The Irish Independent* following Actor E’s departure. The article ascribes quotes to an Anglo spokesman but not specifically to either Drumm or Moran as actor P (S) alludes to above. Indeed, Actor E (A) in interview told me that he believed that Drumm had been responsible for the quotes detailed below. However, there is no way of verifying who made the comments. The newspaper comments are nevertheless relevant to the research question and are quoted below:

“[An Anglo] spokesman described the parting of the ways as ‘something of a cultural thing’. He said that [Actor E] had joined Anglo from ‘a big bank environment and was more used to the slightly slower attitude to business in such organisations that which he found in Anglo”. The article went on to quote another unnamed source, this time from someone “close to the bank”: “ ‘For guys in the senior positions, this means a lot of pressure,’ one source close to the bank commented yesterday. ‘It’s a tough environment,’ he added, ‘a great environment to work in but that means you have to keep up with the pace.’ ” (“Treasury chief [Actor E] leaves Anglo Irish,” n.d.).

The comments in the article in relation to his departure “being a cultural thing” and “needing to keep up with the pace” are examples of how Actor E appears to have been stereotyped and because he came from a “big bank environment” did not conform to group consensus.

Professor Morgan Kelly of UCD provides a final example of negative stereotyping of an outsider to Anglo. As discussed previously Kelly had been a

contrarian in the lead up to the crisis, warning about the overvaluation of property and the likelihood of a property crash (see for example (Kelly, 2007)). Actor A (A) highlighted that:

“everyone in the bank thought that Morgan Kelly was a mad hatter and was reckless for the country and there was a lot of anger towards him”.

The reaction of Matt Moran, the CFO of Anglo towards Kelly is discussed in detail in research question 3 (n) below.

In summary, there does appear to be evidence of members of the Anglo board negatively stereotyping both outsiders to the group and also those that did not conform internally.

Research question 2l)

The members of Anglo did not actively challenge the leadership or strategy but instead self-censored themselves.

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

Janis (1972) reasoned that a member of a cohesive in-group that is under threat “feels himself to be under an injunction to avoid making penetrating criticisms that might bring on a clash with fellow members and destroy the unity of the group” (*ibid*, p. 258). By doing so members ensure that the collective strength and cohesion within the group is maintained. O'Connor (2002) refers to this as a tendency to “put up or shut up” or “go along to get along” (*ibid*, p. 1288) where members remain silent even if they disagree, or may withdraw their objections when they see that the group favour a specific decision.

In relation to Ireland specifically, Nyberg (2011) observed generally within the Irish bank boards that there was “the wish to avoid fractious or consistently contrarian behaviour” (*ibid*, p. 49). Mike Soden was the CEO of Bank of Ireland

between 2001 and 2004¹⁶¹. In 2010, Soden wrote a book about the Irish financial crisis titled *Open Dissent – An Uncompromising View of the Financial Crisis*. Soden concludes that the lack of open dissent, what he terms “silent dissent” in Irish boardrooms, was central to the crisis: “One of the main causes of the banking crisis was the culture of silent dissent in our corporations and Governments. Most people who have served on a board in any corporation or organisation in Ireland will be familiar with this disease (Soden, 2010, p. 57).”

Soden identifies the role that cohesiveness plays in the suppression of dissent: “When friends are part of an elite group it is often deemed disloyal if one professes an opinion that is contrary to accepted orthodoxies” (*ibid.*, p. 59). Finally, Soden recognises that this culture of silent dissent is not isolated to the Irish boardroom and is prevalent throughout Irish society: “whether it is in the church, the government or clubs, it is ever present in our business and social lives” (*ibid.*, p. 61).

Evidence

Actor B (A) highlighted that in his opinion it was difficult at Anglo to offer a contrarian opinion:

“Now it wasn’t an easy organisation to stand up and offer your opinion and depending on who you offered your opinion to. There were some very strong willed people in executive roles, and I am primarily thinking Sean [Fitzpatrick] and Tiernan [O’Mahoney] did not take too kindly to people having strong opinions and maybe strong opinions that were contrary to perhaps what their opinions were.”

Actor B (A) above is suggesting that self-censorship related to a desire not to clash with strong dominant board personalities.

¹⁶¹ Soden was forced to resign from Bank of Ireland when details of his private life were exposed in the press but was subsequently appointed a Director of the Irish Central Bank in 2010.

Actor E (A) noted:

“The NEDS all had shares and they were all getting 150 grand a year for doing nothing. For coming in and having a rubber stamp board meeting and getting nice fancy trips abroad. I don’t think there was any challenge. And at times certain loans were made that should not have been made and bankers who were questioning them and it was not going down too well. They would have been considered overly conservative if they challenged. There was a culture we have to get this though ... It was a culture that if you challenged you might be laughed at. They did not want to hear an outsider tell them it was risky, that things could be done differently.”

Actor E is, therefore, suggesting that another reason for the lack of challenge was that directors would not have been seen to be part of the in-group by being “overly conservative” and that it could result in negative stereotyping.

Actor P (S) suggested in interview that the NEDs did not challenge given their financial interests not to do so when he said:

“By in large, it goes back to the culture, the NEDs they certainly were not in the questioning mode, they were not picked with the view to be in the questioning mode, they were mostly picked on an old boy basis. The other NEDs, and I have come across a few of them, they were getting €50 or €100 grand a year and were being invited to rugby matches and to this that and whatever and this bank is fantastic. There definitely was no-one on the board that was asking any hard questions, even though there were a good few bright people but there was a lot of head nodding. How do you know? I know that from having conversations from Tom Browne ... There was a small clique within the board; McGann Fitzpatrick, Drury, Ned Sullivan, Lar Bradshaw those five or six that ran it. And they were Seanies men and they were getting a piece of the action

from deals that Seanie was involved in and they were borrowing money from Anglo and it was all perpetuating a bit.”

Finally Actor A (A) showed his frustration as an employee of Anglo for the lack of boardroom challenge:

“Towards the end we were screaming for them to stop lending and they were lending. Why? They just thought whinging treasury guys, we are just making money here, they are just jealous, they are telling us they can’t get the money, they can get the money and even when it became wholly inappropriate from a liquidity perspective to lend, they could not get off the crack pipe they thought it was a blip it was going to go away. There were many warning signals; there was Bear Stearns, Northern Rock, Lehman’s and even with the SIV funds in the States, we in treasury were calling out ‘there is a problem here, we have got to stop, we have got to batten down the hatches’ ... I can tell you for a fact that they did not want to listen, and because we did not have an executive director up there saying stop.”

Actor A is suggesting in this comment that the lack of challenge is related to a type of “addiction” in the culture of lending and that financial incentives allowed the director to deceive themselves that the lending model was sustainable. This process of self-deception related to high levels of self-interest is consistent with the literature, see for example Ariely (2013) and Bazerman and Tenbrunsel (2013).

In conclusion there appears to be some evidence that there was a lack of challenge amongst the Anglo board. A number of potential reasons have been suggested as being the cause of this. First Soden’s identifies what he sees as a specific Irish culture of “silent dissent” that pervaded Irish society. Actor B (A) and Actor E (A) highlight that given the strong directional leadership at Anglo it was difficult to voice a contrarian opinion and as a result many remained silent.

Finally, Actor P (S) and Actor A (A) suggest that suppression of challenge was related to financial self-interest.

Research question 2m)

The Anglo board was characterised by the illusion of unanimity.

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity ¹⁶²	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

Janis (1972) argues that a perception of unanimity can help to maintain self confidence in the group and maintain high self-esteem particularly with respect to important judgements. “Without it, the sense of group unity would be lost,

¹⁶² I have interpreted Janis' symptom relating to an “illusion” of unanimity to mean a belief in the unanimity of the group. This is consistent with how other academics have understood this terminology.

gnawing doubts would start to grow, confidence in the group's problem solving capacity would shrink, and soon the full emotional impact of all the internal and external sources of stress generated by making a difficult decision would be aroused" (*ibid*, p. 258). Every group decision process requires some form of consensus but what Janis is referring to here is both a premature and extreme form of consensus. The consequence of this would be the lack of an effective boardroom challenge.

This illusion of unanimity can occur when members of a group remain silent even when they disagree, the process of silent dissent as described previously by Soden (2010). The pressure to remain silent and not to "rock the boat" (O'Connor, 2002, p. 1287) is likely to be higher in a group with a strong directive leader who does not tolerate dissent.

O'Connor (2002) evidences an illusion of unanimity at Enron by noting that board votes were generally unanimous and that there was no evidence that the directors challenged management over strategy. Scharff (2005) makes the link between silence and concurrence and that the lack of objections raised at WorldCom employees with respect to proposed accounting disclosures was interpreted as an illusion of unanimity.

It is submitted that this symptom and the symptom related to self-censorship discussed above are inextricably linked. If actors are undergoing a process of self-censorship then this will lead to an illusion of unanimity and a perception that everyone concurs. Indeed, researchers such as Scharff (2005) and Eton (2001) have looked at both of these symptoms collectively under a general theme related to high levels of consent in a board and a lack of boardroom challenge.

Evidence

The review undertaken in research question 2i) above highlighted a culture of silent dissent in Ireland and emphasised Fitzpatrick's strong and directive

leadership style. Further Nyberg (2011) observed that the Irish bank boards' looked to avoid contrarian opinion" (*ibid*, p. 59). Nyberg (2011) further noted specifically with respect to Anglo that "there is little evidence that [Anglo] board members at the time were active in challenging the bank's approach or its pace of lending growth" (*ibid*, p. 51). This lack of challenge could be seen as a desire for unanimity amongst the members of the Anglo board.

Actor D's (A) observations about Anglo and in particular the need for staff to be "on message" provides an insight relevant to this proposition and can be seen as illustrative of the illusions of unanimity:

"Everyone had to be on message, no matter what happened, and again this is common with people that dominate organisations. Even for internal budgetary management meetings, we all prepped, we all sat around the table and listened to what each other was going to say. Don't say that, say this, shape it this way, you are not coming across the right way, you are not coming across well. Now there is not an organisation that does not press itself and shape its message for external consumption, but internally there was a control mechanism, when people were talking to their peers, explaining what they did, what the budgets were for next year, everything was framed with little room for going off on tangents.

When I look back on it, if somebody like Sean who drives it forward, has a clear message he wants to get across he wants to make sure everything else is in line and he has the ability to inculcate that value and that it will all get done.

I think for all its bluster about being open and honest when it came to criticising each other's areas we were very reluctant to do it. And the lenders were generally beyond reproach."

Actor D's (A) observation above, and in particular the need to carefully script what was said internally at Anglo, highlights the pressure towards unanimity at

Anglo. Actor N (S) also highlighted that at Anglo “*you had to be on message*”. In summary there is evidence from the literature, the Nyberg Report and from the interview process which supports the proposition that there was an illusion of unanimity at Anglo.

Research question 2n)

At Anglo direct pressure was put on those who were considered dissenters.

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

In regard to this symptom, Janis (1972) referred to the social pressures that group members place on individuals who question the group's judgement and position. Janis argues that placing pressure on dissenters is a form of psychological defence mechanism which deflects attention away from anxiety and any doubt associated with the group's decision process. Janis highlighted the pressure put on dissenters by the inner circle of the Johnson Administration as a prime example of this symptom. O'Connor (2002) highlights the pressure put on Enron employees and their auditors by members of the Enron board to agree to their plans particularly as it related to the third-party partnership arrangements. Scharff (2005) highlighted the culture at WorldCom where

employees felt that they risked losing their jobs by disagreeing with executives or policies that were being implemented (*ibid*, p. 114).

Evidence

There are a number of examples from both the literature and the interview process which highlight the pressure which was put on dissenters. In research question 2c) relating to the lack of an impartial leader at Anglo, it was highlighted that Fitzpatrick did not tolerate dissent and disagreements and saw Anglo as “his company”. Carswell (2011) quoted an unnamed director saying that he wanted “semi-yes” men around him. Lyons and Carey (2011) also quoting an unnamed director observed that one did not question Fitzpatrick and that you could not tell him what to do.

Actor B (A) in this regard noted:

“There was a feeling in house that if people had been ‘difficult’ at board meetings and were ones to challenge that they were not necessarily offered a renewal and another go on the board.”

Another example of pressure placed on dissenters within Anglo was provided by Actor C (A) with respect to a colleague of his and the pressure he was put under for not producing the numbers that management wanted (highlighted in more detail in research question 3k) above).

Actor O (S) was a bank analyst at Davy Stockbrokers, Ireland’s largest and most influential domestic stockbrokers. Actor O had expressed a negative view on the Anglo shares and explained in interview the reaction of Anglo in that respect:

“I got a call mid that year [2007] from a guy, Matt Moran [Anglo’s CFO], to meet me for a coffee at the Westbury. I met him and he basically said;

'I hear you are being very negative on Anglo'. He had all the information of what I had been saying but he was unwilling to tell me, he was waiting for me to do it. And then subsequently Kieran and Tony [Actor O's bosses at Davy] met with Sean Fitzpatrick, they came in and wanted me fired. It was not the case of Anglo listening to your view, it was you are wrong basically.

In August of [2008] a reconciliation was made with Anglo, it was all ok, I was told Anglo are relaxed with you. So that allowed me to go to the [Anglo investor] conference in October of 2008, I went into the meeting, and international investors are at the meeting and before the meeting started the CFO, Matt Moran, called me over and said 'can I have a word', and I said 'sure'. So we went out and he said "Look Seamus you are not welcome here". I said, 'Matt I thought it was all resolved'. He said, 'no, you are not welcome so I am going to walk you out'. I can't remember what I called him, we had a few choice words, I walked back to the desk and people were wondering how come I was back and suddenly it got back that I had been kicked out of the meeting. To be honest it was a bad move on their behalf."

This example provides an indication of the pressure that Anglo put on dissenters both by the public signal of excluding him from the meeting and also the pressure that was exerted indirectly on Actor O with his superiors. Actor O notes that there was a meeting with his bosses and that *"they wanted him fired"*.

Actor Q (S), however, told me that *"Matt [Moran] was very aggressive in relation to Seamus but never actually went as far as asking us to fire him."* Actor Q therefore recognised the pressure that Anglo had put on the firm with respect to Actor O's views but disputes the claim that Anglo actually asked for Actor O to be fired. This difference in opinion between Actor O and Actor Q about how far Anglo were prepared to go to put pressure on Actor O as a dissenter, does not

detract from the evidence that there was significant pressure put by Anglo on Actor O.

Actor Q (S) provided a further unrelated illustration of the pressure that Davy were put under by Anglo;

“Pat Kuney, who is number two at Davy and in charge of private clients, ran into Sean Fitzpatrick in the street. Sean practically assaulted him on the street about stories that people at Davy were bad mouthing Anglo. This particular story related to someone in our Cork office who said something mildly negative about Anglo on the phone who said it straight back to Anglo. When we heard this we thought we had better ring Sean, and Kieran [a senior Davy executive] rang Sean and said you had better come around for a chat.

[Interviewer interjection: When was this?]

It was before there was pressure on the bank [so before 2007]. I need to get the diary out to see exactly when it was ... Kieran called Sean and Kieran would generally not be a man who would share his meetings with me, but he asked if I would come to this one, and I said fine. So we sat in there, and there is a sofa in the office and I sat here, Sean sat there Kieran sat there [the interviewee gestured to describe three places around a rectangular table] and we started chatting and very quickly Sean was getting very agitated and using words like ‘treason’ and ‘lack of loyalty to Ireland Inc’. And when he used the word treason I said ‘that is going too far Sean, that is over the top’. He literally jumped over the sofa and he [interviewee demonstrates two clenched fist and an aggressive look] ... it was a pity he never hit me, with his fist raised he just stopped. But he was very agitated, spewing, I was spat upon.”

The use of words like “treason” and lack of loyalty’ and the aggressive confrontation described above provide another good example supportive of this proposition.

Merrill Lynch Investment Bank was Anglo’s corporate brokers and a close advisor to the company. Actor N (S) described the pressure that Anglo put on dissenters:

“They would be aggressive with people, I don’t want that to seem like they were threatening in any way. They would have been polite in the way they dealt with people but they would make their point very forcibly . If something did not go their way there was a three line whip on their side and they would approach different people at different levels or several people at one level in your organisation and you knew that when they had something to achieve the message would be sent out quite clearly and they would have a plan about how they would go about that. They were very effective in giving a group tackle in what they wanted to do.”

An illustration evidencing Actor N’s observations above occurred in March 2007 when Merrill Lynch’s banking analyst, Phil Ingham, published a research note highlighting the problems in the UK commercial mortgage market citing Anglo as having the most significant credit risk in the UK commercial market. Anglo Irish complained to Merrill Lynch (ML) about the report. The result of this pressure was that ML retracted the original report, edited it and then re-released it.

Lewis (2011) describes the reaction to Ingham’s report: “For a few hours the Merrill Lynch report was the hottest read in the London financial markets, until Merrill Lynch retraced it. Merrill was the lead underwriter of Anglo bonds and the corporate broker of AIB: they’d earned huge sums of money off the growth of Irish banks. Moments after Phil Ingham hit the SEND button on his report, the banks called their Merrill Lynch bankers and threatened to take their business elsewhere. The same executive from Anglo Irish Bank who had called to

scream at Morgan Kelly [Moran] called a Merrill research analyst to scream some more. ('I thought your work was fucking shit!') Ingham's superiors at Merrill Lynch hauled him into meetings with in-house lawyers who rewrote the report, purging it of its pointed language and its damning quotes from market insiders, including their many references to Irish banks. Ingham's immediate boss in the research department, a fellow named Ed Allchin, was made to apologize to Merrill's investment bankers individually for the trouble he'd caused them. And from that moment everything Ingham wrote about Irish banks was rewritten and bowdlerized by Merrill Lynch's lawyers. At the end of 2008 Merrill fired him" (*ibid*, p. 111-112)¹⁶³.

The examples above highlight pressure that Anglo exerted on those who worked at Anglo or who provided services to Anglo. Actor K (C) was a senior executive of BKIR and provided an example of the pressure that Anglo tried to exert on their competitors:

"I actually had a shouting match with Fitzpatrick. At one point I happened to be at some function and someone asked me about deposit gathering and I said something to the effect that it will be more challenging for banks that don't have large branch networks like Anglo Irish and literally Sean Fitzpatrick was on the phone yelling at me about this. He threatened to have me reported to the regulator, he was going to tell my board."

