



BOARD BEHAVIOURAL MECHANISMS AND CORPORATE GOVERNANCE IN BANKS AND FINANCIAL INSTITUTIONS: USING A BEHAVIOURALLY-GROUNDED THEORETICAL FRAMEWORK

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Abstract

This study uses a behaviorally-grounded theoretical framework to explain how Board behavioural mechanisms affect corporate governance in banks and financial institutions, which have high leverage, systemic importance, opaque assets, and complex agency relationships. Traditional governance theories view Boards as structural tools for monitoring, coordination, and resource provision, but they ignore boardroom behavioural mechanisms. Board behavior—specifically, how bounded rationality, satisficing, routines, power dynamics, emotions, and political bargaining shape information processing, risk perception, and management challenge—systematically conditions governance effectiveness in financial institutions. We identify two core behavioural mechanisms unique to this context: the regulatory complexity–bounded rationality interface, where directors' cognitive limitations interact with dense regulatory requirements to produce systematic oversight failures, and coalition dynamics in high-leverage environments, where political bargaining among shareholders, regulators, and depositors reshapes monitoring. We present an integrated framework to explain how these mechanisms work under different institutional and cultural settings, providing four testable propositions for future research. Setting behavioural governance theory in banking's unique institutional architecture provides a creative agenda for qualitative and mixed-methods research.

Keywords: Board Behaviour; Corporate Governance; Banks and Financial Institutions; Behavioural Theory of the Firm; Bounded Rationality; Coalition Dynamics.

1. INTRODUCTION

Corporate governance research has long been dominated by agency theory, which conceptualizes governance primarily as a mechanism to mitigate managerial opportunism through monitoring and incentive alignment (Jensen & Meckling, 1976; Fama & Jensen, 1983). This framework justifies structural arrangements—-independent boards, performance-based compensation, separation of CEO and chair roles—designed to align managers with shareholder interests. Stakeholder theory (Freeman, 1984) and resource dependence theory (Pfeffer & Salancik, 1978) extend this logic by framing boards as coordination devices among multiple constituencies and as providers of access to critical resources and external legitimacy. Across these perspectives, boards are understood through what they are expected to do: monitor, coordinate, advise, and provide resources.

For banks and other financial institutions, however, this traditional toolkit appears theoretically incomplete. BFIs differ from nonfinancial firms in fundamental ways that alter the governance problem. They are characterized by systemic importance, meaning their failure can trigger cascading economic consequences; high leverage, with debt-to-equity ratios far exceeding those of industrial firms; lender-of-last-resort arrangements that create moral hazard; opaque and complex assets that are difficult to value and monitor; and multilayered agency relationships among shareholders, managers, depositors, regulators, and borrowers



(Ciancanelli & Gonzalez, 2000; Panta, Gupta & Sharma, 2022). Governance in BFIs is therefore characterized by multidimensional information asymmetries and overlapping principal–agent relationships, where depositors and regulators cannot easily assess risk-taking or asset quality (Panta et al., 2022).

These distinctive features raise a critical question: Are board roles as conceived in traditional theories—control, monitoring, coordination, resource provision—sufficient to explain governance outcomes in BFIs, or must board behaviour itself become a central explanatory construct? This question points to a conceptual gap. Existing frameworks illuminate what boards are expected to do but are less able to explain how boards actually behave under conditions of bounded rationality, political bargaining, and institutional constraints. The behavioural theory of the firm (Cyert & March, 1963; Van Ees, Gabrielsson & Huse, 2009) offers a complementary lens that foregrounds bounded rationality, satisficing, routines, power dynamics, and political bargaining as defining features of decision-making in organizations. Applied to BFI boards, this perspective shifts attention from formal structures to boardroom processes: how directors interact, how conflict is managed, how information is filtered and interpreted, how risk is perceived and negotiated, and how decisions emerge from complex social and cognitive dynamics.

While behavioural governance research has advanced significantly over the past two decades, its application to BFIs remains underdeveloped. Existing studies have documented that board culture, informal norms, and interaction patterns shape governance outcomes (Parker, 2007; Brundin & Nordqvist, 2008), and that directors' cognitive and emotional biases influence risk oversight (Kahneman, 2013). However, what remains unclear is how behavioural mechanisms operate specifically within the BFI context—where regulatory complexity, systemic interdependence, and high leverage create distinctive conditions that may amplify or modify behavioural effects. This paper addresses this gap by asking: What core behavioural mechanisms explain governance outcomes in BFIs that traditional theories alone cannot account for?

We argue that two mechanisms are particularly salient in the banking context. First, in BFIs, directors face extreme cognitive demands from dense regulatory requirements—Basel III capital adequacy norms, liquidity coverage ratios, resolution regimes, stress testing protocols, conduct regulations—combined with complex financial instruments whose risk properties are difficult to assess. This overload triggers reliance on System 1 heuristics—overconfidence, confirmation bias, framing effects—that systematically distort risk perception and oversight, producing failures that structural reforms alone cannot prevent. Second, BFI boards operate as political arenas where multiple stakeholders—shareholders, managers, regulators, depositors—form coalitions that shape decisions and outcomes. High leverage fundamentally amplifies these dynamics because losses affect not only shareholders but also depositors and taxpayers, creating distinctive bargaining patterns around risk-taking that depart from rational optimization.

