The Value Creating Board

Corporate governance and organizational behaviour

Edited by
Morten Huse

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The Value Creating Board

This book presents boards of directors from a strategic and entrepreneurial management perspective. Boards of directors are receiving increased interest in the business world as well as among academic audiences; however, few contributions integrate corporate governance and organizational behaviour. In this book a research stream about value-creating boards is introduced.

Boards of directors have, during the recent decades mostly been studied within a framework of corporate governance where the interests of external investors are emphasized. This book aims to go further and explore actual board behaviour. The framework and the contributions in the book include concepts such as:

- board leadership and structure
- boardroom decision-making
- board task performance
- corporate entrepreneurship and innovation
- boards in small and medium-sized firms
- board diversity and women directors.

The book also presents the results of a research agenda about value-creating boards which was conducted throughout various European countries.

The book is relevant to researchers and graduate students who are studying boards and corporate governance from a strategic and entrepreneurial management perspective. It is a great source book with respect to literature about boards of directors, and detailed operationalizations of many board related concepts are presented.

Morten Huse is Professor of Organization and Management, Norwegian School of Management BI.

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Preface

This book addresses the ways in which board behaviours can actually contribute to making boards more effective. The book presents a research journey. It is based on a long-term rigorous research programme, and it is written in a management tradition. The target group is scholars researching corporate governance, strategic management and organizational behaviour, and it has been developed through doctoral courses on boards of directors. It is a result of the 'Value creating board' research programme taking place at the Norwegian School of Management BI, Oslo. The programme was financed 2003–2006 by the Norwegian Research Council and various actors in Norwegian industry. The general background logic of the book is that value can be created by improving board performance. The book provides a comprehensive overview of various ways of thinking about board performance, and it shows the complexity of the decision-making processes of boards of directors. A key question throughout the book is, thus, why do boards fail in creating values and behaving accountably?

The book introduces a stream of research on actual board behaviour, and it contains five parts. Part 1 presents an overview of board research and a framework for exploring behavioural perspectives of boards and governance. Part 2 presents some classical articles introducing issues and theories that contribute to developing this field of research. Part 3 and Part 4 include empirical studies about actual board behaviour. Part 3 presents various studies about board processes, most of them employ qualitative methods and they contribute to the exploration of methods and concepts. Part 4 presents the surveys used in the 'Value creating board' research programme. The articles presented were developed through the annual 'Norefjell research workshops' on behavioural perspectives of boards of directors. The final article in Part 5 makes a link to implications for practice. The book as a whole is a contribution to what makes a good board.

Corporate governance is a fast growing area of research and teaching. This book is developed as a handbook and as readings for doctoral courses in corporate governance from a strategic management and organizational behaviour perspective. There are few alternative textbooks in this area, and it supplements my recent monograph: *Boards, Governance and Value Creation:*

The Human Side of Corporate Governance (published 2007 by Cambridge University Press), and it will mainly compete with journal articles.

I would like to thank my family for being bearing with my lack of availability when developing this book. I will furthermore thank all contributors in the book, all Norefjell participants, my assistants and colleagues, the publisher, the funders of the research programme, and Torger Reve, Jon Erik Svendsen and Elbjørg Gui Standal from the Norwegian School of Management, who all made important contributions when initiating the 'Value creating board' research programme. I would also like to thank Norwegian School of Management, Tor Vergata University, Federico II University, Magna Graecia University and Hanken/Helsinki, who gave me space when completing this book.

Morten Huse
Oslo, December 2007

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Jeroen van den Heuvel received his Ph.D. from Hasselt University (Belgium) in August 2006. His Ph.D. dissertation is titled 'Boards and Governance in Small and Medium-sized Family Businesses'. His interests extend to entrepreneurship and the position and influence of the CEO. His work has been published in *European Management Journal*, *Journal of Small Business Management*, and *Corporate Governance: An International Review*. Currently, he is employed by the Dutch Ministry of Economic Affairs in The Hague as a policy-maker within the Directorate-General of Entrepreneurship and Innovation/Directorate of Strategy, Research and International Affairs.

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Fabio Zona completed his Ph.D. at Bocconi University. Currently, he is assistant professor at the Strategic Management Department of Bocconi University, Milan. His main research interests focus on both boards of directors and executive compensation, in the context of family firms and large listed corporations.

Part I

Introduction

The value creating board and behavioural perspectives

1 The value creating board and behavioural perspectives

Morten Huse

Abstract

During recent decades boards have mostly been studied within a framework of corporate governance where the interests of external investors are emphasized. We will here break some new ground, offering a major survey on boards of directors throughout various European countries, and opening up the hitherto unexamined area of study of board behaviour and the workings of the value creating board.

A framework is presented including concepts such as: the knowledge and diversity of board members; trust and interactions inside and outside the boardroom; board leadership and structure; boardroom decision-making; and corporate entrepreneurship and innovation. The value creation of boards is not only related to value protection for certain shareholders or value distribution to various stakeholders, but also to value creation throughout the whole value chain – as in relation to innovation and corporate entrepreneurship, for example.

Key words: Boards of directors, Behavioural perspectives, Board task performance, Value creation, Corporate innovation

Introduction

How to achieve good corporate governance is a problem that has not yet been resolved, and many established prescriptions have failed to ensure proper care. Boards of directors are also receiving increased interest in the business world as well as among academic audiences. However, the academic contributions are far removed from business practice, and boards of directors have, during the recent decades, mostly been studied within a framework of corporate governance where the interests of external investors are emphasized. In this tradition boards have generally been considered as a black box, and actual board behaviour has hardly been studied (Daily, Dalton and Cannella, 2003; Gabrielsson and Huse, 2004). Creating board accountability, in the sense of bridging the gap between theory and actual board performance, requires a better understanding of what makes a board function, i.e. looking into the 'black box' of the board (Huse, 2005).

Mainstream board research, and much of the research on agents in corporate governance in general, is based on incomplete and inadequate models. The human dimension is rarely included, and the key question of why boards fail to behave accountably is not properly investigated (Finkelstein and Mooney, 2002). There is thus a need for discussions on the complexity of the decision-making processes of boards of directors (Daily et al., 2003; Forbes and Milliken, 1999).

Lessons learnt from various management disciplines

In this book I aim to present a framework and a research agenda to explore value creating boards. This framework includes thinking about the key relationships which enable the creation of board accountability. As contributors, we try to explore what is needed to make sure that a board does its job, and I present a comprehensive overview of various ways of thinking about board performance.

This book draws on lessons learnt in strategic and entrepreneurial management. The value creation of boards in this perspective goes beyond the question of monitoring and gatekeeping. Value creation of boards is not only related to value protection for certain shareholders or value distribution to various stakeholders, but also to value creation throughout the whole value chain – as in relation to innovation and corporate entrepreneurship, for example.

It is an intention of the book to contribute to opening the 'black box' and explore actual board behaviour. The sub-title of the book directs attention to organizational behaviour. Lessons from psychology and behavioural economics for corporate governance and boards of directors have still to be investigated.

The framework and the contributions in the book include concepts such as

- the knowledge and diversity of board members
- trust and interactions inside and outside the boardroom
- board leadership and structure
- boardroom decision-making
- board task performance
- corporate entrepreneurship and innovation.

Contributions

The book makes various contributions. First and foremost, it addresses one of the most current and topical debates in corporate governance – the ways in which board behaviours can actually contribute to making boards more effective and contribute to value creation. This is done in the context of the 'value creating board' and as such we are seeking to shed light on the inner workings of the board, i.e. open the now famous 'black box'. Therefore, it may be a key resource for any academic and researcher working in this area.

Second, the book is not located in a narrow subject domain, rather it seeks to make contributions to related subject areas including organizational behaviour and entrepreneurship and innovation. As such, it is important secondary reading for students in a range of different courses in business, management, business law and economics. Third, the book contains a balance between 'classic' texts written by eminent writers in the field and newly emerging conceptual and empirical papers by established and new academics. Fourth, the book brings in perspectives from different countries and not only from an Anglo-American research and corporate governance tradition.

Framework and outline

The basic framework for the book is presented in Huse (2005): 'Accountability and creating accountability: a framework for exploring behavioural perspectives on boards and governance', *British Journal of Management*, 16 (special issue): 65–79. An in-depth presentation of the framework is found in Huse (2007). The various articles and research projects represented in this book are the building blocks in Huse (2007).

The classics – developing a field

The book has three main elements. After an introductory section presenting research on boards that has been published in major journals from 1990 to 2002 (Gabrielsson and Huse, 2004) and the framework (Huse, 2005), there is a section (Part II) presenting seminal classical articles that together constitute the basis for this research on boards of directors. Most of these articles are review articles, and they present gaps in existing literature. They show that research attention should be directed to understanding the gaps between board task expectations and actual board task performance (Mace, 1972); explore board composition in relation to various board roles or tasks (Fama and Jensen, 1983; Zahra and Pearce, 1989); explore the relationships between board composition and corporate performance in intermediate steps, including mediators like structures, processes and task performance (Zahra and Pearce, 1989); the board as a decision-making team and processes inside the boardroom (Forbes and Milliken, 1999); and see the board as an open system with interactions between board members, the top management team and various other actors (Pettigrew, 1992).

Exploring methods and concepts

Most of the articles in Part III are empirical studies employing qualitative methods in concept development. They represent contributions from various research projects that I have coordinated from 1990 until 2005. This section contributes both to exploring various research methods in studying boards of directors and introducing various concepts that have been observed in these studies. The qualitative studies presented include a reconstructive case study (Huse and Eide, 1996), participant observation studies using 'fly on the wall' techniques (Huse, Minichilli and Schøning, 2005) and 'one of the lads' (Huse, 1998) methods, and the collection of 'board life stories' from women directors (Huse and Solberg, 2006). Survey studies using different perspectives and respondents are also presented (Huse, 1993; Huse and Rindova, 2001). The studies illustrate variations in board tasks (Huse, 1993 and 1998; Huse and Rindova, 2001), and they present the board decision-making culture and the dynamics inside the boardroom (Huse et al., 2005) and the interactions outside the boardroom (Huse, 1998; Huse and Eide, 1996; Huse and Solberg, 2006).

Testing relationships in the value creating board surveys

Various empirical studies from the 'Value creating board' surveys are presented in the third and final main section: Part IV. The 'Value creating board' surveys were coordinated from the Norwegian School of Management BI, and the main survey instrument consisted of about 250 questions that were linked to the framework presented in Huse (2005). Scholars from various countries contributed to these surveys by being co-authors in articles using data from Norway (Gnan and Zattoni, 2008; Nordqvist and Minichilli, 2008; Nielsen, 2008; Wenstøp, 2008; Zona, Minichilli, Zattoni, 2008), or by collecting and using data from their home countries, i.e. Belgium (Bammens and Voordeckers, 2008), Italy (Minichilli, Zattoni and Zona, 2008), the Netherlands (van Ees, van der Laan and Postma, 2008; van der Heuvel and van Gils, 2008) and Sweden (Gabrielsson and Politis, 2008). The articles have different research questions and focus. Some studies are about small firms (Bammens and Voordeckers; Gabrielsson and Politis; Gnan and Zattoni; van der Heuvel and van Gils), some use data from medium-sized firms (Nielsen; Wenstøp; Zona et al.), while other studies have a main focus on listed firms (Minichilli et al.; van Ees et al.). Research questions centre around board tasks (Bammens and Voordeckers; Minichilli et al.; van der Heuvel and van Gils), board working structures (Nordqvist and Minichilli; Nielsen), trust, power and processes (van Ees et al.; Wenstøp), women directors and diversity (Nielsen) and the boards' contribution to corporate innovation (Gabrielsson and Politis; Zona et al).

Building blocks and accumulation of knowledge

Through this book I hope to break some new ground in exploring boards of directors and corporate governance. Results from a major survey on boards of directors throughout various European countries are presented, and they open the hitherto unexamined area of study of board behaviour and the workings of the value creating board. This book consists of various building blocks. These blocks may contribute to build a research stream about value creating boards where the focus is on behavioural perspectives.

The framework and contributions in the book include concepts such as: the knowledge and diversity of board members; trust and interactions inside and outside the boardroom; board leadership and structure; boardroom decision-making, and corporate entrepreneurship and innovation. The value creation of boards is not only related to value protection for certain shareholders or value distribution to various stakeholders, but also to value creation throughout the whole value chain.

Two articles are presented in this introductory section. The first article (Gabrielsson and Huse, 2004) reviews all empirical articles published about boards of directors in six main scientific journals. A total of 127 empirical articles were found in *Academy of Management Journal*, *Administrative Science Quarterly*, *Journal of Management*, *Strategic Management Journal*, *Journal of Management Studies* and *Journal of Management and Governance*. The articles were sorted based on method and topic. The categories 'input-output studies', 'contingency studies', 'behavioural studies' and 'evolutionary studies' were used. It was found that 99 of the articles were in a stream of research trying to test the relationships between a few variables relating to board composition, often mentioned as 'the usual suspects' (Finkelstein and Mooney, 2003) and corporate financial performance (the input-output category). All these studies relied on archival data about the boards. The contingency study category included 13 articles. These studies also mainly relied on archival data. The behavioural studies category also included 13 articles. The data collection in these studies was mainly surveys. The articles in Part IV in this book are in this category. The final group with only two articles included both behavioural and contextual perspectives. This category typically consists of qualitative case studies but, as indicated, few such studies have been published in main journals. However, several examples of studies in this category are presented in Part III of this book.

The second article in Part I is Huse (2005). Here I present an integrative framework for understanding behavioural perspectives on boards and governance. The contribution of this framework is the development of a terminology that may help us accumulate knowledge and provide a direction for a research agenda. This framework was used in the 'value creating board' surveys and in the articles presented in Part IV. The consistent use of a terminology, the accumulation of knowledge and a commonly shared research agenda among a core group of scholars are among the first steps in developing a research stream. It is the objective of the book to present the research stream about behavioural perspectives on boards and governance through the 'value creating board' surveys.

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2 Context, behaviour and evolution

Challenges in research on boards and governance*

Jonas Gabrielsson and Morten Huse

Abstract

In this article, we present an overview of empirical research on boards and governance in leading U.S. and international academic journals in general management. Samples, methods, theories, and main concepts are presented and compared. The contributions are positioned with respect to contingency perspectives, behavioral perspectives, and evolutionary perspectives. Through an analysis of 127 empirical articles, we find that most studies on boards and governance have been influenced by a research tradition that treats the board of directors as an isolated 'black box.' Only few studies explore boards in context or explore behavioral perspectives of boards. Almost no studies include evolutionary perspectives. Based on our analysis, we explore alternative research streams and outline various directions for future research.

Recent research on boards of directors has been criticized from various sources, and alternative directions for future research have been suggested. The criticism involves the fact that since 1990, research about boards of directors has been dominated by a publish-or-perish syndrome that stems from the U.S. tenure track system (Huse 1998, 2000). The consequences of this system have been a search for easily available data and the use of standardized methods. These consequences have been labeled the 'lamp syndrome' and the 'hammer syndrome.'

This article presents a review of empirical board studies that, in the period 1990–2002, were published in six major general management journals. The objectives of this article are to test the above-mentioned critique and to explore how alternative research directions on studies of boards of directors may be developed.

Several contributions are presented. The first contribution is an overview of empirical research on boards and governance in leading U.S. and international academic journals in general management. Samples, methods, theories, and main concepts are presented. The second contribution is the exploration of alternative research streams. This exploration helps board

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scholars relate to each other and accumulate knowledge in research about boards of directors. The third contribution is a comparison of board research presented in U.S. journals with research presented in international European-based journals. This comparison makes it possible to explore ways European scholars may position their work and contribute in the international arena on boards and governance research. The contributions are positioned with respect to contingency perspectives, behavioral perspectives, and evolutionary perspectives.

Critique and a sorting taxonomy

In a recent state-of-the-art article published in the *Academy of Management Review*, Daily, Dalton, and Cannella (2003) argue that there is a need to dismantle fortresses in research about boards and governance. Catherine Daily and colleagues, earlier, through various meta-analyses, concluded that a concentration of studies on the direct relationships between the 'usual suspects' and corporate financial performance do not give any promising results. The usual suspects are the number of board members, CEO duality, insider/outsider ratio, and the stock holding by board members (Finkelstein and Mooney 2003). The results are ambiguous or weak (Johnson, Daily, and Ellstrand 1996).

The focus on the usual suspects has been driven by the publish-or-perish syndrome resulting from the U.S. tenure track system. The need for many publications by junior faculty has resulted in the use of easily available data and standardized methods. The critics have claimed that the system has driven scholars to use secondary sources about large U.S. corporations, and board data available from these sources have most often been limited to the 'usual suspects.' Boards of directors have been treated as a black box between the input and output. These studies have been criticized for lacking both a contingency (Aguilera and Jackson 2003; Davis and Useem 2002) and a behavioral (Finkelstein and Mooney 2003; Forbes and Milliken 1999) perspective.

Seeing the contingency and behavioral perspectives as two dimensions in a two-by-two matrix, we may develop a sorting taxonomy consisting of four groups that may be labeled input–output studies, contingency studies, behavioral studies, and evolutionary studies. The input–output studies are characterized by black box studies and the hammer and lamp syndromes. The contingency studies are characterized by an emphasis on the context, seeing the board as an open system, including a broader stakeholder perspective and the board's interaction with the environment. The behavioral studies focus on actors, processes, and decision making. The evolutionary label is put on studies that combine the contingency and behavioral perspectives, and it can fit to the call for contribution presented by Pettigrew (1992). The evolutionary studies include history, time, change, and learning.

Based on the existing critique of board research, we expect, when reviewing the research on boards published in leading academic general management journals, that most of the articles will be classified in the input–output category. Generally, universities in Europe have not had a tenure track system in the same way as have U.S. universities. We thus expect that relatively more articles authored by U.S. than European scholars would be found in the input–output category.

Empirical board research in six leading general management journals

We decided to review four U.S.-based and two international general management journals. The U.S. journals were *Academy of Management Journal* (AMJ), *Administrative Science Quarterly* (ASQ), *Journal of Management* (JoM), and *Strategic Management Journal* (SMJ). The two international journals were *Journal of Management and Governance* (JMG) and *Journal of Management Studies* (JMS). These were based in Italy and the United Kingdom, respectively. The selection criteria were that the journal should be considered to be a premier outlet for research about boards and governance, it should very clearly be an academically oriented journal, and it should be focused on general management. Field-specific journals and more practitioner-oriented journals were thus excluded. Among the more field-specific top-ranked journals we considered included *Organization Science* and *Organization Studies*, but few empirical studies of boards were published in these journals. Journals in a financial economics tradition have many empirical articles on boards and governance. These have been reviewed in other places (e.g., Bhagat and Black 1999, 2002), and our objective was to investigate research in a management tradition.

We studied articles published in the period 1990–2002. Studies of boards of directors also existed before 1990, but research in the area did not really start to mushroom until the end of the 1980s. We considered that the seminal review article by Zahra and Pearce (1989) could be a good starting point for our review, as it also has been for others (e.g., Johnson, Daily, and Ellstrand 1996).

Articles from the various journals were selected if the focus of the article was the board of directors or the board's role in governance. In our initial selection, we included 138 articles, but we found that the sample would only be 119 if we employed a strict focus. When using 127 articles in the final sample, we excluded some of the 138 articles that used the board as a variable, but the board of directors in these articles only played a minor role. Compared to the 119 articles in the strict sample, we included some articles in which the board was not at the core of the article but still gave considerable input to the understanding of boards of directors and the board's role in governance.

For the comparison of U.S. and European journals and contributions, we checked the affiliations of the members of the editorial board. At the beginning of 2002, 66–100 percent of the members of editorial teams in the four U.S. journals were listed with affiliations in North America, as were 80–96 percent of the members of the editorial boards. The *Journal of Management* had the highest percentage of editorial board members from North America. The same figures from the international European-based journals were 0–22 percent and 31–69 percent.

A comprehensive list of the reviewed articles is found in the Appendix, while an overview of the journals is presented in Table 2.1

Origin of samples

There is a bias toward North American samples in the reviewed empirical articles. Our review showed that 98 of the 127 articles, about 77 percent, have samples from North America. The rest of the remaining empirical articles primarily have samples from Europe. Only one study has a sample from Asia. This study was found in JMS. There were no samples from Africa or South America in any of the journals. Of the four U.S.-based journals, only SMJ reports empirical studies with samples from outside North America. Of these four studies, two were from the United Kingdom, and two were cross-country comparisons. The origins of samples in the two European journals were more mixed. The majority of articles with European samples were found in JMG (twelve articles). JMS had about an equal number of North American and European samples.

Affiliations of authors

North American scholars authored the majority of the articles. Our review shows that 105 of the 127 articles, about 83 percent, are articles for which at least half of the authors had a North American affiliation. Among the four U.S.-based journals, only SMJ has some studies with a majority of authors outside North America. The origins of authors in the two European-based journals are more mixed. JMG had eleven articles with a majority of authors affiliated with institutions outside North America. They are mostly spread around Europe. JMS had eleven articles with authors affiliated with institutions outside North America. They were all from the United Kingdom.

Theories

The majority of the articles had a rigorous theoretical base. We found that in 69 empirical studies (about 54 percent), agency theory was employed as the main theoretical perspective, either alone or in combination with other theories. Arguments from resource dependency theory were used in 19 articles (about 15 percent), and social network perspectives were used in 17 articles (about 13 percent). The rest of the articles employed a broad variety of theoretical perspectives, such as, for example, legalistic

Table 2.1 Journals reviewed

	Academy of Management Journal (AMJ)	*Administrative Science Quarterly (ASQ)*	*Journal of Management (JoM)*	*Strategic Management Journal (SMJ)*	*U.S. total*	*Journal of Management and Governance (JMG)*	*Journal of Management Studies (JMS)*	*International total*	*Total*
Editorial board members (editorial team members) from North America (2001/2002)	88% (80%)	95% (100%)	96% (100%)	80% (66%)	90% (87%)	31% (22%)	69% (0%)	50% (11%)	77% (61%)
Board articles published 1990–99	24	22	7	25	78	6	5	11	89
Board articles published 2000–2002	3	4	4	9	20	10	8	18	38
Sum	27	26	11	34	98	16	13	29	127
Samples from North America	27 (100%)	26 (100%)	11 (100%)	29 (85%)	93 (95%)	3 (19%)	7 (54%)	10 (34%)	103 (81%)
Authors from North America*	27 (100%)	26 (100%)	11 (100%)	31 (91%)	95 (97%)	5 (31%)	7 (54%)	12 (41%)	105 (83%)

* Articles for which the majority of the authors has a North American affiliation.

perspectives, institutional theory, stewardship theory, stakeholder theory, and gender and diversity theories. We also found that 22 articles (about 18 percent) did not rely on any clearly articulated theory in their studies but used various arguments from previous literature and empirical results. We could not find any clear differences with respect to employed theories between U.S.- and European-based journals.

Sample sizes

The reported studies favor large samples. Only four studies had 20 or fewer cases in their samples (about 3 percent). In 26 articles (20 percent), there were between 21 and 100 cases. In 38 articles (about 30 percent), there were samples with more than 300 cases in the analysis. We could not find any clear differences with respect to sample size between U.S.- and European-based journals.

Data collection

Most of the published studies rely on archival data-gathering techniques. We found that in 91 of the 127 empirical articles (about 72 percent), archival data were primarily used, while the authors of 27 empirical articles (about 21 percent) had collected primary data from mail questionnaires. There were eight studies using data from mail questionnaires in the European journals. In the U.S. journals, this number was 19. A cross-tabulation revealed that a combination of mail questionnaires and archival data was used in eleven articles (about 8.5 percent). In five studies, data were collected from field studies. All field studies included interviews, and some complemented this data with secondary archival data. Four of these studies were reported in the European journals (one in JMG and three in JMS). There were, consequently, relatively more primary data used in the European-based journals.

Methods of analysis

The empirical articles were dominated by sophisticated quantitative analyzing techniques. Multivariate regression analyses were employed in ninety-one of the articles (about 72 percent). LISREL was used in eight of the articles (about 6 percent). Factor analysis was employed in two articles. No articles employed cluster analysis. Only six articles (about 4 percent) employed qualitative techniques for analyzing the empirical data. Four of these studies were reported in European journals (one in JMG and three in JMS). There were, consequently, relatively more qualitative methods of analysis employed in the European journals compared with the four U.S. journals.

Generally, it seems that contributions from North America have been agenda setting for the research reported on boards and governance in the leading U.S.-based and international European-based academic journals in general management. North American authors have written the majority of articles, and there is a clear bias toward North American samples in the empirical articles. We also observe a few differences between U.S.- and European-based journals. There seems to be relatively more use of primary data in the European-based journals compared with U.S. journals, and there are also relatively more qualitative methods of analysis employed in the European journals.

Various streams of research

To test the general critique that research on boards and governance is driven by the U.S. tenure track system, we placed the articles according to our sorting taxonomy. We carefully evaluated each study with respect to the emphasis that was put on context, stakeholders, the board's interaction with the environment, actors, process, decision making, history, time, change, and learning. The results from this sorting procedure are presented in Figure 2.1.

CONTINGENCY FOCUS

Contingency studies: context, open system, stakeholders, interaction with environment 13 articles within the following subgroups: -strategic adaption -substitution and regulation -stakeholder power Boyd 1990, SMJ Pearce and Zahra 1992, JMS Zajac and Westphal 1994, SMJ Beatty and Zajac 1994, ASQ Rediker and Seth 1995, SMJ Buck, Filatotchev, and Wright 1998, JMS Gedajlovic and Shapiro 1998, SMJ MacCanna, Brennan, and O'Higgins 1999, JMG Westhead 1999, JMG O'Sullivan 2000, JMG Coles, McWilliams, and Sen 2001, JoM Huse and Rindova 2001, JMG Grundei and Talaulicar 2002, JMG	**Evolutionary studies: history, time, change, learning** Two articles Christensen and Westenholz 1999, JMG Pye 2002, JMS
Input–output studies: black box, hammer and lamp syndromes 99 articles that may be divided in subgroups based on: -use of "usual" suspects as independent or dependent variables -how agency theory is used in relation to other theories See appendix for all articles being reviewed	**Behavioral studies: actors, process, decision making** 13 articles within the following subgroups: -intermediate steps -locus of power in the boardroom Pearce and Zahra 1991, SMJ Stewart 1991, JMS Judge and Zeithaml 1992, AMJ Judge and Dobbins 1995, JoM Westphal 1998, ASQ Westphal and Zajac 1998, ASQ Westphal 1999, AMJ Gulati and Westphal 1999, ASQ Pitcher, Chreim, and Kisfalvi 2000, SMJ Carpenter and Westphal 2001, AMJ Stiles 2001, JMS Golden and Zajac 2001, AMJ Ng and DeCock 2002, JMS

BEHAVIORAL FOCUS

Figure 2.1 Results from sorting procedure.

First, we made a test of the general critique. After this, we present a more detailed description of the various research streams.

Our first assumption was that most articles would be found in the input–output category. Of the 127 reviewed articles, 99 articles (about 78 percent) were placed in this category. The results from our sorting procedure, consequently, indicate that our first assumption seems to be valid.

Our second assumption was that relatively more articles from U.S. than European scholars would be found in the input–output category. In our total sample, there were 38 articles (about 30 percent) with a majority of authors affiliated with European institutions, and 89 articles (about 70 percent) with a majority of authors affiliated with North American research institutions. Of the 99 articles included in the input–output category, 74 articles (about 75 percent) were authored by scholars affiliated with North American institutions, while 25 articles (about 25 percent) were authored by scholars affiliated with European institutions. This indicates a tendency for a slightly larger number of U.S.-authored than European-authored articles in the input–output category. Our observation was supported by a conducted chi-square test that revealed a significant difference between expected and observed counts. Hence, our second assumption was found to hold some validity.

Input–output studies

The input–output studies are publications with a focus on the 'usual suspects,' i.e., insider/outsider ratios, board size, director's shareholding, and CEO duality (Finkelstein and Mooney 2003). These studies reflect a U.S.-based research tradition on boards of directors, guided by waves of shareholder and investor activism and shaped by the situation and development in large established U.S. corporations. Research questions and choice of method have often been considered to be publication driven and guided by convenience rather than relevance. Many scholars in this research stream seem to use methods and samples that give articles easy access to journals. Board information is most often collected through secondary data from samples of large established U.S. corporations.

The research question of the majority of the articles is about finding an optimal balance in board size, the ratio of outside directors, the director's shareholding, and CEO duality. We categorized 99 articles in this group. A main distinction among contributions in this category is how 'the usual suspects' are used as independent versus dependent variables. Another distinction is the use of theories. Many of the publications lean on agency theory assumptions, but there are also studies that complement agency theory predictions by using either contrasting or complementary theories, such as stewardship theory or various institutional or strategy theories. Theories related to resource dependency, social networks, and interlocking directorates also provide the basic framework in some studies. The studies are embedded in a context, and various context variables are used, but few articles clarify the context in which the empirical studies are embedded. Often, they control only for firm size and industry, while leaving other contingencies largely unexplored. Stakeholder concerns and interactions also receive limited attention.

Contingency studies

The contingency or contextual studies are the studies where contingency and stakeholder perspectives on boards and governance are explored by examining how the relative power of the board of directors depends on the firm's surrounding context. Of the 127 reviewed articles, 13 articles (about 5 percent) were placed in this category. While studies in the input–output category tend to have low emphasis on context, the contingency studies have an emphasis on that what is efficient in a particular firm, industry, or country, is highly contingent on its context. It is emphasized in the contingency studies that corporate governance designs and conceptualizations are embedded in a broader institutional and social environment, and that the relative power of the board depends on such diverse factors as the relative efficiency of input and output markets, the relative power and developing relationships between various coalitions of internal and external stakeholders, regulations, etc. The various governance systems are explored in various ways, mainly by employing and contrasting various theories and contexts. A broad variety of data collection techniques is used in these studies, including statistical analysis of archival data, survey data, interviews, and content analysis of media sources.

We could identify three subgroups in this research stream: strategic adaption, substitution and regulation, and stakeholder power studies. The first subgroup contains studies in which it is proposed that the selection, composition, and interlocks of board members reflect the strategic contingencies a firm faces in its internal and external environments (e.g., Boyd 1990; Grundei and Talaulicar 2002; MacCanna, Brennan, and O'Higgins 1999; Pearce and Zahra 1992; Westhead 1999). The second subgroup contains the studies in which governance structures are seen as configurations of interdependent elements (e.g., Beatty and Zajac 1994; Coles, McWilliams, and Sen 2001; Rediker and Seth 1995; Zajac and Westphal 1994). Hence, the scholars in this subgroup have begun to study them as complements or substitutes rather than regarding any particular aspect of governance as essential. The third subgroup included studies focusing on how differences in stakeholder power influence corporate governance and boards of directors (e.g., Buck, Filatotchev, and Wright 1998; Gedajlovic and Shapiro 1998; Huse and Rindova 2001). The general conclusions that can be drawn from these contingency studies are that the roles of boards vary depending on the firms' internal and external contexts. The characteristics of a firm's internal and external context, consequently, play a key role in shaping decisions surrounding corporate governance.

Behavioral studies

The behavioral studies include those where actors, processes, decision making, relationships, and interactions inside and outside the boardroom are explored. Among the 127 reviewed articles, 13 articles (about 5 percent) were placed in this category. The authors of the articles in the behavioral studies category emphasize that even though formal regulations and policies are necessary, these issues are not sufficient to fully understand effective governance. Instead, the processes and relational dynamics between the various actors in and around the boardroom and the impact on board-level and firm-level outcomes should be in focus. It is generally argued in these articles that boards may play various roles in carrying out their duties, and that actual board task performance may diverge from stakeholder expectations of board roles (Forbes and Milliken 1999; Mace 1971). It is also suggested that multiple theoretical perspectives are required to fully understand board behavior. Most articles in this category rely on surveys, primarily questionnaire surveys, as the main data collection instrument, but there are also articles that combine various data collection techniques, such as in-depth interviews, content analysis, longitudinal field studies, etc.

Two subgroups could be identified in this category. The first subgroup included articles in which board processes are included as variables between board composition and firm performance, thus splitting the overall board composition and corporate performance link in intermediate steps (e.g., Carpenter and Westphal 2001; Golden and Zajac 2001; Gulati and Westphal 1999; Judge and Dobbins 1995; Judge and Zeithaml 1992; Pearce and Zahra 1991; Westphal 1998, 1999; Westphal and Zajac 1998). Intervening board processes are argued to influence the decisions of the board members. The working structures and processes in and around the boardroom are predicted to have a major impact on the efficiency of the board members. Several of the authors publishing in this subgroup are also publishing studies in the input–output category. The second subgroup included studies that are more directly focused on the locus of power in and around the boardroom, as well as the behaviors, decisions, and activities of the directors. Attention is particularly directed to their internal relationships with one another, in order to understand conditions for effective boards and governance (e.g., Ng and DeCock 2002; Pitcher, Chreim, and Kisfalvi 2000; Stewart 1991; Stiles 2001). None of the authors in this subgroup are publishing studies in the input–output category.

Evolutionary studies

The evolutionary studies group includes articles that explore both context and behavior. They explore the system in which governance is embedded as well as the power and attributes of internal and external actors in and around the boardroom. The role of time and learning is important from this perspective. Only two of the reviewed articles were included in this group. The first article by Christensen and Westenholz (1999) focuses on the relational dynamics in and around the boardroom and the developing relationships between various coalitions of internal and external stakeholders. In the second article, Pye (2002) reports a variety of changes in the governance of large UK enterprises during the 1990s. Among other things, she reports how the concentration of power has led to a decisive shift in the rhetoric of directors, investors, and financial analysts toward phrases like 'shareholder value' at the exclusion of other conceptions of corporate purpose. Both articles take an evolutionary perspective by comparing and contrasting longitudinal data to better understand changes in context. The studies in this evolutionary research stream indicate that studies of boards of directors should not be separated from studies of power in institutions and society at large (Pettigrew 1992), hence, recognizing the need to consider boards as open systems that are subject to change and development over time.

Conclusions and directions for further research: Context, behavior, and evolution

Research on boards and governance is at a crossroads (Daily, Dalton, and Cannella 2003). Frustrated by weak and ambiguous findings, scholars have emphasized the need to critically question the models and theories that so far dominate the field (Blair and Stout 2001; Forbes and Milliken 1999; Huse 1998; Pettigrew 1992). However, despite these calls, there have been few attempts to develop alternative research directions. Daily, Dalton, and Cannella (2003) describe the current situation as one where governance researchers too seldom embrace findings that go against their narrow conceptualizations of the entirety of corporate governance. Hence, to move the research field forward, they argue that researchers must be both willing and ready to take on the collective challenge of dismantling their own fortresses of research by exploring new alternative research directions (Daily, Dalton, and Cannella 2003, 379).

Our overall objective with this article has been to meet this challenge by exploring how alternative research directions on studies of boards of directors may be developed. Based on an analysis of empirical research on boards and governance in six leading U.S.-based and international European-based academic journals in general management, we have explored alternative research streams. These research streams emphasize the need to develop contingency, behavioral, and evolutionary perspectives in future studies of boards of directors.

Contextual perspectives

The first challenge is to meet the need of developing contingency perspectives in studies of boards and governance. The growing number of contingency studies during the 1990s has confirmed that there are no universally best corporate governance methods. Firms, as well as economies, should be conceptualized as embedded in a larger social and institutional context that critically conditions their structures and performance (Davis and Useem 2002). This embedded perspective makes it unlikely that a single answer to questions of corporate governance designs will be found. Straightforward applications of a U.S. market-based model in settings outside the U.S. context should only be made with great caution (Davis and Useem 2002). Systems of corporate governance and cultural, legal, and institutional contingencies are inextricably linked, and different sets of institutions support different sets of interactions among actors. This means that we need to understand the diverse multinational nature of corporate governance before we develop global solutions (Huse 2005a). The question should not be which theory of governance is universally valid, but under which contexts or contingencies may one theory have explanatory power over another. Moreover, the various elements that make up the governance structure of a firm should be studied as configurations of interdependent elements, and various governance structures should be seen as complements or substitutes (Rediker and Seth 1995). Documenting and explaining the diversity of governance systems between various contexts and organizational settings may then be of help to bring together past research findings. That will also help in recognizing problems stemming from previous universalistic approaches and general theorizing in research on boards and governance.

Behavioral perspectives

The second challenge will be to meet the need of developing research on behavioral perspectives of boards and governance. The growing number of behavioral studies has emphasized the need to explore intermediate intervening processes between board composition and firm-level outcomes (Forbes and Milliken 1999; Gabrielsson and Winlund 2000). However, most empirical studies treat the actual work of the board as a black box, assuming that the behavior and conduct of directors can be successfully inferred from the board's demographic characteristics. Previous conceptualizations largely neglect board processes, such as interactions among groups of actors inside and outside the boardroom, board leadership, the development of rules and norms, and the board decision-making culture (Huse 2005b). Balancing the power between inside and outside board members may be critical for effective governance, but it takes more than optimum insider–outsider ratios to establish this goal. The relationships and interactions cannot be reliably and fully studied by using only proxies of actual board behavior and standard statistical techniques. This implies that future research should devote more attention to the internal organization of the board, such as relationships, motivations, and abilities among various kinds of directors, which, in turn, could influence board- and firm-level outcomes. Behavioral perspectives on boards are still relatively unexplored. However, insights into the processes would add significantly to our knowledge of effective boards and governance.

Evolutionary perspectives

By emphasizing the need to study the changing power and developing relationships between various coalitions of actors inside and outside the boardroom, we also emphasize the need to study boards and governance from evolutionary perspectives. Governance should be conceptualized as an ongoing evolutionary process (Shen 2003) embedded in a complex network of working relationships among investors, executives, board members, state regulators, etc. (Aguilera and Jackson 2003; Monks and Minow 2004). The stakes and power of the various actors are influenced by the changing context and the underlying political dynamics (Pye 2002; Aguilera and Jackson 2003). However, the 127 empirical studies included in our review are largely biased toward cross-sectional research designs seeking to explain variations in one or a few identified dependent variables. The employed models tend to be fundamentally static, and concepts like history, learning, or change are seldom included. The development of interactions and relationships, and the changing configurations of governance structures that evolve over time, should be better studied. Future studies should, moreover, take a longitudinal perspective by comparing and contrasting data and analyses over time.

In our review, we classified empirical research on boards to various main categories: input–output studies, contingency studies, behavioral studies, and evolutionary studies. We also observed subgroups of studies within each category. Published research about boards of directors in leading general management journals cannot generally be considered to be international. Most of the publications are heavily influenced by the United States or North America. It will be exciting to see if research contributions from Europe will follow the North American research tradition with a focus on black box input–output studies, or whether European scholars in the future will contribute to the exploration of context, behavior, and evolution with respect to boards and governance. Context, behavior, and evolution clearly challenge existing research on boards and governance.

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Appendix

Reviewed articles 1990–2002 sorted by journal in alphabetical order

Academy of Management Journal

Baysinger, B.D., R.D. Kosnik, and T.A. Turk. 1991. 'Effects of Board and Ownership Structure on Corporate R & D Strategy.' *Academy of Management Journal* 34 (1): 205–14.

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3 Accountability and creating accountability

A framework for exploring behavioural perspectives of corporate governance*

Morten Huse

Abstract

What is board accountability, and how is such accountability created? This response to Roberts, McNulty and Stiles suggests a framework for exploring behavioural perspectives of boards and corporate governance. The contribution of this framework is to develop a terminology that may help us accumulate knowledge and provide directions for a research agenda. The consistent use of a terminology, the accumulation of knowledge and an accepted research agenda among a core group of scholar are some of the first steps in developing a promising research field with considerable potential to create actionable knowledge. The framework can help us sort some of the research, concepts and anecdotes that have been presented in efforts to open the black box of board research.

Research on corporate governance is now taking various directions, and new streams of boards and governance research are evolving. The article 'Beyond Agency Conceptions of the Work of Non-executive Directors: Creating Accountability', by Roberts, McNulty and Stiles (this issue) may contribute as one of the building blocks in developing a research stream on exploring behavioural perspectives of boards.

Roberts, McNulty and Stiles explore various aspects of the board accountability concept, and they make an important distinction between accountability and that of creating accountability. The stories of experienced UK directors are the empirical basis of the study. The authors of the article 'challenge[s] the dominant grip of agency theory on governance research and support the search for theoretical pluralism and greater understanding of board processes and dynamics'. Their contributions are in line with the calls made by, for example, Daily, Dalton and Cannella (2003) and Pettigrew through a number of publications (e.g. Pettigrew, 1992; Pettigrew and McNulty, 1995).

Corporate governance research has, since the beginning of the 1990s been

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dominated by a US research tradition with a focus on protecting the investors' stakes. Roberts, McNulty and Stiles go beyond these agency conceptions of the work of the non-executive directors to define accountability. Board accountability is related to value creation (Cadbury, 1992; Taylor, 2001). Roberts, McNulty and Stiles use a pluralistic approach to board accountability, and agency theory is supplemented with other board role theories in defining board role expectations. However, there is a gap between board role expectations and actual board task performance. I perceive that the essence of Roberts, McNulty and Stiles's article is that creating accountability is about bridging the gap between board role expectations and actual board task performance. They argue that researchers need to open the black box of actual board behaviour to contribute to the creation of accountability.

This article is centred around the creating accountability framework presented in Figure 3.1. Core notions are board role expectations, board task performance, actors, context, interactions and influencing processes, formal and informal structures and norms and board decision-making culture. Accountability is discussed as board role expectations. These expectations are reflected in various board role theories. These are summarized in Table 3.1.

Concepts and relationships in a commonly accepted framework are needed to accumulate knowledge. The input-output model between the 'usual suspects' (Finkelstein and Mooney, 2003) and corporate financial performance has been such a framework. The usual suspects are the number of board

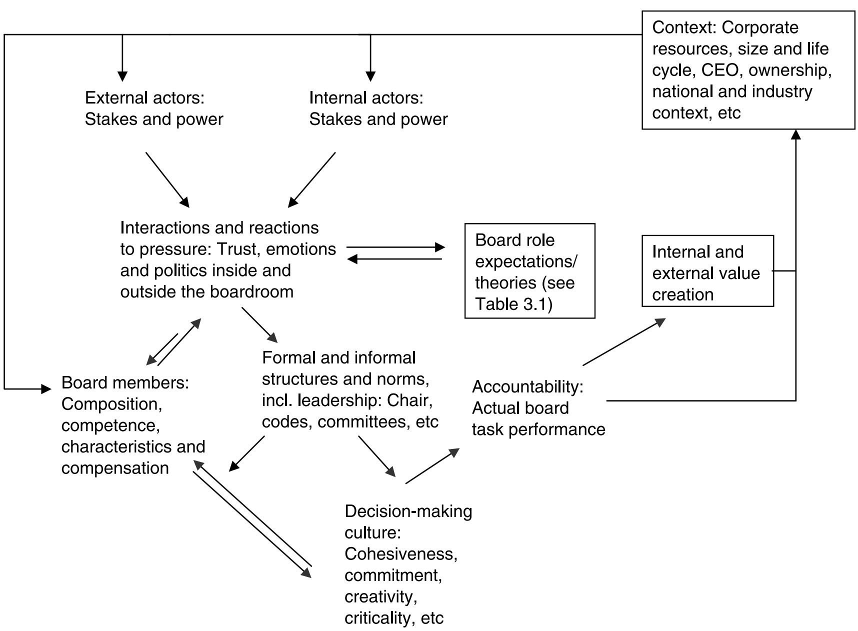

Figure 3.1 Creating accountability: An agenda for black box research on boards – understanding actual board behaviour.

Table 3.1 Accountability and board role expectations: References, main stakeholders, value creation and theoretical rationale

	Firm external perspective Control roles	*Firm internal perspective* Service roles
Internal focus	*Behavioural control* Hillman and Dalziel, 2003 Huse, 1998a Johnson *et al.*, 1996 Shen, 2003 Long-term institutional investors Value creation in the firm through operational control Dividends Agency theory	*Advise and counsel* Daily *et al.*, 2003 Hillman and Dalziel, 2003 Huse, 1998a Mace, 1971 Westphal and Gulati, 1999 Corporate leadership Value creation through directors Resource-based view of the firm
External focus	*Output control* Halme and Huse, 1997 Kosnik, 1987, 1990 Short-term institutional investors and other external stakeholder Value creation for external stakeholders through markets and regulations Value distribution from the firm: Earnings, prices, CSR Agency theory and stakeholder theory	*Networking, lobbying, legitimating, communication* Borch and Huse, 1993 Daily *et al.*, 2003 Hillman and Dalziel, 2003 Huse, 1998a Pfeffer, 1972, 1973 Westphal and Carpenter, 2001 Corporate leadership Value creation in the firm through external actors Resource dependence theory and social network theory
Strategic focus	*Strategic control* (Ratification and control) Andrews, 1981 Baysinger and Hoskisson, 1990 McNulty and Pettigrew, 1999 Zahra and Pearce, 1989 Majority shareholders and blockholders, corporate ownership and family firms Value creation through the firm Agency theory, legal view and property rights	*Strategic participation* (Initiation and implementation) Alderfer, 1986 Daily *et al.*, 2003 Judge and Zeithaml, 1992 McNulty and Pettigrew, 1999 Shen, 2003 Corporate leadership Value creation through collaboration and mentorship in the board Stewardship theory

members, the insider/outsider ratio, CEO duality and directors' shareholding. The input-output model has been driving board and governance research for almost two decades. Roberts, McNulty and Stiles show us that there is now a need for an expanded and alternative framework. Figure 3.1 represents an attempt to present such an extended framework. In this article, I position the work of Roberts, McNulty and Stiles in relation to this framework.

The rest of the article follows in four sections. I will first give an overview of the framework, which is evolutionary, and uses a contingency approach. In the second section, board role theories and board role expectation are presented. The emphasis on various board roles has changed over time, and board roles are categorized depending on dominant perspectives and focus. In this section, the Roberts, McNulty and Stiles article is positioned in the present corporate governance discussion, and the discussion exemplifies how corporate governance definitions and board accountability are influenced by the stakes and power of various actors. This involves a pluralistic approach to board role theories. In the third section, I present behavioural perspectives of boards and governance. Here, I will link Roberts, McNulty and Stiles's discussions about creating accountability to concepts and relationship observed in other studies of actual board behaviour. Summaries, methodological reflections and research implications are found in the final section.

A framework for exploring behavioural perspectives of boards and corporate governance

Roberts, McNulty and Stiles's criticism of mainstream board research follows earlier voices (Daily, Dalton and Cannella, 2003; Finkelstein and Mooney, 2003; Johnson, Daily and Ellstrand, 1996; Pettigrew, 1992). During the end of the 1980s and the 1990s, most research on boards and corporate governance had a US-inspired deductive approach, driven by the 'publish or perish' syndrome that is dominating the US academic community (Huse and Gabrielsson, 2004). Doctoral students and scholars in tenure track positions have preferred research using easily available data and methods that can be evaluated by journal reviewers through well-established validity concepts. The usual board measures employed in these studies, that most often are archival-data based, are CEO duality, insider/outsider ratio, the number of board members and the directors' share ownership (Finkelstein and Mooney, 2003; Johnson, Daily and Ellstrand, 1996). Actual board behaviour is not explored in these studies, even though some of them use proxies for actual board behaviour. Fewer than one out of eight of the empirical board articles published in the leading scientific management journal is about actual board behaviour (Huse and Gabrielsson, 2004).

When combining the explorations in the Roberts, McNulty and Stiles study with some of the most seminal board review articles, we get a framework for studying actual board behaviour. The framework consists of four areas: (a) splitting the link between board composition and corporate financial performance in intermediate steps through mid-range theories (Zahra and Pearce, 1989); (b) using a pluralistic approach to board role theories (Johnson, Daily and Ellstrand, 1996; Zahra and Pearce, 1989); (c) applying theories from group and cognitive psychology to understand board decision-making culture (Forbes and Milliken, 1999); and (d) understanding the board in an open interacting system with various influence and power relations among internal and external actors (Pettigrew, 1992). The framework is presented in Figure 3.1.

The framework integrates three sets of theories: general theories, board role theories and process-related theories. The general theories in the framework are contingency theory (Lawrence and Lorsch, 1967) and evolutionary theories (Nelson and Winter, 1982). Contingency theory arguments will be that there is not one best design of corporate governance, but various designs are not equally good. Corporate governance designs will need to consider the context and the actors. The evolutionary perspective is indicated through various learning loops. These may be at individual, group, organizational, and societal levels. The contingency and evolutionary approaches will be introduced in this section.

The second set of theories is board role theories. Agency theory and resource dependence theory have been the dominant board role theories during recent decades, but various other board role theories exist. Board role theories are in Roberts, McNulty and Stiles's frames linked to board role expectations and thus also to define accountability. Accountability and board role theories are presented in the second section.

The third set of theories is the board process theories. This is where Roberts, McNulty and Stiles's creating-accountability notions are positioned. The theories are grouped in three subcategories, and they are the theories that help us understand actual board behaviour or behavioural perspectives of boards and corporate governance. The first sub-category helps us explain the nature of the interactions taking place in the corporate governance arena. Trust and emotions are included, as well as explanations of how actors are adjusting to various kinds of pressures and influencing forces. The second sub-category includes theories that explain the evolution, existence and consequences of formal and informal structures and norms, including board leadership characteristics. The third sub-category includes the theories explaining the board decision-making culture, including cognitive conflicts, preparation and involvement, generosity and openness, creativity, critical questioning and so on. Within the framework, a corporation is defined as sets of relationships and resources. The purpose of a corporation is to create value. The process theories and the process of creating accountability are presented in the third section.

A contingency approach

The framework includes the use of a contingency approach. It may be argued, based on contingency theory, that there is not one best way of designing a corporate governance system or a board for accountability. Contexts and actors must be considered, and the balancing of perspectives from various actors may define board role expectations and thus also board composition. Research on corporate governance and boards of directors has used various contextual elements as moderating or as predicting variables, but few empirical articles published in mainstream management journals have systematically used a contingency approach. A major flaw is that most articles use samples with large US corporations, and limited attention is thus given to boards in other national contexts (Aguilera and Jackson, 2003), small and medium-sized companies (Huse, 2000) and firms in various life-cycle phases, including young firms (Lynall, Golden and Hillman, 2003).

The contextual factors mostly used in corporate governance research are (Huse, forthcoming):

- national, geographical and cultural differences;
- the industry and the industrial environment of the corporation;
- ownership dispersion and types;
- firm size;
- life-cycle variations, including the importance of crises and the configuration of corporate resources;
- CEO tenure, attributes and background.

The list is not exhaustive, and there are discussions about which factors should be regarded as contextual variables, as design parameters and as resources. Both design parameters and resources may be influenced by earlier board decisions and behaviour, and thus they show some of the dynamism in the framework. Ownership dispersion and ownership types are examples of design parameters, and even CEO attributes and industry may be results of earlier board and governance decisions. Corporate resources are also results of earlier corporate and board decisions and behaviour, and corporate life-cycle attributes are often related to resources. The dynamism linked to approaching these concepts at three levels, as resources, context and design parameters, should get more attention in future research.

The actors are the second element focused on in contingency perspectives. The actors have various attributes, perspectives, stakes and power. Corporate governance definitions most often identify the shareholders, the management and the board members as the main actors, but several other actors should also be included (Cadbury, 1992; Monks and Minow, 2004). Who the most important and powerful actors are, and their attributes, heavily depends on the context and the underlying political dynamics (Aguilera and Jackson, 2003; Gedaljovik and Shapiro, 1998; Huse, 1998a; Mitchell, Agle and Wood, 1997). There may be various configurations and alliances of actors, but for modelling reasons three groups are displayed in the framework: internal actors, external actors and the board members. Internal actors are generally considered to be the top-management team, which includes the employees and their families. Shareholders and other financial capital providers, customers, suppliers and societal stakeholders are most often considered to be external actors. However, we may find many situations, for example in family businesses, where shareholders could be defined as internal actors and the management or the employees as external. We will also find situations where, for example, some shareholders or some managers should be considered as external, and others as internal.

The third group of actors is the board members. The choice of directors is most often a result of the interaction among the various actors. Board members may be described by composition, competence, characteristics and compensation. Board composition refers to the number of board members and the configuration of competence and characteristics among them. The insider/outsider ratio is the usual configuration measure (Dalton *et al.*, 1998), but various diversity measures are also used. Measures of board competence include the directors' general, functional, firm-specific and board-specific knowledge and skills. Relational, social and intellectual capacity or capability may also be included as competence. The board capital concept (Hillman and Dalziel, 2003) is close to board competence. Characteristics may be attributed to formal background, age, tenure, seniority, gender, race, individual behaviour, esteem, influence, independence, integrity and so on (Huse and Schøning, 2004; Westphal and Milton, 2000). Director compensation refers to their incentives and motivations for becoming, and working as, board members. These may be extrinsic as well as intrinsic. The directors' shareholding is the measure most often used (Kosnik, 1990), but professional standards and awareness of legal responsibilities are also found to be of particular importance (Hermalin and Weisbach, 1991; Huse, 1993a).

An evolutionary approach

The dynamism of actual board behaviour and corporate governance is rooted in various learning and influencing loops (Sundaramurthy and Lewis, 2003). This evolutionary perspective is illustrated in Figure 3.1 through the arrows. The learning processes take place at various levels: societal and institutional, organizational, group and individual. The evolution at a societal level is illustrated through the changing awareness, concepts and rules of corporate governance in society (Gomez, 2005; Pye, 2003; Useem 1993). Institutional learning also takes place through social networks mimetic processes at internal levels (Galaskiewicz and Wasserman, 1989; Westphal, Seidel and Steward, 2001). The evolutionary perspective may also be illustrated through contextual changes resulting from the performance of the corporation. Several studies have shown, for example, that there is a negative relationship between prior performance and the overall board involvement (e.g. Johnson, Hoskisson and Hitt, 1993; Judge and Zeithaml, 1992). Literature about behavioural and group learning (Cyert and March, 1963) and dynamic capabilities (Eisenhardt and Martin, 2000) may also contribute to the exploration of the evolutionary processes in the organizational and in the board (Shen, 2003; Sundaramurthy and Lewis, 2003; Westphal and Zajac, 2001). Lastly, individual learning will contribute to evolution. The learning perspective is hardly used in corporate governance research, and the integration of learning theories may be an important direction in future research about boards and governance.

What is accountability? Perspectives on corporate governance and board roles

The fiduciary duty of directors under most legislations is to do what is best for the company (Monks and Minow, 2004). This is also the starting point for understanding accountability in the boardroom. Roberts, McNulty and Stiles use Giddens' (1984, p. 30) definition of accountability as a starting point: '[T]o be accountable for one's activities is to explicate the reasons for them and to supply the normative grounds whereby they may be justified'. Roberts, McNulty and Stiles thus present a pluralistic accountability definition in relation to balancing various external and internal perspectives, various board roles and various theories.

External perspectives on accountability and board roles

Any definition of corporate governance will be biased (Monks and Minow, 2004), and most theories of governance have been efforts to explain existing phenomena from practice (Gomez, forthcoming). Roberts, McNulty and Stiles criticize the one-dimensional investor-based definitions that have dominated much of the recent public discussions and research from financial economics perspectives. These definitions have their origin in the separation of ownership and leadership discussion in the early 1930s (Berle and Means, 1932), and agency theory was developed to explain solutions to this separation dilemma (Fama and Jensen, 1983; Jensen and Meckling, 1976). From this perspective, investors have been principals, and the firms or their management, including the boards, have been the agents.

In the USA, the investors' need for boards to monitor management to avoid managerial misbehaviour and opportunism was clearly evidenced in the 1980s. Several examples then existed of how corporate managers used their power to circumvent shareholders' interest and allowed themselves skyrocketing wage increases and various other perks, such as company jets. The market reactions to managerial opportunism and incompetence were, in theory, hostile takeovers, but in the 1980s, the markets for corporate control were circumvented through various anti-takeover defences as shark repellents, poison pills, greenmail, white knights and so on (Davis, 1991; Monks and Minow, 2004). This was the background for a first wave of shareholder activism. It was lead by major US long-term institutional investors. Guided by agency theory, they wanted boards and board members that were sufficiently independent to resist managerial dominance or hegemony (Fama and Jensen, 1983; Jensen and Meckling, 1976), and the boards should create value for shareholders through value creation in the firm. In this period, the main corporate governance emphasis was on how owners could monitor or control managerial misbehaviour. Corporate governance suggestions following this wave were to separate the positions of the chairperson and the CEO, and to have a majority of independent directors. In order to avoid too much influence from board members with close ties to the CEOs, emphasis was also placed on the role of independent board committees.

A second wave of shareholder activism followed the rapid changes in the new economy, the trends of globalization with disappearance of geographical distances and the development of information technology. Large corporations were listed on stock exchanges around the world, corporate ownership became increasingly global, and owners became faceless and impatient. Attention to market prices and quarterly earnings replaced the attention to dividends. Impatient and faceless owners, their portfolio managers and stock exchanges advocated corporate governance reforms and practices with roots in agency theory and the financial markets. The codes included, in practice, accountability to shareholders only, increased transparency and managerial incentives aligned with shareholders' interests. Managers became residual claimants through shares or stock options. Main board roles returned from behavioural control to output control in financial markets.

An alternative trend in corporate governance got considerable wind in the sails as a result of the large corporate scandals (Child and Rodriguez, 2003; Kochan, 2003). The crises in Enron, WorldCom, Tyco and the like clearly showed the importance of stakeholders other than the shareholders. Employees, customers, suppliers and local societies suffered severe losses because of managers driven by the possibilities of creating personal wealth through dramatic increases in the market prices of their shares (Kochan, 2003). The crises also exemplified negative global consequences of faceless investors (Child and Rodriguez, 2003). A broader perspective of corporate governance was reintroduced and corporations were reminded of their corporate and social responsibility (CSR). Suggestions to meet the problems included CSR reporting and the introduction of various stakeholder representatives on boards (Boeker and Goodstein, 1991; Huse and Rindova, 2001; Kochan, 2003).

Gradually, some groups of shareholders and investors became unhappy with the codes and concepts introduced by the previous waves of shareholder activism. Among these shareholders we find industrial owners, blockholders, corporate owners, private investors and other owners who want to contribute to value creation through their own contribution in the boards of the corporations. Most firms, and in particular small and medium-sized enterprises, are dominated by such owners, and among such firms we have family firms and entrepreneurial firms. These groups of owners may have objectives for their involvement and ownership in firms other than value creation through dividends or earnings. Their involvements may also be of a strategic nature and may also be related to value creation in other arenas.

The presentation of the various waves with different dominant actors has shown various external perspectives on board roles such as behavioural control, output control and decision control. This distinction among the various control roles is also found in Fama and Jensen's (1983) seminal contribution based on agency theory. Behavioural control has an internal focus, output control has an external focus and decision control has a strategic focus. The above presentation also shows how board roles and accountability, even within an agency theory framework, depend on the stakes and power of various actors.

Internal perspectives on accountability and board roles

Roberts, McNulty and Stiles are critical to the dominance of agency theory and external perspectives in the present corporate governance debate. Thus, they also present internal perspectives on accountability, and they argue that internal and external perspectives should be balanced. Stewardship theory is an alternative to agency theory, and it has gained a foothold among many management scholars (Davis, Schoorman and Donaldson, 1997; Stiles and Taylor, 2001). While agency theory builds on the assumption of managerial opportunism, which leads to the needs for boards being active in controlling and monitoring, stewardship theory assumes that managers in general should be considered as good stewards. Stewardship theory will promote board roles as collaboration and mentoring, and boards should thus also be active in the strategy formation and strategy implementation phases (Hillman and Dalziel, 2003; Shen, 2003). The collaboration and strategic participation role is also elaborated upon from social network theory (Alderfer, 1986; Gulati and Westphal, 1999) and institutional theory (Judge and Zeithaml, 1992).

Resource dependence theory was for many years a dominant approach in sociology, strategy and organization theory, used to motivate the existence of active boards (Pfeffer and Salancik, 1978). Resource dependence theory provides an external focus from an internal perspective. The board is viewed from a resource dependence perspective as an administrative body linking the corporation with its environment. The board is considered to be a boundary spanner that could help the corporation to acquire important resources from the environment, and thus reduce the corporation's dependence on external stakeholders or protect the corporation from external threats. More recently, resource dependence theory has been supplemented with contributions from social network theory (Carpenter and Westphal, 2001; Westphal, 1999). Important board roles from this perspective are those of networking, door-opening, legitimacy, and communication in internal relations. The internal part of the interlocking directorates literature also shows how boards facilitate inter-organizational coordination and exchange (Richardson, 1987).

The resource-based view of the firm is more internally focused than the resource dependence theory (Barney, 1991). Through a resource-based view of the firm, the board members are not only resources through their networks, but also through their competency. Board members will be evaluated based on their contribution to sustainable competitive advantage through their professional and personal qualifications. It may be argued that board members contribute resources that cannot be bought in the market or employed in the hierarchy (Williamson, 1985). An internal focus on firm resources will emphasize the boards' role in providing various kinds of advice to the management. Managerial hegemony theory shows that the main ordinary role of boards is to be a council and to provide advice to the management (Mace, 1971), and social network theory also shows how social network facilitates cohesion and exchange of information (Gulati and Westphal, 1999).

Balancing perspectives and focus

Board roles and theories from various accountability perspectives are summarized in Table 3.1.

Accountability and board roles depend on balancing various perspectives and focus. In this section we have shown how board roles may have internal, external and strategic focus, and also have a background in internal and external perspectives. Six distinct board roles are displayed in Table 3.1. These are behavioural control, output control, strategic control, advise/counsel, networking/legitimacy and strategic participation. Examples of studies using or arguing for the various roles are listed in the table. The various board roles relate to various theories used in the board role literature.

We have argued in the two previous sections that the context and the actors will direct the emphasis given to various focuses and perspectives. How different roles should be balanced is discussed in studies using various contingency perspectives, for example life cycle (Lynall, Golden and Hillman, 2003), CEO tenure (Shen, 2003), and the institutional embeddedness of corporate governance in various countries (Aguilera and Jackson, 2003). Other authors, such as Roberts, McNulty and Stiles (this issue) and Hillman and Dalziel (2003), discuss how the various roles should coexist in each firm.

Creating accountability – understanding actual board behaviour

Creating board effectiveness and accountability is to bridge the gap between the myths about board role expectations and the realities of actual board task performance (Forbes and Milliken, 1999; Mace, 1971). In order to create accountability, one would need to explore actual board behaviour and to open the black box of the boardroom. It is displayed in the framework that the board's decision-making culture, formal and informal structures and norms, and the interactions inside and outside the boardroom are important elements in creating accountability.

The board's decision-making culture

It is a major challenge in corporate governance research to explore how a board may be different from other small decision-making groups. This is addressed by Forbes and Milliken (1999), and they summarize various aspects of the board decision-making cultures. They suggest that lessons from psychology should be used to understand boards, and they use concepts like cognitive conflicts, cohesiveness, creativity, commitment, criticality, care, consensus and so on, to describe the boards' decision-making culture. According to Roberts, McNulty and Stiles, a positive boardroom climate or decision-making culture is what matters most for creating accountability. Roberts, McNulty and Stiles go beyond discussions about composition, independence and structure to create board accountability and effectiveness. In their characteristics they use words such as challenging, questioning, probing, discussing, testing, informing, debating, encouraging and the like.

Using three sets of concepts related to boardroom culture, Roberts, McNulty and Stiles summarize some of the ways in which non-executive directors can contribute to the creation of accountability. These are: 'engaged but non-executive', 'challenging but supportive' and 'independent but involved'. They reflect concepts used in the ongoing discussions on boards and governance. Some theoretical and empirical contributions have been made on solving these paradoxes (e.g. Demb and Neubauer, 1992; Huse, 1993a, 1994; Roberts and Stiles, 1999; Sundaramurthy and Lewis, 2003), but their academic content and their relationships are not clearly developed.

Four variables about the board's decision-making culture were found in a recent study of 490 Norwegian firms (Huse, 2004); openness and generosity, preparedness and involvement, creativity and criticality. The variables were extracted through a principal component analysis from notions and measures indicated in earlier literature. There were differences in how the board decision-making culture variables related to board roles. This is displayed in Table 3.2.

It was found that the openness and generosity variable was positively related to behavioural control, strategic control, advising and networking.

Table 3.2 Board decision-making culture and board roles

	Behavioural control	*Output control*	*Strategic control*	*Advise and counsel*	*Networking and lobbying*	*Strategic participation*
Openness and generosity (cohesiveness)	+		+	+	+	
Preparedness and involvement (commitment)	+		+	+		
Creativity				+		+
Criticality	+	+				

The preparedness and involvement variable was positively related to behavioural control, strategic control and advising. Creativity was first of all positively related to advising and to strategic participation, and criticality was positively related to behavioural control and output control.

Interactions inside and outside the boardroom

Boards are not acting in a vacuum, and scholars like Pettigrew (1992) thus argue that studies of board roles should be integrated with studies of top management teams (e.g. Finkelstein, 1992; Hambrick and Mason, 1984; Shen and Cannella, 2002) and interlocking directorates and managerial élites (e.g. Davis and Thompson, 1994; Richardson, 1987; Useem, 1984). Board members are interacting with each other, and with various other actors such as the top-management team, influential shareholders and other important stakeholders. These interactions take place outside as well as inside the boardroom. The interactions are characterized by various types and degrees of trust and emotions (Brundin and Nordqvist, 2004; Huse, 1993a, 1998a, 1998b), stakeholder orientations (Boeker and Goodstein, 1991; Huse and Rindova, 2001; Mitchell, Agle and Wood, 1997), power (Mintzberg, 1983; Pearce and Zahra, 1991; Pettigrew and McNulty, 1995), form and frequency (Macus, 2002).

Studies about board interactions include responses to pressures, for example, through stock repurchasing plans (Kosnik, 1987), the symbolic management of stockholders (Westphal and Zajac, 1998), and the circumvention of stakeholders' control (Huse and Eide, 1996). Institutional theory has been used to explain responses to institutional pressure (DiMaggio and Powell, 1983; Meyer and Rowan, 1997; Oliver, 1991), and political and psychological perspectives, including social network theory, have been used to explain independence and the selection processes of directors (Westphal and Zajac, 1995; Zajac and Westphal, 1996).

Another body of interaction literature is about the political dynamics surrounding the formation of alliances and partnerships (Ocasio, 1994; Selznick, 1957), including how firm behaviour responds to the interest and belief of the dominant coalition of stakeholders (March, 1962). Recent works on micro strategizing also contribute to understanding the interactions inside and outside the boardroom (Johnson, Melin and Whittington, 2003).

Trust is an important notion used by Roberts, McNulty and Stiles, which needs further explorations. In some studies, I have distinguished between competence-based and integrity-based trust (Huse, 1996, 2001), while in other studies, I have contrasted trust concepts from relational contracts theory (Macneil, 1980) to agency theory predictions related to independence (Borch and Huse, 1993; Huse, 1993a, 1994). Concepts like distanced closeness and simultaneous independence and interdependence were used in these studies. Other scholars have used social or procedural justice theory to explain the interactions (Sapienza *et al.*, 2000).

Formal and informal structures and norms

The Higgs Review (Higgs, 2003) and most of the recent work on reforming corporate governance contribute to developing and formalizing structures and norms. Formal and informal board structures and norms, also including board leadership, mediate the impact of the interactions and the board's decision-making culture, and they may moderate the dynamics among the various board members. The development of rules for the boardroom is often explained by imitative processes and institutional theory (Aguilera and Cuervo-Cazurra, 2004). However, even though boards adapt rules and structures as a response to demands from external actors, actual practices seem to be tailored to the needs and demands of internal actors (Westphal and Zajac, 1998).

Most research on board structures has been on CEO duality. Who should be the leader of the board? Roberts, McNulty and Stiles also emphasize the pivotal importance of board leadership, and they claim that the role of the chairperson is 'vital to the board members' engagement in various ways', and 'their own conduct does much to set the culture of the board'. Leadership and structure may influence the board decision-making culture. However, little research attention has been given to systematically exploring behavioural perspectives of board leadership.

Ocasio (1999) has explored the reliance on formal and informal rules in corporate governance. Most rules are informal. Various descriptions exist about informal rules and norms in the boardroom (Lorsch and McIver, 1989; Patton and Baker, 1987; Whisler, 1984). These descriptions have generally reflected managerial hegemony (Mace, 1971) and class hegemony (Useem, 1984) perspectives. The recent development of codes of best practices has lead to a formalization of rules and structures. Most of these codes represent investor perspectives, but we also see codes initiated from other external and internal actors. The empirical work of Roberts, McNulty and Stiles contributes to this discussion. The codes often include requirements about board evaluations, CEO working description, board instructions, board leadership and board committees.

Reliance on rules can be understood from strategic choice perspectives (Child, 1972) and from institutional theory (March and Olsen, 1976). Various efforts have been made to contrast these theories in research about boards of directors (Judge and Zeithaml, 1992; Ocasio, 1999); and Ocasio (1999) concludes that informal rules are more important than formal rules. How rules form decisions and actual board behaviour has partly been ignored in studies of boards and governance (Gabrielsson, 2003; Ocasio, 1999).

Beyond agency conceptions of the work of the non-executive directors: summary and methodological reflections

My response to Roberts, McNulty and Stiles is summarized in Table 3.1 with regard to accountability and in Figure 3.1 with regard to creating accountability. Accountability is about balancing various board role expectations. Creating accountability is about aligning actual board task performance to board role expectations. Creating accountability requires an understanding of behavioural perspectives on boards and governance. In this article I have presented a framework that presents and sorts concepts relating to actual board behaviour.

The framework presented has various contributions. First, it makes an attempt to integrate research on boards of directors. Recent board research has been fragmented and has used various theories without having an overall framework to relate to. In this article, I have related the fragmented development of board research during the last 15 years to the contribution of Zahra and Pearce (1989) and the call from Pettigrew (1992). Board role and board process research have been integrated. Second, Daily, Dalton and Cannella (2003) call for a reconceptualization of the board oversight role and an inclusion of alternative board roles. The contribution in this article to reconceptualizing board roles is to link the various board role notions used in the board literature to various perspectives and focuses. Third, the framework suggests a sorting of various concepts used in the literature with regard to creating accountability. Concepts about board processes and structures have, to a great degree, been anecdotal or borrowed directly from other disciplines. The framework refines concepts about board decision-making, interactions inside and outside the boardroom and board structures and norms. Fourth, the framework contributes to the understanding of the intervening processes that arise between board composition and financial performance. The notions of trust and emotions, which are among the most neglected parts in the current literature, are also included in the framework. Fifth, contextual and evolutionary approaches are employed and integrated. There is very little about learning in board research, and understanding learning in boards and governance may be a natural extension of the ongoing research on behavioural perspectives. Sixth, the contingency and evolutionary perspectives also have practical implications. They should remind corporate governance activists and designers that board roles and structures must be tailored to balance the contingencies facing each corporation. There is not one best way in corporate governance. This also implies that learning aspects, such as requirements about evaluations, transparency and introduction plans for new board members, should be emphasized in codes of best practices. Board memberships should be considered as learning journeys, and board members should plan to use more time to be a part of this journey. Seventh, a research agenda is provided. This agenda goes beyond the 'lamp' and 'hammer' syndromes that have dominated most of board and governance research in recent years.

Research methods implications

The framework contains a large research agenda with various research themes and research questions. There needs to be a way to explore and define concepts, as well as to cluster concepts, measure them and find relationships between them. The dynamism reflected in the arrows should also be explored. How should learning be modelled within board processes? Many of the research questions require data that are not easily available, and the use of venturesome or alternative research methods may be needed to collect and analyse such data.

Roberts, McNulty and Stiles contribute to answering some of the research questions. Their method was to collect experiences and opinions from various board members. The stories have shed light on actual board behaviour and on how to create accountability. The Roberts, McNulty and Stiles study stimulates methodological reflection. They employ a method close to those of Demb and Neubauer (1992), Lorsch and McIver (1989) and Mace (1971). These studies have all made considerable contributions as they give an insight and awareness of various aspects of actual board behaviour. The social constructions of the directors are the study objects, and the strengths of these studies are the topical relevance. However, the research methods in the above mentioned studies have been the subject of considerable criticism for lack of rigour.

'Board life stories' and interviews with directors may also be important in future research. I have found the 'board life stories of women' to be particularly valuable for exploring actual board behaviour (Huse, 1998b). However, also, regardless of methodological orientation, studies need to be done with great rigour. For studies of 'board-stories' we should apply the methodological rigour and interpretative tools developed for other studies interpreting social constructions and life stories. The Roberts, McNulty and Stiles study to a large degree presents various recommendations from directors, but there are also alternative ways to analyse this kind of data, for example, by language analyses (Pye, 2003) or discourse analyses (Parker, 1994).

Most survey studies of boards are also objects for severe criticism (Daily, Dalton and Cannella, 2003). The methodological challenges in survey studies of boards include the development of measurements based on accumulated knowledge, increases in response rates, the use of several respondents, the use of longitudinal data-sets and the use of samples other than large US corporations. Personally, I find the collection of responses from several respondents in each board as a particular fruitful direction for studies of actual board behaviour. Actual board behaviour is perceived differently by various groups of board members, for example, chairs, CEOs, union directors and women directors (Huse, 1993a; 1993b; 1993c).

Studies of processes may use various data collection and interpretation techniques. We have seen how various approaches are needed to meet the various research questions indicated in the framework, and many research questions cannot be met unless venturesome research designs are explored and rigorously developed. Such designs may go beyond the collection of stories of directors and survey research. The use of case studies may be needed to meet some research questions. Such studies may include direct observations as 'fly on the wall' studies (Huse and Schøning, 2004) or as 'one of the lads' studies (Huse, 1998a). Through our studies we have seen that process-oriented data are available. At times, we have heard comments that data may be available in Scandinavia and similar regions, and that it is more difficult in the United Kingdom or the USA. This may be the case, but we also have examples of how similar data have been collected in those countries (Leblanc and Schwartz, 2004).

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Part II

Exploring issues and theories

The classics – developing a field

4 Building blocks in understanding behavioural perspectives of boards

Developing a research stream

Morten Huse

Abstract

A prerequisite for building a field of research is to accumulate knowledge. I will here present some of the building blocks that are important for understanding behavioural perspectives on boards and governance. Theoretical perspectives, a stream of research and some seminal articles are presented. When put together and not only presented as fragmented pieces, they constitute a framework that introduces a new field of research about behavioural perspectives on boards and governance. Five articles in particular are mentioned as seminal building blocks in this framework.

Key words: Field of research, Building blocks, Seminal articles, Behavioural perspectives, Board of directors

Introduction

Research about boards and governance has, during recent decades, been dominated by research in a US-based 'publish or perish' tradition. The consequences have been illustrated by the 'lamp' and 'hammer' syndromes. Researchers are looking for easily available data, and well-accepted methods and theories are applied. Many studies have thus used secondary data from large US corporations about ownership, board composition and corporate financial performance. Most studies have used multivariate statistical techniques, and agency theory has been the main theory used (Daily, Dalton and Cannella, 2003; Gabrielsson and Huse, 2004). However, these studies have only to a limited extent contributed to advance our knowledge about boards of directors, and only a few studies focus on behavioural perspectives of boards and governance.

A new research tradition may thus be needed, and some pillars in a new tradition will be drafted in this article. First, alternative theories to agency theory will be mentioned and, in particular, the behavioural theory of the firm. Second, various path-breaking, much cited articles are listed. It is typical that articles based on mainstream board research only get a limited number of citations even though they are published in the most prestigious journals. The articles listed here, however, have all made major contributions to the accumulation of knowledge about boards. Third, five building blocks are presented; these are the contributions by Mace (1971), Fama and Jensen (1983), Zahra and Pearce (1989), Pettigrew (1992) and Forbes and Milliken (1999). Finally, their implications for a new research agenda are discussed.

Theories

Agency theory has been the starting point for most research about boards and governance for the past two decades (Gabrielsson and Huse, 2004). However, the behavioural insights from agency theory are very limited, and lessons from the behavioural theory of the firm would be the natural starting point for establishing a research field around behavioural perspectives on boards and governance. Since the pioneering studies of Simon (1955), March and Simon (1958), March (1962) and Cyert and March (1963), the behavioural theory of the firm has been developed into a main perspective for understanding decision-making in organizations. The work of Simon and others can be considered as an attempt to link the abstract principles of the rational decision-making model in the economic discipline to actual decision-making processes in real world settings. In this section some of the main concepts from the behavioural theory of the firm are first presented, then we sort various theories about board tasks according to a logic of value creation, and finally the importance of various other theories for understanding behavioural perspectives of boards and governance are shown.

The behavioural theory of the firm

Four core concepts in the behavioural tradition that have been applied in recent board research are bounded rationality, 'satisficing' behaviour, organizational routines, and bargaining among coalitions of actors (for a summary, see e.g. Huse, 2007).

Recent research on boards and governance has addressed the issue of bounded rationality, which is a concept that refers to the actual complexity of decision-making in organizations. The concept emphasizes that organizational actors do not fully understand the world they are living in. The cognitive bias of organizational actors only allows imperfect mapping of the decision-making environment and rather limited, imprecise and selective information processing

Another issue that has been addressed in recent research on boards and governance is 'satisficing'. This concept refers to the fact that actors tend to accept choices or judgements that are 'good enough', based on their most important current needs rather than searching for optimal solutions. Problems are only recognized to the extent that organizations fail to satisfy one or more of its self-imposed goals, or when such failure can be expected in the near future. Decision-making in behavioural theory is consequently seen as an experiential learning process, where firms adapt incrementally to their changing environments through learning and experimentation.

Routines exist mainly for learning by doing, which to a large extent are tacit and hard to codify. They are a source of control and stability, which both enable and constrain organizational action. Rules and routines are not purely passive elements, but they also serve as socially and historically constructed programmes of action that direct attention to selected aspects of a problem situation. Learning thus plays a central role in a behavioural framework.

Organizations can, through *political bargaining and quasi resolution of conflicts*, be depicted as complex political systems with agents organized in coalitions, some of them organized into subcoalitions. Goal conflicts are solved through political bargain rather than through objective alignment by economic incentives. Goal formation is achieved by a series of procedures including the application of local rationality and acceptable level decision rules, as well as sequential attention to goals. Organizations most of the time can be expected to have a considerable amount of latent conflicts and goals. Goal formation is hence seen as the outcome rather than the starting point of the bargaining between coalitions. As such, goal formation and goal conflict may drive the search for additional information and new knowledge.