Fitzpatrick threats to report Actor K (C) to his board and the regulator are examples of pressure that a senior Anglo executive put on a dissenter outside of the Anglo "inner circle" of employees and advisors/providers. Another such

¹⁶³ Actor N (S) who had worked with Ingham at the time at Merrill Lynch confirmed in interview that this story was correct. However he did note that he felt that Ingham's report at the time lacked substance and was based on anecdotal evidence (although this anecdotal evidence did prove to be very accurate).

example of the pressure on an external dissenter was the pressure that Anglo put on UCD Professor Morgan Kelly. Kelly as noted previously had written a research note in 2007 (Kelly, 2007) which highlighted the specific risks in the Irish property market. Kelly noted that: “I had a call from a senior manager of Anglo Irish Bank who basically yelled at me said what I was saying was entirely irresponsible and to shut up.” (Lynch, Adrian, 2010)

Finally Actor G provided an anecdote with respect to how she believed that two of Anglo’s directors (Bradshaw and Fitzpatrick) pressurised a NED within the context of the boardroom of the Dublin Docklands Development Authority (DDDA);

“When Sean [Fitzpatrick] and Lars [Bradshaw] were on the board of DDDA there was a woman NED called Angela Cavendish who had a banking and property background. She was raising questions and Lars drew her aside, she told me, and said Angela I think you should go to Bunny Carr, from Carr Communications, and get some assistance and help with your communication style. In other words, because she was not asking the right questions. He used social and psychological techniques to make out that there was something wrong with Angela. There was nothing wrong with Angela, she was an excellent NED, she was so good that they tried to use psychological techniques to tell her: ‘Angela you have a problem and you need to get help with your problem’. She did not have a problem, she was causing them problems, and they had these little tricks, psychological tricks to manage her. Hearing little anecdotes from somebody like her gives me insights into their modus operandis. “

Actor G’s observations above are not in relation to the Anglo boardroom and it does not necessarily follow that these directors acted in the same way with respect to how they treated dissenting board members at Anglo. However, this anecdote can be seen in the light of the significant evidence noted above which, it is submitted, provides a number of examples which support the proposition

3n) that there was significant pressure put on dissenters from senior managers at Anglo.

Research question 2o)

Anglo had a self-appointed mindguard.

Antecedents of Groupthink	
Decision makers constitute a cohesive group	2 a)
Insulation of the group from outside experts	2 b)
Lack of tradition of impartial leadership	2 c)
Lack of norms requiring methodical procedures	2 d)
Homogeneity of members' social backgrounds and ideologies	2 e)
High stress from external factors	2 f)
Low self-esteem induced by recent failures, difficulties in decision making tasks or moral dilemmas	2 g)
Symptoms of Groupthink	
Illusions of invulnerability	2 h)
Belief in the inherent morality of the group	2 i)
Collective rationalisation	2 j)
Stereotyping of out-groups	2 k)
Self-censorship	2 l)
Illusions of unanimity	2 m)
Direct pressure on dissenters	2 n)
Self-appointed mindguards	2 o)

Self-appointed mind-guard(s) are identified by Janis as those who take it upon themselves to protect the group from adverse information. A mindguard therefore helps to preserve the unity and preservation of the group by ensuring that group members are not exposed to information which might challenge their position.

None of O'Connor (2002), Scharff (2005) and Eaton (2001) found evidence of a self-appointed mindguard in their respective case studies of groupthink. In Anglo's case, there is evidence that Matt Moran was Anglo's mindguard. Moran

was Anglo's chief financial officer and group executive in the lead up to the crisis. Although he was not a main board director, Moran was in the upper echelons of Anglo's leadership hierarchy.

As noted above, Moran called Kelly directly to complain about the research paper he had written on Anglo. Further, as also already highlighted, Moran had forced the removal of Actor O, the Davy analyst from an Anglo investor presentation. Carswell (2011) also highlights an example of a casual e-mail conversation between an independent bank analyst and Kelly and that an e-mail comment made by Kelly to the analyst had found its way back to Moran who had then mailed Kelly himself to challenge him on his comments (*ibid*, p. 138).

Actor B (A) confirmed that Moran had had confrontations with Professor Kelly from UCD and added that:

“At one stage Moran actually went out to University College Dublin to confront him in terms of some piece that he had either written or an interview that he had done in one of the Irish papers so there was no love lost there and as a result there probably was not an awful amount of respect either. It was an aggressive kind of set to.”

Actor C (A) in interview recalled a conversation he had had with an investment banker from Barclays after *“Matt Moran had tried to bully him on something”*. Moran's role as the “protector” of Anglo with respect to the investment banks is consistent with my own dealings with Moran in his capacity as financial officer at Anglo. One on an occasion that our equity analyst had bought out a “sell rating” on Anglo he called our department to complain and to threaten to take away business from our bank.

Actor A (A) observed that:

“He [Moran] would use obscenities to describe people who would say negative things and at the time it was frankly difficult because we all thought they were wrong and we were right because we had been right for so long. I was not at the meeting but I heard that he was at a meeting in London and used the ‘c’ word to another executive at another bank, and that is outrageous. An executive of another bank had challenged the financial growth projections, in particular with regard to lending and potential capital losses. I believe Matt even went out to see Morgan Kelly and was pretty aggressive with him.”

Carswell described Moran as “the bank’s pit bull, charged with chastising bank analysts, financial journalists and anyone else who spoke or wrote negatively about the bank. He would regularly telephone critics to give them a piece of his mind” (*ibid*, p. 119). Actor E (A) further highlighted the role that Moran took in aggressively defending Anglo from any negative press: “His [Moran’s] position was that he was Drumm’s Alsatian. Instead of taking comments listening and seeing whether there was an issue with something he decided he was going to be your man’s guard dog.”

In summary Moran does not appear to be the only senior Anglo executive that aggressively challenged those that questioned the Anglo model, and indeed examples have been provided of Fitzpatrick being aggressive in relation to both Actor Q (S) and Actor K (C). The Anglo executive had been described above as being cohesive, with strong equity holdings and a strong sense of belief in the Anglo story. It is, therefore, not that surprising that they reacted aggressively towards anyone that challenged their perception. An analysis of the evidence from the literature and from interview however, specifically identifies Moran as someone who appeared to take on the role of Anglo’s mindguard.

Overall summary of research question 2: *The board of Anglo Irish Bank was affected by the antecedents and symptoms of groupthink.*

Research question one assessed whether the board of Anglo was characterised by the antecedents and symptoms of groupthink. A review of the antecedents and symptoms of groupthink found in propositions 2a) – n) found evidence which supported all but one of the antecedents (relating to the isolation of the group to outside experts) and broad support for all the symptoms of groupthink. The evidence which supports these propositions came from a combination of secondary sources such as existing literature, from the three official inquiries into the crisis, from the application of industry norms to the relevant research questions, from relevant analysis of the Anglo financial statements and a series of interviews with a number of actors from both inside and outside Anglo.

A summary of the evidence gathered in respect of each of the propositions is tabulated below. The purpose of this analysis is threefold. First, it highlights the different sources of information which I used to review the relevant research questions. Second, it reflects the number of observations which were made in respect of each research question. Third, it provides a contextual comparison with other established and published research on groupthink. In Appendix 5 is a comparative analysis which was undertaken for each of the five groupthink case studies identified previously in this thesis; namely Eaton (2001), Ahlstrom and Wang's (2009), Yetiv (2003), Scharff (2005) and O'Connor (2002).

A summary of my research findings:

Table 7.6: Summary of the evidence I observed in support of groupthink

Proposition	Industry norms	Inquiries, Commissions or other academic papers and books	Indirect interview	Direct interview	Inferred from relevant Annual Financial Statements
2a)	✓ (3)	✓ (2)	✓ (1)	✓ (9)	✓ (3)
2b)	Proposition not proved				
2c)		✓ (4)	✓ (9)	✓ (7)	
2d)		✓ (4)	✓ (5)	✓ (5)	✓ (1)
2e)	✓ (4)	✓ (3)	✓ (3)	✓ (10)	✓ (1)
2f)		✓ (1)	✓ (3)	✓ (3)	
2g)	Proposition not proved				
2h)		✓ (1)	✓ (8)	✓ (11)	✓ (1)
2i)	✓ (2)		✓ (4)	✓ (2)	
2j)	✓ (1)	✓ (2)	✓ (2)	✓ (1)	
2k)	✓ (2)	✓ (3)	✓ (5)	✓ (4)	
2l)	✓ (1)	✓ (1)	✓ (1)	✓ (4)	
2m)		✓ (1)	✓ (2)		
2n)		✓ (1)	✓ (1)	✓ (7)	
2o)		✓ (2)	✓ (2)	✓ (6)	

There are two identified weaknesses in respect of this analysis and in particular a comparison with other published research in this area. First, a simple comparison of the number of different observations in respect of a specific proposition does not take into account the relevance, depth and importance of the observations. It is not the number of observations that is important but rather the depth and relevance of the analysis itself. Second, it may be that for practical purposes (related perhaps to word restrictions in respect to their published journals) that the researchers were not able to include all of their observations identified in respect of each research question.

Whilst recognising these two weaknesses, the analysis does provide some comfort in respect to my proposed research. First, as highlighted previously, three of the five research papers (Ahlstrom and Wang (2009), Eaton (2001) and Scharff (2005) looked only at the symptoms of groupthink. Further, both Yetiv (2003) and O'Connor (2002), who analysed both the symptoms and antecedents of groupthink, grouped the symptoms of groupthink together and looked at them collectively whilst I have considered and evidenced (where appropriate) all seven antecedent and eight symptoms individually. This was an attempt to be as rigorous and systematic in the research process and to try to reduce the opportunities which might exist for unconscious biases and suspicious fits in the analysis.

Second, I have secured evidence from a wide source of materials as is reflected below. The theory being that a wide and diverse source of data can provide for a more robust and rigorous analysis. As highlighted previously, only Yetiv (2003) conducted direct interviews. Eaton (2001) in contrast gathered his data also exclusively from press cuttings from two newspapers over a five year period whilst Scharff (2005) relied very heavily on SEC reports into the fall of WorldCom. Further, three of the comparison case studies were made in respect to corporations (Scharff: WorldCom, O'Connor: Enron, Eaton: BA and Marks and Spencer). None of these researchers referred to the annual report and accounts in their analysis. In contrast my research included relevant analysis of the annual report and accounts in respect of nine separate observations. Although it has been recognised that it is not the number of observations which are important, there is some (small) comfort as to the rigour of my analysis given that my research highlighted a greater number of observations, and from a more diverse source, than any of the comparable case studies.

Finally, this analysis was conducted taking into account Yetiv's (2003) warning with respect to a "suspicious fit" and being subject to a confirmation bias in analysing the data. For each antecedent and symptom of groupthink a number of sources were used which provided some comfort as to the validity of the

data. Further, there was no information in either the source materials or the interviews which contradicted the research findings presented. In summary, it is submitted that the breadth and depth of the evidence presented above is sufficient for me to conclude that the board of Anglo was affected by groupthink in the lead up to the financial crisis.

7.4 Research question 3: The board of Anglo was affected by group polarisation.

Group polarisation has been described previously as a means of explaining how groups tend to be more extreme in the direction in which they are already heading (Moscovici and Zavalloni, 1969). Group polarisation is more likely in homogenous group settings (Sunstein, 2009, 2000b), in situations where there is geographical isolation (Groch, 2001) and where there are high levels of confidence (Baron et al., 1996; Gerard and Orive, 1987). Social influence network theory (Friedkin and Johnsen, 2011, 1999) highlights the role that the relative influence group actors can play in the polarisation process and that actors with greater influence will have a greater effect on the polarisation process itself. An actor with a strong influence on the group, and a strong preference for risk, will result in extreme polarisation of the group's position towards a high risk strategy. These research findings are applied below in the context of the Anglo case study.

An analysis of Fitzpatrick's own personal investments in the lead up to the crisis highlights Fitzpatrick's own personal attitude towards risk. Lyon and Carey (2011, p. 80-90) detail a long list of investments which Fitzpatrick made on his own personal account. In particular, they highlight Fitzpatrick's (catastrophic¹⁶⁴) US\$12 million investment, together with fellow Anglo director Lars Bradshaw, into a Nigerian Oil Company. Lyon and Carey highlight the lack of due diligence and attention to detail that Fitzpatrick paid in this failed investment. They observe that Fitzpatrick had no knowledge of the oil industry and had never even seen the oil rig nor met his Nigerian partners before investing. Fitzpatrick, when asked by Lyon and Carey about the rationale for the investment noted: "We didn't do tremendous due diligence on it [the Nigerian oilfield] ... We didn't have

¹⁶⁴ See Lyon and Carey (2011) for a comprehensive review of the Nigerian oil investment which resulted in Fitzpatrick losing all of the capital he had put into this venture.

them [the Nigerian partners] checked out. I wasn't interested in oil. I knew nothing about Nigeria. I wasn't really interested in Nigeria" (*ibid*, p. 96). Other examples provided by Lyon and Carey as an illustration of Fitzpatrick's attitude towards risk include investing in a sub-prime mortgage business in Ireland in 2006, and a number of high risk and unprofitable property investments in both Ireland and in Europe.

Fitzpatrick, when quizzed about his attitude towards risk noted: "I am being terribly open with you and honest with you by saying there was nothing that was driving me. There were no health issues. There were no blackmails. There were no affairs. There was nothing in my life that was going on. I was just being myself" (Lyons and Carey, 2011, p. 92). In particular the comment "I was just being myself" indicates that Fitzpatrick considered his high level of risk exposure as being reflective of his general attitude towards risk and that he would have taken the same approach to risk in his capacity as a board member of Anglo.

These investments highlight the risk appetite that Fitzpatrick, the most influential member of the Anglo board, was prepared to take with respect to his own personal investments. They may also reflect his general attitude towards risk that he took when transacting not only for his personal gain, but also when acting in his capacity as a board member at Anglo.

Proposition 2c) above, highlighted the influence that Fitzpatrick had at Anglo. The evidence above moreover suggests that Fitzpatrick had a high risk appetite. Proposition 1e) and 1f) respectively evidenced both homogeneity and high levels of confidence within Anglo. Further, Ireland is of course geographically isolated and as noted in the analysis of the Anglo board in proposition 1e) above all the Anglo board members were Irish nationals. In summary, Anglo was a board with an influential leader with a high risk appetite operating in the context of a geographically isolated board characterised by

homogeneity and high levels of confidence, all characteristics associated with group polarisation.

The existence of these factors would point towards the fact that there was group polarisation in the Anglo board resulting in a riskier strategy being adopted. However, it is impossible to “prove” group polarisation in an ex-ante case study given that one needs to understand the thought process and risk preferences of the group members *before* deliberations and to compare those to the post deliberation outcomes. As a result, group polarisation has never, to my knowledge, been researched in relation to an ex-ante case study. Rather, researchers tend to highlight the possibility of group polarisation as having possibly occurred in relation to their specific case study (for example (Janis, 1972; O’Connor, 2002)).

Similarly with respect to the Anglo board, there is no way of evidencing that group polarisation did exist affecting the board’s decision processes. However what I can observe is that decisions were taken at Anglo in the context of an influential leader with a high risk disposition within the context of a homogenous group setting in a geographically isolated environment. Thus, it is submitted, there is an increased likelihood that group polarisation occurred in the decision processes of the Anglo board in the lead up to the crisis. Finally given the interconnectivity and common attributes between groupthink and group polarisation, as highlighted in a previous chapter, it is very possible that the board of Anglo suffered from both phenomena.

7.5 Research question 4: The directors, and in particular the NEDS of the Irish Banks, had limited banking knowledge and experience.

The model of poor decision processes developed in the previous chapter identified low levels of firm specific and functional skill levels as being a factor which might affect the likelihood of a poor decision process. The reasons for this being twofold; first, low skill level increases the chances of poor decisions being made in the first instance and second, low skill level increases the likelihood that directors will assume that others have superior information and therefore squelch their own information and herd.

Nyberg (2011) specifically identifies the lack of banking expertise within the Anglo board when he observes that: “the board members [of Anglo] were experienced and well regarded in their own fields of speciality. However, they were not experts in the field of banking and several therefore appear to have been dependent on senior management to assess the need for the reporting systems and procedures necessary to contain the key risks identified. Accordingly, there is little evidence that board directors at the time were active in challenging the bank’s approach or its pace of lending growth” (*ibid*, p. 27).

In particular the lack of expertise in the Anglo risk committee has been highlighted by both Nyberg (2011) and Carswell (2011). The risk committee was chaired by Michael Jacob from the start of the millennium until he retired in 2007, by Fintan Drury until he resigned in 2007 and then Lars Bradshaw until he was forced to resign (along with Fitzpatrick) when details of loans to directors were disclosed in December 2008. None of these NEDS had any banking experience. Jacob was a NED at communications and a construction company, Drury was a publicist, and Bradshaw was a retired management consultant.

With regard to the other Irish banks, Nyberg highlighted that the board of INBS had only three NEDs, and that board members “had little practical banking experience” (*ibid*, p. 28). Further, Nyberg observed with respect to the other four domestic Irish banks that “while NEDs were successful and respected

individuals from various parts of Irish business, not many of them were banking professionals or had comparative experience” (*ibid*, p. 49).

A review of the NEDs of the six Irish banks and their banking experience in 2006 highlights Nyberg’s point:

Table 7.7: Analysis of the relevant banking experience at the Irish banks (2006)

Bank	Number of NEDs	Number of NEDs with Banking experience
AIB	13	3 ¹⁶⁵
BKIR	10	2
Anglo	6	NIL
INBS	3	NIL
IL&P	7	2
EBS	7	3

Source: AFS from 2006 of the six Irish banks. Banking experience is defined as an NED that had or was working in some capacity in the banking sector.

A number of interviewees questioned the skill levels of the directors of the Irish bank. Specific criticism was directed by three interviewees, Actor C (A), Actor Q (S) and Actor P (S) towards Anglo’s finance director Willie McAteer. In proposition 2k) above, Carswell observed that McAteer was the only director to challenge at group credit committee but that he was ridiculed, reference was made about his age, and this was highlighted as an example of negative stereotyping.

Carswell’s observation that McAteer did challenge (but did not appear to be taken seriously) is in contrast to the observations of Actor C (A):

¹⁶⁵ Of the three AIB NEDs with banking experience, one had worked at the Central Bank of Ireland (so in banking but not commercial banking) and the other two had banking experience in Poland and the US – so no specific experience of the Irish market.

