Leadership styles and improved governance outcomes

By Dr Darren O’Connell MBA FGIA, Manager of Enterprise Risk, Sydney Harbour Foreshore Authority

This article examines a style of leadership that could be deployed at an organisation to create a dynamic, fully functioning and value-adding corporate governance framework.

Many governance frameworks designed to combat nefarious corporate activities worldwide call for leadership to change organisational behaviour. For example, ISO 31000:2009 Risk Management — Principles and Guidelines implies that leadership is the key to achieving a ‘strong and sustained commitment by management’ in order to implement a robust risk management framework. The UK Bribery Act 2010 has identified the need for top management to display leadership in committing to a culture of stamping out organisational bribery, fraud and corruption. Similarly, the ASX Corporate Governance Council requires Australian listed companies to show leadership in adopting its Corporate Governance Principles and Recommendations. The NSW Audit Office Fraud Control Improvement Kit specifically emphasises the trait of leadership as being of prime importance for implementing a successful fraud control framework. However, there is little consensus on exactly what leadership qualities are necessary to inspire employees to embrace a culture of good governance.

Corporate governance is the way in which power is exercised over organisations. It covers the activities of the board and its relationship with shareholders, and with those managing the enterprise, as well as other stakeholders. In this way, governance can be seen as a system of processes, mechanisms, rights distributions and relationships through which an organisation is controlled and directed. There is a distinct difference between governance and management: governance is the work of the board of directors or other governing bodies whereas management is the work of the executive management team. It has been recently argued that the way corporate entities are governed has now become more important than the way they are managed.

Overview of power structures in an organisation

In order to deploy better leadership to improve governance outcomes, it is necessary to briefly dwell on where the power structures reside in a typical organisation. The board is the conduit that gives the practical application to corporate governance, and it controls the direction of the entity. The role of control in the boardroom applies to the supervision and direction over C-level management activities in order that the owners’ interest is duly protected. It also extends to setting corporate strategy and providing the leadership to put it into effect through policy making. In addition, the board’s direction of corporate governance provides the means whereby organisations achieve accountability to policies, to laws and to the norms.
that society expects from its corporate citizens. It is widely believed that these powers are success factors in improving organisation performance and long-term resilience.

While the board is the primary source of governance leadership, there are a number of other conduits within a typical organisation. One of the key modes the board has in discharging its governance responsibilities is to constitute an Audit and Risk Committee (ARC). Indeed, the ASX Listing Rules require all companies on the ASX/S&P All Ordinaries Index to have an audit committee; as does the NSW Audit Office for all public sector agencies. The objective of the ARC typically is to provide independent advice and assurance to the board by overseeing and monitoring the organisation’s governance, its risk and control frameworks, and its regulatory obligations. It comprises non-executive directors with at least a majority being independent and members as a whole to have suitable experience and knowledge to fulfil the ARC’s responsibilities.

As with the board, the ARC normally consults with the top tier of the organisation’s management but will periodically interact with subject matter experts as circumstances dictate. As such, its leadership role in embedding governance across an organisation has little practical application beyond the executive leadership team (ELT).

The ELT is charged with executing the organisation’s strategy, and comprises the CEO and their direct reports. The development of corporate strategies is delivered and crafted through the organisation’s vision, mission and objectives thereby providing the means to implement a governance framework. The ELT’s role is to cascade the cultural behaviours, values and norms throughout organisation. While direct involvement between the ELT and operational staff will vary depending upon organisational size and dispersion, the ELT will more widely interact with staff than the board and is therefore in a better position to articulate the organisation’s governance beliefs.

Middle management is the nexus between operational staff and the ELT. In terms of governance leadership, its role is to embed governance practices into the day-to-day activities of its teams, and provide a supportive environment in which governance concerns can be raised and improvements floated. Operational staff are responsible for performing their specialised functions in accordance with the organisation’s governance framework. For example, staff performance plans may contain a governance accountability that includes, inter alia, a commitment to maintain a safe workplace. Such staff take their cues in governance behaviour from their immediate supervisors, and also from the ELT. Neither middle management nor operational staff have much, if any, regular interaction with the board (or ARC) and so the ELT becomes the main source of day-to-day governance leadership as shown in Figure 1.