The implications for a behavioural theory of boards and governance should be the focus on strategizing rather than objective alignments, the focus on 'satisficing' rather than rational decision-making, the focus on knowledge creation through the deployment of knowledge rather than through control of managerial behaviour, and the focus on interactions and processes rather than on outcomes and structures.

Value creation theories

One way of sorting theories about board tasks and value creation from a behavioural perspective is according to the aunt, barbarian and clan framework (Huse, 2007).

The first group of theories are those where boards in practice will be passive 'aunt' boards. Property rights theory (Alchian and Demsetz, 1972) emphasizes output control and distribution, with the board members as rights holders. Board tasks in the legalistic perspective will be to carry out legally mandated responsibilities, and the board members will, in most cases, be elected by shareholders. Some of the recent developments of soft and hard laws following the recent corporate governance debate are in this tradition. 'Box-ticking' may be the main focus of boards as a consequence of the evolution of corporate governance codes.

The second group of theories are those defining a firm as an instrument for external 'barbarian' actors. Various types of control are recommended in agency theory (Fama and Jensen, 1983): output, behavioural and strategic. The focus in relation to board members is independence and incentives.

Stakeholder theory (Freeman, 1984) has a focus on output control. Stewardship theory (Donaldson, 1990) has a focus on collaboration and mentoring tasks of boards, with the board involved in strategic management. Cooperation and negotiations are board tasks elaborated from game theory, where there should be interdependence among the board members (Aoki, 2004).

The third group of theories is institutional 'clan' theories. Networking tasks and the social capital of board members are important in social capital and social network theory (Burt, 1992). Social movement (Davis and Thompson, 1994) and class hegemony (Useem, 1984) have boards that safeguard and protect values for the inner circles of management and ownership elites. The inner circles keep the boardrooms for themselves.

The fourth group is resource theories, where the purpose is to create value for the firm. Networking, lobbying and legitimacy are important board tasks in resource dependence theory, and the board members are co-opted to perform these tasks (Pfeffer and Salancik, 1978). Resource or competence-based theories (Barney, 1991) focus on advisory tasks and the human capital of the board members.

These groups of theories illustrate various understandings and approaches to what a corporation is for. Different perspectives are used, and they have implications for board tasks and how to improve board effectiveness.

Examples of other theories

There are, however, also various other theories that are important building blocks in understanding behavioural perspectives of boards and governance. Some of these theories are broad and overall theories, like contingency theory, learning and evolutionary theories (Hannan and Freeman, 1977; Nelson and Winter, 2002). Other theories are more specific and address certain aspects of board behaviour.

Contingency theory (Lawrence and Lorsch, 1967) implies that although there is not one best way of designing a board and corporate governance system, not all ways are equally good. When designing corporate governance systems attention must be paid to the actors and the context. Understanding boards also involves understanding dynamic perspectives, including various types of evolution and learning. The dynamism of actual board behaviour is rooted in various learning and influencing loops. This dynamism or these loops exist at different levels, e.g. the societal, institutional, organizational, group and individual levels. The evolution at the societal level is illustrated through the changing awareness, concepts and rules of corporate governance practices in society. Institutional learning also takes place through mimetic processes. These occur in social networks at inter-organizational levels. Evolutionary processes may also be illustrated through contextual changes resulting from the performance of the corporation.

Among more specific theories that may help us understand more specific aspects of actual board behaviour we have, for example, signalling theory, similarity attracts theory and tournament theory which, together with the garbage can model, strategic choice theory and transaction cost theory, can help us understand the selection of board members. Theories relating to power, political economy, micro strategizing, emotions, trust, social exchange and procedural justice are also examples of the knowledge base we can draw on when exploring behavioural perspectives of boards and governance.

Research contributions – accumulating knowledge

The accumulation of knowledge that describes the development of a field will, to a large degree, be found in the references used. Boards of directors have a long tradition, but the roles and task expectations have not been the same. Recent research about boards and governance often traces its roots back to Berle and Means (1932), Coase (1937) or Selznick (1949), but theories as we know them today were developed considerably later through contributions by for example Mace (e.g. 1971 – managerial hegemony theory), Pfeffer (e.g. 1972, Pfeffer and Salancik, 1978 – resource dependence theory), Alchian and Demsetz (1972 – property rights theory), Williamson (1975 – transaction cost theory), Jensen and Meckling (1976 – agency theory), Freeman (1984 – stakeholder theory) and Useem (1984 – class elite theory). Among other important contributors from the beginning of the 1980s we have Pennings (e.g. 1980 – interlocking directorates) and Andrews (e.g. 1981 – board strategic involvement), but a long list of seminal empirical studies of boards then follow, including Baysinger and Butler (1985), Richardson (1987), Kosnik (1987), Mizruchi and Stearns (e.g. 1988). The later developments include much referenced contributions by Lorsch and MacIver (1989), Baysinger and Hoskisson (1990), Donaldson (e.g. 1990), Hermalin and Weisbach (e.g. 1991), Davis (e.g. 1991), Judge and Zeithaml (1992) and Demb and Neubauer (1992).

The first version of Monks and Minow's textbook on corporate governance came in 1995. In the same year, Blair published 'Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century'. Among much referred to articles from the mid-and late 1990s we find work by Rediker and Seth (1995), Ocasio (1994 and 1999), Westphal and Zajac (e.g. 1994 and 1995), Pettigrew and McNulty (e.g. 1995), Davis, Schoorman and Donaldson (1997), Gedajlovik and Shapiro (1998) and La Porta et al. (e.g. 1999).

At the end of the 1990s Daily, Dalton and various colleagues published several meta-analyses of recent research about boards of directors (e.g. Johnson, Daily and Ellstrand, 1996). Most of the large number of studies that appeared during the 1990s tried to test relationships between a few board composition related variables and corporate financial performance (see Gabrielsson and Huse, 2004). Generally, Daily and colleagues found that these studies did not bring any conclusive results, and research should go beyond testing the relationships between these ‘usual suspects’ and corporate financial performance (Daily et al., 2003; Finkelstein and Mooney, 2003). The ‘usual suspects’ in board research are first of all the number of board members, the insider/outsider ratio, CEO duality and the shareholding by the board members.

Four different calls for contributions have been presented during recent years to supplement or even to replace the mainstream of board research. First, to see value creation as being broader than just corporate financial performance; second, to explore different types of board task involvement; third, to see the board as a strategic decision-making group; and fourth, to explore the informal and informal processes and structures that influence board decision-making.

- The first call was strongly pushed by the scandals in large corporations like Enron, and so on. Corporate value creation is not only about value distribution to shareholders, but also how corporations contribute to society (Kochan, 2003). Related is also the discussion that corporations should not only be involved in value distribution and protection, but also in the up-sides of value creation such as innovation, development and use of resources, for example (Taylor, 2001).
- Since the end of the 1990s, researchers have given more attention to the fact that different theories have promoted different types of board tasks. Even though this has been evident for a long time, several contributions in a special issue of the *Academy of Management Review* in 2003 (Daily et al., 2003) emphasized the importance of such distinctions in further research.
- A third call has been to include group psychology and the leadership literature to understand the board as a strategic decision-making group. This also includes a focus on the team leader and the team culture (Letendre, 2004; Sonnenfeld, 2002).
- The fourth call has two substreams, but both are related to how various actors may influence board decision-making. One of them is related to the evolution of codes of best practices and how they develop and vary across countries (e.g. Aguilera and Cuervo-Cazurra, 2004), while the other is largely based in sociology and focuses on how institutional theories help explain power, trust and interactions inside and outside the boardroom, including the development of actual board structures and norms (see, e.g. Westphal and Khanna, 2003).

These four calls present concepts and relationships that should be integrated in a framework for exploring behavioural perspectives on boards and governance.

Some building blocks

Among the various contributions of boards of directors, some particular articles seem to get more attention than others. Five of them will be presented here. They are Mace (1972), Fama and Jensen (1983), Zahra and Pearce (1989), Pettigrew (1992) and Forbes and Milliken (1999). Other articles could definitely also have been chosen, but these five articles introduce approaches that are building blocks for developing the framework that helps us explore behavioural perspectives of boards and governance (Huse, 2005).

Mace (1972) – 'The president and the board of directors' – is an article version of the book, *Directors: Myths and Reality*. Mace argues that there is a gap between myths and realities. In other words, there is a gap between board task expectations and actual board task performance. According to Mace, there are general expectations that boards should set the strategies for firms, ask discerning questions and hire, fire and compensate the CEO. He argues that this is not what boards are doing. Boards are instead providing the CEO with counsels, they are some sort of disciplining tool, and they act in crises. Managerial hegemony is presented by Mace as the reason for this gap. Managers have many ways to circumvent the control from the board, including the use of information asymmetry and the existence of elite networks. The contribution of Mace was for several decades the point of reference for studies of boards of directors.

Fama and Jensen (1983) is one of the main articles in the shaping of agency theory. It builds on the previous works by Jensen and Meckling (1976) and Fama (1980), but it is more than the others directly related to boards of directors. The main tasks of boards in different types of organizations are presented, including requirements to board members. Independence and knowledge are the main requirements, but the importance of the various tasks and requirements depends on firm characteristics. Conceptually the Fama and Jensen article makes a clear distinction between decision management and decision control. This distinction has driven much of the discussion of board tasks based on agency theory. Because of potential managerial opportunism and information asymmetry, Fama and Jensen argue that there should be a division of tasks between the board and the management. Decision management should be the task of the management, while decision control should the task of the board. Decision management includes decision initiation and implementation, while decision control includes decision ratification and control.

The three remaining articles are reviews. The Zahra and Pearce (1989) article has several contributions. First, it reviews research about boards of directors and sorts the publications based on their main theoretical approach. The theoretical approaches used are legalistic perspectives, resource dependence perspectives, class hegemony and agency theory. The different theories have different focuses on various concepts, and the concepts are sorted in the following categories:

- board attributes, including board composition, board characteristics, board structures and board processes
- board roles, including control, service and strategy tasks
- strategic outcomes
- firm performance
- contingencies.

Second, Zahra and Pearce argue and show that there is a need to research the contribution of boards in intermediate steps. Board tasks should be used as mediating variables in studies of the relationship between board composition and corporate financial performance. Contingency variables should be used as moderators, and they argue that the contingency variables will have direct effects on board tasks. Some years later, Johnson et al. (1996) updated the review of Zahra and Pearce, and they concluded that not much was done to meet the challenges raised.

Pettigrew (1992) critically reviews three intellectual traditions on managerial elites. The traditions are studies of board roles, studies of top management teams, and studies of interlocking directorates. They are separated, but need integration. He claims that studies about boards of directors are in their infancy, but that such studies should be too of the priority list for strategy scholars. Pettigrew suggests a complementary approach that combines a contextual and process analysis of managerial elites. A core input from this article is that board members and boards of directors should not be studied as a closed system. An open system integrating lessons from sociology and leadership should be used. The arenas where board members are interacting with other actors need to be explored.

The Forbes and Milliken (1999) article was very timely and has become a main point of reference for scholars wanting to explore behavioural dynamics in the boardroom and looking at the board as a strategic decision-making group. A model of board processes is developed that integrates literature on group dynamics and workgroup effectiveness with the board literature. Forbes and Milliken argue that boards of directors can be characterized as large, elite and episodic decision-making groups that face complex tasks pertaining to strategic-issue processing. They are particularly vulnerable for process losses – the interaction difficulties that prevent groups from achieving their full potential. The model presented by Forbes and Milliken demonstrates how group variables like cognitive conflicts, cohesiveness, effort norms and the use of knowledge and skills influence the performance of control and service tasks.

A new stream of research

We can start identifying a new stream of research by integrating the above presented building blocks and the accumulated knowledge from research about boards of directors. This stream of research is outlined in Huse (2007) and is based on the framework presented in Huse (2005). Main elements in this framework are that:

- Mid-range theories and studies should replace input–output research (Zahra and Pearce, 1989). The relationship between board composition and corporate performance should be done in intermediate steps.
- Research should bridge the gap between theories and expectations about boards and actual board task performance (Johnson et. al, 1996; Mace, 1972).
- Cognitive approaches should be used to understand a board's decision-making and actions (Forbes and Milliken 1999).
- Interactions among the board members and the larger set of stakeholders inside and outside the boardroom should be studied (Pettigrew 1992).

Furthermore, we need to consider boards in a different context than large US corporations (Huse, 2000), we need to balance different board role perspectives (Daily, et al., 2003), and dynamic and evolutionary approaches should replace static solutions and codes (Daily et al., 2003). Lessons from the behavioural theory of the firm should be applied, and mid-range theories – explaining certain issues related to boards – should be developed and used. The issues to be explored in this stream of research may, however, require the experimental use of various research methods.

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5 The president and the board of directors

Generally accepted roles of corporate boards have little relationship to what they in fact do and do not do in actual practice*

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Abstract

Boards of directors have been part of our business scene for over 150 years, but their functions have not been clearly defined and generally accepted through practice in the management of corporations. This author, who has served on and worked with boards of directors for a quarter of a century, reports here the results of his research project to measure the gap between the myths of business literature and the realities of business practice. The article not only contributes to an understanding of that layer of management known as the board of directors, but also offers a five-point program to give meaning in practice to the legal language 'the board shall manage.'

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All business corporations – large, medium, and small – have boards of directors as required by the general corporation laws of the states in which the companies are incorporated. These laws provide, typically, that the business of the corporation 'shall be managed by a board of at least three directors.' But neither does the law define and describe the meaning of 'shall be managed,' nor has 150 years of legal history and litigation revealed precisely what directors do or do not do when they 'manage.'

Over the years, businessmen, business associations, lawyers, and scholars have turned out literature attempting to describe more detailed functions for directors, and some of these statements of functions for directors have considerable intellectual acceptance in corporate circles. But there is a disparity in the literature. Much of it describes the roles that boards should play, not those that they really do.

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For over a quarter century, I have observed, served on, and studied boards of directors. In the process, I have developed a healthy skepticism about the prevailing and generally accepted concepts of boards of directors. What my experience bears out has, in fact, little relationship to the classic statements concerning their appropriate functions.

In short, the generally accepted roles of boards. – e.g., selecting top executives, determining policy, measuring results, and asking discerning questions – have taken on more and more the characteristics of a well-established myth, and there is a considerable gap between the myth and reality.

The purpose of this article, which is based on a recent research project (see accompanying ruled insert for my methodology), is fourfold. First, I shall describe briefly what I have found boards to be actually doing and note the disparity between theory and practice. Then, I shall discuss what directors do not do. Third, I shall identify the critical and controlling role of presidents. And finally, I shall offer a five-point program for more active board involvement in large and medium-sized, widely held companies.

The research method

My study project covered a two-and-a-half-year period of concentrated and intensive field research interviews. During 1969, 1970, and 1971, I conducted about seventy-five in-depth interviews and held several hundred shorter discussions with top business executives.

Thus this is not a statistical study dependent upon questionnaires filled out by corporate respondents. The size of the sample was such that a pattern became apparent, and I concluded that additional interviews would have added little of incremental value.

However, there are certain limitations. For the most part, this study is concerned with large- and medium-sized, widely held companies in which the president and the directors own little common or other voting stock. Instances are included, though, where directors own or represent the ownership of large stock interests.

This study is also confined exclusively to the boards of directors of manufacturing, mining, and retailing companies.

Finally, I use the title ‘president’ to mean the chief executive officer, recognizing that in some corporations the CEO may have the title ‘chairman of the board.’

What directors do

In most companies, boards of directors serve as a source of *advice and counsel*, offer some sort of *discipline value*, and act in *crisis situations* – if the president dies suddenly or is asked to resign because of unsatisfactory management performance. Let us look more closely at each of these areas of 'what directors do.'

Advise and counsel

I found that most presidents and outside board members agree that the role of directors is largely advisory and not of a decision-making nature. Management manages the company, and board members serve as sources of advice and counsel to the management. In addition, most presidents exploit the sources of advice represented on the board, both at board meetings and outside as well. And some thoughtful presidents, when selecting new members of the board to fill vacancies, identify the particular sets of desired qualities or areas of advice – general or specialized – which the presidents believe will add something to their management decisions.

My field interviews turned up some interesting comments on the important function of the board in providing advice and counsel. Here are two typical responses of the presidents interviewed:

> 'I think of a board as a sort of cabinet, a group of generalists, not specialists, who can advise me on all kinds of problems, new ideas, new services, improvements on what we are doing, and criticisms of what we are doing. A cabinet is an assemblage of sources of advice – the cabinet name is a good one for a board.
>
> 'The only decision which we as directors will ever make in that company will be to fire the president, and things have to get pretty awful before we would ever do that. All the rest of our job is to advise the management.'

Perhaps the strongest but not typical statement was provided by one president who said:

> 'We get a little advice from the outside board members, but the management runs the company. The board rubber-stamps the action of management, and the board members are there to mollify the outside stockholders.'

Since typically directors do not devote substantial amounts of time to the affairs of the companies they serve, their advice cannot be of the sort which requires lengthy and penetrating analysis. Accustomed, however, to dealing with top management problems involving sums of money and financial implications of considerable magnitude, directors, within the time constraints, can provide useful inputs to presidents willing to listen.

Outside directors are especially helpful in the advisory role where their general or specialized backgrounds and experiences can be applied to the specific management problems of the company served. For example, if new loans are to be negotiated or if new financing is to be arranged, these are the kinds of problems commonly faced by those on the board, and their judgments on interest rates or terms are useful to the president. Or if the question of a company's pension plan is under review, the experience of other top executives is another bit of useful evidence for the president working for a solution. And if a new plant location, domestic or abroad, is involved in a request for a capital appropriation, members of the board with similar recent experience can often suggest useful and sometimes new factors bearing on the decision to commit large amounts of capital to a specific location.

Sometimes, but not too frequently, the advice and counsel of a board member leads to a re-consideration or modification of a management's commitment or decision. Occasionally, but only very rarely, the advice and counsel of a board member leads to a reversal of a management commitment or decision.

Provide discipline value

A second role performed by boards of directors is serving as some sort of discipline for the president and his subordinate management. The president and his subordinates know that periodically they must appear before a board made up largely of their peers.

I have found that even in those situations where top managements know from previous experience that members of the board will not ask penetrating, discerning, and challenging questions, considerable care is taken in preparing figures and reports for board meetings. Something in the way of discipline results simply from the fact that regular board meetings are held.

Presidents and other members of top management in describing the discipline value of boards, indicated that the requirement of appearing formally before a board of directors consisting of respected, able people of stature, no matter how friendly, motivates the company managers to do a better job of thinking through their problems and of being prepared with solutions, explanations, or rationales.

One president described the discipline value of an outside board in this manner:

> 'The fact that you know that outsiders are going to be looking at what you have done, and what you are doing, forces you to do a little better job. There is a discipline factor here. We go to a lot of trouble to make sure that what we present to the board is well thought through and an

> attractively presented proposal – we want to manifest that the proposal is a product of thoughtful management.
>
> 'I am sure that, if we did not have to account periodically to the board, we would become a lot more casual in our operations. I don't know whether this reaction is fact or flection. But I think we behave differently internally, knowing that we have outside directors. The mere existence of outside directors makes us think a little bit harder, makes us organize our thoughts. It sharpens up the whole organization.'

The discipline value of boards also serves as an administrative device for presidents to use in establishing standards of performance for work done by subordinates. For example, with capital appropriations on the agenda for the next board meeting, many presidents remind functional or divisional managers that market and financial justifications have to be carefully organized and documented so that there will be no possibility of embarrassing questions from board members.

As an element of the discipline concept described by those I interviewed, some used the phrase 'corporate conscience.' The board of directors is regarded as the guardian to ensure and to represent to the outside world that the president and his subordinates do not engage in what might be regarded by outsiders as 'unconscionable conduct.' The establishment of a compensation and stock option committee, say, consisting entirely of outside directors with the president serving as an ex officio member, is assurance, at least theoretically, that compensation policies and practices do not exceed the appropriate bounds of reasonableness.

Consider this top executive's observation, which is typical of the comments of those interviewed:

> 'The board is, in a very real sense, a corporate conscience that the management is aware that they should go to, have to go to, for approval. If management did not have this requirement, I wonder what the ceiling or limits would be on what management might do. The conscience role of the board is a device that makes sure that homework is being done, and that criteria are thought through and proposed. The conscience function is involved in capital appropriations, operating budgets, compensation decisions, and others.
>
> 'The board is not really a decision-making body, but it is involved in the decision-making process as a sort of corporate conscience. The board rarely, if ever, rejects out of hand a proposal by the president, but its existence in the management scheme of things influences the president and helps keep his decisions within the bounds of "conscionable conduct".'

Usually, the symbols of corporate conscience are more apparent than real, and presidents with complete powers of control make the compensation policies and decisions. The compensation committee, and the board which approves the recommendations of the committee, are not decision-making bodies. These decisions are made by the president, and the committee and board approval is perfunctory. The president has de facto powers of control, and in most cases he is the decision maker. The board does, I believe, tend to temper the inclinations of presidents with de facto control, and it does contribute to the avoidance of excesses. Thus it serves the important role of a corporate conscience.

Act in crisis situations

There are two critical states of corporate affairs in which the role of the board of directors is more than advisory.

First, if the president dies suddenly or becomes incapacitated, the board has the decision-making responsibility to select his successor. In some cases, the selection process is largely controlled by the deceased president who has discussed with board members what he wanted them to do 'if I am hit by a truck some day.' In other instances, board members and presidents have neglected to consider the problem of succession. Only when confronted with the unexpected death of the president have they been propelled into a decision-making function. But the board is there – and it is legally constituted to pick a successor and to ensure the continuity of an entity organized to operate in perpetuity.

The drama and trauma that develop when a board of directors has thrust upon it unexpectedly the complete de facto powers of control were illustrated during many of my field research interviews. The dynamics of the assumption of all or part of the de facto powers of control by individual directors and combines of directors, in these situations, is worthy in my judgment of a separate study.

Second, if the leadership and performance of the president are so unsatisfactory that a change must be made, the board of directors performs a decision-making role: here, the president is asked to resign – an important decision, and then the board must decide on his successor – an equally important decision.

I have concluded that generally boards of directors do not do an effective job of evaluating or measuring the performance of the president. Rarely are standards or criteria established and agreed upon by which the president can be measured other than by the usual general test of corporate profitability, and it is surprising how slow some directors are to respond to years of steadily declining profitability.

Since directors are selected by the president, and group and individual loyalties have been developed through working together, directors are reluctant to measure the executive performance of the president carefully against specific standards. Directors base their appraisals largely on data and reports provided by the president himself. Also, top executives serving as outside directors, and being exceedingly busy men, typically do not devote time to pursue through further inquiry any concerns they may deduce from the data presented to them as directors, even when the concern might extend to the performance of the president.

In those situations where mounting and persuasive evidence leads individual directors or groups of directors to a conclusion that the president is unsatisfactory, I have found that one of three courses of action is usually followed:

Hire a management consultant. Periodic management audits by consulting firms appear to be increasingly common and accepted by top executives even in highly successful enterprises. Employing consultants to identify problems at the president's level and to recommend changes is used as a means of handling discreetly the unpleasant task of communicating to a president that he is inadequate.

Resign from the board. This is the most common and typical response of directors who suspect or conclude that the president is unsatisfactory. Resignation from boards for a plausible reason, such as conflict of interest, enables a director to avoid facing the ultimate and inevitably unpleasant task of acting to replace a president. In addition, with public disclosure of an apparently reasonable basis for a resignation, typically there is no embarrassment to the company or to the believed-to-be-inadequate president.

Ask the president to resign. Most boards of directors and most individual directors are intensely reluctant to face the unpleasant conclusion that the president of the company must be replaced. While sometimes the unpleasantness is avoided by hiring outside consultants or by resigning from the board, there are some situations in which board members who have procrastinated in taking any action find themselves obligated to face the task of asking the president to resign. These situations are relatively rare.

In these cases where the board had assumed an important decision-making role by asking for the president's resignation, I found that, by any standard, the board members were impressive in their ability and their willingness to assume top corporate responsibilities. For the most part, the outside directors remained on the board and devoted more than casual amounts of time to the company in distress. Many directors expressed regret for not having responded to the symptoms of weakness they had seen earlier, now more recognizable than before.

Once having faced up to the issue of the president's shortcomings, however, they stayed on the board even though it would have been less embarrassing not to be identified with a company with top management problems. They gave more of their time to the affairs of the ailing company, and they acted as responsible corporate citizens by assuming for the interim the de facto powers of control held previously by the president.

What directors do not do

The business literature describing the classic functions of boards of directors typically includes three important roles; (a) establishing basic objectives, corporate strategies, and broad policies; (b) asking discerning questions; and (c) selecting the president. In this section of the article, I shall discuss the evidence that I collected during my interviews on each of these generally accepted roles.

Establish objectives

Boards of directors of most large- and medium-sized companies *do not* establish objectives, strategies, and policies, however defined. These roles are performed by company managements. Presidents and outside directors generally are agreed that only management can, and should have, these responsibilities.

As one senior executive vice president said:

> 'Management creates the policies. We decide what course we are going to paddle our canoe in. We tell our directors the direction of the company and the reasons for it. Theoretically, the board has a right of veto, but they never exercise it. Naturally, we consult with them if we are making a major change in direction. We communicate with them. But they are in no position to challenge what we propose to do.'

The determination of a company's objectives, strategies, and direction requires considerable study of the organization's strengths and weaknesses and its place in the competitive environment; careful, time-consuming, penetrating analysis of market opportunities; and a matching of the organizational capacities to meet and serve the changing requirements of the market. And the market, for more and more companies, includes opportunities abroad, thus adding another complicating dimension of analysis.

The typical outside director does not have time to make the kinds of studies needed to establish company objectives and strategies. At most, he can approve positions taken by management – and this approval is based on scanty facts, not on time-consuming analysis.

Giving operational meaning to a set of defined corporate objectives is generally achieved by allocating or reallocating corporate capital resources. Statements of objectives and strategies are merely products of an analytical exercise until steps are taken to modify or redirect the company's activities through new allocations of corporate capital. The managements of a few companies, I found, do not accept the idea that boards can, or should be, involved in the process of capital appropriations, even in an advisory capacity. Accordingly, their studies and approvals of capital appropriations are made at management levels and not at the level of the board of directors.

In most companies, the allocation of capital resources, including the acquisition of other enterprises, is accomplished through a management process of analysis resulting in recommendations to the board and in requests for approval by the board. The minimum dollar amounts which require board approval and the quantity of analytical supporting data accompanying such requests vary among companies. Approval by boards in most companies is perfunctory, automatic, and routine.

Presidents and their subordinates, deeply involved in analysis and decision making prior to presentation to the board, believe in the correctness of their recommendations, and – almost without exception – these go unchallenged by members of the board. Rarely do boards go contrary to the wishes of the president.

In a few instances, boards of directors do establish objectives, strategies, and major policies, but these are exceptions. Here, the president wants the involvement of the directors, and he not only allows for, but insists on, full discussion, exploration of the issues, agreement, and decisions by the board along with himself.

Ask discerning questions

A second classic role ascribed to boards of directors is that of asking discerning questions – inside and outside the board meetings. Again, I found that directors *do not* in fact do this. Board meetings are not regarded as proper forums for discussions arising out of questions asked by board members; the president and directors alike feel that such meetings are not intended as debating societies.

In one situation, for example, an outside director, who was concerned about steadily declining earnings and who perceived no apparent management program to reverse the trend, asked the chairman and the president what was being done to correct the situation. The other outside directors also expressed their concern, and the president, obviously embarrassed, responded with unpersuasive and unimpressive replies.

After the meeting, the chairman asked the initial questioner to stop by his office before leaving, and there he explained:

> 'It is just plain bad manners to ask those kinds of questions in a board meeting. You must remember that you are challenging the president in the presence of his subordinates, some of whom are insiders on the board. If you have questions about what is being done to reverse the trend, the proper way is to make a date to confer with the president privately.'

Many board members cited their lack of understanding of the problems and the implications of topics that are presented to the board by the president; thus, to avoid 'looking like idiots,' they refrain from questioning or commenting.

Presidents generally do not want to be challenged by the questions of directors, especially if subordinates of the president are on the board or in attendance at the meeting. Despite the fact that most presidents profess that they want questions to be asked by interested members of the board, I have concluded that, while they may say this, and may even go to some trouble to make directors feel that they are free to question, actually the presidents do not want discerning questions or comments. The unsophisticated director may learn from experiencing rebuffs that the president does not want penetrating and issue-provoking questions, but only those which are gentle and supportive and an affirmation that the board approves of him.

Many presidents stated that board members should manifest by their queries, if any, that they approve of the management. If a director feels that he has any basis for doubt and disapproval, most of the presidents interviewed believe that he should resign.

The lack of active discussion of major issues at typical board meetings and the absence of discerning questions by board members result in most board meetings resembling the performance of traditional and well-established, almost religious, rituals. In most companies, it would be possible to write the minutes of a board meeting in advance. The format is always the same, and the behavior and involvement of directors are completely predictable – only the financial figures are different.

My research disclosed few exceptions to this routine. In a handful of instances, presidents said that they do in fact want discerning, challenging questions and active discussions of important issues at their board meetings. They think of their boards as accountable and responsible to the company's owners. There are also a few directors who do in fact ask discerning questions, the desires of the president notwithstanding.

Typical garden-variety outside directors, selected by the president and generally members of a peer group, do not ask questions inside or outside board meetings. However, directors who serve on corporate boards of companies because they own or represent the ownership of substantial shares of stock generally do in fact ask discerning questions. Their willingness to query presidents is, in part, a manifestation of the split in the de facto powers of control of those companies. The large stockholder-directors are not usually on the board because the president wants them there, but because through cumulative voting procedures they can force their way onto the board.

Directors, as described in the literature, represent the stockholders. Yet, typically, they are actually selected by the president and not by the stockholders. Accordingly, the directors are on the board because the president wants them there. Implicitly, and frequently explicitly, the directors in point of fact represent the president. But a large stockholder-director is not selected by the president and does not therefore represent the president; rather, he represents himself and an interest more likely to be consistent with that of the other stockholders.

The attitude of the large stockholder-director generally is: 'This is my money – these are my assets.' The attitude of the outside nonstockholder-director usually is: 'This is somebody else's money – these are not my assets.'

These differing attitudes with regard to stock ownership often are manifested in the extent to which discerning questions are asked of the president by the directors.

Select the president

A third classic role usually regarded as a responsibility of the board of directors is the selection of the president. Yet I found that in most companies directors do not in fact select the president, except under the two crisis situations cited earlier.

One company vice chairman, in commenting on this function of the board, stated:

> 'The old concept that the stockholders elect the board, and the board selects the management, is fiction. It just doesn't apply to today's large corporations. The board does not select the management, the management selects the board.'

In some situations, formal or informal committees of outside members of boards are charged with the responsibility of evaluating candidates inside the management for the presidency. But, generally, these committees have no more control over the naming of the president than do similar committees charged with identifying and recommending the names of candidates for board membership. In both committee situations, the president with de facto powers of control essentially makes the decisions. The administrative use by the president of board committees to evaluate candidates for his successor in the presidency gives the selection process an appearance of careful evaluation and objectivity. But in most cases the decision as to who should succeed the president is made by the president himself.

Certainly, the president knows the key members of his organization better than anyone else. He has worked with them closely and, typically, over a considerable period of time. He has observed them under various conditions of stress, and he, far better than anyone else on the board, can judge and predict which of the inside candidates can best fit the essentially unique set of job requirements of the company's presidency.

Board members with relatively brief exposure to company executives – whether on the board or not – base their appraisals necessarily on very inadequate evidence. When insiders appear before the board for presentations of their divisional operations, for example, or to explain a request for a large capital appropriation, the setting is artificial and synthetic.

Executives, aware that the process of evaluation is going on, rehearse their appearances to communicate to the board that they have the capacities and skills needed for the presidency. And the most that outside directors can-conclude from such an exposure is: 'The executive gave a well-organized presentation, he answered questions well, he spoke well, and he handled himself well.'

Boards of directors, I found, do serve in an advisory role in the selection of a new president – in their capacity as a sort of corporate conscience. The process of electing a new president requires a vote by the board, and the president generally observes the amenities of corporate good manners by discussing his choice with individual members prior to the meeting. Rarely does a board of directors reject a candidate for the presidency who is recommended by the president.

Powers of control

In the small family company, the ownership of the stock and the management are identical. In an earlier study, I found that the powers of control are in the family owners, and what the board of directors does is determined by the owners.[2]

The owner-managers of some small companies add outside directors to multiply the inputs to policy making, policy implementation, and day-to-day operating problems. The primary function of the outside directors is to provide a source of advice and counsel to the family owner-managers, and they do not serve in a decision-making role, except in the case of the unforeseen death of the dominant family owner-manager.

Even then, the real decision typically is made by the president's heirs. They have the authority to manage the enterprise, and the board is at most a legally required body which can be used for advice and counsel on management or family problems. The family owners determine what the board does or does not do.

At the opposite end of the spectrum is the large, widely held corporation in which typically the president and members of the board own little stock. Here, the de jure powers of control are dispersed among thousands of stockholders who are generally both unorganized as owners and essentially unorganizable. With this absence of control or influence by the corporate owners, the president typically does have the de facto powers to control the enterprise, and with these powers of control it is the president who, like the family owner-managers in the small company, determines in large part what the board of directors does or does not do.

Ownership influences

Between the two corporate situations just cited, there are many variations and combinations of centers of control, or ownership influences on control, of the company. Complete de facto control by the professional manager-president may be diminished or influenced by the presence on the board of a person who owns, or represents ownership of, a substantial block of stock. In this situation the president's de facto powers of control may be affected by what the owners or owner-representatives regard as appropriate functions of board members. This may constitute a challenge to the president.

My research findings show that many directors who own, or who represent the ownership of, substantial numbers of shares of stock take a deep interest in the operations of the company, spend considerable time in learning the business, and insist on being involved in major company decisions. The degree of the president's de facto powers of control in these cases is affected by the involvement of company stock owners.

Some directors who own, or who represent ownership of, large numbers of shares are passive, compliant, and not involved in major company problems; thus the president's complete powers of control are not diminished or influenced. My analysis of the situations where substantial stockholdings are represented on the board has produced no factors which make possible any reliable prediction of whether the stockholder-director will take an active and involved question-asking role.

There is some evidence that if the owner of the stock had come into possession of it through his own efforts, such as an entrepreneur developing his own business and then selling it to a larger company for its shares, the acquired entrepreneur will take a very active role as a director of the acquiring company. If the outside director with large stockholdings is a second or third generation heir of an entrepreneur, his involvement as an active director is less likely.

Another situation in which the president of a large- or medium-sized company does not possess the full and complete de facto powers of control is that of a retired president who stays on as a member of the board. Then, typically, the outside board members have been selected and invited to the board by the retired president, not the new president.

A similar complication of relationships exists in the situation following the sudden death of the president where his successor is designated by the board of directors. The new president holds his position because the directors selected him – directors who were themselves selected by his predecessor. While the new president is demonstrating his capacities to head the enterprise, the outside directors generally share the powers of control of the company.

In both cases, with the passage of time, and with the designation by the new president of new directors who are *his* directors, the complete powers of control will flow back into the office of the president.

Generally, when the president and the directors own only a little stock, the president possesses and exercises the complete powers of control of the enterprise. But, here again, it should be noted that the president with complete powers of control can determine that the directors will, to the extent he wishes, serve primarily as sources of advice and counsel.

The controlling influence of the president in determining what the directors will or will not do was illustrated by many of the discussions during my field research. The top executive of one company said:

> 'To put it bluntly, whether a board has any function or not, it must truly reflect the nature of the chief executive officer of the company more than anything else. If he wants to use the board, he will use them. And if he doesn't want to use the board, he will run over them pretty roughshod. Basically, the board can be made just about as useful as the president wishes it to be.'

Most presidents are completely aware of their powers of control, but they choose to exercise them in a moderate manner acceptable to their peers on the board. The president communicates to *his* board members that he does indeed control the enterprise, and while this is usually done discreetly, it is understood and accepted by the directors. Many of them, as presidents of their own companies with board members of their own, thoroughly understand the existence and location of the powers of control.

Choice of new members

The president, with powers of control, generally selects and invites directors to serve on the board. In some instances, a nominating committee of the board is created to identify, screen, and recommend candidates for board membership. Even with the presumed objectivity of a committee of outside directors, though, the president makes the decision as to new members.

Again, it should be noted that if one or more existing directors own or represent the ownership of substantial stock, the president's de facto power to select new directors may be challenged. In these cases, the stock-owning directors are interested in adding new directors of *their* choice, and the president is interested in new directors of *his* choice. Discussion and negotiation inevitably result in some sort of agreement on who should be added, and the balance of power issue continues.

The stockholders, of course, unless their holdings are substantial enough to assure representation on the board through the provisions of cumulative voting or to result in an invitation by the president to serve, play no part in the selection of directors to fill vacancies or in the nomination of directors' names to be included in the annual proxy statement.

My interview discussions on the topic of who makes a good director indicate that presidents, in selecting directors for their companies, regard the titles and prestige of candidates as of primary importance. Candidates are usually chosen who are (a) in positions equal to those of the other board members or (b) in companies of prestige equivalent to that of the company being served. If existing board members are chairmen and presidents of companies or senior partners of leading financial or legal firms, potential board members with lesser titles are rarely considered.

Here is one company president's comment on the prestige of his board members:

> 'We have a standing rule that no one can be an outside director in our company who is not the top person in his organization. If he isn't, he can't be on our board. I don't care how able he is; our board as now constituted has top men as outsiders, so any replacements over the years have got to be their peers. You can't downgrade the prestige of our board membership by inviting, say, a promising vice president to serve as a board member.'

In addition to the qualifications of prestige titles in prestige institutions – both business and academic – outside directors are selected because they are noncontroversial, friendly, sympathetic, congenial, and because they understand the system. Boat-rockers and wave-makers generally are not the choice of presidents with de facto powers of control and with freedom of choice as to who should serve on their boards.

While most presidents prefer to include on their boards only those who have appropriate titles and positions, there are a few but not many presidents who believe that the requirement of prestigious titles is not important. They want board members who will participate in the management of the company. Not surprisingly, these presidents are the same few who want board members who will help establish corporate objectives, ask discerning questions, and evaluate the performance of the president.

Proposed program

Today, many business leaders are concerned about the workings of boards of directors. In addition, various publics of business corporations are increasingly aware of the gap between the myth of boards' functions and the reality of business practice. In recent corporate disasters, hindsight suggests that it would not have been meddling in the management if the directors had in fact asked some discerning questions and had been involved in the allocation and appropriation of company capital resources.

If what I have reported is what boards of directors in fact do – is it enough? I suggest it is not.

For those presidents and boards of directors who do want boards to perform more than the relatively passive functions and to give meaning in practice to the legal language 'the board shall manage,' I propose a five-point program.

1. *Ask all insiders on the board other than the chairman and the president to resign.*

During my research interviews, many plausible reasons were given for having insiders on the boards – e.g., board membership gives prestige to the insiders and contributes to high morale throughout the organization; membership on the board contributes to the insiders' education by allowing them to participate in the top-level management process; outside directors are enabled to calibrate insiders as potential candidates for the presidency; and insiders at board meetings can answer queries raised with regard to their respective areas of responsibility.

I believe that these seemingly plausible reasons for having insiders on boards of directors are essentially fallacious and specious. The objectives of the reasons cited for having insiders on boards could be accomplished through other means.

If the functional roles of the board of directors are to:

- Provide advice and counsel, do inside officer-directors have to be on the board in order to advise the president?
- Serve as some sort of discipline, how does an insider on the board serve as a discipline on himself?
- Be available in the event of a crisis, can insiders objectively conclude that their president's performance is so unsatisfactory that he should be replaced?
- Determine objectives, strategies, and major policies, inside officer-directors can recommend objectives and strategies, but should those who recommend also approve?
- Ask discerning questions, can an inside officer-director ask discerning questions at board meetings without jeopardy to his working relationship with the president?
- Evaluate the president, how does an officer-director with aspirations of continued employment evaluate the president except in favorable terms?

2. *The specific functions of the board should be discussed and agreed on by the chairman, the president, and the outside board members, and reduced to writing as a charter to board activities.*

I found that many companies have statements of their boards' functions, but that the boards' job descriptions are generally broad, vague, meaningless, and usually unknown to the members of the board. Also, the statements of functions typically include 'the board of directors shall represent and further the stockholders' interests,' but the statements do not go on to describe what directors do when they represent the stockholders' interests. Further, I found that relatively unimportant functions, referred to by some directors as 'legal garbage,' are often intermingled with important functions.

A model for the process of defining appropriate board functions through discussion is provided here by John D. Gray, Chairman of the Board, Omark Industries:

> 'The job of describing the functions of our board evolved over about a

three-month period. I proposed the initial draft, and then met with the individual directors in three separate geographical locations to get their detailed input. This input was finally distilled into one document, circulated again to the directors, and with minor changes, adopted. It has been so far a most helpful document.'

The board's position description in Omark Industries covered seven major areas of functions. I shall include a select few of the many roles in each area to illustrate the specific job defined:

- Shareholder relations –
  . . . approve policy governing quarterly, annual, and special reports to shareholders to ensure that the contents are fair representations to the investors.
  . . . approve policy regarding tender offer strategy and determination of levels of 'fight value.'
- Financial structure and actions –
  . . . approve changes in capital structure and basic changes in debt policy.
  . . . approve annually the maximum limits of short-term debt, receive quarterly reports on short-term borrowings, and be advised of borrowings and lines of credit by the individual bank of the parent and its subsidiaries.
  . . . approve all long-term loans.
- Purpose, objectives, policies, plans –
  . . . approve long-range corporate objectives normally initiated by the chief executive officer.
  . . . review the annual operating budget, which will have been related to the longer-range objectives of the corporation.
  . . . receive annually a special R&D report (products or manufacturing processes) listing major projects by divisions.
  . . . review annually the long-range strategy of the company; confirm its direction or proposed changes of direction.
  . . . receive on request periodic compliance audits concerning conformance to major corporate policy.
- Management –
  . . . appraise performance of the chief executive officer and the chairman, and review with them their annual personal objectives; the chief executive officer will inform the board annually of his appraisal of the executive vice president.
  . . . provide for the orderly succession to the position of CEO.
- Employee relations –
  . . . approve basic corporate benefit plans.
  . . . be promptly advised by the CEO via special letter of any position or decision likely to lead to a strike in any division.

- Control –

  . . . recognize and identify the board's need for company information, and arrange for its timely supply.

  . . . review company performance against purpose, policies, objectives, and plans.

  . . . inquire into causes of measured deficiencies in performance.
- The board –

  . . . propose the size of the board.

  . . . fix the age limit for board membership.

  . . . recruit new members to the board, and elect them as authorized by the bylaws.

  . . . remove members from the board for just cause.

3. *Establish the criteria by which the board is required to evaluate the performance of the president annually, on a formal basis.*

One of the findings of my research is that generally directors do not do an effective job of evaluating or measuring the performance of the president. In most cases, there are no established criteria for appraising the president beyond the general test of 'I sort of look at how the company's earnings are, what the earnings per share are, what the stock price/earnings ratio is, and in general how the company appears to be doing.' Also, I found that careful and objective appraisal of the president's performance usually takes place *only* when increasing evidence indicates that the president is inadequate, and by this time the company is likely to be on the verge of disaster.

Able presidents, on the other hand, typically regard the measurement of the performance of their subordinates as one of the key and essential elements of the president's job: quotas, budgets, and goals are common elements in appraising divisional or product-line results, and the performance by subordinates is carefully evaluated against predefined criteria. Measurement of the performance of subordinate executives is commonplace. I suggest that measurement of presidents be accepted as a commonplace and important function of boards of directors.

In 1958, E. Everett Smith suggested that boards of directors have the kinds of information needed to evaluate the performance of management:

> 'I believe that if we compare the standards of performance and measurement criteria used by a well-managed multidivision company with those supplied the average board, we will find an amazing double standard. The company executives are in a far better position to appraise and evaluate division performance.
>
> 'If we are not to treat the board as an impotent second-class citizen, we must develop specific criteria that it can apply not only to each segment of the business, but also to the business as a whole. By criteria I mean material that will really identify, in each segment, the key factors that control profits and the general health of the business.'[3]

The fact that there are distinguishing characteristics for each company in each industry requires, I believe, that criteria for the measurement of *a* president in *a* company be uniquely tailored to that particular situation. Accordingly, the definition of the criteria should be a joint effort of the president and the board of directors of each company. Generally, the development and recommendation of major corporate policies and long-range objectives are initiated by the president and recommended to the board. Similarly, the construction of appropriate criteria for the measurement of the president's performance should be initiated by the president.

Some presidents have found outside consultants helpful in designing the appropriate and relevant criteria for the measurement of top-management performance. After the president has prepared what he perceives to be the appropriate criteria, they should be submitted to the board of directors for discussion, approval, and commitment.

Recommendations as to the distinctive factors by which the president's performance is to be measured can be constructed on (a) the criteria used by the president in evaluating *his* subordinates and *their* operations, (b) the company's annual operating budget, (c) the company's annual capital budget, (d) market data, when available, such as share of market (e) performance data of competitors with comparable product lines, (f) financial tests, such as return on investment, profit margin, earnings per share, cash flow, inventory levels, and so on.

4. *Directors should ask those discerning questions of presidents at board meetings that they would ask if they owned a substantial part of the companies they serve as directors – i.e., the questions owners would ask.*

One of the conclusions of my research on directors is that in most companies directors do not in fact ask discerning questions. Presidents regard challenging questions as 'inappropriate at meetings,' 'meddling with management,' 'trying to run a company by committee,' 'determining major policies without adequate data and knowledge,' and, as one president said, 'board meetings are not designed as forums for debate.'

Presidents generally prefer not to have discerning and challenging questions, especially at board meetings. And directors comply and accept limited and passive roles by serving as sources of advice and counsel, providing some sort of discipline value, and becoming active only when forced by the conditions of a crisis.

I believe that directors willingly accept the nonquestioning, noninvolved role partly because they are not concerned about their legal liabilities as directors. Typically, corporation law provides that directors must exercise 'that degree of diligence, care, and skill which ordinarily prudent men would exercise under similar circumstances.' With this standard, directors of business corporations enjoy a virtually complete immunity from liability for good-faith errors of judgment in conducting their company's business 'even though the errors may be so gross that they demonstrate the unfitness of the directors to manage the corporate affairs.'[4] Some writers state that the directors' standard of care is higher, but most acknowledge that it is minimal.

To encourage directors to ask those kinds of questions an owner would ask, I suggest that directors' legal responsibility be redefined on a higher and stricter standard than the majority view of judicial opinion currently indicates. The higher standard might be phrased, 'Directors must exercise that degree of diligence, care, and skill which ordinarily prudent men would exercise under similar circumstances *in their personal business affairs*.'

The questions a director would ask in the management of his personal business affairs should be the questions a director poses to the president. With this standard of liability, I believe directors would ask those questions owners would ask or they would resign. Directors unwilling to accept the legal responsibility of representing the shareholders – the owners – in my judgment should resign.

5. *Establish compensation rates for outside directors which motivate them to fulfill active and responsible roles as directors.*

One reason for the passivity and the lack of involvement by outside directors is that the relatively modest compensation provides limited monetary incentive to devote time and energy to another company's problems. Meeting fees and retainers have increased in amount during the past several years, but the amounts paid,[5] as one president noted, 'are still substantially below what a senior professional management consultant would charge on a per diem basis.'

Outside directors, in my judgment, are today generally overpaid for what they do, and underpaid for what they should do. Significantly higher directors' fees would motivate, I believe, able and responsible directors to devote commensurate and appropriate time and energy to the affairs of the corporations they serve.

What are directors for?

There was a time when a corporate director could regard his appointment as just an agreeable tribute to his wealth and his connections, a sign that he had entered the inner circle of the business community. If any director still thinks of his job that way, the proliferation of stockholder suits, the drumfire criticism of the militant comsumerists, and the mounting complaints of minority groups should make him think again.

The problem of the modern director is to define his role so that he does not meddle with day-to-day management but nevertheless knows what is going on and makes his influence felt in the determination of broad policy. It is not a problem that lends itself to easy answers. Each company is a separate case, and it is fair to ask whether a man who serves on a dozen or more boards really is doing his job on any of them.

In too many recent cases – Penn Central, for example – no one has been more surprised than the directors when the management finally admitted that the company was in deep trouble. And in too many cases, consumer groups or spokesmen for minorities have hit home when they charged that no one on the corporate board was thinking about them. As a result, business today is more vulnerable to punitive legislation and regulation than it has been at any time since the 1930s.

If corporate management is to survive in anything like its present form, directors will have to take on new responsibilities. They must make sure that corporate goals are consistent with the larger goals of U.S. society. And they must monitor management to see that it pursues these goals effectively, including the basic objective of earning a reasonable income and keeping the company out of the bankruptcy courts.

Notes

1 *Auther's note*: This article is based on a research study supposed by the Associates of the Harvard Business School, for greater detail, see my book, Directors: Myth and Reality [Boston, Division of Research, Harvard Business School, 1972].

2 *The Board of Directors in Small Corporations* [Boston, Division of Research, Harvard Business School, 1948] p. 12.

3 'For the Board of Directors to Work!' HBR May–June 1858, p. 46.

4 *Everett vs. Phillips*, 288 N Y. 43 NE 2^{d} 18, 20, 1942; see also Bishop, 'Sitting Ducks and Decoy Ducks,' 27 *Yale Law Journal*, 1078, 1005 [1968].

5 See Jeremy Bacon, *Corporate Directorship Practices*, Studies in Business Policy, No. 125 [New York, National Industrial Conference Board, Inc., 1967, Chapter III, pp. 28–29.

6 Separation of ownership and control *

Eugene F. Fama and Michael C. Jensen

Abstract

This paper analyzes the survival of organizations in which decision agents do not bear a major share of the wealth effects of their decisions. This is what the literature on large corporations calls separation of 'ownership' and 'control.' Such separation of decision and risk bearing functions is also common to organizations like large professional partnerships, financial mutuals and nonprofits. We contend that separation of decision and risk bearing functions survives in these organizations in part because of the benefits of specialization of management and risk bearing but also because of an effective common approach to controlling the implied agency problems. In particular, the contract structures of all these organizations separate the ratification and monitoring of decisions from the initiation and implementation of the decisions.

Introduction

Absent fiat, the form of organization that survives in an activity is the one that delivers the product demanded by customers at the lowest price while covering costs.[1] Our goal is to explain the survival of organizations characterized by separation of 'ownership' and 'control' – a problem that has bothered students of corporations from Adam Smith to Berle and Means and Jensen and Meckling.[2] In more precise language, we are concerned with the survival of organizations in which important decision agents do not bear a substantial share of the wealth effects of their decisions.

We argue that the separation of decision and risk-bearing functions observed in large corporations is common to other organizations such as large professional partnerships, financial mutuals, and nonprofits. We contend that separation of decision and risk-bearing functions survives in these organizations in part because of the benefits of specialization of management and risk bearing but also because of an effective common approach to controlling the agency problems caused by separation of decision and risk-bearing functions. In particular, our hypothesis is that the contract structures

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of all of these organizations separate the ratification and monitoring of decisions from initiation and implementation of the decisions.

Residual claims and decision processes

An organization is the nexus of contracts, written and unwritten, among owners of factors of production and customers.[3] These contracts or internal 'rules of the game' specify the rights of each agent in the organization, performance criteria on which agents are evaluated, and the payoff functions they face. The contract structure combines with available production technologies and external legal constraints to determine the cost function for delivering an output with a particular form of organization.[4] The form of organization that delivers the output demanded by customers at the lowest price, while covering costs, survives.

The central contracts in any organization specify (1) the nature of residual claims and (2) the allocation of the steps of the decision process among agents. These contracts distinguish organizations from one another and explain why specific organizational forms survive. We first discuss the general characteristics of residual claims and decision processes. We then present the major hypotheses about the relations between efficient allocations of residual claims and decision functions. The analysis focuses on two broad types of organizations – those in which risk-bearing and decision functions are separated and those in which they are combined in the same agents. We analyze only private organizations that depend on voluntary contracting and exchange.

Residual claims

The contract structures of most organizational forms limit the risks undertaken by most agents by specifying either fixed promised payoffs or incentive payoffs tied to specific measures of performance. The residual risk – the risk of the difference between stochastic inflows of resources and promised payments to agents – is borne by those who contract for the rights to net cash flows. We call these agents the residual claimants or residual risk bearers. Moreover, the contracts of most agents contain the implicit or explicit provision that, in exchange for the specified payoff, the agent agrees that the resources he provides can be used to satisfy the interests of residual claimants.

Having most uncertainty borne by one group of agents, residual claimants, has survival value because it reduces the costs incurred to monitor contracts with other groups of agents and to adjust contracts for the changing risks borne by other agents. Contracts that direct decisions toward the interests of residual claimants also add to the survival value of organizations. Producing outputs at lower cost is in the interests of residual claimants because it increases net cash flows, but lower costs also contribute to survival by allowing products to be delivered at lower prices.

The residual claims of different organizational forms contain different restrictions. For example, the least restricted residual claims in common use are the common stocks of large corporations. Stockholders are not required to have any other role in the organization; their residual claims are alienable without restriction; and, because of these provisions, the residual claims allow unrestricted risk sharing among stockholders. We call these organizations *open* corporations to distinguish them from *closed* corporations that are generally smaller and have residual claims that are largely restricted to internal decision agents.[5]

The decision process

By focusing on entrepreneurial firms in which all decision rights are concentrated in the entrepreneur, economists tend to ignore analysis of the steps of the decision process. However, the way organizations allocate the steps of the decision process across agents is important in explaining the survival of organizations.

In broad terms, the decision process has four steps:

- *initiation* – generation of proposals for resource utilization and structuring of contracts;
- *ratification* – choice of the decision initiatives to be implemented;
- *implementation* – execution of ratified decisions; and
- *monitoring* – measurement of the performance of decision agents and implementation of rewards.

Because the initiation and implementation of decisions typically are allocated to the same agents, it is convenient to combine these two functions under the term *decision management*. Likewise, the term *decision control* includes the ratification and monitoring of decisions. Decision management and decision control are the components of the organization's decision process or decision system.

Fundamental relations between risk-bearing and decision processes

We first state and then elaborate the central complementary hypotheses about the relations between the risk-bearing and decision processes of organizations.

Separation of residual risk bearing from decision management leads to decision systems that separate decision management from decision control.

Combination of decision management and decision control in a few agents leads to residual claims that are largely restricted to these agents.

The problem

Agency problems arise because contracts are not costlessly written and enforced. Agency costs include the costs of structuring, monitoring, and bonding a set of contracts among agents with conflicting interests. Agency costs also include the value of output lost because the costs of full enforcement of contracts exceed the benefits.[6]

Control of agency problems in the decision process is important when the decision managers who initiate and implement important decisions are not the major residual claimants and therefore do not bear a major share of the wealth effects of their decisions. Without effective control procedures, such decision managers are more likely to take actions that deviate from the interests of residual claimants. An effective system for decision control implies, almost by definition, that the control (ratification and monitoring) of decisions is to some extent separate from the management (initiation and implementation) of decisions. Individual decision agents can be involved in the management of some decisions and the control of others, but separation means that an individual agent does not exercise exclusive management and control rights over the same decisions.

The interesting problem is to determine when separation of decision management, decision control, and residual risk bearing is more efficient than combining these three functions in the same agents. We first analyze the factors that make combination of decision management, decision control, and residual risk bearing efficient. We then analyze the factors that make separation of these three functions efficient.

Combination of decision management, decision control, and residual risk bearing

Suppose the balance of cost conditions, including both technology and the control of agency problems, implies that in a particular activity the optimal organization is noncomplex. For our purposes, *noncomplex* means that specific information relevant to decisions is concentrated in one or a few agents. (Specific information is detailed information that is costly to transfer among agents.)[7] Most small organizations tend to be noncomplex, and most large organizations tend to be complex, but the correspondence is not perfect. For example, research oriented universities, though often small in terms of assets or faculty size, are nevertheless complex in the sense that specific knowledge, which is costly to transfer, is diffused among both faculty and administrators. On the other hand, mutual funds are often large in terms of assets but noncomplex in the sense that information relevant to decisions is concentrated in one or a few agents. We take it as given that optimal organizations in some activities are noncomplex. Our more limited goal is to explain the implications of noncomplexity for control of agency problems in the decision process.

If we ignore agency problems between decision managers and residual claimants, the theory of optimal risk bearing tells us that residual claims that allow unrestricted risk sharing have advantages in small as well as in large organizations.[8] However, in a small noncomplex organization, specific knowledge important for decision management and control is concentrated in one or a few agents. As a consequence, it is efficient to allocate decision control as well as decision management to these agents. Without separation of decision management from decision control, residual claimants have little protection against opportunistic actions of decision agents, and this lowers the value of unrestricted residual claims.

A feasible solution to the agency problem that arises when the same agents manage and control important decisions is to restrict residual claims to the important decision agents. In effect, restriction of residual claims to decision agents substitutes for costly control devices to limit the discretion of decision agents. The common stocks of closed corporations are this type of restricted residual claim, as are the residual claims in proprietorships and partnerships. The residual claims of these organizations (especially closed corporations) are also held by other agents whose special relations with decision agents allow agency problems to be controlled without separation of the management and control of decisions. For example, family members have many dimensions of exchange with one another over a long horizon and therefore have advantages in monitoring and disciplining related decision agents. Business associates whose goodwill and advice are important to the organization are also potential candidates for holding minority residual claims of organizations that do not separate the management and control of decisions.[9]

Restricting residual claims to decision makers controls agency problems between residual claimants and decision agents, but it sacrifices the benefits of unrestricted risk sharing and specialization of decision functions. The decision process suffers efficiency losses because decision agents must be chosen on the basis of wealth and willingness to bear risk as well as for decision skills. The residual claimants forgo optimal risk reduction through portfolio diversification so that residual claims and decision making can be combined in a small number of agents. Forgone diversification lowers the value of the residual claims and raises the cost of risk-bearing services.

Moreover, when residual claims are restricted to decision agents, it is generally rational for the residual claimant – decision makers to assign lower values to uncertain cash flows than residual claimants would in organizations where residual claims are unrestricted and risk bearing can be freely diversified across organizations. As a consequence, restricting residual claims to agents in the decision process leads to decisions (for example, less investment in risky projects that lower the costs of outputs) that tend to penalize the organization in the competition for survival.[10]

However, because contracts are not costlessly written and enforced, all decision systems and systems for allocating residual claims involve costs. Organizational survival involves a balance of the costs of alternative decision systems and systems for allocating residual risk against the benefits. Small noncomplex organizations do not have demands for a wide range of specialized decision agents; on the contrary, concentration of specific information relevant to decisions implies that there are efficiency gains when the rights to manage and control decisions are combined in one or a few agents. Moreover, the risk-sharing benefits forgone when residual claims are restricted to one or a few decision agents are less serious in a small noncomplex organization than in a large organization, because the total risk of net cash flows to be shared is generally smaller in small organizations. In addition, small organizations do not often have large demands for wealth from residual claimants to bond the payoffs promised to other agents and to purchase risky assets. As a consequence, small noncomplex organizations can efficiently control the agency problems caused by the combination of decision management and control in one or a few agents by restricting residual claims to these agents. Such a combining of decision and risk-bearing functions is efficient in small noncomplex organizations because the benefits of unrestricted risk sharing and specialization of decision functions are less than the costs that would be incurred to control the resulting agency problems.

The proprietorships, partnerships, and closed corporations observed in small scale production and service activities are the best examples of classical entrepreneurial firms in which the major decision makers are also the major residual risk bearers. These organizations are evidence in favor of the hypothesis that combination of decision management and decision control in one or a few agents leads to residual claims that are largely restricted to these agents.

We analyze next the forces that make separation of decision management, decision control, and residual risk bearing efficient – in effect, the forces that cause the classical entrepreneurial firm to be dominated by organizational forms in which there are no decision makers in the classical entrepreneurial sense.

Separation of decision management, decision control, and residual risk bearing

Our concern in this section is with the organizational forms characterized by separation of decision management from residual risk bearing – what the literature on open corporations calls, somewhat imprecisely, separation of ownership and control. Our hypothesis is that all such organizations, including large open corporations, large professional partnerships, financial mutuals, and nonprofits, control the agency problems that result from separation of decision management from residual risk bearing by separating the management (initiation and implementation) and control (ratification and monitoring) of decisions. Documentation of this hypothesis takes up much of the rest of the paper.

Specific knowledge and diffusion of decision functions

Most organizations characterized by separation of decision management from residual risk bearing are *complex* in the sense that specific knowledge relevant to different decisions – knowledge which is costly to transfer across agents – is diffused among agents at all levels of the organization. Again, we take it as given that the optimal organizations in some activities are complex. Our theory attempts to explain the implications of complexity for the nature of efficient decision processes and for control of agency problems in the decision process.

Since specific knowledge in complex organizations is diffused among agents, diffusion of decision management can reduce costs by delegating the initiation and implementation of decisions to the agents with valuable relevant knowledge. The agency problems of diffuse decision management can then be reduced by separating the management (initiation and implementation) and control (ratification and monitoring) of decisions.

In the unusual cases where residual claims are not held by important decision managers but are nevertheless concentrated in one or a few residual claimants, control of decision managers can in principle be direct and simple, with the residual claimants ratifying and monitoring important decisions and setting rewards.[11] Such organizations conform to our hypothesis, because top-level decision control is separated from top-level decision managers and exercised directly by residual claimants.

However, in complex organizations valuable specific knowledge relevant to decision control is diffused among many internal agents. This generally means that efficient decision control, like efficient decision management, involves delegation and diffusion of decision control as well as separation of decision management and control at different levels of the organization. We expect to observe such delegation, diffusion, and separation of decision management and control below the top level of complex organizations, even in those unusual complex organizations where residual claims are held primarily by top-level decision agents.

Diffuse residual claims and delegation of decision control

In the more common complex organizations, residual claims are diffused among many agents. Having many residual claimants has advantages in large complex organizations because the total risk of net cash flows to be shared is generally large and there are large demands for wealth from residual claimants to bond the payoffs promised to a wide range of agents and to purchase risky assets. When there are many residual claimants, it is costly for all of them to be involved in decision control and it is efficient for them to delegate decision control. For example, some delegation of decision control is observed even in the large professional partnerships in public accounting and law, where the residual claimants are expert internal decision agents. When there are many partners it is inefficient for each to participate in ratification and monitoring of all decisions.

Nearly complete separation and specialization of decision control and residual risk bearing is common in large open corporations and financial mutuals where most of the diffuse residual claimants are not qualified for roles in the decision process and thus delegate their decision control rights to other agents. When residual claimants have no role in decision control, we expect to observe separation of the management and control of important decisions at all levels of the organization.

Separation and diffusion of decision management and decision control – in effect, the absence of a classical entrepreneurial decision maker – limit the power of individual decision agents to expropriate the interests of residual claimants. The checks and balances of such decision systems have costs, but they also have important benefits. Diffusion and separation of decision management and control have benefits because they allow valuable knowledge to be used at the points in the decision process where it is most relevant and they help control the agency problems of diffuse residual claims. In complex organizations, the benefits of diffuse residual claims and the benefits of separation of decision functions from residual risk bearing are generally greater than the agency costs they generate, including the costs of mechanisms to separate the management and control of decisions.

Decision control in nonprofits and financial mutuals

Most organizations characterized by separation of decision management from residual risk bearing are complex. However, separation of the management and control of decisions contributes to the survival of any organization where the important decision managers do not bear a substantial share of the wealth effects of their decisions – that is, any organization where there are serious agency problems in the decision process. We argue below that separation of decision management and residual risk bearing is a characteristic of nonprofit organizations and financial mutuals, large and small, complex and noncomplex. Thus, we expect to observe separation of the management and control of important decisions even in small noncomplex nonprofits and financial mutuals where, ignoring agency problems in the decision process, concentrated and combined decision management and control would be more efficient.

Common general features of decision control systems

Our hypothesis about the decision systems of organizations characterized by separation of decision management and residual risk bearing gets support from the fact that the major mechanisms for diffusing and separating the management and control of decisions are much the same across different organizations.

Decision hierarchies. A common feature of the diffuse decision management and control systems of complex organizations (for example, large nonprofit universities as well as large open corporations) is a formal decision hierarchy with higher level agents ratifying and monitoring the decision initiatives of lower level agents and evaluating their performance.[12] Such hierarchical partitioning of the decision process makes it more difficult for decision agents at all levels of the organization to take actions that benefit themselves at the expense of residual claimants. Decision hierarchies are buttressed by organizational rules of the game, for example, accounting and budgeting systems, that monitor and constrain the decision behavior of agents and specify the performance criteria that determine rewards.[13]

Mutual monitoring systems. The formal hierarchies of complex organizations are also buttressed by information from less formal mutual monitoring among agents. When agents interact to produce outputs, they acquire low-cost information about colleagues, information not directly available to higher level agents. Mutual monitoring systems tap this information for use in the control process. Mutual monitoring systems derive their energy from the interests of agents to use the internal agent markets of organizations to enhance the value of human capital.[14] Agents choose among organizations on the basis of rewards offered and potential for development of human capital. Agents value the competitive interaction that takes place within an organization's internal agent market because it enhances current marginal products and contributes to human capital development. Moreover, if agents perceive that evaluation of their performance is unbiased (that is, if they cannot systematically fool their evaluators) then they value the fine tuning of the reward system that results from mutual monitoring information, because it lowers the uncertainty of payoffs from effort and skill. Since the incentive structures and diffuse decision control systems that result from the interplay of formal hierarchies and less formal mutual monitoring systems are also in the interests of residual claimants, their survival value is evident.

Boards of directors. The common apex of the decision control systems of organizations, large and small, in which decision agents do not bear a major share of the wealth effects of their decisions is some form of board of directors. Such boards always have the power to hire, fire, and compensate the top-level decision managers and to ratify and monitor important decisions. Exercise of these top-level decision control rights by a group (the board) helps to ensure separation of decision management and control (that is, the absence of an entrepreneurial decision maker) even at the top of the organization.[15]

The spectrum of organizations

Introduction

Organizations in which important decision agents do not bear a major share of the wealth effects of their decisions include open corporations, large professional partnerships, financial mutuals, and nonprofits. We are concerned now with analyzing the data each of these organizations provides to test the hypothesis that separation of decision management functions from residual risk bearing leads to decision systems that separate the management and control of decisions.

To motivate the discussion of specific organizational forms, we also outline a set of more specialized propositions to explain the survival value of the special features of their residual claims. These more specialized hypotheses about the survival of specific organizational forms in specific activities are developed in our paper 'Agency Problems and Residual Claims.[16]

Open corporations

Unrestricted common stock residual claims

Most large nonfinancial organizations are open corporations. The common stock residual claims of such organizations are unrestricted in the sense that stockholders are not required to have any other role in the organization, and their residual claims are freely alienable. As a result of the unrestricted nature of the residual claims of open corporations, there is almost complete specialization of decision management and residual risk bearing. Even managers who own substantial blocs of stock, and thus are residual risk bearers, may elect to sell these shares.

Unrestricted common stock is attractive in complicated risky activities where substantial wealth provided by residual claimants is needed to bond the large aggregate payoffs promised to many other agents. Unrestricted common stock, with its capacity for generating large amounts of wealth from residual claimants on a permanent basis, is also attractive in activities more efficiently carried out with large amounts of risky assets owned within the organization rather than rented. Moreover, since decision skills are not a necessary consequence of wealth or willingness to bear risk, the specialization of decision management and residual risk bearing allowed by unrestricted common stock enhances the adaptability of a complex organization to changes in the economic environment. The unrestricted risk sharing and diversification allowed by common stock also contributes to survival by lowering the cost of risk-bearing services.

Control of the agency problems of common stock

Separation and specialization of decision management and residual risk bearing leads to agency problems between decision agents and residual claimants. This is the problem of separation of ownership and control that has long troubled students of corporations. For example, potential exploitation of residual claimants by opportunistic decision agents is reflected in the arguments leading to the establishment of the Securities and Exchange

Commission and in the concerns of the modern corporate governance movement. Less well appreciated, however, is the fact that the unrestricted nature of common stock residual claims also allows special market and organizational mechanisms for controlling the agency problems of specialized risk bearing.

The stock market. The unrestricted alienability of the residual claims of open corporations gives rise to an external monitoring device unique to these organizations – a stock market that specializes in pricing common stocks and transferring them at low cost. Stock prices are visible signals that summarize the implications of internal decisions for current and future net cash flows. This external monitoring exerts pressure to orient a corporation's decision process toward the interests of residual claimants.

The market for takeovers. External monitoring from a takeover market is also unique to the open corporation and is attributable to the unrestricted nature of its residual claims.[17] Because the residual claims are freely alienable and separable from roles in the decision process, attacking managers can circumvent existing managers and the current board to gain control of the decision process, either by a direct offer to purchase stock (a tender offer) or by an appeal for stockholder votes for directors (a proxy fight).

Expert boards. Internal control in the open corporation is delegated by residual claimants to a board of directors. Residual claimants generally retain approval rights (by vote) on such matters as board membership, auditor choice, mergers, and new stock issues. Other management and control functions are delegated by the residual claimants to the board. The board then delegates most decision management functions and many decision control functions to internal agents, but it retains ultimate control over internal agents – including the rights to ratify and monitor major policy initiatives and to hire, fire, and set the compensation of top level decision managers. Similar delegation of decision management and control functions, at the first step to a board and then from the board to internal decision agents, is common to other organizations, such as financial mutuals, nonprofits, and large professional partnerships, in which important decision agents do not bear a major share of the wealth effects of their decisions.

However, the existence of the stock market and the market for takeovers, both special to open corporations, explains some of the special features of corporate boards, in particular: (1) why inside manager board members are generally more influential than outside members, and (2) why outside board members are often decision agents in other complex organizations.[18]

Since the takeover market provides an external court of last resort for protection of residual claimants, a corporate board can be in the hands of agents who are decision experts. Given that the board is to be composed of experts, it is natural that its most influential members are internal managers since they have valuable specific information about the organization's activities. It is also natural that when the internal decision control system works well, the outside members of the board are nominated by internal managers.

Internal managers can use their knowledge of the organization to nominate outside board members with relevant complementary knowledge: for example, outsiders with expertise in capital markets, corporate law, or relevant technology who provide an important support function to the top managers in dealing with specialized decision problems.

However, the board is not an effective device for decision control unless it limits the decision discretion of individual top managers. The board is the top-level court of appeals of the internal agent market,[19] and as such it must be able to use information from the internal mutual monitoring system. To accomplish this and to achieve effective separation of top-level decision management and control, we expect the board of a large open corporation to include several of the organization's top managers. The board uses information from each of the top managers about his decision initiatives and the decision initiatives and performance of other managers. The board also seeks information from lower level managers about the decision initiatives and performance of top managers.[20] This information is used to set the rewards of the top managers, to rank them, and to choose among their decision initiatives. To protect information flows to the board, we expect that top managers, especially those who are members of the board, can effectively be fired only with consent of the board and thus are protected from reprisals from other top managers.

The decision processes of some open corporations seem to be dominated by an individual manager, generally the chief executive officer. In some cases, this signals the absence of separation of decision management and decision control, and, in our theory, the organization suffers in the competition for survival. We expect, however, that the apparent dominance of some top managers is more often due to their ability to work with the decision control systems of their organizations than to their ability to suppress diffuse and separate decision control. In any case, the financial press regularly reports instances where apparently dominant executives are removed by their boards.

Corporate boards generally include outside members, that is, members who are not internal managers, and they often hold a majority of seats.[21] The outside board members act as arbiters in disagreements among internal managers and carry out tasks that involve serious agency problems between internal managers and residual claimants, for example, setting executive compensation or searching for replacements for top managers.

Effective separation of top-level decision management and control means that outside directors have incentives to carry out their tasks and do not collude with managers to expropriate residual claimants. Our hypothesis is that outside directors have incentives to develop reputations as experts in decision control. Most outside directors of open corporations are either managers of other corporations or important decision agents in other complex organizations.[22] 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 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 of an outside takeover is activated.

Professional partnerships

Mutual monitoring, specific knowledge, and restricted residual claims

The residual claims of professional partnerships in activities such as law, public accounting, medicine, and business consulting are restricted to the major professional agents who produce the organization's services. This restriction increases the incentives of agents to monitor each other's actions and to consult with each other to improve the quality of services provided to customers. Such mutual monitoring and consulting are attractive to the professional agents in service activities where responsibility for variation in the quality of services is easily assigned and the value of professional human capital is sensitive to performance. The monitoring and consulting are likely to be effective when professional agents with similar specialized skills agree to share liability for the actions of colleagues.

In both large and small partnerships, individuals or small teams work on cases, audits, and so forth. Because of the importance of specific knowledge about particular clients and circumstances, it is efficient for the teams to make most decisions locally. At this level. however, decision management and decision control are not separate. To control the resulting agency problems, the residual claims in professional partnerships, large and small, are restricted to the professional agents who have the major decision-making roles. This is consistent with our hypothesis that combination of decision management and control functions leads to restriction of residual claims to the agents who both manage and control important decisions.

Large professional partnerships

The partners in large professional partnerships are diffuse residual claimants whose welfare depends on the acts of agents they do not directly control. Thus, these organizations provide a test of our hypothesis that separation of residual risk bearing and decision management induces decision systems that separate the management and control of important decisions. The major decision control devices of large professional partnerships are similar to those of other organizations with diffuse residual claims. For example, residual claimants in large partnerships delegate to boards the ratification and monitoring of important decisions above the level of individual cases and audits. Moreover, the sharing of liability and residual cash flows among important decision agents (the partners) ensures that large partnerships have strong versions of the mutual monitoring systems that we contend are common to the decision control systems of complex organizations.

The boards of large partnerships have special features that relate to the restriction of the residual claims to important internal agents. The residual claimants are experts in the organization's activities, and they observe directly the effects of actions taken by the board of managing partners. Thus, unlike the stockholders of open corporations, the residual claimants in large partnerships have little demand for outside experts to protect their interests, and their boards are composed entirely of partners.

The board is involved in decisions with respect to the management of the partnership, for example, where new offices should be opened, who should be admitted to the partnership, and who should be dismissed. The board is also involved in renegotiating the shares of the partners. Here, as in other decisions, the boards of large partnerships combine the valuable specific knowledge available at the top level with information from partner-residual claimants. The role of the board is to develop acceptable consensus decisions from this information. Thus, the boards of large professional partnerships are generally called committees of managing partners rather than boards of directors. The idea is that such committees exist to manage agency problems among partners and to study and determine major policy issues in a manner that is less costly than when performed jointly by all partners.

Since the residual claims in a large professional partnership are not alienable, unfriendly outside takeovers are not possible. Inside takeovers by dissident partners are possible, however, because the managing boards of these organizations are elected by the partner-residual claimants.

Financial mutuals

A common form of organization in financial activities is the mutual. An unusual characteristic of mutuals is that the residual claimants are customers, for example, the policyholders of mutual insurance companies, the depositors of mutual savings banks, and the shareholders of mutual funds. Like the diffuse stockholders of large nonfinancial corporations, most of the diffuse depositors, policyholders, and mutual fund shareholders of financial mutuals do not participate in the internal decision process. Thus, financial mutuals provide another test of our hypothesis that substantial separation of decision management and residual risk bearing leads to decision systems that separate the management and control of decisions.

The control function of redeemable claims

For the purpose of decision control, the unique characteristic of the residual claims of mutuals is that they are redeemable on demand. The policyholder, depositor, or shareholder can, on demand, turn in his claim at a price determined by a prespecified rule. For example, the shareholder of an open-end mutual fund can redeem his claim for the market value of his share of the fund's assets, while the whole life or endowment insurance policyholder, like the shareholder of a mutual savings bank, can redeem his claim for its specified value plus accumulated dividends.

The decision of the claim holder to withdraw resources is a form of partial takeover or liquidation which deprives management of control over assets. This control right can be exercised independently by each claim holder. It does not require a proxy fight, a tender offer, or any other concerted takeover bid. In contrast, customer decisions in open nonfinancial corporations and the repricing of the corporation's securities in the capital market provide signals about the performance of its decision agents. Without further action, however, either internal or from the market for takeovers, the judgments of customers and of the capital market leave the assets of the open nonfinancial corporation under the control of the managers.

The board of directors

Like other organizations characterized by substantial separation between decision management and residual risk bearing, the top-level decision control device in financial mutuals is a board of directors. Because of the strong form of diffuse decision control inherent in the redeemable residual claims of financial mutuals, however, their boards are less important in the control process than the boards of open nonfinancial corporations. The reduced role of the board is especially evident in mutual savings banks and mutual funds, which are not complex even though often large in terms of assets. Moreover, the residual claimants of mutuals show little interest in their boards and often do not have the right to vote for board members.[23] Outside board members are generally chosen by internal managers. Unlike open corporations, the boards of financial mutuals do not often impose changes in managers. The role of the board, especially in the less complex mutuals, is largely limited to monitoring agency problems against which redemption of residual claims offers little protection, for example, fraud or outright theft of assets by internal agents.

Nonprofit organizations

When an organization's activities are financed in part through donations, part of net cash flows is from resources provided by donors. Contracts that define the share of residual claimants in net cash flows are unlikely to assure donors that their resources are protected from expropriation by residual claimants. In a nonprofit organization, however, there are no agents with alienable rights in residual net cash flows and thus there are no residual claims. We argue in 'Agency Problems and Residual Claims' that the absence of such residual claims in nonprofits avoids the donor-residual claimant agency problem and explains the dominance of nonprofits in donor-financed activities.[24]

The absence of residual claims in nonprofits avoids agency problems between donors and residual claimants, but the incentives of other internal agents to expropriate donations remain. These agency problems between donors and decision agents in nonprofits are similar to those in other organizations where important decision managers do not bear a major share of the wealth effects of their decisions. Our hypothesis predicts that, like other organizations characterized by separation of decision management from residual risk bearing, nonprofits have decision systems that separate the management (initiation and implementation) and control (ratification and monitoring) of decisions. Such decision systems survive in donor nonprofits because of the assurances they provide that donations are used effectively and are not easily expropriated.