“I always thought Willie was a very nice man, but whenever you asked him to sign anything he never asked questions, which was great in terms of getting things through but I never saw him challenge anything. At credit committee Willie would have sat on that where we would have been buying different forms of debt, I never saw him grilling or going into detail and I thought he was either a really smart guy and he doesn’t need to go into detail and he gets it, but I just don’t know if that was the case whether he was really smart. It wasn’t as if he was disengaged but when I see the probing that people do post crisis if they are part of the decision making process. I also never saw him as a strategic driver.”

Actor C (A) is referring above to McAteer’s passivity in debt credit committees whilst Carswell referred to his challenge in lending committee meetings. Carswell’s observation about McAteer providing a challenge in lending committees was backed up by Actor A (A) who told me, in interview, that McAteer was the most conservative in the lending committees he attended. It is possible that McAteer, for whatever reason, felt more comfortable challenging in a lending credit committee than in a debt committee. McAteer’s had previously worked at accounting firm PWC and at a leasing company, which might make him more comfortable challenging on the lending credit committees.

Actor C further highlighted that he thought that McAteer “*should have retired a couple of years ago*”. Actor Q (S) and Actor P (S) both commented that they believed that McAteer had a drinking problem. Actor Q noted that McAteer “*was a bit fond of the jar*” and that he “*was suffering from the stress. He was drinking too much*”. Actor P noted that McAteer was “*getting on and tiring, an alcoholic, he had drink problems*”.

In summary, the interview process provides some evidence that questions McAteer’s effectiveness as an executive director. Actor C noted that McAteer never challenged or engaged in the debt credit committee meetings whilst Carswell observed that in the lending committees he did not appear to be taken

seriously. Further, observations about McAteer appearing tired and suffering from stress and drink issues, if accurate, would further reduce his effectiveness. As highlighted previously in proposition 2e) above, McAteer was the only executive director at Anglo who did not come from a lending background and it could be argued that his lack of effectiveness was particularly important given the homogeneity of the other executive directors' skill sets.

Indeed, Actor D (A) highlighted previously that the executive directors, with the exception of McAteer, all had lending backgrounds and that if you *“asked them what was going on in the financial world, what was in the financial times that day, about commercial mortgage securitisation, how banks manage their risks, not a clue”*. This sense of the lack of banking skills expressed by Actor D was also highlighted in interview by both Actor B and Actor E (A). Actor E noted that there was nobody at Anglo that understood “gap risk, market risk, operational risk in treasury.”

Actor E (A) further questioned the expertise of executive director Pat Whelan as chief risk officer¹⁶⁶:

“I remember when he [Pat Whelan] was appointed to the board and head of all the risk and I knew that this guy was not up to it. I thought this is really quite bizarre. He was a lender. He had been a lender previously, but I went out to talk to him, to test him out. I said to him: ‘Pat in your new role we have to have a serious discussion about market risk and liquidity risk’ and his eyes glazed over, he had no idea what I was talking about. And I mean none. So I think there were quite a few people promoted and put into positions way beyond their ability and competence.”

Actor B (A) echoed the views of Actor D (A) above and provided two examples which, in his view illustrated the lack of banking experience of the executive

¹⁶⁶ Whelan reported into Michael Jacob as head of the risk committee as highlighted above.

directors at Anglo. One related to a conversation he had with the head of US lending (Tony Campbell¹⁶⁷) when Campbell asked Actor B (A) to explain to him the make-up of the capital base of Anglo. Actor B (A) noted in interview:

“Here is to all intents and purposes a board member asking me to explain again the make-up of our capital base in the bank. So that is one example and I remember coming back and explaining that to colleagues much to their interest and amusement and incredulity.”

The other example related to (an unnamed) executive director at Anglo and Actor B’s (A) view of his lack of understanding of risk:

“A question of funding came up at this particular meeting but it was quite obvious from the question asked by the particular person, who was an executive director and who also had a very senior risk role in the company, that he did not know the difference from funding from a liquidity perspective and funding from a capital perspective, and that to my mind was interesting.”

The examples above focus on perceived weaknesses in the executive directors of Anglo. Criticism was also levelled on the lack of expertise of the NEDs at Anglo. Carswell, in interview, noted that Fitzpatrick populated the Anglo board with *“people that were well known in Irish corporate circles but had no banking experience; Anne Heraty, Ned Sullivan, Fintan Drury the PR man and Gary McGann.”*

Actor B (A) was particularly critical of the expertise of Anglo NED Heraty:

“With all due respect to Anne Heraty I am sure she is a very successful business woman and I am sure she is a very nice individual but she hasn’t a rat’s notion about banking. When a new NED was appointed

¹⁶⁷ As highlighted previously, Campbell was a “shadow” board member.

invariably we were asked to put together a presentation and describe in fairly overview terms what the bank was about how the treasury division operated what we did in our respective roles. It was ladybird stuff, ladybird book stuff¹⁶⁸.”

Actor B's view in relation to Heraty's understanding of banking was also confirmed in interview by Actor D (A) and Actor H (C).

Actor B also questioned the expertise of other Anglo NEDs:

“I would question even the likes of Gary McGann, Ned O’Sullivan again extremely successful businessmen but how much did they really understand banking balance sheets and banking and treasury risk. I can remember one time being in treasury we were asked to go to a board meeting to make a presentation on the treasury business and in my last few years when I was at Anglo we had a treasury executive, I think there were eight of us in total on the treasury executive of which I was one, and we were all going to do a piece of this presentation to the board and again I felt it was being done in a very overview straightforward way and even at the meeting when we were presenting we were going through the motions, we were doing it because we needed to do it but I had two questions in my own mind: were they interested in hearing this and do they understand this, are they engaging with us? I got the sense we were facing a lot of glazed eyes or bored faces in the room.

Interviewer interjection: were there any questions?

There were a couple of questions but there were no deep searching, deep rooted questions. This was a presentation to the main board, exec and non-exec. “

¹⁶⁸ The reference by Actor B (A) above to “ladybird stuff” is a direct reference to a series of children books under the title *Ladybird*.

Lack of relevant expertise in banking was not unique to Anglo, as was highlighted by Nyberg (2011) above. Actor I (C) of EBS highlighted a lack of expertise amongst the EBS board when she noted: “We tried to play with the big boys, but we did not have the skills to do that”. ILP NED Actor H noted that the chairman of AIB and BKIR (Gleeson and Burrows) and the Chairwoman of ILP (Bowler) going into the crisis had no specific banking experience and that in hindsight that was a mistake. Finally, Actor J (C) specifically highlighted what he believed was AIB CEO’s Sheehey’s *“lack of understanding of the aggregate view of the whole bank that was being run at 80 miles an hour.”*

In summary, there appears to be evidence supporting the assertion that the directors of Anglo specifically, and the Irish banks more generally, had limited expertise in managing the banks in the lead up to the crisis. This lack of banking knowledge would imply that such directors would be more susceptible to normative influences affecting decision processes resulting in less boardroom challenge, increasing the likelihood of a poor decision process.

7.6 Research question 5: The Irish banks herded in the lead up to the crisis and in particular emulated the strategy of Anglo Irish Bank.

Nyberg (2011) concluded that herding had taken place between the Irish banks and highlighted herding a number of times in his report (see for example pages i, ii, iv, v, 7, 24, 49, 95 and 99). In the Executive Summary of his report Nyberg noted that the Commission frequently found examples of herding and that “as other banks tried to match the profitability of Anglo in particular, their behaviour gradually, and even at times unintentionally, became similar” (p. ii). This view was shared by Honohan (2010) who noted that: “Competitive pressure on the leading banks to protect market share was driven especially by the unprecedentedly rapid expansion of one bank, Anglo Irish (whose market share soared from 3 per cent to 18% in a decade, growing its loan book at an average rate of 36 per cent)” (*ibid*, p.27).

Anglo’s growth was achieved on the back of a single focused strategy of commercial property lending. Anglo achieved not only high growth but also increased profitability and its market capitalisation increasing from €0.6 billion in 2000 to its peak of €17.53 billion in July 2007. In view of this success, Nyberg (2011) observed that AIB and BKIR in particular escalated their commercial property activities in light of Anglo’s strong performance in that sector and noted that: “Anglo was widely admired domestically and abroad and lauded (by many investors, consultants, analysts and the media) as a role model for other Irish banks to emulate” (p. iv).

Nyberg cites the example of an external but unnamed consultancy firm who, at an AIB seminar in 2007, presented Anglo as an example to which AIB should aspire and highlighted that AIB set up specific “Anglo win-back teams” specifically to try and regain market share from Anglo (p. 24)¹⁶⁹. The existence

¹⁶⁹ Carswell (2011) notes that this buy back team consisted of four people and was led by Catherine Moroney, a senior executive at AIB.

of these win back teams, led by AIB's Moroney, was confirmed in interview by Actor J (C), a senior executive at AIB. Actor J further commented in interview: *"Was AIB threatened by Anglo? Yes, from our point of view every time Anglo produced a set of results, it was 'god how did they manage that?'."*

AIB's Actor L (C) noted that AIB felt that the comparison with Anglo was unavoidable when he observed:

"We compared ourselves a lot of the time to the financial services bank index in Europe and what was shocking about that was that Anglo was right at the top of that banking matrix in Europe. You were comparing yourself to a very high performing German bank you might note the differences relate to the size of the German economy and it is fundamentally different. However, if you are comparing yourself to organisations and the best performing of that is doing business in the same country then it is an undeniable comparison that will drive behaviour. They are serving the same customer base as you and if they are growing very rapidly it is at least likely then they are most likely doing so by taking some of your business or customers so you are forced to make that comparison on a continuous basis And ultimately they {Anglo} operated on a sub-set of the markets we operated in and it was quite difficult to justify why we were not performing as well as they were."

Further, Carswell, Actor H (C) and Actor P (S) all highlighted to me a comment made by an AIB's CEO Michael Buckley¹⁷⁰ when he observed that: "Anglo have joined us for breakfast but they are now eating our lunch¹⁷¹" as illustrative of the pressure that Anglo was exerting on AIB in particular. Carswell, in interview,

¹⁷⁰ Buckley resigned as CEO of AIB in June 2005, and was replaced by Eugene Sheehey.

¹⁷¹ This apparent comment by Buckley appears in a number of books (for example Carswell 2011) but I have been unable to find the context in which the comment was made or the direct source of the quote itself.

noted that AIB *“wanted to fight back and get back some of that business. So 2003/2004 you see AIB starting to react and Buckley set up what he called a ‘win back team’ when he said ‘I want you to find out what Anglo are doing to get all this business that’s making them so much money and their investors so much money from the stock market. And I want you to replicate that’.”*

Actor L (C) observed that that AIB was a late starter in trying to compete with Anglo in the commercial property market and this negatively affected the quality and mix of AIB’s property investments:

“On a very specific level, AIB became more aggressively involved in property lending later than Anglo and to grow its property book more rapidly than Anglo to make an impact and it was late to the party and it was therefore lending against asset prices that were already very elevated which was a problem when the bubble burst.”

Actor L (C) further highlighted the unfavourable mix of commercial business that AIB underwrote was affected by its decision to try and catch up Anglo:

“AIB did more development lending, the balance of its development versus investment property lending changed in favour of development lending because that was the business that was available for you to lend against and AIB ended up doing more land development lending against land portfolios rather than development and it did more development than investment and if you think about that from a risk perspective residential property lending is less riskier, and development lending is more riskier than investment property and lending against land banks is more riskier. We did a lot of that.”

Actor L’s comment above that AIB did more of the riskier land development lending “because that was the business that was available to you” highlights the fact that, as a late entrant, the quality of AIB’s lending was affected by Anglo.

This point about the influence that Anglo had on the other banks and the quality of the lending they agreed to underwrite, was also made by Carswell when he noted in interview:

“The issue for Anglo is that they led the charge, everyone wanted to replicate what they were doing. They might not have been the worst of them at the end but they were certainly the worst at the beginning and they were the ones to have started it and by leading the charge and the profits that they made in the period from 1999 to 2006, other banks saw that and initially were disbelieving and wrote them off and then after a couple of years said ‘oh my God, this is real they are actually making this money’ a lot of the banks came under this pressure. I think the case of BKIR was a very good example because BKIR was always a conservative bank, a very conservative establishment from their Protestant Anglo Irish roots, and around 2004 they have a real existential crisis where they said ‘what are we doing wrong that Anglo are doing right’ and we need to do what they are doing and we need to win back some of this market share.”

As Carswell highlights above, BKIR was also under pressure to emulate the success of Anglo. Ross (2010) writes that Mike Soden, Bank of Ireland chief executive until 2004, used to ring Sean Fitzpatrick after sensational sets of annual figures and congratulate him: “Then Soden and his board of directors sat down and wondered how on earth they were going to compete. Anglo Irish Bank led the way and all the others followed” (*ibid*, p84). Carswell (2011) notes that there was even concern within Bank of Ireland that given Anglo’s success that it could secure enough support from institutional investors to mount a take-over bid of BKIR. In 2005 at BKIR’s annual general meeting a prominent shareholder proposed an unsuccessful resolution that BKIR should appoint the then CEO of Anglo as their next Governor (Donovan and Murphy, 2013).

Actor F (C), a senior executive at BKIR whose responsibilities included investor relations, highlighted the pressure that institutional investors placed on BKIR to emulate the success of Anglo:

“You would go out and you would talk to investors and I remember being struck when I went out on an equity roadshow particularly in mainland Europe, it wasn’t so much a London or a US thing, you would ask them if they owned Bank of Ireland shares they would say ‘we used to but you are not dynamic enough and there is better growth potential with Anglo and AIB than there is in your share price’. So BKIR became seen as a bit ‘fuddy duddy’ and not particularly dynamic and in a way we grew our lending in the UK to some extent to make up for that but we also grew our lending in Ireland but in a slightly more cautious way.”

Actor Q (S) as CEO of Ireland’s largest stockbroker Davy, also highlighted the pressure from institutional investors to emulate the success of Anglo in particular:

“They [Anglo] had the same institutional investor base as the other banks. Those institutional investors are coming to Dublin, they are coming to see Bank [BKIR], and Allied [AIB], we are bringing them in, the other brokers are bringing them in, and what are they doing, Anglo are the heroes and investors are applauding them, and the same investors are saying to Bank and Allied, you are not growing nearly quickly enough. So in some respects they put the managements of those banks under pressure as did the media in terms of contrasting growth rates. That was part of the disaster.”

The extent to which both AIB and Anglo looked to emulate the success of Anglo in its commercial property operations is reflected in the analysis that Donovan and Murphy (2013) conducted as reflected below:

Table 7.8 Residential Mortgage and Commercial Property lending by AIB and BKIR (2003 and 2008)

Residential Mortgage lending by AIB and BKIR (in Euro billions)

Bank	2003	2008	Growth Rate (%)
AIB	13.2	31.6	139%
BKIR	30.9	60.1	96%
Overall Total	44.1	91.7	108%

Commercial Property lending by AIB and BKIR (in Euro billions)

Bank	2003	2008	Growth Rate (%)
AIB	11.1	47.9	332%
BKIR	6.6	35.6	439%
Anglo	18.4	74.1	303%
Overall Total	36.1	157.6	337%

Source: Donovan and Murphy (2013, p. 67)

The above tables reflect the increase in growth in both residential and commercial lending and highlight the particular growth in commercial lending during this period¹⁷². As the table indicates, AIB increased its residential lending to €31.6 billion by 2008, a 139% increase from 2003. In contrast AIB's commercial property lending increased by a multiple of 2.4 of the growth in residential lending to €47.9 billion a 332% increase since 2003. BKIR statistics noted in the table above highlight a similar trend of a greater move into commercial lending.

The above analysis focuses on AIB and BKIR. In addition to these two banks Donovan and Murphy (2013) highlight that INBS modelled itself very closely on Anglo, in particular its push into the commercial property market. Finally, EBS also made a strategic decision to enter into the commercial mortgage market in 2005, at the peak of the growth in this market. Murphy and Devlin (2009) describe this decision as a case of "late onset madness" (*ibid*, p. 272).

¹⁷² As highlighted in chapter 7, Anglo only underwrote loans for commercial property.

Nyberg (2011) notes that this was an attempt by EBS to diversify its lending given the increased competition in the residential mortgage market and to protect its status as an independent mutual in light of competition from the other society in the sector INBS (Nyberg, 2011). The pressure of competition on EBS was recognised in interview by EBS's NED Actor I (C) when she commented about the pressure EBS were under when rationalising their decision to enter the commercial property market. She noted that the rationalisation was *"if we don't chase this business we are out of the market completely because we are getting eaten by other financial institutions and we cannot survive without it."*

Actor I (C) further highlighted that EBS did not, however, see INBS as their benchmark but rather looked to Anglo:

"INBS were not influential and did not affect us. Anglo of all places was seen as competition. So we were looking in the wrong place. This is all with the joy of hindsight. First, why did we not see INBS as competition? It was seen as a maverick, an oddity, it was all about the man not the institution. The only time it became a threat was in terms of the demutualisation and their (planned) demutualisation would be a push on us ourselves to demutualise. So that was there to an extent. However, in terms of chasing business and trying to be their model, we never did that. We looked in other places at competitors, and we mainly saw our competitors as INBS in mortgages and everyone had more scale than us. It was ILP and BKIR/AIB for mortgages and then some people were recruited to do commercial lending as it was felt that we never had a large enough mix on our books. And when that team was bought in they were given a mandate and an instruction to build a book. And when they went out to build a book, Anglo held the best book in town and everyone else was picking up the bits. The perception of Anglo was very positive. They were to look up to, and it was also a bit of begrudgery that they were too smart for their own good, but yes we were trying to emulate

them, yes. And Anglo were seen to be the sharp ones and if we could have some of that as well.”

Actor H, a NED at ILP, was another who highlighted the pressure to emulate the success of Anglo. In interview, Actor H noted that a new NED had challenged the ILP board to be more like Anglo and that the new NED had noted that “Anglo was showing them all how it should be done”. This comment should be seen in the context that ILP did not even compete in the same markets as Anglo, as it never underwrote commercial mortgages. The pressure to emulate the success of Anglo therefore appears to be very strong and even affecting EBS, a building society committed to mutuality with no pressure of share price performance and ILP, a bank that did not even compete in the same space.

