

# Accelerating and Amplifying Impact: How Directors can Enhance their Climate Response

with Clare Nickson Havens

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# Behaviours of banks with pioneering approach to climate response risks and opportunities

- Long-term, forward-thinking
- Collaborative approach – with regulators, policy makers and others
- Publicly take responsibility for addressing the issue
- Thorough risk awareness (TCFD etc.,)
- Proactively seeking to fund the transition to low carbon economy
- Embedding climate response within the bank
- Being innovative
- Actively seeking information and knowledge
- Ensuring their customers are capable of transitioning

# What is it that drives these behaviours?

- The board is the key to the bank taking a strategic approach (1)
- Research (2) seeking to understand the board characteristics driving climate response at financial institutions found that the mindset of the Chair and at least one other director was found to be more important than board processes, or structure, whether there is a sustainability committee etc.,
- A University of Cambridge report (3) found that what differentiates pioneering banks from others is an 'active mindset' which seeks to proactively finance the transition to a low carbon economy

# What is this 'active mindset'?

- By understanding better what active mindset is we can identify ways to develop it and improve practice, accelerating and amplifying impact
- This is especially important for bank board directors given that banks sit at the heart of the global economy, and how they allocate capital has significant real-world implications
- Research (4) proposes that firms that outperform others during times of great volatility have hard-to-imitate 'dynamic capabilities' of signal-detection (scanning); planning using these signals; transforming assets and capabilities based on this planning; and reflection on process
- These dynamic capabilities cannot be outsourced but can be developed
- I apply the dynamic capabilities perspective to bank board directors, using the hard-to-imitate dynamic capabilities of scanning, planning, transforming and reflecting as a proxy for 'active mindset'

# How can we overcome the constraint of context?

- In my research (5) of bank board chairs and NEDs, directors had different degrees of active mindset, however, interestingly, all directors expressed that the type of bank they serve – investment, commercial (mortgage) or ethical, heavily influences their climate response – commercial (mortgage) banks are viewed as the most constraining
- However, importantly, some commercial bank directors are pushing through this perceived constraint, accelerating and amplifying climate response – e.g., exploring transforming mortgage book to rent-for-life
- Importantly, there are four factors which influence how a director scans for signals, plans, transforms and reflects (their active mindset) and these can be developed

## But first, what does best practice signal-detection in active mindset look like?

- By far the largest differentiator in the scanning phase is engagement with employees. Directors with a more developed active mindset expressed that frequent engagement, informal as well as formal, with as many employees as possible can help 'overcome confirmation bias stemming from the asymmetry of information coming from management' and you come back to the board 'with a clearly different mindset'. A more cautious approach warns of 'breaking trust with management' if directors engage directly
- Another differentiator is using board interlock (other board roles one holds) as a source of signals, especially companies 'further along the climate journey'. One director spoke of having joined the board of an energy company specifically to better understand energy issues
- Other directors highlighted that being on not-for-profit boards and other social networks as useful in providing a social lens on climate response

# What is best practice in the planning stage of active mindset?

- Deepening customer relationships in order to 'get a sniff' of any demand and then 'maybe create a product that satisfies this demand'
- Engagement with and better servicing small and medium sized enterprises , helping them with climate-relevant information and tools was viewed as one way climate response will be 'weaponized', as a competitive advantage

# What is best practice in the transforming stage of active mindset?

- Embedding climate-related skills within the bank such as the ability to undertake their own scenario analysis in line with the recommendations of the Taskforce on Climate-related Financial Disclosure rather than outsourcing it is a key differentiator – ‘we would no more outsource scenario analysis than we would outsource our credit decisioning (to whom to lend)’
- Empowering staff to make decisions and not fear failure, given it’s the frontline bankers that see the opportunities



# What is best practice in the reflecting stage of active mindset?

- Questioning what is on the board agenda 'because what's on the agenda might not be what needs to be discussed'
- Building a degree of personal fluency in climate-related issues in order to feel competent to test management's assumptions
- Important to remember that climate is just one issue directors face, and changing how one thinks about another issue (such as changing the assumption in suspected cases of credit card fraud to assuming innocence rather than guilt) 'changes how we think about *everything*'