Nonprofit boards

In small nonprofits delegation of decision management to one or a few agents is generally efficient. For example, in nonprofit cultural performing groups, an artistic director usually chooses performers, does the primary monitoring of their outputs, and initiates and implements major decisions. Nevertheless, the important decision agents in these organizations are chosen, monitored, and evaluated by boards of directors. Boards with similar decision control rights are common to other small nonprofits characterized by concentrated decision management, such as charities, private museums, small private hospitals, and local Protestant and Jewish congregations. Boards are also observed at the top of the decision control systems of complex nonprofits, such as private universities, in which both decision management and decision control are diffuse.

Although their functions are similar to those of other organizations, nonprofit boards have special features that are due to the absence of alienable residual claims. For example, because of the discipline from the outside takeover market, boards of open corporations can include internal decision agents, and outside board members can be chosen for expertise rather than because they are important residual claimants. In contrast, because a nonprofit lacks alienable residual claims, the decision agents are immune from ouster (via takeover) by outside agents. Without the takeover threat or the discipline imposed by residual claimants with the right to remove members of the board, nonprofit boards composed of internal agents and outside experts chosen by internal agents would provide little assurance against collusion and expropriation of donations. Thus, nonprofit boards generally include few if any internal agents as voting members, and nonprofit boards are often self-perpetuating, that is, new members are approved by existing members. Moreover, nonprofit board members are generally substantial donors who serve without pay. Willingness to provide continuing personal donations of wealth or time is generally an implicit condition for membership on nonprofit boards. Acceptance of this condition certifies to other donors that board members are motivated to take their decision control task seriously.

The Roman Catholic church

To our knowledge the only nonprofit organization that is financed with donations but lacks a board of important continuing donors with effective decision control rights is the Roman Catholic church. Parish councils exist in local Catholic churches, but unlike their Protestant and Jewish counterparts, they are only advisory. The clerical hierarchy controls the allocation of resources, and the papal system does not seem to limit the discretion of the Pope, the organization's most important decision agent.

Other aspects of the contracts of the Catholic clergy in part substitute for the control of expropriation of donations that would be provided by more effective donor-customer constraints on decisions. For example, the vows of chastity and obedience incorporated into the contracts of the Catholic clergy help to bond against expropriation of donations by avoiding conflicts between the material interests of a family and the interests of donor-customers. In addition, the training of a Catholic priest is organization-specific. For example, it involves a heavy concentration on (Catholic) theology, whereas the training of Protestant ministers places more emphasis on social service skills. Once certified, the Catholic priest is placed by the hierarchy. He cannot offer his services on a competitive basis. In exchange for developing such organization-specific human capital, the Catholic priest, unlike his Protestant and Jewish counterparts, gets a lifetime contract that promises a real standard of living. The organization-specific nature of the human capital of the Catholic clergy and the terms of the contract under which it is employed act as a bond to donor-customers that the interests of the Catholic clergy are closely bound to the survival of the organization and thus to the interests of donor-customers.

Although Protestantism arose over doctrinal issues, the control structures of Protestant sects – in particular, the evolution of lay councils with power to ratify and monitor resource allocation decisions – can be viewed as a response to breakdowns of the contract structure of Catholicism, that is, expropriation of Catholic donor-customers by the clergy. The evolution of Protestantism is therefore an example of competition among alternative contract structures to resolve an activity's major agency problem – in this case monitoring important agents to limit expropriation of donations.

There is currently pressure to allow Catholic priests to marry, that is, to drop the vow of chastity from their contracts. We predict that if this occurs, organizational survival will require other monitoring and bonding mechanisms, for example, control over allocation of resources by lay councils similar to those observed in Protestant and Jewish congregations.

The private university and decision systems in complex nonprofits

In complex nonprofits we observe mechanisms for diffuse decision control similar to those of other complex organizations. For example, large private universities, like large open corporations, have complicated decision hierarchies and active internal agent markets with mutual monitoring systems that generate information about the performance of agents. Again, however, the decision control structures of complex nonprofits have special features attributable to the absence of alienable residual claims.

For example, a university's trustees are primarily donors rather than experts in the details of education or research. In ratifying and monitoring decision initiatives presented by internal decision agents (presidents, chancellors, provosts, etc.), and in evaluating the agents themselves, boards rely on information from the internal diffuse decision system – for example, reports from faculty senates and appointments committees – and on external peer reviews.

Moreover, the structure of internal diffuse decision control systems is a more formal part of a university's contract structure (its charter or by-laws) than in large forprofit organizations such as open corporations. For example, unlike corporate managers. university deans, department heads, provosts, and presidents are generally appointed for fixed terms. The end of a contract period activates a process of evaluation, with search committees chosen according to formal rules and with rules for passing their recommendations on to the board. A more formal structure of diffuse decision management and control is helpful to trustees who do not have specialized knowledge about a university's activities. It also helps to assure donors that the absence of discipline from an outside takeover market is compensated by a strong system for internal decision control.

Summary

The theory developed in this paper views an organization as a nexus of contracts (written and unwritten). The theory focuses on the contracts that (1) allocate the steps in an organization's decision process, (2) define residual claims, and (3) set up devices for controlling agency problems in the decision process. We focus on the factors that give survival value to organizational forms that separate what the literature imprecisely calls ownership and control.

The central hypotheses

An organization's decision process consists of decision management (initiation and implementation) and decision control (ratification and monitoring). Our analysis produces two complementary hypotheses about the relations between decision systems and residual claims:

Separation of residual risk bearing from decision management leads to decision systems that separate decision management from decision control.

Combination of decision management and decision control in a few agents leads to residual claims that are largely restricted to these agents.

Combination of decision management and control

When it is efficient to combine decision management and control functions in one or a few agents, it is efficient to control agency problems between residual claimants and decision makers by restricting residual claims to the decision makers. This proposition gets clear support from the proprietorships, small partnerships, and closed corporations observed in small-scale production and service activities. These organizations are all characterized by concentrated decision systems and residual claims that are restricted to decision agents.

Separation of residual risk bearing from decision management

The role of specific knowledge

In contrast, most of the organizations characterized by separation of residual risk bearing from decision management are complex in the sense that specific information valuable for decisions is diffused among many agents throughout the organization. Thus in a complex organization separation of residual risk bearing from decision management arises in part because efficient decision systems are diffuse. Benefits from better decisions can be achieved by delegating decision functions to agents at all levels of the organization who have relevant specific knowledge, rather than allocating all decision management and control to the residual claimants. Control of the agency problems of such diffuse decision systems is then achieved by separating the ratification and monitoring of decisions (decision control) from initiation and implementation (decision management). The efficiency of such decision systems is buttressed by incentive structures that reward agents both for initiating and implementing decisions and for ratifying and monitoring the decision management of other agents.

The role of diffuse residual claims

In most complex organizations, residual claims are diffused among many agents. When there are many residual claimants, it is costly for all of them to be involved in decision control. As a consequence there is separation of residual risk bearing from decision control, and this creates agency problems between residual claimants and decision agents. Separation of decision management and decision control at all levels of the organization helps to control these agency problems by limiting the power of individual agents to expropriate the interests of residual claimants. Thus diffusion and separation of decision management and control have survival value in complex organizations both because they allow valuable specific knowledge to be used at the points in the decision process where it is most relevant and because they help control the agency problems of diffuse residual claims.

Common features of decision control systems

What we call separation of residual risk bearing from decision management is the separation of ownership and control that has long bothered students of open corporations. We argue that separation of decision and risk bearing functions is also common to other organizations like large professional partnerships, financial mutuals, and nonprofits. Moreover, our central hypothesis about control of the agency problems caused by separation of residual risk bearing from decision management gets support from the fact that the major mechanisms for separating decision management and decision control are much the same across organizations.

The common central building blocks of the diffuse decision control systems of complex organizations of all types are formal decision hierarchies in which the decision initiatives of lower level agents are passed on to higher level agents, first for ratification and then for monitoring. Such decision hierarchies are found in large open corporations, large professional partnerships, large financial mutuals, and large nonprofits. Formal decision hierarchies are buttressed by less formal mutual monitoring systems that are a by-product of interaction that takes place to produce outputs and develop human capital.

The common apex of the decision control systems of organizations, large and small, in which decision agents do not bear a major share of the wealth effects of their decisions is a board of directors (trustees, managing partners, etc.) that ratifies and monitors important decisions and chooses, dismisses, and rewards important decision agents. Such multiple-member boards make collusion between top-level decision management and control agents more difficult, and they are the mechanism that allows separation of the management and control of the organization's most important decisions.

Notes

1 Alchian (1950) is an early proponent of the use of natural selection in economic analysis. For a survey of general issues in the analysis of organization, see Jensen (1983).
2 Smith (1776); Berle and Means (1932); and Jensen and Meckling (1976).
3 See Jensen and Meckling (1976).
4 See Jensen and Meckling (1979).
5 The terms 'public corporation' and 'close corporation,' which are common in the legal literature, are not used here. 'Closed corporation' seems more descriptive than 'close corporation.' The term 'public corporation' best describes government-owned corporations such as Amtrak and the TVA. In contrast, what we call 'open corporations' are private organizations.
6 This definition of agency costs comes from Jensen and Meckling (1976).

7 Specific information is closely related to the notions of 'information impactedness' and 'bounded rationality' discussed in Williamson (1975) and (1981). Hayek (1945) uses specific information to discuss the role of markets in complex economies. See also Sowell (1980). Our analysis of the relations between specific information and efficient decision processes owes much to ongoing work with William Meckling.
8 See, for example, Arrow (1964); or Fama (1976, chs. 6 & 7).
9 In contrast, the analysis predicts that when venture equity capital is put into a small entrepreneurial organization by outsiders, mechanisms for separating the management and control of important decisions are instituted.
10 These propositions are developed in. Fama and Jensen (1983).
11 See Alchian and Demsetz (1972).
12 See Weber (1947); Blau (1956); Simon (1962); and the titles by Williamson (1975). The historical development of hierarchies in open corporations is analyzed in Chandler (1977); and Chandler and Daems (1980).
13 The separation of decision management from decision control that we emphasize is reflected in the auditing profession's concern with allocating operating and accounting responsibility to different agents. For instance, it is recommended that an agent with responsibility for billing should not have a role in receiving or recording customer payments. See, for example, Horngren (1982, ch. 27); or Stettler (1977, ch. 4 & 8).
14 See Fama (1980).
15 Decision functions can be delegated in two general ways: (1) joint delegation to several agents (as in a committee), or (2) partitioning and delegation of the parts to different agents. Boards of directors are examples of the former approach; decision hierarchies are examples of the latter.
16 Fama and Jensen (1983).
17 Monitoring from the takeover market is emphasized in Manne (1965).
18 See Herman (1981, ch. 2), for data on the characteristics of corporate boards.
19 See Fama (1980).
20 For example, Horngren (1982, at 911), describes the role of the audit committee of the board (generally composed of outside board members) as a collector and conduit of information from the internal mutual monitoring system: 'The objective of the audit committee is to oversee the accounting controls, financial statements, and financial affairs of the corporation. The committee represents the full board and provides personal contact and communication among the board, the external auditors, the internal auditors, the financial executives, and the operating executives.'
21 See Herman (1981, ch. 2).
22 See Herman (1981, ch. 2).
23 See Herman (1969), for documentation of such lack of interest. For example, he describes situations where in more than a decade only four depositors in total attended the annual meetings of two savings and loan associations and other situations where management did not even bother to collect proxies.
24 Fama and Jensen (1983). See Hansmann (1980) for a general discussion of nonprofits.

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7 Boards of directors and corporate financial performance

A review and integrative model*

Shaker A. Zahra and John A. Pearce II

This article synthesizes empirical research findings on the impact of boards of directors on corporate financial performance. An integrative model of board attributes and roles is presented, and research support on their links is discussed. The review identifies critical shortcomings of past studies and concludes by offering an agenda for future studies in this promising area of empirical research.

How do boards of directors influence corporate financial performance? This question has aroused interest over the past five decades in such diverse disciplines as management, economics, finance, and sociology, but with contradictory findings. The resulting research has contributed to a growing awareness of the need to understand better how boards can improve their effectiveness as instruments of corporate governance through refinements in their composition, their internal organization, and the processes they follow in making decisions.

This article begins with a review of empirical research published on the contributions of boards of directors to corporate financial performance. The review is structured around four prominent research perspectives on the role of boards in contemporary organizations that reflect the orientations of the studies we examined. These perspectives are evaluated to articulate their propositions on the role of boards in contemporary organization and their empirical findings on the impact of this role on company performance.

The review identifies an integrative model that has been absent from the literature. It proposes specific links among four board attributes (composition, characteristics, structure, and process) and three critical board roles (service, strategy, and control). The existing research evidence on board variables incorporated into this derived model helps to explain the major shortcomings of previous research and, more importantly, suggests an agenda for future research efforts.

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Perspectives on the roles of boards of directors

Research on the roles of boards and the extent to which boards undertake each role has been guided by four distinct theoretical perspectives, as summarized in Table 7.1. These perspectives differ meaningfully in their views of what directors should do, which board attributes influence company performance, and which criteria should be used to assess board contribution to company performance. These differences and illustrative empirical studies are presented in Table 7.1, which also provides an overall assessment of the extent of existing support for each perspective.

The legalistic perspective

This approach suggests that boards contribute to the performance of their firms by carrying out their legally mandated responsibilities. Advocates of this approach posit that corporate laws vest considerable powers in directors to enable them to fulfill their roles. For instance, the Revised Model Business Corporation Act (1985) stated that,

> All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation. (p. 193)

According to this approach, boards are responsible for corporate leadership without actual interference in day-to-day operations, which are duties of the chief executive officer (CEO) and senior executives. It views the role of the board as including responsibility for selecting and replacing the CEO, representing the interests of the firm's shareholders, providing advice and counsel to top management, and serving as a control mechanism by monitoring managerial and company performance (Carpenter, 1988; Ewing, 1979; Mattar & Ball, 1985; Mueller, 1979; Vance, 1983). Thus, by performing these activities, boards can enhance the performance of their companies.

Figure 7.1 summarizes the major propositions of the legalistic approach. Scholars and public policy makers espousing this perspective emphasize four board attributes that determine directors' performance of their roles. Listed in Figure 7.1 according to their apparent relative importance, they are *board composition*, *characteristics*, *structure*, and *process*. Composition refers to the size of the board and the mix of different directors' types (i.e., insiders vs. outsiders). Characteristics refer to the director's experience, functional background, independence, stock ownership, and similar variables that influence directors' interest in and performance of their tasks. Structure refers to board organization, division of labor among standing committees and the efficiency of its operations. Finally, process refers to the decision-making related activities and styles of the board.

Table 7.1 Four perspectives on boards of directors

	PERSPECTIVES			
Dimension	*Legalistic*	*Resource Dependence*	*Class Hegemony*	*Agency Theory*
Board role	1. Representing and protecting shareholders' interest. 2. Managing the corporation without interference in day-to-day operations.	1. Boards are a cooptative mechanism to extract resources vital to company performance. 2. Boards serve a boundary spanning role. 3. Boards enhance organizational legitimacy.	Boards perpetuate the power and control of the ruling capitalist elite over social and economic institutions.	The primary role of boards is to monitor actions of agents (executives) to ensure their efficiency and to protect principals' ('owners') interests.
Operational definition of boards' role	1. Selecting CEO 2. Monitoring CEO performance 3. Representing shareholders' interests 4. Evaluating company performance.	1. Scanning the environment. 2. Representing the firm in the community. 3. Securing valuable resources	1. Selective recruitment of directors. 2. Reducing transaction cost for member firms.	1. Maximizing shareholders' wealth. 2. Reducing agency cost. 3. Selecting & rewarding CEO. 4. Evaluating CEO and company performance. 5. Strategic decision making and control.
Theoretical Origins	Corporate law	Organizational Theory & Sociology	Marxist Sociology	Economics & Finance
Variables of interest	-composition -characteristics -process	-composition -characteristics	-composition	-characteristics -process -strategic contribution
Company performance criteria	-survival -growth -profitability	-growth in resources -goal achievement -relative market position	-ologopolistic market power -profitability	-survival -low operating costs -profitability
Representative studies	Berle & Means (1968) Chaganti et al. (1985) Mace (1971) Molz (1988) Williamson (1964)	Pfeffer (1972) Pfeffer (1973) Pfeffer & Salancik (1978) Proven (1980) Zald (1967)	Domhoff (1969) Mills (1956) Ratcliff (1980)	Baysinger & Butler (1985) Fama & Jensen (1985) Kosnik (1987)
Empirical support	Moderate	Strong	Limited	Moderate

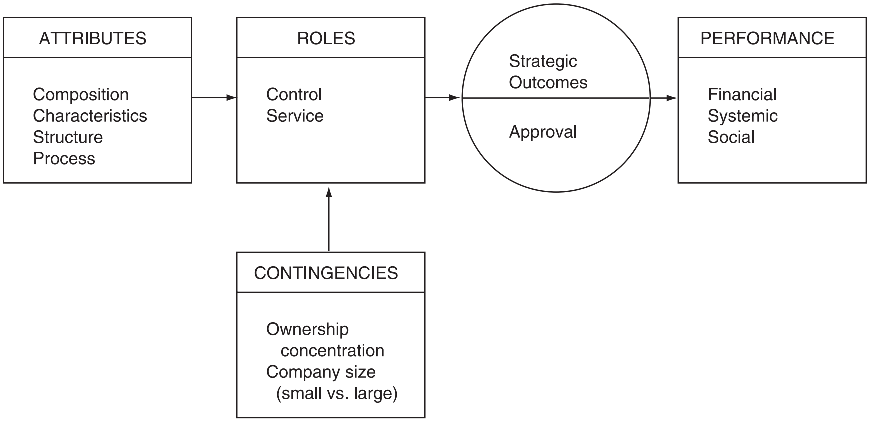

Figure 7.1 The legalistic approach model of the links between boards and company performance.

Note: Variables are listed in the model according to their apparent importance in research using this perspective.

The legalistic perspective posits that board attributes – composition, characteristics, structure, and process – determine a board's performance of its two primary roles: service and control. Service role involves enhancing company reputation, establishing contacts with the external environment, and giving counsel and advice to executives (Carpenter, 1988; Louden, 1982). The control role requires evaluating company and CEO performance to ensure corporate growth and protection of shareholders' interest (Chapin, 1986; Louden, 1982).

As Figure 7.1 suggests, performance of the two board roles of service and control depends on two factors. The first is ownership concentration. If company stock is held by a small number of owners, these owners (or their representatives) on the board are likely to be actively involved in performing the control and service role. These individuals will have a vested interest in ensuring the survival and effectiveness of their firms to maximize their wealth.

The second contingency is firm size. In smaller firms, boards tends to be underutilized cronies of the owners or CEOs (Castaldi & Wortman, 1984). However, these boards can play a major service role that enhances a firm's legitimacy. As firms become bigger, the control function becomes vital. Large organizational size is often associated with complex operations that require careful integration. As a result, a board becomes a major instrument of control as companies become larger.

Research following the legalistic approach suggests that board attributes influence board roles. The effect of boards on company performance, however, is indirect. By performing their service and control roles, directors shape managerial strategic choices or actions (labelled 'strategic outcomes,' in Figure 7.1). According to this perspective, a board is not expected to initiate strategies or develop policies. Instead, it is responsible for reviewing and approving managerial initiatives that will, in turn, determine company performance.

The legalistic perspective adopts a broad view of organizational performance, emphasizing financial, systemic and social criteria. Financial criteria relate to creating shareholders' wealth. These are usually measured using accounting-based performance measures such as return on assets, return on equity, and dividend per share (Vance, 1968, 1978), and market-based criteria (Rechner & Dalton, in press).

Systemic performance criteria center on a firm's survival and growth (Daft, 1989). The study by Chaganti, Magajan and Sharma (1985) of the relationship between board composition and structure and corporate bankruptcy illustrates this orientation.

Social performance revolves around corporate response to changing societal expectations. A recent study illustrates this stream of research. Zahra and Stanton's (1988) study reported positive association between the proportion of outsiders on the boards and measures of corporate social responsibility.

The legalistic perspective has sparked considerable empirical research as well as public debate over the past five decades. Its findings show that directors do not always fulfill their legally mandated responsibilities (Bacon, 1973; Baker, 1945; Berle & Means, 1968; Brown & Smith, 1957; Copeland & Towl, 1947; Epstein, 1986; Juran & Louden, 1966; Koontz, 1967; Mace, 1971; Louden, 1982; Williamson, 1964; Winter, 1964). Boards do not ask executives discerning questions about company goals and performance, do not evaluate CEO performance thoroughly, and do not review managerial decisions before approving them. In fact, some boards have been indicted for failing to examine the consequences of mergers, proposed and approved by managers, for shareholders' wealth (Fleischer et al., 1988; Loevinger, 1986).

From this perspective, boards' failure to fulfill their roles is often explained by the fact that boards have long been considered 'creatures of the CEO' (Patton & Baker, 1987). CEOs are thought to play a most significant role in designing and leading the board. Accordingly, it is argued that most CEOs do not want a strong board that will challenge their power and authority (Rosenstein, 1987). As a result, loyalty to the CEO – not competence – becomes a major criterion in selecting, retaining, and compensating directors.

Managerial domination of boards is seen as having resulted in inadequate attention to board processes. Often, directors function on information provided by the CEO. The flow of information between the CEO and directors is often inadequate (Aram & Cowen, 1983). Thus, directors are not in a position to challenge CEO analyses or recommendations in the absence of reliable data.

Board observers from the legitimacy school of thought note that board decision making is also ineffective. Meetings are infrequent, short, and too superficial to result in insightful discussions of issues at hand (Patton & Baker, 1987).

Lack of attention to effective board process is presumed to have resulted from the fact that the majority of boards have chairs who also serve as the CEOs, making it difficult for the board to evaluate executive performance. Hence, the effective system of checks and balances envisioned by the legalistic approach does not exist. This 'managerial hegemony' of directors perpetuatees weak boards that function as rubber stamps of managerial choices (Nader, 1984; Perham, 1983).

In response to early findings of the legalistic perspective, the decade of the 1970s witnessed a growing interest in 'reforming' boards; that is, an interest in strengthening board powers relative to those of CEOs. Reform-minded activists suggested changes in the way directors should be selected, in the liability of directors for corporate failure, and in separating the position of the CEO and board chair (for a review, Mueller, 1979).

Mounting calls for reform stemmed from a growing concern over the efficacy of boards. Studies and corporate scandals resulted in widespread perceptions of the boards as ineffective (Bacon, 1979; Herman, 1981). Therefore, reform efforts focused on the sources of board inefficiency to transform directors into true partners in governance.

The debate on the role of the organization in society also stirred calls for board reform. Widely perceived as the apex of corporate power, reform efforts aimed to broaden the representation of different stakeholders on boards, with the desired result of enhanced corporate social role by large corporations.

These factors – concern over board effectiveness and interest in the social role of the firm – led to significant changes in board composition and rising interest in how boards make their decisions. As a result, the Securities Exchange Commission (SEC) and different stock exchanges have been increasingly active in shaping the composition and decision-making processes of the board (Bacon, 1979). These calls for reform have resulted in increasing the representation of outside directors, females, and minority groups (Korn/Ferry International, 1982; National Association of Corporate Directors, 1982; Patton & Baker, 1987; *The Changing Board*, 1984, 1986).

Overall, the findings from this perspective have ignited a search for better ways to design effective boards.

Despite the important contributions of the legalistic approach, our review has uncovered five shortcomings of this approach that should be recognized. First, this approach has tended to ignore the important contribution boards can make in coopting the external environment or in developing and implementing strategies. Second, researchers have shown interest in composition variables without sufficient attention to board structure and process. Thus, though normative theory emphasizes board composition, structure, and process, only composition is emphasized in empirical studies. Third, Mizruchi (1983) notes that research following this tradition has been fraught with confusion about the nature of corporate control. The thesis that CEOs dominate their boards has not been studied in a systematic fashion. Yet, most researchers start their analysis taking this assertion as a given. Mizruchi's (1983) own interpretation of the literature shows that boards control CEOs and not vice versa. Fourth, the legalistic approach presumes that shareholders' wealth is well defined and easily measured. Yet, it fails to offer a precise yardstick to reach such a determination. Are corporate survival and distribution of dividends adequate measures of shareholders' wealth? Should market value be used instead? Clearly, a central concept in the legalistic approach – shareholders' interest and wealth – has escaped careful measurement. Fifth and finally, in conducting their empirical work, scholars following this approach tend to overemphasize the direct link between board attributes and corporate performance criteria. That is, the sequence of relationships depicted in Figure 7.1 is ignored. Figure 7.1 indicates that the effect of board attributes on company performance is indirect, occurring through its influence on roles, as explained earlier. This lack of attention to appropriate causal links among board attributes and roles may explain the contradictory findings reported in the literature.

Resource dependence

Grounded in sociology and organizational theory, the resource dependence perspective views boards as important boundary spanners that make timely information available to executives. Furthermore, because of their prestige in their professions and communities, directors are able to extract resources for successful company operations. As summarized in Table 7.1, these activities are believed to enhance the firm's legitimacy in society and to help it achieve goals of efficiency and improved performance (Pfeffer, 1972, 1973; Price, 1963; Provan, 1980; Zald, 1967).

Despite the theoretical proximity of the interlock and resource dependence approaches, they differ in a fundamental way. According to the resource dependence perspective, directors help the firm interface with its general and competitive environments. In contrast, the interlock approach focuses almost exclusively on a company's interface with its competitors. An interlock occurs when an individual sits as a member of the board of directors of two companies. Interlocks can be direct or indirect. A direct interlock exists when one or more directors of one company serve on the board of a second company. An indirect interlock exists when directors of two different companies serve on the board of a third company, often with the intention to coordinate the activities of the firms involved (Daft, 1989).

Empirical support for the resource dependence perspective emerged from research by economists and sociologists on board interlocks. These scholars viewed boards as viable entities whose contribution lay mainly in creating and enhancing mutually beneficial interorganizational relationships. Directors not only provided vital linking pins to other companies, but they also ensured favorable transactions among these firms. The net effects of these actions were increased coordination among organizations, reduced transaction costs, and improved access to vital information and resources (Bazerman & Schoorman, 1983).

An extensive body of empirical and theoretical work on interlocking directors has developed over the years. Penning (1980) thoroughly reviewed this work. His summary observation was that interlocks had a strong favorable effect on company performance because of the many advantages of interlocking directorates. These included horizontal coordination among firms along the same value chain, vertical coordination, and enhancing corporate reputation through networking (Schoorman, Bazerman & Atkin, 1981). These three advantages were viewed as having helped to reduce the uncertainty surrounding corporate operations, enhance the status of the firm in the business community and, on occasion, reduce transaction costs.

Research results support the central argument of the resource dependence approach to board role (Pfeffer, 1973; Pfeffer & Salancik, 1978; Provan, 1980). Directors absorb environmental uncertainty by providing information, thus enhancing company performance.

Figure 7.2 summarizes the potential links between boards and company performance. Scholars following the resource dependence perspective stress two board attributes as antecedents of board roles – composition and characteristics. However, by highlighting a strategy in addition to the service and control roles, these scholars view board roles more broadly than legalistic researchers. The resource dependence perspective suggests that directors may be actively involved in the strategic arena through counsel and advice to the CEO, by initiating their own analyses, or by suggesting alternatives. However, directors may not develop or execute strategies because these activities are within the purview of the CEO.

A board's performance of its roles depends on three contingencies, as presented in Figure 7.2. The first is the characteristics of the external

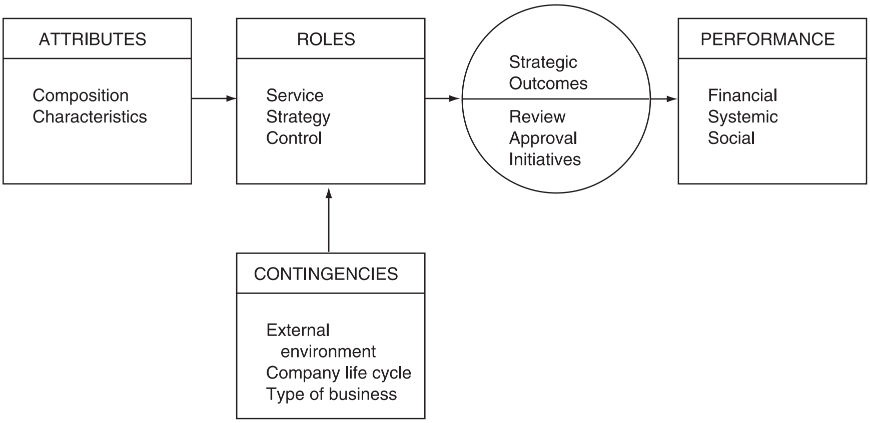

Figure 7.2 A resource dependence perspective on the effect of boards on company performance.

Note: Variables are listed in the model according to their apparent importance in research using this perspective.

environment. For instance, when the environment is volatile and hostile, creating favorable links with external stakeholders becomes an important part of the service role.

The second contingency is the phase of company life cycle. Though the link between the board role and the company life cycle is yet to be clearly defined, boards are expected to perform qualitatively different roles at various points of the cycle as exemplified by the different way a board performs its control function in an entrepreneurial firm as opposed to a well established, mature corporation.

The third contingency affecting board role is the type of firm (i.e., profit vs. non-profit). In profit-seeking firms, directors are held legally liable for their decisions. Hence, these directors may be hesitant to be actively engaged in performing their strategic role. In not-for-profit companies, however, these directors are not legally liable and, therefore, may become deeply involved in shaping the strategic direction of the organization.

Again, board influence on company performance occurs through its impact on the strategic initiatives of executive choices, as depicted in Figure 7.2. From the resource dependence perspective, directors can shape these initiatives directly by proposing new business concepts or initiating their analyses.

Figure 7.2 shows that resource dependence scholars allude to a multidimensional definition of company performance, encompassing the financial, systemic, and social components noted under the legalistic approach. Yet, published research following this approach has stressed only the financial component of organizational performance.

To capture the effect of boards on company financial performance, scholars following the resource dependence research tradition use change measures of organizational performance. Examples are Provan's (1980) study of changes in funding among United Way agencies, and Pfeffer's (1972) study of the effect of board composition on company performance. These studies were designed around the theme that boards which fit the firm's external environment or aid in absorbing uncertainty enhance company performance.

Overall, the resource dependence perspective gained considerable attention in the 1970s. This approach contributed greatly to increasing our understanding of the boards' role as a linking pin, tying the firm and its environment. But, this perspective has three limitations. First, it does not define or even theorize about the processes by which directors develop their strategies to link the firm and its environment. Second, it ignores the dynamics of power associated with board composition and change. Boards do not just exist or match environments; rather, boards are designed and developed to achieve this fit. By overlooking processes and individuals associated with changes in board composition, this approach gives the impression that designing effective boards is a simple, straightforward task. Analyses associated with testing this approach ignore the dynamic nature of organizational adaptation to environment. This task has been described as attempting to 'shoot a moving target' (Thompson, 1967). What do changes in the firm's environment-firm links mean for board membership and process? This question, too, has escaped examination. The limited number of studies published to date makes it difficult to determine how board composition and characteristics vary within different environmental settings. They also fail to provide an adequate test of the perspective's central thesis that companies whose boards meet the demands of the environment experience superior performance. Third, despite its implicit recognition of the firm's social role, this approach has failed to assess empirically the links between board variables and corporate social performance.

Our review shows that despite the strong theoretical underpinning of the resource dependence approach, little effort has been made to articulate its managerial implications for improving governance practices and structures.

Class hegemony

The third perspective on the role of boards of directors is rooted in Marxist sociology (Mills, 1956; Nichols, 1969; Ratcliff, 1980; Rubner, 1965). It views boards as a means of perpetuating the powers of the ruling capitalist elite. In particular, board membership is said to reflect a shared commitment among the ruling capitalists to control social and economic institutions, hence wealth. As evidence of this view, these researchers suggest that only the most influential, prestigious individuals are invited to serve on boards. By this exclusion of other social groups, the values and interests of the ruling capitalists are protected. Thus, the envisioned task of the board is to coordinate actions by the firms they serve and, more importantly, to ensure capitalist control of societal institutions.

Figure 7.3 summarizes class hegemony scholars' perspective. These scholars

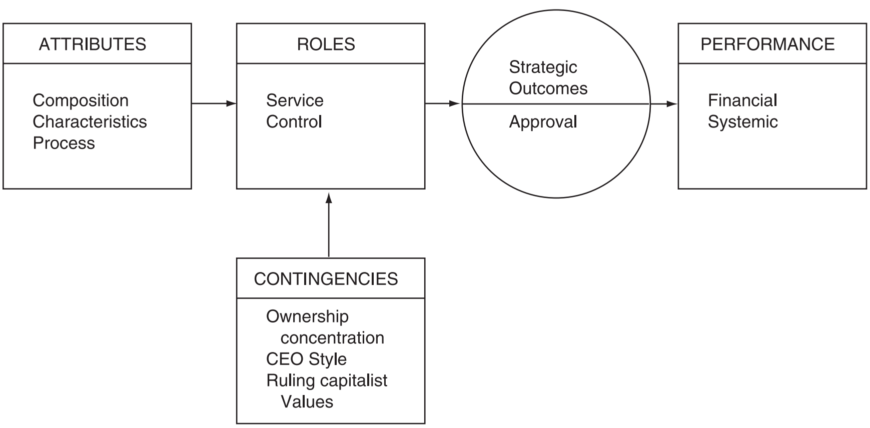

Figure 7.3 A class hegemony model of the links between board and company performance.

Note: Variables are listed in the model according to their apparent importance in research using this perspective.

identify three board attributes: composition, characteristics and process. paradoxically, though class hegemony scholars stress board ‘process’ as an important variable, they do not operationally define its domain. As a result, this variable has escaped attention in the empirical literature of this perspective.

According to the class hegemony perspective, two board roles are important: service and control. Board performance of these two roles depends on two variables: concentration of ownership (discussed earlier) and CEO power and style. In this approach, CEOs are representatives of the capitalist elite. CEOs are seen as having considerable power that they may exercise to enhance or reduce board involvement. Board input is thought to be valued only if it is compatible with CEO objectives, preferences, and style.

From this perspective, the CEO is the ultimate power broker in the firm. Representing the values of the capitalist elite, the CEO and senior executives develop and implement strategic initiatives that are reviewed by directors. This review aims to ensure the consistency of CEO’s initiatives with the interests of the owners.

Class hegemony scholars define company performance as consisting exclusively of two components: financial and systemic. The social role of the firm is not explicitly discussed in this stream of research.

Empirical evidence in support of this perspective has been limited. Indeed, most available evidence centers on patterns of selective board membership where the background of new members was examined to ascertain their wealth and their connection to the Establishment. The intent was to confirm whether the richest in the U.S. society were invited to serve on boards (Domhoff, 1969; Ratcliff, 1980).

This perspective has three limitations. First, it suffers from a lack of specificity on the ways in which a board can enrich company performance, except for the presumption that class hegemony results in increased market powers for specific firms in a given industry.

Second, it suffers from the overgeneralizations of post hoc analyses. Indeed, class hegemony research causation is frequently substituted for associations, direction of relationships is of dubious quality, and ideological rationale is used in lieu of insightful analysis. Thus, although these studies make a point about concentration of wealth and power, they forget to examine actual corporate governance practices.

Finally, this perspective ignores changing patterns of corporate ownership. Though some individuals still hold considerable blocks of corporate stocks, institutional investors representing pension and trust funds owned by millions of citizens have become an important force in large corporations. Thus, focusing on the presumed powers of a capitalist elite may not be well justified.

Agency theory

Once considered the exclusive domain of finance and economic research, agency approach is among the most recognized in research on the contribution of boards. The fourth and final perspective on boards, agency theory argues that agency relationships should be the focal point in analyzing and studying corporate governance. Agency theorists believe that owing to dispersion of corporate ownership, executives (called 'agents') possess considerable freedoms and powers. Left alone, these executives are believed to pursue objectives that may contradict the goals of the principals ('owners'), hence shareholders' wealth maximization may be overlooked (Masson, 1971). Within this context, boards perform the critical function of monitoring and rewarding top executives to ensure maximization of shareholders' wealth, as suggested in Table 7.1. In essence, the board is seen as the ultimate mechanism of corporate control.

Following this approach, board contribution to organizational performance occurs by reducing agency cost arising from noncompliance of executives with established goals and procedures, by articulating shareholders' objectives and focusing the attention of key executives on company performance, and through strategic decision making and control (Mizruchi, 1983).

Figure 7.4 presents the agency theory perspective on how boards influence company performance. Agency theory offers a comprehensive definition of board attributes of composition, characteristics, decision process, and structure. This definition is similar to that of the legalistic approach with a notable exception. Agency theorists have shown more attention to board decision making processes than have legalistic scholars. This emphasis is consistent with agency theorists' interest in how boards perform their job and how they monitor managerial actions to reduce agency cost.

It is important to note that agency theory places a premium on a board's strategic contribution, specifically the board's involvement in and

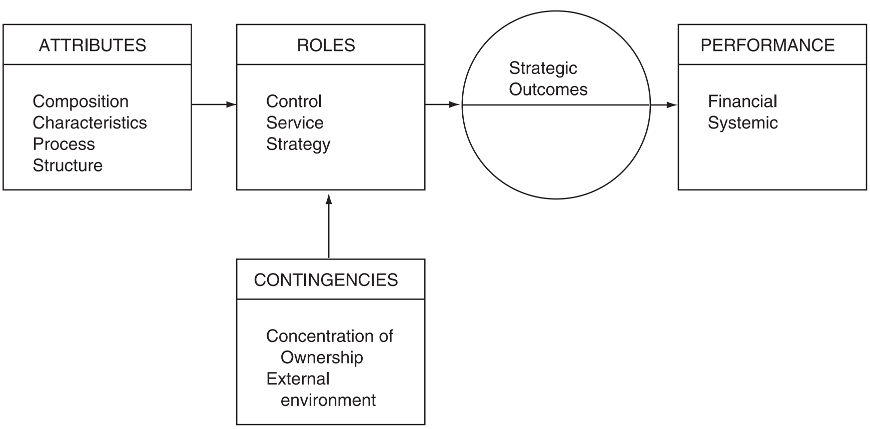

Figure 7.4 An agency theory model of links between board variables and company performance.

Note: Variables are listed in the model according to their apparent importance in research using this perspective.

contribution to the articulation of the firm's mission, the development of the firm's strategy, and the setting of guidelines for implementation and effective control of the chosen strategy. Although existing literature does not fully define the content of this strategic contribution, advocates believe that it becomes evident at those critical points when important choices must be made. Examples of critical choices are acquiring a new firm, divesting a division, or negotiating a takeover bid (Baysinger & Butler, 1985; Kosnik, 1987).

Figure 7.4 shows that agency theorists adopt a broad definition of board roles. Control is the most important board task, followed by service and strategy. This order is different from the resource dependence perspective, summarized in Figure 7.2. The internal control role is the most important of the three roles, according to agency theorists.

Two major contingencies determine a board's performance of its roles: concentration of ownership and the characteristics of the firm's external environment, as depicted in Figure 7.4.

Agency theorists emphasize the financial and systemic components of organizational performance. In that, they are similar to the class hegemony scholars. Yet, they do differ: agency theorists use primarily market-based measures in evaluating financial performance and in determining the value of the organization (Kaen, Kaufman, & Zacharias, 1988). Class hegemony scholars use accounting measures.

Agency scholars pay special attention in their empirical analyses to the direct link between board roles and company performance. Of paramount importance to them is the control role. In assessing the role of the board as a vehicle of corporate control, researchers tend to focus on executive compensation decisions (Brindisi, 1989; Brossy, 1986). They posit that compensation decisions tend to reflect a board's pleasure or displeasure with CEO's performance and leadership (Kerr & Bettis, 1987). Compensation decisions are thought to reveal a board's evaluation of managerial competence and the CEO's contribution to the overall goal of increasing shareholders' wealth.

Despite its popularity, the agency perspective has three shortcomings. First, the agency notion is founded on some questionable assumptions about CEO ('agent') values and motives (Kaen et al., 1988). Agency theorists start their analyses with the assumption that CEOs, driven by self-interests, will deviate from the shareholders' mandate. By accepting this assumption without debate, agency theorists ignore rival and more contemporary theories of the firm. These theories posit that companies must contribute to the quality of life in their communities and societies. Failure to perform this important social responsibility role may undermine shareholders' long-term interest. Therefore, in balancing conflicting demands on the firm, CEOs' deviation from short-term wealth maximization may be prudent (Goodrich, 1987).

Second, like the legalistic scholars, agency theorists have thus far failed to document the extent to which directors perform their different roles and how they make decisions. Thus, the assumption that directors do a credible job in monitoring CEO and senior executives' performance lacks support.

Third, although the agency perspective emphasizes the crucial importance of the board's strategic role, little documentation of this role exists. Also, and perhaps more serious, board critics charge that board strategic contribution is too infrequent to make a significant difference in company performance. These critics suggest that CEOs do not want directors to participate in designing or implementing strategies that are considered to be within the CEO's domain (Rosenstein, 1987). These critics also suggest that poor director selection and ineffective board decision-making processes handicap directors' strategic contribution.

The above review shows that four perspectives have dominated research on boards. These perspectives differ in their theoretical and methodological orientations. Of these perspectives, the class hegemony remains the most controversial because of its political underpinnings. In contrast, the agency perspective is gaining momentum because of its comprehensive definition of the board role and its recognition of the imperfection of existing governance structures in protecting shareholders' interest. Agency theorists do not ignore this potential conflict between agents and principals. Rather, they build their notions of governance around it.

As battles for corporate control continue to rise (Hector, 1988), we believe that more scholars will look to the agency perspective as an appropriate framework. This does not mean that other perspectives will be abandoned. Instead, we believe that there are many opportunities for linking the resource dependence, legalistic and agency perspectives. The empirical study by Kosnik (1987) is an example that illustrates a creative synthesis of the literature.

Toward an integrative model

In combination, the four perspectives contrasted in Table 7.1 identify three important board roles: service, strategy, and control. Our review disclosed a wide gap between the normative literature's recognition of these board roles and empirical documentation of the extent to which each is performed in reality.

For instance, though the control roles are well recognized in the normative literature (Vance, 1983; Waldo, 1985). Research has shown that many boards fail to monitor CEO performance or evaluate CEO decisions, such that board analyses of corporate performance are often perfunctory (Fleischer et al., 1988; Loevinger, 1986). Thus, boards' performance of their control role is often inadequate.

Research support for the service role is strong (Vance, 1983) but equivocal. Critics charge that boards have failed to develop appropriate codes of conduct for their executives and employees (Leibowitz, 1978). In essence, directors have failed to reflect changing societal values in shaping corporate identity because boards lack requisite power to bring about desired changes in the role of the corporation.

Similarly, despite the perceived need to involve boards in the strategic arena (Bavly, 1985; Rosenstein, 1987; Tashakori & Boulton, 1983), empirical evidence is that the contribution of directors in this regard has been very limited (Henke, 1986). However, a growing recognition of the importance of directors' professional expertise in developing, implementing, and refining strategies within their own firms has prompted much new research (Estes, 1980; Kreiken, 1985; Rosenstein, 1987). Among recent findings are that directors function as boundary spanners who have access to information vital to the diagnosis of opportunities and threats. Therefore, directors can aid managers by mapping or reviewing strategic actions (Harrison, 1987; Kreiken, 1985; Tashakori & Boulton, 1983; Waldo, 1985). It has also been argued that the performance of the fiduciary responsibility vested in directors requires attention to strategic concerns. Executive performance cannot be evaluated reliably without an appreciation of the strategic issues facing the firm (Kreiken, 1985; Waldo, 1985).

Overall, empirical research on the strategic role of boards is in the infancy stage. Preliminary results show that directors are not as actively involved in the strategic arena as agency theorists desire.

The tentative nature of empirical evidence on performance of the three board roles may be partially explained by the shortcomings of past research. These research efforts have often been limited in scope, based on convenience samples, and inconsistent in operationalization of board variables. Moreover, the bulk of this research has focused on the direct associations between board attributes and company performance, thus ignoring the indirect path (through roles and strategic initiatives) discussed by the four theoretical perspectives. These limitations suggest that caution is advised in interpreting empirical findings on the relationship between board roles and company performance.

The above observations do not imply that a conflict exists between theory and empirical results. Rather, they suggest that some boards may not always do a good job in performing each role because of poor board structure, inappropriate composition, or the domination by CEOs of board decision-making processes. Thus, without a well-designed strategy to develop and activate boards, the three roles will be poorly performed. In turn, the full potential of board contribution to company performance may not be reached. Before valid empirical evidence can be produced, an integrative model of board roles and their correlates (covariates) is needed. Such a model will help to pinpoint the various dimensions of board roles, their multiple antecedents, and possible directions of relations among variables. Such a model will not only achieve desired theoretical integration, but also will add precision to an area fraught with contradictory empirical findings. Such a preliminary model is presented in the following section.

An integrative model

The four perspectives on board roles suggest an integrative model that synthesizes past research and specifies relationships between board variables and company performance. Our depiction is shown as Figure 7.5, labelled The Model of Board Attributes and Roles. The following sections will explain the inclusion, positioning, and interactions among the critical elements of the model.

The Model builds on past research and, perhaps more importantly, advances specific links among board variables and their influence on company performance. Three important features of the Model deserve attention. First, it explicitly recognizes the contingent nature of relationships among board variables (attributes and roles) and company performance. These relationships depend on several internal and external contextual contingencies identified in the Model.

Second, the Model advances a specific sequence of relationships among variables. Grounded in theory and empirical research, this sequence offers a means of integrating diverse research streams. Of course, different researchers may place varying degrees of emphasis on different components of the Model, depending on their theoretical orientations.

Third, the Model explicitly recognizes the multidimensional nature of company performance, a point that has been highlighted in past theoretical writings but somehow escaped empirical attention. To appreciate the importance of the above three features, consider the Model (Figure 7.5).

The starting point in the Model is the set of contextual contingencies that

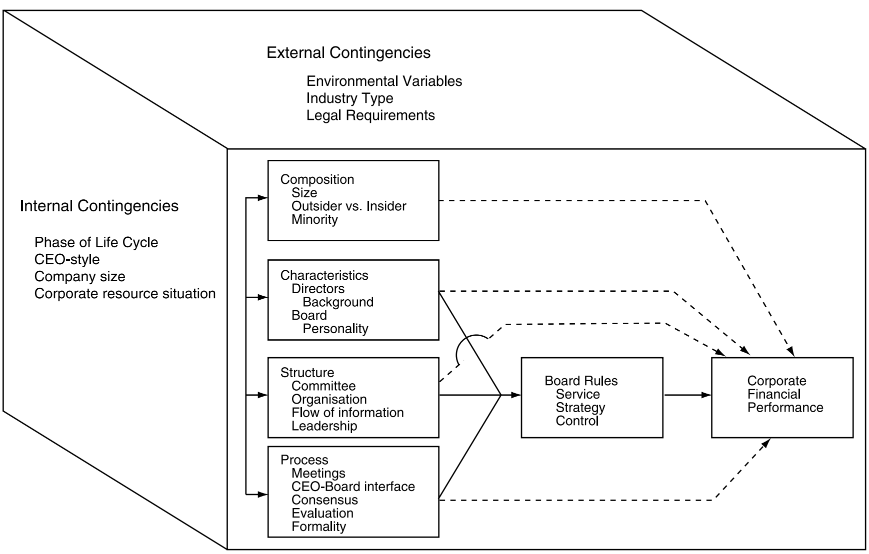

Figure 7.5 Model of board attributes and roles.

influence a board attribute, the conduct of its roles and, ultimately, its contribution to company performance. In a manner that the literature has yet to define in detail, board attributes must possess a beneficial match with internal and external contextual factors to productively facilitate board execution of its three roles. The Model identifies several such internal and external contingencies.

External considerations include the characteristics of the firm's remote environment, its industry, and its legal requirements (Vance, 1983). Internal variables include type of ownership, phase of company life cycle, complexity of internal operations, and the style and preferences of the CEO (Mueller, 1979; Vance, 1983).

In combination, internal and external contingencies determine the mix of the board attributes and, in turn, a board's performance of its three roles and, ultimately, on company performance. For instance, an entrepreneurial company competing in a dynamic market will need a board that differs in its attributes from that found in a well established firm that competes in a mature industry. These two different firms will also require different attention by directors to the three board roles. Hence, boards' effect on company performance will occur for different reasons. Including internal and external contingencies explicitly in the Model allows better determination of the relative contribution of board attributes and role to company performance within given contexts.

Four attributes

Attributes determine a board's undertaking of its roles and, ultimately, its contributions to company performance. Our review of theoretical perspectives identified four board attributes: composition, characteristics, structure, and process. These attributes are important building blocks in the Model. Although discussed separately below, these four attributes should be viewed as highly interrelated. Furthermore, the discussed set of attributes is not necessarily exhaustive; others may be added as corporate practices evolve or as research evidence clarifies the nature and parameters of board roles.

Finally, each board attribute embodies several pertinent elements that may contribute indirectly, through board roles, to company performance. The most important of these elements are highlighted in the Model based on previous empirical research that will be reviewed below. However, the list is not exhaustive; other elements may be added based on future research findings.

Board composition denotes the size of the board and the mix of director types. Size refers to the number of directors who serve on the board. Type refers to the widely recognized dichotomy between inside and outside directors. Outsiders are not members of the top management team, their associates, or families; are not employees of the firm or its subsidiaries; and are not members of the immediate past top management group (Jones & Goldberg, 1982). Minority representation refers to the status of ethnic minorities and the representation of females on the board. These directors are presumed to reflect the values of society at large, not only those of the shareholders. Thus, Figure 7.5 highlights three composition variables: size, type of directors and minority representation.

Characteristics consists of two components. The first, labelled 'directors' background,' reflects the age, educational background, values and experience of directors. These qualities will manifest themselves in the choices directors make (Hambrick, 1987).

The second component pertains to those qualities that transcend directors' individual or collective characteristics and reflect the 'personality' of the board. Board scholars suggest that boards develop their distinct styles or modes of operations or personalities (Lynch, 1979; Mueller, 1981). This personality reflects a board's disposition to focus on internal (e.g., efficiency) versus external issues, such as effectiveness (Pearce, 1983); level of directors' independence from management influence (Geneen, 1984); and their vested interest in the firm as evidenced by stock ownership (Kesner, 1987). Board personality is believed to be more enduring than the characteristics of individual directors (Lynch, 1979). This personality is thought to change only if a significant, quantum change occurs in board composition and directors' background variables.

Board structure refers to the dimensions of the board's organization. As shown in Figure 7.5, it covers the number and types of committees, committee membership, the flow of information among these committees, board leadership, and patterns of committee membership.

Process signifies the approach the board takes in making its decisions. Past research shows that board process embodies five elements: the frequency and length of meetings, CEO-board interface, level of consensus among directors on issues at hand, formality of board proceedings, and the extent to which the board is involved in evaluating itself (Mueller, 1979; Vance, 1983).

Relationships in the model

The Model suggests that there is a temporal linkage among board attributes. Before this link is discussed, a caveat is necessary. The sequence among board attributes depicted in the Model, though appearing to be logical, may need modifications as simultaneous and reciprocal relationships are identified in future research. The proposed sequence, therefore, does not preclude interactive relations among board attributes.

With this qualification in mind, the Model proposes that, first, composition influences directors' characteristics. To illustrate, consider board composition. If the number of outside directors on the board increases, certain board characteristics will become more apparent. Specifically, outsiders may show more objectivity in their deliberations and may consider diverse groups in addition to shareholders in making their recommendations.

Similarly, when minority groups are represented on boards, the mix of directors characteristics (e.g., values, orientation, and education) will vary.

Second, the Model suggests that board characteristics will affect board structure. Directors with different expertise, education, and interests are likely to serve on committees that reflect and benefit from these characteristics (Kesner, 1988). Structure is also affected as a board grows independent from management. Specifically, the board is likely to develop its internal channels of communication and to separate its leadership from the position of the CEO.

Third, the Model portends that board structure will shape its internal processes. For example, the pattern of committee staffing will profoundly affect the frequency and content of meetings, a major component of board processes.

Board dimensions and corporate performance

As suggested in the Model (Figure 7.5), the impact of boards on company performance can occur directly and indirectly. The direct effects of boards take place through the association between board attributes and company performance (depicted by dashed lines). The indirect route represents the effect of board attribute on the board's performance of its three roles, which in turn influence company performance (depicted by solid lines). To date, most empirical studies have focused on the direct effect of board attributes on company performance, even though our review of agency theory and the legalistic approach suggests that the indirect link is more plausible. This is because indirect links take into account the interrelationships among board variables, the contingencies that influence boards' performance of their roles, and the amount of influence that directors exert on senior executives' strategic initiatives.

The bulk of past empirical research has also been devoted to examining the direct effect 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, therefore, should explore the indirect link among board variables and the systemic and social components of company performance.

Board attribute – role linkages

Numerous studies have documented the direct consequences of board attributes on the effective execution of directors' roles. Illustrative empirical studies of these linkages are presented in Table 7.2. These links are discussed briefly below.

Table 7.2 Illustrative studies of board roles and functions

Board Attributes	*Board Roles*		
	Service	*Strategy*	*Control*
Composition	Mace (1971) Pfeffer (1972) Helmich (1980) Provan (1980)	Baysinger & Zeithaml (1985) Judge & Zeithaml (1987) Zahra & Stanton (1988)	Mace (1971) Kesner, Victor & Lamont (1986) Molz (1988)
Characteristics	Zald (1969) Pfeffer (1973) Provan (1980)	Pearce (1983) Kosnik (1987)	Mace (1971) Chitayat (1980) Molz (1988)
Structure	Berg & Smith (1978) Kesner (1988) Jemison & Oakley (1983)	Tashakori & Boulton (1983) Henke (1986)	Dalton & Kesner (1987) Jemison & Oakley (1983) Kesner (1988)
Process	Chitayat (1981) Miller & Norburn (1986)	Tashakori & Boulton (1983) Kohls (1986)	Mace (1971) Zahra & Pearce (1987) Kerr & Bettis (1987)

Composition

Board size and type of membership have been found to influence the service (Mace, 1971), strategy (Baysinger & Zeithaml, 1986), and control roles (Kesner et al., 1986).

Concerning the service role, research indicates that without appropriate board composition, directors may fail to help the firm in achieving its goals (Patton & Parker, 1988). For example, boards that have a majority of their members as outsiders are in a position to establish viable links with different sectors of the external environment. Given the diversity and breadth of their expertise, outside directors are in a position to provide counsel to management. Outsiders are also conducive to successful fund raising in not-for-profit firms because of their connections and professional personal reputation. In case of profit-oriented firms, these outsiders are crucial in securing essential resources for the firm (Pfeffer & Salancik, 1978). These observations indicate that effective board composition is essential to successful performance of the service role.

Composition also plays an important role in enhancing the performance of its control role. Larger boards are not as susceptible to managerial domination as their smaller counterpart. They are also more likely to be heterogeneous in member background, values, and skills. Thus, they are likely to resist managerial domination and present shareholders interest. Therefore, these boards will be more actively involved in monitoring and evaluating CEO and company performance, normally through specialized committees.

Finally, composition is important for performance of the strategic role. Larger boards, the presence of a majority of outsiders, and the representation of minority groups (Figure 7.5) are presumed to be more conducive to debate and discussion of the firm's mission, goals, and appropriate strategy. Such debates enlarge the basis of expertise, force management to consider a wide range of options, and clarify constraints within which strategy implementation should proceed. Thus, composition variables may determine the level and nature of board strategic role.

Characteristics

Research shows that specific board characteristics are essential for the effective performance of the board's three roles, as summarized in Table 7.2. Each role requires distinct skills and abilities. For instance, directors' professional competence and prestige are necessary for legitimizing the firm service. A healthy balance between external effectiveness and internal efficiency is necessary for a strategic role. Independence from management is necessary for the control role (Molz, 1988).

Structure

As depicted in the Model, effective structure is also a major condition for effective board roles in service, strategy, and performance. To perform the service successfully, appropriate committees should be established (Jemison & Oakley, 1983). Committees such as public policy and social responsibility make it possible for the firm to identify major societal concerns that are likely to influence company performance (Kohls, 1986).

Specific features of board structure are also important for performance of the strategic role. The existence of long-range planning (Brown, 1981), technology (National Association of Corporate Directors, 1982), and public policy/social responsibility (Kohls, 1986) enable directors to study issues in depth and offer specific suggestions for managerial action. At a minimum, these committees enable directors to evaluate managerial initiatives.

A second structural issue that affects the strategic role of boards is the flow of information between the CEO and directors (Tashakori & Boulton, 1983). Without access to managerial analysis, directors are not in a position to contribute meaningfully to the strategic initiates under examination.

Board structure also plays an important role in determining directors' success in executing their control roles. A well staffed and run audit committee, for instance, is essential to evaluating CEO and company performance. Also, directors' access to timely and reliable control data makes it possible for them to monitor progress in achieving company goals.

Process

The Model suggests that board processes also influence the three roles of the board, as supported by past research summarized in Table 7.2. Effective meetings are essential for a successful board service role. Effective meetings require that a well thought out agenda be distributed, along with pertinent data, to directors beforehand; that meetings be held promptly; that issues are discussed in sufficient depth; that dissenting directors have a forum to express their views freely, but without monopolizing the discussion; that a true majority of directors make decisions, rather than acquiescing to the CEO; and that good minutes of meetings are kept for documentation of progress made (Milles, 1981; Mueller, 1981; Vance, 1983).

An effective process is required for a successful board service role. Shareholders and interested publics need to be assured that the board is genuinely active in shaping the firm's identity and advancing its goals. Effective processes will enable the board to identify issues of concern to the firm and ensure that a plan for managerial succession is in place.

Process is also important to the performance of a board's strategic role. It encourages discussion, evaluation and, occasionally, initiation of strategic proposals.

Finally, an effective process is required in performing the control role. For example, frequent evaluations of CEO and company performance by the board or a standing committee will result in feedback for appropriate corrective actions.

The above discussion supports the claim that attributes are important for the successful execution of board roles, a prerequisite for effective company performance. We believe that board characteristics, structure, and process exert a significantly stronger influence on board roles and company performance than board composition. Past research on composition 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.

Direct effect of board attributes on company performance

An impressive number of studies have been conducted over the past 25 years to document the consequences of the four board attributes on company performance. This research focuses on the direct associations between the four board attributes and company performance, as shown by the dashed line in the Model (Figure 7.5). Note that the bulk of this research stresses only the financial component of company performance. Therefore, in reviewing this extensive body of research, we will center on financial criteria even though our Model adopts a more comprehensive view of organizational performance.

In the following sections, we review the research traditions and findings on each attribute. In doing so, we will emphasize those relationships found to be significant (p<.05) in prior empirical work. The review yields identification and support for the components of each board attribute set shown in the Model of Board Attributes and Roles (Figure 7.5), and an evaluation of the progress made to date in determining the effect of boards on company performance.

Composition

The importance of board composition is prominently recognized in each of the four perspectives on board research. For the legalistic and agency schools, composition variables reflect the extent to which management dominates the board. This is often judged by the ratio of outside to inside directors. Outside directors are considered essential for ensuring an effective system of checks and balances. For class hegemony theorists, board composition indicates whether selective recruitment of new directors is done in a way to preserve capitalist interests. Finally, for resource dependency scholars, board composition mirrors the characteristics of the firm's environment, helping the firm acquire resources vital to survive and grow (Pfeffer & Salancik, 1978).

Because of the diversity of perspectives on board composition, three variables have been explored in past research and appear in Figure 7.5: overall size, representation of outside directors, and the representation of minority directors, especially women. Table 7.3 summarizes studies that examined board composition as a correlate of company performance. Six of these studies examined the effect of overall size, and 11 examined the effect of outside directors.

Board size. Prior research has frequently used size as a proxy measure of directors' expertise (Bacon, 1973; Herman, 1981). In these studies, larger board size was predicted to relate positively to company financial performance. Larger boards were assumed to have directors with diverse educational and industrial backgrounds and skills and with multiple perspectives that improved the quality of actions taken by the firm. Larger boards were viewed as being essential to coopt multiple aspects of the firm's environment, thus securing resources and establishing a favorable image for the company. Finally, it was suggested that as board size increased, CEO domination of the board became more difficult and directors were in an improved position to exercise their power in governing the corporation. Therefore, a positive relationship between board size and company performance was universally postulated.

Board size has been seen to affect company performance indirectly. For instance, Helmich (1974) found that a large board size was associated with effective CEO succession patterns, a requisite for effective corporate performance. When the board was large, directors were in a position to avoid inbreeding by selecting competent outside executives to lead the firm. Helmich's conclusions urged stability in determining board size to create

Table 7.3 Board composition and organizational financial performance

Study (Year)	*Dimensions*	*Organization Performance Criteria*	*Sample*	*Analytical Approaches*	*Major Findings*
A. *Size*					
Pfeffer (1973)	Criteria for member selection Board size	New programs over five year period Percent increase in number of beds Percent increase in budget between 1965–70	57 short-term, general care hospitals in a large mid-western state	correlations	Board composition reflected sources of funding. Board functions varied by the type of organizational ownership.
Provan (1980)	Size Percent male on board	Amount of intra-agency funding External funding Bequest	46 non-profit agencies	regression	1. Board size and performance were positively related. 2. Male ratio and company performance were not associated.
Zahra & Stanton (1988)	Board size Outsiders' ratio Minority ratio	ROE Profit margin on sales Net sales-to-equity EPS DPS Log profits	100 *Fortune 500*, 1980–1983	canonical analysis	Board size and outsiders' ratio were not associated with financial performance.
B. *Inside-Outside*					
Vance (1955)	Insiders vs. outsiders	Net income Sales Owners' equity	200 major manufacturing companies (1925–1950)	regression	Insiders' representation was positively associated with financial performance.
Vance (1964)	Insiders vs. outsiders	Net income Sales Owners' equity	103 major industrial firms (1925–1963)	regression	Insiders were conducive to effective financial performance.

(*Continued overleaf*)

Table 7.3 continued

Study (Year)	*Dimensions*	*Organization Performance Criteria*	*Sample*	*Analytical Approaches*	*Major Findings*
Pfeffer (1972)	Deviation from an ideal insider-outsider ratio	Income/sales Income/equity	80 manufacturing corporations	Spearman correlation	Firms that deviated from an ideal ratio performed more poorly compared to the industry.
Schmidt (1975)	Insiders vs. outsiders	Long-term debt Dividends Current ratio	80 chemical companies (1962–1971)	regression	No relationship with financial performance.
Schmidt (1977)	Outsiders' financial affiliation	Current ratio ROE Net working capital per sale dollar Long term debt ratio	156 industrial firms	chi-square Z-statistic	No relationship between outsiders' affiliation and company financial performance
Kesner (1987)	Proportion of insiders on board Percent of stock held by board Value of stock by board	Profit margin ROE ROA EPS Stock price Return to investors	250 of 1983 *Fortune 500* companies in 27 industries	correlations	1. Stock ownership by board was not associated with financial performance. 2. In low growth industries, the stockholdings by board performance relationship was not significant. A positive relationship was found in high growth industries.
Chaganti et al. (1985)	Size Outsiders	Firm bankruptcy	21 pairs (successful/failing) of retail firms.	t-test	1. Smaller boards were associated with a higher rate of bankruptcies. 2. No relationship was found between the proportion of outsiders and corporate success/failure.

Cochran, Wood & Jones (1985)	Insiders' representation	Operating income Sales ROE ROA Excess value ratio (market value-book value) Incidence of golden parachutes	406 *Fortune 500* in 1982	correlation logit regression	1. Insiders' ratio was positively associated with financial performance measures. 2. Incidence of golden parachutes offered to the top management team was inversely related to insiders' ratio.
Kesner, Victor & Lamont (1986)	Outsiders Board leadership type	Number of illegal acts by the firm	384 *Fortune 500* firms between 1980–1984	correlation	There was no relationship between the number of illegal acts committed by the firm and outsiders' proportion, firms with a majority of outsiders or insiders, subsequent outsiders' representation, and dual or unitary board chairmanship.
Baysinger & Butler (1985)	Outsiders	ROE	266 major corporations in 1970 and 1980	cross-lagged regression analysis	Companies that had more outsiders on their boards in 1970 outperformed their counterparts in 1980. In addition, companies that achieved higher performance did so without having a majority of outsiders.
Zahra & Stanton (1988)	Board size Outsiders' ratio Minority ratio	ROE Profit margin on sales Net sales-to-equity EPS DPS Natural Log of profit	100 *Fortune 500*, 1980–1983	canonical analysis	Board size and outsiders' ratio were not associated with financial performance.

parallel internal stability in corporate leadership, another important predictor of company performance.

As Table 7.3 shows, three studies investigated the direct effect of board size on company performance. Provan (1980) and Zahra & Stanton (1988) found that large board size was conducive to effective performance. Moreover, Chaganti, Mahajan and Sharma (1985) found that small boards were associated with a higher rate of corporate bankruptcy. The implication was that large boards were conducive to long term organizational survival.

The uniformity of the findings of the above three studies on the impact of board size on company performance should be interpreted with caution. Hiner (1968) argued that there is a threshold where board size may have a negative effect on company performance. As board size increases, it may become difficult for directors to reach decisions in a timely fashion because of the existence of rival factions and cliques that may slow its proceedings. Thus, we hypothesize that the relationship between board size and company performance is non-linear, representing an inverted U. Unfortunately, the above studies ignored the possibility that board size on company performance is non-linear. The studies also ignored the lag effects of board size on performance; it often takes time for changes in board size to influence performance appreciably.

Outsiders' representation

Agency theorists, legalistic scholars, and anti-class hegemony activists have all highlighted the necessity of increasing the relative number of outside directors. Reported advantages of this approach include increasing board independence for management, increasing directors' objectivity, representing multiple perspectives on the contemporary role of the firm, and enhancing the expertise of directors (Jones & Goldberg, 1982; Spencer, 1983).

Others scholars have disputed the purported contribution of outsiders. They suggest that these directors do not have the requisite time and expertise to do their job well. Some claim that outside directors are chosen and retained by the CEO and function on information provided by the CEO (Geneen, 1984; Vance, 1983). Despite this debate, it appears that board composition should be examined to determine if an effective balance between insiders and outsiders exists.

Three approaches have guided researchers' efforts in exploring the effect of outside director representation on company performance. These approaches are summarized in Table 7.3 and are discussed briefly below:

Number of outsiders: As Table 7.3 shows, Vance (1955, 1964, 1968) pioneered research that examined the association between the overall number of outsiders and company performance. His findings suggested that boards that had fewer outsider directors were associated with superior company performance. Despite the consistency and importance of Vance's results, his use of the absolute number of directors did not capture their relative power on the board.

Industry inside-outside norm: Building on the resource dependence tradition, Pfeffer (1972) proposed that an ideal ratio of inside-outside directors existed, and that this ratio was unique to each industry. Deviations from this norm had a negative effect on company performance because this ideal ratio corresponded to demands of survival in a given industry. For instance, in a volatile business environment, a disproportionate number of outsiders was necessary to reduce uncertainty in a firm's operations and to secure critical resources. Pfeffer's empirical results provided limited support for his arguments.

Outsider dominance: Some researchers have argued that simply increasing the number of outside directors is not sufficient to reform a board. Instead, a majority of outsiders is necessary to command sufficient power to challenge chief executive officer's (CEO's) dominance.

In operational terms, researchers measured the power of outsiders by emphasizing either outsider proportion or dominance. Proportion was calculated by dividing the number of outside directors to board size. In contrast, 'dominance' denoted the existence of a large majority of outside directors on the boards, and was treated as a dichotomous variable (outsider vs. insider controlled).

Four studies used both proportion and dominance as predictors of company performance (Kesner, 1987; Kesner, Victor, & Lamont, 1986; Rechner & Dalton, in press; Zahra & Stanton, 1988). As Table 7.3 shows, these studies found no significant differences between boards that were dominated by outsiders and those that were not.

One study used both the absolute number of outsiders and their proportion to board size as predictors of overall corporate performance. Rechner and Dalton (in press) found that only the overall number of outsiders was associated positively with the financial performance measures.

In summary, research on the potential impact of outside directors' representation on corporate performance yields mixed results. Overall, evidence favors a majority representation of inside directors as a prerequisite of performance. This observation should be weighed against three methodological limitations of the studies reviewed. First, there was an apparent lack of uniformity in defining outsiders. In fact, it was not clear when to use the absolute number, proportion, or dominance measures of outside directors' representation. In fact, the relative merits and limitations of each have yet to be defined.

Second, an examination of the analytical approaches used to study the issue shows a widespread use of simple univariate techniques even when the measures were interdependent. As a result, past researchers have failed to account for the interrelationships among the measures, thereby raising suspicions about the results.

Third, the rationale for studying outsider representation centered on the possibility that these directors were more objective, independent, and experienced than inside directors. However, no attempts have been made to determine the association between outside director classification and these qualities.

Minority representation

As Table 7.3 shows, one study examined the association between minority (females and racial minority groups) representation on boards and corporate financial performance. Zahra and Stanton (1988) found that the association was not significant. This finding was not surprising because of the limited representation of females on boards that were studied (i.e., typically, one woman per board). The difficulty of finding boards with more than one female director was supported by results from two studies that attempted to define the determinants of the representation of females on corporate boards. These studies were excluded from Table 7.3 because they did not include specific corporate financial performance measures. In the first, Harrigan (1981) collected data from 112 publicly traded firms. Her results showed that 79.5% of these firms did not have women on their boards.

In the second, Elgart (1983) collected data from 143 *Fortune 500* companies. He found that the representation of females on boards was associated with sales volume and the type of industry in which firms operated. In addition, Elgart found that three factors led to the low representation of females on boards: a belief that boards were already staffed by capable directors, the difficulty in finding qualified females, and opposition by corporations to the concept of recruiting directors of particular background to represent specific constituencies.

Summary

The foregoing summary on the contribution of board composition to company performance leads to an important point. Board size, outsider representation, and minority representation should be examined systematically, as depicted in the Model of Board Attributes and Roles (Figure 7.5). Despite the tentative evidence, previous research suggests that board composition profoundly impacts directors' characteristics (Pennings, 1980; Provan, 1980). Further, in view of the contradictory findings reported to date, researchers should focus on the implications of composition for other board attributes and roles if the impact of composition on company performance is to be ascertained.

Characteristics

The literature is replete with articles that describe and catalogue the characteristics of an effective board (Aram & Cowen, 1983; Castaldi & Wortman, 1984; Vance, 1983). Certain characteristics are thought to encourage or limit potential interlocks (Pennings, 1980); ensure a firm's access to vital resources (Pfeffer & Salancik, 1978); strengthen a director's power through the CEO (Dalton & Kesner, 1987); and determine the board's ability to monitor company performance. However, only a modest amount of empirical evidence exists on the importance of these characteristics to company financial performance. This situation is surprising because all four perspectives on board research have stressed the importance of board characteristics as summarized in Table 7.1.

Past research on characteristics has been unified by a dominant theme; namely, identification of the factors that resulted in a powerful board. Because boards function at the nexus of the environmental-organizational link, directors were expected to deal with the internal and external contingencies that were viewed as essential to enhancing company performance (Provan, 1980: 222). To deal with internal concerns, directors were expected to possess appropriate education, training, and experience (Zald, 1967). To deal with external uncertainties facing the firm, directors were seen to need to establish appropriate links with political, financial, or competitive collaborators (Pfeffer & Salancik, 1978).

In profit-seeking corporate settings, research has taken two approaches to determine the characteristics of a powerful board, as summarized in Table 7.4.

The first approach was based on the belief that there was merit in integrating research on board characteristics and composition. The two studies that exemplify this perspective (Vance, 1978; Pearce, 1983) are summarized in Table 7.4. Perceiving the need to go beyond the traditional dichotomy between insiders and outsiders, Vance (1968) developed a model of 10 important board characteristics: technical expertise, management expertise, specific economic service, director economic sophistication, image, asset impact, corporate interlocks, percentage of patronage, owners equity, and membership contact. A decade later, Vance (1978) tested and validated his model. His results showed that the degree of insider representation on the board was associated positively with company financial performance. In contrast, emphasis on special interest groups and reliance on the expertise of outside directors were associated negatively with performance.

Pearce (1983) attempted to overcome some of the weaknesses of past composition research by focusing on directors' orientation toward internal efficiency issues versus external effectiveness concerns. He measured directors' concern for internal factors of cost control, employee relations, organizational structure, employee utilization, and quality control relative to their concern for external factors, including services and programs to meet community needs, relations with government agencies, relations with competing firms, relations with community groups and capital investment. Pearce's results showed that director orientation (internal vs. external) was more strongly associated with financial performance than the traditional insider-outsider director classification. For his small sample of banks, a significant, positive relationship was found between a board's internal orientation and firm profitability.

The above two studies (Pearce, 1983; Vance, 1978) shared a common theme: their emphasis on directors' orientation. These authors, however,

Table 7.4 Board characteristics and corporate financial performance

Study (Year)	*Dimensions*	*Organization Performance Criteria*	*Sample*	*Analytical Approaches*	*Major Findings*
Vance (1978)	Insidedness External expertise Interest groups Asset impact	Total return to investors Changes in *Fortune* rankings Return on stockholders capital	40 large manufacturing corporations (1966–1976)	frequency analysis cross-tabulation	Performance was related positively to board insidedness, negatively to reliance on external expertise, and negatively to increased focus on interest groups.
Pearce (1983)	Internal vs. external orientation	Profit margin ROA ROE Return on interest spread Net charge-off to average loans Loan growth Loans/deposits-Capital to assets	137 respondents in eight banks	Spearman correlation	Director orientation (internal vs. external) was strongly associated with performance while insider-outsider ratio was not.
Norburn (1986)	Director background, beliefs, and attitudes	Industry average performance	354 directors (18 industries)	regression ANOVA	Director's background, attitudes and beliefs, and industry performance were significantly associated.

viewed orientation differently. Whereas Pearce examined directors' strategic orientation, Vance attempted to determine whether the board members reflected the characteristics associated with insiders or outsiders. Clearly, these two viewpoints were complementary and both deserved attention from scholars. Yet, consistent with the popularity of the agency perspective, strategic orientation (Pearce, 1983) took added significance.

The second approach to studying board characteristics was developed by Norburn (1986). This author examined several director characteristics including their early background, education, experience, beliefs, and attitudes. Norburn's findings showed that directors in growth industries were characterized by nine different factors, such as short tenure with their firms, wide exposure to other cultures, and disposition to use participative decision styles. In turbulent industries, directors exhibited a different profile. They were marketing oriented, valued career mobility rather than loyalty to a certain company, had little international exposure, and were people-oriented in their managerial styles. In declining industries, still a third profile of directors emerged. These directors were motivated by monetary rewards, had little international exposure, valued individual-type sports, were older than directors in other industries, and placed a premium on integrity as the hallmark of managerial excellence.

Norburn's study showed that three industry settings – growth, turbulence, and decline – were associated with distinct director traits, abilities, beliefs, and skills. As such, Norburn (1986) has provided an important glimpse into the psychological and cognitive components of director behavior. These variables shaped directors' characteristics and skills and may have manifested themselves in the varying levels of company performance.

In summary, the Model of Board Attributes and Roles (Figure 7.5) reflects the results of prior research on board characteristics insofar as it highlights the importance of board characteristics for effective corporate financial performance.

Three additional findings emerge from Table 7.4 regarding research on board characteristics. First, the studies showed more careful attention on the part of researchers to the operationalization of board variables. In all the studies reviewed, multiple items were employed to gauge board dimensions, which was a significant improvement over board composition research summarized in Table 7.3. Second, the analytical tools were carefully chosen to capture the interrelations among board characteristics. Researchers moved away from the simple correlation analysis that was stressed in most board composition studies to the use of more sophisticated techniques. Finally, although little attention has been given to reaching an agreement on a definition of relevant board characteristics, several variables have been found to be associated with company performance. To move research forward, future investigations should examine the consequences of these characteristics for board roles and, ultimately, performance.

Structure

An evolving research stream suggests that the internal structure of the board is a major determinant of financial performance. Efficient board structure is thought to facilitate directors' involvement in shaping the mission and strategies followed by the firm, and in strengthening the position of directors relative to that of the CEO. As depicted in Figure 7.5, board structure refers to its internal organization, as judged by the division of activities among committees, the flow of information among directors, and the type of board leadership. Thus, from the perspective of theory building, board structure is important because it influences directors' decision-making styles as well as their interaction with the CEO. Board structure is also important because it influences the speed and quality of directors' decisions and the potential board contribution to company performance.

Recent interest in board structure is best explained as a response to the widespread belief that boards are dominated by CEOs (Nader, 1984). As mentioned in our discussion of the legalistic and agency perspectives, ineffective board structure is believed to result in lack of directors' involvement in their three roles of service, strategy, and control. This occurs when directors do not receive information in a timely fashion, and do not interact with corporate staff responsible for conducting a range of analyses. As a result, the boards' role is reduced to evaluating managerial analyses, rather than being active in mapping appropriate strategic choices for the firm.

Our review indicates that consulting companies and trade associations have been more actively involved than academics in documenting changes in board structure (e.g., Kern/Ferry International, 1982; *The Changing Board*, 1984–1986; The National Association of Corporate Directors, 1982). In one of the first comprehensive efforts, Bacon (1973) examined the existence, composition, and functions of board standing committees. These include the executive, salary, stock option, audit, and finance committees. This study concluded that more committees had been added to boards in the late 1960's and early 1970's. This trend appeared to persist today (*The Changing Board*, 1986).

The concerns of stockholders and the general public about the board's functions and changing roles have led consultants to pay considerable attention to the audit (Arthur Anderson & Co., 1984; Bacon, 1979); public policy (McGrath, 1980); planning (Brown, 1981; Horton, 1984); nominating (Goodrich, 1987); and compensation committees (Meuter, 1989; Salwen, 1989). These efforts attempted to document the potential role of board committees in view of legal requirements and evolving practice in leading U.S. corporations.

Academic interest in tracking and understanding changes in board structure has been less enthusiastic. In one of the few studies on the topic, Kesner (1988) studied the representation of inside and outside directors on important committees that were thought to be most likely to influence corporate financial performance: audit, nominating, compensation and executive. In addition, she studied differences among directors who served on these committees in terms of occupations, tenure, and gender. Kesner found that the majority of members of the important board committees were outsiders who had business careers and enjoyed long tenure on boards. These findings posed two questions for future analysis. Do the structural elements (e.g., number and types of committees) of boards differ between successful and less successful companies? Do successful companies staff their boards in significantly different ways from those of less successful firms?

In a second study of board structure, Jemison and Oakley (1981) found that only 42% of the companies responding had nominating committees, and 45% of the sample had audit committees. These committees were dominated by outside directors.