Actor Q (S) in interview observed that pressure for emulation came not only from institution investors but also from the media. Media pressure was also highlighted in interview by ILP’s Actor H (C) and EBS’s Actor I (C). Actor H referred to a radio programme called “Morning Ireland” (he compared it to *Radio 4* in the UK) which had a business section and would always interview the CEO of the banks when their half and full year results came out. He said that when AIB and BKIR were interviewed the first question they would always get asked is “how are you going to compete with Anglo?”. He used this as an example of the pressure banks were under in the press to compete with Anglo. Actor I (C) noted that; *“There was pressure from the financial press, most definitely. Ted McGovern [the CEO of EBS] used to feel the pressure of that a lot.”*

A review of the Irish press covering the period 2005-2006 using the search engine *Nexis UK* underlines this point. There are a number of comments in the press over that period lauding the performance of Anglo and comparing the results to the other Irish banks. A selection of such comments includes:

- *“Over the past few years, both Bank of Ireland and AIB have had problems translating volume growth into improved underlying profitability because of margin attrition ... Anglo Irish Bank continues*

to be the star performer of the sector, however.” (insider’s and market, 2005)

- *“No matter how much bankers at the other financial institutions pay themselves, it will be hard for them to match the rewards available at Anglo Irish Bank.”* (Niall Brady, 2006)
- *“While the absolute return from Irish bank stocks has been good in recent years, the return relative to a strong overall equity market has been disappointing, with the notable exception of Anglo Irish Bank.”* (“Outlook positive for financials,” 2006)

Moreover when BKIR appointed a new CEO in 2004, following the resignation of Mike Soden, *Irish Independent* columnist and senate member Shane Ross questioned why BKIR did not approach Fitzpatrick for the job asking whether he was “far too dynamic” for the BKIR CEO position (“Ahoy, a toff at helm of Bol,” n.d.).

Carswell (2011) quotes an unnamed chief executive whose comments sum up the competitive pressure and motivation that the banks were under to emulate the success of Anglo: “You must remember that at this time Anglo was racing ahead and my shareholders were asking what I was doing about this. Sadly, it came down to the fact that it was a bunch of people trying to compete ... The market were saying that this was a new paradigm, a new model in banking – the relationship thing [the Anglo model of banking]. Why do you think every bank in town went with the same thing to a different degree or another? It wasn’t about pay or bonuses. There was a natural pride at stake” (*ibid*, p. 58).

The comments above refer to “a natural pride at stake” which drove the desire to emulate and compete with Anglo. Nyberg, in interview, suggested that the motivation for emulation came from a fear of losing out: *“What some people feared was that unless you made out like Anglo did profit wise then your owners might start telling you off and you would lose out, you would lose your position, your salary.”* It is submitted that the desire to emulate the success of Anglo was

perhaps different for different actors, but that such emulation would have been, as identified above, some combination of a competitive pride and a fear of being left behind and losing out.

Competitive pressures were not, however, exclusive with respect to wanting to emulate Anglo. The interview process also identified the pressure to compete in the high competitive residential mortgage market as well, particularly in light of the competition from both HBOS and RBS. David Went, the CEO of ILP summed up these pressures when he noted: “You have a decision to make, do you follow the competition or not, do you allow somebody who is essentially a suitcase banker¹⁷³ to come in and take your business and at the end of the day that is the decisions that the Irish banks made, we had franchises and we were going to protect those franchises.” (Lynch, Adrian, 2010)

Actor K (C) noted the pressure that BKIR were under to underwrite 100% mortgages:

“If you look at the peak, 100% mortgages was a big deal in Ireland for lots of people. At BKIR our portfolio for 100% mortgages was only 5%. They [BKIR management] were really unhappy to do it, but they felt they had to do it because the market was pushing them but it wasn’t something they wanted to do. They are a very conservative organisation; the idea of them having 100% mortgages completely flew in the face of anyone in the credit committee.”

Actor K (C) notes that “only 5%” of BKIR mortgages were 100%. A review of BKIR’s 2007 AFS reveals that 5% of residential mortgages would still have amounted to a not inconsequential €1.67 billion.

Actor K provided an illustration of the competitive pressure when he provided the following anecdote:

¹⁷³ This is a reference to foreign banks like HBOS who did not have a strong “on the ground” presence in Ireland.

“I remember when we started melting down [2008] and the 3 month libor rate was 100 basis points I would be running in the morning on Pembroke Road [Dublin] and there would be this sign that said ‘Bank of Ireland tracker loans + 64’¹⁷⁴ and I would be like: why are we doing that, we are not making any money and the response would be ‘we can’t lose market share’ so there was a lot of market pressure.”

Actor J (C) additionally noted the competitive pressure at AIB to maintain market share in residential mortgages at AIB, and that this was done at the expense of asset quality in the lead up to the crisis.

In summary, a review of the literature and the comments in interview suggests that both of Ireland’s leading banks, AIB and BKIR, looked to emulate the success of Anglo in the commercial property market. Further, evidence in interview suggests that even EBS and ILP, who were not direct competitors of Anglo, were affected and pressurised due to Anglo’s apparent success. Pressure to emulate came from the financial press and from institutional investors and from a natural pride and fear of being left behind. Competitive pressures to herd were not exclusive to Anglo and the commercial property market but were also prevalent in the residential market. However, as highlighted in the analysis of the relative growth of both AIB and BKIR’s residential and commercial property assets, and from the evidence above, there was particularly strong pressure to emulate the success of Anglo.

¹⁷⁴ What Actor K is describing is the bank lending money at a margin of 0.64% over the reference rate when it was costing BKIR 1% above the reference rate to borrow the funds to pay for the mortgages, in effect taking a loss of 0.36% per annum on the mortgages (before accounting for administrative and capital costs, counterparty and market risk associated with the mortgages).

7.7 Conclusion

This chapter identified and discussed five separate research questions. These questions were developed in relation to two of the three strands of this thesis. First, to provide some academic rigour with respect to Nyberg's (2011) assertion that the Irish banks were characterised by groupthink symptoms and herding in the lead up to the crisis. The analysis in research questions 2 and 5 above, focused on Anglo and the theory developed earlier in this thesis that Anglo suffered from groupthink symptoms and that the other Irish banks looked to emulate Anglo's strategy.

Groupthink was measured with reference to Janis' original construct and each of his seven antecedents and eight symptoms of groupthink. The decision was taken to follow Janis' definition of the strong version of groupthink to reduce the opportunities for a suspicious fit, which can exist if a researcher can "self-select" the relevant antecedents and symptoms of groupthink and then apply those to a case study. Further, as discussed Janis' version of groupthink has specific relevance in the context of the corporate board environment, This approach provided a clear structure and discipline for the analysis.

Observations for each research was drawn from a very wide and extensive range of sources, including a series of interviews. It is accepted that the sheer volume of information included in the discussion of each research question may make the reading of this chapter "heavy going". However it is submitted that the volume of the evidence provided is a consequence of the desire to counteract any unconscious confirmation bias I may have in this research. The thought process being that a very thorough and rigorous examination from as many different sources as possible is necessary to mitigate the risk of a suspicious fit. This analysis was, therefore, made with a great awareness of the risks of inherent confirmation biases .. However, it is accepted that there still remains a risk of unconscious biases affecting my research findings.

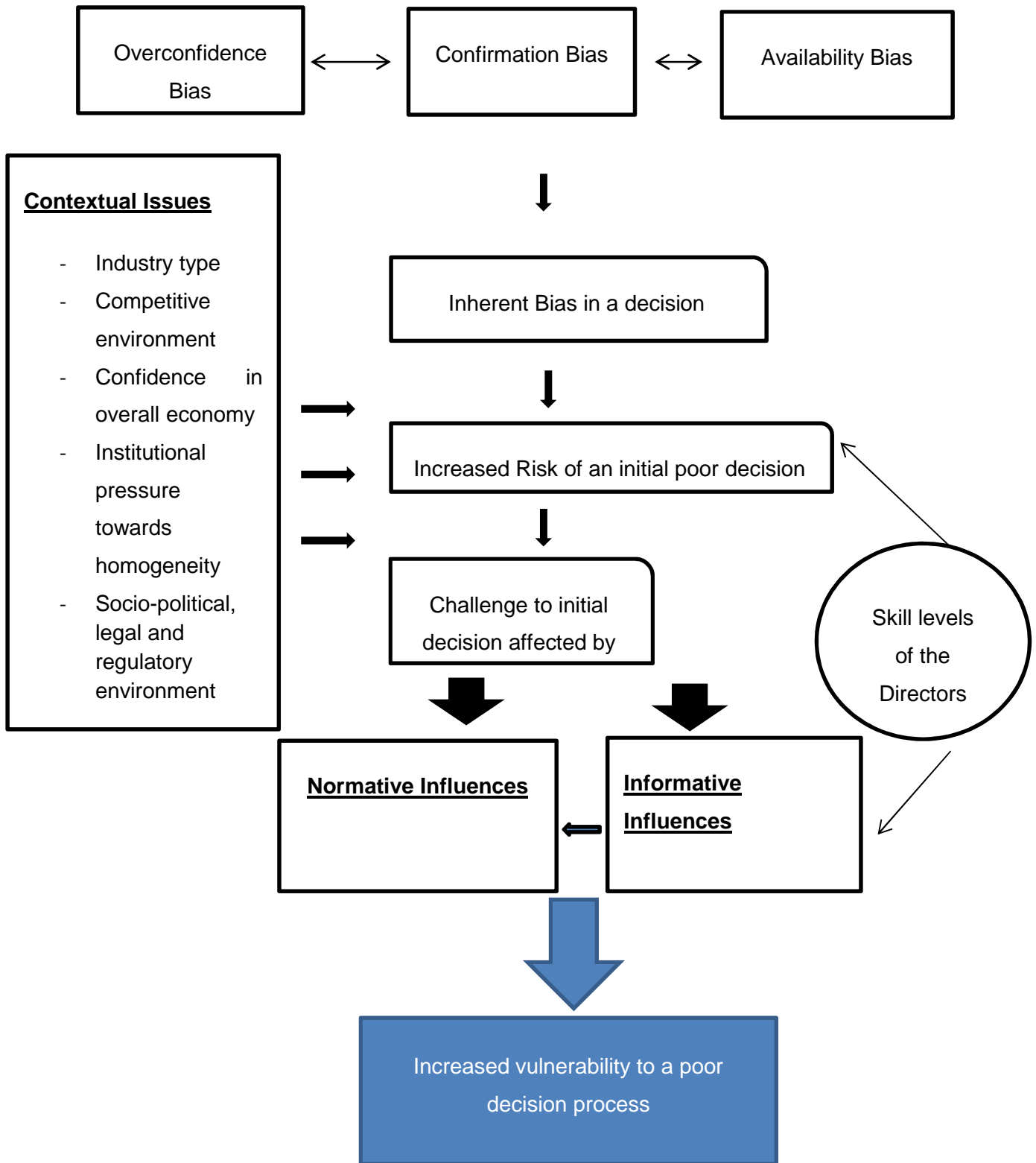
A summary of the research questions and the summary observations drawn are summarised below:

Research question	Summary
<i>Research question 1: The Anglo board was affected by an epistemic blind spot towards property as an asset class and also displayed other inherent biases in their decision processes.</i>	Support evidenced for this proposition.
<i>Research question Two: The Anglo Board was affected by the antecedents and symptoms of groupthink in the lead up to the financial crisis.</i>	Support evidenced for this proposition.
<i>Research question Three: The Anglo board's decision process in the lead up to the crisis was affected by group polarisation.</i>	Limited support evidenced for this proposition. Analysis of the research question was affected by lack of access to Anglo board members.
<i>Research question Four: The directors of the Irish banks had limited banking knowledge and experience.</i>	Support evidenced for this proposition.
<i>Research question Five: The Irish banks herded in the lead up to the crisis and in particular emulated the strategy of Anglo.</i>	Support evidenced for this proposition..

What follows below is reconciliation between the observations from the case study and the model itself.

A summary of my firm specific proposed model is included below for ease of reference:

Repeat of my completed model (firm specific)



The applicability of the model to the Anglo case study is summarised in the table below:

<p>An initial poor decision process affected by inherent biases in decision processes related to overconfidence, availability and confirmation. An epistemic blind spot being an extreme form of confirmation bias.</p>	<p>Research question 2h) above highlighted the high levels of confidence at Anglo and the belief that the Anglo board was “infallible” (quote from interview with Actor A).</p> <p>Research 1 above observed examples of availability biases and a strong confirmation bias relating to property as an asset class which pervaded Irish society. This emotional attachment to property may have led to an epistemic blind spot towards property at Anglo and competing banks.</p>
<p>The decision processes at Anglo were affected by normative influences.</p>	<p>Research question 2 reviewed all seven antecedents and eight symptoms of groupthink and the conclusion drawn was that there was support for Nyberg’s assertion with respect to groupthink as it related to the board of Anglo.</p> <p>Research question 3 further identified that the board of Anglo could have been affected by group polarisation, another identified normative influence on decision processes.</p>
<p>The decision processes at Anglo were affected by informative pressures.</p>	<p>No direct evidence was gathered which could evidence “internal” herding and that Anglo board members chose to ignore their own information based on the rational act of assuming that other directors had superior knowledge¹⁷⁵.</p> <p>However, what the research did observe was highlighted levels of homogeneity (research question 2e)), a strong directional leader (research question 2c)) and low levels of director skill levels (research question 4) all characteristics associated with internal herding. The existence of these observables increases the likelihood that the board was affected by normative pressures on decision processes.</p>
<p>The board of Anglo was characterised by low level of director skill levels.</p>	<p>Research question 4 observed that the executive directors of Anglo had strong lending backgrounds but little or no experience about the liquidity and</p>

¹⁷⁵ The lack of access to main board directors at Anglo meant that there was no way to directly verify this claim.

	<p>treasury functions at Anglo. Further, the research questions identified very low levels of banking experience amongst the NED directors. Low functional skill levels increases the likelihood of internal herding and the initial suggestion of a poor decision process.</p>
<p>Influence of contextual influences</p>	<p>A number of contextual macro influences were identified as potentially affecting the micro decision processes.</p> <p>The model identified the industry type as creating a social identity within which individual firms operate and banking, and indeed the Irish banking industry specifically, was identified as an industry which had a history of failure associated with poor judgements, and ethical indiscretions.</p> <p>High levels of confidence in the overall economy was identified as affecting confidence at the micro level. The perceived success of the Celtic Tiger and the associated new era thinking has been identified and discussed, particularly in relation to the chapter on the Irish economic background leading up to the crash.</p> <p>High levels of competition were another contextual factor identified as affecting firm specific behaviour. Research question 5 above identified an extremely competitive industry in the lead up to the crisis.</p> <p>Finally, broad institutional pressures towards homogeneity was identified as a factor which could impact homogeneity within individual firms. Evidence highlighted that Ireland's geographical isolation, its small population, and the domination of its two leading Universities were all contextual factors which encourage homogeneity within the micro board environment.</p> <p>Finally the socio-political environment in which the Irish banks were operating has been highlighted in chapter 5.</p>
<p>Increased likelihood of a poor decision process with risk of associated ethical indiscretions.</p>	<p>Anglo has been identified as being associated with a number of poor decision processes costing the Irish government in excess of €50 billion to bail out this "rogue" bank (Nyberg, 2011). Further, a number of ethical indiscretions related to the Anglo board have been identified and discussed in this thesis.</p>

Furthermore, the model of poor decision processes identified that the model can be applied at different levels and that a poor decision process at a leading firm

(Anglo) could lead to herding at rival banks. The Irish case study evidenced that there was herding by the Irish banks (research question 3) and that the skill levels of the directors of the Irish banks in general was low (research question 4) which would have increased vulnerabilities to informative pressures. Further, the contextual factors identified as affecting the micro environment in which decisions are made was the same for all the Irish banks. In other words, the model highlights the systemic risk to a poor decision process.

The model emphasised the interconnectivity of the related phenomena and their common attributes and that these phenomena can combine together to create an even more powerful force. Homogeneity, high levels of competition, and a strong directive leader are common to both normative and informative influences. All three of these observables were observed in the case of Anglo . Finally, the model recognised that there is importance not only identifying the observables but also in measuring the strength of the observables. This thesis did not undertake a comparative analysis between Anglo and other institutions to measure the relative “strength” of relevant observables. A comparative analysis which looks to apply the model in relation to both firms that failed and those that came through the crisis relatively unscathed would provide further insights into the robustness of the model itself. For practical purposes such a detailed comparative analysis was not feasible and is highlighted as an area for further research. In summary, however, evidence from the five research questions analysed in this chapter are supportive and consistent with the attributes identified in the model of poor decision processes.

Chapter 8 Policy Recommendations and Concluding Discussions

8.1 Introduction

The introduction to my thesis identified three related strands which form the basis for this research. The first of these relate to evidencing and developing the Nyberg Commission's assertion that Anglo suffered from groupthink and that the Irish banks looked to emulate the success of Anglo increasing systemic risk in the Irish banking sector. The second related to the development of my model of VPDP. The third and final strand to this thesis relates to the recommendation of reforms which arise from the model itself.

