

The Fearless Fiduciary: Board Decisions under Uncertainty

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Are you afraid of heights? Needles? Public speaking? When you experience fear, which of the famous Three F's best describes your reaction: Do you fight, take flight, or freeze?

Fear is a common, understandable reaction in uncertain and ambiguous situations. Research shows that the way we experience fear and how we act on it depends fundamentally on both individual and contextual factors.¹

Fear becomes particularly consequential when leaders are legally entrusted to decide on behalf of the organizations they serve. As fiduciaries, boards of directors are legally required to act in the best interest of the corporation. It's important to note that the beneficiary of the directors' fiduciary duty is not the shareholder, or shareholders, but the *entire corporation*, which is a separate legal entity in its own right.

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Most of us buy health insurance – we are *risk-averse*. Most of us would refuse to flip a coin if heads meant winning two million euros and tails meant losing one million – we are *loss-averse*. Most of us care a great deal about our neighbors' children, but we care even more about our own – we are *self-interested*. Individually and collectively, these characteristics make us attentive to threats. We often act before a perceived threat becomes an actual one. This tendency reflects *short-term orientation* and *bounded rationality*, two fundamental features of human decision-making.

It is therefore unsurprising that fiduciaries, as human beings, experience fear. They, too, are risk-averse, loss-averse, and self-interested. However, the manifestations and behavioral consequences of fear in fiduciary settings require careful contextualization. Across analyses of board decision-making during the 2008-2009 financial crisis and the Covid-19 pandemic, a consistent pattern emerges: Board decisions are driven by short-termism, centralization, and parochialism.²

Fear in the boardroom is often elusive and deceptive and thus rarely labeled. It tends to manifest itself as hesitation and procrastination on the one hand and excessive rule-following and mimicry on the other. Through the lens of the Three F's, these behaviors resemble freeze and flight responses. Both are understandable. The challenge is that avoidant and hesitant behaviors by a legal fiduciary may constitute a breach of the fiduciary duty of care. Directors individually – and boards collectively – are legally mandated to defend the best interest of the corporation, particularly in times of crisis when the very survival of the corporation may be at stake. Leadership when the going gets tough is *precisely what boards are paid to provide*. One might even argue that fear in the boardroom, if present, should not be allowed to manifest externally.

Several recurring patterns reveal how fear shapes board decision-making. Throughout, it is useful to distinguish between what might be described as “fearful” and “fearless” responses.

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Even though board diversity does not formally fall within the general fiduciary duty of care, it is consistent with the objective of prudent governance. But how do boards ensure sufficient diversity?

The “fearful” response to the issue of board diversity boils down to reducing it to *demographics*: diversity is deemed achieved when a glance at the board roster transmits an image of gender, ethnic, and age diversity. However, the kind of diversity aligned with the duty of care is not demographic but cognitive, professional, and experiential – in short, *intellectual diversity*. While opinions abound, rigorous evidence linking demographic diversity to intellectual diversity remains limited. Of course, demographic variables are easy to measure and straightforward for regulators to enforce, but governance questions are complex and elusive, qualities that should make all easy answers suspect.

Furthermore, focusing on individual characteristics glosses over a crucial aspect of diversity: board dynamics. Are dissenting voices genuinely welcomed? Are all feasible alternative courses of action discussed and analyzed? From a duty-of-care viewpoint, intellectual diversity is not just about individual characteristics but the quality of the decision processes: how effectively does the board reason as a collective, particularly in moments of crisis?

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In 2003, Norway passed a law requiring that forty percent of board members in publicly traded companies be female. Independent analyses have since concluded the law to be an abject failure. First, it did not serve the corporations’ best interests: “The quota led to younger and less experienced boards, increases in leverage and acquisitions, and deterioration in operational performance.”³ Second, its broader societal impact on gender equality was equally disappointing: “Overall, seven years after the board quota policy fully came into effect, [...] it had very little discernible impact on women in business beyond its direct effects on the women who made it into boardrooms.”⁴ There were no significant spillover effects, such as increased female enrollment in business education. If legislation is evaluated by its outcomes rather than intentions, these results should give us pause.

The “fearless” response would be to unapologetically focus on what is in the best interest of the organization no matter the optics. Concern about reputational backlash from bad optics is understandable, but it can also signal that a fiduciary is acting primarily out of fear. Furthermore, framing governance through the lens of demography risks reinforcing stereotypes and prejudices. In what contexts will those wishing to engage in a serious debate welcome arguments built on naïve generalizations about, for example, the differences between men and women? And from a strictly logical point of view, how relevant are *average* differences when it is *individuals* we appoint to boards? It should be obvious that any person appointed to the board of a publicly traded corporation is, by definition, anything but average.