By specifying these mechanisms, we advance behavioural governance theory in two ways. First, we contextualize it within the institutional architecture of banking, showing how generic behavioural processes (bounded rationality, political bargaining, satisficing) take on distinctive forms under conditions of systemic interdependence and regulatory density. Second, we develop an integrated framework that maps causal pathways from behavioural mechanisms to governance outcomes, generating testable propositions that can guide empirical inquiry. The remainder of this paper is structured as follows. Section 2 describes our integrative synthesis methodology. Section 3 reviews traditional governance theories and identifies their limitations



in the BFI context. Section 4 elaborates on the behavioural theory of the firm and its application to boards. Section 5 develops our integrated framework, specifying core mechanisms and generating propositions. Section 6 concludes with implications for research and practice.

2. METHODOLOGY AND SELECTION PROCESS OF PAPERS FOR REVIEW

This paper develops a conceptual framework through an integrative synthesis of the literature on governance theories and board behaviour in BFIs. Rather than a fully replicable systematic review in the narrow sense—which would require exhaustive searching, dual coding, and meta-analytic aggregation—we adopt a structured integrative approach that combines theoretical synthesis with mechanism-based theorizing (Rousseau, Manning & Denyer, 2008; Hedström & Ylikoski, 2010). This approach is appropriate given our aim: not to aggregate empirical findings across studies but to integrate theoretical perspectives from multiple disciplines—economics, sociology, psychology, management—and specify behavioural mechanisms that explain governance outcomes. The integrative synthesis approach prioritizes theoretical development over methodological formalism while maintaining transparency about search procedures and selection criteria.

2.1 Search Strategy

The systematic review process spanned across four major academic databases: Sage Journals, ProQuest (including ABI/INFORM), EBSCOhost (including Business Source Complete), and Wiley Online Library. These databases were selected for their comprehensive coverage of management, finance, economics, and governance literatures. The search covered the period from January 1955 to March 2025, capturing foundational theoretical texts (Cyert & March, 1963; Jensen & Meckling, 1976; Pfeffer & Salancik, 1978) through contemporary empirical and theoretical contributions. The search strategy employed Boolean operators to combine terms related to three conceptual domains: governance, board behaviour, and banking context. The full search string was: ("corporate governance" OR "board of directors" OR "board behavior" OR "board behaviour" OR "boardroom dynamics" OR "board process") AND ("agency theory" OR "stakeholder theory" OR "resource dependence" OR "institutional theory" OR "behavioral theory" OR "behavioral theory of the firm" OR "stewardship theory" OR "legitimacy theory") AND ("bank" OR "financial institution*" OR "financial sector" OR "banking").

Additional search terms were applied in iterative rounds to capture specific mechanisms of interest: "bounded rationality", "satisficing", "heuristics", "cognitive bias", "coalition*", "political bargaining", "regulatory complexity", and "systemic risk".

2.2 Inclusion Criteria and Selection Process

We applied the following inclusion criteria: publication type limited to peer-reviewed journal articles, with books, book chapters, conference proceedings, dissertations, and working papers excluded to ensure quality consistency; journal quality requiring articles published in journals rated A or A* on the Australian Business Deans Council list or equivalent quality indicators such as FT50 or ABS 3/4; language restricted to English-language publications; substantive relevance requiring articles to address governance theory, board behaviour, or banking governance substantively, with purely empirical studies without theoretical engagement excluded unless they provided direct evidence for behavioural mechanisms; and time period from 1955 to 2025. The selection process proceeded in five stages. Initial database searches yielded 43,087 articles, reflecting the breadth of governance research across multiple disciplines. After removing duplicates across databases, 26,071 articles remained. Title

screening removed articles clearly unrelated to governance, boards, or banking—such as those using "governance" in political science contexts or "banking" in environmental contexts—leaving 7,873 articles. Abstract screening assessed substantive engagement with governance theory, board behaviour, or banking-specific governance issues, retaining 42 articles. Finally, manual searching of reference lists from included articles and existing systematic reviews yielded 14 supplementary articles, bringing the final corpus to 56 sources.