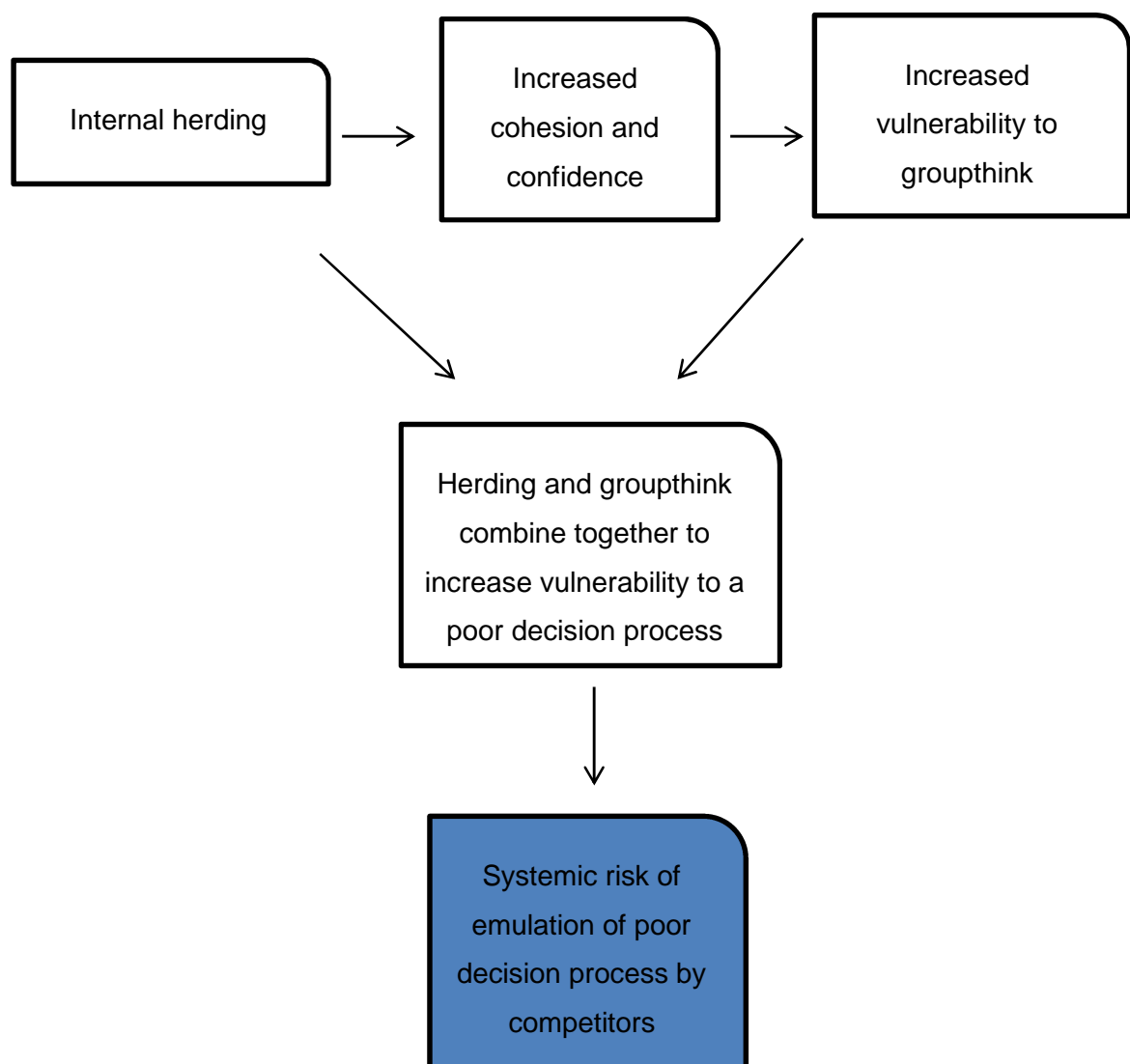
In this chapter I use my model of VPDP as a basis for identifying areas to concentrate governance reforms. I then discuss and recommend reforms which can reduce the chances of a poor decision process in the context of a corporate board. Finally, I conclude the chapter, and my thesis, with a summary discussions highlighting both the limitations of my research and identifying areas for further research.

8.2 Application of my model with respect to potential reforms

Herding, as discussed previously, is an informational pressure where subjects subordinate their own private information in favour of the signals they receive from others. Herding within a boardroom ("internal" herding) can result in a reduction of boardroom challenge as actors assume that others have superior information, suppress their own information, and follow. This lack of boardroom challenge related to informative pressures can create an environment where there are high levels of consensus which can result in the board becoming more cohesive and more confident in its chosen strategy. Cohesiveness and high levels of confidence are attributes associated with normative influences on

decision processes and in particular groupthink. Informational influences then increase the likelihood of normative pressures on decision processes. Related phenomena can, as highlighted previously, combine together to create an even more powerful force than when looked at in isolation. The connection between herding and groupthink and the cause and effect relationship is reflected diagrammatically below:

Figure 8.1: Herding and Groupthink

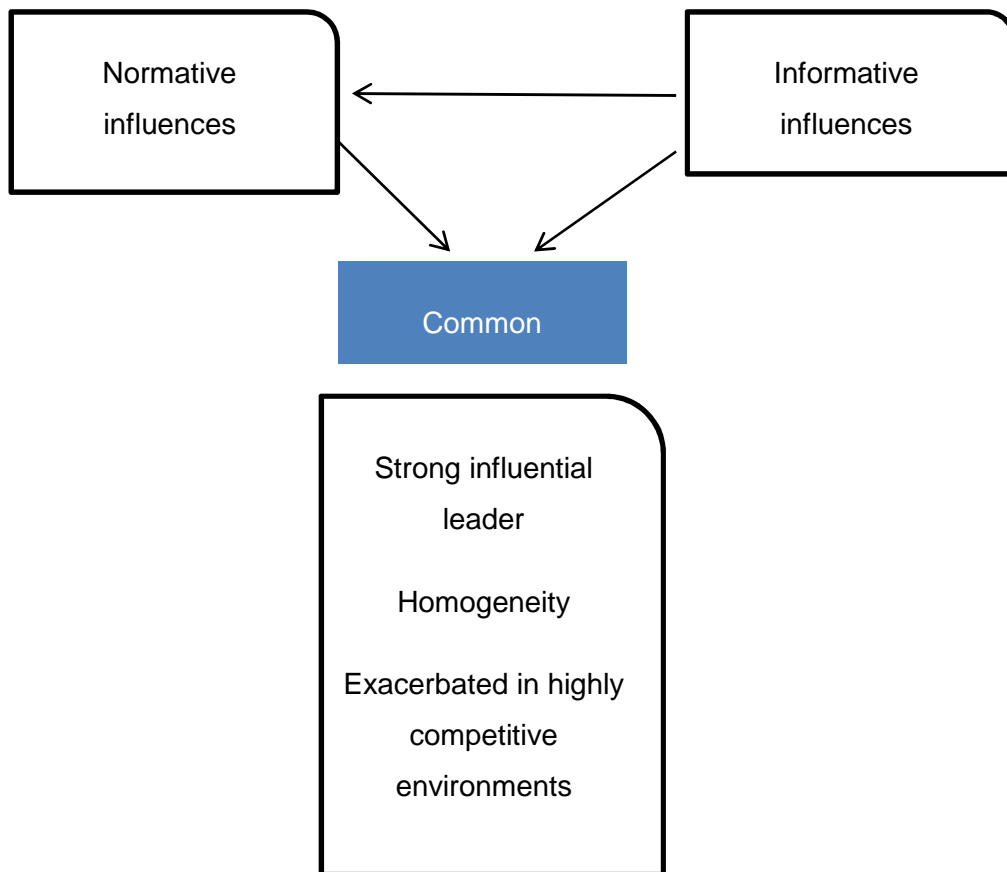


Given the potential cause and effect relationship between herding and groupthink, and the systemic significance of herding, a good starting point for reforms may be to look at ways of reducing internal herding, therefore increasing boardroom challenge, and potentially dampening board confidence and cohesion related to groupthink. A summary of the literature on herding from chapter 3 identified that herding is more likely:

- when there is a strong influential leader
- in homogenous group settings
- in highly competitive scenarios
- when the skill levels of directors is low

The literature review further highlighted common observables between groupthink and herding, and that groupthink, like herding, is characterised by antecedents related to directive leadership and homogeneity. Moreover, boards which are homogeneous with similar values and ideologies are more likely to be characterised by the socio emotional cohesiveness that is core to Janis's groupthink construct. High levels of competition are associated with both normative and informative influences on decision processes. External competition was identified as increasing an "in group" bias and exacerbating cohesiveness associated with groupthink. Herding was identified as being exacerbated when levels of competition are high. These common links between are reflected diagrammatically below:

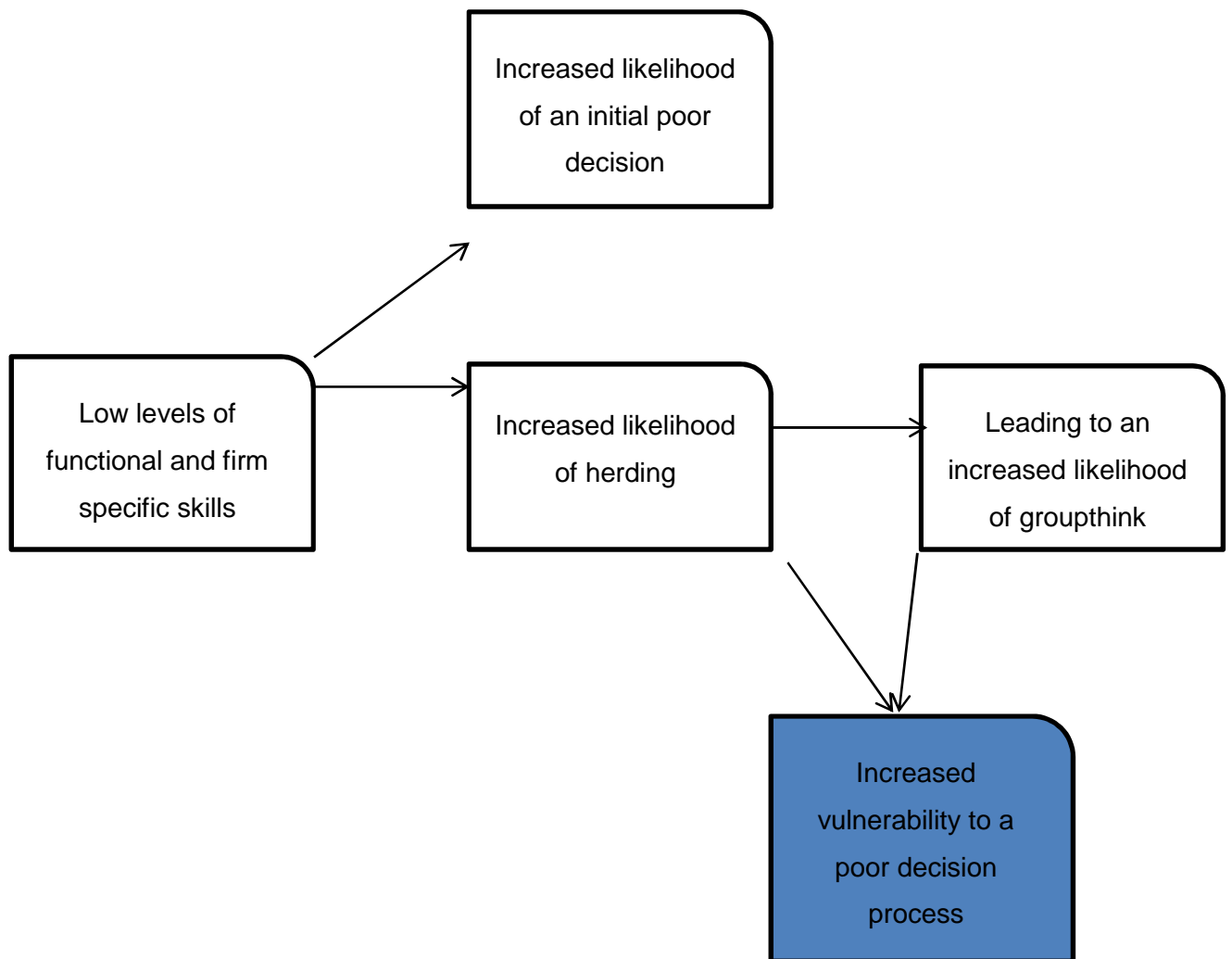
Figure 8.2: Normative and Informative Influences



The skill levels of the directors, and the NEDs in particular, are associated with normative but not informative pressures to conform. Directors' skill levels however affect not only the likelihood of herding (and indirectly the increased likelihood of groupthink) but *also* the likelihood of an initial poor decision being made¹⁷⁶. The skill level of a director therefore “touches” two important parts of the proposed model. This is reflected diagrammatically below:

¹⁷⁶ An initial poor decision, or suggestion, is the starting point for the model of VPDP itself.

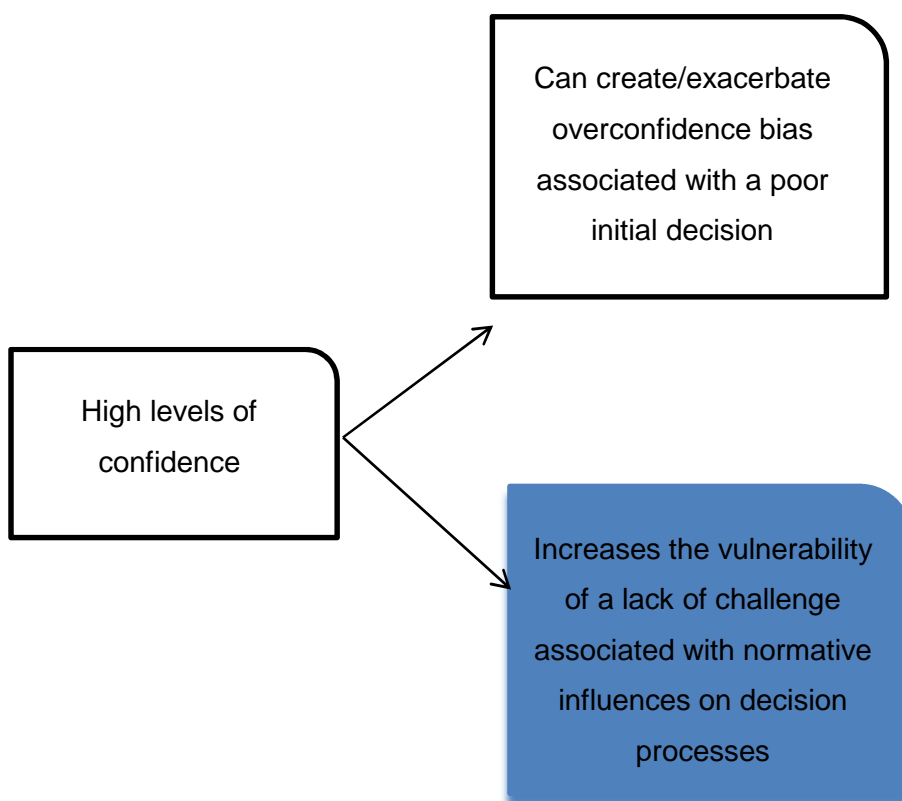
Figure 8.3: Skill level of Directors



The model identified the importance of context and that the macro environment has an impact on the micro environment in which boards are operating. In particular, the literature review highlighted that high levels of confidence in the broad environment in which firms are operating, will impact confidence levels within individual boards. High confidence levels have been linked to group polarisation and in heightening group extremity, and are associated with the illusions of invulnerability which is a symptom of groupthink.

Further, one of the inherent biases in decision processes which can affect an initial strategy recommendation relates to an overconfidence bias where actors overestimate their own abilities which can lead to mistakes in decision making. Overconfidence therefore affects both an initial decision suggestion, and is associated with normative influences which can then dampen the likelihood of a boardroom challenge. This is highlighted diagrammatically below:

Figure 8.4: High levels of confidence



In summary, this chapter has identified the need for reforms associated with informative influences on decision processes. The rationale for this being the close interplay between normative and informative influences and that informative influence can increase the likelihood of normative influences on

decision processes. A review of the attributes identified three factors which are common to both normative and informative influences, namely; directive leadership, homogeneity and the impact of competition. This commonality is not surprisingly given the constant interplay between the various factors identified as affecting decision processes identified in the model. The review further highlighted the importance of the skill levels of the directors both in affecting an initial strategy recommendation and the likelihood of herding and dampening of the challenge to an initial recommendation. Finally confidence, both in the wider economy, and also within the firm itself, was another factor identified as affecting different parts of the model. What follows below is a discussion of potential reforms which address the “pressure points” identified in the analysis above.

8.3 Uncontrollable variables; competition and confidence

The analysis above highlighted that both high levels of competition and confidence as factors that could influence a decision process. It is submitted that reform suggestions relating to both of these factors are outside the remit of this thesis. Competition between actors is a key cornerstone of a capitalistic ideology and economists dating back to Adam Smith (1863), have argued that competition ensures the efficient allocation of resources to the most productive resources. This thesis therefore is not intending to argue that competition should be dampened so as to reduce the opportunities for both groupthink and herding from occurring within boardrooms. A wider discussion on how to manage and regulate competition is beyond the remit of this thesis.

However, what the literature does highlight is that high levels of competition, as was evidenced in the Irish banking environment, is a factor that can influence decision process within boards. Further the threat related to high levels of competition has been mentioned as a contributing factor with respect to the mistakes made by credit rating agencies in the lead up to the crisis (Angelides

et al., 2011) and has been mentioned with respect poor decision made by accounting firms (Bazerman and Tenbrunsel, 2013). High levels of competition in a particular industry could be viewed as a red flag that identifies the increased susceptibility of individual firms and the industry collectively of a poor decision outcome.

High levels of confidence relates to both confidence within the boardroom and also the general confidence that pervades the broader environment particularly in periods of high growth and perceived wealth creation (see for example Akerlof and Shiller, 2009). Confidence in the macro environment feeds into confidence in the micro board creating a cycle of confidence.

Former US Federal Reserve Chairman Martin famously commented that the job of the regulator “is to take away the punch bowl when the party gets going” (Mankiw, 2007). One of the tasks of a regulatory body is to temper confidence in an economy to prevent the economy from “overheating” and suffering from “explosive euphoria” associated with speculative booms (Minsky, 1992). However, a debate on the techniques and merits of central bank regulation are beyond the remit of my thesis. All this research intends to do is to highlight that high levels of confidence in an economy can impact decision processes within individual firms, and that this could increase the vulnerability of a poor decision outcome from occurring.

The discussion above refers to general confidence in the macro economy and that high levels of confidence in the broad macro environment will impact confidence on a firm specific or micro basis. However this is not the only determinant of confidence within individual firms. Firm specific levels of confidence could be affected by a number of factors. For example, recent successes which result in high growth and share price appreciation could increase management confidence in their strategy. This confidence could be exacerbated by the lack of a robust boardroom challenge which could make management more resolute and confident in the execution of their strategy.

High levels of confidence can, as highlighted above, be associated with overconfidence biases and normative influences on decision processes so that an ultimately poor decision goes unchallenged. The Anglo case study highlighted the confidence of Anglo's management in the lead up to the crisis. Further, there is evidence to suggest that the boards of RBS and HBOS were both characterised by high degrees of confidence associated with past successes in the lead up to the crisis (for evidence of this see at RBS see Martin (2013) and at HBOS see Perman (2012)).