What the above discussion highlights is that leadership in governance is not necessarily confined to individuals in formal leadership positions however such individuals may have a particularly wide remit of governance influence within an organisation. Ultimately, every member of an organisation plays a role in embracing corporate governance.

It is widely believed that good governance promotes confidence in the realm of corporate, public sector and charitable activities. The better these entities are governed, the better they will perform and the more satisfied all stakeholders will be. Sound governance is the key to achieving an entity’s objectives and aims as well as the efficient and optimal use of shareholders capital or taxpayers money. Indeed the Audit Office of NSW strongly believes that good governance provides:

...independent assurance that public sector agency management delivers their services to the taxpayer in an ethical and legal manner. Risks and opportunities are recognised and addressed. The rights of stakeholders are respected with open and transparent information on organisational activities and performance. And importantly, the organisation and its leaders embrace a governance culture that focusses on achievement, accountability and ethical behaviour.

**Good governance not just about processes**

While there is evidence that governance processes are critical it is the quality with which processes are designed and implemented rather than the mere...
presence of policies and procedures that determines whether they will be successful. There is a sense that research about effective organisational governance should move away from the features of a system such as proper risk management application or a workable CEO succession plan and instead focus attention on contextual issues — a company’s leadership, culture and specific situation. While these are more difficult to measure, they are also likely to have a far greater impact on quality governance outcomes than structural requirements.

To bring governance to life and embed it into organisational attitudes, values, beliefs and behaviours, the board and senior management must create a supporting culture that fosters commitment to ethical conduct. This is where leadership becomes paramount. There is widespread agreement between industry, regulators and academics that leadership is a key component in the successful implementation of a corporate governance framework. However, there was little agreement on the types of leadership styles that foster a culture of good governance.

Transformational and transactional leadership

Leadership, defined here as the process of influencing an organised group towards accomplishing its goals, involves creating a vision and establishing strategies; communicating goals and seeking commitment from followers. It includes motivating and empowering people to achieve organisational goals. Leadership theory has undergone a number of evolutionary stages since it was first given serious academic focus in the 1930s. The leadership type that has been widely researched since the 1980s focuses on the ways that leaders influence their followers’ behaviours and decisions within a power structure. One subset of this approach that has garnered significant recent attention in a governance context is transformational–transactional leadership.

This style of leadership is concerned with the leader’s influence in aligning the follower’s attitudes to the organisation’s goals. Transformational leaders are gifted in ‘creating a vision, developing followership, implementing the vision, following through, achieving results and team playing’. They generate trust, respect and admiration from followers, which are considered important facilitators, and motivate followers to perform beyond expectations. By acting as role models, they inspire and challenge followers to meet self, team and organisational goals, and enable them to see the value of meeting those goals beyond their own self-interests. There are identified four components to such leadership:

1. Idealised influence — leaders behave in a fair manner inspiring trust and respect from followers and articulate an inspiring vision. Followers are motivated to achieve goals that further the vision’s realisation and put in an effort that goes beyond their own self-interest.

2. Idealised consideration — leaders nurture the achievement and growth needs of their followers by creating a supportive climate and promoting learning opportunities.

3. Intellectual stimulation — leaders challenge the status quo, are receptive to new ideas and encourage followers to innovate.

4. Inspirational motivation — leaders clearly articulate the vision that followers can aspire to and seek to attain.

Transactional leaders, on the other hand, focus on motivating followers to attain set objectives by the use of rewards. They are less concerned with inspiring followers and are less attentive to individual needs. Such leadership consists of two components:

1. Contingent reward — a process whereby leaders and followers formalise the tasks to be completed and clearly articulate performance expectations in exchange for both material (for example, salary) and psychological rewards (for example, praise).

2. Management by exception — concerns the degree to which a leader takes corrective action such as negative approval or discipline against a followers’ behaviour. This monitoring of behaviour can occur prior to (active leadership), or post (reactive leadership), behavioural problems arising.