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Board demographics are merely one example of governance turning to compliance rather than deliberation. There are numerous other examples of governance decisions turning into *tick-the-boxes* exercises instead of context-specific reasoning. While compliance and contextual deliberation are not mutually exclusive, over-reliance on the former allows fiduciaries to avoid independent thinking – often at the expense of innovation in governance.

Effective governance suffers when corporate leaders consider board diversity in terms of demographics, or sustainability in terms of, say, the United Nations' Sustainable Development Goals. The deeper concern is boards becoming docile actors whose strategic responses to institutional pressure are based on habit, imitation, and compliance. Such acquiescence “elevates [the corporation’s] legitimacy and protects it from public criticism and the financial penalties of noncompliance.”⁵ But we must ask, “At what point does preoccupation with legitimacy start hindering effective governance?” After all, effective governance solutions must be fitted to the organizational context, which is always, at least to an extent, idiosyncratic. This calls for tailored, not one-size-fits-all, solutions.

Organizational economists remind us that effective governance is often less about compliance and more about *private ordering* – the development of “self-created mechanisms to accomplish adaptive, sequential decision making.”⁶ This unearths three fundamental shortcomings of compliance-based thinking.⁷ One, it shifts the fiduciary’s attention to externally imposed standards that ignore contextual factors. Two, once institutionalized, these standards often resist adaptation and become resilient to even the most well-founded critique. Three, acquiescent behaviors are often simply *ceremonial* – signaling legitimacy rather than actually tackling governance problems.

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The collapse of Lehman Brothers in 2008 illustrates the most troubling consequence of fiduciary fear: a detrimental vicious circle in which fear amplifies crisis and crisis amplifies fear. As the Valukas Report⁸ indicated, Lehman’s collapse was linked to poor corporate governance. It was not that Lehman’s management breached their duty of candor in its communication with the board, or that the board was so reckless or irrational to formally breach its fiduciary duty of care. In fact, neither the board nor management did anything illegal.

Yet the duty of care goes beyond legality to questions of effectiveness. And this is where we see the locus of Lehman’s problems: the board was afraid of management. Not that board members were literally scared of managers but that they showed deference toward them, over-relied on their judgment, and failed to ask discerning questions. The problem is that in times of crisis, such deference, over-reliance, and credulity will likely make an already bad situation even worse. We cannot think of a better justification than this for why we need *fearless fiduciaries*.

¹ Yiyu Wang, Philip A. Kragel & Ajay B. Satpute (2024). Neural predictors of fear depend on the situation. *Journal of Neuroscience*, 44(46), etwij44462024.
<https://doi.org/10.1523/JNEUROSCI.twij.44.46.2024>

² Alberto Lavin Fernandez & Carmelo Mazza (2024, 2014 original). **Boards under Crisis: Decision-Making in the Age of Uncertainty and Fear** (2nd ed.). Palgrave Macmillan.

³ Page 137 in Kenneth R. Ahern & Amy K. Dittmar (2012). The changing of the boards: The impact on firm valuation of mandated female board representation. *Quarterly Journal of Economics*, 127, 137-197.
<https://doi.org/https://doi.org/10.1093/qje/qjr049>

⁴ Marianne Bertrand, Sandra E. Black, Sissel Jensen, & Adriana Lleras-Muney (2019). Breaking the glass ceiling? The effect of board quotas on female labor market outcomes in Norway. *Review of Economic Studies*, 86(1), 191-239.
<https://doi.org/10.1093/restud/rdy032>

⁵ Page 153 in Christine Oliver (1991). Strategic responses to institutional processes. *Academy of Management Review*, 16(1), 145-179.
<https://doi.org/https://doi.org/10.2307/258610>

⁶ Page 378 in Oliver Williamson (1996). **The Mechanisms of Governance**. Oxford University Press.

⁷ John Meyer & Brian Rowan (1977). Institutionalized organizations: Formal structure as myth and ceremony. *American Journal of Sociology*, 83(2), 340-363.
<https://doi.org/10.1086/226550>

⁸ Pages 157, 183 in Volume 1 of the **Report of Anton R. Valukas, Examiner, In re Lehman Brothers Holdings Inc., et al., Chapter 11 Case No. 08-13555 (JMP) (Bankr. S.D.N.Y. Mar. 11, 2010)**.

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