High levels of confidence within individual firms are, it is submitted, another red flag that might indicate the susceptibility of a firm to a poor decision outcome. Such high confidence is however a symptom rather than an antecedent and the way to address this symptom is to suggest reforms which themselves might temper high confidence itself. This can be achieved indirectly through the reduction of boardroom homogeneity, which is associated with high confidence levels. Such reforms are discussed later in this chapter.

In summary, both high levels of competition in a specific industry and high levels of macro and firm specific confidence have been identified as potential warning signals related to the risks of a poor decision processes. However, for the reasons given above, this thesis has not suggested specific or direct reforms which might mitigate these factors.

8.4 Socio economic environment in which firms operate

The literature review in chapter 3 highlighted that the socio-economic climate in which organisations operate is hugely important in creating an environment which influences and shapes attitudes and thoughts of boards and their decisions. Bank boards are largely a microcosm of the wider business related macrocosm. The ethical, moral, regulatory and political environment which existed in Ireland, as evidenced above, are contributing factors when explaining

why Ireland suffered disproportionately in the recent crisis. Indeed, Levine et al. (2000) argue that culture, and the ways of thought, tools and the artefacts of a group of people, is both socially constructed and socially transmitted and that it carries the past history of a group into the present and influences how group members understand their environments.

It does not, however, follow from this that research should focus *only* on wider and broader type reforms of a socio-economic and political nature and that specific corporate governance research and reform recommendations are meaningless. Strong corporate governance and robust decision making procedures within boardrooms will affect the wider attitude of recklessness and speculation within a given network. The broader attitudes in society towards consumption are affected by decisions by bank boards to encourage lending and risk taking. A symbiotic relationship therefore exists, and reckless decision making within bank boards encourages an environment of risk taking and speculation within the wider society. At the same time, the environment in which the banks operate, and the overconfidence and new era thinking that might be built up in a network, will affect the attitudes and risk tolerances of bank board members. The micro and macro both affect each other and are inextricably linked.

Understanding the wider socio-economic environment is an important building block in understanding why banks made some of their decisions in the lead up to the crisis. It is not, however, a panacea for explaining the reasons why, for example, the Irish banks became so exposed to an overvalued property market. There are specific structural reasons within and between boards that can contribute towards understanding their decision making process in the lead up to the Irish banking crisis. Research and reforms need to address both macro and micro issues. My thesis is concerned with research and reforms at the micro bank level (which will affect the macro environment) but also recognises that such research and reforms need to be accompanied by a wider socio

economic and political discussion. However, a discussion of such reforms is considered outside the remit of this thesis.

8.5 Homogeneity and Diversity within the context of corporate boards

Homogeneity has been identified as being an attribute associated with both normative and informative influences on decision processes and thus represents an important touch point for which to focus potential reforms. The antidote to homogeneity is to increase diversity within the context of the corporate boardroom. In theory, if boards are diverse rather than homogenous, its members are less likely to be subject to the social pressures of conformity. Diverse board members should have more creative ideas which members are not afraid to express, leading to greater levels of boardroom challenge. Diverse boards are also less likely to be isolated and have access to a wider range of networks and information.

Finally, confidence can be associated with high levels homogeneity and the lack of a challenge to the status quo resulting in the re-enforcement of existing views. Diverse groups are also more likely to have different viewpoints which can stifle over confidence in a group setting.

Diversity can, in theory, therefore be an important mitigating factor in reducing cohesiveness, isolation, confidence and homogeneity, all factors associated with poor decision processes. Chapter 2 included a review of the relevant literature on diversity, and in particular gender diversity. The conclusions from this review was that diversity can be a double edged sword but that, in the context of the corporate boardroom, there is often a natural pull away from diversity and resulting cognitive conflict associated with a robust boardroom challenge, and a tendency for boards to be characterised by collegiality and homogeneity. On the subject of gender diversity, the chapter concluded that it does not necessarily follow that simply increasing the number of women on a

board will result in greater cognitive diversity. Rather, achieving true cognitive conflict is more complex than simply changing the gender mix of a board. However, the chapter concluded that gender diversity although not a panacea, may be a good proxy for true cognitive diversity.

The UK Corporate Governance Code (2014) recognises the importance of diversity in the context of good governance. Indeed, the Preface to the 2014 Governance Code highlights that: “The problems arising from ‘groupthink’ have been exposed in particular as a result of the financial crisis. One of the ways in which constructive debate can be encouraged is through having sufficient diversity on the board. This includes, but is not limited to, gender and race” (*ibid* para 2). Provision B2 of the Code notes that the appointment of board candidates “should be made on merit, against objective criteria and with due regard for the benefits of diversity on the board including gender”. Provision B.2.4 further highlights that the annual report should describe the work of the nominations committee and that this should include a description of the board’s policy on diversity, including gender. As discussed in chapter 2, the UK has decided against imposing a gender quota on boards¹⁷⁷. The explicit

¹⁷⁷ There are a number of challenges when recommending reform which would encourage diversity in the corporate boardroom. First, should such recommendations or reforms be enforced on boards or should boards be “encouraged” to promote diversity? This is, it is submitted, a discussion about the merits of the different means of enforcing/encouraging governance changes and in particular the philosophy of “comply or explain” which is central to the UK Code of Conduct. The UK appears committed to this philosophy and, as highlighted above, this is reflected in the UK’s response that gender diversification should be encouraged but not enforced.

However, despite the benefits of diversity being highlighted in the Cadbury (1992) and the Tyson Reviews (2003) there was a lack of diversity associated with boards in the financial crisis. Therefore, it could be argued that a similar call from the Walker Review (2009), the Davies Report (2011) and the Corporate Code will also go unheeded and that the natural pull towards homogeneity within boardrooms is too strong. This argument would point towards the need for

acknowledgement in the Corporate Governance Code and the requirement for boards to disclose their policy on diversity are, it is submitted, helpful in ensuring that boards are aware of the need for diversity in the boardroom.

However, my model of VPDP has identified the need for cognitive diversity as being a critical “red flag” in the model and given this, perhaps more could be done to stress the importance of diversity. There are a number of challenges when recommending reform which would encourage diversity in the corporate boardroom. First, should such recommendations or reforms be enforced on boards or should boards be “encouraged” to promote diversity? This is, it is submitted, a discussion about the merits of the different means of enforcing/encouraging governance changes and in particular the philosophy of “comply or explain” which is central to the UK Code of Conduct. The UK appears committed to this philosophy and, as highlighted above, this is reflected in the UK’s response that gender diversification should be encouraged but not enforced.

A potential solution could be the creation of a diversity index which measures the diversity of a boardroom by means of a diversity scorecard. The scorecard could work on a points system which recognises the type of cognitive diversity described in this chapter. Board members could score “points” for their educational and industry background, their age and gender (in relation to existing board members) and time of service. Such a scorecard would need to be dynamically managed and consider the existing mix of a board into account when scoring diversity. For example, if all of the directors are of a similar age or gender, then this would need to be reflected as a scorecard “negative”.

legislative enforcement in the area of boardroom diversity. This would be however contrary to current UK libertarian philosophies with respect to governance reform and contradictory to recent conclusion in the Davies Report (2011). A debate on the merits of the “comply or explain” philosophy of corporate governance is however outside the remit of this thesis.

A fundamental weakness identified with respect to such an index is that diversity alone is inadequate to ensure a robust boardroom challenge. The functional and firm specific skill level of the directors was highlighted in the model as being an important focus point in determining a decision outcome, and low skill levels will increase the likelihood of an initial poor strategy decision. Further, low skill level will also increase the vulnerability of directors to internal herding. If a NED does not have the necessary levels of skill or experience then it is more likely that he/she will accede to the majority view based on the assumption that others have better information. In effect uninformed and unqualified NEDs will tend to herd, with no, or limited, ability to challenge management. Indeed, Kirkpatrick (2009) argues that one of the causes of the crisis was the lack of necessary experience and understanding by the NEDs on many boards¹⁷⁸. In summary, a director which brings diversity to a boardroom but lacks the necessary skills and knowledge is still vulnerable to informative pressures to herd.

Indeed it is submitted that what could be created instead is an index which looks to capture *both* diversity and director skill and knowledge. Such an index would recognise the relationship between diversity and knowledge and that the benefits from diversity can be dampened by low levels of director knowledge.

A combined skills and diversity scorecard could be published and publicly available and used in a number of ways. It could potentially just be another form of disclosure and would highlight to regulators, investors, and to boards themselves the relative mix of both diversity and skill levels of their board. This

¹⁷⁸ The lack of experience of many independent NEDs is highlighted also by the Walker Report (2009). The Walker Report has made a number of recommendations to improve the level of expertise and knowledge of NEDs (*ibid*, p. 14). These reforms which focus on director training has been adopted by the UK Corporate Governance Code 2012 (see para B1, B51, B.3.2, B4.1 and B.4.2).

would be in keeping with the “comply or explain” philosophy underlying UK governance reforms.

The scorecard could however be more impactful in that boards would be required to meet a predetermined minimum score and that if boards went below the agreed threshold, boards would need to modify their board composition. This would be a more forceful suggestion in that it would impose minimum standards of diversity and expertise on board compositions.

The arguments against such a suggestion are that the mix between diversity and knowledge cannot accurately be measured by an “arbitrary” list of criteria. Further, how do you go about setting a minimum level of diversity that all firms are to meet? Can one force a company that might be performing very well, from altering its board composition on the basis of a scorecard¹⁷⁹? Indeed, it could be argued that regulators should not impose or enforce changes on the composition of public companies. Rather they should be free to decide themselves on the composition of their own boards. The counter argument to this being the importance of diversity in the context of boardroom challenge and the pull towards homogeneity and the influence of behavioural factors which may mean that boards are not best placed to manage the mix of their boards. As such regulators need to intervene in the best interests of companies and the wider society.

Regardless of whether such a combined index is enforced or not, it would, it is submitted, be a useful tool to highlight the importance of both diversity and expert knowledge in boardrooms. Such a scorecard would ensure that diversity and the importance of the concept retains a high profile whilst at the same time would highlight that diversity in isolation may not be enough to ensure a robust boardroom challenge. An additional benefit of such a scorecard is that it would

¹⁷⁹ However, as highlighted previously, a strong performing non-diversified board may still be vulnerable to a poor decision outcome in the future.

be done on a dynamic basis. As highlighted previously, diversity should be dynamically measured and that there is tendency of boards to become more cohesive and homogenous over time. A scorecard could take this into consideration (through the inclusion of years of service as one of the measurement criteria). In contrast, however, the level of expert knowledge of the directors will increase over time. There is an important trade-off between diversity which reduces over time and skill and expertise which should increase over time. This reflects that a constant and dynamic balancing act is required when looking to achieve a robust bank board.

An analysis could be undertaken to check the robustness of such an index using archival data of boards in the lead up to the crisis. Such an index could be tested retrospectively to see if there was any correlation between the relative board rankings of a combined diversity and expert index and the financial performance of banks in the lead up to the crisis to see if there is any correlation. High levels of correlation would provide further weight to the concept.

Like many recommended reforms, the “devil is in the detail” and there would need to be much debate as to the agreement and weighting of the criteria that would make up the index and the weighting with respect to both knowledge and diversity. Ideally a board is looking for an NED who can bring both diversity and expert knowledge to the boardroom. Although it is accepted that there might be a degree of arbitrariness in the creation of such an index and that it can be accused of meddling in the affairs of the privately owned corporations, the importance of diversity and expert knowledge to robust boardroom challenge is arguably significant enough to override these concerns.

8.6 Directive Leadership

The influence of a strong directive leader has been recognised in the model as a characteristic that could be associated with both groupthink and group polarisation and as such has been identified as another important area for governance provisions and reform recommendations. The UK Corporate governance Code (2014) recognises that an overbearing and directive leader can be detrimental to good decision making. Section A of the Code stresses that the company should be run collectively by the board and that: “No one individual should have unfettered powers of decisions.” Section A2.1 sets out a clear distinction between the chief executive and the chairman noting that they should not be exercised by the same individual. Further Section A.3.1 discourages a chief executive becoming the chairman of the same company and that if a company decides to do this, it must consult with major shareholders in advance of the appointment and set out the reasons in the annual report¹⁸⁰.

Further Section B1 notes that “No one other than the committee chairman and members is entitled to be present at a meeting of the nomination, audit or remuneration committee, but others may attend at the invitation of the committee”. Section B1 further notes that “The Board should include an appropriate combination of executive and non-executive directors such that *no individual or small groups of individuals can dominate the board’s decision making*” (italics added).

Janis (1972) recognised the role that a strong directive leader might play in creating an environment in which groupthink thrived. Janis devotes chapter eleven of his book *Groupthink* (Janis, 1972) to the subject “Preventing

¹⁸⁰ The Irish Corporate Governance Code for Financial Institutions (2010) is more prescriptive in this regard and notes that an individual who has been the CEO during the previous 5 years cannot become the Chairman of that institution (para 8.10). This reflects the only discernible difference between Irish and UK governance codes in this area and perhaps is a direct response to Fitzpatrick moving from CEO to Chairman at Anglo.

Groupthink". In this chapter he made seven core recommendations as means of preventing groupthink which focus primarily on the reducing the influence of a directive leader. These are noted below:

- 1) The group leader should encourage all group members to air their doubts and objections.
- 2) Leaders should adopt an impartial stance rather than stating upfront their own preferences.
- 3) Organisations should set up independent groups working under a different leader on the same issue with these groups then coming together afterwards to discuss their specific solutions.
- 4) Each member of the group should discuss the group's deliberations with trusted associated in his/her own unit and report back their reactions.
- 5) Outsider experts should be invited to meetings and should be encouraged to challenge the views of the majority.
- 6) At each meeting a member should be assigned the role of a devil's advocate.
- 7) Introduce a system of "multiple advocacy" which may look to mitigate the effects of homogenous groups. This would involve a selection policy for the policy groups that captured members of groups which had naturally divergent positions within the organisation. In other words, specific selection of non-homogenous members to form groups.

Janis, in making the recommendations above, appears to assume that membership of the group are fixed and as such he makes no recommendations related to increasing the diversity of the group itself - highlighted previously as an effective means of reducing both normative and informative influences on decision processes. Moreover, Janis's recommendations are not directly linked to what he identified as the causes of groupthink and in particular cohesiveness.

Rather they appear to be presented partly as a wish-list with no implicit link or reference to the underlying causes of groupthink.

Janis's first recommendation that the leader must encourage members to air their doubts attempts to mitigate the impact that a directive leader might have on group processes. However in a groupthink situation often the problem is that group members do not have doubts. Further Janis does not comment on what the incentive might be for a leader to encourage a challenge from group members.

A similar comment can be made about Janis's second recommendation that leaders should be impartial and not state their preferences upfront. Again it is difficult to see why a leader that wishes to impose his beliefs would do that. Janis's third recommendation that groups should set up independent bodies to then report back to the board has been implemented in UK Corporate Governance Codes through the recommendations of the creation of separate audit, remuneration and risk committees all chaired by an independent NEDs. These committees did not, to my knowledge, appear at face value to have made any difference in the decision process of boards in the lead up to the crisis.

Janis' recommendation that outside experts be invited to attend meetings and challenge views may provide the group with the cognitive diversity, identified previously as an important factor which could create cognitive conflict, reduce cohesion and the likelihood of groupthink. Further the introduction of outside experts will address the issue of the isolation of board members, a characteristic highlighted as being a key characteristic of poor decision processes. Indeed, one could argue that the boardroom NED is in effect an outside expert as envisaged by Janis. NEDs, as outside experts in many of the bank board in the lead up to the crisis were ineffective in preventing poor decisions being made. This was primarily because of two reasons. First, NEDs characterised by high levels of homogeneity lost their independence and

became too cohesive with the executive board and as such suffered from groupthink like symptoms. Second, NEDs lacked the level of expertise and skills and as such were more susceptible to informational pressures to conform and herd.

The lack of effectiveness of a potential recommended reform, in this case the use of outside experts, highlights the interconnectivity of all the characteristics highlighted in the model related to poor decision processes. A recommended reform cannot be seen in isolation but needs to be considered in light of the overall environment. In principle the idea of bringing in outside experts is a good one, but if the overall environment is one characterised by high levels of cohesiveness, homogeneity and low levels of skills then it will be ineffective given those strong counter-forces.

Janis's suggestion of the creation of a devil's advocate has received the most attention from researchers as a potential mitigating factor to reduce groupthink. Longley and Pruitt (1980) note that the appointment of a devil's advocate could encourage other potential deviants to speak out more freely if they believe that they are not alone. Longley and Pruitt cite Asch's (1955) "line test" in which conformity to an obviously incorrect answer relating to the matching of the length of a line, dropped from thirty three percent to five per cent when a group member other than the subject deviated from the norm.

Longley and Pruitt, however, warned that if the devil advocacy had too much influence this could ironically result in "reverse" groupthink. Further, they highlighted the danger is that the role of the devil advocate will have too little influence, which can occur if the role becomes ritualised. This is a strong possibility when the role is appointed rather than naturally emerging. They recommend the establish of a culture where the individual who on the basis of decision sees himself as most in disagreement with the emerging consensus should speak up as the self-appointed and accepted devil's advocate.

Further, Hollander's (1960) study focuses on the position of the deviant within the group and concluded that it would be inappropriate for the devil's advocate to be either a very high or very low status person, but rather to come from someone with a moderately high status. This recommendation avoids the problems highlighted by Longley and Pruitt cited above.

In summary, the concept of a devil's advocate in a boardroom context is appealing as a "have it all" recommendation as it provides for boardroom challenge but without the conflict. However research undertaken by Nemeth et.al. (2001) highlighted that an authentic minority position in a discussion results in a better decision process than using the "contrived" system of devil's advocacy. Furthermore, Nemeth found that in some circumstances the use of a devil's advocate actually resulted in more support for the initial position and that the process generated more ideas confirming the members' initial position. The concept of a devil's advocate is not, it is submitted, a perfect substitute for "real" cognitive conflict in a decision process. Nevertheless it might still help to encourage a culture of the need for open dissent and challenge within boardrooms.

Kahneman (2011) argues that a system which allows a post mortem before important decisions are made, can be a potential deterrent to groupthink. "The main virtue of the post-mortem is that it legitimizes doubts. Furthermore, it encourages even supporters of the decision to search for possible threats that they had not considered earlier. The post mortem is not a panacea and does not provide complete protection against nasty surprises but it goes a long way to reducing the damage" (*ibid*, p. 265).