…transformational–transactional leadership… is not solely dependent upon the actions and behaviours of leaders but is based upon the interactions between leaders and followers, which of course mirror real world situations.
Of the two styles, transformational leadership is generally more strongly correlated with lower turnover rate, higher productivity and higher employee satisfaction, as the comparison in the types of behaviours given in Table 1 shows.35 One of the reasons why transformational–transactional leadership theory is popular is because it is not solely dependent upon the actions and behaviours of leaders but is based upon the interactions between leaders and followers, which of course mirror real world situations.35 Critics argue that the four transformation factors, identified above, cannot be sufficiently separated in practice to determine what individual influence they have on leadership capability.31 In addition, it has been argued that transformational–transactional leaders may deceive or manipulate followers as a means of attaining self-serving interests.32 However, this leadership theory is supported by a body of empirical research with a substantial governance focus.33 For example, moving from a transactional to a transformational leadership style could have a positive impact on governance by demonstrating a high priority for governance over other organisational outcomes (for example, reduced workplace injuries rather than pursuing short-term profit objectives).34 Indeed, Workplace Health and Safety (WHS) surveys consistently find that transformational–transactional leadership is cited as a critical element in either preventing WHS incidents or rectifying failures.35 Clearly then, this style of leadership has wider governance applications.

There are at least three ways in which organisations can unlock the value of transformational–transactional leadership to embrace a governance commitment and develop a positive governance culture. Firstly, tailored training programs can identify management’s transformational–transactional traits and how they affect governance outcomes. Secondly, leaders must cultivate productive working relationships with their staff founded on openness, mutual respect, behavioural consistency, sharing and delegation of control and demonstrated empathy.36 These are factors that inspire open and trusting communications about corporate governance. Thirdly, management needs to actively commit to good governance by incorporating it into their day-to-day processes. This may be done through prioritising governance as strategic and business unit initiatives and providing the subsequent resources. Team meetings should encourage active involvement in governance, encouraging a two-way dialogue in which concerns are raised and suggestions floated for the improvement of workplace governance. Although a correlation exists between transformational–transactional leadership and positive governance outcomes, the identification of passive leadership traits and the consequences of ignoring governance issues require greater understanding. There are empirical examples, particularly from the financial sector, of the negative effects that passive leadership has on governance. In addition, the ways in which leaders identify and manage governance errors may be particularly relevant for high risk organisations — such as banks — where the margin of error is small and the consequences high (for example, Lehman Brothers). Furthermore, authentic leadership, that emphasises developing the leader’s legitimacy through honest relationships with followers are built on ethical foundations, is another style that could favour good governance outcomes but requires greater investigation.37

### Table 1: Comparison between transactional and transformational leadership

<table>
<thead>
<tr>
<th>Transactional leadership</th>
<th>Transformational leadership</th>
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<tbody>
<tr>
<td>Builds on human need to get a job done and make a living.</td>
<td>Builds on a human need for meaning.</td>
</tr>
<tr>
<td>Is preoccupied with power and position, politics and perks.</td>
<td>Is preoccupied with purposes and values, morals, and ethics.</td>
</tr>
<tr>
<td>Is mired in daily affairs.</td>
<td>Transcends daily affairs.</td>
</tr>
<tr>
<td>Is short term and hard-data orientated.</td>
<td>Is orientated toward long-term goals without compromising human values and principles.</td>
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<tr>
<td>Focuses on tactical issues.</td>
<td>Focuses more on missions and strategies.</td>
</tr>
<tr>
<td>Relies on human relations to lubricate human interactions.</td>
<td>Releases human potential — identifying and developing new talent.</td>
</tr>
<tr>
<td>Follows and fulfils role expectations by striving to work effectively within current systems.</td>
<td>Designs and redesigns jobs to make them meaningful and challenging.</td>
</tr>
<tr>
<td>Supports structures and systems that reinforce the bottom line, maximise efficiency, and guarantee short-term profits.</td>
<td>Aligns internal structures and systems to reinforce overarching values and goals.</td>
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**In conclusion**

As this brief review has indicated corporate governance is critical to the way in which organisations are managed. To be a well governed organisation requires leadership to be displayed by all governance sources.
The literature, and empirical evidence, indicates that transformational–transactional leadership is perhaps the most conducive style for organisational governance.

Darren O’Connell can be contacted on (02) 9240 8863 or by email at darren.oconnell@shfa.nsw.gov.au.

Notes
4 Ibid.
10 Ibid.
16 Ibid.
23 Ibid.