2.3 Analytical Approach

Our analysis proceeded in three stages, consistent with integrative synthesis methodology. First, theoretical mapping involved mapping each source to its primary theoretical framework and extracting core assumptions, key constructs, and empirical claims. This mapping produced a comparative cross-matrix identifying which governance issues each theory addresses and where explanatory gaps remain. Second, mechanism extraction from behavioural theory sources extracted core constructs—bounded rationality, satisficing, routines, political bargaining—and identified how they manifest in board settings. We also extracted evidence on how BFI-specific conditions—regulatory density, leverage, systemic interdependence—might modify these mechanisms. Third, mechanism-based theorizing followed Hedström and Ylikoski (2010) to specify the entities and activities constituting each mechanism, the conditions under which mechanisms operate, the causal pathways linking mechanisms to outcomes, and boundary conditions and moderators. This theorizing drew on both deductive reasoning from behavioural theory and inductive insights from the banking governance literature.

3. TRADITIONAL GOVERNANCE THEORIES: CONTRIBUTIONS AND LIMITATIONS IN THE BFI CONTEXT

3.1 Agency Theory: The Dominant but Incomplete Frame

When principals (shareholders) and agents (managers) have conflicting interests and knowledge asymmetries, agency theory sees the company as a contract (Jensen & Meckling, 1976). According to Fama and Jensen (1983), the board is the organization's main control system, overseeing management and aligning incentives through executive compensation and board independence. Bonus-driven managerial risk-taking, independent scrutiny, and BFI owner-manager disputes are covered under agency theory. However, its limited shareholder-manager focus and rationality assumptions limit its banking explanatory power.

First, cognitive limitations hinder rational monitoring. Kahneman (2013) shows that directors, like other decision-makers, have systematic biases—overconfidence, confirmation bias, framing effects—that impede impartial monitoring. BFIs have complicated financial products and regulations, making these biases central restraints. Directors overloaded with information use heuristics that simplify judgment but introduce predictable errors.

Second, agency theory's bilateral framing cannot accommodate BFIs' numerous principals with competing interests—depositors seeking safety, regulators demanding compliance, stockholders seeking returns (Panta et al., 2022). This multiplicity poses governance issues beyond shareholder-manager alignment.

Third, regulatory interventions significantly distort incentive structures. Agency theory predicts moral hazard from deposit insurance, lender-of-last-resort facilities, and capital requirements, but board-level decision processes cannot explain it (John, De Masi & Paci, 2016).

3.2 Stewardship Theory: Trust and Its Fragility

Stewardship theory holds that managers are trustworthy stewards who act in organizational interests (Donaldson & Davis, 1991). The board's role shifts from monitoring to supporting management in creating strategic value. Rebeiz (2022) contends that stewardship requires psychological maturity and professional skill, which are rarely present. More importantly, BFI managers switch from long-term stewardship to short-term survival measures during financial crises, showing stewardship's fragility (Panta et al., 2022). In banking, where crises occur frequently, stable trust theories are ineffective.

3.3 Stakeholder Theory: Broadening Accountability

Stakeholder theory (Freeman, 1984) extends governance to all recipients of corporate actions. This breadth is crucial for BFIs, as the 2008 financial crisis illustrated that institutional failures result in expenses for taxpayers and depositors (Panta et al., 2022). Consequently, stakeholder theory encompasses the systemic externalities of banking governance that agency theory fails to account for. Yet stakeholder theory faces practical difficulties in BFIs. Diverse and conflicting stakeholder interests—including shareholders who desire returns, regulators who demand safety, and depositors who require liquidity—are intrinsically difficult to reconcile (Rebeiz, 2022). The theory offers normative guidance, but it offers limited analytical leverage to elucidate how boards actually navigate these trade-offs under pressure. Cultural contexts further complicate stakeholder governance: high-individualism cultures achieve stronger stakeholder accountability through transparency norms, whereas collectivist contexts may prioritize relational over formal accountability (Chan & Cheung, 2012).

3.4 Resource Dependence Theory: Networks and Constraints

Resource dependence theory (Pfeffer & Salancik, 1978) emphasizes boards as boundary-spanning mechanisms that reduce environmental uncertainty by securing critical resources, knowledge, and legitimacy. In BFIs, board networks facilitate access to regulatory capital, interbank markets, and policy influence (John et al., 2016; Singh, 2025). However, resource dependence is constrained by expertise limitations. Ferreira, Kirchmaier, Metzger and Ye (2025) document a global shortage of directors with specialized financial expertise, which impairs resource-acquisition functions. Moreover, network ties can become liabilities when they create groupthink or regulatory capture. The "illusion of validity" explains how expert directors may overestimate their judgment, compounding rather than mitigating cognitive biases (Kahneman, 2013).

3.5 Institutional Theory: Embeddedness and Isomorphism

Institutional theory explains the role of coercive (regulatory), normative (professional), and mimetic (imitative) pressures in the formation of governance structures (DiMaggio & Powell, 1983). Global standards, such as Basel III, exert coercive pressure on convergence in the banking sector, while mimetic isomorphism encourages the adoption of foreign models (John et al., 2016). However, institutional theory often demonstrates "decoupling," in which formal structures adopt legitimized forms but fail to implement them substantively (Panta et al., 2022). This gap between structure and practice reveals the behavioral characteristics institutional theory demonstrates but does not penetrate. Theory explains why banks adopt similar governance arrangements but not why similar boards achieve different results.