A third investigation of board structure was conducted by Chitayat (1980, 1981). He collected data from Israeli firms and examined the existence of specific committees and how board meetings were conducted. His findings echoed the earlier results reported by Mace (1971) in the U.S. Boards were poorly structured, meetings were not well attended, and the flow of information between CEO and the board was superficial. Overall, boards rubber stamped managerial decisions and were not active in undertaking their responsibilities.

In combination, the above studies have three implications. First, they reinforce the need to examine board processes because of their potential effect on company performance. Second, they point out that an effective board structure is one that allows directors to carry out their responsibilities in a timely fashion and do their job well. Without such structure, information will not flow among directors and decisions will be delayed. Third, the studies show that an effective board structure is manifested in its proper organization into committees, the existence of appropriate communication channels and strong board leadership.

Board leadership: Unitary vs. dual

Three studies have examined the effect of dual versus unitary board leadership on company performance. Unitary leadership exists when the CEO serves also as the board chair. Dual leadership means that different individuals hold the CEO and chair positions. Dual leadership was predicted to have a more positive effect on performance because effective checks and balances were in place. Consequently, the dominance by the CEO of board activities would be minimized (Dalton & Kesner, 1987). The studies are, at best, suggestive of the need to document the implications of board structure for its performance of its roles and its contributions to company performance.

Berg and Smith (1978) found that unitary leadership had a negative effect on only one of four performance criteria, total return to investors. Even this relationship disappeared when additional analyses were carried out using subsamples from selected industries. In a second study, Chaganti et al. (1985) found that unitary leadership was not associated with a measure of performance, firm bankruptcy. In contrast, Rechner and Dalton (in press) found that dual leadership was associated with other measures of financial performance. Overall, the three studies summarized in Table 7.5 tentatively suggest that dual leadership is positively associated at a modest level with company financial performance.

Efficiency of board structure

Zahra and Pearce (1987) posited that the efficiency of board structure was a significant predictor of company performance. Noting the difficulty in identifying pertinent dimensions of board structure, these authors developed a multi-item, overall index of the efficiency of board process. The items covered efficiency of division of tasks and flow of communication among committees. Regression analysis indicated a positive relationship between efficiency of board process and company financial performance. This finding corroborated the importance of an efficient board structure as a means of enriching company financial performance. An efficient structure facilitated effective decision making by directors and helped improve performance of the service, control and strategy roles.

Summary

The results of prior research show that board structure is a potentially important predictor of company financial performance. These results support inclusion of board structure in the Model. However, the insights gleaned from the studies on board structure should be interpreted with caution. These studies are few in number. They also tend to overemphasize one or a few dimensions of board structure. In addition, these studies do not provide rich information on how board structures influence board decision styles. Hence, the results of Chitayat's (1984) study in particular may not be generalizable because of its small sample and differences in ideological context between U.S. and Israeli firms.

The few studies conducted to date have failed to incorporate appropriate controls to alleviate the confounding impact of internal or external contextual variables. For example, 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 (Dalton & Kesner, 1987). Therefore, to understand how board structure relates to performance, scholars should pay attention to these and other contextual variables. Finally, the implications of board structure for the execution of its roles should be examined more systematically. Indeed, we believe that this indirect effect on performance (represented by a solid line in Figure 7.5) will be stronger than that of the direct effect summarized above.

Table 7.5 Board structure and process: Implications for organizational financial performance

Study (Year)	*Dimensions*	*Organization Performance Criteria*	*Sample*	*Analytical Approaches*	*Major Findings*
A. *Structure*					
Berg & Smith (1978)	Unitary vs. dual board chairmanship	Change in stock price Dividend growth, Stock price growth, Total return to investors	200 *Fortune 500*	t-test	Unitary leadership had negative effect on total return to investors. However, analyses by industry types did not yield identifiable patterns.
Chaganti et al. (1985)	Unitary vs. dual	Firm bankruptcy	21 pairs of successful & unsuccessful retailers	t-test	No association
Rechner & Dalton (in press)	Unitary vs. dual	ROI ROE Net profit margin	230 *Fortune 500*	MANOVA	Dual leadership outperformed others where the two jobs were dominated by one individual.
B. *How Boards Make Decisions (Process)*					
Miller & Norburn (1986)	Process followed in making strategic changes	Severe profit decline	64 directors from 10 companies	frequency	1. Directors and CEOs were unable to define how boards made decisions 2. Directors were not able to articulate the strategic changes implemented.
Zahra & Pearce (1987)	An overall index of BoD board process efficiency	Overall index consisting of five items (ROE, EPS, DPS, RDA & evaluation of stock performance)	139 *Fortune* firms (69 manufacturing and 70 service)	path analysis	Internal process was associated positively with company performance.

Process

Research on board process has attempted to identify the approaches that boards take to making decisions (Bacon & Brown, 1975; Mueller, 1974). Scholars who follow the legalistic perspective believe that ineffective decision making processes weaken boards and limit their contribution (Mace, 1971). Consequently, board internal processes have increasingly come under public scrutiny to ensure that boards are not rubber stamping managerial choices (Fleischer et al., 1988; Kohls, 1986). From an agency perspective, process variables are important in explaining how boards contribute to strategy, exercise control, and make executive compensation decisions.

Normative and empirical research have highlighted the importance of five dimensions of board processes: the intensity and quality of directors' interaction, the interface between the CEO and the board, and the level of the directors' consensus, the process of board evaluation, and the comprehensiveness and explicitness (formality) of board proceedings and actions (Milles, 1981; Mueller, 1974; 1979).

The above five dimensions of board processes are not universally supported in the empirical literature. Unfortunately, studies on processes have been limited in their number and scope. In one of the first efforts, Mace (1971) interviewed executives in several firms in different industries. He found that boards were passive, functioning only as rubber stamps of managerial choices. Follow-up studies by Chitayat (1980; 1981; 1984) corroborated these findings, though in a non-U.S. setting.

A study by Miller and Norburn (1986) added some insights into board process. Although CEOs and directors were not able to define in clear terms how boards made decisions, the study showed that the way board meetings were run, the frequency of these meetings, and the timeliness and quality of information exchanged between the CEO and directors affected the board's ability to make decisions as well as its contribution to company performance.

Finally, Zahra and Pearce (1987) focused on three dimensions of the board process identified from the literature: internal proceedings, involvement, and representation. Internal proceedings referred to the length and quality of board meetings. Involvement indicated the extent to which directors were active in performing their board-related activities. Representation referred to the extent to which directors were active in articulating the expectations of different groups of the firm. Zahra and Pearce found that these dimensions of board process affected a board's performance of its strategic role and, ultimately, company performance.

Overall, the relatively low number of empirical investigations into board processes is explained in part by the difficulty in securing access to boards to observe over time. Without such information, it will continue to be difficult to prescribe changes in the process by which boards should perform their roles. This is in fact, one of the most challenging areas for future research on the contribution of boards. As in other social groups, board process variables are likely to influence directors' decisions (for a review, Ross, 1988). Also, as a means to determine the extent of directors' liability, courts are increasingly interested in the processes boards follow in making their decisions (Kohls, 1986; Vance, 1983). Our interest goes well beyond the issue of liability, however. As Mueller (1979) notes, over time a board develops unique approaches to carrying out its roles, to interact with the CEO, and to link the firm with its environment. In turn, these approaches determine the content and quality of a board's contribution.

The above review suggests that future research effort should focus on the indirect link between board structure and company performance, represented by a solid line in Figure 7.1. This indirect effect will be stronger than the direct effect of board structure on performance that has been found in previous studies.

Agenda for future research

Our review suggests that research on boards of directors is at a crossroads. The divergence of perspectives that was intended to enrich our understanding of what boards do needs to be reexamined. Attention should focus on integrating these research traditions to fully appreciate the effect of boards on corporate governance and performance. Therefore, in this section we will sketch some issues that appear to deserve examination in future research endeavors. In doing so, we build on the insights gained from past research. But first, we think it is worthwhile to reflect briefly on some of the shortcomings of prior efforts because they have influenced the interpretations of results reported in the literature.

Limitations of previous research

Several limitations of past research warrant attention. First, the impact of contextual forces on board variables has been widely ignored. For example, Tables 7.3 through 7.5 suggest that few studies have intentionally controlled for interindustry differences, company size, and organizational life cycles. Because studies lacked controls, many published results are open to speculation and different interpretations. To minimize misleading interpretations, future researchers should attempt to examine the moderating effect of contextual factors that we identified in Figure 7.5 on board attributes or roles.

Second, there has been a tendency among researchers to prescribe desirable board reforms without sufficient description of board attributes, especially structure and process. Reflecting on Table 7.5, in particular, it is evident that researchers are not clear about how boards make their decisions. Furthermore, the nature of board processes over time has not been studied. As we indicated earlier, without sufficient attention to board process variables, little progress can be made in understanding how boards affect corporate performance. Examining these variables will make it possible to determine when boards exercise their power, how their actions may influence the direction a firm takes, and how directors bring about changes in the strategic initiatives advanced or implemented by senior executives. As an initial step to remedy the current deficiencies in research, field studies should observe directors' behavior over time to appreciate better the dynamics of boardrooms.

The tendency of researchers to prescribe changes in boards without a clear understanding of current board behavior is also evident in discussing board roles. There are countless lists of what boards should do. Yet, evidence on what boards actually do is not well documented. The few case studies that exist highlight the necessity of a systematic effort to articulate how directors, shareholders, and executives value different aspects of boards' roles. Similarly, there is a pressing need to document what boards actually do.

Third, emphasis on univariate analytical approaches has handicapped efforts to develop integrative board models. As Tables 7.3 through 7.5 show, variables are usually studied without attention to their precursors or consequences. This has had two negative effects: the causal chain that may exist among board attributes has not been identified, and any attempt to integrate past findings is fraught with danger, owing to the contradictory results reported to date.

Fourth, research samples have been inadequate to address the range of questions that have been asked. The large majority of studies focused on the Fortune 500 population. These firms are important to the national economy, have been the target of board reform, and provide the relative ease of data collection. Although these are all important considerations, exclusive attention on *Fortune 500* companies ignores the contribution of boards in different types of firms. For instance, the role of boards in smaller, medium size, and nonprofit firms has yet to be examined in a systematic fashion. In fact, we were unable to find empirical studies that compared the role of boards of directors in different types of companies.

Fifth, researchers have failed to operationalize board variables in a consistent manner. For example, the representation of outside directors has been measured differently by researchers, as mentioned earlier. In fact, the definition of an outside director is still a matter of dispute. Another example relates to the dimensions of board characteristics. Some researchers focus only on directors' orientations, but others use multiple dimensions. Further, these dimensions are not used in a consistent manner by different researchers. As a final example, the importance of a strategic contribution by boards has not been convincingly demonstrated empirically. That is, the role of the board has not been sufficiently articulated to judge whether strategic contributions should be expected. Additionally, assuming that such contribution is necessary, its nature has not been well defined. How comprehensive should this contribution be? What is the role of the CEO versus the board? These issues need to be addressed before the adequacy of past results can be evaluated.

A similar concern relates to the measures of board process and structure. There is no agreement concerning the components and measures of these variables. These disagreements suggest that considerable field work is necessary before scholars can examine the effect of board process and structure on company performance. The proposed Model (Figure 7.5) moves us one step toward identifying theme dimensions.

Sixth, measures of organizational performance have been inappropriately restrictive. As Tables 7.3 through 7.5 show, over the past 25 years, accounting measures dominated board research while market risk considerations have been ignored. As Venkatraman and Ramanujam (1986) suggest, different corporate financial performance measures provide different perspectives on the impact of the board. Hence, if the board is a mechanism for reducing environmental uncertainty (Pfeffer 1972, 1973), market considerations should be introduced into the analysis. Only a study by Rechner and Dalton (in press) has integrated this perspective into board research.

Also of concern regarding corporate financial performance measures is the lack of attention that has been given to the lag effect of board variables on organizational effectiveness criteria. Indeed, many of the studies reviewed in this article used contemporaneous, not lagged, measures of performance. One would assume that changes introduced into one or more of the board variables took time before they influenced company performance in a significant fashion.

A third concern relating to performance criteria is the overemphasis that has been placed on static measures. With only a few exceptions (e.g., Baysinger & Butler, 1985; Helmich, 1980; Provan, 1980), scholars have tended to ignore the impact of changes in board variables as predictors of changes in company performance.

A sixth issue is the narrow definition of company performance in the board literature. The bulk of past research focuses on the financial dimension of company effectiveness. Though insightful, past research has ignored the many suggestions of system and resource dependence theorists (Steers, 1975). Multiple perspectives are desirable to establish the efficacy of corporate board for company performance. In addition, more attention should be given to the systemic and social dimensions of company performance. To date, only a few studies have examined these two components (Jones, 1986; Kohls, 1986). Findings from these investigations are, of course, tentative but they show that board attributes and roles may influence corporate social performance. To advance research and better assess board effect on performance, researchers need to appraise the systemic and social responsibility components of performance.

A final concern is the tendency among scholars to search for universal associations between board attributes, roles, and company performance. This tendency should be replaced by well crafted studies that aim to develop mid-range theories and test their predictions. Clearly, the four theoretical perspectives make very different predictions on how boards influence company performance; these differences should be recognized in designing future research efforts.

The above seven shortcomings urge cautious interpretations of results of past research on board roles and attributes. Although this research has been insightful, it has not adequately documented the impact of boards on company performance. Indeed, evidence has been sporadic and inconclusive. Future efforts should aspire to overcome the shortcomings of past efforts cited above while moving toward building an integrative, coherent framework of board behavior.

Future research directions

The starting point for future research involves conducting extensive field work to understand better, document, and operationalize board variables. As indicated in several places in this review, more descriptive work is necessary before normative board models or theories can be advanced. This field work will also help in validating the links among board variables, roles, company performance, and in documenting effects of changes in board variables on changes in company performance.

Another path for future research efforts is to delineate systematically how executives, directors, shareholders and public policy makers view the role of the board. Despite the abundance of writings on the topic, it is unclear what boards actually do or how they are evaluated by these various groups. We have presented a summary of the three roles of the board: service, strategy, and control. Future research is necessary to identify and document the important components of each set.

There is controversy over the nature of directors' strategic role. Harrison (1987) suggests that boards are increasingly involved in examining strategic issues, using strategy or other traditional committees such as audit and compensation. Henke (1986) reports that a large percentage of the boards of Fortune 500 corporations are not involved in the strategic arena. Further, as mentioned, the four theoretical perspectives on boards differ markedly in their emphasis on this role. Therefore, future research should clarify the nature of this role in precise terms and its implications for directors' liability. If this role requires actual formulation of strategy, this will subject directors to considerable perils if strategies are judged to be ineffective. It will also alter the dynamics of the relationship between directors and executives. If the strategic role is expanded to include direct strategy formulation and implementation, lines of authority and accountability within corporate structure may become difficult to identify. That is, an extensive strategic role will change the way the contemporary organization is being managed.

Clearly, defining the domain and the importance of boards' strategic role is a promising, albeit controversial, arena for future research. As the very concept of the firm changes, it becomes almost imperative to define this role in practical terms. Does it refer to the intensity of directors' contribution to strategy? To the quality of this contribution? To its type (e.g., audit vs.

actual formulation)? How does an expanded strategic role influence company performance? These questions deserve attention in future studies.

A third avenue for future research is to develop a typology of board context and associated variables. By focusing on internal and external contingencies in the Model, researchers can identify different board settings, theoretically and empirically. Subsequent work may determine how these settings contribute to the determination of board composition, characteristics, structure, and process. This effort will involve understanding how successful and less successful companies differ in board variables within each setting. Such research will help integrate the variables highlighted earlier in our Model, adding coherence to future prescriptions.

A fourth avenue for future study involves conducting comparative research on board attributes, including international comparison (e.g., Dalton & Kesner, 1987; Kriger, 1988). Industries are increasingly global in nature and their performance may depend on the characteristics of directors (Norburn, 1986). This means that future research should examine differences in international governance practices and their implications for industry and company performance. Additionally, it will require attention to companies at different stages of their life cycles, at different organizational sizes, and in different industry groupings. These efforts will help in determining the effect of contextual variables on board attributes and, ultimately, the board's contribution to company performance.

Research is also necessary to validate the linkages posited in the Model of Board Attributes and Roles (Figure 7.5). In Table 7.6 we outline some pertinent research questions with the hope that they will interest other scholars. The questions address each of the boards' roles and attributes and their suggested links with company performance. We would like to urge researchers to consider the proposed Model in designing their research programs. Such studies would help greatly in refining the Model and in clarifying the interactive relations among its variables. These refinements may be essential before researchers undertake a wide-ranging empirical investigation if they wish to avoid additional contradictory findings. We believe that search for direct links among board attributes and company financial performance is misguided and will yield contradictory findings. Scholars need to ponder whether examination of the indirect links (attributes → roles → company performance) would enrich our understanding of board contribution to organizational performance, as this review suggests. Ultimately, longitudinal studies will be required to examine alternative links among the variables in the model, using causal modeling techniques or other approaches.

Finally, future researchers need to acknowledge the complexity of company performance measurement. At a minimum, multiple perspectives in gauging this complex variable seem appropriate. Similarly, caution should be exercised in data collection on board attributes. Thus far, secondary references and surveys completed by management have dominated the literature. We recognize the importance and richness of these data sources, but we urge

Table 7.6 An inventory of future research questions on boards of directors

A. *Board Attributes*

1. Composition
   1. What are the environmental and organizational determinants of board composition?
   2. Do environmental and organizational determinants of board composition vary by phase of company life cycle? By company strategy? By industry type?
2. Characteristics
   1. What is the appropriate mix of board characteristics by company performance?
   2. Do these characteristics vary by the phase of company life cycle? By strategy type? By industry type?
   3. How do board characteristics affect company financial performance?
3. Process
   1. What are the dimensions of board internal processes? How can they best be measured?
   2. What are the major determinants of board process?
   3. How do different process dimensions influence company performance?
4. Structure
   1. What are the dimensions of board structure? How can they be best measured?
   2. What are the determinants of board structure?
   3. Do the elements of board structure affect company performance?

B. *Board Roles*

1. Service
   1. How does board service role impact company performance?
   2. What is the impact of board service roles on company performance?
   3. How do service roles vary according to the internal and external variables listed in Figure 1?
2. Strategic Contribution
   1. What are the appropriate dimensions of the strategic contribution of boards?
   2. How can the strategic contribution by boards be measured? Should we emphasize level of directors' involvement or should 'contribution' to strategy be developed?
   3. How does the nature of board strategic contribution vary according to external environment and internal contingencies?
   4. What are the implications of board strategic contribution for the content and process of strategy formulation and implementation?
   5. How does board strategic contribution impact company performance?
3. Control
   1. What are the dimensions of the board control role?
   2. How do these control functions influence corporate financial performance?
   3. At what point do directors utilize formal and informal controls?
   4. How can the role of boards in control be strengthened?

C. *Integrative Questions*

1. What is the nature of the causal chain among board attributes (composition, characteristics, structure, and process)?
2. Does this causal chain vary based on the external environment, and internal considerations? If so, how?
3. How do board attributes and roles influence company performance?

researchers to consider incorporating directors' views in the study of board behaviors, supplemented by the researchers' secondary data with their observations of board attributes.

Conclusion

Boards of directors are among the most venerable instruments of corporate governance. Directors cannot only protect the interests of shareholders through effective controls of managerial actions, but also have the potential to render valuable services to the firm in the shaping of its strategic posture. Our review shows a growing interest in understanding how boards influence corporate financial performance. Although findings from past research mirror the diversity of perspectives on the topic, they invite thoughtful and imaginative integration. Our model prompts several research questions toward this end. Reflecting on these questions and the progress achieved over the past 25 years, boards of directors promise to be an area for exciting research over the next decade.

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8 On studying managerial elites *

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The study of managerial elites is one of the most important, yet neglected areas of social science research. This paper synthesizes and critically reviews three intellectual traditions in the study of managerial elites. These are: interlocking directorates and the study of institutional and societal power, the study of boards and directors, and the composition and correlates of top management teams. The paper concludes by arguing for the development of a complementary research tradition which combines a contextual and processual analysis of managerial elites.

Key words: Studying managerial elites, process research

The purpose of this paper is to synthesize and critically review elements of the research literatures on managerial elites. The paper assesses a number of intellectual traditions and studies of managerial elites, and then offers a research agenda for future scholarly work in this most important but difficult area of social science research.

The phrase managerial elite is certainly not neutral, indeed many scholars have articulated the long tradition of value laden debate around the term elite (Giddens, 1974; Field and Higley, 1980). But if the term elite is emotive and analytically value laden for some, it also has the virtue of inclusiveness in the social sciences. This is important for the aims of this paper, since it is being written partly to draw together aspects of the sociological, organizational and managerial literature, which in the past have not talked to one another. So who are we to embrace in this inclusive term managerial elite? Broadly the interest is in those who occupy formally defined positions of authority, those at the head of, or who could be said to be in strategic positions in private and public organizations of various sizes. Institutionally the interest, in the first instance, is in position holders who carry labels such as Chairman, President, Chief Executive Officer, Managing Director, or inside or outside Director. However, the focus goes beyond the individual position holder to consider the behavior of groups of actors as they operate as boards of directors, executive committees or top management teams. No assumption is made by starting

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with position holders or formal groupings of individuals, that power lies with those at the strategic apex of the organization. There is now ample empirical evidence from organizations of many different kinds, in many societies, that the power and influence of senior position holders is constrained by the countervailing influence of others inside and outside their own organizations, as well as by rules, traditions, and other institutional arrangements (Mechanic, 1964; Pettigrew, 1973; Herman, 1981). The question of the relative power of managerial elites and others is a crucial empirical issue.

Sociologists and political scientists will quickly remind us that the study of managerial elites has to include not only the leaders of business and political institutions, but also 'members of the media, trade unions, educational, cultural, and religious institutions, and voluntary associations', (Mizruchi, 1992: 18). Thus the focus of analysis is not just power and control within the business institution, or indeed within a broader range of institutions, but whether, and to what extent, and under what conditions, there may be an inner circle of business leaders 'who define and promote the shared needs of large corporations . . . . and give coherence and direction to the politics of business' (Useem, 1984: 3).

Whilst the purposes and activities of managerial elites are a source of fascination in everyday conversation and in journalistic accounts of the fate of large enterprises (Auletta, 1991), the study of elites within institutions and societies by social scientists remain few and far between. Access difficulties have been and remain a source of constraint on studies of elites. As long ago as 1957, Kahl was arguing 'those who sit amongst the mighty do not invite sociologists to watch them make the decisions about how to control the behavior of others' (Kahl, 1957: 10). Pahl and Winkler (1974), Norburn (1989) and many others have reported the real practical difficulties of getting close to the top of large institutions. But access problems are not insurmountable. The early and clever use of publicly available data by Wilson and Lupton (1959) to reveal the interconnecting networks in the City of London, and the astute use of archival data more recently by Kosnik (1987) and Davis (1991), all show what can be done from public sources. Equally well, the Harvard Business School tradition of work on boards of directors and chief executives (Mace, 1971; Gabarro, 1987; Vancil, 1987, and Lorsch and MacIver, 1989) demonstrates that direct access to key figures and important processes is negotiable. The developing tradition of research on top level strategic change processes in the U.K. by, for example, Pettigrew (1985a), Johnson (1987), Smith, Child and Rowlinson (1991) and Pettigrew and Whipp (1991) should provide further optimistic signals that substantial access to managerial elites is possible even in a society with perhaps even stronger norms of privacy than is customary in the U.S.A. I remain sanguine that access difficulties alone need not be an impediment to the extended development of managerial elites as a field of empirical study.

Progression in the study of managerial elites can be characterized under six themes:

1 Interlocking directorates and the study of institutional and societal power.
2 The study of boards and directors.
3 The composition and correlates of top management teams.
4 Studies of strategic leadership, decision making and change.
5 Chief executive compensation.
6 Chief executive selection and succession.

It is beyond the scope of this paper to review all six of these often quite separated areas of intellectual enquiry. The choice of the first three offers a number of analytical possibilities. First of all there are strong and distinctive intellectual traditions in two of the three areas. The study of interlocking directorates has a clear focus on the structural analysis of business in its societal context and a distinctive methodological approach in its use of the quantitative techniques of network analysis. Important representative studies in this tradition include Burt (1983), Clawson, Neustadtl, and Scott (1992), Galaskiewicz (1985), Mintz and Schwartz (1985), Mizruchi (1992), Palmer (1983), Pfeffer and Salancik (1978), Stokman, Scott and Ziegler (1985); Useem (1984) and Whitt (1982).

Research on top management teams was given a fresh lead in 1984 by the Hambrick and Mason paper setting out a research agenda for the study of the 'upper echelons' of business. Since then a noteworthy pattern of work has emerged linking the demographic characteristics of top management teams to a variety of organizational outcomes such as performance, innovativeness, and strategic change. Illustrative studies in this tradition include D'Aveni (1990), Finkelstein and Hambrick (1990), Hambrick and D'Aveni (1991), Keck and Tushman (1991), Norburn and Birley (1988), O'Reilly, Snyder and Boothe (1992) and Wiersema and Bantel (1992). With the notable exception of D'Aveni, this research has neither sought nor made any connections with the sociological research on elites and interlocking directorates. Like the interlocks research, the top management team research is held together by a common methodological approach, but this time the use of demographic data and multivariate analysis, rather than network based multivariate analysis.

Without doubt the weakest of these three areas of research is the work on the composition and operation of boards and the activities of inside and outside directors. A good deal of the literature in this area 'is non-academic, even nonanalytical, and relies heavily on unquestioned assumptions as a basis of prescription' (Pettigrew, 1992). Nevertheless, there are some scholarly pillars to stand on to develop this intellectual approach exemplified, for example, in the empirical work of Bradshaw, Murray and Wolpin (1992), Goodstein and Boeker (1991), Herman (1981), Kosnik (1987), Lorsch and MacIver (1989), Mace (1971), Norburn (1989), Pahl and Winkler (1974), Pearce and Zahra (1991), Stewart (1991), and Zajac (1990). As yet, this research has developed neither a coherent methodological approach or a sound set of conceptual categories and findings. Links with research on interlocking directorates and top management teams remain undeveloped. The whole field of research on boards and directors awaits energetic intellectual leadership.

This paper has four sections. The first three characterize the underlying assumptions and main findings of research on interlocking directorates, boards, and top management teams. Each section identifies the strengths and weaknesses of the three areas of research and suggests some profitable themes and questions for future enquiry.

Because three research areas are being considered for critical review, the paper has had to trade-off a certain amount of depth of presentation for breadth. Nevertheless the central tendencies of each research tradition are considered and in the fourth and final section the beginnings of a new research tradition is articulated for all three areas of research which combines a contextual and processual analysis of managerial elites (Pettigrew, 1990, 1992).

Interlocking directorates and the study of institutional and societal power

Research in this tradition is avowedly sociological. The focus is on the analysis of business power and the corporate elite rooted in the quantitative techniques of network analysis. The concern is less with the structure of power relations within individual organizations than the social relations between enterprises. Thus Scott (1991: 182) characterizes work in this area as focusing 'on the social networks in which enterprises are embedded and the importance of viewing these networks as arenas of power.' The deeper sociological assumption in this work picks up on the Granovetter (1985) embeddedness thesis reinterpreted by Mizruchi (1992: X) as 'the ability of business to accomplish its goals must ultimately be studied in the context of the actions of other segments of society.' United more by method than theory, a strong tradition of work has developed over the past 20 years suggesting that structures of interorganizational relations are consequential for managing resource dependencies, Pfeffer and Salancik (1978); class action, Zeitlin (1974); the formation of inner circles of corporate power in society, Useem (1984); the political activities of business, Mizruchi (1992); Clawson, *et al.* (1992); and corporate charitable donations in regional, Galaskiewicz (1985), and national settings, Useem (1991). This research has been comprehensively reviewed by Glasberg and Schwartz (1983), Scott (1991), Mizruchi and Schwartz (1987), and Davis and Powell (1992). Although this stream of research has had its descriptive reviewers and commentators, it is only very recently that stronger critical attention has been given to assessing the additive outcomes of such work. Recent notable critical reviewers include Zajac (1988, 1992), Stinchcombe (1990), Davis (1992), and Davis and Powell (1992).

Central to the network approach is the view that interlocking boards of directors represent political and social as well as business ties. An interlocking directorship is said to exist when a particular individual sits on two or more corporate boards. Direct as well as indirect linkages may be included in the analysis. Indirect linkages exist where directors of firms A and B do not sit on each other's board, but are linked through joint membership of a third board. Zajac (1992: 13) argues that while the study of indirect links increases the number of ties that can be uncovered, this further aggregation of the network analysis merely adds to the systemic problems of assessing the significance of the wider set.

As Davis and Powell (1992) and others have argued, it is method rather than theory which unites the interlock research. Sonquist and Koenig (1975) describe the developments in graph theory and associated computational algorithms and programs which have allowed the network researchers to isolate and identify linkages between corporations and other interest groups. Aside from this common methodological approach, one or two data bases have been crucial in harnessing interest in the study of interlocking directorates. A notable driving force has been the data base developed by Schwartz of the State University of New York, Stony Brook. Indeed the Stony Brook group of scholars, (Schwartz, Mintz, Glasberg, Mizruchi, and Palmer) have themselves formed a crucial part of the academic network which has launched and perpetuated the interlocking directorates tradition of research.

But what are the consistent empirical findings to evolve from the network researchers? After very careful reading of nearly all the original studies and personal conversations with a few of the key scholars, this writer finds it remarkably difficult to summarize the key patterns from these studies of interlocking directorates. Part of the reason for the difficulty in identifying unequivocal findings lies in the challenge made to earlier apparently conclusive results. For example, Zajac (1988) has used the 1969 Schwartz data base to successfully question previous conclusions about collusive relationships between competing firms in the chemicals, primary metals, and transportation equipment industries. Reanalyzing the same data set, but this time using a control group comparison, Zajac (1988: 436) is able to query earlier work by Dooley (1969) and Burt (1980) and contend that 'interlocking directorates among competing firms are not significant in number and probably not significant in meaning.' However, an even bigger obstacle to pattern recognition in the findings derives from the widely different theoretical interpretations made from the interlock results.

Mizruchi's (1992) successful attempt to describe the natural history of development of the different theoretical interpretations and frameworks used to expose network findings leads him to attempt a synthesis of the interorganizational and class theorists in what he describes as an interorganizational model of class cohesion. But this Herculean effort of intellectual synthesis cannot paper over the cracks of the different intellectual traditions, or the inconsistent empirical findings.

The two most easily isolatable theoretical interpretations of interlocks data are the resource dependency and class theorists. Resource dependency approaches, for example, by Pfeffer and Salancik (1978), argue that interlocks are mechanisms designed to reduce the uncertainties created by the dependency relationships which develop between firms. Such links, although widespread, are normally seen as particular instrumental acts by one firm in relation to another and do not represent class-wide based entities. The purpose of interlocks in this tradition may be to reduce uncertainty, effect cooptation, or diffuse information.

Class based theorists interpret interlocking directorates as evidence of linking between powerful elites into elite class networks, (Zeitlin, 1974). Within this approach, bank control and financial hegemony theorists have studied the development of ties between industry and financial institutions and see the allocation of capital through regional and national networks as evidence of class based financial hegemony (Mintz and Schwartz, 1985). Useem (1984) takes this argument a stage further and uses a U.K.–U.S. comparison to propose that the individuals who form the interlocks are an inner circle of the corporate elite who can represent that elite in societal wide political processes. Later work summarized by Stokman *et al.* (1985) and Scott (1991) uses international comparative data to note the striking variations in patterns of interlocks between different countries, and in particular how the centrality of banks differs from country to country. Thus British networks stood out for the low level of interlocking and a much less dense and weakly tied network than, for example, the United States. The Stokman *et al.* (1985) 10-country comparison also found a positive relationship between the profitability of firms and interlocking with banks, a finding not replicated from the U.S. data. Correspondingly, highly indebted companies in Belgium and The Netherlands seemed less able to attract bankers, or network specialists (1985: 282). Some general tendencies found across all 10 countries were for the largest firms to be most interlocked, for regionally based and foreign owned firms to be less central in national networks, and for family owned companies generally speaking to be poorly interlocked compared with publicly owned enterprises.

Mizruchi and Schwartz (1987) conclude their review of resource dependency and class theorists by contending that the empirical predictions made by both approaches are often similar, since the dependency theorists acknowledge the existence of leadership discretion and to varying degrees the class theorists admit the possibility of the autonomous dynamics of corporate processes. 'As a result much of the dispute between proponents of the two perspectives centers around divergent interpretations of the same data,' Mizruchi and Schwartz (1987: 9).

A more recent stream of work on network ties seeks to go beyond the descriptive codification of interlocks and tries to link the effects of networks on organizational structure, ideology, and action. (See the Davis and Powell review, 1992). Thus Palmer, Jennings and Zhou (1989) found a link between the adoption of the multidivisional form by firms and their ties with previous adopters. The relationship between ties and innovation was also studied in a quite different domain by Davis (1991). He reports findings that larger firms were quicker to adopt a poison pill takeover defence to the extent that they were tied to prior adopters. These studies, along with research by Galaskiewicz and his colleagues on the impact of networks on charitable giving (Atkinson and Galaskiewicz, 1988), and by Clawson *et al.* (1992) on the consequences of business networks for political party contributions, represent attempts to redirect this analysis of interlocking directorates away from the description and interpretation of structural anatomy to examine the more fundamental question of the consequences and effects of network relationships.

Interlocking directorates research: A brief critique

Three broad areas of criticism can be directed towards the interlocking directorates research. The criticisms are themselves interlinked, but they can be disentangled and labeled as, the so what problem, what do interlocks really mean; the methodological problem of aggregation and randomness; and problems of inference and proof.

Of these three areas of criticism of interlock research the most fundamentally disabling is 'that nobody really knows what they mean' (Mizruchi, 1984: 142). As Stinchcombe (1990: 380) penetratingly argues, this area of research is driven more by the allure of network methods and the ready availability of data than by substantive issues . . . 'using a method that starts with a dichotomy of present or absence as a descriptor of a link between corporations condemns us to the sterility of structural theory and irrelevance of the data . . . the result is theoretical floundering in tables of data that seem to be mostly random numbers.'

This strident criticism is echoed and amplified by Zajac (1992), Davis (1992) and Davis and Powell (1992). In Zajac's (1992) view the very term interlocking directorate prejudges the issue of linkage. He would prefer to use the phrase multiple-board membership than interlocking directorate, since the former stops short at describing the phenomenon, whilst the more customary phrase is already interpreting it. Zajac (1992) wants to start with the basic question, does dual board membership actually serve a linkage function, and if so what function? The related criticism from Davis (1992) and Davis and Powell (1992) starts from the proposition that the network analysts' preoccupation with describing the structural anatomy of networks has not allowed them to adequately explore the consequences and effects of ties. Whilst interlocks research serves a crucial theoretical function in countering atomistic approaches to the corporation, a vexing problem remains, 'there is virtually no empirical evidence that particular interlock ties serve any discernible corporate purpose, or that the interlock network has any substantive impact on what corporations do' (Davis, 1992: 8).

Of course, doubts about the real purposes of interlocks are very much a function of the highly aggregated data sets used by the network scholars. As

Zajac (1988) has argued, there is a need to disaggregate network data to examine precisely who is linked with whom. Adding indirect to direct links merely adds to problems of aggregation and ultimately creates further problems of inference and proof. Hirsch (1982) has been equally scathing of interlock studies iterating around competing models for which critical tests are not provided. The interlocks tradition illustrates 'the costs entailed by allowing accessible data to serve as proxies and indicators for theoretical positions whose substantive likelihood and plausibility is increasingly ambiguous and difficult to articulate' (Hirsch, 1982: 3). A good example of the shifting and ambiguous character of the interpretation process in empirical research on interlocking directorates is provided by Useem's otherwise notable book on *The Inner Circle*. Thus Useem wobbles between the view that the inner circle 'can impose a class-wide logic on corporate decisions, and they often do' (1984: 116), to the view that 'most corporate decisions are, of course, still largely a product of the internal logic of the firm' (1984: 146).

The above sharp criticisms invite a corresponding search for positive suggestions to redirect research on interlocking directorates and the structure of corporate power. Clearly one important way forward is to move away from an exclusive concern with the structural analysis of networks and begin to analyze the purposes of networks and how and why key actors in the networks use links to achieve corporate, political, or class wide interests. In this approach, studies of networks in action, and of links between actions and processes and the achievement of outcomes, would take center stage in the analysis. So the content of ties, their development and use, would become critical for analysis and not just the structure of ties in the network. As Stinchcombe (1990: 381) has so eloquently put it 'we need to know what flows across the links, who decides on those flows in the light of what interests, and what collective or corporate action flows from the organization of the links, in order to make sense of intercorporate relations.

In a soundly argued paper, Zajac (1992) argues that the label interlocking directorates has itself historically led researchers to assume that multiple board membership is a linkage mechanism. He contends that the study of multiple board membership should begin with the study of individual board membership motives, rather than the study of interlocks. Rather than asking as a lead question what does multiple board membership represent, the starting questions should be, what does single and then multiple board membership represent? Such an approach might complement interorganizational and intra-class views of network ties with 'a personal advancement pespective' on multiple board representation. In Zajac's view (1992: 21) 'personal prestige, monetary rewards, and friendship would be posited as significant factors in the decision to accept *and* extend offers of dual board membership.'

But any redirection of interlocking directorates research surely needs to go beyond questions of personal motive. Central to any development should be the exploration of how, why and when networks of intercorporate relations affect corporate behavior and outcomes. How are variations in the structure and conduct of elites decisive for major commercial, political, and social outcomes? How are actual relationships of control, coordination, and power mobilized around concrete issues and events which are of importance to individual organizations, or sets of organizations in the same or different markets and sectors? It is studies of the actual exercise of corporate and societal power which are needed and not just distant and highly aggregated analyses of the attribution of power.

Recent reviews of research patterns by Stokman *et al.* (1985) and Scott (1991) indicate the analytical and empirical promise of the comparative analysis of intercorporate relations and interlocking directorates. As Scott (1991) argues, much U.S. research has focused on the organization of business activity in relatively homogeneous economic, cultural and political terms. However, European and Asian businesses show important differences in the pattern of intercorporate relations. Revealing such empirical differences has now stimulated a search for explanations of those variations. This is turn is drawing scholars to offer more contextualist explanations of the origins and trajectory of development of interlocking directorates across a variety of societies. An important benefit of this process is that historical and cultural factors, the structure of the state, kinship systems, and processes of industrialization are now more explicitly being used to explain the fashioning of intercorporate relations both within and between societies (Fligstein, 1990; Hamilton and Biggart, 1988; Stokman *et al.*, 1985).

None of the above conceptual and empirical developments are possible, however without progress in complementing existing network research methods with other styles of research and other forms of data. All the studies mentioned above on the motives for joining and extending offers to join boards; on the analysis of networks in action; and the varying trajectories of development of corporate relations and elites in different societies, require first hand data much closer to the phenomenon than was envisaged by the structural analysts of network relations. Perhaps as Davis and Powell (1992) assert, the primacy of method over substance in the study of interlocking directorates is now nearing its end and the close observation and analysis of actual relationships can begin to inform traditional social science concerns with interlocking directorates and the study of institutional and societal power.

The study of boards and directors

Whilst the 1980s has witnessed a burgeoning of popular and scholarly interest in the contribution of top leaders to the fate of organizations, (see Bryman, 1992, for a recent review) this preoccupation with charisma, vision, and transformation has not been complemented by equivalent scholarly concern with the study of boards and directors. Policy interest in boards is, of course, now very evident in the U.K. and U.S. as boards have been placed at the center of a number of financial scandals involving major public companies and corporations. (See Cadbury Report (1992) and Lorsch and

Maclver (1989) for recent policy discussions of corporate governance matters). This policy interest, buttressed by the legal and financial requirements expected of boards, and the assumption that board effectiveness can contribute to corporate performance, has produced a constant stream of prescriptive writing about alternative ways of harnessing the productive potential of boards (Charkham, 1986; Loose and Yelland, 1987). Statements about the importance of boards in the business process are normally underpinned by a list of the critical board functions. Thus Cadbury (1990) summarizes board functions in these terms:

- to define the company's purpose
- to agree the strategies and plans for achieving that purpose
- to establish the company's policies
- to appoint the chief executive and to review his performance and that of top executives
- in all this to be the driving force of the company.

Other writers (Pearce and Zahra, 1991) suggest that powerful boards provide useful business contacts, thus strengthening the link between corporations and their environments; that powerful boards are necessary to ensure the protection of shareholder interest; and finally, that powerful boards play a crucial role in creating corporate identity, especially in the establishment and maintenance of a code of ethics.

Such apparently sensible statements of business intention and practice conceal the dearth of basic descriptive information on the composition, conduct, and performance of boards and their directors. Tricker's 1978 observation that 'the work of the director, in and out of the boardroom, is rated as the most under-researched management topic' is still ringingly true in 1992. The study of boards and their directors must rank near the top of any management scholar's list of priority areas for the 1990s.

Because research on boards and directors is still in its infancy, there are few theoretical, empirical, or methodological guideposts to assist the optimistic yet wary researcher through the prescriptive minefield. What has been written from a descriptive and analytical viewpoint is fragmented and largely nonadditive. Methodological difficulties in gaining access for behavioral or interview based studies, or poor response rates from questionnaire based studies, have also contributed to the patchy and often inconclusive findings on boards. The interlocks research tradition, reviewed in the previous section of this paper, still comprises a large proportion of the scholarly literature on boards.

Perhaps the most clearly stated theme in the prescriptive and descriptive writing about boards has to do with board composition. Typically boards are composed of a combination of executive (inside) directors (who are also senior managers and include the chief executive) and nonexecutive (outside) directors who are external to the day-to-day operation of the firm. From either of these two groups a chairperson of the board will also be chosen. Thus although a board is composed of individuals, analysis and prescription tends to assume that boards can be subdivided into homogeneous, interest sharing groups. The ready availability of demographic data at least on gender, age, present functional or business responsibility, and, of course, number and proportion of inside to outside directors, has contributed to the range of studies linking board size and composition to variables such as performance (Pfeffer, 1972; Baysinger and Butler, 1985; Hermalin and Weisbach, 1991). However, inherent difficulties in separating out the multitude of endogenous and exogenous factors that influence company performance, make the assumed effects of board demographic characteristics on board effectiveness very difficult indeed to establish. The recently published work by Hermalin and Weisbach (1991), which could find no relationship between board composition and performance, provides a good instance of this general problem.

The issue of CEO duality, where the positions of chairperson and CEO are occupied by the same individual, has also attracted prescriptive and descriptive writing and research. Rechner and Dalton (1991) examined the financial implications of CEO duality (as opposed to the position of an independent chairperson) in terms of investment returns, equity returns and profitability over a 6-year period. Their study concluded that firms opting for independent leadership consistently outperformed those relying on CEO duality.

Pearce and Zahra (1991) examined the relative power of CEOs and boards of directors and their association with board performance. Their study suggested that powerful, independent boards were associated with superior corporate financial performance. The study also provided loose support for the author's typology of four board types with different emphases on the power relationship between CEO and board member. One of their most interesting findings was that more powerful board types were viewed by the CEOs as being more progressive and more encouraging and supportive of CEO efforts, which in turn raised a question about the widespread belief that CEOs desired weaker boards that rubber stamp their decisions. Promising as this line of enquiry is, replication of the findings using different populations and measures is certainly necessary to give confidence to the stated results. Behavioral evidence of board processes is also necessary in this kind of study to counter the possible self-reporting biases of CEOs.

Stewart (1991) focused not on this duality problem but on how a separate chairperson and chief executive interact. Her study of 20 general managers and their chairmen in the National Health Service (NHS) revealed the extent to which such senior roles are open to wide operational interpretation, and how different individuals come to different conclusions about their precise duties, and their relationship with the other. Perhaps because of the particular political and accountability issues in the NHS, the two roles were often seen as interdependent, complementary, indeed as a partnership. This kind of detailed, longitudinal field based study, examining from first hand reports the balance of activities, interdependencies, and choices between key figures in and around the board, is a very necessary complement to the more quantitative, correlational, and empirically distant studies which suggest board composition, power, and performance linkages.

Another tradition of research and writing on boards debates and analyzes the Berle and Means (1932) thesis that although shareholders have legal ownership and control of large corporations, they no longer effectively control them. Although this area of research has been bedevilled by conceptual disagreements about the term control (see Mizruchi, 1983 and Herman, 1981) there is now a body of analytical work in this tradition. Mace (1971) in an oft quoted study concludes that the powers of control rest with the president – not the board. Herman (1981) in an extended and subtle analysis argues that management (the CEO and inside directors) control the firm, but always in the context of the varying sets of constraints and latent powers of stakeholders such as the outside members of the board, shareholders, and at certain moments, creditors. Different studies using what Kosnik (1987) describes as the managerial hegemony theory, offer different explanations of management's control over the board. The mixture often includes the management's control over the selection of outside board members and the latter's subsequent co-optation; the limited time outsiders have to devote to their duties; the superior expertise, information, and advice available to management; and norms of board conduct which restrict the outsiders abilities to operate as strident independent voices (Mace, 1971; Herman, 1981; Lorsch and MacIver, 1989).

As we have seen, there are a host of difficulties in the research attempting to link board composition to the overall financial performance of the firm. However, recently scholars within the managerial hegemony tradition have been attempting to study the slightly more confined link between board composition and board as distinct from company financial performance. Thus Kosnik (1987), using board decisions to pay greenmail (the repurchasing of its stock at a premium above market price), and Kesner and Johnson (1990) who focused on shareholder suits rather than greenmail as an indicator of board performance, have both attempted to link board composition to board performance.

In the Kosnik (1987) study, green-mail was assumed to be universally defined as against the interests of shareholders and thus indicative of board failure to fulfill its principal function of representing shareholder interests. It was further assumed that green-mail payments allowed poor company management to consolidate its control position when faced with a challenging raider. The study found that the board's effectiveness in preventing green-mail was increased when it was composed of relatively more outside directors, more outside directors with executive experience, and more outside directors with contractual interests in the company. Thus, according to the structure of Kosnik's investigation, board composition did have an effect on board performance.

The Kesner and Johnson (1990) research operated under the assumption that the more times shareholders pressed legal charges against their board, the less effective was the board at reflecting or representing shareholder interests. In this way they hoped to evaluate the effect that a predominance of outside directors had in representing shareholder interest. Their results indicated that boards sued tended to have a greater percentage of inside directors than those not sued, a relationship that was even stronger when the CEO also had the position of chairperson. Crucial also to their findings was the apparent fact that in actual rulings against the boards there was no difference in outcome for the differently composed boards. Thus the proportion of outside to inside director was not related to the company's 'guilt' and therefore composition did not affect the degree to which shareholder's interests were represented by the board.

The use of archival data to derive indicators or surrogate measures of board composition and control is also evident in research on CEO 'golden parachutes' and board 'poison pill' (a form of takeover defence) adoption. Thus research by Cochran, Wood, and Jones (1985) and Singh and Harianto (1989) has found that greater outsider representation on the board is associated with a higher likelihood of having a golden parachute. However, contrary to hypothesis, Davis (1991) found that boards with more insiders were no more likely to adopt a poison pills takeover defence.

Methodologically adroit as the Kosnik (1987), Kesner and Johnson (1990) and Davis (1991) studies are in their clever use of surrogate measure from archival data, they cannot represent the only way forward for studies of boards of directors. All three studies utilize the crisis situations of takeover or litigation to study the performance of boards, when we perhaps also need data on the performance of boards in situations of relative normality. But these studies also suffer from their distance from the phenomenon they are addressing. As a result great inferential leaps are made from input variables such as board composition to output variables such as board performance with no direct evidence on the processes and mechanisms which presumably link the inputs to the outputs. The celebrated studies by Donaldson and Lorsch (1983) and Lorsch and Maclver (1989) get much closer to the actual operation of the strategic apex of the enterprise.

The Donaldson and Lorsch (1983) study draws on the analysis of 12 'mature successful industrial companies' from the upper half of the *Fortune 500* list to explore the decision making behavior of corporate management (defined as the CEO and those who report directly to him). The corporate decision makers are portrayed as pursuers of corporate survival rather than shareholder wealth. The decision making process is characterized as one of great complexity and uncertainty, with beliefs and experience performing crucial roles in filtering out ambiguity in the choice process. 'Beliefs serve as uncertainty reducers and to provide continuity and stability when change threatens to undermine the lessons of experience' (1983: 80). Like Herman (1981), Donaldson and Lorsch (1983) capture the constraints on top-management choice. There is no pretense of the 'senior corporate executive as a man who moves mountains with a memo,' (1983: 172). Rather top level decision making is constrained by a combination of industry sector pathways and standards, capital market restrictions, the need to attract and retain personnel to achieve rates of growth, and by the implicit belief systems of the executives themselves.

The Donaldson and Lorsch (1983) book provided fresh direct evidence on decision making at the top without dealing specifically with the structure and dynamics of board operation. The study published in 1989 by Lorsch and MacIver responds to that gap. The Lorsch and MacIver research is exceptional not only in terms of the methodology employed, but also the nature and quality of the empirical findings. The investigation covered the period 1986–89 and involved a combination of large scale questionnaire survey, interviewing, and case study analysis. Although the response rate from the questionnaire survey of outside directors was a disappointing 32 percent, the authors claim the respondents are representative of the underlying population from which they self-selected in terms of age, primary occupation, number of directorships held and the size of companies whose boards they are on.

If this had been the sole aspect of the method employed it would have been open to serious objection from what Mace (1971: 3) had earlier described as a director's 'self serving and conscience-solving descriptive phrases of his own perception of his role as a responsible director.' Consequently the second dimension of the Lorsch and MacIver methodology, the random selection of 100 directors to be interviewed for an hour or more, is significant. In all 80 were actually spoken to (roughly the same number as in the 1971 Mace study). The interviews were conducted throughout the U.S. and in several European countries. The third and final element of the methodology involved interviews with 35 directors and other corporate officers relating to the book's four case studies of boards in crisis.

The Lorsch and MacIver (1989) book confirms the stream of work in the managerial hegemony tradition (exemplified by Mace, 1971 and Herman, 1981) that real power lies with the governed, that is the top management team, and the success or failure of individual companies normally rests with them. The problem for the outside directors on the board is to translate their legal mandate into effective power over the top managers, especially the CEO. The Lorsch and MacIver case studies illustrate how this can be achievable in crisis situations such as takeover attempts, the death or incapacity or succession of CEOs, or legal, environmental or performance threats, but control relations are quite different in normal times. Lorsch and MacIver argue that gradual declines are a tremendous challenge to directors. Their study also suggests a need for future work on boards to examine processes of problem sensing, choice, and change over longish periods of time.

The other strong feature of the Lorsch and MacIver (1989) study is their attempt to characterize directors and boards in operation. Although the Harvard study is still one stage removed from the direct observation of boards in action (for an example of this rare species of work see Alderfer, 1986) the findings of the Lorsch study do add to the little that is known about how and why the norms of conduct on boards influence power relationships between outside and inside directors and the CEO.

The study of boards and directors: A brief critique

The above brief attempts to characterize existing research on boards and directors has emphasized its limited scale and scope. It is remarkably difficult to offer a thorough going critique of a body of work which hardly exists. Indeed one might argue that the issue at present is not one of critical reflection on what exists, but the open positive encouragement of any serious social science research on the conduct and performance of boards and their directors.

At the early phases of the development of any field of research there is a requirement for certain basic descriptive information. Even given the apparent preoccupation with publicly available demographic data on board composition, and the useful contribution made by surveys conducted by, for example, the Bank of England (1985, 1988) and consultancy firms such as Korn/Ferry International (1992), there is still a need for further surveys of board member characteristics and boards structure, culture, and process, linked to theoretical traditions such as managerial hegemony and agency theory (Kosnik, 1987; Fama and Jensen, 1983; Jensen and Meckling, 1976; Davis, 1991).

Studies of the locus of power in and around the boardroom are of crucial importance not only for theorists of intraorganizational power, but also to bridge with the interlocking directorate tradition, with its interest in the structure of elite power in different industrial societies. We still know remarkably little about the behavior patterns and consequences of the CEO duality situation (where the roles of chairperson and CEO are held by the same person); or of any of the other crucial areas of relational dynamics in and around the board, for example between chairperson and CEO, CEO and outside and inside director, and inside and outside director. Indeed as Stewart (1991) and others have reminded us, we still have limited knowledge of the similarities and differences in what chairpersons, CEOs and directors actually do, and what motivates individuals to be invited, or to join boards.

Recent work by Murray, Bradshaw, and Wolpin (1992) trying to establish typologies of patterns of board power and linking those patterns to board and organizational performance, illustrates the analytical value of typologies and classificatory systems at the early development of new research fields. But again, before tenuous links can be made between independent variables and dependent variables, perhaps we need to know more about the substance we are seeking to link with other phenomena. Alongside an interest in different patterns of board power, we need to know much more about the general conduct of board affairs and how and why board processes impact on empirical patterns and theories of choice and change (Pettigrew and Whipp, 1991; Fennell and Alexander, 1989; Goodstein and Boecker, 1991).

The Pettigrew and Whipp (1991) study reminds us that the examination of choice and change processes cannot stop with the analysis of the strategic apex of the firm. Boardroom and other top influences are shaped not only by the activities of actors at other levels in and outside the firm, but also a much broader range of contextual forces and processes emanating from economic, political, and industry sector conditions. When and if the ground breaking work is done on board patterns of behavior, including questions of control, choice, and change; there will be a need in parallel or in sequence to link such analyses to the different settings and contexts in which boards operate, and ultimately to board level and firm level performance.

The composition and correlates of top management teams

The Social Science literature on leadership is immense as reviews by Stogdill (1974), Bass (1990), and others can testify. However, research on leadership in bureaucratic contexts is much less developed, and still contains a number of controversies, chief amongst which is whether, and to what extent, leaders make a difference to various kinds of organizational outcomes. Recent writing by, for example, Thomas (1988), Meindl (1990), House, Spangler, and Woycke (1991), and Pettigrew and Whipp (1991) illustrate that the leadership impact debate is still very much alive. In 1984, partly as a response to the controversies around leadership studies, Hambrick and Mason published an important research agenda paper arguing that the strategic apex of firms contained more than individual leaders, and was it not time that scholars began to give more attention to top management teams. In so doing, Hambrick and Mason (1984) can justifiably argue to have created a relatively coherent stream of research with its own distinctive set of empirical findings. In this section of the paper, the aim is to describe this body of work, its assumptions and findings, strengths and weaknesses, and then suggest some complementary research themes and questions on the characteristics, conduct, and performance of top management teams.

Hambrick and Mason (1984) describe their approach as the upper echelons perspective in macro-organizational research. The target group for study is the dominant coalition of the firm and their starting general proposition was that 'organizational outcomes – both strategies and effectiveness – are viewed as reflections of the values and cognitive bases of powerful actors in the organization' (1984: 193). Eschewing 'some important but complex psychological issues,' Hambrick and Mason (1984: 196) recommend that the primary emphasis is placed on observable managerial characteristics as indicators of the givens that a manager brings to an administrative situation. 'These observable managerial givens are demographic factors such as age, tenure in the organization, fuctional background, education, socioeconomic roots, and financial position.'

Although the 1984 paper by Hambrick and Mason was already sensitive to problems of causality, disentangling intercorrelations and needs for time series data, and there was a special plea for clinical and statistical studies, in fact, the tradition that has emanated from the paper has largely been driven by cross-sectional studies using demographic data. Within this tradition, Hambrick and his students and colleagues have explored links between top-team characteristics, managerial discretion and corporate strategies (Finkelstein and Hambrick, 1990; Michel and Hambrick, 1992); and top-team characteristics and organizational bankruptcy (D'Aveni, 1990; Hambrick and D'Aveni, 1991). The Hambrick stimulus has also encouraged a stream of research suggesting that the integration and functioning of the top management team is at least partly affected by the demographic composition of the team (O'Reilly *et al.*, 1993). This demographic research is now also broadening to include studies linking team characteristics to firm innovation (Bantel and Jackson, 1989), and the nature and extent of corporate strategic change, such as diversification level (Wiersema and Bantel, 1992). Another group of scholars seek to link director and top-team characteristics to firm performance (Norburn, 1986; Norburn and Birley, 1988; Keck, 1991). Inconsistent findings, particularly in linking group demography to firm performance, and whether homogeneous or heterogeneous teams contribute to team and organizational success, have forced some rethinking of the theoretical interpretations given to findings, but not yet the wholescale questioning of this style of research.

Faced with inconsistent and contradictory findings about the homogeneity/heterogeneity top team and firm performance link, Priem (1990) in a conceptual paper, argues for a curvilinear relationship between the two. In Priem's view, performance is likely to suffer with extreme levels of homogeneity or heterogeneity. The appropriate degree of homogeneity and heterogeneity is predicted on how much variation exists in the firm's environment. In stable environments, more consensus is productive, while in dynamic conditions, more heterogeneity may be required. This attempt to contextualize theory development has led to a study by Keck (1991) which found that open teams lead to higher performance in turbulent contexts and stable teams lead to higher performance in nonturbulent contexts. More importantly perhaps, as the former rather acontextual theorizing in this area is discarded, so scholars are beginning to examine the relationships, if any, between executive team context and executive team characteristics. In an important new study, Keck and Tushman (1991) are able to conclude from time series data from the United States Cement Industry from 1900–86, that within the firm, reorientation and CEO succession were both associated with significant changes into and out of the executive team, decreased team tenure and increased executive team heterogeneity. Interestingly, this study was also able to link different kinds of changes, internal and external to the firm to different forms and degrees of impact on the top team. Thus, for example, technological jolts and non-retirement successions of the CEO, were more associated with significant changes in the senior team, decreased executive team tenure and increased team heterogeneity than either changes driven by legal and/or regulatory shifts.

The above brief characterization of the Hambrick inspired research on top management teams can only give a flavor of what can be achieved by setting out an ambitious research agenda and then following through with a sustained set of empirical enquiries. Progress has been tied to a narrow focus and the rather singular use of demographic data, but the pattern of development has also been to add conceptual and analytical complexity. Control variables are now used more extensively than in the earlier input-output based work. Time series data is helping somewhat with problems of causal attribution. Early universalistic theorizing is being sharpened by the exploration of contextual variation, and notably in D'Aveni's work, there is an explicit attempt to link the top management team tradition both to the interlocking directorates research, (D'Aveni, 1990) and to agency theory (D'Aveni and Kesner, 1991). However, if the top management team tradition is not to end up as another triumph of method over substance, new questions and methods need to emerge in order to complement and redirect this research.

Top management teams: A brief critique and some suggestions

So dominated is the upper echelons perspective by demographic analysis that any assessment of its strengths and weaknesses must start there. It is probably no coincidence that a year before the Hambrick and Mason (1984) article appeared, an important review article on organizational demography was published by Pfeffer (1983). In this article Pfeffer defines what he means by organizational demography, outlines his view of the structure of demographic hypotheses and explanations, and uses a range of examples to explore the largely untested and unfulfilled promise of demographic approaches. Thus 'demography refers to the composition, in terms of basic attributes such as age, sex, educational level, length of service or residence, race and so forth of a social entity under study' Pfeffer (1983: 303). Demographic distributions are described as having a theoretical and empirical reality distinct from the aggregation of responses of individual members, and crucially, are 'readily measured and reasonably objective,' certainly as compared with a range of 'hypothetical unobservable constructs such as commitment, arousal, conflict, aspiration level, and so forth' (Pfeffer, 1983: 352). Demography is portrayed as an important causal variable that affects a number of interventing variables and processes and, through them, a number of organizational outcomes. Pfeffer illustrates the demographic characteristic (independent variable), intervening variable, and outcome variable linear-link by, for example, research on the length of service distribution of an organization, assumed intraorganizational conflict, and rates of turnover.

Pfeffer (1983) suggests the promise in such an approach will be dependent on resolving a number of empirical and philosophy of science issues. Thus empirically, to what extent does demography predict and explain variation in either the intervening construct (conflict) or the dependent variable (turnover)? But the bigger issue Pfeffer (1983: 351) describes as a matter of taste and philosophy of scientific explanation. 'To what extent is it incumbent on the research to trace through a demographic effect on the various intervening constructs; or, to what extent can the postulating effect of demographic effect and a plausible mechanism be examined simply by investigating the empirical relationship between demography and what demography affects?' (Pfeffer, 1983: 351). Pfeffer answers his own question. 'As soon as you say it is necessary to understand the intervening constructs or process, one inevitably embarks on an infinite regress of reductionism from which there is no logical escape' (Pfeffer, 1983: 352). In a carefully researched, and soundly argued article, Lawrence (1991) draws on a good deal of the organizational demography research since the Pfeffer article to present a contrary point of view.

The title of Lawrence's (1991) article, 'The Black Box of Organizational Demography' makes clear her debate with Pfeffer and also the Achilles heel of the top management team research. Basically, Lawrence challenges the demographers' assumption that the use of demographic variables as surrogates for intervening processes negates the need to study the intervening process and thereby actually tests the links between the independent variable, intervening process, and predicted outcome. Lawrence (1991) goes on to put forward a competing case that the black box (between the input and output variable) is populated by weak relationships between dependent variables and intervening constructs, by many intervening social psychological processes besides those assumed, and that perhaps the links between input and output variables are not linear and unidirectional, but dynamic and recursive. Demographic forms of analysis alone 'move researchers further and further away, both empirically and theoretically, from the actual mechanisms underlying observed relationships' (Lawrence, 1991: 21), and without the direct, concrete analysis of the intervening mechanisms and processes, how indeed can the reasons for any empirical link between input and output variable be explained?

The more damning indictment of the demography-based top management team research is that no-one has ever been anywhere near a top team in an organizational setting, either to directly observe a team in action, or to interview the members about the links between their characteristics and structure, processes of communication and decision making and their impact and performance. Recent studies, for example, by O'Reilly *et al.* (1993) which have tried to go beyond archival data and demographic analysis have relied upon CEO reports of top-team characteristics, structure, and dynamics. Thus enormous interpretative leaps are made from distant demographic surrogates of team characteristics such as homogeneity and heterogeneity, through unobserved and remote intervening processes such as information processing, conflict resolution, and problem solving, to outcome variables such as team effectiveness or organizational performance. The result is a series of inconsistent and inconclusive findings, for example, about the relationship between homogeneity and heterogeneity and team effectiveness (see Keck, 1991 and O'Reilly *et al.*, 1993, for reviews) and continuous problems of disentangling cause and effect. Examples of the reverse causality problem include, do long tenure top teams lead to the persistence of business strategies or are the existence of persistent strategies a cause of long tenure teams? (Finkelstein and Hambrick, 1990) And do top teams embark on diversification strategies because of their team composition, or does the pursuit of diversification lead to the creation of certain kinds of top team competences and characteristics? (Michel and Hambrick, 1992).

A further difficulty with the top management team literature is the inconsistency in defining who the top team is. Flatt (1992) is absolutely right in arguing that this issue may be crucially determining the results and in so doing contributing to inconsistency in the empirical findings. Current variants of who is in the top team include, those executives on the board, (Finkelstein and Hambrick, 1990), the CEO and direct reports, (O'Reilly *et al.*, 1992), or the two highest executive levels (Wiersema and Bantel, 1992). But this issue cannot be resolved just by the arbitrary choice of titles or levels of management. Keck (1991) has argued that some players without titles may have a role in the team, and others with titles may be marginalized. There is also the deeper issue which warrants investigation, do all executives interact as teams? Such questions can only be answered by some combination of observation and interviewing of top teams in action as has been demonstrated, for example, by Eisenhardt and Bourgeois (1988), and Eisenhardt (1989).

Some of the lines of future research on top management teams have been signaled above. Within the top team demography tradition there is a need to treat team characteristics as a dependent variable – why do teams look the way they do? With this approach can emerge more refined theoretical and empirical work contextualizing the demographic characteristic, intervening process, outcome variable, linkages. But surely the real pay-off in future work will come from a parallel research stream on top teams which examines the structure, process, and performance of top teams in action. How and why do teams emerge? How do particular constellations of complementary team assets build up, develop and dissolve in certain firms and industries at certain points in the firms trajectory of development? What cliques and cabals emerge and how is power won and lost within the team as certain key issues are resolved? How do team interpretations of leadership behavior match against previous assumptions about the heroic roles of CEOs? How do the task interdependencies within top teams and associated features of intrateam culture and power affect the control relationships between team members, the CEO, and the board? Does the character and quality of the group process impact the capacity of the team to learn and change, and if so in what way, and why does team process affect team effectiveness and ultimately the competitive performance of the firm?

Conclusion

All three research areas reviewed in this article have their strengths and weaknesses. In different ways, using contrasting methods and levels of analysis, they have each contributed to the little we know about managerial elites. The distinctive methodological approach in the interlocks and top management team work has given those traditions greater intellectual coherence and impact than work on boards and directors. The more scattered, limited, and prescriptive character of the boards work, has produced a less easily identifiable set of theoretical and empirical achievements. By and large all three areas of research have developed in isolation from one another. A case can certainly be made that incremental developments are possible within the logic and methods of all three areas of research. Progress is also possible, as D'Aveni (1990), Goodstein and Boeker (1991) and others have suggested, by linking some of the questions posed by the three approaches into more broadly based studies.

However, the conclusions of this paper go beyond suggestions of incremental development within each of the traditions. With a few noteworthy exceptions, all three areas of research share the common limitation of studying managerial elites several paces from the actors, processes, and issues facing those elites. Rarely can we see interlocking networks in action. We know little at first hand why directors form ties across the boundaries of their own organization, to what purposes such ties are put, and what issues are created or resolved through such behavior. Power relationships are attributed. Control relationships within and between social classes are inferred. The mobilization and use of power to achieve outcomes in line with perceived interests remain unobserved. In the top management team research, easily measurable demographic characteristics are used as surrogates for unobserved intervening processes and inferential leaps are then made to a range of organizational outcomes. The existence of a top management team is assumed. No-one sits close enough to the phenomenon to identify whether and to what extent the top team exists and through what processes the team fashions its impact. Tilting research on managerial elites towards processual studies of interlocking networks, boards, and top management teams in action is surely no longer a nice to have, but now an essential.

In making the argument for process studies of managerial elites, there is no concomitant assumption being made that the three traditions reviewed here be replaced by this alternative one. Quite the contrary, the intellectual purpose is to complement, not replace. By tilting the study of managerial elites in a process direction, new answers may be possible to previous baffling questions, new questions will emerge not posed by prevailing approaches, and new forms of knowledge can arise to inform existing empirical patterns. Of course, it is beyond the ambitions of this paper to specify in detail a range of detailed processual hypotheses on interlocking directorates and networks, boards, and top management teams. In conclusion, this paper suggests some broad areas and questions for empirical enquiry guided by a processual and contextual analysis of managerial elites.

Elsewhere this author has described a range of analytical requirements for studying processes in a contextualist manner (Pettigrew, 1985a, 1985b, 1990, 1992). In summary, six requirements call for attention. These are in turn:

1 Embeddedness, the study of processes across a number of levels of analysis;
2 Temporal interconnectedness – studying the processes in past, present, and future time;
3 A role in explanation for context and action;
4 A search for holistic rather than linear explanations of process;
5 A need to link process analysis to the location and explanation of outcomes; and,
6 A need for the researcher to balance involvement and distance with actors in the research process.

Set against these requirements, existing research in the interlocking directorates and top management team traditions, has little to offer the process analyst. Indeed the logic of both approaches eschews any real concern for process questions. In each case inputs are measured, the structure of interlocking networks or the demographic characteristics of teams and then inferences are made about the causal role of these independent variables on some dependent or outcome variables. The processes in between the input and outputs have a role in explanation but are not directly analyzed or observed. Thus the interlocks tradition is strong on describing the structural anatomy of director ties, but is largely silent on the observation of the emergence, use, and impact of such linkages. It is not surprising that doubts remain about the meaning and significance of interlocking directorates.

Any attempt to redress this imbalance between structural and process analysis would entail the following lines of questioning. Why and how do interlocking ties emerge, consolidate and dissolve? What mixed motives are behind the offering and acceptance of multiboard membership? What flows across the interlinkages, shapes those flows and with what purpose and interests in mind? How are influence processes conducted in the network and is it possible to unravel the place of influence processes from coordination, information giving and control? What indeed are the purposes of linkages and do those purposes alter over time in the context of broad changes in the political, social, economic and commercial context of the firm? Are there network stars in any set of sectoral or national patterns of interlinkage? Who are these network stars? Do they share any common social class, educational, gender, or professional characteristics? Are there common threads in the career of network stars, and how and why are they able to exert power in certain kinds of spheres of activity but not others? If as Bauer and Bertin-Mourot (1992) and Hamilton and Biggart (1988) have shown there are differences in the structure and demographic characteristics of business elites in different societies, what explains these differences and what consequences do they have for the conduct of corporate affairs within and between societies? Empirical enquiry guided by the above broad questions (and many others capable of development) will rapidly take the interlocks tradition on from the distant description of the structure of networks, to examine the substance, processes, consequences, and impact of interorganizational ties.

The black box in the top management team research contains the assumed but unobserved mediating process which are purported to link demographic characteristics with organizational outcomes. More fundamentally, however, the black box also contains the essence of enquiry for the process scholar, the emergence, developments, conduct, impact, and performance of the team itself. The actual close analysis and observation of the top team will at least help to clear up some of the intractable definitional problems of who the top team is, and whether and to what extent managers operate in groups or teams in processing strategic issues (Jackson, 1992). Rather than assuming titles and positions as indicators of involvement in choice and change processes, the first task for the process scholar is to identify which players are involved, and why. We still know little about why and how top teams and other groupings look the way they do, the processes by which top teams go about their tasks, how CEOs engage with their immediate subordinates, and how, why, and when the upper echelons engage in fundamental processes of problem sensing, decision making, learning, and change. The pessimists who consider access is never forthcoming for such research might gain some confidence from progress made in recent studies by Eisenhardt (1989), Eisenhardt and Schoonhoven (1990), and Pettigrew and Whipp (1991).

Progress in our third area of research, the study of boards and their directors, has not been helped by over-ambitious attempts to link independent variables such as board composition to outcome variables such as board and firm performance. The research agenda here need not be guided just by studies testing the relative explanatory power of agency theory or theories of managerial hegemony. The task is perhaps a simpler one, to redress the overwhelmingly prescriptive bias in this literature, and begin to provide some basic descriptive findings about boards and their directors. We need to know more about the structure and functioning of boards beyond customary preoccupations with size and composition. There are still few surveys of who external directors are, what motivates them to join boards and what they, CEOs and internal directors do. Very little is known of the relational dynamics in and around the boardroom. How relationships are formed and developed between the CEO and a separate chairman if one exists. How CEOs engage with their internal director colleagues on matters of substance, and how and why patterns of relationships between internal directors impact on their relations with external board members.

For the process scholar, however, the real fascination is with the actual operation of the board in and outside the boardroom. What is the extent of the involvement of the board in the strategy process, how and why are they involved in different kinds of issues at various time periods in the organization's development, and with what consequences? The exploration of board functioning and performance needs in the first instance to be linked to the specific concrete issues normally thought to be within the board's sphere of interest and influence. How are boards involved in processes of CEO and director selection and compensation? Who assesses the performance of the CEO, when and how?

What board committees are created for what purposes, and how does information flow in and around these committees, the board, the CEO, and individual directors? How are complementary assets of human resources on the board defined, created, and dissolved around different eras of organization development when crises of performance and succession shake the credibility of cadres of external and internal directors? How does the mobilization and use of power in and around the board impact on the major choices and changes faced by the organization? And how and why are the powerful bolstered by linkages outside the firm and checked by nonelites inside the firm? Sustained attention to these empirical questions, informed by existing theoretical advances in decision making, change, and power in and between firms, will advance our knowledge of the conduct of managerial elites in organizations.

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9 Cognition and corporate governance *

Understanding boards of directors as strategic decision making groups[1]

Daniel P. Forbes and Frances J. Milliken

Recent research developments underscore the need for research on the processes that link board demography with firm performance. In this article we develop a model of board processes by integrating the literature on boards of directors with the literature on group dynamics and workgroup effectiveness. The resulting model illuminates the complexity of board dynamics and paves the way for future empirical research that expands and refines our understanding of what makes boards effective.

Recent reviews of management research on boards of directors (Johnson, Daily, & Ellstrand, 1996; Pettigrew, 1992) have indicated that, although much has been learned, the time is ripe for reflection and for the exploration of new directions in board research. In particular, Pettigrew has observed that in many studies of boards, 'Great inferential leaps are made from input variables such as board composition to output variables such as board performance with no direct evidence on the processes and mechanisms which presumably link the inputs to the outputs' (1992: 171). Pettigrew goes on to argue that future research on boards should focus on the actual behavior of boards, thereby supplementing our knowledge of what boards look like with evidence of what boards do.

The importance of studying board behavior directly is underscored by evidence that practitioners – in some cases, boards themselves – are also beginning to pay more attention to what boards do (Lublin, 1997; Schine, 1997). Whereas in previous decades boards of directors could be characterized as essentially formal and passive institutions that seldom came under public scrutiny (Mace, 1971), boards today are increasingly finding their actions closely monitored by institutional investors (Heard, 1987; Judge & Reinhardt, 1997) as well as by the media (Byrne, 1997; Orwall & Lublin, 1997).

Further evidence of interest in board behavior can be seen in the increased

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level of legal scrutiny to which boards are subjected and in the growing competitiveness of the market for corporate control (Kesner & Johnson, 1990; Monks & Minow, 1995). Moreover, *Business Week* reported recently that the board of Campbell Soup conducted an internal assessment, in which it determined

> that it wasn't devoting enough time to long-range strategic planning; that some colleagues didn't speak up enough in meetings; that the quality of some committee reports needed upgrading; and that the company had to spend more time broadening and diversifying the skills of directors.
>
> (Byrne, 1996: 98)

It would have been almost unthinkable to encounter such a rigorous self-analysis from one of the characteristically unresponsive boards documented by Mace (1971) almost 30 years ago. In summary, it appears that as boards assume a more central oversight role in the governance of organizations, researchers and practitioners alike are seeking to better understand the processes and behaviors involved in effective board performance.

In addition, recent research developments have reinforced Pettigrew's (1992) point that it is necessary to go beyond the demography-outcome approach in order to understand fully the performance implications of board characteristics. Reviews of the boards literature indicate that the predictive power of parsimonious models has failed to materialize, even in the most well-researched areas (Johnson et al., 1996). Furthermore, research on demography in other contexts has called into question the assumptions that underlie the search for direct demography-performance links (Lawrence, 1997; Melone, 1994). At the same time, other recent studies have demonstrated the superior explanatory power of studies that incorporate the study of process constructs (Amason & Sapienza, 1997; Ancona & Caldwell, 1992; Smith, Smith, Olian, Sims, O'Bannon, & Scully, 1994).

Here, we propose a model of strategic decision-making effectiveness in U.S.-based boards that bridges some of the gaps that currently characterize much theorizing about boards. We begin by considering the factors that characterize boards as decision-making groups and by discussing some criteria that distinguish effective boards from ineffective ones. Then, drawing on the literature on small-group decision making, we define and develop three critical board processes and two board-level outcomes that we believe serve as mediators of the relationships between commonly studied aspects of board demography and firm performance.

Our analysis focuses on the board's control and service tasks, which, to be performed effectively, require that board members cooperate to exchange information, evaluate the merits of competing alternatives, and reach well-reasoned decisions. We acknowledge that, in practice, it is often difficult for boards to do these things and that on many boards the quantity and quality of substantive interaction are, in fact, minimal. However, the very existence of the board as an institution is rooted in the wise belief that the effective oversight of an organization exceeds the capabilities of any individual and that collective knowledge and deliberation are better suited to this task. The processes we discuss are those that enable boards to achieve their full potential as strategic decision-making groups.

In the course of our discussion, we suggest ways of operationalizing the constructs we identify in an effort to guide future empirical research based on our model. We also explain how the processes we identify are likely to be affected by various aspects of board demography, such as job-related diversity and size. Finally, we discuss ways in which the dynamics of boards as groups may differ among boards of different types of organizations.

Theoretical background

Most scholars agree that predictions about the performance implications of demographic variables are presumed to operate through some set of intervening processes. However, there has been debate over whether the direct study of those intervening processes is necessary. Pfeffer (1983), for example, argues that the study of such processes is not necessary, because executives' beliefs and behaviors can be inferred successfully from demographic characteristics. This argument is essentially one of parsimony: as long as research can explain *what* the group- or organization-level impact of demography is, it is not necessary to determine (or one can speculate about) *why* demography operates in the observed way. This is an appealing argument, and it has provided the inspiration for a great many studies of the demography of top management teams (TMTs) and boards of directors. However, recent research findings suggest at least three reasons why the argument for parsimony over precision in the study of board demography is no longer convincing.

First, recent literature reviews have concluded that board research has failed to establish any clear consensus as to which demographic characteristics lead to which outcomes, even in the most well-researched areas (Daily & Schwenk, 1996; Johnson et al., 1996, Zahra & Pearce, 1989). This conclusion suggests that the influence of board demography on firm performance may not be simple and direct, as many past studies presume, but rather, complex and indirect. To account for this possibility, researchers must begin to explore more precise ways of studying board demography that account for the role of intervening processes.

Second, the assumptions that underlie the search for direct demography-performance links have been shown to be unreliable. Lawrence (1997), for example, conducted an intensive review of past demographic research, precisely for the purpose of evaluating the assumption that it is unnecessary to test the inferences involved in demography-outcome relationships. She found that, in a majority of cases, the explanations offered for demography-outcome relationships are not supported by studies in which researchers have actually examined the intermediary process phenomena. Recent findings by Walsh (1988) and Melone (1994) also dispute the notion that executive beliefs and behaviors can be inferred reliably from demographic variables alone.

Third, scholars have shown that the study of process constructs has the potential to expand and refine our understanding of group dynamics. For example, Smith and colleagues' study of TMTs (1994) showed that firm performance was impacted (1) directly by demographic variables, (2) indirectly by demographic variables operating through process variables, and (3) directly and independently by additional process variables. The identification of independently predictive processes represents an important complement to knowledge about the direct or indirect effects of board demography. Other studies have shown how a single group characteristic can have multiple implications for group performance. For example, Amason and Sapienza's (1997) study of TMTs shows that group size is positively related to both cognitive conflict and affective conflict – two processes generally understood to have opposite effects on the quality of groups' strategic decisions. Studies that account for such complexities enable researchers to draw more informed conclusions by clarifying the multiple factors that managers must consider in making decisions regarding group design.