Finally Schnall and Greenberg (2012) analysed groupthink in the context of the ancient court of Israel, known as the Sanhedrin, and concluded that although there were a number of organisational and situational factors that should have predisposed the Sanhedrin to the risk of groupthink there were a number of preventative measures in place which would have mitigated the risk of

groupthink. These included very specific guidelines that mandated a methodical review and analysis of the evidence and information presented to the court. Outside experts were encouraged to participate in court rulings and a system of devil's advocacy was introduced into court hearing and indeed if a defendant refrained from defending himself, a selected member of the Sanhedrin was appointed to argue on his/her behalf. Further, if after only brief deliberations all members supported a conviction then the final verdict would be postponed until the next day, and group members then formed into smaller groups for a "second chance meeting". Moreover, members were encouraged to speak in reverse order of seniority, with the most junior Sanhedrin members speaking first. This would minimise the pressure for both normative and informative social influences on junior members.

In summary, a number of processes or techniques have been identified which might dampen the impact of a directive leader specifically and more broadly reduce the likelihood of normative influences on decision processes more generally. These include the creation of a devil's advocate, encouraging influential leaders to speak last, allow "second chance meetings", and encouraging the influence of outside experts.

These are however techniques that can be used by boards and to increase boardroom challenge but are difficult to implement as reforms. Rather, these suggestions are more relevant to be implemented informally or mentioned as part of broad training that boards might undertake. The possible exception being that, in theory, it is possible to recommend that boards are obliged to appoint a devil's advocate. However, as discussed above, this is a contrived solution and can actually have the opposite effect (Nemeth et al., 2001), especially if imposed on boards.

8.7 Skill levels of Directors and education and research

The UK Corporate Governance Code (2014) stresses the skill level requirements for both executive and NED in its provisions. In the Preface to the Code it notes that “To achieve good governance requires continuing and high quality effort” (para 6 page 2). Section 2 of the Main Principles of the Code further highlight the requirement that board members need to have the appropriate level of skills and experience and the time to discharge their responsibilities effectively. Section B4 of the Code sets out the training and education that directors are supposed to take, both on joining the board and in regularly updating their knowledge. Finally the Code emphasise that directors should receive accurate, timely and clear information (para B5).

It is submitted that one of the most effective means of reducing the likelihood of poor decisions occurring lies in the area of education and research. In particular a greater appreciation and acknowledgement of some of the normative and informative drivers of board decision making is critical. The Walker Review recognised the importance that psychological factors play in decision process but this was only highlighted in the appendix to the report. More research and exposure needs to be given to the role that psychology plays to move this into the main body of the report¹⁸¹. Indeed, the 2014 UK Corporate Code includes in the preface the comment that “the problems arising from ‘groupthink’ have been exposed in particular as a result of the financial crisis”. This is a comment which has been included since the 2012 Code and perhaps reflects that fact that governance codes are beginning to recognise the importance of normative influences, such as groupthink, have on good governance.

¹⁸¹ There is the beginning of the groundswell of support for greater appreciation of behavioural factors in economic decisions being made in UK Universities. See for example the push by students to change the economics syllabus in Universities. See <http://www.theguardian.com/business/2013/oct/24/students-post-crash-economics>

The UK Corporate Governance Code recognises groupthink and the need for training for directors but it does not go far enough. The Code, it is submitted, should specify that the training should cover the behavioural aspects of groups and how psychological factors such as those identified can affect decision processes. Such training should also include recommendations as how these powerful psychological forces that effect decision processes can be avoided. The behavioural aspects of boards, and the impact that psychology has on board behaviour, needs to be explicitly recognised in the UK Corporate Governance Code.

Turner and Pratkanis (1998) recommend education and training of group members and leaders aimed at increasing their understanding of the processes by which group decisions are made and increase awareness of the need to create an atmosphere in which critical evaluation of projects can occur. Cognitive biases, if acknowledged and understood, can lose their power to unconsciously drive our decisions (Hall, 2007). Board directors can reduce the likelihood of phenomena such as groupthink and group polarisation occurring through a better understanding of the decision processes and acceptances that unconscious biases can, and do, effect decisions¹⁸².

Bazerman and Tenbrunsel (2013) use a visual metaphor to explain the importance of education with respect to identifying behavioural aspects related to ethical decision processes. They show their readers the picture below:

¹⁸² Hopefully this thesis can make a small contribution in this area.



For many readers at first glance the picture is just a blur of dots. However if a reader is told that there is a Dalmatian dog in the centre of the picture, and then asked to try and locate the dog in the picture, then most (hopefully including you) can see the Dalmatian. From then on Bazerman and Tenbrunsel observe that it is very difficult to look at the photo and *not* see the Dalmatian. Bazerman and Tenbrunsel use this metaphor to argue that an important starting point to identifying behavioural aspects which affect decision processes starts with the identification of the phenomena themselves. Although the authors are referring specifically to behavioural aspects as they relate to ethical indiscretions, their point is also appropriate when looking at the type of phenomena identified in this thesis connected to poor decision processes. If this thesis can help in identifying the “Dalmatian” then it would have, it is submitted, have achieved a purpose!

8.8 Recommendations to ensure NEDs are truly independent of mind

The model has identified three key focus areas for potential reforms, namely diversity, skill levels of directors and directive leadership. What follows below is a discussion of complementary but alternative means of improving the decision process in boardrooms which are behavioural based.

The lack of boardroom challenge has been identified as being a contributing factor in the governance failures related to the crisis. This has raised questions as to whether NEDs were truly independent in the lead up to the crisis. Indeed, a potential conflict of interest exists in the appointment process for directors as it is the directors themselves that appoint new directors to the board. The Code has looked to try and mitigate the risk of the perpetuation of an old boys' network with high levels of homogeneity by insisting that the majority of the nominations committee are made up of independent NEDs (code B.2.1 of the UK Corporate governance Code (2014)). There is still, however a risk that the nominations committee is influenced by homophily and the pressure to appoint members that will conform to the existing "in-group" of the current board.

One possible suggestion to both the potential conflicts highlighted above is that an independent advisor, for example legal counsel or the firm's auditor, could be involved in both deciding whether a NED does meet the independence criteria and could also form part of the nominations committee. This may ameliorate some of the existing conflict of interests highlighted above. Practically, it would be difficult for an advisor to opine whether a NED has been independent without attending board meetings and observing the behaviour of the NEDs in board meetings, and even then there is still of course the subjective decision of what determines independence. However an independent outsider could act as an important challenge to strong "in group" biases which might exist and this challenge, or even threat of challenge, might make for a more rigorous process in the review of director independence and in the appointment of directors.

Zhao (2011) recommends greater levels of disclosure to mitigate the potential conflicts highlighted above. For example, the nominations committee should have to explain in detail the nominations process, how the candidate was found, how many candidates were interviewed, and why the candidate was selected. The theory being that this disclosure requirement would ensure some rigour and accountability in the selection process. This point has, however, been

addressed in the UK Corporate Governance Code (2014, para B.2.4) which requires companies to provide detailed disclosure with respect to director appointments and the process it has used in relation to board appointments.

Further, Zhao recommends that independent NEDs are required to make an annual statement to the company confirming their independence and noting any potential conflicts and justifying why such conflict do not affect their ability to be independent. In effect this recommendation puts the onus on individual directors to validate their independence rather than just relying on the board of directors collectively to decide independence. Zhao recommends that this statement be made on an annual basis. A positive implication of putting the onus of independence with individual directors themselves, would ensure that the importance of independence is at the forefront of any NEDs thoughts, and would act as reminder of the individual responsibilities of NEDs.

Marchesani (2005) argues that too much emphasis is placed on ensuring that a director is independent at the time of appointment, whilst what is really critical is how a director displays such independence in the fulfilment of his/her duties. Marchesani therefore suggests a procedure whereby each new independent NED is required to undergo an evaluation process at the end of his/her first or second year of office. At such a time the current directors would determine whether the new director has proven himself to be sufficiently independent. What Marchesani is suggesting is that directors are not given independent status immediately but only after they have proven this in the fulfilment of their duties. Until they are assessed they would be on a form of "probation".

A natural extension of Marchesani's suggestion would be that NEDs would be re-assessed after a period of say six or seven years to ensure that they had retained independence given the risks highlighted above that the ability to monitor diminishes as they become more cohesive and attraction to the group grows. In the current UK Code all directors are assessed collectively on a yearly basis and the Corporate Governance Code calls for the board to undertake a

formal and rigorous annual evaluation of its own performance and that of its committees and individual directors (para B.6). However, the proposal above highlights attention on a specific director at critical times in his appointment, in the early stages and after he/she is well established in the organisation.

It could be argued that the focus of attention on a NED to effectively “pass” a test of independence could ironically result in greater pressure of such director to conform in order to be seen favourably by the very directors who are passing judgement on him. In other words, such an assessment could perversely reduce independence of thought. However the remaining directors are supposed to be assessing a director on the basis of independence of mind, and it would be counterintuitive to decide that a director was independent when he/she is purposely conforming.

In summary, two recommendations arise relating to maintaining NED independence. First, that NEDs are required to make an annual statement to the company that they are indeed independent as suggested by Zhao above. Reminding directors of their own responsibility with respect to maintaining independence of mind will ensure that the importance of independence is at the forefront of NEDs’ minds. Ariely (2013) has shown that when a responsibility is specifically highlighted to an individual this implicit reminder increases the likelihood that the individual will honour the commitment. Second, that directors are not given independent status immediately upon joining the board, but that independence needs to be proven after a trial period. This will further serve to highlight to NEDs the importance of independence in their role and that it is not assumed on election, but rather they need to prove such independence in practice. Further, the need for independence to be reconfirmed after a period of time, forces the board to assess whether directors have maintained this independence of mind in light of the pressure over time towards cohesiveness and collegiality which often exists in board settings.

8.9 Summary of recommended reforms

This chapter has identified a number of potential reforms which are intended to reduce the vulnerability of a poor decision process in the context of a corporate board. These recommendations flow from the model which I have developed, and the identification of three key “touch points” to focus these reforms. These touch points are in relation to reducing homogeneity, increasing the skill level of directors and reducing the impact of a directive leader. These were identified in the model as being of particular importance because of their linkages across the model. For example, if homogeneity can be addressed this can potentially mitigate *both* normative and informative influences on decision processes. Thus any reforms in this respect can reduce both influences and can also reduce the likelihood of related phenomena combining together to create a more powerful force than if looked at in isolation.

Some of the recommendations and suggestions for reforms which have been made are not original but are a summary of those suggested by other academics. However it is submitted that the contribution that this thesis can make is in respect to providing an alternative lens through which these reforms can be understood. For example, a number of commentators have focused on the need for greater diversity in the context of boardrooms and my thesis is in no way unique in suggesting reforms which increase diversity and a robust boardroom challenge. However this thesis has presented the importance of the need to increase diversity in the context of how homogeneity can impact phenomena such as groupthink, herding and group polarisation and how these phenomena can combine together. If you can reduce homogeneity you are reducing the vulnerability to the each of these phenomena and also to the risk of them combining together in a more powerful force (Cox and Munsinger, 1985).

The Walker Report (2009) and the UK Corporate Governance Code (2014) have both recognised the need to increase director skill levels. However my

model describes how increasing skill level in relation to two touch points of the model *both* in terms of an initial policy recommendation but also in terms of the effect that lack of skills can have on internal herding. Internal herding can, as discussed, then create an environment which fosters confidence and cohesiveness associated with normative influences. To my knowledge, I have not seen the need to encourage skill levels of directors being analysed through this lens.

My thesis recognises the balance that is required between diversity and knowledge and that diversity alone can be insufficient to ensure a rigorous challenge in the boardroom. Diverse directors without a sufficient knowledge base are still vulnerable to informative pressures on decision processes. What is required is a balance between diversity and knowledge. For this reason I have suggested the creation of an index which looks to measure both diversity and expert knowledge as a potential means of highlighting the importance of these two characteristics. The conclusion that was drawn was that the need in the context of a corporate board room for both diversity and expert knowledge should not be seen in isolation but rather needed to be viewed collectively when looking to increase boardroom challenge.

The problems with the measurement of this proposed dual knowledge/diversity index were discussed and it was recognised that this is an area which would need a greater level of consideration. Further analysis in respect of the make-up of an index and the opportunities to test such an index retrospectively has been earmarked as an area for future follow up.

The chapter further identified and discussed a number of other reforms that other academics had recommended which could reduce the vulnerability to a poor decision outcome, highlighted in the model. The chapter concluded by emphasising the importance of education in achieving reforms and that a greater recognition is needed to bring the behavioural aspects around bank

boards to the forefront of corporate governance thinking. If this thesis can be the start of a small step to achieving this, then it has been worth it!

A summary of the reforms recommended is provided in the following table:

Recommended Reform
<p>Combined diversity and knowledge index</p> <p>An index has been suggested which looks to capture both the diversity and skill level of directors. Such an index could be made publicly available and would serve a number of purposes. First it would highlight the importance of both diversity and expertise particularly amongst NEDs. Second it would de-emphasise gender diversity as a panacea to increasing boardroom challenge. Third such an index could be dynamically measured so that it takes into account the length of time that directors, and especially NEDs have served. Thus such an index would recognise the constant trade-off between the positive of high levels of skills which are gained from longevity compared to the potential negatives related to lower levels of diversity and cohesion.</p>
<p>Reduce the opportunities for a directive leader dominating meetings and reducing the likelihood of a robust challenge.</p> <p>Directive leadership has been identified as being associated with both normative and informative influences on decision processes and as such is an important touch point to focus reforms.</p> <p>A number of strategies have been suggested by academics which might reduce the impact of a directive leader. These include modifying the order in which board members speak so that more junior members get the chance to</p>

Speak first.

The designation of a specified “devil’s advocate” amongst board members, whose job it is to argue a contrary position, has been discussed as a possible technique that might increase board challenge generally and also potentially dampen the influence of a directive leader. However, on balance it was concluded that this was an artificial and contrived means of trying to create cognitive conflict.

Other techniques to increase boardroom challenge recommended by academics included the concept of a second chance meeting and the encouragement of outside experts to join and opine on board processes. The conclusion drawn was that these were all potential techniques that boards can use to increase cognitive conflict.

The existence of a strong influential leader should act as a warning signal to both regulators and boardrooms that there are risks associated with directive leadership. Furthermore, even if the corporation appears to be successful at the time, this does not mean that there is not a risk of a poor decision outcome occurring in the future which is not sufficiently challenged, or that the consequences of an already poor decision process will be felt at some stage in the future.

Requirements to remind NEDs of their responsibilities of independence

The chapter identified a number of potential recommendations that other academics have made in respect of highlighting to NEDs the importance of their independence.

Further, the thesis identified that one of these recommendations could be developed further whereby there is individual and dynamic assessment of NED

independence especially after an NED has served a certain number of years in the office. Such assessment could include additional director training which emphasises and highlights the behavioural influences on decision processes.

A greater awareness and understanding of the biases which affect decision processes is an important starting point to preventing these biases from affecting decision processes. It is argued that if we are collectively aware and are reminded of the psychological forces and inherent inbuilt biases that can and do impact our decisions, this awareness alone can reduce the impact that such forces will have on decision processes. As Hall (2007) highlighted cognitive biases if acknowledged and understood can lose their power to unconsciously drive decision processes.

8.10: Conclusions, limitations and suggestions for further research

The introduction to my thesis identified three related research strands upon which my thesis was based. First, was to provide some academic rigour to the assertions of the Nyberg Report (2011) that the Irish banks suffered from both groupthink and herding in the lead up to the crisis. My research focused on evidencing groupthink at Anglo and whether the other Irish banks looked to emulate Anglo's perceived success. The literature review on groupthink undertaken in chapter 3 highlighted the complexity of the groupthink construct and the epistemological difficulties associated with groupthink measurement. A decision was taken to test groupthink versus a "strong" version of Janis's original construct analysing both the antecedents and symptoms of groupthink. Evidence was gathered from a number of sources and presented in research question 2 of chapter 7. The conclusion from my research was that there was evidence to support that proposition that the board of Anglo suffered from groupthink tendencies in the lead up to the financial crisis. Moreover, support

was found in research question 5 that the Irish banks herded and in particular tried to emulate the success of Anglo.

The second strand of my thesis was the building of a theoretical model which identifies vulnerabilities of a bank board to undertaking a poor decision process which can have systemic consequences. Chapter 6 detailed the theoretical underpinnings of the model, which draws on the literature review in chapters 2, and 3. My model of VPDP combines behavioural and contextual influences with the practical skill levels of directors. It stresses the interconnection between the identified phenomena and how they can, and do, combine together. Further my model attempts to explain vulnerabilities to a poor decision processes at three different levels; first with respect to an initial poor decision or recommendation, second with respect to the ratification of this decision by the collective board of directors and finally with respect to the risks that such a poor decision outcome is emulated by competitors. The model was applied to the Irish bank case study, as highlighted in chapter 7. Cautious conclusions were then drawn as to the relevance of the model with respect to the identified Irish case study.

The third strand of my thesis related to the discussion of reforms which can be identified from the model itself. A review of the model identified a number of key touch points or “red flags”. Specifically, these related to high levels of confidence, high levels of competition, high levels of homogeneity, directive leadership and low director skill levels. Reforms related to high levels of confidence and competition were considered outside the remit of my thesis but a number of reforms were suggested with respect to the how to combat homogeneity, reduce directive leadership and increase the likelihood of a robust boardroom challenge.

There are a number of identified weaknesses and limitations with respect to my thesis. There is no one accepted groupthink model and the researcher is required to make a subjective judgement as to whether a group suffered from groupthink tendencies. This risk is arguably exacerbated given my own

personal experiences with the Irish banks. The subjectivity of qualitative research has been discussed in my review of my research methodology in chapter 4. The conclusion was that subjectivity is an inherent part of interpretive research and should not necessarily be seen as a negative but rather as intrinsic to the type of research I am engaged in. However I was acutely aware of the risk of confirmation bias and the risk of a suspicious fit in the analysis of the data. I tried to mitigate this through an acute awareness of the potential for such a bias, a review of conflicting theories and a through a process of significant data triangulation and verification. I do, however, recognise that my finding may be affected by unconscious biases in interpretation. Further limitations were identified with respect to the model which I have developed. My model of VPDP focuses on a scenario of collaboration over control. Sundaramurthy and Lewis (2003) highlight the scenario where control exceeds collaboration and the board is characterised by distrust leading to a poor decision process. This potential scenario is not captured by the model, and as such it is not a complete model for explaining the vulnerabilities of a board to a poor decision process. Further my model only identifies vulnerabilities to a poor decision process and it does not necessarily follow that if the observables are present that a poor decision outcome will always occur.