3.6 Comparative Assessment: The Need for Behavioural Specification

Table 1 in Annexure 1 presents a comparative cross-matrix mapping governance issues in BFIs against theoretical lenses. The matrix reveals that no single theory fully captures BFI

governance complexity. The table indicates where the theories demonstrate strong explanatory power (\checkmark), partial or conditional relevance (Δ), or weak explanatory adequacy (X). The key insight from this mapping is that traditional theories identify structural conditions for governance effectiveness—*independence, diversity, stakeholder representation, network resources*—but cannot explain why boards with similar structures produce different outcomes. This explanatory gap points to behavioural mechanisms as the missing link.

4. BEHAVIOURAL THEORY OF THE FIRM: FOUNDATIONS AND BOARD APPLICATIONS

4.1 Core Constructs

The behavioural theory of the firm (Cyert & March, 1963; March & Simon, 1958) offers a foundational alternative to rational-actor models. Its core constructs provide analytical tools for understanding board behaviour.

- Bounded rationality recognises that decision-makers have limited information-processing capacity and use heuristics to improve efficiency but risk systematic bias (Simon, 1945; Kahneman, 2013). Bounded rationality in boards causes selective attention to salient information, dependence on established frameworks, and difficulties digesting complex facts. Bounded rationality is a central limitation for BFIs, which have complicated financial products and regulations.
- Satisficing—accepting "good enough" solutions instead of optimising—is common under time pressure or uncertainty (Cyert & March, 1963). Board decisions on strategy, risk appetite, and CEO succession typically reflect satisficing rather than extensive search, especially when information is expensive or confusing (Aguilera, Florackis & Kim, 2016). During crises, satisficing intensifies as boards focus on immediate threats at the expense of long-term considerations.
- Repetitive, interconnected actions are routines (Feldman & Pentland, 2003). Meeting protocols, committee processes, and risk assessment cycles provide stability and efficiency but can become rigid when circumstances change. Risk assessment may take longer than financial innovation in BFIs, creating blind spots (John et al., 2016).
- Political bargaining recognizes that organizations are coalitions of actors with partially conflicting interests, and decisions emerge from negotiation rather than rational optimization (Cyert & March, 1963). Boards are inherently political arenas where directors, executives, and external stakeholders form coalitions that shape agendas and outcomes (Huse & Rindova, 2001).

4.2 Behavioural Governance Research: Current State and Gaps

A behavioral theory of boards by Van Ees et al. (2009) states that cognitive processes, interaction patterns, and power dynamics affect monitoring and advisory functions. Research has shown that board culture, informal norms, and emotional dynamics affect deliberation quality (Parker, 2007; Brundin & Nordqvist, 2008), director characteristics affect risk perception (Lu, Ntim, Zhang & Li, 2022), CEO-board relationships affect information flow (Westphal, 1999), and group dynamics can suppress dissent (Janis, 1972). Nevertheless, this literature has been primarily developed in nonfinancial contexts. BFI study usually focuses on structure rather than behavior. It is unclear how BFI-specific conditions—*regulatory density, systemic interconnectedness, high leverage*—change behavioral mechanisms.



5. AN INTEGRATED FRAMEWORK: BEHAVIOURAL MECHANISMS IN BFI GOVERNANCE

We develop an integrated framework that specifies how behavioural mechanisms operate under BFI-specific conditions. The framework identifies two core mechanisms linking board behaviour to governance outcomes, specifies boundary conditions, and generates testable propositions.

5.1 Mechanism 1: The Regulatory Complexity–Bounded Rationality Interface

In BFIs, directors operate within an exceptionally dense regulatory environment. Basel capital adequacy requirements, resolution regimes, liquidity coverage ratios, stress testing protocols, and conduct regulations create information demands that overwhelm cognitive capacity. This overload triggers systematic reliance on cognitive heuristics—mental shortcuts that simplify judgment but introduce predictable biases.

Three biases are particularly consequential in BFIs:

- Overconfidence leads directors to overestimate their understanding of complex products and underestimate tail risks. Kahneman (2013) demonstrates that experts are especially prone to overconfidence in domains where feedback is slow or ambiguous—precisely the condition in banking, where risk models validate rarely and crises unfold over years. Directors with specialized financial expertise may be most vulnerable, as their confidence in their domain knowledge spills over into areas of genuine uncertainty.
- Confirmation bias causes directors to seek and interpret information consistent with existing beliefs, overlooking disconfirming evidence. In board discussions, this bias can produce "risk myopia"—attention to familiar, quantifiable risks while novel or ambiguous threats are discounted. During the 2008 crisis, boards systematically underestimated systemic risk because attention focused on institution-specific indicators while ignoring accumulating evidence of interconnected vulnerabilities.
- Framing effects shape how options are evaluated based on presentation. Loss aversion—the tendency to prefer avoiding losses over acquiring equivalent gains—can lead boards to prioritize short-term liquidity preservation over long-term restructuring, particularly during stress. This bias helps explain why troubled banks often delay necessary restructuring until crises become acute.