These findings demonstrate the value of studying group processes. They indicate that researchers need to incorporate the study of process variables so that they can expand their understanding of the factors that contribute to group performance and address questions concerning the influence of group demography with adequate care. While these lessons are applicable to many areas of group demography, they are particularly applicable to boards.

In the following sections we show how the study of board processes can help to disentangle the predictions offered by multiple theoretical perspectives with regard to board demography. For example, it is plausible that a high proportion of outsiders will enhance some aspects of board functioning, such as board effort norms, as agency theory would suggest, but will have a negative impact on other aspects of board functioning that are beyond the scope of agency theory's rational framework, such as the level of cohesiveness on the board. Attention to process variables permits researchers to develop and test models that reflect these complexities of board dynamics. Researchers will be able to use the knowledge generated by process studies to clarify the tradeoffs associated with various aspects of board design and to resolve long-standing inconsistencies in board research.

Toward a model of board processes

Extensive literature exists on the effectiveness of workgroups in organizations (for reviews, see Bettenhausen, 1991; Cohen & Bailey, 1997; Gist, Locke, & Taylor, 1987). In developing our model of boards as groups, we define workgroups as 'intact social systems that perform one or more tasks within an organizational context' (Bettenhausen, 1991: 346), and we believe that all boards quality as groups in this respect. In addition, we look to the general 'heuristic model of group effectiveness' identified by Cohen and Bailey (1997: 244), which is based on earlier models by Hackman and Morris (1975) and Gladstein (1984).

In particular, we value the input-process-output approach this framework uses, as well as its distinction between 'task-performance' outcomes and those outcomes concerned with the ability of the group to continue functioning. However, following Goodman, Ravlin, and Schminke (1987), we believe that the specific processes that mediate between board demography and firm performance are likely to depend on factors that are specific to boards as groups and on the specific criteria of effectiveness under consideration. In the sections that follow, we discuss the factors that distinguish boards from other types of workgroups and propose specific criteria that could be used to evaluate the decision-making effectiveness of boards.

Distinctive features of boards as groups

Scholars most commonly describe the board of directors as the formal link between the shareholders of a firm and the managers entrusted with the day-to-day functioning of the organization (Mintzberg, 1983; Monks & Minow, 1995). Consistent with this description, Fama and Jensen have described the board as the 'apex of the firm's decision control system' (1983: 311). Like a TMT – another elite workgroup with a major role in the firm's decision control system – boards face complex, multifaceted tasks that involve strategic-issue processing (Jackson, 1992). However, an important difference exists between boards and TMTs in that boards are responsible only for monitoring and influencing strategy – not for implementing strategic decisions or for day-to-day administration (Fama & Jensen, 1983).

Our analysis focuses on the specific board tasks that are most relevant to an understanding of boards as groups: control and service. The board's control task refers to its legal duty to monitor management on behalf of the firm's shareholders and to carry out this duty with sufficient loyalty and care (Monks & Minow, 1995). The board's service task refers to its potential to provide advice and counsel to the CEO and other top managers and to participate actively in the formulation of strategy.

Several additional distinctive features of boards deserve note. First, contemporary boards often include many 'outsiders,' who have their primary affiliation with another organization. These outsiders serve on only a part-time basis and have limited direct exposure to the firm's affairs. Second, boards average 13 members (Monks & Minow, 1995) – a size considerably greater than that of other workgroups studied in the management literature. The top management teams studied by Eisenhardt and Bourgeois (1988), for example, ranged in size from 5 to 9 members, whereas the workgroups studied by Gersick (1988) and Jehn (1995) averaged 5.6 members and 5.9 members, respectively. Finally, unlike many workgroups, boards function only episodically. Full board meetings are held, on average, only 7 times per year (Monks & Minow, 1995). Committee meetings provide some additional opportunities for intraboard interaction, but, in general, directors still spend less than 2 weeks per year working on the boards they serve (Monks & Minow, 1995).

In summary, boards of directors can be characterized as large, elite, and episodic decision-making groups that face complex tasks pertaining to strategic-issue processing. Because boards are not involved in implementation, the 'output' that boards produce is entirely cognitive in nature. In addition, because boards are large, episodic, and interdependent, they are particularly vulnerable to 'process losses' (Steiner, 1972) – the interaction difficulties that prevent groups from achieving their full potential. Taken together, these factors suggest that the effectiveness of boards is likely to depend heavily on social-psychological processes, particularly those pertaining to group participation and interaction, the exchange of information, and critical discussion (Butler, 1981; Jackson, 1992; Milliken & Vollrath, 1991).

Criteria of board effectiveness

The model we develop is concerned with two criteria of board effectiveness: (1) board task performance, defined as the board's ability to perform its control and service tasks effectively, and (2) the board's ability to continue working together, as evidenced by the cohesiveness of the board. These are the classic 'task' and 'maintenance' criteria identified in many past models of group effectiveness (Cohen & Bailey, 1997; Gladstein, 1984). Both are board-level constructs that are distinct from firm performance, but both also contribute to firm performance. Board task performance influences firm performance directly, whereas board cohesiveness does so indirectly by influencing present and future levels of board task performance.

In our model board task performance represents the degree to which boards succeed in fulfilling their control and service tasks. Specific board activities that are critical to the fulfillment of the control task include decisions regarding the hiring, compensation, and replacement of the firm's most senior managers, as well as the approval of major initiatives proposed by management. Specific activities that correspond to the fulfillment of the service task include providing expert and detailed insight during major events, such as an acquisition or restructuring, as well as more informal and ongoing activities, such as generating and analyzing strategic alternatives during board meetings.

Because of the strictly confidential and highly interpretive nature of board activity, it is likely to be extremely difficult for researchers to measure the task performance of boards in ways that are both reliable and comprehensive. Certain publicly announced board actions, such as the adoption of golden parachutes (Singh & Harianto, 1989) or CEO replacement (Boeker, 1992), may be used as proxies for performance on the control dimension. Board performance on the service dimension may be assessed by asking the CEO, a nonmember manager, or an outside consultant to rate the value of the advice and analysis the board contributes to strategic decisions. Alternatively, researchers may regard board task performance as a latent construct.

Board cohesiveness refers to the degree to which board members are attracted to each other and are motivated to stay on the board (Summers, Coffelt, & Horton, 1988). Because boards meet only episodically and are composed of persons for whom directorship is a part-time responsibility, the relationship of directors to the board can be characterized as one of 'partial inclusion' (Weick, 1979). Cohesiveness captures the affective dimension of members' inclusion on the board and reflects the ability of the board to continue working together.

In studies of workgroups, researchers have found that when group members are more attracted to one another, they realize higher levels of member satisfaction (Katz & Kahn, 1978; Summers et al., 1988) and higher levels of commitment to the group (Zaccaro & Dobbins, 1989); they are also less likely to engage in excessive turnover (Angle & Perry, 1981; Jaros, 1995; O'Reilly, Caldwell, & Barnett, 1989; Piper, Marache, Lacroix, Richardsen, & Jones, 1983). On boards with very low levels of cohesiveness, members may choose not to stand for reelection, or, in extreme cases, they may resign from the board. Although a certain amount of turnover is normal and even healthy, high levels of turnover are likely to reduce the presence of firm-specific knowledge on the board.

In addition, owing to the tendency of groups to preserve the collective structures they create (Weick, 1979), cohesiveness may influence future board processes as well. For example, in light of past research linking organizational commitment to members' extrarole, prosocial behaviors and a willingness to expend effort on behalf of the organization (O'Reilly & Chatman, 1986), there is reason to expect that high levels of cohesiveness may enhance the future effort norms of the board. Moreover, high levels of cohesiveness may strengthen the future impact of effort norms, because more-cohesive groups are better able to influence their members' behavior (Janis, 1983; Shaw, 1981).

Cohesiveness also can exert a more immediate influence on the task performance of boards – a point we return to later. Cohesiveness can be operationalized using the scales from O'Reilly et al. (1989) that correspond to the affective components of social integration.

Board processes and their impact on board effectiveness

We have argued that board task performance and board cohesiveness are two key criteria by which to assess the effectiveness of boards as decision-making groups and that board task performance is likely to be influenced by social-psychological factors. In this section we discuss three board processes that we propose will significantly influence a board's task performance and cohesiveness: effort norms, cognitive conflict, and the board's use of its knowledge and skills. We also consider the relationship between cohesiveness and board task performance.

Effort norms: Ensuring preparation, participation, and analysis

Effort norms are a group-level construct that refers to the group's shared beliefs regarding the level of effort each individual is expected to put toward a task (Wageman, 1995). Effort – an individual-level construct – is a product of motivation and refers to the intensity of individuals' task-performance behavior (Kanfer, 1992) or to the proportion of members' 'total cognitive resources [that are] directed toward the target task' (Kanfer, 1992: 79). Norms often exert a strong influence on member behavior (Feldman, 1984; Steiner, 1972), particularly in groups that, like boards, are interdependent (Wageman, 1995). Thus, strong effort norms can be expected to enhance the effort of individual group members (Steiner, 1972; Wageman, 1995), which, in turn, can contribute to the performance of workgroups (Latané, Williams, & Harkins, 1979; Steiner, 1972; Weldon & Gargano, 1985).

Most directors face many competing demands for their time and must keep carefully budgeted schedules (Lorsch, 1989; Mace, 1986). Although most board members face these constraints, the time that directors devote to their tasks can differ considerably across boards, and these differences can significantly determine the degree to which boards are able to represent shareholders' interests successfully and to make contributions to strategy. Mace argues that most boards fall far short of realizing their potential contributions and that this is due, in part, to their failure to even 'do the homework' necessary for understanding the company's problems (1986: 107). Similarly, Lorsch argues that directors who devote sufficient time to their duties and seek out the information they need are better able to prevent and manage crises and to govern effectively in times of stability (1989: 191–192).

Although time is an important manifestation of effort, even boards that spend similar amounts of time can exhibit different levels of effort. Past qualitative studies have shown that boards undertake their duties with widely varying degrees of attentiveness, analysis, and participation. Some boards simply 'go through the motions' of attending meetings and registering votes, without being mentally engaged with the issues facing the board (Herman, 1981; Mace, 1986). However, there are counterexamples of boards that conduct diligent research on the firms they serve (Lorsch, 1989: 104–105), that participate actively in board discussions (Lorsch, 1989: 118), and that use pocket calculators during meetings (Monks & Minow, 1995: 217). Boards that have standards and expectations promoting such high-effort behaviors among members are more likely to perform their control and service tasks effectively.

Drawing on Wageman's (1995) example, researchers could operationalize effort norms by asking board members to rate the board's support for behaviors with statements such as the following: 'carefully scrutinizing the information provided by the firm prior to meetings,' 'researching issues relevant to the company,' 'taking notes during meetings,' or 'participating actively during meetings.'

Cognitive conflict: Leveraging differences of perspective

Cognitive conflict refers to task-oriented differences in judgment among group members. Jehn defines cognitive conflict as 'disagreements about the content of the tasks being performed, including differences in viewpoints, ideas and opinions' (1995: 258). Cognitive conflict differs from effort norms in that effort norms refer to group expectations regarding the intensity of individual behavior, whereas cognitive conflict is concerned with the presence of issue-related disagreement among members. Cognitive conflict is likely to arise in groups that, like boards, are interdependent and face complex decision-making tasks. Because the issues facing boards are complex and ambiguous, board members are liable to characterize issues differently and to hold different opinions about what the appropriate responses to these issues are (Dutton & Jackson, 1987). However, boards are likely to differ considerably in the degree to which they experience cognitive conflict (Byrne, 1997; Monks & Minow, 1995).

Cognitive conflict involves the use of 'critical and investigative interaction processes' (Amason, 1996: 104) that can enhance the board's performance of its control role. The presence of disagreement and critical investigation on the board may require CEOs to explain, justify, and possibly modify their positions on important strategic issues and to entertain alternative perspectives and courses of action. Moreover, the existence of cognitive conflict on the board can serve to remind management of the power and role of the board and of the importance of considering shareholder interests in the formulation of strategy even beyond the boardroom.

In addition, cognitive conflict results in the consideration of more alternatives and the more careful evaluation of alternatives – processes that contribute to the quality of strategic decision making in uncertain environments (Eisenhardt, Kahwajy, & Bourgeois, 1997; Jackson, 1992; Milliken & Vollrath, 1991). Watson and Michaelsen (1988) have found that groups performing an intellective task perform better when their interaction behaviors feature the inclusion of multiple viewpoints and the exchange of both positive and negative comments. Likewise, Wanous and Youtz (1986) have found that solution diversity has a positive influence on the quality of group decisions; Schweiger, Sandberg, and Ragan (1986) have found that conflict-inducing techniques contribute to the effectiveness of strategic decision-making groups.

In spite of these beneficial effects of cognitive conflict, cognitive conflict also can arouse negative emotions (Nemeth & Staw, 1989) that diminish interpersonal attraction among members. Findings by Jehn (1995) and Schweiger and colleagues (1986) demonstrate that members of groups with high levels of cognitive conflict experience lower levels of satisfaction with the group and express less desire to remain with the group. Mace (1986) has found evidence that these dynamics can apply to boards as well. Because of the pressures of their competing responsibilities, he observed, many directors respond to high levels of cognitive conflict on the board by reducing, rather than increasing, their commitment to the board (Mace, 1986: 33–36).

One recent example of a reliable operationalization of cognitive conflict is Jehn's (1995) four-item scale for task conflict. Using this scale, researchers could ask respondents to gauge, using Likert-type items, the frequency of conflicts about ideas and the extent of differences of opinion on the board.

The presence and use of knowledge and skills

Boards require a high degree of specialized knowledge and skill to function effectively. Jackson notes that although 'an implicit assumption often made in the management literature is that expertise will be used, assuming it is present, psychological research clearly indicates that the availability of expertise in a group does not guarantee the use of that expertise' (1992: 359). Thus, our model accounts for the presence and use of knowledge and skills with two separate constructs: (1) an 'input' variable that represents the knowledge and skills present on the board and (2) a "process" variable that represents the way in which those resources are used by the board.

Presence of knowledge and skills. One can characterize the knowledge and skills most relevant to boards on two main dimensions: (1) functional area knowledge and skills and (2) firm-specific knowledge and skills. Functional area knowledge and skills span the traditional domains of business, including accounting, finance, and marketing, as well as those domains that pertain to the firm's relationship with its environment, such as law. Boards – as elite, strategic-issue-processing groups – must have members who possess knowledge and skills in these areas or have access to external networks that can aid in information gathering and problem solving (Ancona & Caldwell, 1988).

Firm-specific knowledge and skills refer to detailed information about the firm and an intimate understanding of its operations and internal management issues. Boards often need this kind of 'tacit' knowledge (Nonaka, 1994) in order to deal effectively with strategic issues. In order to make informed decisions regarding diversification or acquisition opportunities, for example, the board may need to have a detailed understanding of how new and existing businesses would complement one another (Farjoun, 1994; Sirower, 1997).

Researchers may assess the knowledge and skills present on the board by asking board members to assess, using a Likert-type scale, the degree to which both types of expertise are present on the board. The scale used to assess the presence of functional area knowledge and skills might include items intended to gauge the presence of knowledge in domains that are common to virtually all businesses, such as finance, accounting, marketing, and law. These items could them be summed to obtain a composite score.

Alternatively, because some functional areas are liable to vary in importance across industries, researchers may want to ask respondents to rate the importance of various functional areas to their businesses and use an additive measure that weights more important areas more strongly.

In assessing firm-specific knowledge and skills, researchers could draw on measures similar to those developed by McGrath, MacMillan, and Venkataraman (1995) to measure 'comprehension' within executive teams. Specifically, researchers could ask respondents to assess the degree to which the board understands cause-effect relationships involving the needs of customers, sources of risk to the firm, and impediments to output quality.

Use of knowledge and skills. The use of knowledge and skills refers to the board's ability to tap the knowledge and skills available to it and then apply them to its tasks. The construct, first identified by Hackman and Morris (1975), represents the minimization of 'process losses' and the occurrence of 'cross-training' and 'collective learning' among members (Hackman, 1987: 327). This construct is related to the behavioral dimension of social integration, which refers to a group's ability to cooperate (Cohen & Bailey, 1997). It is also related to Weick and Roberts' concept of heedful interrelating, which they define as a 'complex, attentive system [of interaction] tied together by trust,' in which individual actions are subordinated and responsive to the demands of 'joint action' (1993: 378). The use of knowledge and skills is distinct from cognitive conflict in that the use of knowledge and skills refers to the process by which members' contributions are coordinated, whereas cognitive conflict refers to the content of members' contributions.

If boards are to perform their control task effectively, they must integrate their knowledge of the firm's internal affairs with their expertise in the areas of law and strategy. In addition, if boards are to perform their service task effectively, they must be able to combine their knowledge of various functional areas and apply that knowledge properly to firm-specific issues. In both cases board members must elicit and respect each others' expertise, build upon each others' contributions, and seek to combine their insights in creative, synergistic ways.

Empirical studies of related constructs suggest the importance of the use of knowledge and skills in determining group effectiveness. Wageman (1995), for example, has found that cooperation norms contribute to group performance, particularly in interdependent groups. Similarly, Weick and Roberts (1993) show how heedful interrelating is a prerequisite to the effective performance of flight deck crews. Studies also show that the performance of TMTs is enhanced by group processes similar to the use of knowledge and skills, such as the 'smoothness' of group process (Eisenhardt, 1989) and executive team 'deftness' (McGrath et al., 1995).

A board's ability to use its knowledge and skills could be operationalized by asking board members to assess the validity of statements like the following, using Likert-type items: 'people on this board are aware of each others' areas of expertise,' 'when an issue is discussed, the most knowledgeable people generally have the most influence,' and 'task delegation on this board represents a good match between knowledge and responsibilities.' In addition, although the construct of executive team deftness is broader than the use of knowledge and skills construct, the scale developed by McGrath and colleagues (1995) to measure deftness contains several items pertaining to the exchange of information within groups that could be adapted for use in this context – for example, 'important information often gets withheld on this board' (reverse coded) and 'information flows quickly among board members.'

Cohesiveness

We have discussed the effects of effort norms, cognitive conflict, and the use of knowledge and skills on board task performance. We now address the potential for board cohesiveness to exert an immediate influence on board task performance.

Because boards are charged with complex, interactive tasks, the degree of interpersonal attraction among members is likely to influence the effectiveness with which those tasks are performed (Williams & O'Reilly, 1998). The relationship between board cohesiveness and board task performance is likely to be curvilinear. Both the control and service components of the board's task require extensive communication and deliberation, and board members must have a certain minimum level of interpersonal attraction in order to engage in these things. In addition, board members must trust each others' judgment and expertise, and such trust will be difficult to sustain on boards with very low levels of interpersonal attraction. Furthermore, cohesiveness has been found to enhance decision making in some ways, such as by promoting earlier and more extensive discussion of alternative scenarios (Hogg, 1996).

However, very high levels of cohesiveness are likely to prove deterimental to the quality of the board's decision making. Highly cohesive boards may be distracted by the proliferation of personal exchanges. In addition, cohesiveness is the most prominent and frequently noted antecedent of 'groupthink' (Mullen, Anthony, Salas, & Driskell, 1994) – a dysfunctional mode of group decision making characterized by a reduction in independent critical thinking and a relentless striving for unanimity among members (Janis, 1983). Janis hypothesizes that 'for most groups, optimal functioning in decision making tasks may prove to be at a moderate level of cohesiveness' (1983: 248).

Although, as we have noted, cohesiveness is a key determinant of groupthink, it is not sufficient to produce groupthink (Janis, 1983; Mullen et al., 1994). In order to lead to groupthink, cohesiveness also must be accompanied by an absence of cognitive conflict among members. According to Janis (1983), groupthink occurs when members of highly cohesive groups engage in self-censorship and act as 'mindguards,' pressuring deviant thinkers to conform to majority opinions. But such behaviors do not invariably accompany cohesiveness. It is entirely possible for groups to have high levels of both interpersonal attraction and task-oriented disagreement (Jackson, 1992). In fact, the most effective boards, like the best management teams (Eisenhardt et al., 1997), can be characterized in precisely this way (Byrne, 1996). Cognitive conflict can help to prevent the emergence of groupthink in cohesive groups by fostering an environment characterized by a task-oriented focus and a tolerance of multiple viewpoints and opinions (Bernthal & Insko, 1993; Janis, 1983).

Concluding observations regarding the effects of board processes

The following propositions summarize our predictions regarding the influence of board processes on board effectiveness.

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

> *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.*

In addition to the effects captured in these propositions, we note that the processes discussed above have the potential to influence one another. For example, to the extent that high-effort norms result in more intense participation among members, they may stimulate cognitive conflict and lead to an increased use of members' knowledge and skills. Similarly, cognitive conflict may surface task-relevant information, and, conversely, the elicitation of members' knowledge may give rise to further conflict. However, the exact nature and strength of these relationships are likely to vary. For example, when a board's meetings are dominated by prolonged debates between two individuals, cognitive conflict may actually inhibit the use of members' knowledge and skills. Similarly, the collective experience of cognitive conflict may enhance board effort norms when disagreements are moderate in scale, but conflict may also diminish effort norms if disputes seem unresolvable.

Figure 9.1 presents a graphical depiction of the relationships proposed in this section.

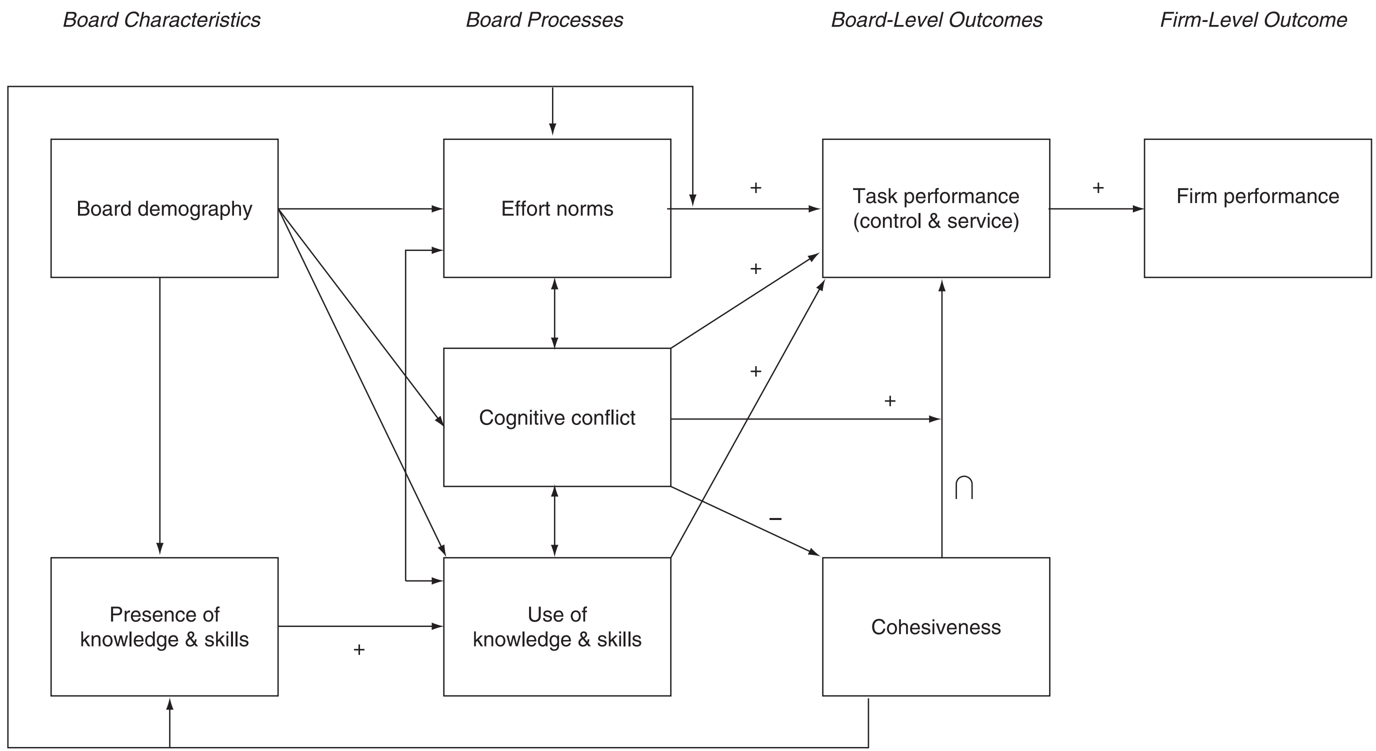

Figure 9.1 A model of board processes and their impacts on board effectiveness.

The effects of board demography

In this section we illuminate the complexity of board dynamics by showing how a single aspect of board demography can have multiple and contrasting effects on different mediating constructs. This point contradicts the prevailing view, which holds that either (1) there exist unequivocal relationships between board demography and firm performance or (2) demography does not exert a significant influence on board performance (Johnson et al., 1996: 433). We maintain that demography is very likely to be a significant predictor of board behavior but that its effects are too fine grained to be revealed by tests of the demography-performance relationship.

We begin by making a detailed case for the effects of a specific aspect of board demography – job-related diversity – and then offering some speculations regarding the effects of other demographic variables.

Job related diversity

Forms of diversity that are job related in the context of board work include functional background, industry background, and educational background. Boards exhibit a considerable degree of diversity on these dimensions. Contemporary boards include CEOs who represent a variety of industries and functional backgrounds, as well as significant numbers of lawyers, investment bankers, academics, and nonprofit executives who represent diverse educational and industry backgrounds. Diversity of this sort clearly enhances the presence of functional area knowledge and skills on the board, although diversity is likely to have other influences on board functioning as well.

In their recent review of the literature on the effects of diversity in organizational groups, Milliken and Martins (1996) note that diversity is a 'double-edged' sword for groups: although it increases the aggregate level of resources at the group's disposal, it is also associated with higher levels of conflict, interaction difficulties, and lower levels of integration. These double-edged consequences are likely to be particularly pronounced in board settings. Because boards comprise part-timers who interact only periodically, board members have few opportunities to diminish or smooth over the differences that separate them. Thus, consistent with the findings of recent studies on the effects of diversity in organizational groups, diversity can be expected to increase the level of cognitive conflict present on the board and to decrease the board's level of cohesiveness and its use of knowledge and skills.

To the extent that board members have different educational, functional, and industry backgrounds, they are more likely to experience differences in the ways that they perceive, process, and respond to issues they confront on the board (Milliken & Martins, 1996; Williams & O'Reilly, 1998), and these differences are likely to precipitate higher levels of cognitive conflict. Empirical support for this argument can be found in studies of the influence of functional background on executive perception (Dearborn & Simon, 1958;

Waller, Huber, & Glick, 1995), as well as in more recent studies of conflict in groups (Eisenhardt & Bourgeois, 1988; Pelled, 1993; Jehn, Northcraft, & Neale, 1997). Moreover, groups with diverse backgrounds are more likely to have access to information and perspectives drawn from outside the group (Ancona & Caldwell, 1992), and attempts to pool and integrate these 'exotic' contributions may lead to higher levels of cognitive conflict.

Diverse boards are also more likely to experience communication and coordination difficulties that inhibit the effective use of knowledge and skills, because their members may be unaware of each others' expertise or unable to appreciate its applicability to issues facing the board. In addition, diverse board members may have difficulty understanding one another because of differences in jargon or terminology. These difficulties may prove frustrating to board members, making them less inclined to offer information or opinions that highlight their diversity and more inclined to discuss information that is already shared by the group (Stasser, 1992). A laboratory study by Wittenbaum and Stasser (1996) shows that group members are less likely to share unique information when it is distributed among group members.

Finally, boards whose members have diverse backgrounds are also likely to be less cohesive. Williams and O'Reilly (1998) conclude that demographic diversity is associated with lower levels of interpersonal attraction within groups. The most common explanation for this effect is that demographic differences are associated with differences in attitudes (O'Reilly et al., 1989) and language (Wiersema & Bantel, 1992), which, in turn, lead to less mutually satisfying interactions among members and, ultimately, psychological ties among members that are fewer in number and weaker in strength than they are in more homogeneous groups (Shaw, 1981). Because boards are large groups that meet only episodically, they are unlikely to have time to fully resolve the attitudinal and linguistic differences that divide them, and board cohesiveness will suffer as a result.

> *Proposition 4: The degree of job-related diversity on the board will be positively related to the presence of functional area knowledge and skills and cognitive conflict on the board but negatively related to the board's cohesiveness and its use of its knowledge and skills.*

We have confined our attention to job-related diversity because, unfortunately, the amount of visible diversity on American corporate boards remains very low (Dalton & Daily, 1998). In general, however, the effects of visible diversity are likely to be similar to those that we have outlined for job diversity (Milliken & Martins, 1996). It should be noted that visible diversity is significantly more common on nonprofit boards – a point we return to later.

Other aspects of board demography

As with diversity, other aspects of board demography are likely to have similarly complex effects on board processes. We briefly discuss three of these effects below.

Proportion of outsiders. Outsiders may enhance the effort norms of the board in that they are inclined to conceive of the board's task as a task separate from and complementary to that of management, whereas insiders may view their governance responsibilities as simply an extension of their managerial duties (Mace, 1986). In addition, the presence of outsiders may stimulate a desire on the part of insiders to show that they have their 'house in order,' leading to higher expectations of effort among them. The presence of outsiders is also likely to enhance the levels of cognitive conflict on the board, because outsiders share significantly fewer experiences with management and are liable to think more freely with regard to the firm's goals and the range of alternatives available to it.

At the same time, however, the presence of outsiders is likely to reduce the presence of firm-specific knowledge on the board, for outsiders lack the intimate understanding of the firm's affairs that insiders possess. Finally, the percentage of outsiders on a board is likely to have a direct negative effect on board cohesiveness. Whereas insiders are well acquainted and must work together regularly, outsiders have their primary affiliations dispersed across many different organizations and are likely to interact only periodically with insiders or with each other.

Board size. Board size is not truly a demographic attribute, but it is an important and much-studied board characteristic that is likely to have important effects on board functioning. Larger boards are likely to have more knowledge and skills at their disposal, and the abundance of perspectives they assemble are likely to enhance cognitive conflict. However, at the same time, the difficulty inherent in coordinating the contributions of many members is likely to make it difficult for them to use their knowledge and skills effectively. Large boards also may have difficulty building the interpersonal relationships that further cohesiveness, or maintaining high board effort norms, owing to the potential for 'social loafing' that exists in large groups (Latané et al., 1979).

Board tenure. Boards that have served together for a long time are likely to have acquired a high level of firm-specific knowledge and skills. In addition, their members' familiarity with one another is likely to lead to higher levels of cohesiveness and, possibly, to the better use of their knowledge and skills. However, long-tenured boards are also likely to experience lower levels of cognitive conflict, because in working together they are likely to have developed a shared understanding of the issues facing the firm and the appropriate repertoire of responses available to it. In contrast, board members who have only served together a short time will draw more strongly on the understandings they bring with them from their nondirector experiences; therefore, they are likely to have more diverse perspectives on these matters.

In summary, each of the aspects of board demography discussed above is likely to have multiple and contrasting effects on the processes that contribute to effective board performance. Table 9.1 summarizes our expectations regarding the effects of board demography on board processes.

Board dynamics across different types of boards

In our effort to develop a model of boards as groups that is widely applicable and readily testable, we have been guided by a rather generic conception of the corporate board. This conception is drawn from quantitative and qualitative descriptions of the boards of large, for-profit corporations, such as those in the Fortune 500. We acknowledge, however, that these organizations represent only part of the wide world of organizations and that the functioning of boards as groups may be different in organizations of different types. We address some of these differences below.

Boards of nonprofit organizations

The tasks of nonprofit boards differ in important respects from those of for-profit boards. First, the control function of nonprofit boards must be revised to account for the distinctive legal status of nonprofits, and the service function must be expanded to account for the fact that nonprofit boards typically exert more influence over operating functions than do for-profit boards (Oster, 1995). Second, because of the multifaceted nature of performance in the nonprofit sector (Stone & Brush, 1996), the relationship between board performance and organizational performance may be quite complex. For example, the board's performance of its service function may have a strong influence on certain operational measures of organizational performance, such as the quality of services, but little or no influence on financial measures, such as funding levels, which instead depend heavily on the board's performance of its external functions. In addition, it may actually be part of the control function of nonprofit boards to not only monitor organizational performance but to define and measure it in appropriate ways. In dealing with complexities of this sort, researchers should consider how issues of board effectiveness have been addressed in the nonprofit literature (e.g., Jackson & Holland, 1998).

Demographic differences between nonprofit boards and for-profit boards are also significant. Nonprofit boards include considerably more women and minorities (National Center for Nonprofit Boards, 1996), are larger (averaging 17 members, and often including 30 or more), and consist almost entirely of outsiders (Oster, 1995). Thus, to begin with, nonprofit board processes are likely to be affected by visible diversity, as well as job-related diversity.

Table 9.1 The effects of board demography on board processes

Board Process	*Job-Related Diversity*	*Proportion of Outsiders*	*Board Size*	*Board Tenure*
Effort norms	No hypothesized relationship	Positive	Negative	No hypothesized relationship
Cognitive conflict	Positive	Positive	Positive	Negative
Presence of functional area knowledge & skills	Positive	No hypothesized relationship	Positive	No hypothesized relationship
Presence of firm-specific knowledge & skills	No hypothesized relationship	Negative	No hypothesized relationship	Positive
Use of knowledge & skills	Negative	No hypothesized relationship	Negative	Positive
Cohesiveness	Negative	Negative	Negative	Positive

Although the impact of these types of diversity is likely to be similar initially (Milliken & Martins, 1996), the salience of visible diversity may decline over time, as Pelled (1996) suggests. In addition, the sense of commitment to organizational objectives that is shared by nonprofit board members may be associated with high levels of cohesiveness. Golden-Biddle and Rao (1997) note that many nonprofit board members face a sharp conflict between the personal aspects of their association and the trusteeship duties their board service carries.

Boards of small firms

The governance of small firms, defined as those with revenues of $25 million or less (d'Amboise & Muldowney, 1988), is distinct from that of larger firms. First, because these firms tend to be undiversified, less structurally complex, and less formalized than their *Fortune 500* counterparts, the range and depth of service activities available to the boards of small firms are likely to be greater (Castaldi & Wortman, 1984; Judge & Zeithaml, 1992). Second, because firm size and age are generally thought to be negatively related to the inertial forces that constrain organizational action, there may be a stronger link between the board's service contributions and firm performance (Hambrick & Finkelstein, 1987). Third, because the managers of small firms may be entrepreneurs with relatively little general management experience, the board's own knowledge and skills may be a particularly critical ingredient of its own service effectiveness (Gorman & Sahlman, 1989).

Demographically, the boards of small firms are small, averaging 6 members for *Inc.* 100 companies (Daily & Dalton, 1993), and even fewer for less-developed firms (Rosenstein, 1988). More important, because the ownership of small firms usually is much more concentrated than that of larger firms, shareholders often are represented directly on the boards of small firms. For example, firms backed by venture capitalists routinely have some or even a majority of their board seats held by their investors (Fried, Bruton, & Hisrich, 1998) – a condition certain to enhance the board's effort norms and to diminish the likelihood of groupthink. However, in owner-managed firms the board may simply have no control function in the conventional sense, because shareholder rights and managerial responsibilities will reside in the same persons.

Boards of high-technology firms

It is possible for industry-based differences among boards of directors to impact their functioning as groups. Perhaps the best illustration of such differences is provided by the boards of high-tech firms. If these boards are to assess the competence of management and provide advice on such issues as a firm's competitive environment, their members must have knowledge and skills that exceed the ordinary requirements of board service (Kotz, 1998).

In particular, high-tech boards must have firm-specific knowledge that encompasses the technological intricacies of their firms' products and their production and development (McKenna, 1995). In addition, they may need additional functional area skills that are specific to high-tech environments, such as intellectual property law.

Because of these requirements, the presence and use of the board's knowledge and skills are likely to figure more prominently in these boards than in most others. These requirements may have indirect effects on board functioning as well, because many high-tech boards attempt to address these needs by adjusting the demographics of their boards. For example, high-tech firms tend to enhance the firm-specific knowledge of their boards by including a higher percentage of insiders and by favoring younger directors with current technological knowledge over older directors with prestigious appointments (Kotz, 1998). Finally, because many high-tech firms occupy industry environments characterized by high levels of growth and product differentiability, the boards of such firms may enjoy higher levels of discretion, thereby exerting a stronger influence on firm performance (Hambrick & Abrahamson, 1995).

Limitations and boundary conditions of the model

The model we have presented is characterized by several limitations and boundary conditions that deserve note. First, our discussion is rooted in the upper echelons (Hambrick & Mason, 1984) and strategic choice (Child, 1972) perspectives of organizations. Consistent with these orientations, we have emphasized those aspects of boards that pertain to their ability to influence firm performance by influencing strategic decisions. In this respect our approach differs from other perspectives, such as the institutional (Pfeffer, 1982) or resource dependence perspectives (Pfeffer & Salancik, 1978), which, historically, have emphasized the symbolic and external functions of boards, respectively.

Second, although our model is predicated on the argument that boards can exert a significant influence on organizational performance through the fulfillment of the control and service functions, we acknowledge that, in practice, boards often do not fulfill this potential. We further acknowledge that this potential is not invariant across boards. As we have noted, factors relating to sector, size, and industry may confer on boards a greater or lesser ability to exert this influence. Other factors may influence this ability as well.

Third, the model we have developed is intended to apply primarily to the boards of U.S. based firms. Boards in other countries often operate in legal, historical, and financial contexts that are very different from those of the United States (Roe, 1993), and for this reason applications of our model to the study of boards in other countries should be undertaken with special care.

Finally, although we are optimistic about the prospects for understanding boards as groups, we caution researchers that not all group processes apply to boards. For example, existing theories of group socialization typically have focused on members' decisions to join or leave groups on the basis of their personal satisfaction with the group experience (Moreland & Levine, 1989). Given that members of boards join as much for organizational as for personal reasons, and serve for specified terms, such theories do not readily explain the dynamics of board membership.

Conclusion

Understanding the nature of effective board functioning is among the most important areas of management research on the horizon. William T. Allen, former Chancellor of the Delaware Chancery Court, noted in a recent speech that 'the role of outside director [is] a private office imbued with public responsibility' (Allen, 1992). The same can be said for the role of inside directors. When directors are seen as stewards of organizational resources that impact, for better or for worse, the whole of society, the importance of understanding and improving the way they discharge their responsibilities becomes readily apparent. We believe that management researchers can inform the work of boards in ways that go beyond arguing for the manipulation of composition ratios. By treating boards as decision-making groups and by drawing on existing knowledge of group dynamics in this article, we encourage researchers to focus directly on what boards need to do in order to discharge their responsibilities more effectively.

Future research based on the process-oriented model we have developed here will enable researchers to better explain inconsistencies in past research on boards, to disentangle the contributions that multiple theoretical perspectives have to offer in explaining board dynamics, and to clarify the tradeoffs inherent in board design. Such research will complement and inform the growing interest in opening up the 'black box' of organizational demography that has been manifested in recent research on various kinds of organizational groups (Hambrick, 1994; Lawrence, 1997; Pelled, 1996). We have sought to facilitate future empirical research by incorporating established, measurable constructs into our model, as well as by developing and proposing measurement guidelines for several new or adapted constructs.

From a practical standpoint, knowledge of the roles of board processes can help to clarify the complexity of board design to practitioners concerned with the composition of boards and may induce boards to consider adopting process-related interventions to enhance board effectiveness. In these ways research on board processes can help to bring a measure of sophistication and balance to an area of corporate governance that is all too often fraught with contention and ideology.

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Part III

Exploring methods and concepts

10 Exploring methods and concepts in studies of board processes

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Abstract

Research about boards and governance has been characterized by the dominance of few concepts and a limited number of methods. This article introduces methods and concepts that help us explore board processes. Six illustrative studies of board processes are presented, including the use of 'one of the lads' – methods, 'flies on the wall' – methods, interpretation of 'board life stories' of women directors, reconstructive case studies and the use of questionnaire surveys directed to multiple respondents in each case. The article shows directions for how to open the 'black box' of board processes.

Key words: Research methods, Qualitative studies, Boards of directors, Board Processes

Introduction

Since 1990, research about boards of directors has been dominated by a 'publish-or-perish' syndrome that stems from the US tenure-track system (Huse, 2000). The consequences of this system have been a search for easily available data and the use of standardized methods (Gabrielsson and Huse, 2004). Several calls have thus been made to 'dismantle' these 'fortresses' (Daily, Dalton and Cannella, 2003), and to opening the 'black box' of board processes and actual board behaviour (Forbes and Milliken, 1999; Pettigrew, 1992).

The objective of this article is to present paths to follow that may help us fill this gap in the literature and research about boards of directors. Six studies are presented that illustrate concepts and methods that are useful for exploring processes inside and outside the boardroom. The article contributes to accumulating knowledge about boards of directors by offering concepts and methods as building blocks for further research. Individual and stand-alone studies may suffer methodological and conceptual flaws, but knowledge is created and findings may be validated when several studies are combined.

The article follows in three sections. In the first section research and research methods used in studies of board processes are presented. Six empirical illustrations are then presented in the next section. Conclusions and recommendations for further research are presented in the final section.

Studying board processes

Several authors have emphasized the need to explore board processes and not only board member demographics, board structures and board tasks (Forbes and Milliken, 1999; Letendre, 2004; Pettigrew, 1992; Zahra and Pearce, 1989). Mace (1972) is a study of board processes, and in this study board processes are the factor that creates the gap between myths (board task expectations) and reality (board task performance). Board processes include the understanding of opportunism and independence (Fama and Jensen, 1983). Both managerial hegemony theory and agency theory are theories about trust, power and interactions.

Zahra and Pearce (1989) make a distinction between four types of board attributes. These are board composition, board characteristics, board structures and board processes. They make a distinction between internal and external processes, and they define board internal processes as the decision-making related activities and styles of the board (1989: 292). Internal processess include meetings, CEO-board interface, consensus, evaluation and formality as process elements (1989: 305). Board internal processes are more systemized by Forbes and Milliken (1999) in their presentation of boards as strategic decision-making groups. Their team process concepts include: i) effort norms that ensure preparation, participation and analyses; ii) cognitive conflicts that leverage differences of perspectives; iii) the use of and not merely the presence of knowledge and skills and cohesiveness.

Pettigrew (1992) calls for contributions that integrate board internal and board external processes. He argues from a process perspective that it is not enough to study the inner workings of boards to understand board decision-making. There is also a need to explore the interactions between the board members and various firm internal and external actors. Boards must be seen as open systems, and core actors are interacting both formally and informally inside as well as outside the boardroom, and board processes include power, politics, learning and changing, and creativity and risk (Pettigrew and McNulty, 1998; Pye and Pettigrew, 2005). Included in these processes are also trusting, influencing and problem-solving behaviour. Elsewhere (Huse, 2005, 2007) I have presented processes in relation to the interactions among the board members and internal and external firm actors and used concepts like trust, emotions, power, influencing and strategizing.

Directions in research methods about board processes

There seem to be two extreme schools in studies of board processes. One the one hand, is the stream of research that follows an input–output approach where proxy or surrogate measures are used for board processes. In this school board independence and board power are often studied by using large-scale archival data. Board composition and board member characteristics, events or outcomes of board decision-making are often used as proxies for the power and independence of various actors. There are several seminal contributions in this stream (Davis, 1991; Kosnik, 1987; Ocasio, 1994, 1999; Westphal and Zajac, 1994). On the other hand, there are scholars claiming that processes can only be studied by processual methods. This stand is generally taken by scholars like Pettigrew (1992), Pye and Pettigrew (2005), Samdra-Fredericks (2000). Process studies are embedded in context, process and time (Pye and Pettigrew, 2005), but almost no empirical studies of this type have been published in main journals (Gabrielsson and Huse, 2004). Variations in context reveal differences in the dynamic interplay of practices, processes and performance over time. Pettigrew (1997) describes what a processual analysis is. He describes it as 'catching the reality in flight, to explore the dynamic quality of human conduct and organizational life and to embed such dynamics over time in the various layers of context in which streams of activities occur' (p 342).

Various types of method exist between these extremes including: i) types of survey methods, including questionnaire surveys and interviews; and ii) types of case studies of boards and directors, including reconstructive studies and direct observations. The conduct and purposes of studies within each group vary considerably, and no general agreement exists about whether they can be considered as process studies. However, Pettigrew (1992: 177) lists six analytical requirements that call for attention when studying board processes in a contextual manner:

- a role in explanation for context and action
- a search for holistic rather than linear explanation of process
- embeddedness, the study of processes across a number of levels of analyses
- temporal interconnectedness – studying the processes in past, present and future time
- a need to link process analyses to the location and explanation of outcomes
- a need for the researcher to balance involvement and distance with actors in the research process.

Process scholars will need to emphasize both context and behaviour, and processes should be studied holisticly over time. Process studies often emphasize behaviour, but the presentation of the context, the method and the theoretical reflection is often weak. It is important to address the level of analysis. Processes imply changes, and process scholars will need to be working across or between levels of analysis to explore the dynamic between relationships at individual, group, organizational and societal levels of analyses.

In the next section I will present six empirical studies of board processes. They will be evaluated according to the above criteria. Three of them are survey based, and three are case studies. The survey-based studies employ different methods. Huse (1993a, 1994) is based on a questionnaire survey with two respondents in each case. Dyadic analyses are employed. The second study (Huse, 1993b; Huse and Rindova, 2001) combines questionnaire surveys with interviews and document analyses. Several respondents representing various stakeholders are used in each subcase. Stakeholder analyses are employed. The third study presents in-depth interviews with women directors. They present their 'board-life stories'. Qualitative analyses are employed. Among the case studies, one is reconstructive based on interviews and document analyses (Huse and Eide, 1996) and two are based on direct observations using ethnographic methods such as 'one of the lads' (Huse, 1996 and 1998; Huse and Halvorsen, 1995; Huse and Zattoni, 2008) and 'a fly on the wall' (Huse, Minichilli and Schøning, 2005; Huse and Schøning, 2005).

Illustrative cases of board process research

It is generally considered to be difficult to get access data about board processes (Daily, Dalton and Cannella, 2003). It is therefore important to find methods or models for gaining access to such data. Some illustrative examples will be presented here. They include quantitative as well as qualitative approaches. We often make distinctions between quantitative and qualitative methods, or between survey-based and case-based methods. However, these distinctions are not always unambiguous. It may also be difficult to make clear statements about what a process study is. This will also be indicated in the presentation of the six illustrative studies. The ambiguousness is partly caused by the use of different methods in the same study, e.g. in relation to data collection and data analyses, and in relation to triangulation. An additional issue is related to unit of analysis, e.g. individuals, groups, organizations or society.

Survey-based studies

A list of published articles about actors, board processes and decision-making is found in Gabrielsson and Huse (2004: 19). Most survey-based studies have some focus on board processes, use survey approaches and have the board or the organization as the unit of analysis. The contribution by Pearce and Zahra (1991) is an illustration of studying board internal processes, while contributions by Westphal and various colleagues generally include board external processes (e.g. Westphal, 1998 and 1999). With the exception of contributions by Westphal, most studies have used CEOs (CEO/chairperson in the case of CEO duality) as respondents to presenting the processes in the boards. Westphal has also used responses from other board members, but mostly for validation reasons. The above mentioned surveys have generally used deductive and quantitative data analyses.

Another type of survey-based study is those focusing on the experiences of board members (Pye, 2002; Finkelstein and Mooney, 2003; Roberts, McNulty and Stiles, 2005; McNulty and Pettigrew, 1999). Data collection is mostly done through interview, data analyses have largely been inductive and qualitative, and the presentation of results is often based on stories or citations. Even though the experiences of the various board members have been the source of data collection, there is often some ambiguity with respect to the unit of analysis. Within the same study we may move between the individual, organizational and societal levels.

Among the three following survey-based studies the Huse study (1993a) follows the first tradition, the Huse and Solberg study (2006) is closer to the second tradition, while the study used as a basis for Huse and Rindova (2001) does not clearly fall into any of these categories.

Dyadic analyses: Relational norms and board task performance

The research question in Huse (1993a) was to explore the impact of board-management relations on actual board task performance. Independence and trust in board management relations are the independent variables. The independence measures were developed from agency theory reasoning (Kosnik, 1987), while the trust arguments and measures stemmed from Macneil's relational norms (1980). A theory driven deductive design was chosen, and dyadic analyses were used in testing the hypotheses on a sample of small firms from Sweden and Norway. Responses in each case were collected from CEOs and board chairpersons. The data were collected retrospectively from two points in time. Processes in this study are explored both by using concepts and theories about processes, and by using dyadic analyses of responses from CEOs and chairpersons in the same firm. The findings show the importance of trust and relational norms for board task performance. The study also showed that there are various reasons for CEOs and chairpersons to respond differently in evaluating board processes and task performance. Some differences will occur because of their different positions. Other differences will occur as indicators of processes taking place in the boardroom.

Stakeholder analyses: Board task expectations and strategizing

Huse and Rindova (2001) present stakeholder expectations about board tasks. The article presents results from a case study from a Norwegian bank. More than 140 informants responded to a major questionnaire about expectations and perceptions of board task performance in regional subsidiary boards in this bank. Respondents were board members of the mother company and the subsidiary boards, and members of the board of representatives of the bank. They represented and had identifications with various stakeholder groups. The article is part of a large study that employed interviews and document analyses in addition to questionnaire surveys (Huse, 1993b). The article contributes to understanding how board task expectations vary across different stakeholder groups. The findings show that board task expectation in reality is a result of the interactions among actors with different expectations and perceptions of board tasks. Strategizing among actors with various types of power is likely to occur.

'Board life-stories' of women directors: Power and boardroom dynamics

The Huse and Solberg (2006) article is a follow-up of Bilimoria and Huse's qualitative comparisons of the experiences of US and Norwegian women directors (1997). After initial interviews with 20 Scandinavian women holding positions on various corporate boards, eight of them were selected for in-depth interviews. They told their stories about their experiences as board members. The women had experiences from more than one hundred boards, and about 350 stories about their boardroom experiences were collected. The Huse and Solberg (2006) article presents some of the stories. Both quantitative and narrative methods were used in the data analysis. The main findings presented in the article are that men and women directors need to understand the power game that takes place inside and outside the boardroom, and that the individual director's contribution depends on their ability and willingness to make alliances with the most influential actors. The importance of time spent on preparations and being present for the most important decision-making areas is stressed, as is the need to take on leadership roles in order to influence board decision-making. The study shows that boardroom dynamics are not neutral to gender.

Case studies: Degrees of involvement and direct observations

The three survey-based studies mentioned above all contributed to understanding board processes, but they did not fully meet the requirements listed by Pettigrew (1992: 177) for process studies. The contribution in explaining context and action was limited, they did not seek a holistic picture, the embeddedness in various levels of analyses was limited, they did not study the processes in past, present and future, the need to link the processes to the location and explanation of outcomes was limited, and the researchers did not really need to balance involvement and distance with actors in the research processes. Process studies may need a larger degree of direct observations and involvement in studies that holisticly explore cases in the past, present and future.

Case studies, even though they are holistic and explore the cases over time, may be characterized by different degrees of direct involvement and observation. Huse (1998) and Huse et al. (2005) are based on direct observations

– the first also with direct involvement – while Huse and Eide (1996) and Johannisson and Huse (2000) are examples of case studies with limited degrees of involvement and without direct observations. In the Johannisson and Huse (2000) article we follow the processes when two family firms select, for the first time, an 'outside' board member. Interviews were made at two points of time with various respondents, including the CEOs and the new 'outside' board members. The Huse and Eide (1996) article is a reconstructive case study.

Reconstructive case study: Power bases and influencing techniques

Little research has been done on the principles and processes of stakeholder management. In Huse and Eide (1996) we studied several principles and processes important to the understanding of corporate governance, strategic management and business ethics. In a holistic setting we used an inductive approach with data from events leading to the crisis in a Norwegian insurance company. Data were collected through interviews with actors and other informants, collection of newspaper articles, books and reports about the events, and through an open hearing about the case. Various levels of analyses were embedded, and we followed the events from the past through the present to the future. The data collection started as the case was evolving, and we watched it develop as distant and non-participating observers. The article contributes to a description of manipulation and power dimensions of stakeholder management and corporate governance. The capacity of management of large companies to circumvent control and thus accountability is illustrated.

Participant observation and board-in-action research

Despite the richness of data that can exist in a reconstructive case study, as with the UNI case in Huse and Eide (1996), scholars argue that additional steps need to be taken to understand processes. For example, Samdra-Fredericks (2000) argues that there may be a need to move from 'asking board members questions to seeing and hearing them interactively perform in the boardroom (and elsewhere) over a time'.

Direct observations or participant observation studies have been used to understand various organizational phenomena, but only rarely in understanding boards of directors. Among the few studies applying this approach on boards we find Brannen (1987), Brundin and Nordqvist (2004), Hammer, Curral and Stern (1997), Huse (1998), Huse et al. (2005), Leblanc and Gillies (2005), Olzon and Huse (1997), Samdra-Fredericks (2002) and Winkler (1987). The most challenging of these studies are possibly the 'following director' study (Brannen, 1987) and the 'one of the lads' studies (Hammer et al., 1997; Huse, 1998). Brannen followed directors in their daily activities and not only in the boardroom, while I participated in a research project in which for 18 months I stood in as the board chairperson of three small firms

(Huse, 1998). Hammer et al. analysed communication in the boardroom by statistical methods. Tove Helland Hammer collected data over five years by being a union elected director. Field notes were important tools in all these studies.

The most typical approach in participation studies is probably that of being a fly on the wall in the boardroom (Brundin and Nordqvist, 2004; Huse et al., 2005; Letendre and Gillies, 2005; Olzon and Huse, 1997; Samdra-Fredericks, 2000; Winkler, 1987). The core of some of these studies is to analyse the 'talk-based interpersonal routines' (Olzon and Huse, 1997; Samdra-Fredericks, 2000).

'Fly on the wall': Director involvement and process-oriented boardroom dynamics

The insights in Huse et al. (2005) stem from a research project dealing the corporate board of a major Scandinavian corporation, the TINE Group. We used a direct observation methodology referred to as 'fly on the wall'. We were two researchers allowed to attend the board meetings of TINE during the autumn of 2003 and the spring of 2004. The observation period lasted for almost a year. In addition to direct observations at the board meetings, we also conducted interviews with all board members and the corporate top management team. We entered the boardroom as independent researchers, but soon agreed to provide TINE with board evaluations. In that way, our project became a win-win situation. However, no feedback was given until the observations were completed. Our observations were based not only the content of the boardroom discussions, but also the body language of the actors, their actions and even their opinions, expressed perceptions and displayed emotions in relation to activities taking place both inside and outside the boardroom. Various publications from this project exist (e.g. Huse and Schøning, 2004 and 2005), but the objective of Huse et al. (2005) was to present knowledge about boardroom decision-making culture. We present in this article a process-oriented decision-making culture in which a strong emphasis is given to hearing all voices, involving the whole board and reaching unanimous decisions. This is time consuming. However, the decision-making culture, characterized by cohesiveness, openness and generosity, involvement, and time-consuming discussion, as well as creativity, fostered a board-level dialogue on strategy that enabled part-time board members access to the thinking of executives and vice versa. The article contributes to an understanding of the board as a team and team leadership.

'One of the lads': Exploring interactions and emotions inside and outside the boardroom

A different approach is taken in Huse (1998). In this project I was at first invited to be the chairperson of one small company, but my acceptance of this position was contingent on whether I was allowed and able to develop a research project around this position. My requirement was accepted, and I was finally able to design a research project where I was board chairperson of three small firms simultaneously. A steering group consisting of skilled ethnographers, other researchers, the project funders and other business people was developed to guide me through this challenging project. For 18 months my notebook was my closest companion, and I made notes on all my activities, meetings, conversations, perceptions and feelings in this period that had any relation with the firms in which I was the chairperson. Aspects of this study are presented in various publications (e.g. Huse and Halvorsen, 1995; Huse and Zattoni, 2008) in addition to the Huse (1998) article. Reflections related to research ethics are presented in Huse (1996). The main objective of Huse (1998) was to identify and understand the processes which influence the behaviour of board members. The article contains contributions in relation to the importance of contexts and contingencies, e.g. life cycle and industry differences, the importance of understanding actors and arenas outside the boardroom, and the importance of trust and emotions. The article illustrates how main board tasks may vary with the life cycle phase of the firm.

Conclusions and recommendations

In this article I have presented methods and concepts that go beyond what is presented in mainstream research about boards and governance. Concepts and methods are presented that help us explore board processes. A distinction between studies of processes and process studies is made. Six illustrative studies of board processes are presented, including the use of 'one of the lads' methods, 'a fly on the wall' methods, interpretation of 'board-life stories' of women directors, reconstructive case studies and the use of questionnaire surveys directed to multiple respondents in each case.

Boards and directors are known for being difficult to get access to (Daily et al., 2003; Pye and Pettigrew, 2005). The six illustrative studies give us some examples of how it is possible to get access to them, and how data can be collected. However, the six empirical illustrations meet Pettigrew's (1992) requirements to processual studies to different degrees. This is summarized in Table 10.1.

The core of the studies has been to explore and understand actors and interactions inside and outside the boardroom. When looked at together, the studies contribute to developing research of board processes with greater analytical rigour. They contribute to the awareness of assumptions, analysis and assertions in studies of board processes (Pye and Pettigrew, 2005), and they illustrate that not all studies of processes should be called process or processual studies. The illustrations have contributed to the introduction and understanding of concepts like trust, power, emotions, actors, arenas, teams, personalities and leadership in studies of boards and governance. They

Table 10.1 Comparison of illustrative studies of board processes

	Data collection	*Data analyses*	*Processes studied*	*'Processual study' requirements*
Huse, 1993a	Survey based – postal questionnaires	Dyadic analyses – CEO and chairperson responses	Trust and relational norms	Not met
Huse and Rindova, 2001	Case study based on a questionnaire survey, interviews and document analyses	Stakeholder analyses of board task expectations	Different stakeholder expectations of task performance	Limited
Huse and Solberg, 2006	'Board-life stories' – in-depth interviews	Narrative – 350 stories	Power game inside and outside the boardroom	Limited
Huse and Eide, 1996	Reconstructive case study – interviews and document analyses	Inductive comparisons within a sorting logic	Strategizing – power bases and generic techniques	Yes, but only indirect observations and limited need to balance distance and closeness
Huse, Minichilli and Schøning, 2005	'Fly on the wall' observations – combined with interviews and document analyses	Inductive – concept development as background for later testing	Board member behaviour and interactions in the boardroom	Yes. Direct observations, but limited need to balance distance and closeness
Huse 1998	'One of the lads' participant observations – field notebook	Comparisons between cases (contexts)	Actors and arenas – behaviour and emotions outside and inside the boardroom	Yes. Direct observations with need to balance distance and closeness

contribute to the understanding of interpersonal and relational boardroom dynamics. Most studies of board processes lack a theoretical framework, and this often undermines the impact of process studies (Pye and Pettigrew, 2005). However, the accumulation of the illustrative studies point to including theories like the behavioural theory of the firm, institutional theories, contingency theory and stakeholder theory.

This article has provided directions to open the 'black box' of board processes, and it has contributed to 'dismantling the fortress' in studies of boards of directors (Daily et al., 2003). It contributes to the accumulation of knowledge as it offers concepts and methods as building blocks for further research.

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11 Relational norms as a supplement to neo-classical understandings of directorates

An empirical study of boards of directors *

Morten Huse

Abstract

This article presents some of the conclusions from a study about board of directors in small firms in Norway and Sweden. Theories built on neo-classical and socio-economic assumptions are integrated, and a stakeholder approach is adapted. Theories based on neo-classical paradigms have dominated most recent research about boards of directors. These studies have focused on board composition such as insider/outsider ratio, board members stock ownership and board size. Models based on agency theory and legalistic approaches have contributed to the framework for these studies, which mainly discuss the consequences of the board's independence of management in order to be an effective control mechanism. The present study adds a dimension of 'interdependence' or closeness to the traditional 'independence'-criterion. Interdependence is measured by the degree of relational norms (Macneil, 1980) between directors and management. The study is an associative cross-sectional field survey of 108 joint stock dual leadership hotels in Norway and Sweden, and uses a dyadic approach with CEOs and chairmen as respondents. This is the first study conducted using a dyadic approach in understanding directorates. The findings of this research contribute to an increased understanding of the role of directorates and board – management relations. The study illustrates the importance of distinguishing company size in research about directors and management, and it shows that a socio-economic approach may have larger explanatory power than theories based on neo-classical paradigms.

Intention and background

What is the role of directorates in small firms? How do the relations between the board and the top manager influence the role of the board? How are the functions of the board performed? What importance do the directorates have for company performance?

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These and similar questions are the focus of this article. The purpose of this study is to move towards a better understanding of boards in small firms and how such boards influence company performance and results. The study is based on a cross-sectional field survey of joint stock hotels in Norway and Sweden.

The understanding of directorates has mainly evolved through studies of large US-based firms. This study uses constructs from these studies in understanding boards in small Scandinavian firms (5–300 employees). Recent discussion has considered ways to improve board performance. One solution, according to legalistic and agency theory approaches, is to create independence in the board-management relations by board compositional means. This approach is based on neo-classical assumptions about individual decision makers behaving rationally and opportunisticly. The main hypothesis of this study argues that approaches based on relational exchange theory or socio-economics are also important in understanding the role of directorates. Relational exchange theory postulates the importance of interdependence and trust in the board-management relationship in improving board performance. This article tries to address the apparent paradox of both independence and relational norms by considering them as two distinct dimensions.

Theoretical perspectives

Board functions and company performance are be considered differently by different stakeholders. For instance, Fama and Jensen (1983) argue that owners consider boards as tools in controlling management, while Herman (1981) reported evidence that management evaluates boards by considering the service rendered. Owners also consider company performance measures like return on investment and return on equity. Management tends to focus on measures of importance for their own labor market value, such as sales growth and market share. Different stakeholders may thus give different emphasise to the relations between board and management. Board management relationships will be examined in this study in terms of independence and relational norms (interdependence).

Independence

Observations about how board members are selected and how boards function indicate that a board is a body controlled by management (Patton & Baker, 1987). Board reformers have been discussing ways to make the boards more effective. Approaches based on agency theory or legalistic perspectives suggest that the board members should be independent of top management. During the last few years there have been some studies that show the effects of board-management independence. Although these studies have varied in their main focus, they have indicated relations between board composition (independence) and:

- the board's strategic involvement (Henke, 1986; Zahra & Pearce II, 1990; Judge & Zeithaml, 1992),
- the results of control decisions (Cochran, Wood, & Jones, 1985; Kosnik, 1987; Singh & Horianto, 1989),
- the results of the company's strategic decisions (Hill & Snell, 1988; Baysinger, Kosnik, & Turk, 1991),
- the company's financial performance (Baysinger & Butler, 1985; Chaganti, Mahajan, & Sharma, 1985; Hermalin & Weisbach, 1988; Schnellenger, Wood, & Tashakori, 1989); and
- the company's social performance (Zahra & Stanton, 1988; Dalton & Rechner, 1989).

The results of these studies have been ambiguous, but they have generally supported the agency theory suggestion that independence in the board – management relationships increases company performance. Most studies of directorates have focused on directorates in large public corporations. Composition of directorates may however have another effect in small firms (Ford, 1988).

Relational norms

Agency theory is based on the neo-classical economic paradigm, and is utilitarian, rationalistic and individualistic (Etzioni, 1988). These assumptions are insufficient for many management purposes because they do not give enough consideration to human motivational resources (Griesinger, 1990). In neo-classical theories contracts are based on promises. These promises will, however, represent only one side of a continuum for various exchange transaction, namely discrete transactions. In order to complete discrete transactions, all necessary information must be present at the time of entering into the contract. Such assumptions imply that contracts concerning complex relations about the future will usually be incomplete (Tirole, 1988). Furthermore, according to Macneil (1980), contracts governing continuous transactions should be relational rather than discrete. Individuals behavior cannot be described in simple utility terms, and individual action must be understood in a social context (Sjöstrand, 1985; Etzioni, 1988). These problems have been addressed during the last decade, and new concepts have been introduced to adapt to this problem. Relational contracting represents one such attempt (Sjöstrand, 1991). The concept stresses the fact that 'interactions and relations are sometimes lasting, and that the importance of the original agreement has been de-empasized in favor of a kind of specific norm system connected to the exchange relationship' (Sjöstrand, 1991, p. 5).

Theory of contractual relations (Macneil, 1980) gives room both for lasting relationships, for individuals harmonizing with the social matrix, and interdependence. According to the theory of contractual relations, relational contracts will be characterized by relational norms. These norms are (1) role integration, (2) preservation of the relation, (3) harmonizing of relational conflicts, and (4) supracontract norms.

Few studies have been conducted using Macneil's theory of contractual relations, however, four recently completed Ph.D. thesis use Macneil's constructs (Kaufmann & Stern, 1988; Noordewier, 1986; Heide & John, 1988; Haugland, 1988). All of these studies used perceptual evaluations of relations between buyer and seller or in distribution channels. The studies support the theory, but also show that the theory is difficult to operationalize (Haugland & Reve, 1988). It also appears that, in studying relations, dyadic analyses are preferable.

Model and hypotheses

The preceding discussion suggested that both independence and relational norms are distinct dimensions, and that both will influence board performance and company performance. These dimensions will be the independent concepts in the modell of this study. A common way to divide board roles is to separated control, strategy and service (Zahra & Pearce II, 1989). Attention to these roles depends to a high degree on whether the boards are management or owner dominated (Mace, 1971). If the boards are owner dominated, they would prefer control functions ('myth-functions'), while management dominated boards would be service oriented ('reality-functions'). Strategy would relate both to control and service. Strategy is thus in the modell of analysis omitted. This is illustrated in Figure 11.1.

According to Zahra and Pearce II (1989) the board functions may be considered as mediators between board attributes and company performance. Figure 1 also indicates that the evaluation of board performance and company results may vary depending on stakeholder perspective. Independence in the board-management relationship defines the degree to which board members are financially or psychologically independent of the top management (Baysinger & Butler, 1985). Independence is described using constructs from agency theory and the legalistic literature. In a Scandinavian small firm tradition, family relations between the CEO and the board members were considered to be of great importance in understanding the independence construct.

The board's control involvement is often justified by, or based on an owner oriented principal-agent perspective (Kosnik, 1987). The board's service involvement is primarily based on a managerial hegemony perspective (Herman, 1981). In order to attend to the owner's interest through goal setting and control, many authors have argued for independence in the board management relations (Rechner & Dalton, 1991). Independence may, however, attend to control at the expense of service.

Most studies of directorates concern large corporations. Even though the complexity of small firms usually is considered to be less than in large corporations (Fama & Jensen, 1983), these organizations will normally have

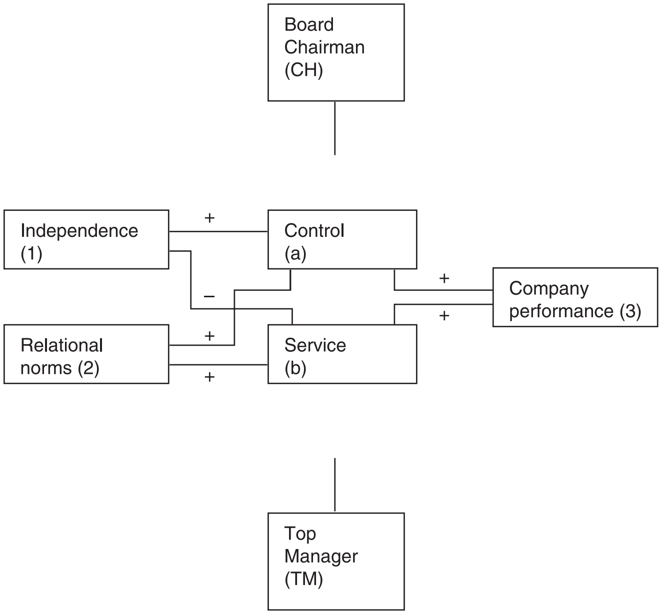

Figure 11.1 Model of analysis.

less competency for control and service (Castaldi & Wortman, 1984). Assuming that there are no differences between the role of directorates in small and large firms, the preceding reasoning will lead to the following hypothesis:

> **Hypothesis 1.** All else being equal, independence in board management-relations in small firms will be (1) positively related to the board's control involvement, and (2) negatively related to the board's service involvement.

The hypothesis may, however, be adjusted depending on stakeholder perspective. Assuming that board chairmen and CEOs are different persons, they may evaluate board performance differently. Board chairmen in independent boards may, for example, evaluate the board's competency and involvement higher than the respective evaluation of the CEO.

Relational exchange theory and relational norms introduces a new and distinct dimension of monitoring firms. It contains a more complex picture of human interaction, focusing on interaction and preservance of relations. These aspects are essential in understanding and monitoring long lasting relations characterized by complexity, uncertainty. Board-management relations may be considered as such long lasting relations (Huse, 1993). According to Macneil (1980) relational norms are intensifications of relational contracts describing whether a contract is relational or not. Relational contracting will also be the monitoring device most proper in such long lasting relations.

If a board shall support and render service to management, there is a need for communication and understanding of the situation of the management. This may be achieved by establishing common norms and long term personal and professional relations with mutual expectations to each other about the future (Macneil, 1980).

Relational contracts will have both a management perspective with service and an owner perspective with control. This suggests the following hypothesis:

> **Hypothesis 2.** All else being equal, relational contracting in board-management relation in small firms will be (1) positively related to the board's control involvement, and (2) positively related to the board's service involvement.

In the model of analysis, board functions are considered as mediators between the board attribute dimensions of independence and relational norms. From an owner perspective the board's control involvement will be positively related to company performance, and from a managerial hegemony perspective the board's service involvement will be positively related to company performance.

Company performance may, however, be considered on different meters depending on different stakeholder perspectives. Using company performance measures of interest both for owners and management, the following hypothesis is formulated:

> **Hypothesis 3.** All else being equal, company performance in small firms will be (1) positively related to the board's control involvement, and (2) positively related to the board's service involvement.

According to Bradach and Eccles (1989) the most rational monitoring systems are not based on ideal types, but on plural forms. Pearce II and Zahra (1991) found that companies with board's involved in both CEO motivated activities and board/owner motivated activities achieved the highest performance (the 'participative' board). The 'caretaker' board, with a low degree of involvement in both CEO-motivated activities and owner-motivated activities, achieved the lowest performance.

Similarly, if the paradox of both simultaneous independence and relational norms (interdependence) can be solved by means of a synthesis, the following hypothesis may be argued:

> **Hypothesis 4.** All else being equal, the board will take care of its functions best when there is both (1) independence, and (2) relational norms in the relationship between board and management.

Different stakeholders will, however, emphasize different performance measures.

Method

Supported by existing knowledge about the research question, pilot studies and available empirical data, a theory generated empirical study with theory testing design based on descriptive field survey data, was designed (Calder, Phillips, & Tybout, 1982). In such research designs validation focus and the critical phases of the research would be in connection with statistical conclusion validity and construct validity at the expense of internal and external validity (Cook & Campbell, 1979, pp. 82–83).

The statistical conclusion criterion resulted in a need to isolate the relations in the model from relations outside the model. This resulted in the selection of firms from one industry with similar internal structure in a limited geographical area. Joint stock hotels in Norway and Sweden were selected.

The focus of analysis of the study was the relations between the top manager and the board of directors. Because company laws in Norway and Sweden require dual leadership, (that is chairman and top manager have to be separate persons,) in all firms with total share capital of more than one million crowns, it was possible to design a dyadic study with both the chairman and the top manager as key informants. Using two key informants for each case, and using several measurement criteria for each variable should enhance the validity and reliablity of the data (John & Reve, 1982). Furthermore, since the study focused on the relations between the two parties, a strength of this study is that data from both parties were collected (Haugland, 1988, p. 107).

Because the total population was unknown, it was necessary to have a screening phase. This was conducted by a mail questionnaire to all members being hotels of the industry organizations in Norway and Sweden. 359 questionnaires were returned out of 1106. Out of the 359 firms responding, 129 firms satisfied the criteria of (1) being joint stock company, (2) having dual leadership, (3) being a single business unit firm, (4) at least one year tenure of both chairman and top manager, and (5) no chairman was represented more than once. The firms had an average between 5 and 300 employees. The questionnaire in the screening phase also consisted of questions about ownership, localization, results, board composition, chairman demography and top manager demography.

In the main phase of the study, a mail questionnaire was sent to both the CEO and the chairman of the board in all the 129 firms. The questionnaires using 5-point rating scales were in Norwegian or Swedish (an English translation of the questions in the questionnaire is enclosed). Questionnaires from 118 CEO's and 88 chairmen were returned, of which 14 and 8 respectively were rejected mainly due to population limitation criteria. 75 firms were represented with accepted responses from both the CEO and the chairman.

The data collection also had a third phase. In a telephone interview all CEO's from the 108 firms with accepted responses either from CEOs or chairmen were asked to range 20 Likert-type questions about company performance and corporate social or ethical performance on a five point scale. Responses were received from 102 top managers.

Construction and validation of variables

Construct validity contains a number of elements. A common way to classify these elements is according to (a) face validity, (b) reliability, (c) convergent validity, (d) discriminant validity, and (e) nomological validity (Peter & Churchill, 1986, p. 1). The reliability of the contructs was measured by means of (1) comparing the perceptual measures from the main phase with objective measures from the screening phase and proxy reports (inter-method coefficients), (2) comparing the responses from the two respondents (inter-rater coefficients), and (3) and by measuring internal consistency in multi-item variables (alpha-coefficients, Nunnally, 1978). The convergent and discriminant validation of the variables were done by means of varimax rotated factor analysis. Face validity was attained by pilot studies, literature search and discussions with academians and practitioners, while nomological validity was evaluated in correlation analysis. Table 11.1 presents the various variables.

The study used four main constructs with corresponding variables:

IND The relation variable measuring the degree of independence between the board and the top manager.
REL The relation variable measuring the degree of relational norms between the board and the top manager.
CON The function variable measuring the degree of board involvement in control functions.
SER The function variable measuring the degree of board involvement in service functions.

For each of the four main concepts three sets of variables were developed. The variables were constructed on the bases of the answers from the top managers (TM), from the chairmen (CH), and from the product of the respondents responses (P) ($item_{tm} \times item_{ch} = item_p$).

Deviation analysis of the responses from the respondents was conducted. This was done by comparing the differences in the means with the squared differences in the means of the items in order to find systemic and arbitrary variances in the responses on the items. The items measuring board functions seemed to be exposed to systemic variances. The ratings from the chairmen were generally higher than the ratings from the CEO's. The dyadic deviation analysis also indicated arbitrary variances regarding some items. Arbitrary variances may be due to weaknesses in the measurement method or the

Table 11.1 The construction of the variables

	N	*Items*	*Mean*	*STD*	*Alpha*
Independence					
IND-TM	103	2	4.02	1.33	.65
IND-CH	77	3	3.84	1.19	.69
IND-P	69	3	17.4	6.45	.68
Relational norms					
REL-TM	101	4	4.02	.77	.76
REL-CH	78	3	4.28	.73	.78
REL-P	70	3	17.4	4.78	.82
Control					
CON-TM	102	4	3.33	.97	.84
CON-CH	76	5	3.72	.89	.86
CON-P	72	5	12.9	5.01	.85
Service					
SER-TM	103	3	2.93	.95	.76
SER-CH	76	4	3.21	.99	.80
SER-P	73	3	10.0	5.39	.78
Company performance					
GROWTH	75		1.36	.49	
S-RES	102	6	1.00	1.37	.78
ETHICS[1]	101	3	79.8	38.8	
GOP	87		1.00	3.37	

[1] Formative index

question formulations. None of these items were used in the construction of the variables.

Factor analysis were conducted for each set of the relational and the functional items. The variables were constructed as the mean of the items meeting the criteria in the validation process. The following criteria were used:

1 factor loading higher than .4 (convergent validation),
2 correspondence with expected factor (face validity),
3 no high factor loading on the other used factor (discriminant validity); and
4 maximal alpha (internal consistency).

There were small differences between the constructions of the different variables on the same concepts. Internal consistency was satisfactory according to Nunnally (1978). The Pearson product moment correlation coefficients between IND-TM and IND-CH (the inter-rater coefficient) was .60, between the relative number of family board members and IND-TM, IND-CH and IND-P (the inter-method coefficients) were respectively –.57, –.60 and –.63. The correlation coefficient between REL-TM and REL-CH (inter-rater coefficient) was .38, and the correlation coefficients between the REL-variables and the IND-variables were between −.20 and .02. The latter coefficients indicate that the variables REL and IND represent distinct dimensions.

The construct validation showed that items derived on the relational norm (a) role integration loaded on another factor in the factor analysis than items from the three other norms (b) preservation of the relation, (c) harmonizing role conflicts, and (d) supracontract norms. The role integration items followed the same patterns as family ties between the board members and the CEO. The role integration items were thus not included in the analysis.

Because of expected high collinearity between the function variables, the discriminant validity criterion was given higher priority in the development of the function variables CON and SER than in the construction of the relation variables IND and REL. Still the discriminant validity between the function variables was not particularly strong.

The deviations in the responses were also subject to a factor analysis to construct deviation variables. The analysis based on the deviation variables confirmed that the CEO does not significantly distinguish between control functions and service functions.

The study used four main company performance measures:

1	GROWTH	Sales growth from 1986 to 1989 (according to annual reports).
2	S-RES	A financial company performance index subjectively rated of the top managers consisting of six items (alpha = .78) made relative to country and city location.
3	ETHICS	A formative ethics and social responsibility index consisting of three items rated of the top managers.
4	GOP	Gross operating profit on sales in 1989 relative to country and location in a city.

The use of relative measures was due to considerations regarding statistical conclusion criteria. The relative criteria were based on actual figures and were considered proper by the industry. The GROWTH measure missed data from some firms because of non-existence in 1986.

Business, management and board literature discribes a large number of contingencies of importance for company performance and board performance (Zahra & Pearce II, 1989). Important company external contingencies tend to be geographical location and industry. The most important internal contingencies are often considered to be company size, ownership and the life cycle phase of the company. In addition CEO and board chairman characteristics are considered important.