There is also the question mark of the generalisability of my research. Can my model be applied to other institutions and jurisdictions? My thesis touches on HBOS, RBS and Northern Rock as institutions that appeared to suffer from similar characteristics to Anglo in the lead up to the crisis¹⁸³. Moreover, can the model be applied to banks that did not fail in the lead up to the crisis? For example the Australian banks came out of the financial crisis relatively unscathed. A cursory review of the annual financial statements of the Australian banks revealed boards that had relatively high levels of diversity and skill levels

¹⁸³ Indeed my own experiences in dealing with these highlighted institutions were that their boards had many characteristics common with that of Anglo.

amongst the directors – however much greater detail of analysis is required. Further can the model be applied to organisations such as Enron, and WorldCom, both of which researchers have already evidenced groupthink? Can the model be applied in the recent case of UK supermarket Tesco?

Further, how do the findings of my model of VPDP compare with alternative academic explanations of the poor decision processes at corporate boards? Stein (2013) suggests that the failure of HBOS and RBS could be attributable to the closeness of the organisational identities of both organisations which resulted in a form of sibling rivalry and a tendency for greater risk taking and vulnerability. Stein suggests that this same sort of rivalry might have accounted for the failure of AIB and BKIR. Kerr and Robinson (2011) apply a Bordieusian approach to leader-leader relations to explain how the leaders of HBOS and RBS competed against each for domination in the field which ultimately leading to the demise of both organisations. Finally, McConnell (2014) explains the failure of HBOS using a behavioural finance perspective¹⁸⁴. These all represent alternative lenses for which to view failures related to poor bank decision processes. My research is not intended to “prove” that my model is correct and that these alternative theories are therefore incorrect, rather it is to add to the literature which looks to understand the decision making process in corporate boards. My contribution, it is submitted, is in stressing how normative and informative influences combine together and that these taken together with low director skill level and the importance of contextual issues can create an environment where there is vulnerabilities, both at the bank and industry level, to a poor decision process.

Finally a number of reforms were recommended in this chapter. This included the creation of a knowledge/diversity index. As highlighted earlier, more thought

¹⁸⁴ McConnell's arguments are not hugely dissimilar to what I have developed in my thesis. However, McConnell focuses on overconfidence and groupthink. I have, however, consider behavioural factors alongside informative influences, lack of director skill level and the macro environment within which firms operate as additional factors which affect decision making.

is needed in the make-up of such an index. The index, once developed, might be applied retrospectively to see if there is any correlation between the index values and firm performance. All this to come 😊.

Thank you for reading my thesis!

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Appendices

Appendix 1: A fuller discussion of the conclusions of the Nyberg Report (2011)

Nyberg concluded that the causes of the Irish crisis can be attributed to two factors. First, the failure of the gatekeepers, narrowly defined as the auditors and the financial regulators. This was ascribed to the application of a naive version of the efficient paradigm and the belief that the markets were self-regulating and as such required a very “light touch” by regulatory bodies. The report noted a deferential and subservient

approach by both the regulator and auditors towards the banks. Second, the Commission attributed the failure of the decision making processes within the Irish banks primarily to groupthink and herding.

The efficient market paradigm is an underlying philosophy which provided the intellectual underpinning for financial innovation and “light touch” regulation. The Turner Review (2009, para 1.4) in the UK set out the five core intellectual assumptions that underpin the efficient market hypothesis and the intellectual assumptions on which regulatory approaches are based. These are summarised below as:

- 1) Market prices are good indicators of rationally evaluated economic value.
- 2) The development of securitised credit has improved efficiency and financial stability.
- 3) The risk characteristics of financial markets can be inferred from mathematical analysis.
- 4) Market discipline can be used as an effective tool in constraining harmful risk taking.
- 5) Financial innovation can be assumed to be beneficial since market completion would eliminate any such innovation that did not add value.

Underpinning this ideology is the core belief that the markets were self-correcting and efficient and that as a result only light touch regulation was required. Furthermore, strict or intrusive regulation would not be required and indeed would be seen as harmful and reduce financial innovation and efficiency and that it was more beneficial and efficient for the financial markets to self-regulate behaviour.

One of the most outspoken and influential supporters of this ideology was past US Federal Reserve Chairman Alan Greenspan¹⁸⁵. Greenspan’s ideology is highlighted in his testimony to US Congress in 1994 in response to a debate as to whether credit derivatives should be regulated when he stated: “Risks in financial markets, including derivatives markets, are being regulated by private parties There is nothing involved in federal regulation per se which makes it superior to market regulation” (cited by Sun et al. ((Sun et al., 2011b)).

¹⁸⁵ Alan Greenspan was Chairman of the Federal Reserve Bank in the U.S. from 1987 to 2006.

Greenspan was to subsequently question the underlying philosophy of the efficient market hypothesis and trust in the ability of markets to self-regulate when testifying before the US Senate in October 2008 when he admitted: “I made a mistake in presuming that the self-interests of organizations, specifically banks and others, were such as that they were best capable of protecting their own shareholders and their equity in the firms”(cited by (Knowlton and Grynbaum, n.d.).”

The assumptions underlying the efficient market hypothesis have been subject to extensive challenge since the onset of the financial crisis¹⁸⁶. The adoption of the efficient market paradigm, and the contribution that it made towards the financial crisis, is well documented and detailed in the various official inquiries and the wider academic research into the causes of the crisis itself. The Official US Inquiry Report in its conclusion notes that the failures “were in no small part due to the widely accepted faith in the self-correcting nature of the markets and the ability of financial institutions to effectively police themselves” (Angelides et al., 2011, p. xviii). The UK’s Turner Review (2009) placed the acceptance of the efficient market hypothesis right at the heart of the causes of the crisis in the UK whilst the Icelandic Truth Commission (“Report of the Special Investigation Commission (SIC),” n.d.) Noted in great detail the neo-liberal attitude taken by the Icelandic regulators to the activities of the Icelandic banks. Furthermore, criticisms of the adoption of the efficient market hypothesis can be found in the works, inter alia, of Stiglitz (2010), Friedman (2009), Davies (2010), Shiller (2008) and Skidelsky and Skidelsky (2012). These commentators all stress that the failure of the efficient market hypothesis and the inability of the market to self-regulate

¹⁸⁶ Greenspan was not alone in promoting the concept of efficient markets and supporters of this paradigm and other supporters included Milton Friedman and Eugene Fama (both past recipients of the Nobel Prize for Economics). Indeed, the efficient market hypothesis is closely associated with the Chicago School of Economics. See Skidelsky and Skidelsky (2012) for a discussion of the different views of the freshwater economists (defined as those from Chicago and Minnesota) who championed the efficient market hypothesis and the saltwater economists from institutions such as Harvard and Yale who placed much greater emphasis on human behavioural aspects in decision making processes and outcomes .

and self-correct were significant contributing factors in the lead up to the global financial crises.

The misplaced belief that the markets were rational and had an innate ability to self-correct and self-regulate shaped the behaviour of both the management of the financial institutions itself and the gatekeepers of the financial industry. Management assumed that risks related to sophisticated credit derivatives were being efficiently priced, and that as a result these risks were understood whilst the gatekeepers and the regulator in particular, applied a light touch regulatory approach to the industry in the belief of the financial industries' ability to regulate itself adequately.

The debate over the conceptual failures of the efficient market hypothesis ideology is well researched and has been comprehensively debated by some of the world's most eminent academics and, it is submitted, that there is little that this thesis can add to that debate. However, it is the conclusion of the Nyberg Commission with respect to the role that groupthink and herding played in the Irish crisis that this thesis intends to make a contribution.

Appendix 2: A comparative case study review of how groupthink is defined

Case Study	How Groupthink is measured	Information Sources	Conclusions
<p>Marks & Spencer, BA (Eaton, 2001)</p>	<p>Eton focused on providing evidence to meet just three of the symptoms of groupthink identified by Janis; namely illusions of invulnerability, stereotyping of out-groups and the illusion of unanimity.</p>	<p>Eton relied on content analysis from press reports from <i>The Guardian</i> and <i>The Independent</i> newspapers spanning a five year period.</p> <p>Eton analyses the press reports for both manifest and latent content. Manifest items were defined as being actually present whilst latent content being a matter of inference or interpretation on the part of the coder.</p>	<p>Eton concluded that the content analysis was sufficient “to suggest that groupthink was present” (p. 183).</p>
<p>Enron (O’Connor, 2002)</p>	<p>O’Connor followed Janis’s groupthink construct precisely, identifying examples of both the antecedents</p>	<p>O’Connor relied primarily on the statements of Enron directors made to the SEC Senate Inquiry which followed Enron’s collapse.</p>	<p>O’Connor (2002) concluded that the Enron Board “may</p>

	<p>and symptoms of groupthink. O'Connor stressed that not all the symptoms and antecedents of groupthink needed to be present.</p> <p>O'Connor further recognised that broader contextual issues need to be taken into consideration when assessing group dynamics and groupthink and focused in particular on the concept of "new era thinking" which she argued pervaded the thinking of the executives of Enron.</p>	<p>She also used data from journalist interviews and reports and broader academic articles which highlight specific characteristics relating to what she saw as "boardroom norms" (p. 1264) which she then applied to the Enron case study.</p>	<p>have been affected by a significant impediment to group deliberation called "groupthink" (p. 1238)</p>
WorldCom (Scharff,	Scharff focused on identify some, but not all, of the symptoms of	Scharff focused almost exclusively on a 2003 SEC report into the collapse of	Scharff concluded that: "In many ways,

2005)	groupthink as identified by Janis.	WorldCom for evidence which was linked to Janis's symptoms of groupthink.	groupthink may help to explain some of the issues and fraudulent activities at WorldCom" (p. 109).
Gulf Crisis (Yetiv, 2003)	<p>Yetiv drew "heavily on the guidelines for testing the theory provided by Janis" (p. 421-22).</p> <p>Yetiv, like O'Connor, considered both the antecedents and symptoms of groupthink in his analysis.</p>	<p>Yetiv reviewed documents at the George Bush Presidential Library, memoirs, public statements by key decision makers, and supplemented this with his own interviews with key decision makers.</p>	<p>Yetiv concluded that "enough conditions of the theory of groupthink existed (although certainly not all) to say that President George Bush's inner circle exhibited significant elements of groupthink (p. 420). "</p>

<p>France's defeat to German in 1940 (Ahlstrom and Wang, 2009)</p>	<p>Ahlstrom and Wang noted that: "Groupthink is generally not accessible to direct observation and its presence in a group has to be inferred from recognition of its symptoms" (p. 162).</p> <p>Ahlstrom and Wang focused just on the eight symptoms of groupthink as identified by Janis.</p>	<p>Ahlstrom and Wang relied on the extensive literature of French military historians for their information.</p> <p>To reduce the risks of confirmatory evidence bias and of simply selecting evidence that would confirm their initial expectation they required at least three sources of information to provide the same example to illustrate a particular symptom of groupthink. Further the interpretation of these sources was independently confirmed by multiple codes including one independent of the study.</p> <p>Further, any example that they used could not be used to illustrate more than one antecedent or symptom of groupthink.</p>	<p>The researchers conclude that "the eight groupthink symptoms are demonstrably present with data provided by multiple examples from the primarily and secondary documentary evidence on this case. The incidence of these symptoms in the interwar years and at the beginning of WWII suggests that groupthink was present" (<i>ibid</i>, p. 173).</p>
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Appendix 3: A comparative analysis of the evidence gathered in support of groupthink

Eaton (2001)

Eaton analysed whether two British companies, BA and Marks and Spencer suffered from groupthink in the 1990's resulting in "blocked management communications and leading to the fall in reputation and stock market valuations of these two companies" (*ibid*, p. 183). Eaton focused just on the symptoms of groupthink and three specific areas. First, whether there was an overestimation of the abilities of the two groups (the illusions of invulnerability and belief in the inherent morality of the group, research questions 2h) and 2i)). Second whether there was a close mindedness, grouping together collective rationalisation and stereotypes of out-groups (research questions 2j) and 2k)). Third on the pressure towards uniformity, grouping together self-censorship, illusions of unanimity, direct pressure on dissenters and self-appointed mindguards (research questions 2l), 2m), 2n) and 2o). Eaton focused his analysis on press reports from *The Guardian* and *The Independent* newspapers covering a five year time horizon and in the case of Marks and Spencer referred to literature on the history of that organisation. When a newspaper articles contained direct quotes, these were coded as "direct interviews", whilst any newspaper reports were included as "academic papers

and books". Eaton did not undertake any direct interviews, he did not analyse the annual financial statements of the two companies and did not infer any industry norms.

Proposition	Industry norms	Inquiries, Commissions or other academic papers and books	Indirect interview	Direct interview	Inferred from AFS
2a)	Not reviewed by Eaton.				
2b)					
2c)					
2d)					
2e)					
2f)					
2g)					
2h) and 2i)		✓ (5)	✓ (4)		
2j) and 2k)		✓ (6)	✓ (1)		

21), 2m), 2n) and 2o)		✓ (5)	✓ (0)		
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O'Connor (2002)

O'Connor (2002) analysed groupthink in the context of Enron, evidencing both the antecedents and symptoms of groupthink. O'Connor grouped Janis' seven antecedent of groupthink into three categories and analysed them collectively whilst she analysed each of the eight symptoms of groupthink individually. Evidence was obtained from a wide source of information, including SEC Reports on Enron, industry norms, indirect quotations and an analysis of the Enron financial statement. O'Connor, consistent with Eaton above, summarised the antecedents of groupthink into three categories, namely overestimation of the group (covering research questions 2h) and 2i)), close mindedness (covering research questions 2j) and 2k)), and pressure towards uniformity (covering symptom 2l) to 2o).

O'Connor did not, as discussed previously, undertake any interviews in support of her research.

Proposition	Industry norms	Inquiries, Commissions or other academic papers and books	Indirect interview	Direct interview	Inferred from AFS
2a)	✓ (4)	✓ (10)	✓ (4)		
2b) – 2e)		✓ (10)	✓ (1)		
2f) and 2g)		✓ (5)	✓ (3)		
2h)		✓ (7)	✓ (8)		
2i)		✓ (6)	✓ (10)		
2j)	✓ (2)	✓ (7)	✓ (1)		
2k)		✓ (3)	✓ (4)		
2l)		✓ (2)	✓ (2)		
2m)		✓ (2)	✓ (5)		
2n)		✓ (3)	✓ (1)		
2o)	No evidence in support of this proposition.				

Yetiv (2003)

Yetiv (2003) analysed groupthink in the context of the President Bush's handling of the Gulf crisis. Yetiv relied on the analysis of documents at the George Bush Presidential library (coded below as "inquiries, commissions, or other academic papers and books") as well as memoirs and public statements by key decision makers (coded under indirect interviews) and interviews (coded under direct interviews). Yetiv followed Janis' (1972) construct of groupthink, focusing on all seven of Janis's antecedents of groupthink. For the symptoms of groupthink, Yetiv, consistent with Eaton and O'Connor condensed the seven antecedents of groupthink into three broad categories.

Proposition	Industry norms	Inquiries, Commissions or other academic	Indirect interview	Direct interview	Inferred from AFS
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		papers and books			
2a)			✓ (1)	✓ (1)	
2b)		✓ (3)	✓ (1)	✓ (3)	
2c)		✓ (4)	✓ (2)		
2d)		✓ (7)	✓ (5)	✓ (2)	
2e)	✓ (1) ¹⁸⁷	✓ (1)		✓ (1)	
2f)		✓ (4)	✓ (3)	✓ (4)	
2g)	Not proved by Yetiv.				
2h) and 2i)		✓ (1)	✓ (2)		
2j) and 2k)			✓ (1)		
2l), 2m), 2n) and 2o)		✓ (4)	✓ (4)	✓ (2)	

¹⁸⁷ Yetiv here refers to the work of Powell and DiMaggio (1983) referred to in my analysis of groupthink.

Scharff (2005)

Scharff (2005) analysed groupthink in the context of the failures at WorldCom. Scharff relies (heavily) on a SEC Report into the failures of WorldCom which includes a number of quotes from Enron employees (coded as indirect interviews) as well as newspaper reports and related academic articles. Scharff focused only on the symptoms of groupthink in his analysis. Further he did not consider the groupthink symptom related to self-appointed mindguards (research question 1o)). No explanation was provided for this omission.

Proposition	Industry norms	Inquiries, Commissions or other academic	Indirect interview	Direct interview	Inferred from AFS
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		papers and books			
2a)	Not reviewed by Scharff.				
2b)					
2c)					
2d)					
2e)					
2f)					
2g)					
2h)		✓ (1)	✓ (1)		
2i)		✓ (2)	✓ (2)		
2j)		✓ (2)			
2k)		✓ (4)	✓ (1)		
2l)			✓ (2)		
2m)			✓ (2)		

2n)		✓ (2)			
2o)	Not analysed by Scharff.				

Ahlstrom and Wang (2009)

Ahlstrom and Wang's (2009) research focused on France's defeat to Germany in 1940 and drew on a number of historical reference (coded below as "academic papers and books") as well as diaries and retrospective eye witness accounts (coded as "indirect interviews). Direct interviews were not possible for the research and neither are the categories "industry norms" and "inferred from the annual financial statements" relevant for this analysis. Further Ahlstrom and Wang focused just on the symptoms of groupthink and as such did not consider the antecedents as I did in my analysis.

Proposition	Industry norms	Inquiries, Commissions or other academic papers and	Indirect interview	Direct interview	Inferred from AFS
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		books			
2a)	Not reviewed by Ahlstrom and Wang.				
2b)					
2c)					
2d)					
2e)					
2f)					
2g)					
2h)		✓ (5)	✓ (2)		
2i)		✓ (6)	✓ (1)		
2j)		✓ (5)			
2k)		✓ (4)			
2l)		✓ (4)	✓ (2)		
2m)		✓ (2)	✓ (1)		

2n)		✓(2)	✓(2)		
2o)		✓(1)	✓(2)		