These biases interact with regulatory complexity in distinctive ways: dense regulations create compliance overload—directors focus on verifiable compliance metrics (capital ratios, liquidity buffers) at the expense of qualitative judgment about risk culture, business model sustainability, or emerging threats. This displacement is not irrational; compliance metrics are tangible, measurable, and directly linked to regulatory consequences. However, it produces a systematic pattern: regulatory compliance displaces substantive risk oversight, generating governance failures that structural reforms alone cannot prevent.

The mechanism operates through several pathways:

- 1) Limited cognitive resources are disproportionately directed toward compliance-verifiable information, crowding out attention to ambiguous but potentially critical signals.
- 2) Regulatory categories shape how information is interpreted. Risks that fit within regulatory frameworks receive systematic attention; those that do not are marginalized.

- 3) Directors are accountable for compliance failures in ways they are not for failures of qualitative judgment, further skewing attention.

This mechanism is amplified under crisis conditions. Kahneman's (2013) dual-process model predicts that time pressure and uncertainty shift decision-making from effortful System 2 reasoning to intuitive System 1 heuristics. In banking crises, this shift intensifies reliance on familiar routines and salient cues, even when conditions have fundamentally changed.

Proposition 1: In BFIs, regulatory density interacts with bounded rationality such that directors systematically over-weight compliance-verifiable information and under-weight qualitative risk indicators, producing oversight gaps that increase with regulatory complexity.

Proposition 2: Under crisis conditions, BFI boards exhibit intensified reliance on System 1 heuristics, leading to risk perceptions that lag actual threat evolution and decisions that prioritize short-term liquidity over long-term viability.

5.2 Mechanism 2: Coalition Dynamics in High-Leverage Environments

BFI boards are political arenas where multiple stakeholders—shareholders, managers, regulators, depositors (indirectly)—form coalitions that shape decisions. High leverage fundamentally alters these dynamics because losses threaten not only equity but also deposits and taxpayer guarantees. This creates distinctive bargaining patterns.

- Unlike nonfinancial corporations, banking authorities indirectly influence board decisions through capital instructions, supervisory interventions, and merger approvals. As coalition members, regulators influence agendas and outcomes (John et al., 2016) through formal actions (approval, enforcement) and informal ones (supervision, moral suasion).
- While depositors are not board members, their ability to run provides implicit limits. This "shadow coalition" drives risk-taking because boards fear deposit outflows or regulatory action. It tightens more during stress, when withdrawal dangers are more apparent.
- Shareholders and regulators often have divergent preferences regarding risk. Shareholders may favor higher risk for higher returns, especially with deposit insurance creating moral hazard. Regulators prioritize safety and systemic stability. This tension creates coalitional politics where management may align with either coalition depending on incentives and framing.

Behavioural theory predicts that these coalition dynamics produce outcomes departing from rational optimization in systematic ways.

- Prospect theory (Kahneman, 2013) explains why coalitions confronted with losses (regulators facing systemic risk, stockholders facing equity erosion) bargain more vigorously than those seeking gains. This means BFI boards' risk judgments are asymmetrically sensitive to possible losses, which can lead to excessive caution (when loss frames dominate) and excessive risk-taking (when gains are conspicuous and losses disregarded).
- Framing effects influence which coalition dominates. If risks are framed as threats to systemic stability, regulator preferences prevail; if framed as competitive pressures, shareholder preferences gain traction. Management can strategically shape these frames, presenting proposals in ways that activate preferred coalition alignments.
- Political bargaining affects information flow. Huse and Rindova (2001) demonstrate that coalition members selectively exchange information to advance their causes. Selective

disclosure can bias BFI board deliberations—management may highlight upside scenarios to win shareholder coalition support while downplaying hazards that might raise regulator concerns.

High-leverage environments amplify these dynamics since stakes are higher and more widespread. When leverage is high, small asset value changes cause substantial equity fluctuations, increasing shareholder risk preferences. Meanwhile, failure's systemic effects increase regulators' safety preferences. The tension is structural.

Proposition 3: BFI board decisions reflect political bargaining among coalitions whose relative influence is shaped by framing effects and loss aversion, such that risk decisions systematically depart from both shareholder optimization and regulatory optimum.

Proposition 4: The relative influence of regulator and shareholder coalitions varies with institutional context: in strong regulatory regimes, regulator preferences dominate through formal powers; in weak regulatory regimes, shareholder coalitions prevail unless depositor runs create binding constraints.

5.3 Boundary Conditions and Moderators

These systems are contextually moderated. Institutional setting influences behavior. Status inequalities reduce challenge in high-power-distance societies, boosting dominant coalition members' overconfidence. Compliance–oversight displacement increases in high-uncertainty-avoidance cultures due to strict routines. Strong enforcement regimes can reduce cognitive biases by establishing external accountability, but weak regimes leave biases unchecked.