The main control variables in the study were selected items mainly from annual report corresponding to the above mentioned issues. The selection process facilitated by correlation analysis. Because of variances between the company legislature regarding employee representation in Norway and

Sweden, company size was used as a discrete variable. This also confirm to research about small firms (e.g. Gray, 1991).

Three size groups were formed according to the legislature:

5–24 employees in average (no required employee representation in boards),
25–49 employees in average (employee representation in boards required in Sweden); and
50–300 employees in average (employee representation in boards required in both countries).

The other control variables used in the multiple regression analysis were (a) the natural logarithm of the number of employees, (b) a dummy variable indicating country location, (c) a dummy variable indicating location along an European highway, (d) the age of the chairman, (e) chairman tenure as board chairman, (f) a dummy variable indicating sex of top manager, (g) the number of years the CEO has been employed in the company, and (h) a dummy variable indicating whether the CEO is a board member. Ownership structure and family ownership were variables considered in the study. They were, however, highly correlated with company size, and thus omitted from the regression analysis.

Data analysis and testing of hypotheses

Hypotheses 1–3 were tested both by correlation analysis and by stepwise regression allowing all variables with F-significance higher than .3 into the equation. Table 11.2 shows the results of the correlation analysis, and Tables 11.3 and 11.4 show the result of the regression analysis.

Table 11.2 Correlation analysis of hypotheses 1–3 (Pearson's Correlation Coefficients)

	CON-TM	*CON-CH*	*CON-P*	*SER-TM*	*SER-CH*	*SER-P*
Hypothesis 1						
IND-TM	−.10	.02	−.09	−.04	.25*	.18*
IND-CH	.04	.07	.03	.09	.40*	.26*
IND-P	−.12	.02	−.13	.06	.25*	.09
Hypothesis 2						
REL-TM	.30*	.06	.20*	.29*	−.02	.09
REL-CH	.03	.08	.09	−.08	−.04	−.03
REL-P	.16*	.12	.21*	.12	−.03	.08
Hypothesis 3						
GROWTH	.08	.14	.12	.05	.02	.15
S-RES	−.09	−.01	−.13	−.25*	.09	−.08
ETHICS	.25*	.18*	.31*	.08	.27*	.27*
GOP	.13	.16*	.25*	.04	.07	.11

1-tailed sign * $p < 0.1$

Table 11.3 Regression analysis (beta coefficients) of hypotheses 1–2

	TM	*CH*	*P*	*A*	*L*	*Summary*
1. Independence-control	–.06	.02	.04	.05	–.09	–
(5–24 employees)	–.03	.05	–.02	–.07	.28	–
(50–300 employees)	.04	.13	.68*	.33	.11	Support
Independence-service	.08	.31*	.22	.24	.20	Contra
(5–24 employees)	.09	.34*	.34*	.24	.28	Contra
(50–300 employees)	.08	.48*	–.55*	–.41*	.13	–
2. Rel. norms-control	.40*	.17	.30*	.30*	.28*	Support
(5–24 employees)	.49*	.44*	.66*	.62*	.55*	Support
(50–300 employees)	.26	–.78*	–.36	.45	–.03	Contra
Rel. norms-service	.32*	.09	.20	.16	.13	(Support)
(5–24 employees)	.33*	–.09	.10	–.09	.09	(Support)
(50–300 employees)	–.15	–.18	–.52*	–.27	–.07	Contra

F-sign: * $P < 0.1$

Table 11.4 Regression analysis (beta coefficients) of hypothesis 3 (company results)

	All			*5–24 employees*			*50–300 emplyees*		
	TM	*CH*	*P*	*TM*	*CH*	*P*	*TM*	*CH*	*P*
Control									
GROWTH	.09	.16	.15	.04	.34*	.25	.22	–.29	–.13
S-RES	–.01	.00	–.15	–.04	.17	.03	–.22	.09	.04
ETHICS	.20*	.12	.24*	.23	.21	.30*	–.12	–.22	–.49*
GOP	.12	.17	.26*	.30*	.33*	.49*	–.18	.10	–.52
Service									
GROWTH	–.00	–.00	.10	.04	.18	.21	–.00	–.46*	–.31
S-RES	–.26*	.09	–.04	–.15	.17	.09	–.65*	.20	.26
ETHICS	–.03	.26*	.22*	.00	.18	.28*	–.13	.34	.02
GOP	–.01	.07	.09	–.01	.23	.25	–.23	.13	–.50*

F-sign: * $P < 0.1$

The correlation analysis showed no significant correlations regarding hypothesis 1 a about the relations between independence and the board's control involvement. Regarding hypothesis 1b there were large correlations between independence and the board's service involvement, but the direction was opposite of what was predicted. This was the case for most of the combinations of the variables.

The analysis showed the predicted correlations between the relational norms and the board's control involvement, while hypothesis 2 was not supported. The correlation analysis did not give support to hypothesis 3 when using the GROWTH and S-RES performance measures. ETHICS was significantly positively correlated to both control and service, while GOP only had significant correlation coefficients with CON.

In the regression analysis hypotheses were tested by using various sets of data:

(TM) data from the managers' responses,
(CH) data from the chairmen's responses,
(P) data from the paired responses,
(A) data sets reflecting a principal-agent approach; and
(L) data sets reflecting a managerial hegemony approach.

The principal-agent approach (A) was based on the paired relation variables (IND-P and REL-P) and the function variables based on the chairmen's responses (CON-CH and SER-CH). The managerial hegemony approach (L) was also based on the paired relation variables, but on the function variables based on the managers' responses (CON-TM and SER-TM).

The regression analysis showed profound differences between the smallest firms (5–24 employees) and the largest firms (50–300 employees). There were few significant beta coefficients for the firms with between 25 and 50 employees.

Hypothesis 1 regarding positive relations between independence and the board's control involvement did not receive general support. It was, however, supported in the analysis for the largest firms. The relation was strongest in the pairwise analysis, and in the analysis from an agency perspective (A). The hypothesis did not get any support in the overall analysis or for the smallest firms, but from a managerial hegemony approach (L) for the smallest firms.

Hypothesis 1 regarding negative relations between independence and service was generally contradicted in the analysis. The relation was smallest using data from the managers' responses. Independence in the board management relation seems to be positively related to the board's service involvement. One explanation for this result, may be that independent boards may have more experts and experienced members able to render service, than boards with strong family and friendship ties to the CEO. The analysis showed, however, some diverging results. The pairwise and the principal-agent approaches indicated significant negative relations between independence and the board's service involvement for the largest firms. An explanaition for these results may be the construction of the pairwise IND variable, consisting of an item reflecting the board members ownership interests. This item may have been of great relativ significance for the largest firms, but not for the whole sample. This may indicate that incentives may be of greater importance in understanding independence than composition.

Hypothesis 2 about the relational norms being positively related to control was supported in the overall analysis, and for the smallest firms. It was, however, contradicted from the analysis of the largest firms using CON-variables from the chairmen's responses. The latter results may indicate that when trusting the CEO, the boards do not see the importance of being involved in control functions.

The analysis of Hypothesis 2 regarding positive relations between relational norms and service gave a mixed picture. The overall analysis supported the hypothesis. The significance was largest using data sets from manager's responses. The hypothesis was contradicted in the analysis of the largest firms. The pairwise analysis gave the most significant results. The analysis for the smallest firms gave support to the hypothesis when using data from managers, but data from the chairmen could indicate the opposite direction.

Table 11.4 shows the beta coefficients between the function variables control and service and the four performance measures.

Hypothesis 3 regarding positive relations between control and company performance has mixed support depending on data set, company size and performance measure. When using the GROWTH, ETHICS, and GOP measures, the relations are positive in the overall analysis and when analyzing the smallest firms. When analyzing the largest firms, most data sets indicate negative relations. The most significant relations are found using paired responses, and for the smallest firms. The relative subjective financial performance index (S-RES) indicates no significant relations regarding any firm size or data set. This finding may seem to be surprising as S-RES is the performance measure expected to be the most related to control functions. The findings may, however, support the results of the classical study of Mace (1971) that it is a 'myth' that boards are involved in control functions on behalf of the owners.

S-RES is, however, related to service. In both the overall analysis and when analyzing the largest firms, S-RES is significantly negatively related to service when using the data sets from the managers' responses. When using the other data sets, the relation seem to be positive. The findings of Mace may also be confirmed from these results. The 'reality' may be that boards are involved in service functions, but not on behalf of the owners.

ETHICS seems to be positively related to service in the overall analysis, and when analyzing the smallest firms. The responses from the chairmen and the paired data set give the strongest indications. The same trends are found for the largest firms.

The only significant relation (negative) between GROWTH and service is for the largest firms, when using responses from the chairmen. A positive relation may be the situation for the smallest firms. GOP follows the same pattern. The negative relation for the largest firms are strongest when using paired (and managers') responses, while the positive, but insignificant relations for the smallest firms are highest when using chairmen's and paired responses. There are no results of any relations between service and the objective performance measures GROWTH and GOP in the overall analysis.

The testing of hypothesis 4 regarding simultaneously independence and relational norms was conducted by a T-test with split halves of both independence and relational norms. The test gave a very complicated picture. This may be due to the model of analysis using board performance variables as mediators between the relational variables and the company performance variables. This does not seem to be the case.

Many of the results followed the pattern from the results from the other hypotheses. Comparing means gave no basis for supporting hypothesis four generally. When testing for simultaneous control and service, the study found, based on the responses from chairmen and pairwise responses, that best financial performance is achieved (GOP) when the boards are involved in both control and service. These findings were strongest for the smallest firms. The service board with high service involvement and low control involvement got highest evaluations regarding S-RES in the data sets based on pairwise and chairmen responses. ETHICS was in general rated highest in boards involved in both control and service.

Discussion, contributions and limitations

The understanding of directorates has both theoretical and practical implications, but research about boards of directors has many shortcomings (Zahra & Pearce II, 1989). This study has given contributions to the understanding of boards by:

1 controlling for contingencies such as industry variations and company size,
2 focusing on both composition and process relating board attributes and functions to several company performance measures; and
3 developing operationalizations of constructs.

This study of directorates is unique in the way that it has used an empirical setting with firms from one industry in a limited geographical area. The study has also controlled for company size. The selection of empirical setting causes, however, several limitations regarding external validity. Pilot studies indicated, however, that board composition and attendance to the board functions varied depending on industry (Huse, 1990). Generalizations to other industries or to other empirical settings are not recommended.

Practical literature about directorates has to a large extent had anecdotal features with no holistic understanding of the role of boards. The development of concepts and using a holistic model increases the practitioners possibilities to use the board as a powerful tool by the increasing insight into factors influencing board and company performance. This study has tried to implement a holistic model of directorates relating board attributes regarding composition and process to board performance and company performance.

The study is conducted in an area where few comparative studies have been done. A critical and difficult part of the study is then the transformation of theoretical constructs into operationalized questions. The construct validation process of research on issues focused on in study needs special attention. The present study gives a contribution to this process. In this study constructs derived form agency theory regarding independence between board and management in small firms are developed. Emphasis was given to independence regarding family ties, but friendship ties was also important in the construction of the INDependent variables. The evaluative measurements correlated highly (about −.6) with the relative number of family board members.

Few studies have been conducted using theory of contractual relations, and even though this article does not in depth discuss and operationalize the concepts of Macneil (1980), variables are derived from the relational norms of Macneil. The author does not know any empirical studies consequently using Macneil's relational norms or any intraorganizational study using Macneil's concepts.

The study showed that items derived from the relational norm (a) role integration loaded on another factor in factor analysis than items from the three other norms (b) preservation of the relation, (c) harmonizing role conflicts, and (d) supracontract norms. Using variables based on items from the three latter norms, theory of contractual relations was supported among the smallest firms (5–24 employees) in the sample. The theory was not supported for the largest firms (50–300 employees) in the sample. The study clearly indicated that the variables based on socio-economic assumptions had large explanatory power about the boards' involvement in control and service functions. The socio-economic variables seemed to have a larger explanatory power than the variables based on the neo-classical paradigm.

Conclusions and directions for future research

The study tried to resolve the apparant paradox of both independence and interdependence (relational norms). Paradoxes may be resolved by opposition, spatial separation, temporal separation or by synthesis (Poole & Van de Ven, 1989). The separation solution of the independence and interdependence/relational norms paradox may involve separation regarding:

1 different kinds of organizations (industry, localization, company size, public – private – voluntary organization),
2 different levels of analysis in the principal-agent hierarchy (owners, board, management),
3 different functions of the board (control, service); and
4 different situations in the firm's life cycle (birth phase, growth phase, maturation phase, crisis situation).

Even though these possibilities exist, this study tried to resolve the paradox by means of a synthesis. The study did not succeed in solving this paradox by means of intergrating simultaneuosly independence and relational norms by focusing on the distinct assumptions used in the two approaches.

The study has, however, contributed in giving an understanding of the role of directorates in small firms. By studying joint stock hotels in Norway and Sweden the research has indicated that:

1 the role of directorates depends on company size,
2 directors seem to be motivated of the manager rather than of the owners,
3 there are relations between company financial performance and the board's involvement in the functions of control and service (the 'participative' board, involved in both control and service, seems to be most effective regarding most financial performance measures),
4 an active board influences company ethical performance; and
5 the concepts independence and relational norms in the relationships between board and management are both important in understanding the role of directorates.

Even though all companies in the present population may be considered small (all less than 300 employees), the study clearly shows that the importance of using company size as a distinction criterion in studying boards and firms in general. Boards in very small firms (less than 25 employees) function differently than boards in larger firms. This finding is close to the results of other studies of small and medium sized firms (Gray, 1991). The different paradigms used, also have different importance regarding the roles of directorates in small and larger firms. Understanding small firms may thus require other theoretical approaches than understanding larger firms. Relational norms and trust seem to be of greater importance in understanding and monitoring small firms than large firms (cf. Perrow, 1991).

By using a dyadic stakeholder approach, the study gave statistical empirical support to earlier studies of directorates, that directors seem to be motivated by the managers more than by the owners (Mace, 1971; Herman, 1981). Furthermore, the study showed that firms with board involved in both service functions and control function will achieve better financial results than firms with a more limited involvement. This evaluation is, however, dependent on the stakeholder perspective used in evaluating both company performance and board performance. The effects and the needs for board involvement will also depend on a number of circumstances related to both the company and the environment.

The study showed the value of both socio-economic and neo-classical approaches in understanding directorates. The study did not succeed in integrating these approaches, but depending on contingencies such as company size, and the involvement in the different board functions, the different theoretical approaches were supported or rejected.

The empirical setting of this study has been small firm directorates. The concepts and the discussion of paradigms should, however, also be applied to other settings. Interesting situations in which similar discussion could be applied to are for example discussions regarding masculin (neo-classical) or feminin (socio-economic) leadership styles, authorative (neo-classical) or participatory (socio-economic) raising of children, and similar issues.

Because few studies have been conducted about small firm directorates, future research may take many directions. This study has focused on construct validity and statistical conclusion validity, a natural direction for further research could be regarding external and internal validity. External validity could be increased by conducting studies of similar boards from other industries, similar boards in other countries, and by studying board of companies of other sizes. Studies improving the internal validity of this study could use longitudinal data, prepare for experiments and quasi-experiments.

This study was designed as a cross-sectional field survey with structured questionnaires. Studies with participant observation, studying minutes from board meetings, registration of board decisions and evaluation of events, might be of importance in achieving construct validity in future research.

This study has focused on two dimensions in the relationships between the board and the top manager: (1) Independence connected to board composition, and (2) relational norms in connection with processes and future expectations. The study was conducted with constructs drawn from agency theory and theory of relational contracting. There are, however, a number of other attributes expected to influence board functions. Among these are (1) board characteristics, such as total board competency (Kosnik, 1990), (2) incentives and procedures for directors (Holmstrom & Tirole, 1989), (3) board structures, and (4) actions and processes in the board's work (Lundgren, 1986). Little empirical research has been done on the effects of these attributes, but they are expected to have greater impact on board functions than compositional attributes (Zahra & Pearce II, 1989). It would be significant to study the relative effects of these attributes and how they influence each other.

The article has underlined the importance of understanding the board in relation to company size. This is of importance both regarding differences in board performance depending on size, but also regarding company performance controlling for size. The study has formed the basis for further studies focusing on:

1 Relations between organizational context and the role of directors, and
2 the importance of organizational context relative to the role of directorates for company performance.

Studies of the organizational context implies i.e. studying the board in different phases of the companies life cycle, included crisis situation, the role of directorates in relation to varying degrees of internal complexity in the organization, and top manager attributes and incentives.

Constructs from agency theory and theory of contractual relations have been used in understanding the role of the boards. Little empirical research has been done about either of these theories. Theory of contractual relations is mostly used in inter-organizational relations. A direction for future research could be to use these theories in other intraorganizational principal-agent relations in order to operationalize, test and integrate them.

Appendix

Questions from the main questionnaire (used in the construction of SER, CON, IND and REL variables)

To what extent is the board involved:	*Very low*			*Very high*		
2c as specialist advisors for the top management (finance, law, technology)	1	2	3	4	5	SER-TM,CH,P
2d as generalist advisors for the top management (strategy, management)	1	2	3	4	5	SER-TM,CH
2e in networking and getting contacts with the environment (banks, customers, suppliers, government)	1	2	3	4	5	SER-TM,CH,P
2f in lobbying and influencing the environment (banks, customers, suppliers)	1	2	3	4	5	SER-CH,P
To what extent is the board involved in controlling:	*Very low*			*Very high*		
3a cost budgets	1	2	3	4	5	CON-TM,CH,P
3b sales budgets	1	2	3	4	5	CON-TM,CH,P
3c company liquidity	1	2	3	4	5	CON-TM,CH,P
3d investments	1	2	3	4	5	
3e departmental profit	1	2	3	4	5	CON-TM,CH,P
3f top manager	1	2	3	4	5	CON-P
3g product quality	1	2	3	4	5	
3h human resources	1	2	3	4	5	CON-CH
To what extent is the main recruitment criterion for directors:	*Very low*			*Very high*		
4a family ties with top manager (rev)	1	2	3	4	5	IND-TM,CH,P
4b friendship ties with top manager (rev)	1	2	3	4	5	IND-TM,CH,P
4c business ties with the company (rev)	1	2	3	4	5	(Arbitrary variations)
4d experience and professional competency	1	2	3	4	5	
To what extent is the chairman positively motivated to do a good board work by the foillowing factors:	*Very low*			*Very high*		
5a ownership interests (own and others)	1	2	3	4	5	IND-P
5b formal legal responsibilities	1	2	3	4	5	IND-CH
5c professional standards	1	2	3	4	5	

To what extent are the relations between the board and top manager characterized by:	*Very low*				*Very high*	
6a habits and internal unwritten rules	1	2	3	4	5	(Arbitrary variations)
6b overlapping tasks	1	2	3	4	5	
6c mutual expectations about the others actions in future	1	2	3	4	5	
6d a community with common attitudes and norms (e.g. regarding ethics, justice)	1	2	3	4	5	REL-TM

To what extent do the chairman and the top manager emphasize:	*Very low*				*Very high*	
7a preservation of good personal relations	1	2	3	4	5	REL-TM,CH,P
7b preservation of good professional relations	1	2	3	4	5	REL-TM,CH,P
7c mutual trust and positive attitudes when conflicts are to be resolved	1	2	3	4	5	REL-CH,P

Questions from the telephone survey (in the construction of the S-REs and ETHICS variables)

(5 = fully agree, 1 = fully disagree)

* The company highly emphasizes to give a societal contribution
* The company is today a very good employer for the employees
* The company is managed out of well discussed ethical codes
* The company has today a very good equity situation
* The company is today a very good investment for the owners
* The company is today threatened financially (Reversed)
* The company considers out of financial reasons to fire employees (Rev.)
* The company is today very profitable
* The company cannot today afford sufficient maintenace work (Rev.)

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12 Stakeholder management and the avoidance of corporate control *

Morten Huse and Dorthe Eide

Principles and processes of stakeholder management are still conceptually at an embryonic stage. This article analyzes several principles and processes important to understanding strategic management and business ethics. Using an inductive approach with empirical data from a Norwegian insurance company, the article contributes to a description of manipulation and power dimensions of stakeholder management. The capacity of the management of large companies to circumvent control and thus accountability is illustrated. New analytic insights are presented, such as the distinction drawn between movement, multimatum, and manipulation.

Given their size and economic power, business organizations have an impact on all other institutions of society above and beyond their economic spheres. However, corporate strategic behavior is not only a matter for the particular corporation, but also for society (Wood, 1991); and conflicts between managerial visions and objectives, on the one hand, and stakeholder interests, on the other, are often crystallized in times of recession and economic decline. This article addresses such ethical dimensions of strategic management.

The various stakeholders of a firm, such as the local communities, governments, employees, financial institutions, and stockholders, have various means to avoid undesired results of corporate strategic behavior. Such means may be laws, constitutions, ethical norms, control mechanisms in the form of governmental control boards or bodies, politicians, various markets for control, the board of directors, and so forth (Donaldson and Preston, 1995; Freeman, 1984).

An important issue, from both business and society perspectives, is how these control mechanisms may work and how corporate management may maneuver to achieve its objectives. Important questions about corporate power bases, corporate values and norms, and corporate unethical behavior are not new (see Brenner and Molander, 1977). The various stakeholders' concerns have been highlighted by recent financial scandals. Ex post evaluations have shown that large corporations have been able to avoid undue or

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excessive control by stakeholders. The objective of this article is to explore processes and techniques of stakeholder management and corporate control through which stakeholder relations can be managed. The research question will be addressed through observations related to power bases and strategic unethical behavior.

While most earlier research to a large extent has been fragmented and deductive, this article will, in a holistic setting, use an inductive methodological approach where a literature review and a model integrating various traditions will serve as a sorting logic for the presentation of a case. The first section will present a sorting logic based on an integrative literature review, displaying how agency theory, resource-based theory, and corporate social performance theory make partial contributions to the research question. The following sections present the methodology and the case. An integrated model of stakeholder management and corporate control is then introduced. The model presents power bases (individual, institutional, and integrative), stakeholder management techniques (movement, multimatum, and manipulation), and various groups of stakes (equity, economic, and environmental). Finally, the key conclusions from this research and their implications for practice and research are discussed.

Literature review: A sorting logic

A general framework for the research question is offered by stakeholder thinking (Freeman, 1984). Stakeholder thinking has proven especially valuable in understanding business ethics and strategic management (Carroll, 1995). The stakeholder notion embraces the concept that corporations face stakeholders other than owners. The firm's relationship to its environment and external stakeholders is, however, fraught with issues whereby individual values integrate with institutional or organizational requirements, and organizational actions influence social and societal goals (Aram, 1989). There are a large number of interdependencies between a firm and its stakeholders. This section discusses how agency theory, resource-based theory (and other interorganizational theories), and corporate social performance theory have approached some of these issues and contributed to a sorting logic (Mitnick, 1993). The choice of theories relates to the equity, economic, and environmental stakes that are found in the classical stakeholder grid (Freeman, 1984).

The stakeholder framework

A framework which seeks to enhance a corporation's stakeholder capability must begin with an application of this basic question: 'Who are those groups and individuals who can affect and are affected by the achievement of an organization's purpose?' (Freeman, 1984:54). Most large corporations have a stakeholder map that includes owners, the financial community, activist groups, customers, customer advocate groups, unions, employees, trade associations, competitors, suppliers, government, and political groups. There may be variations among industries, companies, and geographies with respect to the intensity and importance of the stakeholders' stakes and power (Freeman, 1984; Huse, 1995).

The stakes may vary as to whether they are based mainly on equity (stockholders, directors, and minority interests), economic interests (customers, competitors, suppliers, debtholders, unions), or environmental interests based on influence (consumer advocates, government, trade associations). Freeman (1984) asserts that while the classical stakeholder grid assumes congruence between the various power bases and stakes (formal and voting power for equity stakes, economic power for economic stakes, and political power for influence stakes), the real world is more complex. For example, the government, the Securities and Exchange Commission (SEC), and outside non-equity-holding directors may have formal power or voting rights; local governments may have economic power; and consumers and unions may have political power.

Even though Freeman (1984) emphasized the importance of integrating various theoretical approaches (equity, economic, and environmental) to understand stakeholder management, few attempts have been conducted to integrate them. Agency theory primarily helps the understanding of a firm's relations to its equity stakeholders; and resource-based and other interorganizational theories describe a firm's relations to economic stakeholders, while corporate social performance literature illuminates major influence-based stakeholders. All three approaches raise questions regarding corporate control with respect to different types of stakeholders.

Stakeholder/agency theory

It has long been the gospel that corporations have sacred obligations to the holders of the firm's equity. Thus any action taken by management must ultimately be justified by whether or not it furthers the interests of the firm's owners. Research related to the monitoring and control of corporations from an ownership or stockholder perspective is dominated by agency theory approaches. Agency theory, focusing on the role of directors, has evolved because of assumptions of asymmetric information and conflicting stakes between the executive management (agents) and the residual claimants (principals) of firms (Eisenhardt, 1989; Fama and Jensen, 1983). In agency theory, the stockholders are the residual claimants being dealt with in large corporations.

While agency theory describes the potential impact of monitoring mechanisms like the markets for control and the board of directors, a large number of studies and other observations show how management maneuvers to avoid these control mechanisms. Managerial dispositions involve efforts to pacify the board of directors' control possibilities by recruiting board members, setting the boardroom agendas, and investing in defense mechanisms toward the market for corporate control (Davis, 1991; Gustavsen, 1972; Herman, 1981; Whisler, 1984).

Hill and Jones (1992) applied agency theory to stakeholder management. They join together notions of power and efficiency within the same framework. By introducing this stakeholder-agency paradigm they explain aspects of the firm's strategic behavior, the structure of incentive alignment mechanisms, and the institutional forms that have evolved to police the implicit and explicit contracts between managers and stakeholders. The paradigm explicitly focuses on the causes of conflict between managers and stakeholders. The legitimacy of managerial behavior is a core concept used in understanding corporate strategic behavior from this perspective.

Agency theory contributes to the understanding of stakeholder management and corporate control in emphasizing input variables as the formal power that external stakeholders, traditionally equity owners with formal or voting rights, have in relation to corporate management. Agency theory considers organizational processes as a 'black box' and uses assumptions regarding managerial opportunism and information asymmetry. Agency theory, including Hill and Jones's (1992) agency-stakeholder paradigm, does not explain the processes surrounding such opportunism and information asymmetry. Thus agency theory only has a partial explanation of stakeholder management and corporate control. There is a need for approaches that permit investigation into organizational processes.

Stakeholder/resource-based theory

Stakeholder management can also be studied by considering interorganizational relationships. In the classical stakeholder grid, interorganizational relations are often represented by the intersection of economic power and economic stakes.

In theory, the strategic objective of economic organizations is to create sustainable competitive advantage (Barney, 1991; Hall, 1993; Penrose, 1959). Recent theoretical developments in resource-based theory show how organizations handle interdependencies with each other to develop their strategic resource base (Amit and Schoemaker, 1993; Hall, 1993; Peteraf, 1993).

One organization frequently establishes linkages or exchanges with other organizations in order to meet necessary legal or regulatory requirements. Mandates from higher authorities (e.g., government agencies and legislation) may provide the impetus for interorganizational relationships that otherwise might not have occurred voluntarily. Interorganizational relations are often characterized by asymmetric power relations and prompted by the potential to exercise control or power over others. According to Oliver (1990) organizational power is often considered to be a function of organization size. The proposition of reciprocity, in part an opposition to the asymmetry proposition, emphasizes cooperation, collaboration, and coordination among organizations, rather than domination, power, and control (Macneil, 1980).

Resource dependence theory can be considered a predecessor to the resource-based view of the firm. External control of organizations is a key element in resource dependence theory and interorganizational relations (Pfeffer and Salancik, 1978). Resource dependence theory emphasizes that when elements in the environment have considerable power over an organization, it is logical to assume that the organization will try to pursue activities that secure its success or contribute to making the environment more friendly (Pfeffer, 1972). Resource dependence theory focuses on the development of interorganizational power, and the way in which the organization attempts to manage its external dependencies. Resource dependence theory emphasizes cooptation. This is a strategy for absorbing powerful external organizations, and a way of dealing with environmental dependence (Selznick, 1949). It can be implemented by using the board of directors as an instrument for dealing with important external organizations, by putting representatives of these institutions on the board (Pfeffer, 1972:222).

While resource dependence theory focuses on dependencies, resource-based theory emphasizes interdependencies between economic organizations. Assumptions about opportunism in interorganizational relations are supplemented with processes that develop trust-based relationships and social networks (Husted, 1994; Ring and Van de Ven, 1992, 1994).

Resource-based and other interorganizational theories contribute to the understanding of stakeholder management and corporate control by emphasizing the role of economic stakeholders. These theories focus on interdependencies between economic institutions. Economic power relationships advanced both directly and indirectly through, for example, cooptation, social networks, and other activities, may also lead to formal and political power. Even though these theories highlight the role of the power bases of economic institutions, little attention has been given to the processes of stakeholder management and corporate control.

Stakeholder/corporate social performance theory

The societal control of business may be considered at the core of the field of business and society (Jones, 1983). Traditionally the law has been the means for societal stakeholders to control organizations, but as Stone (1975) clearly concludes, the law can only control organizations up to a certain point. However, from a business and society perspective, corporate social performance (CSP) may be a dominant evaluation criterion of businesses.

Stakeholder management is an important part of corporate social performance (Clarkson, 1995; Gatewood and Carroll, 1991; Wood, 1991; Wood and Jones, 1995). Wood's (1991) model of corporate social performance involves the relationships between principles of corporate social responsibility, processes of corporate social responsiveness, and outcomes of corporate behavior. The model describes how an ethical dimension may be incorporated into corporations by institutional, organizational, and individual reasoning.

According to Wood (1991), stakeholder analysis provides a starting point for scholars to think about how society grants and takes away corporate legitimacy and power bases. A principle of legitimacy indicates that society has the right to establish and enforce a balance of power among its institutions and to define their legitimate functions. Businesses are also responsible for outcomes related to their areas of involvement with society and, according to the principle of public responsibility, it is the organization's duty to act affirmatively for social well-being. A third principle considers managers as moral actors.

The processes of responsiveness in Wood's (1991) model include environmental assessment, stakeholder management, and issues management, and provide an action counterpart to the principled reflection of social responsibility. Organizational responses to social pressure can be reactive, defensive, accommodative, and proactive, according to Carroll (1979), and stakeholders are likely to evaluate outcomes of corporate behavior differently, depending not only on their own interest, but also on their understanding and acceptance of social responsibility principles.

Swanson (1995) argues for a reorientation of Wood's (1991) CSP model. She argues that normative aspects of corporate and individual behavior must get more attention when understanding corporate social performance, and the processes of stakeholder management must be understood both in light of economic reasoning (utilitarian ethics) and positive duty (deontological ethics), and both utilitarian (outcome) and deontological (process) approaches in understanding corporate performance should be included in evaluating businesses (Etzioni, 1988).

CSP theory contributes to the understanding of stakeholder management and corporate control by focusing on processes of ethical/unethical behavior by individuals and institutions. CSP theory offers a dynamic perspective on stakeholder management and corporate control, as the stakeholders' evaluation of corporate behavior and performance gives input to the power base of the corporation through the principle of legitimacy.

Stakeholder management and corporate control

The three reviewed approaches all contribute to a sorting logic that guides us and helps us in our inquiry into the research question. This sorting logic is presented in the input-process-output systems model in Figure 12.1.

Various power bases were introduced. Agency theory introduced formal power bases, resource-based theory had a focus on economic power bases, and CSP theory introduced social legitimacy as a power base. While agency theory and resource-based theory concentrated on the power bases related

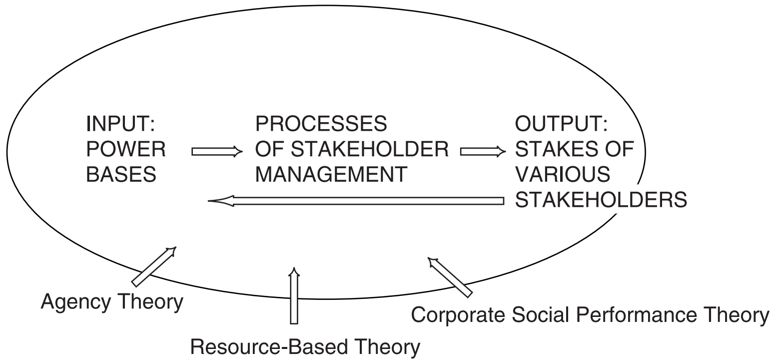


Figure 12.1 Sorting logic based on review literature about stakeholder management and corporate control.

to economic institutions, CSP theory also related power to individual discretion. While agency theory assumed opportunism and resource-based theory allowed for trust in a corporation's stakeholder relations, it was only CSP theory that gave attention to the factual processes of stakeholder management.

The sorting logic in Figure 12.1, according to the stakeholder framework of Freeman (1984) and CSP theory, is presented as a dynamic model where the stakeholders' evaluations of the outcome of the processes of stakeholder management influence the bases for managerial and stakeholder power. The core of the model, and the heart of the organization, is corporate management, including the board of directors (Stone, 1975), and according to CSP theory the board's power base depends on stake-holder relations.

The different bodies of theories give weight to the stakes of different stakeholders. Agency theory traditionally emphasizes the stakes of equity stakeholders, resource-based theory balances the stakes of various economic stakeholders, and CSP theory accentuates the importance of the stakes of other stakeholders in the corporation's environment ('environmental stakeholders'), and various stakeholders are likely to evaluate outcomes of corporate behavior differently.

Even though these theories have been in existence for years, few studies, either empirical or theoretical, have tried to integrate the various perspectives of principles and processes of stakeholder management into a holistic dynamic model. The objective of this article is to explore processes and principles important to understanding stakeholder management and corporate control from a business and society perspective. While most research has used only one of the three reviewed approaches to understand stakeholder management, in this article all three perspectives are included in a holistic dynamic model. In order to meet these objectives, the paper reports the findings of a case study of the largest Norwegian insurance company, UNI Storebrand.

Methodology

This article's research goal is to understand the processes through which stakeholder relations can be managed. In addition, we address questions of unethical corporate behavior. Ethical dimensions within strategic management are difficult to investigate because of their complexity and sensitive characteristics (Borch and Arthur, 1995). The question of stakeholder management and the importance of norms in stakeholder relations come to the surface in situations where transgressions of these rules have taken place. This makes it difficult to get access to proper data. The case of UNI Storebrand is an example of severe manipulation of stakeholders and a breach of ethical standards. An in-depth single case study was conducted in an attempt to get under the surface of the largest financial scandal in Norway in decades.

As the objective for this study was to explore processes and principles rather than to test hypotheses, an inductive case study design was selected. The UNI Storebrand case was selected as the research vehicle for several reasons. First, the case has received much attention in Scandinavia and internationally. Because of the scandal, the name 'UNI' has already been used internationally as a derogatory term in situations where corporate management has acted *ultra vires* by circumventing the control powers of stakeholders, thereby rendering them virtually impotent to act as control bodies. Second, the sources available to reconstruct the case were abundant. Almost every day over a period of half a year, newspaper and journal articles regarding the crisis in UNI Storebrand were published, public investigations to identify the persons responsible for this crisis were initiated, and a book defending his actions and behavior was written by the company's CEO. Third, Norway is a small country known for values and management cultures different from those revealed in this case. Within this small and rather simple national setting, the issues – though not necessarily different from a similar case in a complex U.S. setting – probably stand out more.

In constructing the case, data were collected in several ways, through: (a) 20 in-depth interviews with representatives of the stakeholders and the corporate management, (b) a thorough reading of about 1,000 newspaper and journal articles about the events in UNI Storebrand, (c) books and investigation reports (e.g., Adm.styret, 1993; Jacobsen and Langangen, 1992), (d) searches for additional data in archives and annual reports, and (e) a public hearing about stakeholder management and corporate control related to the UNI Storebrand crisis.

The data collection started with an open approach, gathering any kind of data that could be of relevance in understanding strategic management. We tried to enter the study without having any clear assumptions regarding what would be found (Glaser and Strauss, 1967). The data were first organized chronologically in terms of the historical development of the case. In analyzing the data, certain principles and patterns seemed to occur. We then structured the data and gathered additional data in order to illuminate these observations further.

The case

In August 1992, UNI Storebrand, Norway's largest insurance company, was taken under public governance because of bankruptcy threats. The corporate management of this company had failed in its hostile takeover raid against Skandia, the largest Swedish and Scandinavian insurance company. In its raid, UNI Storebrand had violated the interests of the stockholders, the Norwegian public and their representatives in Parliament and bureaucracy, corporate democracy, and the interests of the creditors. This raid resulted in a loss of billions of dollars for stakeholders as stockholders, creditors, and customers. Because of the severity of the crisis and the events leading to it, 15% of the St.meld. (1992), the annual presentation from the secretary of finance to Parliament about the national economic situation, was used to make a preliminary orientation of the crisis. (See Appendix A for a timeline of important events in the takeover raid.)

UNI Storebrand was the result of a merger between the two largest insurance companies in Norway. The merger was approved by the Norwegian authorities in January 1991. In 1989 UNI tried to merge with another large Norwegian insurance company (Vesta), but the merger was stopped by the government. Before the merger between UNI and Storebrand, UNI was the largest life insurance company in the Norwegian market, while Storebrand was the largest non-life insurance company. In both the life and the non-life sectors, the new company (UNI Storebrand) had domestic market shares of between 30% and 50%. UNI Storebrand had an average of 4,661 employees in 1991. Skandia in Sweden was the largest Scandinavian insurance company and had an average of 11,321 employees in 1991. The merged company was a public joint stock company, but 30% of the stock was owned by the UNI Foundation. The UNI Foundation was established because UNI was a mutual insurance company before the merger with Storebrand. The equity of the UNI Foundation was the accumulated results of the non-life activities of UNI Insurance. In the merger, Storebrand CEO Jan Erik Langangen became the new CEO of UNI Storebrand, while the CEO of UNI and the UNI Foundation became chairman of the board.

The remainder of this section is presented according to Figure 12.1's logic, by distinguishing between power bases (inputs) and techniques (processes) of stakeholder management. The next section will summarize the findings in a model of stakeholder management and corporate control.

Input: power bases

Power bases observed included institutional, individual, and integrated sources. The institutional power bases were related to the power coming from organizational size and power (e.g., economic power), individual power bases were related to characteristics of the manager as individual, and integrated power bases were the additional power arising because of simultaneous institutional and individual power.

Institutional: concentration of power

UNI Storebrand was the largest investor in the Norwegian financial market. Even though both stockholders and governmental bodies were aware of the possible danger related to this concentration of power, they were more victims than monitors of this power. The press reported that politicians, bureaucrats, and corporate managers alike were afraid to oppose the 'Langangen-sphere' because of potential personal or financial repercussions.

According to agency theory, the board of directors is considered to be one of the stockholders' principal devices of control over management in a situation of separation of ownership and leadership (Fama and Jensen, 1983). Another mechanism is the market for corporate control. UNI Storebrand's board composition was decided by corporate charter, which states that there should be 10 board members, 4 of whom should be elected as employee representatives, 2 from the UNI Foundation (including the chairperson), and 4 representing the other stockholders. The CEO and top management group also attended the board meetings, but had no voting rights.

Even though the four outside directors were among the most influential executives of major Norwegian corporations, board composition and the board's behavior as reported in Adm.styret (1993) indicate that there was a managerial hegemony in UNI Storebrand (Herman, 1981), and that in reality the stockholders had little influence. As he entered the position as board chairman, Thorleif Borge commented to the press that his main job was to support and inspire the CEO. The Skandia raid had been on the board agenda 19 times, and the CEO and his administration received unanimous support every time. A public investigation report indicated, however, that the CEO used the chief officer of the Ministry of Finance in Norway as a hostage in relation to the board's considerations. The members of the board have been sued by the stockholders for not having looked after their stakes in supporting the Skandia raid: One of the main accusations concerned the directorate's lack of concern for the takeover defenses adopted by Skandia. The importance of Skandia's unequal voting stock defenses had been commented on in a major Swedish journal a few days before UNI Storebrand started its takeover raid. These defenses included that no stockholder could vote for more than 30 shares at the general assembly meeting, and the CEO of Skandia formally requested that all stockholders be given proxies to distribute their voting rights.

UNI Storebrand also had direct and indirect interlocks with other corporations. The ownership structure of UNI Storebrand made it possible for the corporate management to set the conditions for the election of the outside board members. They were (with one exception) top executives of some of the most influential Norwegian corporations, but none of them was in the core of the personal networks of CEO Jan Erik Langangen (Granovetter, 1973). As a large financial institution, supposed to be the financial locomotive in Norwegian industry, UNI Storebrand actively used its directors and top executives in interlocking directorates to influence other corporations (Pfennings, 1980). As part of the UNI Storebrand study presented here, a survey of corporate interlocks between 50 of the largest Norwegian corporations was conducted, and UNI Storebrand was found to have the most interlocks. It had eight direct interlocks and indirect interlocks with about 50% of the corporations being studied (see Appendix B for a map of the interlocks). These interlocks indicate a concentration of institutional power and mutual interdependence, and may have a potential impact on the development of networks and power elites. Some of the corporations in this network represent large financial sources, and the management and the board of directors in some of them have been sued for insufficient evaluations/considerations of the economic and financial consequences in supporting UNI Storebrand's takeover bid.

Individual: CEO charisma and relation-building abilities

The individual characteristics of the CEO have been heavily emphasized in this case. His relation-building abilities, personal charisma, and friendly behavior appeared to legitimize his actions. He was compared to an evangelist preaching his gospel in such a way that everybody said 'Hallelujah and amen.' He was considered to be a person of high managerial discretion, acting morally within every domain of social responsibility (Wood, 1991). A majority of the employees adored him. They were loyal to him, but not so much to the firm. He was considered to be a managerial genius and the 'wonderboy' of Norwegian management. Because of his personal integrity, communicating love, reciprocity, and respect (Boulding, 1989), Jan Erik Langangen was awarded the Norwegian Best Manager Prize in 1991. He created enthusiasm for his plans and visions.

Integrated: friendship and power elites

Integrated power is defined here as the power that stems from combining institutional and individual power. The UNI case clearly illuminated how friendships among power elites across organizations are crucial in understanding strategic management and stakeholder control. In this case, these elites seemed to evolve from a common ideology, the most apparent of these related to politics, university background, and a leadership ideology (Jacobs, Useem, and Zald, 1991). The groupings resulted in an 'old boys' network' wherein politicians, bureaucrats, and corporate leaders supported and encouraged each other.

In light of the UNI Storebrand crisis, three elite networks were revealed. The first ('the old boys club') consisted of 20 to 30 of the Norwegian corporate managers. This was not one defined group with a distinct inner core, but had several levels. The core was characterized by giving terms of trade to both business and government. One of the members of this network explained: 'To be a member of "the old boys club" involves that it is possible to arrange everything if you know the group and the rules of the game. The members are members of each other's board of directors, they own each other's companies and decide each other's compensation.' The UNI Storebrand crisis almost destroyed this network.

The second network was 'the presidents club.' This club was a more exclusive variant. The group developed around a U.S. management consultant who became a guru in Norway. His leadership philosophy was based on the belief that leadership is a profession and that leadership skills are independent of the corporation or business to be led (Schjander, 1988). Seven to 10 of the Norwegian corporate presidents were members of this group. They met twice a year to cultivate a common leadership philosophy and to discuss marketing trends and corporate strategies.

The third network was an example of how industry leaders and politicians came together. The group was the close network of the secretary of finance. Together with his political advisers he met regularly with eight of the industrial and financial leaders in Norway.

Jan Erik Langangen was at the core of each of these networks. He was on particularly good terms with the members of the cabinet. He was half-officially declared to be a social democrat and shared the vision of Prime Minister Brundtland that Norwegians must be active in forming the inner financial market that will arise within Europe. The process of involving the politicians in the Skandia raid started in the office of the prime minister on June 18, 1991 (Jacobsen and Langangen, 1992). At this meeting, where only Jan Erik Langangen and Prime Minister Brundtland were present, Langangen informed the prime minister about his plan. After this time Langangen nurtured his good relations with the secretary of finance and his closest advisers. From August 1991 they had regular meetings discussing the Skandia raid.

Processes of stakeholder management

Observations about the processes of stakeholder management were sorted into three concepts: movement, multimatum, and manipulation.

Movement: 'The road is made while you walk'

The UNI Storebrand case showed a proactive response of movement to avoid stakeholder control. 'The road is made while you walk,' a quotation from Ferdinand Finne, a contemporary Norwegian novelist, was adopted as a slogan for UNI Storebrand's board chairman, Thorlief Borge. The concept refers to one of the ways the corporate management of UNI Storebrand dealt with laws, regulations, and other forms of stakeholder control. The quote relates to starting toward a destination without having control of apparent obstacles, yet still having faith in a solution. It was reported that in corporate management meetings Jan Erik Langangen smiled several times when confronted with comments that his plans were not in line with laws or regulations. His response to such comments was that the road will be made while we walk. He saw that laws and decisions by governmental bodies and other stakeholder groups were changed 'as he was walking.' As a corporate manager he had thus far succeeded in whatever he tried; why should he not also succeed this time? These observations are also reinforced by a citation from his personal diary: 'Think positively about what you can do with the situation. Push worries ahead of you' (Jacobsen and Langangen, 1992: 81).

The board of directors, business leaders, financial institutions, politicians, employees, and the society in general seemed to be blinded by his earlier success, and they tended to believe that he also would achieve his visions in the future.

Multimatum: 'Requesting approval after the point of no return'

Both in the merger and in the Skandia raid, UNI Storebrand used the risky but obviously effective escalator tactic of putting oneself and another party in a position of mutual destruction unless the other party acts to save them both.

One of the most frequent descriptions of the corporate strategic response to corporate control was that 'approval was requested after the point of no return.' The Norwegian Parliament and other governmental control bodies had presented requirements to UNI and Storebrand in order to avoid undesirable consequences of the corporation's behavior in relation to customers, competition, financial institutions, and society in general. In 1989 UNI, the second largest insurance company in Norway, wanted to merge with Vesta, the fourth largest. This was stopped after a thorough discussion in Parliament, which resulted in a bill that prohibited any of the largest Norwegian insurance companies from merging. In 1990 the two largest Norwegian insurance companies, UNI and Storebrand, merged in direct opposition to this bill. They did not get permission until after the merger had taken place. The firms had relocated together and had integrated their EDP (computer) systems and all organizational and marketing structures and systems. The stock market and the Norwegian equivalent of the SEC, most members of Parliament, the Norwegian Price authorities, and even the members of the social democratic Labor party opposed this merger.

The main formal reason for letting UNI and storebrand merge was that they should be a locomotive in Norwegian industry by investing in Norwegian firms. During the fall of 1991 they 'asked' the Norwegian secretary of finance whether (a) the Norwegian state would join them in buying the Swedish insurance company Skandia, or (b) the cabinet would allow UNI Storebrand to invest all its resources in Sweden in the Skandia takeover raid. In a secret letter of November 12, 1991 from the corporate director (chief of staff) of UNI Storebrand, the Credit Supervision (Kredittilsynet), the main Norwegian governmental body controlling financial institutions, was told that unless it made concessions, UNI Storebrand would suffer destructive losses. UNI Storebrand had at that time already bought 20% of the shares in Skandia without concession.

According to Adm.styret (1993), the board of directors also faced the managerial ultimatum tactics of requesting approval after the point of no return in the Skandia raid, and financial institutions and partners could not withdraw from obligations without suffering severe losses.

Manipulation: 'Playing one party off against another'

One aspect of the manipulation that occurred in UNI Storebrand involved a kind of cooptation of the decision-making processes without letting the coopted parties have any influence. It seemed to be Langangen's style to make frequent briefings to the official governmental authorities and other control bodies, but never to ask permission. Langangen did not get any promises from the prime minister at their meeting, but neither did he get the opposite. The atmosphere at this meeting was such that UNI Storebrand on several occasions explicitly declared that the Norwegian prime minister supported the takeover raid. These declarations were never denied. Langangen played one party off against another like a child might play one parent off against another. The cabinet thought Langangen was supported by a unified Norwegian industry, and the industry leaders thought he was supported by the cabinet. Both the cabinet and the industry leaders had a sort of unquestioned trust in Langangen. Due to the crisis, stockholders and financial institutions considered legal proceedings against the Norwegian authorities for not having stopped the raid. The political parties have also been considering whether the authorities' relations with UNI Storebrand's unsuccessful Skandia raid should lead to a motion for a vote of no confidence in Parliament against the secretary of finance and the prime minister.

Another example of the use of manipulation emerged when, in interviews, both employees and stockholder activists described how the CEO and the board chairman actively tried to suppress comments from the shareholders at the general assembly meeting in May 1992. This was done by directly and personally contacting and threatening shareholder activists, and by attempting to manipulate the assembly. At the assembly meeting, 800 employees were allowed admittance and were instructed to applaud whatever the corporate management said and to react negatively to whatever was said from potential opposition.

An integrated model of stakeholder management and corporate control

The preceding has illustrated (a) corporate power bases (input) and (b) techniques (processes) of stakeholder management in relation to (c) various stakeholder groups (output) in the UNI Storebrand case. A summary of the concepts and the preceding sections is presented in the stakeholder/strategy matrix in Table 12.1, while Figure 12.2 presents a 'You 'n I' (UNI) model of stakeholder management. The model provides an insight into unethical corporate strategic behavior. In this section we first discuss the concepts explored, then present five propositions.

Concepts

The matrix in Table 12.1 sorts the examples from the case into the logic presented in Figure 12.1. Examples of power base concepts and process concepts are sorted depending on stakeholder orientation. The power base for stakeholder management is sorted into institutional, individual, and integrated, while the processes or techniques of stakeholder management are sorted into movement, multimatum, and manipulation. Output and company performance are related to various equity, economic, and environmental stakeholders.

Power base concepts

Compared with Freeman (1984), the grid presented in Table 12.1 also includes the power bases for corporate management. In normative literature there has been a tendency to view managerial behavior mainly as a result of individual considerations (the Whig attitude), while descriptive literature has had a tendency to focus on evolution and institutional factors (the Tory attitude; Etzioni, 1988). The observations from the UNI case illustrated the importance of understanding a 'You 'n I' model of stakeholder management where institutional Tory approaches (You) and individual Whig approaches (I) are integrated. The observations illuminated how the CEO's 'You 'n I' relations were power bases facilitating strategies in avoiding corporate control.

Three groups of power bases were indicated: (a) concentration of institutional power (institutional), (b) CEO charisma and relation-building abilities (individual), and (c) friendship and power elites (integrated). The groups are not quite distinct, as they seem to overlap and influence each other, but the concentration of power has an institutional or organizational origin, CEO charisma has mainly an individual origin, and to a high degree the friendship and power elite power base seems to be a result of integrating individual and institutional/organizational factors.

The institutional power base reflects power asymmetries and dependencies as expressed in resource dependence theory and agency theory. From the

Table 12.1 Stakeholder/strategy matrix. Examples of observations

Output/Stakes	*Equity (Owners)*	*Economic (Competitors, suppliers, financial inst. etc.)*	*Environmental (Employees, society in general, consumer groups, etc.)*
Input/Power Base			
Institutional 'Concentration of institutional power'	Ownership structure made it possible to set the premises for the election of outside board members	Financial power made it possible to use its directors and executives in interlocking directorates	Employees, politicians, and bureaucrats were afraid to oppose because of potential repercussions
Individual 'CEO charisma and relation-building abilities'	He made everybody enthusiastic about his plans	He was considered to be a managerial genius and was awarded the 'Best Manager Prize'	He was considered to be a man of managerial discretion, acting morally within every domain of social responsibility
Integrated 'Friendship and power elites'	The board chairman defined his role to support and inspire the CEO	He was in the core of power elites, sharing common leadership ideologies	He shared ideologies and was on friendship terms with influential politicians and bureaucrats, and he was their adviser
Process/Technique			
Movement 'The road is made while you walk'	Corporate management was far ahead of the board in strategy formulation	Business leaders and financial institutions tended to believe he would have success	Laws and regulations were changed if they were in opposition to the corporation's behavior
Multimatum 'Requesting approval after the point of no return'	The raid was on the board agenda after dispositions had been made	Creditors and partners would suffer losses if they did not support	The governmental regulatory bodies were faced with a moral dilemma
Manipulation 'Playing one party off against another'	The board was informed about positive signs from government	Industry leaders and financial institutions thought he was supported by government	Politicians and bureaucrats thought Langangen was supported by a gathered Norwegian industry

UNI case we observed that the CEO could set the premises for electing board members, he used his executives in interlocking directorates, and employees and politicians were afraid of potential repercussions. The individual power base builds on trust and emotions, and was illustrated by how the CEO created enthusiasm and was considered to be a managerial genius and a man of managerial discretion. The importance of such issues is recognized in resource-based theory and in the corporate social performance literature. Because he integrated institutional and individual power, he was able to dominate his chairman and be in the core of corporate and societal power elites. The importance of social networks, how they work, and how they are established based on integrated power bases, was illuminated in the study.

The UNI Storebrand case illustrated how similar patterns of power bases are reflected in the relations to the various stakeholder groups. This observation is in line with Freeman's (1984:63) assumptions in his 'Real World' stakeholder grid, and thus it is indicated that there may be some generic approaches in relating to stakeholders. While a classical stakeholder approach assumes congruence between power and stake where environmental stakeholders (like employees, consumers, and society in general) have political power, economic stakeholders (like competitors, suppliers, and financial institutions) have market power, and equity holders have formal or voting power, the UNI Storebrand case identified more complex power bases across the different stakeholder groups.

The UNI Storebrand case illustrated how corporate management utilized power and information asymmetry in relation to the various stakeholders. The corporation as a financial institution used its stockholding in other firms to influence decisions and to establish networks of interlocking directorates and power elites (Palmer, 1983; Useem, 1984). A reciprocity contingency in the case studied was clearly exemplified by the relationships with S-E Banken, Hafnia, and Pojohala (leading banks and insurance companies from the other Scandinavian countries) in order to make joint takeover attempts on Skandia. The relationship formations in the UNI Storebrand case were primarily voluntary. Resource dependence objectives seemed to be a main reason for strategic behavior (Pfeffer and Salancik, 1978). These relationships were mainly initiated toward stake-holder groups perceived as the most important in relation to the goals of the corporation.

The interactions of various power bases in relation to the various stakeholders constituted a network of complexity that is hard to reduce to simple descriptions, but the case showed how various forms of power in the dynamics of business and society systems may act and interact on each other (Boulding, 1989; Weber, 1947). While the various contingencies underlined the importance of organizational or institutional power, the importance of CEO charisma and personality emphasized that noneconomic factors are important in understanding the power bases for strategic behavior (Etzioni, 1988; Granovetter, 1985).

Process concepts

The UNI Storebrand case indicated that the integration of institutional and individual power gave the CEO and corporate management a unique power base for strategic behavior, which was utilized by the strategic processes of (a) movement ('the road is made while you walk'), (b) multimatum (requesting approval from the stake-holders after the point of no return), and (c) manipulation (playing one party off against another). The various techniques were employed in relation to all stakeholder groups, and it is thus indicated that such processes may have a generic character.

The movement process is characterized by the attitude that no hindrances are too big to be solved. They will be overcome while the process unfolds. Movement was displayed in the UNI case when the CEO implemented decisions even though obstacles seemed to exist. He could do so because he was far ahead of the board in strategy formation, business leaders tended to believe he would have success in whatever he did, and laws and regulations were changed if they were in opposition to the behavior of the corporation. The use of this technique may, however, signify little respect for others and existing principles in society.

The CEO of UNI Storebrand described the multimatum process as monumental dynamism (Jacobsen and Langangen, 1992: 131). When large organizations are moving, they may be hard to stop without excessive costs for the stakeholders trying to stop them. The various stakeholders and constituencies – like the board, creditors, partners, and governmental regulatory bodies – faced moral dilemmas as approval was requested after the time of no return. The case presentation showed that the raid was placed on the board agenda only after decisions had already been made; creditors and partners would suffer losses if they did not support it; and other regulatory bodies recognized that harm would occur if regulations were enforced.

The manipulation process is described as playing one party off against another. In the UNI case, the CEO played the various stakeholders and constituencies off against each other. The board was informed about positive signs from the government, the industry leaders and financial institutions thought the CEO was supported by government, and politicians and bureaucrats thought Langangen was supported by a unified Norwegian industry.

The combination of stakeholder management processes observed in the UNI Storebrand case indicated that the CEO and his dominant coalition were following the managerial prerogative enterprise strategy (Freeman and Gilbert, 1988). An enterprise strategy symbolizes the perceived moral obligations of a corporation and expresses what the corporation stands for. Following a managerial prerogative enterprise strategy, the corporation maximizes the interests of its management. The UNI Storebrand case showed, however, that a large corporation can circumvent the checks and balances of various stakeholder groups by employing various techniques of avoiding corporate control.

Propositions

The various elements of the preceding discussion are summarized in the 'You 'n I' (UNI) model of stakeholder management (Figure 12.2). The model's rationale combines the sorting logic and literature review presented in Figure 12.1 with the observations from the case.

Figure 12.2 indicates how the different concepts observed in the UNI case may relate to each other. The model and the relations are expressed by the following propositions:

1. *Generic Stakeholder Relations*. The relationship between a firm and its stakeholders can be characterized by generic (a) power bases, and (b) stakeholder management techniques.

This proposition relates to the general nature of a corporation's stakeholder relations. While most scholarship assumes congruence between stakeholder groups (equity, economic, environmental) and power bases (formal, economic, and political), we propose, in line with the observations from the study, that there exist generic power bases and strategic processes valid in relation to all stakeholder groups. The arguments for generic stakeholder strategies are also found in Freeman (1984). Equity, economic, and environmental stakeholders must all relate to the same kinds of power bases (institutional, individual, and integrated) and strategic stakeholder management processes or techniques (movement, multimatum, and manipulation). The case gave several examples of how these power bases and processes were generic.

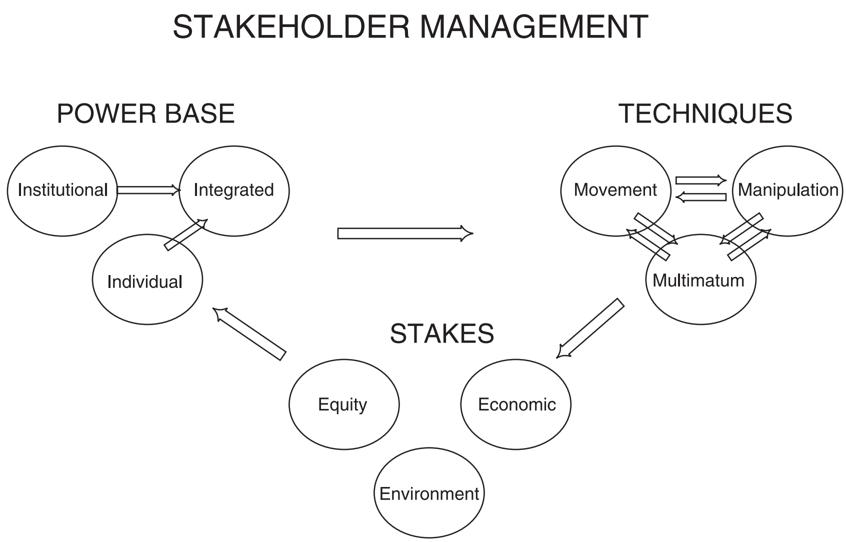


Figure 12.2 The You 'n I (UNI) model of stakeholder management and corporate control.

2. *Relations Between Power Bases*. Managerial power is based on (a) institutional, (b) individual, and (c) integrated sources. Integrated sources of power stem from both institutional and individual sources, but are different from the sum of them.

The second proposition describes the relations between the three power bases. While most research and theories about corporate governance only emphasize institutional power bases (e.g., economic power), this study also illuminated the importance of characteristics of the individual, and that a combination of institutional and individual power bases gave rise to an integrated power base. The integrated source of managerial power is related to the importance of social elite networks. The case showed that managerial power is more than the sum of institutional and individual power. The CEO of UNI Storebrand lost his membership in the core of the elite networks when he resigned from the corporation, and his predecessor did not get into these cores.

3. *Relations Between Power Bases and Techniques*. The more joint availability of power bases, the more freedom the firm will have in using stakeholder management techniques effectively.

Proposition three describes the relations between the power bases and the stakeholder management techniques. The UNI case showed how the stakeholder management techniques of movement, manipulation, and multimatum were implemented effectively. This proposition is in line with Pfeffer and Salancik's (1978) resource dependence arguments. If the CEO of UNI Storebrand had not been able to integrate his personal charm and relation-building abilities with the power of his giant corporation, he would not have had the freedom to use the various techniques successfully. The case illustrated that the corporate management of UNI was able to implement them because of strong institutional, individual, and integrated power bases.

4. *Relations Between Stakeholder Management Techniques*. There are interdependencies between the various stakeholder management techniques. The employment of the techniques (e.g., movement, multimatum, and/or manipulation) intensifies the potential of the others.

This fourth proposition describes the relations between the various stakeholder management techniques. The use of one technique reinforces and intensifies the potential of each of the others. The case showed that the UNI management used several stakeholder management techniques at the same time on the same stakeholders. The various techniques seemed to reinforce each other. If the CEO had not been ahead of the board in strategy formation (movement), the raid would probably not have been on the agenda after dispositions had been made (multimatum). Because governmental regulatory bodies were faced with moral dilemmas (multimatum), laws and regulations were changed if they were in opposition to the behavior of the corporation (movement). Movement techniques reinforced multimatum and manipulation techniques. Multimatum and manipulation techniques facilitated the use of movement techniques, and multimatum and manipulation techniques reinforced each other.

> 5. *Dynamism in Stakeholder Relations*. A company's stakeholder relations are dynamic processes. Earlier company performance influences (a) the present stakes, and (b) the power of each stakeholder.

The final proposition is based on the legitimacy rationale in corporate social performance theory (Freeman, 1984; Wood, 1991). A social institution must avoid abusing its power, and if central stakeholders lose confidence in the firm's performance, legitimacy may be withdrawn. A major shortcoming in much corporate governance research is the lack of dynamic aspects. A company's stakeholder relations vary over time depending on the stakeholder's evaluation of the company's earlier performance.

Summary

The model of stakeholder management (Figure 12.2) summarizes concepts and relations explored in the UNI case. The model provides insight into unethical corporate behavior by exploring principles and processes of stakeholder management. The UNI case demonstrated how intricate networks of friendship and business ties allow corporations to act *ultra vires* by circumventing the control powers of stakeholders, thereby rendering them virtually impotent to act as control bodies. When large influential networking corporate locomotives are moving, the road is made while they are moving, and the stakeholders have no option but to approve the movement and adjust the regulations thereafter.

The study revealed that there may exist some generic stakeholder management strategies, independent of which stakeholder group is in focus. The main process observations from this study in relation to the external stakeholders are not explicitly described in theory. They are (a) 'the road is made while you walk' (movement), (b) requesting approval from the stakeholders after the point of no return (multimatum), and (c) playing one party off against another (manipulation). These approaches are used on most stakeholders, and the more power the firm has relative to the various stakeholders, the more likely it is to succeed when transgressing the formal and informal stakes of the stakeholders. The power bases are both institutional ('You') and individual ('I'), and when these are integrated (UNI) they are manifested through ideological friendships and power elites making the controllers 'native,' that is, not able to make independent actions or decisions.

The concepts and relations in the model are in line with assumptions based on network theory and interlocking directorates (Granovetter, 1985; Useem, 1984). The case clearly illustrates Granovetter's point about how economic transactions may be enmeshed in social and elite relationships. Network theory builds on a long-term perspective, where transactions are built on trust between the actors in long-term commitments. The strength of the network exists in the social ties that develop between the actors. The ties are connected to the actors' social and personal backgrounds. These ties create fertile soil for cooperative structures that can be developed in keeping with the increase in the economic obligations in a transaction system (Granovetter, 1985). The case also emphasizes the importance of business groups like 'the presidents club' in legitimizing corporate behavior (Goto, 1982; Granovetter, 1994). Corporate managers may be involved in the development of personal networks and power elites. Power elites work as social infrastructures for elite cohesion. This structure provides a flow of information between organizations and transmits norms, values, and strategies through friendship ties across organizations. In this way corporate behavior is not only a function of attributes related only to the particular corporation, but also of characteristics of other organizations and the environment. Actions will accordingly not only be a result of each actor's personal interest, but also of the transfer of norms and the copying of actions from other organizations (DiMaggio and Powell, 1983).

One feature not directly presented in the model is the role of the board members. Board members, who in agency theory are considered to be representatives for the owners, will have many roles. These roles are studied in relation to interlocking directorates. Some of the roles of directors relate to cooptation (Pfeffer and Salancik, 1978), others relate to the development of power elites across corporations (Useem, 1984). In the UNI Storebrand scandal, cooptation took place when firms admitted representatives of influential stakeholders into the firms' governing bodies in order to reduce uncertainty and create a positive attitude toward them. The board of directors acted only reactively, while the CEO set the agenda and the pace. The board chairman defined his role as an inspirational source to the CEO. These findings also confirm earlier observations (Patton and Baker, 1987).

Discussion and directions for future research

This study investigated the principles and processes of stakeholder management. It used an inductive methodological approach with empirical data from a Norwegian insurance company, and the article contributes in describing methods and power dimensions of stakeholder management. The objective of this study was to explore concepts and relations of importance in understanding stakeholder management and corporate control, specifically the processes through which stakeholder relations can be managed. A potential contribution of this study is that practitioners may have a heightened awareness of these issues, as the model elaborated can be used as a metaphor for unethical stakeholder management. The main contribution to further theory development is the exploration of concepts, and the elaboration of the integrated model, relating to theories from various disciplines and traditions. An effort has been made to present an integrative model from the fragmented literatures that exist on the topic, as well as from a case study.

The study has illuminated important issues in strategic management and business ethics by showing how corporate management, balancing on the edge of formal laws and following an informal set of laws in a network based on cooptation, can maneuver in order to avoid control by stakeholders such as owners, creditors, public governance, suppliers, and employees. It has shown how laws may be made, and how boards of directors and the general assembly meeting may be overrun, when powerful corporate managers use relation-building abilities, persuasive charm, and financial power in building strategic alliances with politicians, union leaders, corporate managers, and even its own board of directors.

The article has illustrated the importance of analyzing noneconomic power bases for the understanding of social issues in management (SIM). It describes strategies of power-driven unethical corporate behavior, in which two of the three are new to the SIM literature (movement and multimatum). The article also exemplifies the embeddedness concept (Granovetter, 1985).

Several provocative questions are raised as a result of the UNI Storebrand events. What led an avowed social democratic CEO, recognized for his sense of leadership, ethics, and social responsibility, to so grossly abuse the power he had accumulated? What kinds of checks and balances are missing in the Norwegian society that make such an abuse of power possible with no resistance? The case and the model only give partial answers to such questions.

The formal justification used by the CEO for both the merger and the Skandia raid was efficiency. The efficiency argument was related to economies of scale in facing the challenge from insurance companies from continental Europe. Uncertainty reduction was a contingency causing the mimetic processes related to friendships and power elites (DiMaggio and Powell, 1983), and an example of the legitimacy contingency and coercive isomorphism was applied when the CEO referred to his meeting with the prime minister (DiMaggio and Powell, 1983). Nepotism and megalomania may be noneconomic reasons leading the CEO to the abuses.

Norway is a small social democratic society. It is probably missing the checks and balances that exist in societies where people do not rely on trust. In the United States, business is probably more cynical. Societies like the United States would probably discover a breach of trust more quickly. Consequently, a society where there is much reliance on trust must accept that, in the long run, occasional abuses may occur.

There are several limitations in drawing generalizations on the basis of the results of the UNI Storebrand case. The study involved only one case, but it replicated and compared observations between several groups of stakeholders. Second, the case is a peculiar instance of strategic management. It is a case about abuse of power in mergers and acquisitions. The universe of generalizability is therefore limited to such cases. Further, the UNI case involved a Scandinavian financial institution. Since the U.S. societal environment strongly departs from Norway's (a small country were power elites are small, powerful, and deeply interpenetrated), the case can be applied to the United States only in those situations where elite power bases have the same characteristics as they do in Norway. This may be the case at the state or local level. However, similar findings could also appear in the United States or other nations, in other industries and firms of other sizes, both relative and absolute to the action domain, even though the issues involved are supposed to be highlighted in small and visible societies (Abolafia, 1993; Goto, 1982; Jacobs, Useem, and Zald, 1991; Schulte, 1991; Useem, 1991).

We explored integrative concepts and relationships that might be fruitful in future studies from a business and society perspective. The 'You 'n I' (UNI) model summarizing the explored concepts and relations of stakeholder management clearly indicates how the complex and intricate relationships between corporate management and stakeholders can be manipulated by charismatic leaders working in powerful organizations. Future research should investigate further into the concepts and relationships indicated in this article.

Relevant literature on stakeholder management contains countless examples of how stakeholders attempt to control corporations (e.g., regulatory laws, boards of directors, state licensing bodies). All the bases for strategic behavior examined in this case illustrate one-way control of the corporation over the stakeholder. In many ways, this is a case about the failure of institutional control mechanisms over the conduct of big business. One future direction for research could thus be to explain the lack of stakeholder control over big business or over the corporation in general. A related question regards the long-term consequences. The social control of business is an important element of the legitimacy principle in corporate social performance theory, but what are the long-term consequences for corporations circumventing this control?

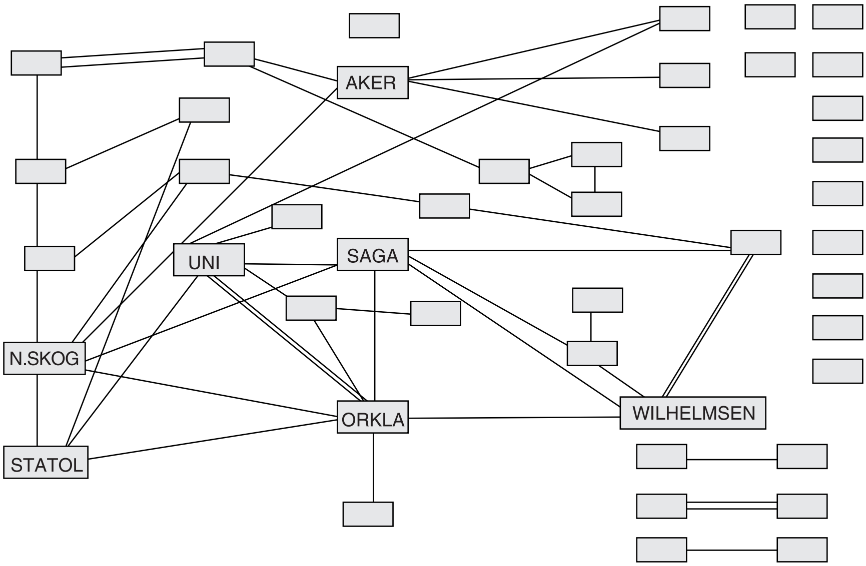
We elaborated a model of stakeholder management. This model could be developed further as, for example, a model of avoiding stakeholder control. Such a model should include how and why such avoidance is likely to occur: For example, when will strategic alliances facilitate avoidance, how do the six identified contingencies help predict stakeholder management, and what conditions need to be present for avoidance to be successful? Examples of institutional, individual, and integrated power can be easily identified. Thus the concepts related to the power bases might be a good starting point for empirical studies and theory development.

Appendix A: Important events in the takeover raid

5/8/91	The CEO of S-E Banken comes to Oslo to discuss with UNI Storebrand (UNI) the potential for a joint takeover of Skandia.
5/18/91	The CEO of UNI informs the prime minister about the takeover opportunity.
7/9/91	The takeover plan is presented to the board of directors for the first time. The board agrees with the UNI management that this is an interesting strategic possibility.
7/30/91	New information to the board. Management is asked to keep probing.
8/15/91	The board gives management permission to buy up to 10% of the stock in Skandia.
9/3/91	The board decides to buy a larger block of shares in Skandia, up to 20%.
9/18/91	UNI has bought a block of 11.4% stock in Skandia. This is 1.4% above governmental regulations. In the following days, UNI's own share value decreases 18% and continues decreasing.
10/7/91	The Ministry of Finance gets a formal application from UNI requesting concession to buy a larger block of shares than 10% in Skandia.
October 1991	The CEO asks for state guarantees as help in financing the raid. His request is refused.
11/18/91	S-E Banken, UNI's alliance partner, decides to sell its block of stock (28.2% of Skandia). S-E Banken gives up the struggle with Skandia to get control. The UNI board gives the CEO and the chairman of the board permission to negotiate with S-E Banken for their Skandia block of stock. First, they discuss whether they should buy all the shares alone, which would have resulted in a 48% stock majority in Skandia. They decide instead to proceed with alliance partners, putting UNI is in the driver's seat.
11/22/91	UNI buys S-E Banken's block of stock in Skandia (28.2%), along with the Danish insurance company Hafnia. They make an agreement that the shares cannot be sold again for at least two years. At this time, UNI alone owns 28% of the total block of stock in Skandia. The stock value is about 4.6 billion Norwegian krone (NOK). UNI believes it has control over Skandia, but because of an unequal voting stock defense adopted by Skandia, UNI gets only 30 out of 13,000 votes. UNI must take up short-time loans to finance the stock investments.

11/29/91	At a board meeting the board tells management to work out the long-term goals related to the takeover attempt.
12/23/91	The Ministry of Finance gives UNI a short-term concession (until summer 1992) to have the present block of stock, 25%. The ministry does not know of UNI's obligations.
3/2/92	An English bank makes two or three offers to buy the Skandia block of stock from UNI. The management rejects the offers. With the exception of the chairman, the board is not informed about the offers.
3/20/92	Nordic Cooperation, an alliance company between UNI and Hafnia, is created. It is closed four days later.
3/24/92	The crisis is obvious, but UNI's top managers and chairman of the board pretend that everything is okay, even to the board.
4/29/92	The Oslo Stock Exchange warns against UNI's vision because of low equity. The Banking, Insurance, and Securities Commission (BISC), a government financial supervision agency, is planning actions, but does not implement them because it is afraid of new crises in the company.
6/3/92	Hafnia rejects an important agreement that affects UNI's shares in Skandia. Hafnia is nearly bankrupt.
6/17/92	UNI sends a formal application to extend the concession to own more than 10% of the shares in Skandia to the Ministry of Finance.
7/1/92	UNI is granted a concession until 1.07.93. UNI is finally legally allowed to keep its Skandia block of stock on the premises that were agreed to in the binding agreement with S-E Banken.
7/26/92	The CEO of UNI is forced to resign. The members of the board announce that will leave their positions if ordered to do so. A new CEO and chairman of the board take over the company.
8/24/92	UNI is suspended from the Oslo Stock Exchange. During the prior year UNI shares have fallen from 80 to 13 NOK each. The value of Skandia shares has also decreased, with the result that UNI's Skandia block has lost about 3.2 billion NOK.
8/25/92	UNI has short-term loans of 4 billion NOK. One loan is due the same day, another on 1 billion NOK is due next month. UNI cannot pay and cannot raise new loans or financial input because of low trust in the company. All payments are stopped and UNI is put under public administration.

Appendix B



Interlocking directorates among a sample of large Norwegian corporations

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13 Researching the dynamics of board–stakeholder relations[1] *

Morten Huse

Academics and business executives are frustrated because of the ambiguous results in research into boards of directors. This article criticises mainstream research about directors and presents the results of a study, conducted in a Scandinavian research tradition. This study shows how interactions between the board and external and internal stakeholders influence board roles and how trust and emotions affect the effectiveness of the board. A new model for board activities is introduced and the implications for research and practice are discussed.

During the last decade few areas in the field of management have received more academic interest than corporate governance and boards of directors. However, there are many shortcomings to mainstream research in this area. These leave the door open for studies of directors' behaviour inside and outside the boardroom in small Scandinavian firms.

This article aims at improving our understanding of how director–stakeholder interactions influence board performance. It contributes new information about the area and provides guidance for future research. When the 'black box' of board structures, processes and roles is opened, the work of the board will be better understood and regulated. Corporate governance will become a topic that can be studied in business schools and by business executives and the gap between academics and practitioners will be reduced.

The article is divided into four sections.

1 A critique of mainstream research into boards of directors;
2 A description of a Scandinavian approach to research into boards;
3 A study of the dynamics of board–stakeholder interactions;
4 A revised model of how boards work and directions for further research.

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Editor's note: In the literature on corporate governance it is conventional to use the term 'Chairman' whether the incumbent is male or female. I have therefore used the term 'Chairman' throughout rather than 'chairperson'.

Mainstream research into boards of directors

Research into boards is dominated by a tradition in which board composition is related to company performance. However, this has produced ambiguous results and no significant findings.[2] Articles about boards of directors appear frequently in management journals but research into boards is still in its infancy.[3] Few studies go beyond board composition variables such as insider/outsider ratios, CEO duality and the number of board members. There are few studies of actual board roles, structures and processes. Research into board processes inside and outside the boardroom, and the dynamics of board–stakeholder relations is virtually non-existent.

Although small firms also have boards, most of the studies are concerned with the Fortune 500 or other large firms.[4] This bias reflects the 'under-the-lamp' syndrome, i.e. research is conducted where data is easily available. As a consequence we know little about the role of boards in small firms, family firms, owner-managed firms, start-ups, entrepreneurial or fast-growing firms.

Board research studies are usually quantitative, often testing hypotheses based on arguments from agency theory and managerial hegemony theory, resource dependency theory, stewardship theory, strategic choice and institutional perspectives. As archival data from Fortune 500 firms are easily available, these figures are often used as proxies for board performance, but the measures are identical whatever theory is being tested. The results from these studies have little relevance for practitioners, or even business school students.

Studies using other methods such as questionnaire surveys or interviews are few, although their number is increasing. Innovative research, exploring actual board behaviour and personal relationships inside and outside the boardroom, are rare. There are a few studies which explore boardroom processes through participant observation,[5] but this kind of data is hard to obtain and the research process is likely to take too long a time for the usual Ph.D. candidate.

Although the board of directors forms an important 'bridge' between external and internal stakeholders, few studies have been made of the links between boards and stakeholder groups. This lack of information about stakeholder relations may prevent us from understanding how boards work. Most mainstream studies do not consider issues from the point of view of the various stakeholder groups so their conclusions are seriously flawed.