# How can we develop an active mindset?

- As mentioned on slide 5, there are four factors which heavily influence our active mindset (our signal-detection, planning, transforming and reflecting dynamic capabilities)
- These can be developed – even directors with the most developed active mindset that were leading pioneering practices at their bank had room to develop some of these factors

# The first factor is Human Capital

- Human capital is our experience and knowledge
- Can be developed through ongoing learning within the board context and beyond
- Directors spoke of undertaking sustainability training, cybersecurity training, using internal and external experts and joining boards in other sectors

# The second factor is Social Capital

- Our networks and board interlock (other boards on which we sit)
- These groups can be formal or informal and bring different lenses to climate-response such as a social perspective

# The third factor is Cognition

- Our understanding of climate-related issues
- This can be developed by engaging with people that know more than we do on an issue, extending us out of our 'zone of mastery' into the 'zone of proximal learning' (7), which thus increases our level of mastery
- This should be happening throughout the firm to embed understanding and increase organisational learning

# And the fourth factor is Emotional Capital

- This is the area with most opportunity for development – it is the most powerful lever to accelerate and amplify climate response. I examined three elements of emotional capital: conviction narrative, perceived self-efficacy, and reflection-in-action
- Conviction narrative is our preferred narrative which uses cognitive and emotional resources to attract us to or repel us from an issue in order to help us cope with decision-making in radical uncertainty
- Conviction narrative is underpinned by our mental state, a divided mental state which does not want to listen to new or contradictory information, and which can lead to groupthink, or integral mental state which is open to non-confirming data
- Our mental state differs issue by issue depending on our understanding and emotional response to the issue

# Emotional Capital 2

- Becoming aware of our conviction narrative and observing our mental state, whether we are truly open to receiving non-confirming information or not, and articulating this, can help us become aware of our personal biases and take in new data that can help overcome these biases
- Articulation, or being willing to voice our conviction narrative and mental state requires a high level of perceived self-efficacy, or belief in our own ability to effect change – I found that directors with higher perceived self-efficacy have a more active mindset
- Academic research (6) finds that individuals with higher levels of perceived self-efficacy are persistent, undeterred by complexity, feel less anxiety and can better identify opportunities

# Emotional Capital 3

- Importantly, perceived self-efficacy can be developed through increased mastery, increasing our learning and understanding (touching on our Human Capital and Cognition as discussed before)
- Perceived self-efficacy can also be developed by watching other directors succeed through perseverant effort – we can observe this via the third element of emotional capital I examined, reflection-in-action
- Reflection-in-action is particularly powerful when the chair articulates their thought process behind their decision-making in real time for other directors
- This helps the chair who can air their conviction narrative and check for personal biases and gather new information from peers
- This also helps less-experienced directors by modelling decision-making, increasing their perceived self-efficacy



# In summary

- A handful of banks are taking a pioneering approach to climate response (see behaviours on slide 2). At these banks, the boards have taken responsibility for embedding climate response in the bank
- An active mindset is what differentiates pioneering banks from others
- I define active mindset as dynamic capabilities of signal-detection, planning, transforming and reflecting, and these capabilities distinguish high calibre, pioneering directors. These dynamic capabilities or active mindset cannot be outsourced but must be developed
- The dynamic capabilities associated with active mindset can be developed by developing our knowledge and learning (Human Capital), networks and board interlock (Social Capital), understanding (Cognition) and self awareness of our conviction narrative, perceived self-efficacy and reflection-in-action (Emotional Capital)
- Developing these capabilities can enable us to push against the constraints of context (i.e., type of bank), enabling us to accelerate and amplify our climate response

# Practical implications

- Human capital can be developed by training, learning by doing.
- Social capital can be developed by expanding networks, engaging with networks, joining the board of a different industry.
- Cognition can be developed by learning from experts, life-long learning and curiosity.
- Emotional capital can be developed by becoming aware of one's own conviction narrative and underlying mental states on specific issues. Actively asking oneself "what am I missing?" Perceived self-efficacy can be developed by increasing mastery of a subject and observing other directors succeed through perseverance. Reflection-in-action can be developed through articulating thought processes and decision-making process to others and asking others to voice their own processes.
- By developing these four factors, human capital, social capital, cognition and emotional capital, the fifth factor, the constraint of context, can be pushed against, allowing for acceleration and amplification of climate response.

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