Bounded rationality is moderated by board composition and competence. Financial expertise improves mental models for comprehending complex information, somewhat offsetting cognitive constraints. However, expertise can also amplify overconfidence if unaccompanied by intellectual humility. Diversity—cognitive, demographic, experiential—may moderate coalition dynamics by introducing multiple perspectives that challenge dominant frames.

Both mechanisms intensify under crisis conditions. The effects of bounded rationality strengthen as cognitive load increases and time pressure mounts. Coalition bargaining sharpens as stakes rise and loss aversion intensifies. Under crisis, reliance on heuristics increases while coalition politics become more consequential, potentially producing rapid deterioration in governance quality.

5.4 What Becomes Explainable Through This Framework?

Figure 1 presents the integrated framework graphically. This framework explains governance patterns that traditional theories cannot:

- Traditional theories predict that independent, diverse, expert boards will govern effectively. Our framework explains variation through differences in behavioural processes—how boards actually deliberate, how coalitions form, how heuristics shape judgment. Two boards with identical structural attributes may produce different outcomes because one has a culture that encourages challenge while the other suppresses dissent, or because different coalition alignments emerge.
- Structural reforms (independence requirements, committee mandates, diversity quotas) address agency problems but cannot eliminate bounded rationality or coalition politics. Our framework explains why compliance metrics improve while substantive oversight may not—the displacement mechanism (Proposition 1) predicts precisely this pattern. Reforms

increase attention to compliance-verifiable indicators without necessarily improving judgment about ambiguous risks.

- Ex post analyses of banking crises consistently find that boards underestimated tail risks. Our framework explains this through bounded rationality mechanisms (overconfidence, confirmation bias, framing effects) that operate systematically, not as random errors. These biases are not eliminated by expertise or independence; they are features of human cognition that structural reforms cannot fully address.
- Agency theory predicts that deposit insurance creates moral hazard; our framework explains how this occurs through coalition dynamics—how shareholders and managers, protected by safety nets, form coalitions favoring higher risk than regulators prefer. The mechanism operates through board-level bargaining, not just abstract incentive effects.
- Traditional theories struggle to explain systematic cross-national variation in governance outcomes beyond noting institutional differences. Our framework specifies how institutional context moderates behavioural mechanisms—for example, how power distance affects willingness to challenge, or how regulatory regime strength shapes coalition influence.

6. CONCLUSION AND FUTURE RESEARCH DIRECTIONS

6.1 Theoretical Contributions

This paper makes three contributions to governance theory. First, we describe BFI-specific behavioral mechanisms—the regulatory complexity–bounded rationality interface and coalition dynamics in high-leverage environments—that explain governance outcomes that traditional theories cannot. To understand BFI-specific behavioral processes, this goes beyond "multi-theoretic integration" calls. The mechanisms are shaped by banking's institutional architecture: regulatory density that overloads compliance, high leverage that intensifies coalition tensions, and systemic interdependence that creates regulator-as-coalition-member dynamics.

Second, we create an integrated framework that links structural antecedents, behavioral processes, and governance outcomes, regulated by institutional environment and board characteristics. A framework generates testable propositions to guide empirical research. It indicates not only that behavioral processes matter but also their paths and conditions of amplification or attenuation.

Third, we contextualize behavioural governance theory. Van Ees et al. (2009) proposed a board behavioural theory but did not explain how industry background affects behavior. Banks' unique characteristics enhance some behavioral consequences (heuristic dependence under complexity) and produce other ones (regulator-as-coalition-member dynamics). This shows that behavioural governance theory should consider industry-specific conditions rather than universal methods.

6.2 Implications for Research

Our framework suggests several research directions. Boardroom processes must be captured through observations, interviews, process tracing, and archival analysis to open reduce the complexities. Burney, Arnold-Saritepe & McCann (2023) recommend qualitative behavior analysis in BFIs; our methodology gives theoretical support. Specific questions include: How do directors handle complex regulations? In genuine board meetings, how do coalitions work? How do framing effects work?

Testing propositions: The four propositions can be tested through multiple approaches:

- 1) Comparative case studies of BFI boards across varying regulatory regimes and cultural contexts, examining how mechanisms operate under different conditions.
- 2) Survey-based measures of board processes, capturing director perceptions of deliberation quality, coalition dynamics, and heuristic use.
- 3) Experimental designs examining how regulatory complexity affects judgment, using simulated board tasks with professional directors.
- 4) Archival studies linking board process indicators (meeting minutes, voting records) to outcomes, where such data are accessible.

Our methodology for BFIs may apply to other highly regulated, systemically important sectors including insurance, utilities, and huge technology platforms with comparable criteria. Comparisons could determine if mechanisms generalize or need context-specific modification.