There are some studies in which measures of company performance are related to various stakeholder perspectives,[6] but little attention has been given to how the power of various stakeholders can influence board behaviour. Various stakeholder groups are assumed to have specific interests in the company and to play corresponding roles on the board.[7] Consequently, there is continual discussion about the use of 'worker directors', 'community directors', 'green directors', etc.

The stakeholder perspective in Europe

In the European Union (EU) there are proposals to harmonise the corporate governance systems of the member countries. These proposals include the introduction of two-tier boards, and compulsory worker participation.

There are two main types of boards. One kind of board can delegate operational management to the full time executives; this is the case in Scandinavia. The other type of board cannot delegate the management of the daily operations as a 'package', so the board is involved in operational management. This is the situation in the U.K. In Continental Europe there is also a tendency to develop 'two-tier' boards in which the upper tier is concerned with supervising and controlling the corporation on a general basis, and the lower tier is concerned with the company's operations.

The varying strengths of governance forces in different countries is clearly demonstrated in Europe. In the U.S.A. the boards and the owners traditionally have had little power and regulatory forces and society have been of greater importance in corporate governance. On the other hand, in Germany the role of the board is usually strong. The empowerment of boards in Germany can be explained by the large proportion of banks, major shareholders and workers who hold seats on the boards.

The differences between European countries make it clear that corporate governance systems can only be understood in the light of each country's history, culture and political system. Company law on boards of directors in Norway, Sweden and Denmark is very similar. A key feature is the requirement to separate the positions of the Chairman and the CEO. Another characteristic is the requirement for worker representation on boards. In Scandinavia the tradition is to have independent boards even in very small companies. Most directors are outsiders and CEOs are not usually on the board.

The board arrangements in Scandinavia and other European countries suggest new directions for research. They could move the focus of discussion about board independence from the study of outsider/insider ratios, to trying to understand what kinds of systems are necessary to produce an independent board. These studies could include international comparisons. Investigations into co-determination and employee representation on boards would help to clarify the roles of boards of directors in Europe. Some of the questions for investigation would be: What is the value of worker directors? What role can the board play in influencing company policies on environmental management? What are the expressed needs of various stakeholder groups? and How do the different stakeholder groups try to influence the directors outside and inside the boardroom? Some research into these issues is included in the book 'Stakeholder perspectives on corporate governance: A sample of Scandinavian contributions', edited by Morten Huse (1995).[8] One of these studies is described in the following section.

The dynamics of board–stakeholder interactions

The main objective of this study was to identify and to understand the processes which influence the behaviour of board directors. The research approach was exploratory and qualitative. We assumed that the CEO and the Chairman would be the most influential persons on the board. The main focus of the research was the Chairman's relationship with different individuals and stakeholder groups.

We would have liked to 'shadow' a number of Chairmen throughout the day for a substantial period, but this was impossible. However to enable the research to take place, the author was appointed in the normal way as the non-executive Chairman of three small companies and he recorded his experiences as the Chairman of each of these companies for a period of 15 months. The three companies were deliberately selected to enable the researcher to explore three very different situations. As a research method this approach involved many challenges and ethical dilemmas which are described and discussed elsewhere.[9] On the other hand the research design had certain advantages. It was possible to explore how the board arrangements in the three companies influenced board behaviour. By keeping a diary every day for 15 months, it was possible to record all the activities of the Chairman and all the contacts he had with the company and its stakeholders, how and when these contacts occurred and how they influenced his behaviour with the directors, with company employees, with other companies and with the various stakeholders.

Three company cases

A board's relationships with its stakeholders depends critically on the balance of power between the stakeholders and the top managers and among the various stakeholders. This power balance, in turn, depends on the situation in the industry and the degree of crisis in the firm. Therefore, a key objective in selecting the companies was to ensure that they were in different industries and faced different challenges. To identify the challenges we used a 'company life-cycle' approach. One of the companies was in recovery after a bankruptcy, another was facing challenges and threats because of market restructuring and the third company was facing bankruptcy and needed re-financing. In this article I will refer to the three companies as RECOVERY, REORGANISING and REFINANCING. All the companies were small and the numbers of board members and the proportion of non-executives, were about the same as for other small companies in Norway.[10] The Recovery company increased its work force from 5 to about 40 over the 15 months. The other two companies each had around 20 employees. All three were in the same small town in Norway and they were important to the local community.

The companies were in three very different businesses: car retailing, construction, and fish processing. The car dealer and the builder served the local market, but the fish processor was one of the largest producers of processed fish in Norway.

Boards in an open system: the role of stakeholder interactions

Tables 13.1 and 13.2 summarise and compare the situation in the three companies.

Table 13.1 Meetings and contacts

	Recovery	*Reorganising*	*Refinancing*
No. of board meetings*	7	10	16
Chairman's contacts:			
No. of meetings with			
The bank	8	4	14
The press	5	1	2
The management	9	16	22
No. of telephone calls with management	24	33	53
No. of other contacts	21	75	23

* From January 1993 to April 1994.

Table 13.2 The board and the stakeholders

	Recovery	*Reorganising*	*Refinancing*
The main stakeholders	Bank Town Council & Officials Media/press Local residents The local community	Family Potential new CEO (Bank) (Other financial institutions) (Local community) (Customers)	Bank Employees Management Importer/Supplier Owners Tax Authorities Owner of buildings Labour Commission Customers Competitors
The Board's main role	Legitimising	Advising	Monitoring
The Board's other roles	Specialist advice Discipline Discussion partner, and counsel Influencing/lobbying Control Representing the company on formal occasions	Strategic control Discussion partner, support Specialist advice Network Market information Appointing a new CEO	Ratifying decisions Monitoring decisions Partner in discussions, support and counselling Discipline

Table 13.1 presents the number of board meetings and the number of other contacts between the Chairman and the CEOs, the bank, the press and other stakeholders, including the other directors. The figures are calculated from the Chairman's personal diary of events.

The number of board meetings, listed in the table, reflects the relative urgency for the boards to take control. The importance and the power of the board is also seen in the number of additional contacts between the CEO and the Chairman. The number of contacts also demonstrates the level of investment and the power of the different stakeholders.

There were both formal and informal meetings with the bank. In the REFINANCING company all minutes of meetings were sent to the bank. Table 13.1 also shows the importance of the press for the RECOVERY company. The large number of 'other contacts' in the RESTRUCTURING company occurred partly because one of the other external directors was a friend of the Chairman.

Some of the stakeholders who the Chairman met are shown in Fig. 13.1. This Figure shows the importance of understanding the role of both internal and external stakeholders when researching boards of directors. The work of the board goes on outside as well as inside the boardroom. There is an ongoing dialogue, not just among the directors but also between the directors and the management; the discussion extends to a large number of internal and external stakeholders.

Table 13.2 lists the main stakeholders and the board roles. These lists are based on the agendas and minutes from the board meetings, with additional material from the Chairman/researcher's 'field notes'.

The recovery company

The board's roles were shaped by the ways in which the different stakeholders used their power to influence management in the three companies. In the RECOVERY company the CEO told the directors informally that the board's main role should be to re-establish the company's credibility first with the bank, then with the local authority, the media, the general public and the families who lived near to the company's premises. The local residents were important because the company might be accused of polluting their environment. However, the board did not have much contact with the owners, customers, business partners and employees. The power of the bank was primarily related to providing essential loans and guarantees. For the RECOVERY company the bank had provided some guarantees which no other bank would take over. The town authorities had the power to make life difficult for the new firm and the media and the public in general were important because they could put pressure on the authorities and could influence the company's customers. During the project period some local residents at one time sued the company for making too much noise on Sundays.

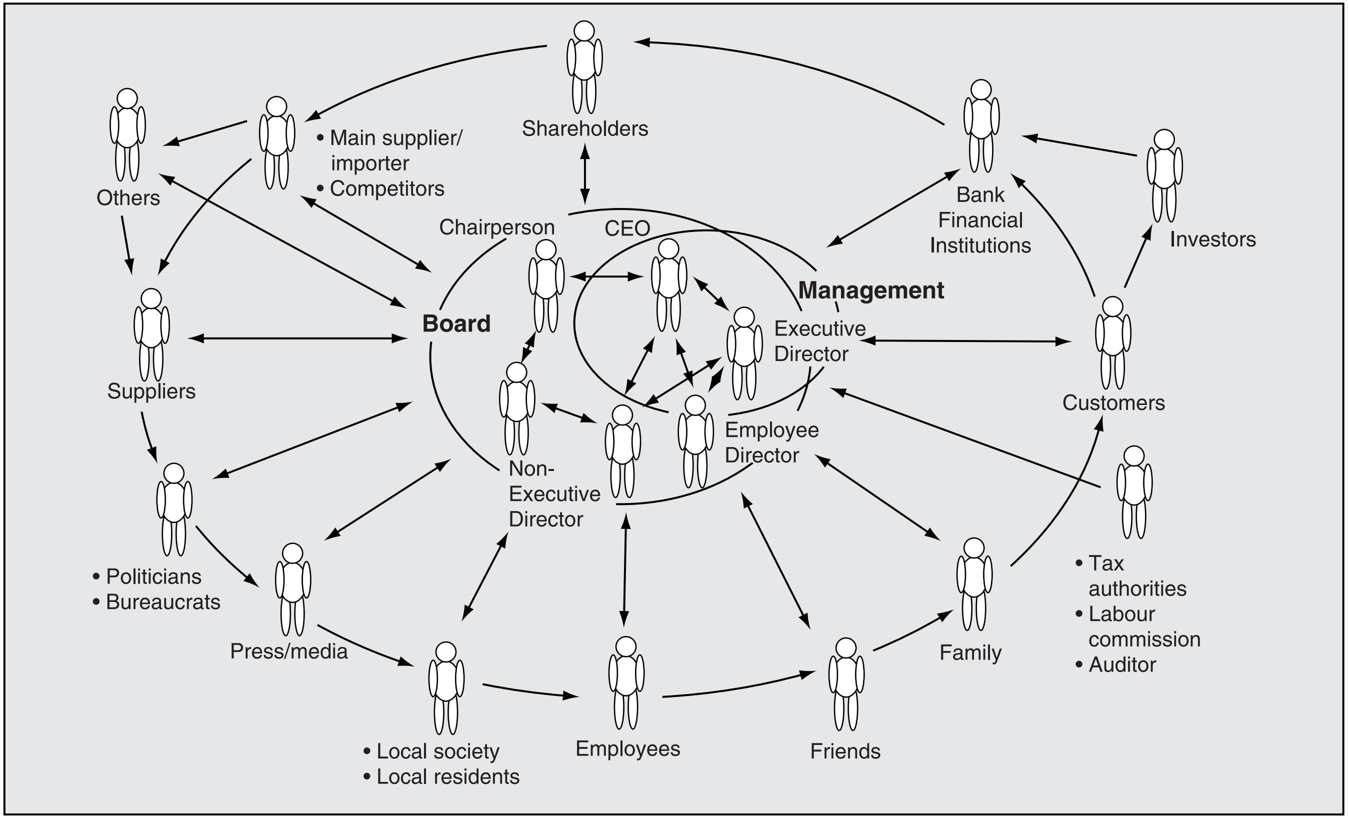

Figure 13.1 The relationships between the board and various stakeholders – an open system view.

The reorganising company

In the REORGANISING company the board provided advice, and discipline, ensuring that important issues were addressed and cautioning the owner/manager against making hasty decisions. The owner/manager's reasons for having a board of directors were largely personal. The company's main stakeholders were his family and a potential new CEO. The board also gave the company credibility in the eyes of the bank, other financial institutions, the local community and the company's customers (wholesalers). The bank and the other stakeholders did not interfere with the CEO's decisions, but they believed that the creation of an outside board would be very good for the company. This was mentioned explicitly in the Chairman's meetings with the bank and in a report which the bank prepared for an external funding agency. The bank said that, in future, they would closely monitor the board's decisions and any changes in board composition.

In the REORGANISING company the board made little contact with the other stakeholders; their retailers, suppliers and workers. However the board may have played a mediating role in relation to the competitors: on several occasions the Chairman met people in aeroplanes or at social events who were interested in co-operating with the company.

The refinancing company

In the REFINANCING company the board developed a strategic plan which identified the company's most important stakeholders and listed the stakeholders' concerns which should be given the highest priority. A high priority was given to ethical behaviour. The first priority was to be given to the following stakeholders: the workers, the bank, the management, the main supplier and the owners. A second tier of stakeholders was also identified: the tax authorities, the owners of the building, the local labour commission, the customers and the competitors. The stakeholders were ranked in this way based on the company's Code of Ethics and the values of the board of directors. However, the board recognised that any of the stakeholders had the power to bankrupt the company if their needs were not met.

The study indicated that the power of the various stakeholders depended on the companies's situation and their industries. The role of the boards and their powers varied in the three companies. In the REFINANCING company, the board was mainly concerned with *monitoring* the actions of the managers. In the RECOVERY company the board was there to *legitimise* management's decisions and in the REORGANISATION company the board had an *advisory* role.

Group dynamics

As an active participant in the boards the author found that trust and emotion played an important part in the boards' activities – in relationships between the Chairman and the three CEOs, in relations among the board members, in the contacts between the directors and the managers, in the interactions which occurred between the board members, and the stakeholders. As Tables 13.1 and 13.2 show, the board is not a sealed unit, but a complex open system. The Chairman found that his feelings towards other people and their feelings towards him and towards each other varied over time depending on the situation and the issues under discussion. Also, trust could not be taken for granted in board level relationships. From time to time directors, managers and stakeholders might have doubts about each others' competence, capacity, timing, even their integrity, their good intentions or their reliability. The trust might be mutual, or the trust could be only in one direction.

John & Jerry

Some quotations from the Chairman's field notes may help to illustrate this point.

> 'Driving to the board meeting we discussed our roles during the meeting. I had confidence in John's judgement. When working with John I find that checking is not necessary. John knows what it is all about.'

John was one of the non-executive board members. He was a friend of mine and as we were working in the same neighbourhood, he often picked me up when we went to board meetings. During the drive we usually discussed the agenda for the meeting, and how we should get our points across. I really trusted John. He always did what he promised to do and he always had the expertise which was needed. He was an auditor by training and he helped me evaluate the financial reports. Besides being able to trust his reliability and competence, our informal contacts between board meetings were helpful in facilitating board decision-making.

Another person who had an impact on the board was Jerry as is shown by the following extracts from the Chairman's records:

> 'When I returned from my trip I found I had not been sent an invitation to the next board meeting. I therefore called Jerry (another outside director and a close friend of the owner/manager). I wanted to learn from him about the work of the board while I had been away. He told me that he was going to Germany and was unable to attend the meeting. I then called the owner/manager. He said that he did not send out the invitations for the meeting because Jerry could not attend. I then called Jerry again and we agreed upon a new date for the meeting.'

As the new date for the meeting approached:

> 'I called the owner/manager about the meeting which was to be held the following Monday. Everything is prepared for the meeting, but Jerry could not come. He (the owner/manager) and Jerry were going to do some voluntary work at some place out of town on a joint project during the weekend and Jerry could not get back. I wanted to check whether Jerry would be available on the phone during our board meeting.'

The board meeting took place without Jerry, but the date for the next board meeting was set so that he could fit it in to his diary. As the time for that next board meeting approached, I wrote my field notes as follows:

> 'I had a message from the owner/manager on my voice mail so I called his private number. He said that Jerry had called him to say that he is taking his wife on a one week vacation to the Canary Islands. He would therefore not be able to attend and he asked whether the meeting could be postponed. As there were no urgent matters on the agenda, we decided to postpone the meeting by fourteen days.'

And then:

> 'Jerry suggested that we should have a two-day strategy meeting.'

However, when the date for the strategy meeting came, Jerry was only able to attend for two hours.

Jerry was one of the most successful businessmen in the local community. He had an excellent reputation and he was invited to join a number of boards. He was a director of several companies and he was Chairman and CEO of his own company. However, this man, who was competent, popular and trusted in the local business community, turned out to be unreliable as a director. Because of his other responsibilities, he did not have enough time for this board position and in practice he reduced the efforts to have an active board in his friend's company. As this story shows, when recruiting a director whether he or she can make the time available is sometimes just as important as whether they have the required knowledge and experience, or whether they are executives or non-executives.

Emotions in the boardroom

Emotions can play an important role in board activities: irritation, friendship, love or hatred, sympathy and antipathy, exhaustion and fatigue, frustration and uncertainty etc.

Here are some examples from the field notes:

> 'As I presented the issues that the management should deal with, Tony sighed and breathed heavily . . . Obviously he did not want to be involved in more board activities, and several times he tried to move the discussion on to other topics. When we discussed strategy, I talked about the concept of 'driving forces'. But Tony tried to take over the discussion and to introduce other issues. He was obviously tired and reluctant to take on new responsibilities.'

Tony was a senior executive director and he felt that he was already working as hard as he could. The top management team had produced their own strategic plan and he did not want to take on the extra work that would be required if the board became involved in developing the strategy. However, the board discussed the company's strategy, produced some suggestions for new developments and the CEO was asked to write a document reviewing the practical implications for the firm. He never produced this document. He always made the excuse that other issues were more urgent. Some years later (after I had withdrawn from my position as Chairman) he told me he deliberately did not take action. He and his management team had their own strategy for the company, and they preferred their own strategies to those proposed by the board.

Another tactic that Tony used with me was to praise the work done by other board members to make me feel excluded and to indicate that what I did was not helpful. In one of the other companies I told the CEO in the presence of other directors that we should review the human resource situation, but he disagreed. 'The board should not interfere in personnel policies. They would not understand the employee relations situation. They live in a different world'. For some time after this outburst we did not discuss human resource questions. But we later found out that he was sitting on a 'time-bomb' and he was unable to deal with it.

Tactics for avoiding board control

The observations concerning the attitudes of various individuals were classified into four categories: board roles, board structures, board members and board processes.[11] As a result of board discussions, the management sometimes took the necessary action, but often they employed different tactics, conscious or unconscious, to avoid taking action and this reduced the effectiveness of the board. When related to the four aspects of board activities, the management teams used four different approaches to evade board control.[12] These evasion techniques are described in Table 13.3 and in each case management adopted a different 'ethical focus'.

Table 13.3 illustrates the complex interactions involved in understanding boards of directors. Considering all the relationships and interactions between the board members and various internal and external stakeholders, it is not surprising that mainstream 'input-output' research into boards of directors

Table 13.3 Management techniques for avoiding board control

Evasion Technique	*Board Activities*	*Influencing Techniques*	*Ethical Focus*
MOVEMENT 'The road is made while you walk' How to initiate processes and action without including the board?	*Board roles*	Ignore formalities Ignore the board Ignore board decisions Implement before permission is given	*Company ethics*
MULTIMATUM* 'Requesting approval after the point of no return' How to influence the outcome of the board's decisions?	*Board structures*	Place, time, form and leadership of meeting Agenda for meetings Information provided for the board Committee structures and alliances Form, distribution and follow-up of board minutes	*Board ethics*
POWER BASE How to ensure that directors are 'dependent' on the CEO?	*Board members*	Number of directors Selection of directors Changing directors Incentives to directors	*Management ethics*
MANIPULATION 'Playing one party off against another' How to pacify certain board members?	*Board processes*	Own arguments Refer to own experience Frighten, threaten Praise Create confidence Expel Spread suspicion	*Board member's ethics*

* These three evasion techniques 'movement', 'multimatum' and 'manipulation' are described in detail in Huse and Eide (1996).

Editors Note: In general terms 'Movement' means '*fait accompli*', 'Multimatum' means delay, and 'Manipulation' means fostering conflict in the board.

produces ambiguous results and frustration for researchers. In the next section a model describing these dynamics will be presented.

A model of board activities: The implications for research and practice

This article represents a critique of mainstream U.S.A. research into corporate governance. As Europe consists of many countries with different laws and ownership structures, research into corporate governance has for many years focused on the board's relationships with the company's stakeholders.[13] European research into boards also studies the processes inside and outside the boardroom and this has produced some novel research initiatives.

In this article we have examined some results from a study of board-stakeholder relations. Some of the interactions are described in Fig. 13.2. This figure puts some board attributes inside the 'black box', but it also suggests that boards must be seen as open systems.

The power and authority of boards of directors come from the relative strength and importance of the external and internal stakeholders, and how far they trust each other.[14] The roles played by the board depend on the changing relationships between the external and internal stakeholders and the performance of the board and its effectiveness also depends on these relationships. The dotted lines in the figure suggest some areas for future research.

Board membership

The composition of board members and its effects should be studied. Who are the board members? What are their motives? And how do they relate to each other? Many studies focus on the directors' relationships with external stakeholders, (e.g. shareholders), outside the 'black box', or the impact of board composition on company performance. We suggest in the model that the board's performance of its different roles should also be studied. It is also necessary to study how the composition of the board can affect board processes and structures.[15] Another area for research is how directors are recruited and selected. To understand this selection process, is it best to use a rational decision-making model or would it be more useful to analyse the directors' personal networks?

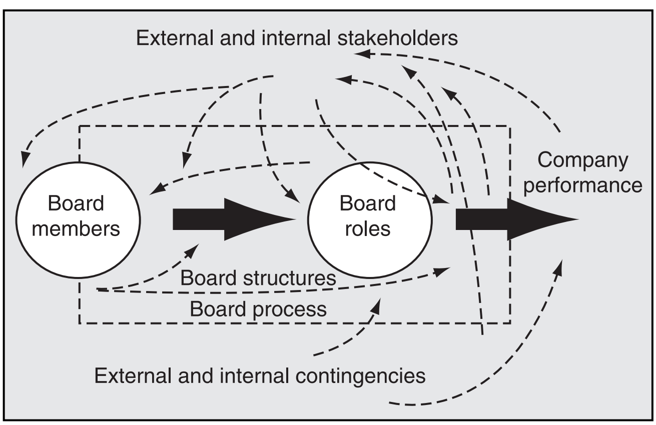

Figure 13.2 Revised model of boards.

Board roles and structures

The actual performance of board roles should also be analysed. What are the different roles of the board?; why and how are they performed? The model in Fig. 13.2 and the study summarised in this article suggest that the board's roles may be influenced by changes in the company and in the business environment, and also by the stakes and the power of the external and internal stakeholders. The stakeholders' impact on the board's roles may be direct but the stakeholders can also exert pressure on the board indirectly by making changes in board membership, the board's processes and board structures.

The relationships between the board members, how they act as a group or as individuals, what they do, how often they meet, where they meet, how the board meetings are conducted and chaired, the agenda of the board meetings, and how the minutes are written and distributed, are some of the factors influencing board behaviour. But they have hardly been studied. We should try to discover what impact these factors can have on board roles, company performance and the stakeholder relationships.

Board processes

Many processes inside and outside the boardroom may be difficult to research. They often involve trust, emotions and personal relationships among external and internal stakeholders, including the directors themselves. These interpersonal relationships may be laden with ethical issues or dilemmas. The interactions may be conscious or unconscious and they may result in the adoption of new techniques to improve board performance. Other techniques may be used by the executive directors to frustrate the board's attempts to control their behaviour. Our study has highlighted the importance of these processes. So far they have received hardly any attention from researchers. Future research should be aimed at understanding and exploring the dynamics and processes which occur inside and outside the boardroom. Research into these processes is very complex and may demand innovative designs.

Different perspectives on boards

Company performance is evaluated differently by different stakeholders. Boards are usually expected to act in the best interests of the company, but the differences in stakeholder perspectives are hardly discussed or studied. In an earlier section we also suggested the limitations of much research into corporate governance. The importance of such factors as the industry, company size, company location, government legislation, ownership patterns, company life-cycles, etc. should also be given more attention in future studies. How do these factors influence the board members, board roles, board structures and board processes? Among the other interesting and important questions for study are the roles of boards in family firms, entrepreneurial firms and small businesses which we were researching.

Until recently few business schools have had the topic of Corporate Governance in their courses. In this article we have tried to identify concepts and relationships which are important to understand what happens in the boardroom. We have tried to show that boardroom behaviour is something that can be modelled and researched. We have shown that there may be many external and internal stakeholders, and board members, who would benefit from understanding more about how boards operate. The analysis of board behaviour is an important issue for management in general, not just for top management. Boards of directors should receive more attention in business schools. The communication of the latest findings about board should not be left to consultants presenting their experiences at seminars for directors.

A deeper understanding of how boards behave could help various stakeholders to have greater influence and to improve their efficiency. This argument is acknowledged in the forthcoming Norwegian company legislation which will require certain board structures to be formalised. The legislators want to make sure that other actors and stakeholders besides top management may have an influence in the boardroom. These groups will include worker representatives, individual shareholders, financial intitutions, etc. Studies of actual board behaviour may help to bridge the gap between research and practice in the field of corporate governance – a gap that has been there for many years.

Notes

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14 Stakeholders' expectations of board roles

The case of subsidiary boards *

Morten Huse and Violina P. Rindova

Abstract

What is the best for a company? In most countries it is considered to be a duty for board members to act in the best interest of the company. Few, however, question 'who or what really counts' in the boards' governance decisions, and that boards may play various roles in carrying out their duties. In this paper we review and discuss stakeholder expectations of board roles. The arguments are illustrated by an empirical example. Depending on the definition of what is the best for the company, key stakeholder groups may have different expectations of various board roles.

Key words: board roles, corporate governance, subsidiary boards, stakeholders

Introduction

'The largest owners are not wanted on the board'. The board of Storebrand, a large Scandinavian insurance company argued this point when it claimed that the two largest owners of the company would not act in the company's best interest, and thus were not wanted as board members? The arguments from the board chairman of Fokus Bank in Norway were similar when defending his actions and attitudes against a takeover. 'The company is more than its shareholders, and the board must think holistic'. In both cases, other stakeholders were referred to rather than shareholders. 'Who or what really counts' was a main question in both cases along with the claim that the shareholders did not necessarily work in the company's best interest. The objective of this paper is to explore stakeholder expectations, the 'who and what really counts' question, in relation to boards of directors.

The illustrations were found in Scandinavian newspapers, but similar examples exist elsewhere. This is a dilemma board members face in many countries (Demb and Neubauer, 1992; Lorsch and McIver, 1989). Recently Fortune 500 companies in the U.S. have started appointing prominent environmentalists on their corporate boards. This is particularly often the case of chemical, oil, and pulp and paper manufacturers – i.e. industries under strong public scrutiny for their environmental impacts. For example,

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the leader of the Conservation Fund – Patrick Noonan sits on the boards of Ashland Oil and International Paper Co. A former EPA administrator and currently the company's board member advised E.I. du Pont through its difficult decision to keep making ozone-depleting CFCs upon government request. Including environmentalists as board members, is a strategic decision that ensures that companies have access to sophisticated outside views on environmental issues, and thus improve the company's bottom-line results (Greenwire, 1994). However, focusing on 'bottom-line' results may not be a board role and a criterion of performance to every stakeholder group.

This change in the composition of some corporate boards contradicts the conventional theoretical views of corporate directors be either as pawns of powerful managers (Davis, 1991; Herman, 1981; Mace, 1971; Patton and Baker, 1987) or 'watchdogs' for the company's shareholders rather than for its broader community of stakeholders (Williamson, 1985). These two theoretical approaches – managerial dominance and agency theory – have dominated research on boards seeking to resolve the issue of whether boards control managers or incumbent managers control their company's boards (Kosnik, 1987). However, boards also perform service roles such as giving advice to management and legitimizing the corporation in relation to important stakeholders (Mintzberg, 1983; Pfeffer and Salancik, 1978; Selznik, 1949; Zahra and Pearce, 1989).

This article makes a step in exploring what different stakeholders expect from boards by explicating and comparing the expectations of various stakeholder groups. Using the multiple subsidiary boards of a single large Norwegian bank as empirical 'test sites', it examines the degree to which various stakeholder groups differ in assigning importance to board roles. This research design captures the expectations of stakeholders from subsidiary boards, rather than from the parent company's board. Thus, in addition to exploring stakeholder expectations of boards, this paper also makes a contribution towards understanding the role of subsidiary boards.

The article is presented as follows: The next section, 'Theory and hypotheses,' presents a review of various perspectives and theories that may explain stakeholders' expectations to board roles, and it applies a stakeholder approach to boards to advance hypotheses about board roles. The third section, 'Empirical illustration,' presents the method and results of the illustrative case study of the bank. The final section, 'Discussion,' reviews the results and contributions of the research and suggests implications for further research and practice.

Theory and hypotheses

Stakeholder perspectives in strategy research

The 'Who or what really counts' question is a main issue in the stakeholder perspectives literature. The stakeholder literature is more than fifty years old

(Näsi, 1995), but Freeman's landmark book (1984) made the stakeholder concept prominent in the management literature (Clarkson, 1998; Donaldson and Preston, 1995; Näsi, 1995). There exist various definitions of stakeholders (Mitchell, Agle and Wood, 1997). In narrow definitions of the stakeholder concept the focus is most often on how a company defines relevant groups in term of 'their relevance to the company's core economic interests'. The broad definitions are based on the 'empirical reality that companies can indeed be vitally affected by, or they can vitally affect, almost anyone' (Mitchell, Agle and Wood, 1997, p. 857). In the context of this paper we use a broad definition of the concept, and define a stakeholder as 'any individual or group who can affect or is affected by the achievement of the organization's objectives' (Freeman, 1984, p. 46). Stakeholders with similar interests, claims or rights can be classified as belonging to the same group. Stockholders, employees, communities (general public) and customers have been considered to be four major stakeholder groups in most companies (Clarkson, 1995; Preston, 1990).

Three main streams of stakeholder literature are generally referred to (Donaldson and Preston, 1996; Mitchell, Agle and Wood, 1997). There is a normative stream arguing about the legitimacy of various stakeholder groups, and a descriptive stream presenting their stakes and power. There is also an instrumental stream arguing that a company that attends to the demands of various stakeholders, gains favorable reputation and easier access to resources that stakeholders control (Fombrun, 1996; Fombrun and Rindova, 1994), and that the attention to stakeholders leads to competitive advantage by reducing opportunism and enhancing trust and cooperation (Jones, 1995). The objective of this paper is not to argue about the legitimacy of various stakeholders, nor to argue for why and how a company can benefit by attending to various stakeholders' demands. The objective of this paper is to make a contribution in the descriptive stakeholder stream.

Although interest in stakeholder theory continues to grow, the theory has been applied to boards of directors research infrequently and with few empirical findings. Partly, this lack of integration is due to difficulties in specifying variables pertaining to different stakeholder groups. Partly the problem arises from the preoccupation of research on boards with the interest of shareholders to the neglect of other stakeholder interests. In this paper we want to explore why and how it matters to ask 'who or what really counts' when defining the role of boards of directors.

Perspectives on the roles of boards of directors

The roles of corporate boards have received much recent attention with the increase of visible and highly consequential actions of corporate boards, such as ousting CEOs and selecting their successors (Hills, 1994; Verspej, 1994). The increased attention to corporate boards calls in questions what roles boards actually perform and what roles they should perform. In reviews of the research on the role of corporate boards (Johnson, Daily and Ellstrand, 1996; Zahra and Pearce, 1989) five main theoretical streams in conceptualizing the role boards are found: legalistic, resource-dependence, class hegemony, agency, and resource based perspectives. The various streams vary in stakeholder emphasis and on the different board roles.

A legalistic perspective on boards suggests that the legal obligations of boards are to protect the interests of shareholders and to manage the affairs of the corporation without interfering in day-to-day operations. The obligations imply the following roles: selecting and monitoring the CEO of a company, evaluating its performance, and representing shareholders' interests. Thus, in order to influence, boards are supposed to set the premises within which managers exercise strategic choice. Overall, board effectiveness depends on organizational and board characteristics that enable or constrain boards in performing their legally prescribed roles. For example, Kimberly and Zajac (1988) demonstrated that whether and how boards exercise their legal rights depends on the power of the CEO and on the congruence between directors' and managers objectives.

A resource-dependence perspective suggests that boards span the boundary between a company and its environment and serve their company as a legitimizing and co-optation mechanism to extract resources (Pfeffer and Salancik, 1978). Directors help companies manage environmental interdependencies (Pfeffer, 1972). This unique boundary spanning position of directors is associated with two types of benefits for companies: co-optation and connection. Co-optation is a tactic for managing interdependence (Selznik, 1949), and it can be implemented by putting stakeholder representatives on the board (Pfeffer, 1972). Directors themselves are resources to companies' management through their contacts or connections with stakeholder groups and through their professional and personal prestige in these groups. Connection refers to the ability of directors to supply management with timely information and to convey to the environment information about the company. Furthermore, the prestige and reputation of board members in the political or business communities enable boards to legitimate companies' actions and to mobilize external support and resources for them. Thus, by connecting, co-opting and legitimating boards are expected to contribute positively to companies' achievements and performance (Provan, 1980).

A class hegemony perspective focuses on interlocking directorships as instruments of intraclass integration and structural support of a ruling elite (Useem, 1984). However, board interlocks are also a co-optation mechanism similar to the one described from a resource dependence perspective (Daft, 1989; Palmer, 1983; Pennings, 1981; Richardson, 1987). For example, a company can reduce risks by horizontal coordination when two or more competitors are linked together through interlocking directorates, by vertical integration when suppliers or customers are invited to be board members, by the personal expertise of the board members, and by the reputation of board members with high prestige. As a class hegemony instrument interlocking directorates integrate, maintain and support existing power elites (Palmer, 1983; Useem, 1982, 1984). As a co-optation mechanism in inter-organizational relationships, board interlocks ensure financial and managerial control across interdependent organizations (Richardson, 1987).

Agency theory argues that boards should monitor the actions of agents (managers) on behalf of their principals (shareholders) (Eisenhardt, 1989a; Fama and Jensen, 1983). Agency theory is the most recognized and prominent perspective that has guided research on corporate boards (Zahra and Pearce, 1989). With roots in economics, agency theory was developed to address the conflicting relationships between owners and managers in large corporations (Berle and Means, 1932; Jensen and Meckling, 1976). Agency theorists typically take the maximization of shareholder wealth as the primary standard for evaluating corporate performance, and ask how the board can serve to further corporate performance. Boards maximize shareholder wealth and minimize agency cost. Operationally, they monitor and evaluate a company's performance, its CEO, and its strategies. Hill and Jones (1992) extended agency theory arguments to understanding relationships with other stakeholders and suggested a stakeholder-agency theory.

Finally, the service roles of the board have during several years been described in the literature. The board is considered to be a service resource for the company and its management (Mace, 1971). More recently this approach has been considered within the framework of the resource based view of the company and similar theories, and the board has been considered as a strategic resource impacting company performance. The resource based view is related to the resource dependency approach in their consideration of the board members as connecting and legitimizing vehicles. Activities or subroles often mentioned within this service perspective are the board roles in providing advice and information, and as vehicles providing networks (Borch and Huse, 1993; Provan, 1980).

These various perspectives rest on different assumptions about the nature of corporate boards as a governance structure. Varying assumptions lead to various emphasis on different board roles here listed in alphabetical order: advice (resource based perspectives), influence (legalistic perspectives), information (resource based perspectives), initiation (legalistic perspectives), legitimation (resource dependence and class hegemony perspectives), lobby (resource dependence perspectives), monitoring (agency perspectives), ratifying (legalistic and agency perspectives), supporting (class hegemony perspectives). However, even though several board roles or subroles are indicated, they are often summarized in two general or overall roles: control and service (Mintzberg, 1983). Their different assumptions about the nature of boards and its relation to various stakeholders lead to different emphasis on one role over another and to disagreements about the means that boards have available in order to perform their roles. Despite the differences in what is considered boards' prerogatives and priorities, the two main categories of service and control are prominent. Some view the involvement of boards in strategy as a third role (Zahra and Pearce, 1989), but it can be argued that while some aspects of the boards' involvement in strategy are related to control, e.g. ratification and control of strategic decisions (Fama and Jensen, 1983), other aspects of strategic involvement as providing advice and connections, are related to implementation and service activities. The control role typically includes the following activities: monitoring and ratification (Fama and Jensen, 1983), initiation (Andrews, 1983), and influence (Freeman and Reed, 1983; Hunter, 1998) of decisions. The service role mostly derived from resource and class perspectives encompasses giving advice, support, information, lobbying and legitimizing the company (Pfeffer, 1972; Mace, 1971).

The scope of the boards' service role is particularly highlighted in literature about subsidiary boards (Björkman, 1994; Demb and Neubauer, 1990; Kriger, 1988, 1991; Leksell and Lindgren, 1982). A subsidiary board is the board of a subsidiary company. Traditionally when seen from a corporate perspective, they are considered only to be formal entities, or as a management group. But in some instances, in particular when dealing with regional or national subsidiaries as in the case of multinational corporations, they are often used for advisory purposes (Kriger, 1988). In general, subsidiary boards add value to companies' strategies by providing strategic information, understanding of, and influence over local factors. They may also provide strategic and financial control over the company's subsidiaries. This is particularly emphasized from a stakeholder perspective. Subsidiary boards could also exercise control over a company as a whole, especially with regard to centralized policies and practices that effect local stakeholders (Demb and Neubauer, 1990; Kriger, 1991). In a European setting the subsidiary boards are also often important mechanisms for the employees of the subsidiaries. The recent corporate governance debate in Europe has in some countries, as in Norway, resulted in reforms in board legislation to ensure codetermination also in subsidiary companies.

Björkman's (1994) study of the boards in Norwegian and French subsidiaries of Swedish and Finnish corporations found that their subsidiary boards contributed both to the local competency and legitimacy of the subsidiaries and to their interaction with parent companies. Subsidiary boards had an active role in ratification of budgets and short term plans, in monitoring actions, in formulating strategies for the subsidiaries. However, these roles of boards differed between the Norwegian and the French subsidiaries; i.e., the importance of giving advice to the parent company was emphasized more in France than in Norway, whereas giving advice to and monitoring local management was more prevalent in Norway.

The above presentation shows that when understanding subsidiary boards, it is important to make distinctions between central stakeholders (i.e., shareholders and the corporate management) and local stakeholders (i.e., local employees, local communities and local customers). Overall, effective subsidiary boards contribute to a company's performance by attending to local issues both from the perspective of the parent company and from the perspective of their subsidiary.

Stakeholders' expectations of board roles

In this section we discuss different stakeholders' expectations about boards' overall roles of service and control. We suggest arguments about why various stakeholders such as owners, managers, employees, local community, customers, and suppliers will emphasize one role over the other.

In the United States and Canada, corporate law states that directors have a fiduciary duty requiring them to act honestly and in good faith and to avoid conflicts of duty and self interest while acting in the best interests of the corporation. Similar requirements are found in other countries, i.e. in Norway. This requirement would appear to prohibit directors from 'representing' any particular group of stakeholders, since representation as such can involve a conflict of interest between the interest of the stakeholder group and the best interest of the corporation (Hunter, 1998). In determining what is the best for the corporation, different courts in different states and provincial jurisdictions have come to different conclusions. These conclusions range from what can be called a 'shareholder first' or 'maximize shareholder value' conclusion to the much broader provisions in some thirty states that directors are 'permitted' to consider the impact, in takeover situations, on stakeholders other than shareholders.

Williamson (1985, p. 298) has wider argumentations: 'The board of directors should be regarded primarily as a governance structure safeguard between the company and owners of equity capital and secondarily as a way by which to safeguard contractual relations between the company and its management'. Other stakeholders such as labor, customers, and the community maybe sometimes invited as board members. Yet, according to Williamson (1985), they are better advised to perfect their relationships with a company at the contractual interface. Considering the roles of boards from different stakeholders' viewpoints, however, may be critical to the overall effectiveness of boards, including with respect to their responsibility to protect shareholders.

The corporate board is one potential and important mechanism for addressing stakeholders' concerns (Lorsch and McIver, 1989). In general, companies that do not respond to the concerns of their stakeholders forgo the benefits of a favorable reputation (Fombrun, 1996), supportive environments (Pfeffer and Salancik, 1978; Pfeffer, 1972) and lower agency, transaction, and team costs (Jones, 1995). Agency theorists have argued that corporate boards and the market for corporate control are alternative control mechanisms and that corporate boards are the cheaper of the two (Oviatt, 1988). In a similar fashion, corporate boards may be more efficient and less costly mechanism for addressing concerns of stakeholders than fluctuating competitive positions of a company vis-à-vis different stakeholder groups. Whereas directors in the United States do not have immediate legal responsibility to all stakeholders, this paper uses a Northern European setting where some directors may get elected as representative of certain stakeholder groups and as such have legal responsibility to attend to its interests. This research seeks to transfer lessons from that setting to other environments by explicating the expectations of different stakeholder groups from boards and by highlighting the differences and the similarities across stakeholder groups.

Since we investigate our propositions in a sample of subsidiary boards, we formulate specific hypotheses about the expectations of a particular stakeholder group from subsidiary boards. The various expectations to subsidiary boards are presented in Figure 14.1.

Expectations of stakeholders from parent and subsidiary boards may differ depending on whether a particular stakeholder group is a central or a local stakeholder for a given subsidiary. Many stakeholders interact with a company's regional division, plant, or branch more than they interact with a company as a whole. Therefore, their immediate interests lie with the actions and outcomes generated by this particular subunit. Such stakeholders may be more interested in the contribution of a board to the subsidiary, rather than to the company as a whole. Thus, we distinguish between 'central' and 'local' stakeholders and control for their various orientations about whether the board should contribute to the company's or to the subsidiaries' performance. In general, regarding subsidiary boards, central stakeholders are likely to perceive the parent's board as the key control mechanism and emphasize

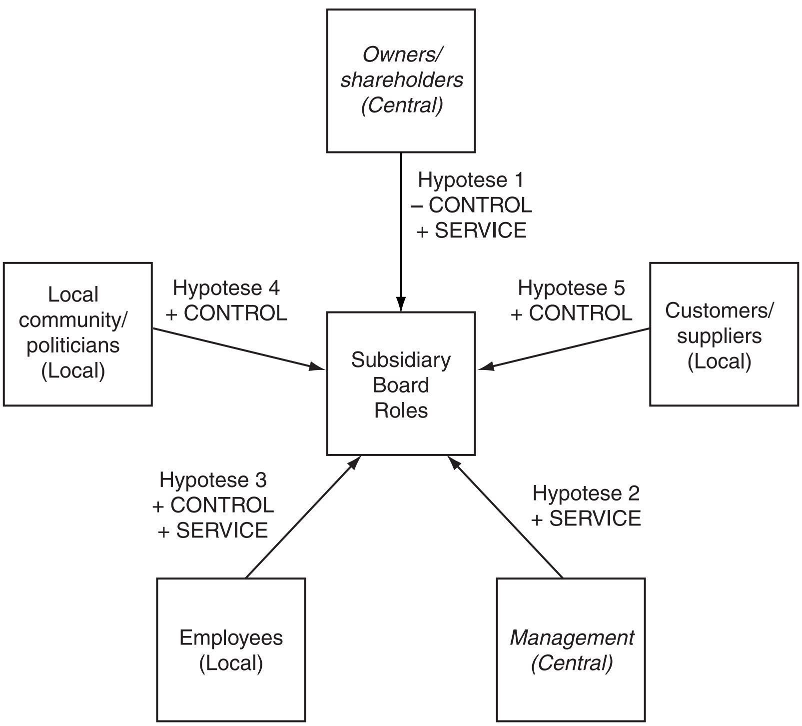

Figure 14.1 Central and local stakeholders' expectations to subsidiary board roles.

mainly the service role of subsidiary boards. In contrast, local stakeholders are likely to view subsidiary boards as performing the full range of board roles.

Hypotheses about stakeholders' expectations to board roles may be derived from the above reviewed theories and stakeholder perspectives. Hypotheses about the expectations of owners, managers, employees, customer and the local society will now be presented.

Owners

Owners' interests have been the central concern of most of the research on boards. Protecting owners' interests is a legal responsibility of boards leading to their control role over a company's management (Fama and Jensen, 1983; Jensen and Meckling, 1976). The control role of boards is their raison d'être as a cheaper mechanism than the market for oversight over managerial actions (Fama, 1980). The board is the highest authority in a company's decision system with 'the power to hire, fire, and compensate top-level decision makers and to ratify and monitor important decisions' (Fama and Jensen, 1983, p. 311). Thus, strategy ratification and monitoring are the activities that comprise the control role of boards. The strategy formulation involvement stems from the board's control role. Involvement in strategy formulation improves the board's potential in influencing and monitoring company performance (Andrews, 1983; Judge and Zeithaml, 1992; Pearce and Zahra, 1991). However, owners are central stakeholders, in that their key functional relationship of exchange is with the parent company. They are likely to have different expectations from parent and subsidiary boards. They may expect more control from a parent board and more service activities from subsidiary boards. Powerful subsidiary boards may be perceived as being in conflict with centralized decision authority (of which the parent board is the apex). In general, parent companies tend not to see an active role for their subsidiary boards (Kriger, 1991). Accordingly, owners as central stakeholders will de-emphasize the subsidiary board's control activities, and rather want it to give priority to service activities. Therefore, we hypothesize:

> *Hypothesis 1*: For subsidiary boards, owners will not want the boards to give priority to control activities, and will want the boards give priority to service activities.

Management

The management is often excluded from the lists of stakeholders (Jones, 1995). In discussions about stakeholders and corporate governance, management is assigned a mediating role between other stakeholders and a company. Management is often considered an agent of one stakeholder group, rather than a legitimate stakeholder in its own right.

Managers, however, also have expectations about the role of corporate boards. Managers may use the board as a supporting structure (Pfeffer, 1972). The board may be rendering service to the management in giving advice and by establishing networks. Studies indicate that among boards' most important roles is that of advisors to management (Mace, 1971). The position of CEO within a company is often an isolated one, and one function of the board, often mentioned in executive literature about boards, is the supporting or comforting role a board plays. Many CEOs face issues which are not suited for discussion with subordinates or colleagues. They need a discussion with trusted partners, whose advice they can rely on (Eisenhardt, 1989b). Board members, individually or as a group, may be such discussion partners. The variation in experience, views, technical and general knowledge, and the quality of a well-selected board, may increase the management's perspectives on the issues they face, and introduce new ideas for company decision making and performance (Andrews, 1983). The board of directors may also be a source of information about local economic, political and social conditions (Kriger, 1991). For small companies where the internal competencies are smaller, the advisory role of boards becomes of great importance (Castaldi and Wortman, 1984).

The management may also rely on directors for managing interdependencies with various actors in their environments. The importance of directors' networking for a company's survival has been discussed in research on interlocking directorates and external control of organizations (Pennings, 1980; Pfeffer and Salancik, 1978; Richardson, 1987). Networking may be conducted by co-optation (Selznik, 1949; Thompson, 1967) and through informal strategic networks (Borch and Huse, 1993). It enhances the ability of directors to lobby for and legitimize company in front of the government, industry and other stakeholders (Mintzberg, 1983). Regarding subsidiary boards, the management of the subsidiary may be a central stakeholder to the degree that it experiences strong pressures to conform to policies, standards and decisions of the parent company. As such, it will place even stronger emphasis on the service role of boards, because it is already subject to the control of headquarters. Therefore, we hypothesize that:

> *Hypothesis 2:* For subsidiary boards, subsidiary management will want the boards to give priority to service activities.

Employees

Employees and management may have widely divergent views and definitions of board roles. Such differences are indicated in studies about workers' participation on boards (Engelstad and Qvale, 1977; Hammer, Curral and Stern, 1991; Hunter, 1998). In Europe, particularly in Scandinavia and Germany, a representation of workers on corporate boards is common because of codetermination legislation (Charkham, 1994; Parkinson, 1993). In the United

States worker directorships are usually results of voluntary plans (Hunter, 1998). Chrysler, for example, appointed a worker director as a part of the larger negotiation process with the government and various stakeholders for saving the company from bankruptcy. Hammer, Curral and Stern (1991) found that in the United States in the case of workers-directors management emphasized the downward direction of communication from the board to employees. The employees represented on boards emphasized the protection of workers' interests as their main function. Engelstad and Quale (1977) present similar findings from Norway. In general, supporters of codetermination regard workers' participation in boards for informational purposes only as inadequate. They maintain that the workers should have influence in decision making (Hunter, 1998; Williamson, 1985). For subsidiary boards, employees are local stakeholders. As such, they are also likely to emphasize the board's control role. However, employees' representation on the board may increase their interest in the service roles of the board. Because boards include representatives of various stakeholder groups, including employee representatives, employees may view boards as better equipped to obtain local information, legitimize the company's actions, and implement local strategies. Therefore, employees may have strong interests in both the control and the service roles of subsidiary boards. Therefore, we hypothesize that:

> *Hypothesis 3*: For subsidiary boards, employees will want the boards to give priority both to control and to service activities.

Local communities

Local communities are most often local stakeholders. A community's interest in a company may include a company's social performance, environmental policies, charitable contributions, job creation, and taxes paid (Demb and Neubauer, 1992; Wartick and Cochran, 1985; Zahra, 1989). The research on corporate social performance (Jones and Goldberg, 1982; Stone, 1975; Wang and Coffey, 1992) and on boards of subsidiaries of multinational corporations (Demb and Neubauer, 1990; Kriger, 1988) has discussed the roles of boards from a local community's perspective. Board composition and the ability to exercise independent control resulting from it, have been associated with the commission of illegal acts (Jones, 1986; Kesner, Victor and Lamont, 1986), actions on environmental issues (Halme and Huse, 1997) and corporate charitable contributions (Wang and Coffey, 1992). Boards play even more important roles where formal regulations are insufficient or not properly developed. Stone (1975) argues that neither markets, nor the legal system can provide sufficient control over corporate social performance. He argues that this control should occur within the decision making process of a company. Since boards set the premises of strategic decision making in companies (Mizruchi, 1983), they may influence socially responsible behavior of companies.

Including outside directors with diverse backgrounds and community affiliations broadens the social values and perspectives represented in a company's strategic decisions (Lorsch and McIver, 1989). Outside directors may make also a company more legitimate in its relations with important stakeholders, such as public officials. The literature about regional subsidiary boards also emphasizes that local outside directors will control that a company follows local standards and norms. Thus, outside directors act both as watchdogs from the local community and as providers of service to management through local information and advice. The local community may see the subsidiary board as having the potential to guard the community interests. Since the subsidiary board is likely to include outside directors who are also members of the community and understand its concerns, we expect the local community to focus on the control role of boards. Therefore, we hypothesize:

> *Hypothesis 4*: For subsidiary boards, local communities will want the boards to give priority to control activities.

Customers and suppliers

Customers and suppliers are two stakeholder groups that have received the least attention in research on boards. Some attention to customers and board representation has, however, been shown in analyses of coops (Lundgren and Boman, 1985). The reason for the limited attention to these groups may be that customers and suppliers often have more flexible relationships with companies than employees and local communities. Thus, they may be in a better position to regulate their relationships with companies through change in the contracts they write (Williamson, 1985). Some customers and suppliers, however, may have made relation-specific investments, which reduce their contractual flexibility and increase their incentives to seek alternative control mechanisms over the companies they transact with. Boards are one such mechanism, and customers and suppliers are likely to have expectations regarding board performance. These expectations will mainly be related to reliable company behavior. More active involvement by customers and suppliers is in the board literature also discussed within a resource dependency perspective (Pfeffer and Salancik, 1978). Regarding subsidiary boards, customers and suppliers are local stakeholders. As such, they will focus on boards' control role. Therefore, we hypothesize:

> *Hypothesis 5*: For subsidiary boards, customers and suppliers will want the boards to give priority to control activities.

Empirical illustration

The above stated objective of this article is to discuss and illustrate how various stakeholders may have different expectations of board roles. This section presents the methods and results of an empirical illustrative study testing the above hypotheses. The empirical setting was a case study of the ten regional subsidiary boards of Sparebanken Nord-Norge, the largest bank of Northern Norway. The case study included both a quantitative survey of attitudes toward boards and follow-up interviews to enhance the interpretation of results.

Methods and sample

The key advantage to using this setting is the existence of multiple, yet sufficiently comparable stakeholder groups that surround the subsidiary boards of a single organization. Whereas corporate management, employees and board members are easily identifiable in most companies, other stakeholders tend to be more disperse and difficult to tap into. Thus, this setting overcomes one of the recurrent problems with doing research on stakeholder issues – identifying a broad yet specific set of stakeholders.

The number of board tiers and whether it is required that the board delegates the daily operation of the company to a separate management are main legislative differences among countries. In Europe there also exist differences within some countries (Huse, 1995; Monks and Minow, 1995; Parkinson, 1993). Variations are partly due to historical differences of the functioning of the various markets for control inclusive ownership structures. A discussion of public and employee corporate directors in a European setting is found in Parkinson (1993). Employee representation on boards varies among countries. In Norway the markets for control have not been particularly efficient, and corporations have traditionally had high degrees of external financing. There has thus been an emphasis on independent boards. Norwegian boards of directors differ from the U.S. boards in that Norwegian legislation prohibits CEOs from serving as board chairperson and mandates employee representation (Huse, 1995, 1998). Further, in banks community representation has also been mandatory. Thus, the general assembly meeting of a savings bank in Norway may consist of members elected by institutional owners, county parliaments, customers (depositors), and employees. Thus, subsidiary boards of a saving bank in Norway may have identifiable stakeholder groups similar to those discussed in the propositions.

Using subsidiary boards of a single large institution has some disadvantages. First, the results of this research resemble quantitative analysis of data from case studies in that the responses may reflect organization-specific relationships between company and its stakeholders, rather than a general pattern of relationship observable in a randomly drawn sample. As we had an exploratory objective for this study, we did not consider that as a major concern. The ten boards we examined belonged to a single organization, but they differed in their working modes. Although they all had the same general composition and size, their working patterns depended to a high degree on the board-management relations. The first author examined board minutes that show that in some of the boards the atmosphere was one of distrust, whereas in other boards there was established trust. Differences in boardroom atmosphere may also influence what board roles respondents emphasized. The setting of this study also made it difficult to explore the effect of companies in various life-cycle phases. We expected, however, that the role of external stakeholders will become more profilated in some stages than in other, e.g. when companies are in crisis (Huse, 1998, 2000).

A questionnaire containing statements prescribing various subroles for well functioning boards, was mailed to all members and deputy members of the general assembly meeting (similar to the 'shareholders' meeting'), all members and deputy members of the ten subsidiary boards, and to all members and deputy members of the board of the parent company. The general assembly meeting includes representatives of the stakeholder groups listed below. It has members and deputy members, who do not have to attend the meetings regularly. In total, 157 questionnaires were mailed to persons representing various stakeholder groups. One hundred and two completed questionnaires were returned thus producing a response rate of 65 percent. Table 14.1 summarizes the response rates for each stakeholder group.

There were seventeen responses from respondents representing owners, eighteen responses from persons being top executives at the corporate or subsidiary level of the bank, thirty six respondents represented employee interests, twenty five were politically appointed and represented the local communities, and six respondents were representatives of customers. In total 102 responses were used in the analyses.

The results of the survey were supplemented with in-depth interviews conducted by the first author of this paper. Fifteen key stakeholders, including members of corporate management, the chairman of the general assembly meeting, members of the board of the parent company, local politicians and members of the subsidiary boards were interviewed. Minutes from the board meetings were also made available to the first author.

Table 14.1 Response rates for various stakeholder groups

	Number of responses	*Total members surveyed*	*Response rate*
Owners	17	27	63%
Management	18	20	90%
Employees	36	50	72%
Local community	25	40	62%
Customers	6	20	30%
Totals	102	157	65%

Variables

The variables were measured by several items on a seven points Likert-type scale (7 = fully agree, 1 = fully disagree). We developed measures for the nine board subroles presented in the previous section. The subroles were constructed as composite indexes and validated by factor analyses. The following specific board roles were constructed: Ratification (9 items, $\alpha = 0.93$), monitoring (9 items, $\alpha = 0.94$), initiation (9 items, $\alpha = 0.93$), influence (4 items, $\alpha = 0.85$), advice (3 items, $\alpha = 0.71$), support (3 items, $\alpha = 0.70$), information (2 items, $\alpha = 0.49$), lobby (2 items, $\alpha = 0.87$), legitimation (6 items, $\alpha = 0.95$). Details about the subroles are presented below. The overall control and service roles were empirically constructed as factor scores based on the factor loadings of the subroles.

Ratification, monitoring and initiation measure the degree to which different stakeholders expect a board to be involved in different stages of decision making in nine main areas of strategic management of the bank. These areas included marketing, distribution and sales strategies, product development, cost control, human resource policies and major investments. The ratings of ratification and monitoring were higher than the ratings for initiation, consistent with previous research that has shown that boards are not expected to be proactive (Pearce and Zahra, 1991). *Influence* measures the degree to which boards are expected to influence major decisions, such as hiring a CEO or making major investments. Unlike the other three strategy control variables, the influence variable is based on specific decision, rather than on general areas of involvement. *Advice* measures the degree to which boards are expected to give advice about general management, marketing, and legal issues. *Support* measures the degree to which boards should have a role as forums for management to discuss and generate new ideas. *Lobbying* measures the degree to which boards are expected to influence local politicians and the local community. *Legitimation* measures the expectations of the board's legitimating role through participation in various social networks. *Providing information* measures the degree to which boards should provide information about local issues of concern to the CEOs. Because it was measured using only two items, the information variable had an alpha coefficient = 0.49. However, similar measures have been used in previous research (e.g. Björkman, 1994; Kriger, 1991). All other variables had alpha coefficients higher than 0.7 and met the construct validity criteria (of Nunnally, 1978). Table 14.2 presents the relationships between the various subroles and the *overall board roles of control and services*. The overall board roles were derived in factor analyses.

The results of the factor analysis show that advice, legitimation and lobbying have high factor loadings on factor 1 and almost no loadings on factor 2. Monitoring and ratification have high loadings on factor 2, and almost no loadings on factor 1. Influence, initiation, information and support have loadings on both factors. These activities represent boards' involvement in strategy making. As such, they have elements of both service and control. The

Table 14.2 Factor analysis of board roles

	Factor 1	*Factor 2*	*Communality*
Advice	0.65	0.13	0.45
Influence	0.38	0.46	0.36
Inform	0.53	0.48	0.51
Initiate	0.50	0.30	0.35
Legitimate	0.78	–0.05	0.60
Lobby	0.73	0.02	0.54
Monitor	0.09	0.72	0.52
Ratify	–0.06	0.86	0.74
Support	0.55	0.38	0.44
Eigenvalue	3.17	1.34	
Pct of var	35.3	14.9	
Interpretation (factor scores)	'Service'	'Control'	

factor analysis indicates that factor 1 could be interpreted as the board's overall *service role* and that factor 2 could be interpreted as the board's overall *control role*.

Analyses and results

To test the hypotheses advanced above, this research used ANOVA and bivariate correlation analyses. ANOVA and *t*-tests of difference captured variations in expectations of board roles across stakeholder groups. Comparisons included both specific activities and overall service and control roles. In the ANOVA analysis we controlled for the effects stemming from being members of the subsidiary or the parent company boards respectively. Two covariate variables were thus used to account for respondents' affiliation with either the parent company board, or a subsidiary's board. Table 14.3 shows the differences between the various groups.

The table shows the mean values for the expectations regarding subroles and overall roles for each of the stakeholder groups. Significant differences are displayed in the right column. Advice is highly emphasized by customers. Influence and information are emphasized by employees and customers. Initiation is emphasized only by customers, legitimation by all groups, lobbying is not much emphasized by any group, and monitoring and ratifying were higher emphasized by customers than owners. No significant differences between the various stakeholder groups occurred with respect to support. The managers have low emphasis on the overall service role, while the owners have low emphasis on the overall control role.

The results of the ANOVA analysis are found in the *F*-value column. The

Table 14.3 ANOVA analyses

	Owners (A)	*Manager (B)*	*Employers (C)*	*Local society (D)*	*Customer (E)*	*Main eff./ covariates (F)*	*T-tests of difference 0.05% one-tail sign*
Advice	4.16	4.02	4.09	3.95	5.22	0.87	E>A,B,C,D
Subsidiary board						4.53*	
Parent board						0.63	
Influence	4.44	3.01	6.08	5.25	6.20	12.42***	A>B
Subsidiary board						1.05	C>A,B,D
Parent board						5.66*	D>B
							E>A,B,D
Inform	5.71	5.33	6.33	6.03	6.44	3.58**	C>A,B
Subsidiary board						2.12	D>B
Parent board						0.17	E>B
Initiate	4.18	4.08	4.23	4.44	5.36	6.58	E>A,B,C,D
Subsidiary board						2.82	
Parent board						0.00	
Legitimate	6.31	6.22	6.46	5.72	6.33	1.16	
Subsidiary board						0.55	
Parent board						3.06	
Lobby	4.63	4.31	5.08	3.98	4.75	1.51	C>D
Subsidiary board						1.83	
Parent board						2.41	
Monitor	5.28	5.77	5.40	5.44	6.20	0.92	E>A,C
Subsidiary board						0.08	
Parent board						6.99**	
Ratify	4.18	5.86	5.81	5.44	6.22	4.06**	E>A,D
Subsidiary board						3.85*	
Parent board						3.48	
Support	5.49	5.59	5.65	5.76	5.89	0.42	
Subsidiary board						0.76	
Parent board						0.88	
Service	0.37	–0.29	0.24	–0.13	0.43	0.88	A>B,D
Subsidiary board						5.08*	C>B
Parent board						4.13*	E>B
Control	–0.99	–0.23	0.13	–0.08	0.54	3.54**	B>A
Subsidiary board						1.01	C>A
Parent board						1.56	D>A
							E>A,B,D

F-values for the main effects (variations between the various stakeholder groups) and for the controlling covariate variables (membership in parent or subsidiary bodies) are also displayed. The analysis shows that stakeholder groups differ significantly in the emphasis they place on the various subroles of the board. Stakeholder groups seem to differ the most with respect of influence, ratification and information, and for the overall control role. The covariates also explain significant differences in influence and ratification and are associated with differences in monitoring, advice, and the overall service role. Only minor differences in the main effects are found in the evaluations of legitimation and support.

The analysis provides support for hypothesis 1. Owners will de-emphasize control activities, and emphasize service activities. Hypothesis 2 was not supported. The opposite relation was indicated. Management did not emphasize the board's service activities. The management emphasized the roles of influence and information less than other stakeholders. Support was indicated for hypothesis 3. Employees emphasized service activities more than the management and control activities more than the owners. Employees had a particular emphasis on the roles of influence, information and lobbying. Regarding hypothesis 4 the local community had a significantly higher emphasis on control activities than the owners. Some support was also given to hypothesis 5. The customers had a high emphasis on the board's control activities. Overall, customers placed significant emphasis on all board roles.

Bivariate analyses were conducted by correlation analysis. The same picture as with the ANOVA analysis was displayed. The results from the correlation analysis corroborated the results from the ANOVA. A significant negative correlation between owners and control shows that owners de-emphasize the control role of subsidiary boards. At the same time, the correlation coefficient between owners and service was positive as predicted, but insignificant. The coefficient between ratification and owners was significantly negative. Service was negatively correlated to managers. Influence and information had the highest negative correlation. Both service and control were positively correlated to employees, but only control was significantly correlated. However, the subroles influence, information, lobby and ratification, which comprise both service and control activities, are all significantly correlated to employees. No significant correlations were found between local community and control. No significant correlations were found between customers and the overall board roles. However, given the results form the ANOVA analysis, the lack of significant correlations with the customers variable may be due to the small number of responses from this group.

The correlations between the board roles and membership in a subsidiary or corporate governing body (used as covariates in the ANOVA analysis) show some significant differences in perspectives of the two groups. The members of the subsidiary bodies de-emphasize the service role, whereas the members of the corporate bodies emphasize service and de-emphasize control. They de-emphasized the ratification subrole in particular.

Discussion

The main objective of the paper has been to review theories about board roles and to discuss and explore how various stakeholders may have various expectations to board roles. Research on corporate boards has traditionally privileged the interests of owners as primary responsibility of boards (Fama and Jensen, 1983). Since stakeholders have different functional relationships with companies, they are likely to emphasize different board roles. We did not find any previous empirical investigations of these issues, but such differences are found in the present study of subsidiary boards. In this concluding section we will first summarize the above conceptual and empirical presentation. The results will be supplemented with examples from qualitative interviews. The contributions of the paper are then discussed before suggestions for further research are presented.

Summary

The importance of asking 'who or what really counts' when defining the roles of boards, has been the focus of this paper. We have explicated how boards traditionally are considered to have two main roles: control and service. However, in literature various theoretical traditions or perspectives have been used to understand various aspects of these roles. Often used theoretical perspectives are the legalistic perspective emphasizing the legal rights of boards to hire, fire and compensate the CEO, the resource-dependence perspectives emphasizing the boards' boundary spanning roles as legitimation and connecting, the class hegemony perspective emphasizing how boards support existing power elites, agency theory emphasizing monitoring roles, and the resource based perspectives emphasizing the boards' role to be a service resource for the company and its management. The various perspectives rest on different assumptions about the board and its relation to its stakeholders, and various stakeholders are thus also expected to have various expectations to board roles. We have argued that it is important to have an understanding of stakeholder perspectives when defining what is the best for a company and consequently also what the roles of boards should be. In this paper we developed hypotheses about the expectations of five different stakeholder groups about board roles.

To illuminate the importance of understanding the various stakeholder expectations to board roles, we tested the hypotheses in the empirical setting of the ten subsidiary boards of a Scandinavian bank. The study showed that stakeholders emphasize different subsidiary board roles:

- Owners de-emphasize control and appreciate service roles.
- The relationship between management and service expectations was negative.

- Employee expectations are positively related to both service and control roles.
- The local community seemed to be a passive stakeholder.

Supplementing qualitative interviews

Our results suggest that various stakeholders indeed emphasize different board roles. Owners de-emphasize control and most likely appreciate the service role of subsidiary boards. Although this finding is in the opposite direction of the general emphasis on control by owners, it is in the predicted direction for subsidiary boards, to which the owners are central stakeholders. To understand better the results of the survey and to probe into the underlying rationales of certain expectations, the first author conducted in-depth interviews with members of the corporate management (including the CEO) and members of the board of the parent company, members of the subsidiary boards, employees, and people from the local community. Thus, informants explained that the negative relationship between owners' expectations and the control role was because owners preferred limited influence of subsidiary boards. However, the boards' legitimizing roles were highly valued. According to a corporate manager:

> The boards have an important networking role. They are important vents or outlets towards the local society and customers. They are feedback channels from the customers to the bank. They are antennas or tentacles in the local society.

Another highly valued role of subsidiary boards was related to ethics and values. Since boards make decisions about policies toward customers, each board member's human and ethical values were considered important in this situation.

The relationship between management and service expectations was negative. This is a surprising finding, given the growing role of corporate boards in assisting managers in developing strategies (Judge and Zeithaml, 1992). One reason for the low expectations related to the service role may be that managers consider that they have sufficient expertise and competency either internally or from other sources. Another reason may be that managers do not see boards as active participants in the development and implementation of strategy. According to a subsidiary bank manager:

> It may be difficult to find roles for the subsidiary board. Strategies and organizational plans are ratified at other levels of the organization. In general the subsidiary boards only get the minutes. Why do we then need a subsidiary board?

Another subsidiary bank manager said:

> The subsidiary management is in close contact with the corporate management. The subsidiary board is forgotten.

Employees' expectations are positively related to a variety of board roles, comprising both service and control activities. This result is consistent with our predictions. Yet the specific subroles it includes may carry some surprising implications about our understanding of employee-board relationship. Evidently employees are active stakeholders. They also seem to view subsidiary boards as a diverse resource that contributes both to internal control and to the external relationships of the company. The reason for this diverse orientation may be that employees place importance on the reputation and the legitimacy of organizations they work for (Ashforth and Mael, 1989). From a social identity perspective, the legitimacy of the organization is very important, and the board is a key mechanism for developing and maintaining it (as indicated in the last quotation from the corporate manager). However, if this is the case, employees may be less concerned with their own representation on boards and more concerned with having directors with high prestige in the community. Employees may perceive other organizational mechanisms as more efficient means of control than subsidiary boards.

The local community seems to be a relatively passive stakeholder regarding boards and do not place high expectations on any of the board roles. Most of the correlations with different board roles were very low. The negative relation between local community and legitimation indicated the very different perspective they had on this issue compared with other stakeholder groups. Thus, public directors may define their roles as watchdogs from the local society rather than representatives of the bank. The watchdog role was clearly discouraged by all other directors, and as the public directors also most often did not have knowledge about how to manage a bank, they often became passive directors. This was indicated in the interviews:

> The public directors have been passive (subsidiary bank manager).
>
> The public directors do not fit into the system. They often behave contrary to the rest of the board (subsidiary board chairperson).

These results may reflect some of the widely spread skepticism in the eyes of the public in general about the effectiveness of corporate boards.

Whereas the correlation analysis shows no significant associations of customer expectations and board roles, this outcome may reflect lack of statistical power due to the small number of respondents from this group, rather than lack of importance they place on certain board roles. Indeed, the ANOVA analysis shows that customers score significantly higher than other stakeholders on several subroles and higher than all other groups on the overall control variable. It appears that customers are active stakeholders with respect to boards in that they give high importance to many board roles and in particular, to control. If this is the case, companies need to consider how they can increase the interaction between customers and boards, so that customers' concerns get addressed.

Contributions

Why is it important to ask 'What is the best for a company?' and 'Who and what really counts?' We have in this study seen that it really counts to understand stakeholder issues when studying boards of directors. Understanding stakeholder issues is also important for board members and whoever evaluating board performance. We have seen that various stakeholders have different expectations of board roles. There are several consequences of this insight.

First, the findings supplement existing models of boards of directors by emphasizing the relationships between various stakeholders and board roles. The study has given contributions in positioning the various theoretical reasoning about board roles into a stakeholder discussion. The first step in defining board roles should be to ask who really counts. This also helps positioning the ongoing debate about shareholder and stakeholder activism in relation to corporate governance, board roles and research about boards.

Second, the findings of our study are particular important when understanding stakeholder expectations from subsidiary boards. Although some research has been done on subsidiary boards in multinational corporations (Björkman, 1994; Kriger, 1988, 1991), the research on domestic subsidiary boards is limited. Furthermore, IBM and other major corporations have recently abolished its subsidiary boards, substituting boards of one or two executive directors for legal purposes, and adding 'advisory boards'. In this context it is important to notice the expectations of other stakeholders than the owners, and how subsidiary boards may be utilized.

Third, the study gives a contribution in understanding stakeholder management. Although most research on boards has focused on their effectiveness in overseeing whether a company's management acts in accordance with the company's shareholders' interests, boards can contribute to a company's success in various ways. By involving outsiders in making key strategic decisions about a company's future, corporate boards can serve as a powerful mechanism for representing the interests of various stakeholders in a company's environment. A company's boards of directors representing a company's various stakeholders will enhance the company's ability to balance conflicting interests and improve its social performance (Wang and Dewhirst, 1992). The 1990s witnessed a significant increase in the proactiveness with which corporate boards seek to enhance the competitiveness of their companies. From ousting CEOs to approving organizational policies and restructuring plans (Hill, 1994; Verespej, 1994), corporate boards have claimed a new place for themselves in deciding the future of major corporations in the United States and abroad. This paper suggests another domain in which boards' involvement could increase to the benefit of their companies – stakeholder management. By identifying and comparing specific expectations of several stakeholder groups about board roles and activities, this paper provides a few starting points for researchers and practicing managers in that direction.

Fourth, the study may have a direct implication for business practitioners. Besides contributing to our understanding about how each stakeholder group views board roles, this study casts light on the similarities and differences across stakeholder groups, thus suggesting implications about using boards to manage multiple stakeholder relationships. Some board roles such as legitimizing and monitoring received uniformly high scores from all stakeholder groups. Such board roles with high averages and low dispersion should be considered a high priority in board-stakeholder relationships because activities related to these roles have the potential to satisfy multiple stakeholders. Other board roles, such as advice and initiation, still generated low dispersion but their average scores were closer to the average. Thus, acting upon these roles also has the potential to satisfy multiple stakeholders but on aspects of board behavior that they may deem less important or expected. Finally, there is a group of subroles around which stakeholders seem to diverge in their expectations. Management and owners give low ratings on influence and information, whereas employees, customers, and the local community to some extent, give high ratings to these roles. These areas may require the highest degree of awareness of specific stakeholder issues, and require the highest attention with regarding management of stakeholders' expectations.

Directions for further research

Our results suggest some interesting directions for future research and theory development on board-stakeholder relations. Although stakeholders have significant differences in expectations, they also have important similarities. As this research shows, the divergence of stakeholders' perspectives on boards may be less than current stakeholder theory would predict. Studies of companies in various life cycle phases may provide other results (Huse, 1998; Lorsch and McIver, 1989). Furthermore, the divergence and convergence of stakeholders' expectations, once studied and understood, could provide a company's management with critical leverage in using boards for stakeholder management (Huse and Eide, 1996).

Our empirical study is exploratory in nature in that it uses as setting the ten subsidiary boards of a single organization. In doing so it takes advantage of the existence of multiple, yet sufficiently comparable stakeholder groups. However, the study was not designed to make detailed generalizations of the findings and suggests that the findings should be treated as quantitative analysis of data from case studies. Since the data come from a single organizational entity, the empirically observed relationships may not only be a function of stakeholder group membership, but of the actual degree of interaction, communication, and trust between the company, its subsidiaries, and their stakeholders. Thus, future research should investigate the generalizability of our findings across settings, including companies in various life cycle phases. Further, it should try to extend this study to corporate boards, which will also enable comparisons with the differences between corporate and subsidiary boards.

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15 Corporate boards as assets for operating in the new Europe

The value of process-oriented boardroom dynamics *

Morten Huse, Alessandro Minichilli and Margrethe Schøning

The golden age of board governance

Some would say that we are now in the golden age of board governance. Boards of directors have recently been accorded enormous attention, and board roles have experienced considerable change. The last 10 years, in fact, can be looked at as the decade of board transformation. Various waves of shareholder activism have contributed to changing some boards from being relatively ineffectual pawns or ornaments on a corporate Christmas tree, to security guard-like monitors of managerial opportunism. However, security guards are not known for understanding or adjusting to corporate norms and standards, and many thus may have a stronger focus on shareholder value and value distribution than on corporate value creation with a broader stakeholder perspective.

Board dynamics and effectiveness in a Norwegian organization

Our objective is to provide ideas to help in developing effectively functioning corporate boards of directors. Board effectiveness in this article is concerned with how boards and their members contribute to value creation. Value creation takes place in the whole value chain, and thus it goes beyond measures of earnings or corporate financial performance. It includes a larger set of parameters – for example, innovation and development of resources. It also includes value for employees, society, and the like. Board effectiveness is thus concerned with how a board is meeting expectations about such value creation, and how actual board task performance compares with those expectations. Value creation, in short, involves a fit between the corporate context, board roles, board members, and the inner working of boards.

In contrast to this value-creation approach, much research has been devoted to finding relationships between board composition and corporate

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financial performance. The usual criteria concerning board composition have been the insider/outsider ratio, chief executive officer (CEO) duality, the number of board members, and members' shareholdings. We go beyond these parameters and focus on the inner workings of boards and the human side of governance. We discuss how boardroom dynamics contribute to board effectiveness. Boardroom dynamics refer to the interactions among various actors, which may contribute to virtuous or vicious circles in relation to board task performance and value creation. The interactions are not only among board members, but also among board members and various other actors.

The article is primarily intended for board members, managers, and academics who want to enhance company management, strategy, and decision-making. The value of the article is the presentation of practical ideas that can help boards become important assets for value creation. We interpret the results of our study to provide insights and lessons for managers and academics. These insights may be particularly valuable for United States (U.S.) companies wanting to operate successfully in the new European environment, with its wide-ranging diversity of national, cultural, and legal influences relative to the American environment.

The insights presented stem from a research and evaluation project dealing with the corporate board of a major Scandinavian corporation, the TINE Group. We used a direct observation methodology referred to here as 'fly on the wall.' This research stage and setting helped us reflect on boardroom dynamics, accountability, and effectiveness with a broader stakeholder perspective. Our major conclusion is that process-orientation may be crucial for a board's contribution to strategic decision-making, and ultimately to value creation.

The article is organized into five sections, starting with a definition of board effectiveness. Core concepts in our board effectiveness definition are corporate governance, accountability, board role expectations, and board task performance. In the second section, we present our research approach, as well as information about the company itself. We interpret these in the context of our board evaluation. We also reflect on the feedback we provided to the corporation, in the form of various kinds of evaluations. Board evaluation, we believe, is one of the most promising initiatives for increasing board effectiveness, and we present and discuss various types of evaluation and their consequences. In section three, we present the board decision-making culture and the dynamics inside the boardroom. Cohesiveness, openness, generosity, involvement, creativity, and criticality are aspects of the decision-making culture. The fourth section is about interactions and norms, and we present observations about board structures, board leadership, and board-management relations. In the fifth section, we briefly discuss ways of creating virtuous boardroom dynamics and board effectiveness. We conclude with implications for practice, including a discussion of corporate boards as assets for companies operating in the new Europe.

Effective boards and board role expectations

Board effectiveness is concerned with how actual board task performance meets board role expectations. Board role expectations, however, are being redefined. These new expectations have resulted from various interactions and stakeholder pressures. Shareholder activism, for instance, has emphasized certain control roles that in practice have been at the expense of other stakeholders. Such issues fall within the domain of corporate governance.

Corporate governance has been defined as monitoring by owners, or outlining how owners may avoid managerial opportunism. This is a very narrow definition, and it has its roots among investors, stock exchanges, and financial economics. Boards are, from this perspective, effective if shareholders are receiving value. Different shareholders may have different objectives since there are various types of shareholders, and many have different time perspectives regarding their investments. A distinction can also be made between shareholders and other stakeholders. Boards have legal responsibilities to these other stakeholders in addition to shareholders, particularly in Europe.

Corporate governance has recently come to be viewed as being far more comprehensive than simply how owners can avoid managerial opportunism. This expanded view is clearly discussed by such sources as United Nations Secretary General Kofi Annan, the shareholder activists Monks and Minow in their bestselling book, *Corporate Governance*, and Harvard Business School professor Michael Jensen. Corporate governance is now seen as being concerned with long-term value creation. It is dynamic and takes into consideration interaction among various actors or stakeholders in directing a corporation. Corporate governance is about who is making the most important decisions, why they are doing so, and how they are making them. It is thus concerned with the development of structures and norms that ensure that proper questions are being asked, and that necessary controls are in place to see that answers are provided that reflect what is best for long-term value creation in a company.