Our framework can be beneficial for the advancement of methodology. Testing behavioural mechanisms involves credible board process measures, modifying group psychology, political science, and organizational behavior instruments and constructing BFI-specific measures.

6.3 Implications for Practice and Policy

- 1) Director selection and development: Consider expertise, cognitive styles, and challenge. Intellectual humility—awareness of cognitive limitations—should be considered when choosing directors, not only area knowledge. Board development programs should address cognitive biases and how regulation complexity distorts attention.
- 2) Board processes and culture: Boards should require systematic review of disconfirming evidence, rotate devil's advocacy, and create psychological safety for dissent to offset prejudices. Meeting agendas should include qualitative risk discussion as well as compliance review.
- 3) Board evaluation: Boards should evaluate deliberative quality, not simply structural compliance. Quality of dissent management, breadth of perspectives examined, depth of challenge to management plans, and handling of unclear information are indicators..

For regulators, our analysis suggests that structural reforms, while necessary, are insufficient.

- 1) In addition to structural needs, regulation should address behavior. Boards may be required to show how they assure real risk deliberation, not just metrics compliance. Supervisory reviews can analyze board dynamics through observation and interviews, not only document review.
- 2) Like financial stress tests, governance stress tests simulate how boards might react in a crisis, looking for biases and coalition dynamics that could hinder action.
- 3) Regulators should realize their interventions affect behavior. Compliance overload from dense regulations may distract from genuine risk. Regulatory communication should support board judgment (not undermine it).

6.4 Limitations

This paper has several limitations. First, it is conceptual, synthesizing existing theory to develop new propositions. The framework requires empirical testing; propositions remain to be validated. Second, the integrative synthesis, while structured, does not claim full systematic review replicability.



We have prioritized theoretical development over methodological formalism, but this choice involves trade-offs in transparency and comprehensiveness. Third, the framework focuses on behavioural mechanisms at the board level, giving less attention to individual director characteristics or organizational context beyond banking. Future work should integrate these levels more fully.

6.5 Concluding Remarks

The governance complexities that are inherent in BFIs have not received sufficient scholarly attention for an extended period. While structural reforms have multiplied— independence requirements, committee mandates, diversity quotas—governance failures persist.

This persistence suggests that what happens inside the boardroom matters as much as the board's formal architecture. By specifying behavioural mechanisms unique to the BFI context, we hope to open this black box to theoretical and empirical inquiry. The framework offered here is a beginning, not an end—a foundation for research that can illuminate how boards actually behave and how their behaviour shapes the safety and soundness of institutions on which financial stability depends.

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Annexure 1: Table #1: Comparative cross-matrix of governance issues in BFIs × theories

Issues \ Theories	Agency	Stewardship	Stakeholder	Resource Dependence	Behavioral Theory of Firm	Institutional
Agency conflicts	✓ strong on monitoring but risk-intensifying	△ viable in stability, fragile in crises	△ broadens to multiple constituencies, lacks prioritization	△ networks help, but risk groupthink	✓ exposes bounded rationality, undermining monitoring	△ cultural norms shape effectiveness



Moral hazard from guarantees	✓ shows risk-shifting under bailouts	✗ assumes restraint, unrealistic	△ frames the systemic cost to society	△ ties deepen dependence, often worsen hazard	✓ shows biases amplifying hazard	△ explains the variation across regimes
Board trust & long-term alignment	△ stresses monitoring, skeptical of trust	✓ core lens but fragile under stress	△ broader trust but conflicts unresolved	△ networks aid but risk capture	✓ explains erosion via bounded rationality	△ cultural mediation of trust
Balancing stakeholder (depositors, regulators, taxpayers) interests	✗ narrow shareholder primacy	✗ unrealistic multi-party balance	✓ central explanatory lens	△ networks privilege powerful stakeholders	△ overload leads to bias toward salient actors	✓ explains the systemic orientation variation
Access to capital, knowledge, networks	✗ marginal concern	△ trust may aid but risky	△ argues inclusivity but skewed	✓ boards as boundary-spanners, limited by expertise	△ illusion of expertise validity	✓ context-specific importance
Maintaining public trust	✗ weak explanatory reach	△ narratives aid, collapse in crises	△ multi-stakeholder framing	△ symbolic reassurance via networks	△ routines and biases weaken trust	✓ trust strategies vary by culture
Bounded rationality of directors	✗ assumes rational actors	✗ assumes maturity, ignores limits	✗ overlooks decision limits	△ expertise partially offsets limits	✓ central — heuristics and satisficing	△ context shapes manifestation
Short-term satisficing	✗ assumes optimization	✗ fragile under stress	△ notes societal costs	△ resource scarcity intensifies satisficing	✓ explains satisficing behavior	△ pressures worsen in weak institutions
Rigid routines & path dependency	✗ blind to adaptation	✗ misplaced trust in routines	△ multiple claims complicate adaptation	△ obsolete networks reinforce rigidity	✓ explains lock-in failures	✓ isomorphism preserves routines
Coalition bargaining	✗ narrow dyadic view	✗ unity assumption masks bargaining	△ multi-stakeholder coalitions complicate	△ resources skew coalitions	✓ boards as political coalitions	△ coalition dynamics shaped by norms
Cultural influence	✗ universalist, blind to culture	△ viable in collectivist, not individualist	△ ethics vary culturally	△ external ties valued differently	△ heuristics shaped by culture	✓ governance embedded in institutions
Ownership concentration & minority rights	△ less relevant under concentration	✗ controlling owners often exploit minorities	△ frames minorities as stakeholders	△ dominant owners control resources	△ coalitions marginalize minorities	✓ explains weak protection in poor regimes
Post-crisis reforms	△ monitoring reforms but expertise gaps	✗ trust weakened, stewardship sidelined	△ justified as social protection, weak in trade-offs	△ reforms overlook expertise deficits	✓ cognitive biases persist despite reforms	✓ global convergence produces shallow fixes

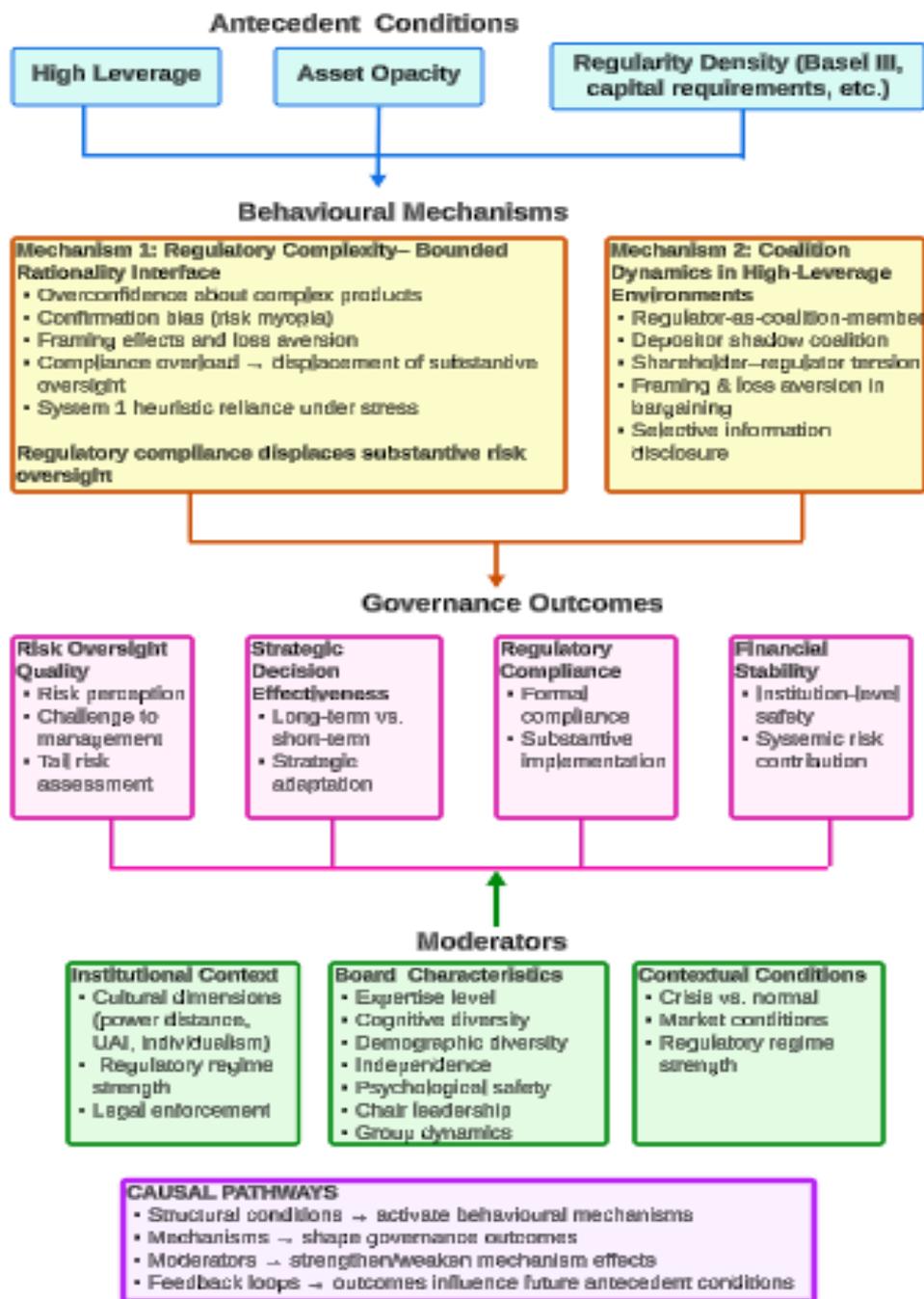


Figure 1: Integrated Framework