The understanding of value creation may differ across various actors, and board role expectations may thus also differ. Interactions and pressures on boards to engage in various activities are thus a cornerstone in understanding board accountability and board effectiveness. Such pressures may have both external and internal sources, and board accountability addresses both internal and external environments and stakeholders, as well as strategic issues. Table 15.1 illustrates how different board roles may relate to various sources and issues.

Advice, network/legitimacy, and strategic management are roles often stemming from the influence of internal actors. Behavior control, output control, and strategic control are most often results of external influence. Board effectiveness is thus not based on a static criterion, but is a dynamic phenomenon. It varies with the strength and power of the various actors.

Table 15.1 Critical board roles and issues

Internal Perspectives Service	*External Perspectives Control*	
Internal issues	Advice	Behavioral control
External issues	Network	Output control
Strategy issues	Strategic management	Strategic control

This may vary across firms, across time, and across country cultures. Europe has traditionally had a stronger stakeholder orientation than the United States. Some nations, like Germany and Scandinavian countries, require corporations to have employee representatives on their boards. Also, in some organizations there may be board members representing public or regional interests, banks, customers, suppliers, or other such stakeholders.

Board evaluation and the human side of governance at TINE Corporation

We studied the corporate board of TINE to gain more insight into boardroom dynamics. The TINE Group is a Norwegian suppliers' cooperative owned by milk-producing farmers. The group was formed in 2002 after a merger of 10 regional dairy companies. The TINE Group has approximately 5,000 employees and 18,000 members. Its main activities are to produce and refine milk and milk products. TINE also has subsidiaries in other food-producing sectors, including a U.S. subsidiary known for Jarlsberg cheese. TINE is a major actor in Norwegian business life, is highly recognized for its community services, and is one of the most popular employers among Norwegian college graduates.

We were allowed to attend corporate board meetings of TINE during the fall of 2003 and spring of 2004. The observation period lasted for almost a year. In addition to direct observation at the board meetings, we also conducted interviews with all board members and the corporate top management team. We entered the boardroom as independent researchers, but soon agreed to provide TINE with board evaluations. In that way, our project became a win-win situation. However, no feedback was given until the observations were completed.

In our discussions with TINE representatives, we had to clarify our interests, as well as the potential and consequences of our board evaluations. We positioned our contributions in relation to the board evaluation system presented in Table 15.2.

Board evaluations have recently been considered to be one of the most promising tools for developing boards and instituting good corporate governance practices. Key questions in board evaluation systems are: who does what, for whom, and how. This means that initially there is a need to make decisions about the objectives and who receives the evaluations, as well as

EVALUATOR

Self-evaluation

Board committees

Consultants

Researchers

External agents

Board-to-board evaluation Objective – Effectiveness – Improve behavior	Board-to-market evaluation Objective – Self-legitimatizing – Meet legal requirements
Market-to-board evaluation Objective – Legitimate evaluation practice – Effectiveness	Market-to-market evaluation Objective – Accountability – Control – Reputation-building

ADDRESSEE Self-development Internal board committees Academic, research External board committees Owners, investors, etc.

Table 15.2 Four types of board evaluations.

about choosing the evaluator. This summary is presented in Table 15.2, and the content and the modalities of the evaluation itself depended largely on the answers to the first two questions.

Our first objective was to acquire knowledge about boardroom dynamics and actual board behavior that could be communicated to the business community as well as to academics. A primary objective for the TINE Group was to use our input and observations to increase its board effectiveness. It was also to be used, however, to create legitimacy within society, as well as to inform and educate the owners on occasions such as the owners' meeting and meetings of the nominating committee. A formal evaluation report was thus published and made available to the public, and the presentations in this article draw from that report.

In Scandinavia, there is a one-tier board system. It is also required that the board must delegate the executive functions to a CEO. CEO duality is not allowed. The CEO cannot be a board chairperson. Scandinavian countries have a system of employee representatives on boards, and the pressure to include women as board members is very high.

The corporate board of the TINE Group had 14 members, four of whom were employees elected from among their ranks in a union vote. The remaining 10 board members were owners elected by all the owners. Regional and gender representation were among the election criteria. The CEO and other persons from the top management team were not board members. The CEO was always present at meetings, but without voting rights, and other members of the top management team were invited to board meetings. This means that, in total, almost 20 people attended each board meeting. The chairperson had a full-time position, and several other board members spent close to 50% of their time in various TINE assignments related to being a board member.

The board had 11 formal meetings in 2004, and the meetings usually lasted from before lunch the first day until some time after lunch the second day. A few times every year, the board members spent approximately three full days together in comprehensive meetings, and at least once a year visited production facilities outside the head office. In 2003, all board members spent a week visiting TINE's U.S. subsidiary.

The dynamics of the TINE Group's corporate board is depicted in Fig. 15.1. The figure displays the context and resources for the corporate board, the most important internal and external actors, the board members, and the value-creation objectives for the corporation. The main role expectations are centered on representing the owners and participating in strategic decision-making and control. Board task performance was also considered in the context of strategic decision-making and control. These functions involved internal and external embedding and communication of values and decisions in the board processes. The end result of these dynamics was various elements of value creation.

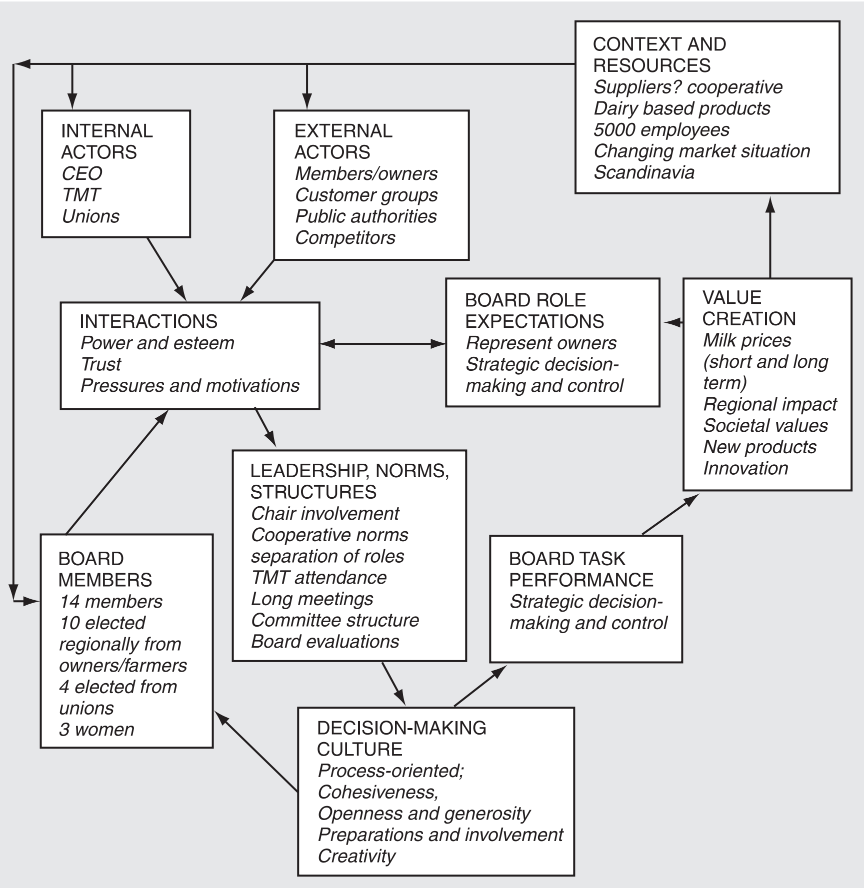

Figure 15.1 Board dynamics leading to value creation in the Tine Group.

In the following sections, we present our observations about boardroom dynamics by discussing the elements of interactions, rules and norms, structures, leadership, and boardroom decision-making culture.

Boardroom decision-making culture

Our first and immediate observation as we entered the TINE boardroom was the positive atmosphere among the board members. We detected a distinct and supportive decision-making culture. This was confirmed during our further observations, even though we later got a more detailed and nuanced picture. The atmosphere in the boardroom was characterized by friendliness and openness, but with a strictly structured meeting agenda. The board members were usually very well prepared. We summarized the decision-making culture to be characterized by several positive characteristics: cohesiveness, openness and generosity, preparation, involvement, use of knowledge and skills, and creativity.

First, the board members clearly enjoyed being together, and looked forward to the board meetings and to seeing one another. That was the case for all the board members including the union representatives, as well as for the CEO and the top management team.

Second, the board was a well-functioning social system where trust and confidence were built on openness and the willingness of all board members to contribute and say what they thought. Board members were not sitting on the fence defending themselves, but were open to sharing information and knowledge, and often got into arguments. They were also generally open to alternative outcomes of their decision-making processes.

Third, the board members devoted considerable time to board work. Extensive documents were read before each meeting, and all board members were also involved as board members of subsidiary companies. Additionally, they had regular meetings with the owners through the regional membership organizations. Finally, many board members were willing to devote nearly 50% of their working hours to board-related activities.

Fourth, we found that creativity was stimulated through differences in the personalities of the board members, which led to differences in their contributions as well as to disagreements. Most of the owner-elected representatives had similar backgrounds, but the differences in personalities were very evident, and could be illustrated by the nick-names we gave them. These included the crusader, the politician, the analyst, the strategist, the sound farmer's wisdom, the summarizer, and the unionist. We also observed how managerial interests were challenged by various regional interests, employee interests, societal interests, women's interests, and others.

These observations gave a picture of a process-oriented decision-making culture in which strong emphasis was given to hearing all voices, involving the whole board, and reaching unanimous decisions. This was a very time-consuming process. This decision-making culture, characterized by cohesiveness, openness and generosity, involvement, and time-consuming discussion, as well as creativity, fostered a board-level dialogue on strategy that enabled these part-time board members to shape the thinking of executives and vice versa. The board members' involvement inside and outside the boardroom made it possible to bridge the gap between the knowledge of the board members and the executives. Our conclusion was that the culture of TINE's corporate board resulted in decisions being solidified between the board and management as well as between the board and the owners. The boardroom was a communications arena that, with its focus on processes, shaped the context for strategic debate.

Boardroom dynamics and creating a process-oriented boardroom culture

We have presented some observations about the decision-making culture inside the boardroom. In this section we present observations about interactions, leadership, norms, and structures that are antecedents of the decision-making culture inside the boardroom (see Fig. 15.1).

Interactions

It is crucial to understand the role of interactions between external actors, internal actors, and the board members. The most important external actors are generally considered to be the owners, and the most important internal actors are the CEO and the top management team. The interactions among these groups are characterized by various aspects of trust, power, influence, and emotions. Board role expectations are a result of these interactions. However, little has been written about the relational dynamics in and around the boardroom, particularly from the perspective of direct observation. In our study, we focused on interactions among the board members, and to some extent, on board-management interactions. The interactions with or among other actors were given less attention.

Our observations, supplemented with comments from interviews, indicated that the board members had different levels of esteem and influence, and made different contributions. The esteem and influence of individuals were not only a matter of their particular knowledge, but were also the result of individual behavior, processes among the board members, and their relative position among other actors. It was not difficult to identify a ranking of the various board members with regard to esteem. The board members with the highest esteem generally received the most attention from other board members and from the CEO.

Esteem and influence are related but the rank orders differ. Influence was observed to be issue-oriented. Some board members had more influence on certain issues than other members. To understand the interactions, we developed a typology and a rank order of board members regarding the degree of their influence on decisions. We observed strategists, crusaders, and supporters, with the strategists clearly having the highest influence.

- The strategists were aware of techniques that could be used to get their ideas or objectives across to others. They were able to squelch the crusaders and to convince the supporters.
- For the crusaders, the most important thing was not to arrive at unanimous decisions, but to raise issues that often resulted from their relationships with external actors or stakeholders.
- The supporters had various reasons for taking this role, a major one of which was that they wanted to support the chairperson or the CEO. Some had other outlets or arenas for influencing decisions, and thus supported various strategists depending upon the issue.

These observations indicate that interaction techniques can take precedence over expertise, such that board members with the most knowledge might not always have the most influence. The most powerful persons probably have a combination of high esteem, knowledge, and interaction skills that could influence group decisions.

Leadership

Board leadership undoubtedly has important effects on group performance. The TINE board chairperson was a full-time, nonexecutive chair, and was clearly the leader of the board. One aspect of being a nonexecutive chair is that he did not have a permanent office at the TINE headquarters. One of his main roles was maintaining and fostering relations with the owners and other external stakeholders. He was the one who managed the process that led to the establishment of the present TINE Group, and he chaired the board in selecting the current CEO. He also set the standards for the board and its operations. All of these activities demonstrated his deep involvement with, and leadership of, the board and its processes.

The chairperson was highly respected and had been widely praised for creating enthusiasm among the board members, as well as for being excellent at managing processes. He was considered to be a role model with high integrity. At times, the board members even made decisions based primarily on loyalty to him, rather than on the content of the particular case. One of his mottos was: ‘When you search for the best in others, then you will find the best in yourself.’ He was skilled and enthusiastic about including others and bringing out the potential of individual board members. We observed that he also utilized particular techniques to influence board decisions. These techniques included holding preparatory discussions with the CEO and other board members, preparing thoroughly before each meeting, summarizing discussions, and arranging the order of voting.

Norms and structures

Codes about best practices are usually intended to create norms and structures, which ensure that board decision-making takes place in efficient and just ways. They are meant to creat board effectiveness and to bridge the gap between board role expectations and actual board performance. Norms may be formal as well as informal, and informal rules of the game can sometimes be more important than formal regulations and structures.

Norms included expectations about attendance, advance preparations for meetings, values, corporate cultures, and ethical standards. Our observations were that board norms at TINE reflected those from cooperatives and not-for-profit organizations. This was in contrast to norms from investor groups and stock markets, managerial dominance, and business elites, or even family business. Process-oriented board involvement is one such norm we observed at TINE. There was a norm that the board was both the formal and the real decision-maker. Board members were very conscious that decisions needed to be embraced by the members. Use of time, commitment, and independence were among other norms that governed the behavior of members. The board structures at TINE included the length and frequency of meetings, board–management relations, including attendance of the top management team at board meetings, preparation and presentation of agenda items, and other such protocols.

An important feature was that board meetings usually lasted 2 days, with a third day added when there was a lengthy and important event like a strategy seminar, board development seminar, council meeting, or the annual owners' meeting. In most cases, social activities like a dinner were arranged for the evenings. The board members thus had considerable time to socialize and discuss issues outside the formal meetings. They came to know each other personally as well as professionally.

One reason for having such long meetings was the norm that all board members deserved the opportunity to voice their opinions. On most major agenda items, the chairperson initiated a 'round' during which each board member was asked to give his or her opinion. A result of this practice was that a comment or an idea from one person often triggered ideas from others, resulting in some very creative sessions. Several times we observed how a comment from one person led to discussions resulting in very important and relevant decisions.

The long meetings were also needed to encourage the involvement of members of the top management team who were in attendance. Those individuals, and their staff, prepared the agenda items on some occasions, and the managers also made decision proposals and presented them to the board. Most often, such proposals were changed after the boardroom discussions. The CEO and the board chairperson were clearly open to such changes, and people did not put their egos into having their proposals accepted. Still, various staff members often joked among themselves about who got the most proposals accepted.

At every meeting, there was an agenda item called 'open post.' On this item, board members were invited to introduce issues they wanted to have discussed. The CEO and the chairperson also introduced issues they were planning to put forth as agenda items at a later meeting.

The formal communication between the top management team to the board was expected to go through the CEO, and the CEO was expected to communicate with the chairperson. TINE had a structure where some board members and members of the top management team were on the same subsidiary company boards. A system of internal interlocking directorates existed. This system created professional and friendship ties between members of the corporate board and the top management team. These interlocks also facilitated communication and coordination. These structures and processes provided additional opportunities for board members to develop the context for strategic discussions. They continuously worked at shaping the content, context, and conduct of strategy and important decisions, and their influence was not limited to distinct decision episodes.

Earlier, we described the closeness in TINE's board–management relations and trust as a basic characteristic of boardroom relations. The TINE board was like a work group, and boardroom norms were reflective of this. The chairperson of TINE was a role model, coach, and leader, while chairpersons in some other organizations act as troubleshooters, decision-makers, and more controlling chairs. Decision-making at TINE took place through negotiation and communication. The decision outcome was open, and the long-term decision consequences and ownership interests were paramount, not necessarily a common approach. In TINE, we observed dynamism with virtuous development circles.

The assumptions behind prevailing corporate governance thinking, managerial opportunism has been frequently criticized because it can lead to vicious development circles. In contrast, we found at TINE a comprehensive value creation definition that clearly went beyond a pure shareholder value approach.

Boardroom dynamics and board effectiveness

The observations from the TINE study have provided good insights into how to create effective boards. Generally, a process-oriented boardroom culture seems to be important for board effectiveness and value creation.

Our conclusions about the TINE board were supported by the results of an ongoing survey we conducted of the relationships between attributes of boardroom culture, actual board task performance, and value creation. The main characteristics of a process-oriented culture, in particular, preparedness, involvement, and creativity, were significantly related to all the board roles presented in Table 15.1. Cohesiveness, openness, and generosity were also significantly related to the board roles of advice, network, strategic management, and strategic control, but to a lesser degree to behavioral and output control. Criticality was mostly related to output control. These relationships are illustrated in Table 15.3, which reports results from the ongoing survey.

In the survey, we also found that the main process-oriented boardroom measures were significantly and positively related to product innovation, organizational innovation, and international market venturing.

At TINE, we observed that the motivation of board members, and good board leadership, were important for all aspects of an effective boardroom culture. We found that trust and common norms in the boardroom, the professional motivation of the board members, and the diversity among board members were important elements for positive board dynamics. Good board leadership and various kinds of board evaluation and development activities seemed to be important ways of improving board effectiveness and accountability. Some observations were that board members need to spend considerable time in that role, board leadership should get more attention, and board evaluations and development activities should be formalized. These indications suggest some important ways to develop good boardroom dynamics, and strengthen a process-oriented board culture.

Corporate boards as assets for operating in the new Europe

Our observations at TINE reflect norms from cooperatives and not-for-profit organizations, rather than profit-oriented organizations. However, our experience at TINE may provide insights for those organizations as they seek to evolve their board cultures to ones more suited to operating in the changing dynamics of a new Europe.

The focus of the article has been to illuminate how boardroom dynamics may contribute to board effectiveness by exploring a process-oriented boardroom culture. Boardroom dynamics and a process-oriented culture were illuminated through direct boardroom observation. We found that process orientation contributed significantly to board effectiveness. This article has contributed to knowledge about relational dynamics in the boardroom, and it presents some understanding of board contributions in the strategy process. The article also contributes toward developing concepts to discuss and exploit in considering boards as social systems.

Boards should be seen as social systems. Our observations of the corporate board of the TINE Group showed the importance of board leadership, individual personalities, group values, and decision-making processes. We observed how the board chairperson had direct and indirect influences on developing good dynamics. That role went far beyond chairing a decision-making group. In the TINE case, the chairperson was not only a role model who created enthusiasm and loyalty, but also a leader and coach striving to get the best out of individual board members. We also observed diversity

Table 15.3 Survey results of relationships between board effectiveness and a process-oriented boardroom culture

	Process-Oriented Boardroom Culture				*Decision-Oriented*
	Cohesiveness	*Openness and Generosity*	*Preparedness and Involvement*	*Creativity*	*Critical Attitudes*
Board task performance					
Advice	+	+	+	+	
Network	+	+	+	+	
Strategic management	(+)	+	+	+	
Behavioral control		(+)	+	+	
Output control		(+)	+	+	+
Strategic control	+	+	+	+	
Innovation					
Product innovation	+	(+)			
Process innovation	(+)				
Organizational innovation	+	+		+	
Domestic market venturing	(+)				
International market venturing	(+)	+	(+)		

Note: Blank cells denote no significant correlations. The signs indicate correlations at the following two-tailed significance levels: +/–, significant at 5% confidence level; (+/–), significant at 10% confidence level.

among the board members that went beyond criteria about gender, race, education, and business experiences. We observed how persons with different personalities, motivations, and values interacted. The effects of these differences became evident through an atmosphere of mutual trust and respect, the use of time inside and outside the board meeting, and a supportive leadership style.

A process-oriented decision-making culture is a core concept in the article. The nature of the interactions among the board members was important for fulfilling their roles. We explored the content, as well as the impact and drivers for attributes like cohesiveness, openness and generosity, preparedness and involvement, creativity, and criticality. Time spent together was important for cohesiveness. Trust and confidence were built upon openness and the willingness of all board members to speak their minds. Preparedness, time, and commitment were needed to address decisions comprehensively. Creativity and criticality were developed through interactions, questionings and discussions among board members with various personalities. The inclusion of persons with alternative backgrounds, such as employee representatives and women directors, seemed to be valuable in such processes.

The process-oriented decision-making culture makes it possible for the board to shape the content, context, and conduct of strategy. The contribution to strategy is continuous and not limited to decision episodes. The TINE board placed major attention to internal and external embedding of decisions. A consequence of this embedding was time spent on transparency and communication with various actors, including the top management team and the owners, but also other stakeholders. One result of its processes is that the TINE Group received recognition for its corporate social responsibility reports, and also opened the boardroom to evaluation (market-to-board) and allowed public reports of those evaluations (board-to-market).

The broader or more comprehensive approach to value creation could well be an important asset for boards and corporations operating in the new Europe. A strict shareholder value logic and a governance system based on assumptions about managerial opportunism has its limitations. Instead, a more inclusive and stakeholder-oriented approach can provide a broader perspective that can take into account many of the diverse and changing circumstances in that fast-changing environment. To facilitate such flexibility, the human side of governance and a process-oriented boardroom culture should be stimulated in corporations wanting to use boards as assets for operating in the new Europe. Success within this new, highly diverse context appears to depend heavily upon developing these critical attributes.

Selected bibliography

This article has been inspired by E. E. Lawler, D. L. Finegold, G. S. Benson, and J. A. Conger's article, 'Corporate Boards: Keys to Effectiveness,' *Organizational Dynamics*, 2002, 310–324.

For more details about the theories, the various board roles and the overall framework of this article see M. Huse's *Boards, Governance, and Value Creation* (Cambridge University Press, forthcoming) and M. Huse's 'Accountability and Creating Accountability: A Framework for Exploring Behavioural Perspectives of Corporate Governance,' *British Journal of Management*, 2005, 16, 65–79. The book also contains more data and examples from the studies presented. The overall framework has its roots in S. A. Zahra and J. A. Pearce's 'Boards of Directors and Corporate Financial Performance: A Review and Integrative Model,' *Journal of Management*, 1989, 15, 291–334. Key references to the various theories cited are E. Fama and M. C. Jensen's 'Separation of Ownership and Control,' *Journal of Law and Economics*, 1983, 26, 301–325, for control roles and agency theory; J. Barney's 'Firm Resources and Sustained Competitive Advantage,' *Journal of Management*, 1991, 17, 99–120; for the resource-based view of the firm, see J. Pfeffer and G. Salancik's, *The External Control of Organizations: A Resource Dependence Perspective* (New York: Harper & Row, 1978), and J. H. Davis, F. D. Schoorman, and L. Donaldson's 'Towards a Stewardship Theory of Management,' *Academy of Management Review*, 1997, 22, 20–47.

An overall presentation of corporate governance, corporate governance definitions, and corporate governance development internationally may be found in R. Monks and N. Minow's *Corporate Governance* (Cambridge: Blackwell Business, 2004). A work that specifically discusses the board responsibility of value maximization is by Michael Jensen, who notes: 'Indeed, it is a basic principle of enlightened value maximization that *we cannot maximize the long-term market value of an organization if we ignore or mistreat any important constituency*' (M. C. Jensen, 'Value Maximization, Stakeholder Theory, and the Corporate Objective Function,' *Bank of America Journal of Applied Corporate Finance*, 2001, 4(3), 8–21, cited on p. 16, italics in original).

For more about behavioral perspectives on boards and governance see D. Forbes and F. Milliken's 'Cognition and Corporate Governance: Understanding Boards as Decision Making Groups,' *Academy of Management Review*, 1999, 24, 489–505, and T. McNulty and A. Pettigrew's 'Strategists on the Board,' *Organisation Studies*, 1999, 20, 47–74. See also the February 2004 issue of *The Academy of Management Executive*, 94–108, with contributions from W. Cascio, L. Letendre, E. Briggs, and J. A. Sonnenfeld.

Detailed information about the TINE Research Project and the survey results summarized in Table 3 can be obtained from the first author. The survey sample consisted of 230 Norwegian publicly traded companies. A questionnaire survey addressed to CEOs was conducted during the winter of 2003/2004. The mean number of employees in the firms was approximately 1,000. Most of the variables were constructed as indexes guided by confirmatory or exploratory factor analyses. Each index contained two-five measures. The results showed a number of significant correlations.

16 Gender-related boardroom dynamics

How Scandinavian women make and can make contributions on corporate boards*

Morten Huse and Anne Grethe Solberg

Abstract

Purpose – The objective of this article is to examine and conceptualise gender-related boardroom dynamics that affect how women can make contributions on corporate boards.

Design/methodology/approach – Stories were collected from eight women directors about their experiences from more than 100 corporate boards. Narrative methods were used in the data analysis.

Findings – Women as well as men need to understand the power game inside and outside the boardroom. Their contribution depends on the ability and willingness to make alliances with the most influential actors, to spend time on preparations, being present on the most important decision-making arenas, and to take leadership roles.

Practical implications – The study has implications for theory as well as practice. Process-oriented theories should be included in studies of boards and governance, and the study showed that boardroom dynamics are not neutral to gender. Concepts and relationships are suggested that should be included in further theory development. The study has also given several practical examples and suggestions on how women can make contributions on corporate boards.

Originality/value – The study has value for developing the role of women directors.

Paper type Research paper

Keywords Women directors, Boards of directors, Group dynamics, Management power, Corporate governance, Scandinavia

The study of women directors has received increased attention since the early 1980s (Daily *et al.*, 2000). Attention has, in particular, been given to the extent women have been able to break through the 'glass ceiling' and become members of corporate boards of directors. Considerable research has thus comprised benchmarking surveys with respect to the number or increase in

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number of women directors across industries, countries and so on (Burke and Mattis, 2000a; Daily *et al.*, 1999).

This article concerns gender-related boardroom dynamics. Its objective is to explore and conceptualise ways women make and may make contributions on corporate boards. Various authors have argued that women directors on corporate boards offer many contributions (Bilimoria, 1995; Segal, 1996; Bilimoria and Huse, 1997). Indeed, by being more receptive to contributions of women at the top, corporations can gain competitive advantage (Morrison, 1992; Fernandez, 1993). Women directors may also serve other corporate women as role models (Burke, 1994; Ely, 1995). The prime focus in this study is not simply the contributions women are making, but how women may make contributions. This will have implications for developing the role of women directors. In this article, we mainly focus on exploring and developing concepts.

The article is organized in four sections. In the first, the empirical study is positioned in relation to recent reviews of research on boards of directors and women directors. The second section presents the methods and the sample of the empirical study. The results are presented in the third section, and the conclusions and the implications are addressed in the final discussion section.

Research on boards and women directors

Research on boards has been dominated by a tradition in which board composition is related to corporate financial performance (Johnson *et al.*, 1996; Pettigrew, 1992; Zahra and Pearce, 1989), and mainstream research has been heavily influenced by a research tradition from financial economics and theories treating the board as a so-called 'black box' (Daily *et al.*, 2003; Finkelstein and Mooney, 2003).

The research is based on theoretical reflections about board role expectations, but actual board task performance is rarely measured (Gabrielsson and Huse, 2004). Even though Zahra and Pearce (1989) showed that there was a need to use middle-range theories including measures of a set of board attributes going beyond board composition, this is rarely done. Forbes and Milliken (1999) present the board as a social construction and employ cognitive theories to understand boards. They argue that boards should be understood through attributes of the board members, the board's working style, and actual board task performance. They align attributes to boards, as with any other decision-making group, including preparation and the use of knowledge and skills, cognitive conflicts, effort norms, and cognitive conflicts. While Forbes and Milliken argue for understanding and measuring processes inside the boardroom, Pettigrew (1992) argues for considering the board as an open system, and that studies of board roles should not be separated from studies of power in institutions and society, or from studies of the composition and attributes of top management teams.

Increasing the presence of women in the boardroom may be considered as a business imperative. Daily and Dalton (2003) argue that women may add unique perspectives, experiences and work styles as compared with their male counterparts. Furthermore, adding women on corporate boards may have important signalling effects to stakeholders. Bringing women onto corporate boards should thus have positive bottom line effects. However, the representation of women corporate directors shows little variation no matter where one searches, but various efforts have been undertaken to increase the number of women on corporate boards. For example, the low representation of women directors has in Norway prompted legislation that would mandate at 40 per cent women's representation by 2005 (Daily and Dalton, 2003, p. 8; Fouché, 2005).

Studies of women directors are to a large degree descriptive benchmarking studies, but there are also various studies that follow the larger corporate governance literature, generally engaging in quantitative input-output studies based on archival data (Bilimoria and Pederit, 1994; Burke, 1994; Fondas and Sassalos, 1996). These studies aim at showing that corporations benefit from having women on their boards by showing relationships between the existence or ratio of women directors and corporate financial or social performance. These studies often include women as one of several independent variables (Pearce and Zahra, 1991; Grundei and Talaulicar, 2002; Westphal and Milton, 2000). However, some recent studies, using questionnaire surveys, also explore aspects related to the contribution of women directors to the performance of board roles.

Bilimoria and Wheeler (2000) critically reviewed the extant empirical literature on women directors, and found that research has not sufficiently been such that gives the impetus for organizational change, and that will improve the representation and status of women in corporate governance. One of their conclusions was that future research on women directors should be directed at exposing the underlying dynamics of boardrooms that affect women. Bilimoria (2000) suggests that research on women directors that aims to have practical impact should go beyond agency theory and frame research on boards in a gender-specific way. There is a need for empirical research that generates coherent and forceful framing of ideas, language and insight useful for women directors in constructing their collective reality. Research should expose the hidden dynamics of boardrooms and bring light to the systemic structures that affect women and are influenced by gender relations (Bilimoria, 2000; Burke and Mattis, 2000b; Van der Walt and Ingley, 2003). Furthermore, research on boards and governance should focus on the conditions that assist directors in using their knowledge and skills (Hillman and Dalziel, 2003). We thus decided to focus this article on gender-related boardroom dynamics, and how women can make contributions on corporate boards. This includes exploration of what happens when women are entering the boardrooms (Burke and Mattis, 2000b).

Methods and sample

Through the understanding of gender-related boardroom dynamics we wanted to explore how women can make contributions on corporate boards. Burke and Mattis (2000b, p. 8) suggest that such information can best be obtained through in-depth interviews. We thus decided to collect board-life-stories of women directors to respond to our research question. Our data collection had several phases. Initially we interviewed 20 women directors. They were generally selected because they were highly profiled women, but some were also interviewed because they were in the private or professional network of the researchers. In these interviews, the women directors reported on their board experiences, and the interviewer and the interviewees got to know each other. With eight of these women there were follow-up interviews. The second interview was an in depth interview, most, of which lasted about 3h, and were taped and transcribed. We had an open approach to the number of interviews to be conducted, but due to the rich data provided by each of the women, we decided to utilize the received material in depth rather than to increase the number of story-tellers. Three main areas were explored in the interviews: their background, their experience as director, and their advice to other women regarding being on boards. The background sequence made up about a quarter of most interviews, but is not reported on in this paper. See Bilimoria and Huse (1997), for an example of how the background sequence may be used. All interviews took place in Scandinavia, and the women directors were either Swedish or Norwegian.

Characteristics

The characteristics of the eight women are presented below.

Age

Four women were between 40 and 50 years, two women were between 50 and 60, and two women were older than 60 years of age.

Education

Five of the women had graduate degrees from university – one a law degree, three in management, and one in political sciences. One of them had a PhD. The other women directors had their main training within their industries combined with various college exams.

Profession

The present profession of the women also varied, and most of them had changed not only job, but also profession through their ways to the top.

Between two and four of the women had their main background from banking and financial services. Two or three of the women had considerable experiences within sports administration. Three of the women had their main employment experiences from public administration, and two from large corporations. Two of the women were now working as management consultants.

Boards

The largest corporations in Norway and Sweden were represented, as well as boards of small privately owned firms, universities, banks, service industries, sports, boards of state of companies, as well as boards for particular events. Even Fortune Global 500 firms are represented in the sample. Some of the women had experiences from the same boards, with the same chairpersons, and experiences even with each other.

Family

Four of the women were divorced, and one had never been married. Seven of the women had children, and two of them had grandchildren. The eight women directors had been raised in various parts of Scandinavia, their parents had diverse backgrounds, and most of them had siblings. The experience most of the women had in common was that their fathers had treated them as boys, and/or that their mothers wanted them to get a higher education or a professional career.

We have here given them the following names: Anne, Bente, Cathrine, Dorthe, Ellen, Frøydis, Gro and Hilde. The women were all highly profiled, and we promised to keep their identity hidden. However, Table I shows some of the diversity represented among them. They were all over 40 years old, the education level was generally high, they had experiences from more than 100 boards ranging from voluntary organizations and small partnerships to large multinational corporations.

There may be differences among countries as to the experiences of women at the top (Antal and Izraeli, 1993; Bilimoria and Huse, 1997), but the narrow sample and empirical setting was not considered to be problematic as our purpose was to explore concepts and relationships.

Data analysis and presentation

A narrative approach was used in the data analysis. Through story telling (Spickard *et al.*, 2002) the interviewees were given the opportunity to frame their own experiences. The story telling approach made it possible to explore new and relevant issues. The women interviewed were often good storytellers, and, in analysing the data, we decided for the purpose of this paper to focus on the stories more than on quantitative text analyses. At first 339 stories and statements from the eight women were extracted and sorted into 28 specific themes. We then sorted the 28 themes in four overall themes or headings, helping us understand boardroom dynamics and how women can make contributions on corporate boards. A summary is presented in Table 16.1.

Table 16.1 also shows the number of stories told by each of the eight women (a to h). This shows that there are individual differences and perceptions, but also that most themes had some general significance.

We made analyses of the subgroups based on deviations and similarities between the stories of the various women. In this article we present ten findings. The findings are indicated in Table 16.1. We have selected as findings some of the themes that were most frequently addressed under each heading in the table. The presentation in particular focuses on the issues we have found under-represented in existing research on boards of directors and corporate governance (Daily *et al.*, 2003).

The stories presented are the social constructions of the women. What are based on real events, and what are myths and wishful thinking in the stories, may be hard to answer. Many of the observations, even though they have not been focused in research about directorates, are appealing and sound reasonable. And even though they may not be accurate representations of reality, they still are parts of the women's perception of reality.

Results

The findings are presented according to the overall themes in Table 16.1. Only the most frequently presented themes are included in the following presentation. Our focus was to explore concepts and relationships. We thus decided to present the findings as statements.

Power inside and outside the boardroom

One of the women told that it was a shock for her to explore the power games taking place among the male board members inside and outside the boardroom. The observations of the women regarding the male directors and the power games were sorted in six subgroups: the importance of nurturing contacts and networks, the 'old boys' network', people of authority, prestige, power and creating alliances. Women need to understand and relate to such areas, if they are to contribute on corporate boards.

Some of these subgroups have been commented on in the literature, for example, in managerial (Mace, 1971) and class (Useem, 1984) hegemony literature, and interlocking directorates (Pennings, 1980; Richardson, 1987). The women also perceived that the motives of their male colleagues for joining a board were a matter of prestige and to be around people of power or authority (Mace, 1971; Whisler, 1989). Following the previously mentioned suggestions of Pettigrew (1992), we empahsize two aspects observed by the women directors: the importance of power and the importance of creating alliances.

Table 16.1 Number of stories sorted on director and theme

	Sum	*A*	*B*	*C*	*D*	*E*	*F*	*G*	*H*
Overall reflections	*13*	*1*	*2*	*2*	*3*	*1*	*3*	*1*	*0*
Overall reflections	2			1			1		
Boards are different	7		2	1	1	1	2		
Other countries	4	1			2			1	
Power and influence	*65*	*17*	*13*	*3*	*8*	*4*	*14*	*6*	*0*
1. Creating alliances (finding 2)	21	3	5	2	2	1	4	4	
2. Power (finding 1)	10	2	2		1	3	1	1	
3. People of authority	9	4	1		1		2	1	
4. 'Old boys network'	7	1	3		3				
5. Prestige	7	1			1		5		
6. Nurturing contacts	6	2	2	1			1		
Various	5	4					1		
Board decision-making	*66*	*4*	*7*	*3*	*10*	*6*	*17*	11	8
1. Preparations (finding 3)	19	2	6	1	2	1	1	2	4
2. Not equal admittance (finding 4)	12	2	1	1			3	3	2
3. Decisions	11				8	1	1	1	
4. Leadership (finding 5)	9			1			8		
Various	15					4	4	5	2
The women directors	*96*	*12*	*8*	*8*	*9*	*13*	*21*	*8*	*17*
1. Resource provision (finding 7)	54	6	5	3	7	5	14	2	12
a. Diversity	13		1		5	2	2	1	2
b. Asking questions	8	2	1				1		4
c. Good atmosphere	7			1	1	1	3		1
d. Role models	6	1					4		1
e. Perspective	5	2	2		1				
f. Wisdom and diligence	5			1		2			2
g. Female values	5		1				3		1
h. Women issues	5	1		1			1	1	1
2. Tokens-signalling (finding 6)	22	4	3	3	2	5	3	1	1
3. Way of being	10	2				1	3	2	2
4. Family and social life	10			2		2	1	3	2
Gender-related interactions	*70*	*7*	*14*	*8*	*10*	*6*	*8*	*11*	*6*
1. Flirtation (finding 8)	18	2	10	1	2		1	2	
2. Mentors	15	2	2	2			2	4	3
3. Ruling techniques	14	2	2	2	2	1	2	3	
4. Men in skirts	11	1		2	4	2		1	1
5. Critical mass	10			1	2	2	3	1	1
6. Women networks	2					1			1
Advice to women	*29*	*2*	*0*	*1*	*6*	*2*	*11*	*5*	*2*
Why be a board member? (finding 9)	10	1		1	1	1	5	1	
How to be recruited? (finding 10)	9				1	1	3	2	2
What to do when invited?	10	1			4		3	2	
Total number of stories	*339*	*43*	*44*	*25*	*46*	*32*	*74*	*42*	*33*

Note: A story or statement is placed in only group even though many stories could have been included several places

Finding 1: board decision-making may be a power game

Most of the women had stories or statements of the board as an arena for intense power games:

> . . . others used me in their power play. As I discovered what happened in the inner chambers, then I thought that I have been innocent too long. Yes, there is definitely a lot of power play (Bente).
>
> It is a game and those not being experienced – and I feel that I have become experienced – they are getting completely manipulated. There is a lot of power in being like that. It is kind of nice to know that you master this game, but it is unnecessary that it shall be like that (Ellen).
>
> It takes some time before you see the power balance in a board. Who are deciding? It is not always that the top person that decides. You need to find out who is having the wheel in their hands (Gro).

Finding 2: decisions are influenced through the building of alliances

The women clearly attributed power relationships to the boardroom. The women also made observations as to how and why directors form ties or alliances. Creating alliances was the theme mostly referred to by the women with respect to power and processes. Alliances are means to get power and thus tools for influencing board decisions. All the women directors, but one, made similar comments:

> You must not imagine that you can fight things through without having some allies (Bente).
>
> It is important that you make alliances with the most influential and heavy board members. Not the employee directors (that are by Scandinavian corporate law elected by employees). Board members are not all the same. You will easily get a feeling of whom the most influential board members are (Cathrine).
>
> I have not made phone calls in advance, and manipulated (decisions). However, this happens often in the board. I believe men do so more often than women. They talk before the meetings. They clarify (things) ahead (of meetings). I have attended many board meetings where I have not been able to understand that suddenly something has been decided without having been discussed (Gro).

The women observed that when men wanted to be influential, they made alliances. Their stories showed that some of them just accepted these alliances as a part of the game, while others clearly disliked them. While studies of boards of directors have recognized the role of alliances through interlocking directorates from inter-organisational and intra-class perspectives (Richardson, 1987), the women directors emphasized alliances as a part of the internal power mobilization among directors to achieve support in the decision-making processes.

Boards' decision-making processes

The starting point for the women was that decision-making does not only take place within the boardroom. It takes place before the meetings, during the meetings, outside the boardroom, and after the meetings. We will here present extracts of stories about preparations, decision-making arenas and board leadership.

Finding 3: contributions are made through preparations

Preparations for board meetings were among the issues receiving most attention from the women. They had two general comments: most men do not prepare well, and women directors should do their homework. Here are some examples:

> Many of these men did not have time to prepare properly. They had many board assignments and often many operative duties. They can attend a board meeting and read the board documents one page ahead (Dorthe).

> One issue that I found to be a fundamental difference between women and men, was that I found the women to be much better prepared than the men . . . It is the regulars, and they can boast that they have such a photographic reading capacity that makes them capable to go through a document in 3s and get an impression. That is nonsense. The consequence is that they have to talk into the air – to keep the meeting running – while they read their documents, and it takes a lot more time. The advantage for these women is that they can take advantage of the men 'while in bed', and the men just have to try to follow (Gro).

> I have seen that male members of this board open the envelope in the elevator. We were often joking by saying that the boardroom should be as far as possible away from the garage. The quality of the board meetings was a function of the distance between the boardroom and the garage (Frøydis).

Preparation and involvement can be seen as indicators of commitment, and the stories of the women thus contribute to the literature about the board members' commitment. The level of commitment of many male board members is limited, and the stories told indicate that the introduction of women on corporate boards may contribute to raise the level of commitment.

Finding 4: there is unequal admission to decision-making arenas

The stories revealed that the board members did not have equal admission to all decision-making arenas. This topic is illustrated by the following citations:

> Sometimes you must be involved in particular arenas to get to understand who makes decisions. In the leadership team of the company we were as many women as men. In a meeting we were discussing a difficult issue. Then we had a break, and all the girls went to the restroom to wash hands, and while we stood there doing so, we then decided what should happen (Gro).

> In xx board you now and then share room with other women. You see the bathroom with other women. Some common things like that, building communion between women, make it easier to make contact. You go to the swimming pool or to the sauna. It means a lot not to be alone as a woman on a board. In particular, not in the breaks. During the meetings this does not so much matter. It is the glue around. There are some arenas where you feel you are excluded (Frøydis).

The issue of unequal admission has not received attention in the corporate governance literature, but it fits very nicely in with some recent work on decision-making in family businesses. Nordqvist (2005) shows that the understanding of actors and arenas are crucial for family business governance. Non-family actors will often not have access to many of the important arenas where decisions are made in family businesses.

Finding 5: the chairpersons' influence in decisions

With respect to leadership, some of the women made some astute observations. One of the women indicated that many chairpersons are not good in utilizing the boards' resources, while another was fascinated by how the chairman manipulated the boards by formulating decisions. Here are two examples:

> I have never experienced good chairpersons. A good chairperson helps all board members into the discussion and utilizes all the resources that exist in the board. All board chairpersons I have experienced have been men (Cathrine).

> That of letting people be able to say what's in their heart, without letting

> the discussion slide. He stopped the debate when it was about to get away from the topic or repeat itself, and then to draw conclusions based on his own directions. He used phrases or formulations being used by others in the debate. If I, for example, used the phrase – relevant problem – he would use the same phrase, but put in his own context. But still I felt that I had been heard – very astute. But he was also very raw. He was making conclusions – so that all felt that they had been heard, but later they experienced that he had used his own opinions. He had a lot of opinions himself (Frøydis).

Board leadership is an almost neglected area in the boards and governance literature (Huse, 2005; Huse *et al.*, 2005). Here we have examples of the importance of board leadership, and how a board chairperson may influence board decision-making.

The women directors

The main objective of this study guided us to explore what women directors report about their contribution as board members (Bilimoria and Wheeler, 2000). When referring to their particular situation as women directors, three main aspects were observed: the existence and consequences of tokenism, attributes of women directors and the contribution of women directors. Many statements similar to those of the women can be found in the gender and women in management literature (Kanter, 1976; Loden, 1985; Acker, 1992), and even in the discussions of the role of women directors (Burke, 1994; Segal, 1996). Here we highlight perceptions related to the signalling and resource contributions (Daily *et al.*, 2000).

Finding 6: signalling: tokenism may be an advantage

The phenomenon of tokens and tokenism has received considerable attention in the women in management literature (Kanter, 1976). An interesting observation from the stories of the eight women directors was that they all had experiences from being elected as tokens. Here are some of them:

> I have been elected to some boards because they needed to have a women director. The persons they needed had first been selected, and then they had to have an alibi. They used to have one women director, and they needed to replace her (Anne).

> Others also consider me to be a female alibi. But I feel that this was only at the start (Ellen).

The observations from this study question the relevance of the 'glass ceiling' concept for women as board members (Morrison *et al.*, 1987). Being elected as tokens has not only negative implications. It was interesting to notice that even though all women were familiar with the glass ceiling concept, none of them referred to it as relevant. Rather the opposite. They experienced that women, at first as tokens, had a great potential in becoming a board member and getting to the top (Powell and Butterfield, 1994). Some of them clearly told that they would never have reached the same status or positions if the boards had not needed women as tokens. Tokenism makes it is easier for women to become board members than to become a member of a top management team. However, being selected as tokens puts great pressure on them. They met several barriers to having influence, and had to prove themselves competent in other ways than their male counterparts. Women are often getting selected as tokens, which may create problems (Acker and Houten, 1992). However, the signalling effect and representation of diversity possibly involve more advantages and challenges than problems (Morrison *et al.*, 1987).

Finding 7: women have many resource contributions.

We will here present some of the contributions the interviewed women perceived themselves and other women directors to have. Generally, they considered women directors to have more wisdom and diligence than many male board members. Women were also able to create a good atmosphere in the boardroom, they represented diversity, soft values, women's issues, and they were asking questions a lot more than men. Similar lists are presented in other literature (Bilimoria and Huse, 1997; Segal, 1996). We will here thus present just a few aspects that may show some more complexity and divergence in the reasoning. The areas presented are related to the decision-making culture in the boardroom.

The women directors were very sensitive to having a good atmosphere in the boardroom:

> The company secretary told that after I came, the atmosphere changed. It was not so tough any more. Things loosened up. It became more relaxed. Some more laughter (Dorthe).

> Many have pointed out that the tone is different with me as a women there. And I have wondered many times whether it is because I am a woman – or whether it is because it is me. I think it is possible to have some humour. I allow myself to present comments that can make the others smile (Ellen).

The women director showed examples of how the board members liked to see each other and looked forward to the board meetings. Forbes and Milliken (1999) refer to this as cohesiveness. A good atmosphere also facilitated openness and generosity among the board members. Another frequently mentioned attribute contributing in a similar way was about asking questions. The following comments illustrate how women directors may have a contribution by asking questions:

> I am often good in asking questions that gives the others something to reflect on. I believe that they experience it as interesting, and I am not critical. I am not asking questions to criticise. I ask to see whether there is something we need to illuminate. I am trying to include other perspective – to get a broader discussion (Bente).

> Women often ask questions that nobody else dare to ask. Girls dare to ask some very relevant simple questions – is it millions or billions? (Frøydis)

Such questions may be important for developing a process-oriented boardroom culture (Daily and Dalton, 2003; Huse *et al.*, 2005).

How men and women directors interact

The contributions by women may also be affected by gender-related interactions. Men and women directors interact in various ways. The statements and stories of the eight women directors were sorted in six themes: ruling techniques, men in skirts, critical mass, women's networks, mentors and flirtation. Flirtation was the theme most often mentioned, but mentorship and flirtation were closely related in some of the stories.

Finding 8: attraction may exist in the boardroom

Attraction, flirtation and chivalry were frequently mentioned by some of the women.

> I think it is an advantage to be young, not necessarily very good-looking, but attractive and be articulate, and have a sparkle in the eye (Bente).

> I have had many advantages by being a woman. They have remembered me, and they have treated me as gentlemen would. They have wanted to help me. Everybody has remembered me because I have been the only women . . . It may be an advantage to be a woman, but sex or gender does not mean much at the top (Dorthe).

> I can allow myself some flirtatious behaviour that makes me acquire some knowledge of the other board members in a different way. I can see other sides of them than their male colleagues. You get knowledge about your male colleagues that they do not have about each other. Thus I may get support from them. I know a lot more about Tom as a person. I have been dancing with him. It gives another kind of insight, understanding of behaviour, that I can use if I want (Frøydis).

The women in management literature has suggested that whenever women and men interact, whether at 'work or at play, there is some level of sexuality involved. How they choose to deal with sexuality is determined by many factors' (Harriman, 1985, p. 113). Such concerns have not been included in the literature on board of directors. Most of the women gave warnings about getting involved in sexual relationships with other board members, and if doing so women directors should be aware of potential problems – in particular if you get involved with people with power. The observations about attraction and flirtation are in line with observations about emotions and feelings in the boardroom (Huse, 1998; Brundin and Nordqvist, 2004). However, these observations go beyond gender.

How women can make contributions

Most of the stories of the women directors are formulated to help others, and particular women, overcome barriers to make contributions on corporate boards. However, before ending the interviews we asked the women directly what advice they would give to other women. Their responses were in three categories: why become a board member, how to be recruited, and what to do when invited to become a board member? Here are some of the responses:

Finding 9: there is excitement in being a board member

The women interviwed displayed intrinsic motivations as reasons for aiming at board positions:

> Through my board assignments I have experienced having power. It is satisfactory to know that you have power. To take big and important decision. As a board member I have learnt a lot. Not only in general management, but also various professions. I have learnt a lot of technology through one of the boards (Cathrine).

> Own learning. A lot of fun. I receive a lot in return. It has been fantastic. I enjoy it. A good change from the daily duties. Other themes, other industries, other views. Learning, excitement and new people – that is what I consider to be the most important (Gro).

Excitement was the general comment we got from the women directors. They were learning and meeting new people. They also experienced having power. They encouraged other women to get similar experiences for the sake of excitement and to make contributions as board members.

Finding 10: how to be selected – visibility is important

A major question for many was how were women to be recruited to boards. The general advice given to women was to be visible. Women aspiring to become board members must be visible on the arenas where men recruiting board members can see them. Here are some comments:

> At first you must consider yourself whether you have time and desire. Make some choices. If you want to give it priority, you then have to position yourself. Be a member of rotary instead of studying arts. Be present on the arenas where you can develop some networks. Do not sit at the women's table at lunch. Take some initiatives so that you become visible. Show interest. Take initiatives. Make phone calls, talk, take contacts, and be proactive. You may ask people for lunch. Be conscious of the initiatives you take (Frøydis).

The women clearly expressed that if you are discovered and are recognized for doing a good job on a board, your main problem is not to get invitations, but to know when to say no.

Conclusions

This study has examined gender-related boardroom dynamics, and how women can make contributions on corporate boards. Our approach was to collect 'board-life-stories' from women directors, and the boards have been studied as social constructions. The study has drawn attention to the role and contribution of women directors, and to ways the status and representation of women on the top may be improved (Bilimoria and Wheeler, 2000). The extensive descriptive fieldwork has also helped to better understand, document and operationalise board variables related to the use of power and the relational dynamics in and around the boardroom (Zahra and Pearce, 1989; Pettigrew, 1992). We found that women as well as men need to understand gender-related boardroom dynamics. The contribution of women directors is not only a matter of what they can contribute with, but highly depends on their ability and willingness to make alliances with the most influential actors, to spend time on preparations, being present on the most important decision-making arenas, and to take leadership roles.

Our main findings on how women may contribute on corporate boards were summarized in ten points or statements. The women talked about advantages, challenges and problems in relation to making contributions. These contributions are often divided into resource provision and signalling roles. We have in this study found examples of various resource provision contributions (finding 7), and we have seen that tokenism and signalling roles may be an advantage in becoming a board member (finding 6). The women showed excitement of the power and the learning opportunities resulting from the board memberships (finding 9). The stories of the women directors also showed that the understanding of boards as arenas for power games was an essential starting point for women wanting to have contributions on corporate boards (finding 1). Five ways women may make contributions on corporate boards were highlighted in the stories presented in this article. These are:

1 creating alliances (finding 2);
2 preparation and involvement (finding 3);
3 attending the important decision-making areans (finding 4);
4 taking leadership roles (finding 5); and
5 being visible (finding 10).

The importance of alliances and preparations seemed to be the most prevalent general practical observations about how women can contribute. Board members have different authority and decision-making power. The women directors reported that it is the power game at the top, which involves permanent or temporary alliances and alliance building, which is the most important element in understanding board behaviour. Several studies of directorates have included aspects of this power issue, but when implemented it is most often seen in relation to the relative power of the board and the CEO (Pearce and Zahra, 1991; Daily *et al.*, 2003). The CEO is considered to have power if there is a majority of inside directors, and/or the CEO also is the chairperson. However, the power game at the board level is a lot more complex. There may also be various power alliances among individual board members or groups of board members. There may also be alliances between individual board members and individuals or groups outside the board. Running a board is very much a matter of being able to manage interactions and create alliances. When entering a board as a token, a woman is often not a part of the ruling alliances. She has, however, means to become a part of the power game and be influential. Some of the means are gender specific, but the starting point is to understand the boardroom dynamics in a gender perspective.

All the women gave comments on preparations for the meetings. Women were in general, better prepared than men. The men's lack of preparation was by some women considered to be very arrogant, and valuable time at the board meetings was thus lost. The board members coming poorly prepared or even unprepared were often business executives with high reputation, and they had often many board assignments. The lack of preparations often also reduced the board members' independence and supported managerial dominance. By preparations and asking critical questions the women directors became less dependent of reports and presentations made by the management. Furthermore, the unsatisfactory preparations of male directors, gave the women possibilities. By doing good homework, the women got the possibility to influence decision-making and to improve their status as directors – even though they often had been elected as tokens. Although the women had less board experiences, and those in the corporate hierarchies ranked several levels lower than their male counterparts, the women directors soon proved to have great positive impact on board performance. Sometimes this started a positive virtuous circle for improving board behaviour and board effectiveness (Huse *et al.*, 2005). The 'old boys' did not want to be caught asleep, thus the women representation induced that the male directors also improved their preparations.

Discussion and implications

We have, in this paper, shown how women make and can make contributions on corporate boards. Women directors are expected to see or understand actual board behaviour in other ways than their male counterparts (Acker, 1992; Bilimoria and Huse, 1997), but gender lenses have only to a limited degree been included in research on boards and governance (Bilimoria and Wheeler, 2000).

We have seen the need to understand boardroom dynamics from a gender perspective. Making contributions on corporate boards go far beyond the independence and competence criteria found in most studies about boards and corporate governance. The literature on boardroom dynamics is found in contribution about interactions and power inside and outside the boardroom (Useem, 1984; Pettigrew and McNulty, 1995; Ocasio, 1994; Huse and Eide, 1996; Zajac and Westphal, 1996; Huse, 1998; Carpenter and Westphal, 2001), norms and rules of the game (Mace, 1971; Alderfer, 1986; Whisler, 1989; Ocasio, 1999), and the board decision-making culture (Forbes and Milliken, 1999; McNulty and Pettigrew, 1999; Finkelstein and Mooney, 2003; Huse *et al.*, 2005). The present article has contributed to increase our understanding of boardroom dynamics and to explore the above issues from a gender perspective. Through the stories we explored gender-related aspects of the interactions and reactions to power and pressures (findings 1, 2, 6 and 8), we explored how aspects of norms, leadership and rules of the game may have consequences for women becoming board members (findings 4 and 5), and we explored how women contribute to a process-oriented decision-making culture (findings 3 and 7). We have seen through the perceptions and social constructions of the eight women directors that boardroom dynamics are not neutral to gender. Gender influences cognition as well as behaviour.

The study has demonstrated the importance in governance research, regardless of gender, to understand and consider emotions and micro strategising processes inside and outside the boardroom (Huse, 1998; Johnson *et al.*, 2003; Brundin and Nordqvist, 2004; Nordqvist, 2005). Women often find it exciting to explore the power games of the board, and being a board member is considered to be a tremendous learning experience. The understanding of organisations and boards from the perspective of women directors showed how various power and manipulation techniques influence the boards' decision-making. Alliances should be built, preferably with the most influential people. The women directors also clearly described how processes outside the boardroom are important in understanding boardroom dynamics. Decisions are often prepared at other arenas than the boardroom. These arenas may be formal and informal. They may be hidden or unconscious, and they may not be equally open to all board members. The traditional 'sauna-story' is such an example. We have still a society where women and men do not have access to the same arenas.

The results of the study have implications both for research and practice. Our focus has been on gender perspectives, but our study also supports general efforts in exploring behavioural perspectives on boards and governance (Finkelstein and Mooney, 2003; Huse, 2005). Process-oriented theories should be included in studies of boards and governance. Efforts should be placed on developing measures and variables that can capture the dynamic power game inside and outside the boardroom. Such variables would facilitate further integration of the various intellectual traditions in research of boards of directors and people at the top (Pettigrew, 1992). In this study we have clustered observations. This clustering is important for concept development.

In this study we have had a focus on women, and the stories were collected from Scandinavian women directors. We have not collected stories from men, and we have not aimed at making inferences in relations to minorities. Future studies could benefit from the experiences from people with other backgrounds: for example, minorities, other countries, and various groups of male directors (Hillman *et al.*, 2002). Such studies may help us understand what really is gender-related and not only the perceptions of women.

The study has also given several practical examples and suggestions on how women can make contributions on corporate boards. In this article we have met the call to generate knowledge and insights that can assist positive change in the representation and status of women on corporate boards (Bilimoria, 2000). Through the stories of the women directors we have gained detailed knowledge of board behaviour. We have seen that various rules of the game exist in the boardroom, and it is important to know these rules of the game. The practical contribution of this study has been to improve board behaviour and to help women and men to meet the challenges and obstacles in the power game of the boardroom. Contributions can be given by making alliances, solid preparations, being present at the most important decision-making arenas, taking leadership roles, and being visible.

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Part IV

Exploring relationships

Results from the 'value creating board' surveys

Trust and power

17 The 'value creating board' surveys: A benchmark

Morten Huse

Abstract

The 'value creating board' surveys have been conducted in several European countries, and initiatives have also been under taken to conduct similar studies on other continents. The objectives of this article are to present methodological issues in relation to survey research about boards of directors and to document some of the methodological reflections from the 'value creating board' surveys. Some studies using 'value creating board' survey data are also presented.

A main concern in survey research about boards of directors is the common method bias. Questionnaire surveys are the common method in the 'value creating board' surveys, but the development of the instrument and the interpretation of the findings are based on results and experiences from board research using other methods. Furthermore, another methodological strength of the surveys is that they have been conducted in different countries, with different samples, at different points of time, with various respondents and by different researchers. The various studies are not only individual articles, but also pieces in a big puzzle. Details about samples and responses in the Norwegian 'value creating board' surveys are presented here as an input to this discussion. The article thus serves as a point of reference for contributions drawing from these and similar surveys. Ten studies are presented to illustrate the concepts, methods, samples and contribution from the 'value creating board' surveys.

Key words: Survey research, Common method bias, Board behaviour, Value creating boards.

Introduction

Archival data research about boards of directors has often been criticized for not addressing the most important research questions, and the archival observations are often a far cry from actual board behaviour. Survey data is often closer to both important research questions and actual board behaviour. However, very few articles using survey data about boards of directors have been published in top-tier scientific journal (Gabrielsson and Huse, 2004). The main reasons for the limited number of published articles with survey data are that it is difficult and time consuming to gain access to good survey data, and various validation issues have been difficult to overcome. Response rates tend to be very low, respondent and common method biases are likely to occur, survey data tend to be cross-sectional, and concept validity is often weak. One objective of this article is to show how some of these problems can be overcome. This is done through a presentation of the 'value creating board' surveys that have been conducted in various European countries. Another objective of this article is to document some of the methodological issues in the 'value creating board' surveys. The article will thus have relevance for studies of behavioural perspectives on boards and governance in general and more specifically for those using or evaluating data from the 'value creating board' surveys.

The questionnaires in the 'value creating board' surveys follow the framework presented in Huse (2005). The survey instrument was developed in Norway and Sweden from 1989 to 2003 through various empirical and conceptual studies. Scholars from various countries were invited to contribute, and measures employed or suggested in previously published top-tier journal articles were used (e.g. Forbes and Milliken, 1999; Hillman and Dalziel, 2003; Kosnik, 1987; Lynall, Golden and Hillman, 2003; Pearce and Zahra, 1991). The original survey instrument was developed in English, and it was made available to scholars in several countries. Scholars that had contributed to the development of the instrument were also invited to use the original survey data being collected in Norway in 2003. The accumulation of knowledge and the fact that each survey is part of a larger study meets some of the frequently raised critiques related to common method bias (Podsakoff et al., 2003).

This article contains four sections. First, I will present the development of the value creating board survey instruments, including the spread to different countries. In the second section, samples and responses from the Norwegian surveys will be presented. Then, in the third section, ten contributions using the surveys that were developed through the 'Norefjell' – workshops will be presented and summarized. In the final section there is a discussion about implications for research and publication.

The development of the 'value creating board' survey instrument

The 'value creating board' surveys explore the impact of actual board behaviour on corporate value creation. The development of the survey instrument started with survey studies in Norway and Sweden conducted in 1990, which were inspired by similar studies that took place in the USA at the end of the 1980s (Zahra and Pearce, 1990). Articles by Mace (1972), Andrews (1981), Kosnik (1987), Hermalin and Weisbach (1988) and Zahra and Pearce (1989), as well as the theoretical contributions from Macneil (1980) and Fama and Jensen (1983), influenced the survey instrument development. The studies resulted in various publications including Borch and Huse (1993) and Huse (1990, 1993a, 1993b, 1994a, 1994b, 1994c). A screening survey preceded the main survey, and data from the screening survey, the full survey, a follow-up phone survey and data from annual reports were combined. Data were collected at two points in time, responses were collected from CEOs and chairpersons in the same firms, and various dyadic analyses were conducted.

In this period I started a collaboration with Shaker Zahra, and a survey instrument focusing on corporate innovation developed in the USA was used in Norway. This instrument was used and measures were validated in a large number of publications (e.g. Huse, 1994d; Huse and Gabrielsson, 2004; Huse, Neubaum and Gabrielsson, 2005; Zahra, 1991 and 1996; Zahra, Neubaum and Huse, 2000). In 1999 and 2000 combined boards and corporate innovation surveys were developed (Gabrielsson, 2003, 2007a, 2007b; Gabrielsson and Politis, 2008; Gabrielsson and Winlund, 2000). The section on actual board behaviour was built upon the measures taken from the studies from 1990. The measures were later developed through various quantitative (e.g. Huse and Rindova, 2001) and qualitative studies (e.g. Huse, 1998; Huse, Minichilli and Schøning, 2005). They were also highly influenced by the work of Forbes and Milliken (1999) on the board as a strategic decision-making group. The section on corporate innovation was taken from the above-mentioned innovation surveys. Responses were only collected from CEOs.

The 'value creating board' research programme started with a review of 100 student theses about boards of directors (Gabrielsson and Huse, 2005), a review of publications of boards in small- and medium-sized firms (Huse, 2000), a review of empirical publications of boards in main management journals (Gabrielsson and Huse, 2004), and a pilot survey study conducted in Norway during the spring 2001 (see e.g. Huse, 2003). The instrument in the pilot study contained 250 questions, and 140 CEOs responded.

Scholars and practitioners from various countries were invited in 2003 to contribute to developing the 'value creating board' survey instrument. Contributions were received from Europe as well as from the USA, and contributions from the recent studies of, for example, Hillman and Dalziel (2003), Lynall, Golden and Hillman (2003), McDonald and Westphal (2003) and Westphal (1998) were included.

The design of the survey instrument, including the order of the questions, was carefully chosen based on earlier experiences, pre-tests and recommendations. With respect to the row of ordering of the questions in the questionnaires, we decided to follow logical sequences. This made the respondents understand and respond to their real observation from the actual board. Considerable energy, lots of experience and many methods were used for motivating the CEOs and chairpersons to respond. The samples and responses from the various Norwegian 'value creating board' surveys will be presented in the next section.

During the autumn 2003 and spring 2004 research teams were set up at the University of Groningen, Bocconi University, Maastricht University and Hasselt University, and the survey instruments were translated and used for various samples in Italy (Minichilli, Zattoni and Zona, 2008), the Netherlands (van Ees, van der Laan and Postma, 2008; van den Heuvel and van Gils,

2008) and Belgium (Bammens and Voordeckers, 2008). The efforts were partly coordinated through seminars in Oslo that later evolved to become the 'Norefjell' workshops. The number of questions in each of these surveys varied, and questionnaires were adapted to the local situations. The Norwegian data were the most comprehensive, and scholars from various countries were invited to use the Norwegian data when investigating their own research questions (e.g. Gnan and Zattoni, 2008; Nielsen, 2008; Nordqvist and Minichilli, 2008).

Follow-up surveys were conducted in Norway during the autumn 2005 and the winter 2006. One of the objectives for the 'follow-up' surveys was to make comparisons with the surveys that were conducted two years earlier, and we tried to get both firm comparisons and sample comparisons. The questionnaires were revised based on the most recent developments in the field, the experiences from the surveys in 2003–2004 and the need to address some additional issues. The wordings of most of the questions remained the same, but in most cases in order to get a greater variation in the responses, we changed the response alternatives from a five-point Likert-type scale to a seven-point scale. The 'follow-up' survey instruments were translated during 2006 and used for samples in Denmark and Turkey. The use of the survey instruments seems to have spread to additional samples in Europe as well as on other continents.

The Norwegian surveys: Samples and responses

Samples and responses of the Norwegian 'value creating board' surveys 2003–2006 are presented in Table 17.1.

The surveys in the table are sorted in four groups. These are the 'innovation' surveys, the 'SME' surveys, the 'follow-up' surveys and the 'board member' surveys. Responses from CEOs and chairpersons were collected in the three first groups, while only responses from other categories of board members were collected in the fourth category.

The 'innovation' surveys

A survey containing 244 questions was sent during the autumn 2003 to the CEOs of the largest Norwegian firms, all firms listed on the Oslo Stock Exchange (OSE) and some samples of small- and medium-sized firms. We received valid responses from the CEOs of 488 firms. Two reminders and a follow-up phone call were made. The phone call was also used for validation reasons, and we recorded reasons for non-response. We then sent a similar questionnaire with 230 questions to the chairpersons in the firms that had responded. No chairperson questionnaires were sent to 42 firms with CEO duality. We received complete responses from 186 chairpersons. One reminder was sent.

The majority of the responses from the CEOs came from the samples with the largest firms. These samples had 249 responses with a response rate of

Table 17.1 An overview of the Norwegian 'value-creating board' surveys

Survey	'Innovation' surveys	'SME' surveys	'Follow-up' surveys	'Board member' survey
Year	2003	2004*	2005	2006**
Questions	Questions (5-point): 244 to CEO/230 chair	Questions (5 point): 216 to CEO/223 chair	Questions (7 point): 265 to CEO/235 chair	Questions (7 point): 215
CEO responses	488 responses	498 responses	973 responses (33%)	
CEO duality	Large: 249 (33%) 31–50: 115 (27%) 10–31: 124 (23%) OSE (35%) Publ own (33%) Foreign own (26%) 42 firms with CEO duality	Size/Employees <5: 52 responses 5–10: 213 responses 11–20: 151 responses 21–30: 61 responses >30: 21 responses 143 firms with CEO duality	OSE: 55 (31%) Other ASA 76 (26%) AS>100: 193 (27%) AS 50–100 empl 156 (32%) AS 5–50 empl 471 (38%) Others 22 (49%) 81 firms with CEO duality	
Chairperson responses	186 responses (42%) All matching CEOs	87 responses All matching CEOs	561 responses (21%)*** OSE: 56 (32%) Other ASA: 52 (18%) AS>100: 111 (16%) AS 50–100: 83 (18%) AS 5–50: 241 (19%) Others: 19 (42%)	
Other board members				841 responses OSE: 112 resp (78s+34e) Other ASA: 72 resp (61s+11e) AS>100: 223 resp (112s+111e) AS 50–100: 142 resp (78s+64e) AS 5–50: 237 resp (173s+64e) Others: 55 resp (36s+19e)
Total responses	674 responses	585 responses	1520 responses 293 matching pairs	841 responses
Total firms	488 firms	498 firms	1227 firms	396 firms

OSE=firms listed on Oslo Stock Exchange, ASA=publicly tradable companies, AS=other joint stock companies

* Response rate is hard to identify in the small firm survey because the survey also included screening of firms that had boards of directors

** Questionnaires were sent through the CEOs in firms where either CEOs or chairpersons had responded in 2005

*** Chairperson response rates are not adjusted for CEO duality in AS firms

33%. The response rates were lower for the firms in the other samples. One reason for the lower response rates was that a considerable number of the smallest firms did not have any real boards and thus did not respond. More detailed analyses showed that we received 35% response rates from firms listed on the Oslo Stock Exchange, 33% from publicly-owned firms, and only 25% from foreign-owned firms. One reason for this lower response rate was that the questionnaire was in Norwegian, and the ratio of non-Norwegian speaking CEOs was higher in this category than in the other categories. A total of 674 complete responses from 488 different firms were received in the 'innovation' surveys.

The 'SME' surveys

Boards in small firms, entrepreneurial firms, family firms and venture capital financed firms have recently received increasing interest, but very little research has been done on such samples. We thus decided to create a special survey for firms with less than 30 employees (the 'SMEs' surveys). The instrument was almost identical to the instrument used in the 'innovation' survey, but the innovation questions in the 'innovation' survey were replaced with questions about internationalization. Furthermore, as we did not have any database telling us about the existence of boards in these firms, we decided to send our questionnaire to a sample of almost 3000 firms. The questionnaires were distributed during the winter 2004, and included some screening questions. We received responses from 973 firms, but 471 of them reported that they did not have real boards. We received completed questionnaires from 498 firms. Two reminders were sent. A corresponding survey was sent to chairpersons in the 332 firms where it was reported that they had a separate chairperson. We received 87 completed responses from chairpersons. No reminders were sent.

The 'innovation' surveys and the 'SMEs' surveys can, for many purposes, be considered as one survey with various samples and respondents. The surveys followed each other very closely in time and related to the same time period. Questions were also presented in the same order, but some questions did not appear in all questionnaires.

In a subsample of 'SMEs' surveys we carried out some validity exercises. Some questions were presented in a different order, and some questions were presented as the negative of the original questions. No significant differences were found in the results. More details about methods, samples and descriptive results from the 'innovation' and 'SMEs' surveys can be found in various research reports (e.g. Haalien and Huse, 2005; Lervik et al., 2005)

The 'follow-up' surveys

In Table 17.1 we have divided the follow-up surveys in two groups – the 'follow-up' surveys and the 'board member' survey. Most of the questions in these surveys are identical, but the data collection, the validation of the data, and the use of the data varies between the groups. Details about the samples, responses and descriptive data presentation are presented in Sellevoll, Huse and Hansen (2007).

The 'follow-up' surveys were sent simultaneously to chairpersons and CEOs in the selected samples. An eight-page questionnaire with 265 questions was sent to CEOs, and a seven-page questionnaire with 236 questions was sent to the chairpersons Two postal reminders were sent. The second reminder contained a survey of why the responses were missing. CEOs also got a phone reminder.

We received 973 responses from CEOs. The overall response rate was 33%. The response rate for firms listed at OSE was 31% and it was 26% for other publicly tradable firms (ASA). In the other joint stock companies (AS) the response rates were highest for the smallest firms. This was due to a bias in the selection process in some samples of the smallest firms (Sellevoll et al., 2007). In 81 firms (8%) CEO duality existed. CEO duality existed only in AS firms (in five in the largest category, in seven of the 50–100 employee category and in 68 of the firms in the smallest category).

Furthermore, we received 561 responses from chairpersons. The overall response rate from the chairpersons was 21%. The response rate figures are not adjusted for CEO duality. This means that the response rates from chairpersons in reality were considerably higher in the sample with the smallest firms than what is reported in the table. The overall adjusted response rate is probably around 30%. In total we received 1520 responses from CEOs and chairpersons in 1227 different firms in the 'follow-up' surveys. In 293 firms we had responses from both the CEO and the chairperson.

The 'board-member' survey

A questionnaire corresponding to the 'follow-up' surveys was developed for board members other than CEOs and board chairpersons. The questionnaire contained 215 questions. This questionnaire was sent during the winter 2006 to board members in firms where either the CEO or the chairperson had responded in the 'follow-up' surveys. The questionnaires were distributed through the CEOs. One postal reminder was sent, and in total we received 841 responses, including 303 responses from board members elected by employees. It is displayed in Table 17.1 how many shareholder-elected and employee-elected board members responded in each firm category. The board members represented 396 different firms.

Overall descriptions

The surveys included 3630 completed questionnaires in total. The most responses were from CEOs. We received 1955 responses from 1563 CEOs. Almost 400 CEOs responded in both 2003 and in 2005. In total there were

2361 comparable responses from 2005 and 2006. In most of the surveys it was also controlled for whether the respondent really was the person the questionnaire was targeted at.

Norway has a reputation for a high number of women on corporate boards. However, until recently only a few women were in the positions of CEOs and board chairpersons. Among CEO and chairperson respondents less than 5% were women. The ratio of women among the respondents in the 'board-member' survey was 29%.

Contributions from the 'Norefjell' workshops

To illustrate the concepts, samples and contributions of the 'value creating board' surveys, I will present here ten original articles using the 'value-creating board' surveys. They have all been developed through the Norefjell workshops and presented at main academic conferences. Most of them have been presented at the Academy of Management meeting (Academy) and some have been presented at the European Academy of Management (EURAM). The articles have not been published previously and they have been through three rounds of blind and open reviews. Four papers that were accepted and presented at the Academy or EURAM meetings in 2006 did not get to a final publication in this book. The Norefjell workshops are research workshops aiming at stimulating research and publications about behavioural perspectives on boards and governance. The articles presented here, with one exception (Wenstøp, 2008) use data collected in 2003 and 2004. Chairperson responses are only used for validation reasons. A summary of the articles are found in Table 17.2.

The table displays keywords from each of the articles, the samples and statistical analyses used, and their main findings. Measures of board task performance are important in most of the articles. The only exception is the article by Zona, Minichilli and Zattoni (2008) on the relations between various board attributes and innovation. However, board task performance is divided into various sets of tasks. One main conclusion from the studies is that the different sets of tasks have different antecedents. This finding is apparent in studies in all countries, in firms of different sizes, and so on. The conclusion should thus be inferred that considerable problems may exist in studies about boards and firms results not including the importance of attribute variation in board task performance. Another overall main contribution of the studies is the exploration of various moderating and mediating effects of the boards' working styles, including board processes. The articles are presented here in the order they will appear in the following chapters.

Understanding board task performance

Nordqvist and Minichilli (2008) test hypotheses of what makes boards in small firms active and allows them to contribute to value creation. Activity is

Table 17.2 Summary of the contributions from the Norefjell workshops

Authors	*Title*	*Key words*	*Samples/method*	*Main findings*
Mattias Nordqvist and Alessandro Minichilli	'What makes boards in small firms active?'	Small firms, Board task involvement, Knowledge, Board evaluations	347 firms, 5–30 employees Norway, SME survey 2004, CEO responses, validated by chair responses, regression	The board members' knowledge and various board maintenance activities are important for making boards in small firms active.
Jeroen van den Heuvel and Anita van Gils	'How actual board task performance influences value creating boards in Dutch SMEs'	Boards of directors, Governance systems, Perceived value creation, Board task performance, SMEs	203 firms, 10–250 employees, the Netherlands, 2004, CEO responses, manufacturing firms, regression	Advice and counsel are the main value creating activity of boards in small Dutch firms. Strategy tasks are also important in executive boards.
Yannick Bammens and Wim Voordeckers	'The board's control tasks in family firms: Theoretical perspectives and exploratory evidence'	Family firms, Agency problems, Boards of directors, Trust, Control tasks	94 firms, 10–250 employees, Belgium, 2004, CEO responses, family firms, t-tests	Boards in small family firms devote considerable time in controlling the management. Boards that employ both control and trust in a complementary manner will be the most effective.
Alessandro Minichilli, Alessandro Zattoni and Fabio Zona	'Board activity in large Italian companies: A behavioural perspective'	Board task involvement, Diversity, Commitment, Cognitive conflict	301 firms, large manufacturing firms, Italy, 2004, CEO responses, regression	Commitment and diversity positively impact on the level of board activity. Future studies should pay more attention to specific board tasks.
Sabina Nielsen	'Women directors, board working style and board task performance'	Women directors, Board processes, Length of board meetings, Board maintenance, Board task performance	249 firms, 50–5000 employees, Norway, innovation survey, 2003, CEO responses, regression	Women have differential impacts on three main board tasks: service, financial control and qualitative control. Effects are mediated and moderated by the board working style.

(*Continued overleaf*)

Table 17.2 continued

Authors	*Title*	*Key words*	*Samples/method*	*Main findings*
Luca Gnan and Alessandro Zattoni	'Board task performance in small firms: The role of incentives and board processes'	Board processes, Board task performance, Board incentives, Small firms	498 small firms, Norway, SME survey, 2004, CEO responses, LISREL	Board processes have considerable impact on board task performance, but different process concepts have impacts on different tasks. Intrinsic motivation of board members also significantly influences board processes.
Hans van Ees, Gerwin van der Laan and Theo Postma	'Trust and board task performance'	Disclosure trust, Reliance trust, Board task performance	86 CEO responses and 43 responses from other board members, incorporated firms with more than 100 employees, the Netherlands, 2003, regression	Disclosure trust is positively related to strategy tasks, while reliance trust negatively affects control task performance.
Pingying Zhang Wenstøp	'Consequences of board power'	Board power, Board roles, Decision-control roles, Structure-influence roles, Opinion-shaping roles	452 + 388 responses, Norway, innovation survey 2003 and follow-up survey 2005, CEO responses, LISREL	Board decision-controlling roles can be studied through board structural-influencing and opinion-shaping roles.
Fabio Zona, Alessandro Minichilli and Alessandro Zattoni	'Boards of directors and firm innovation: An empirical analysis on large Italian companies'	Boards of directors, Agency theory, Firm innovation	301 large manufacturing firms, Italy, 2004, CEO responses, regression	Directors' shareholding negatively influence firm propensity to innovate. Board size is positively related to innovation.
Jonas Gabrielsson and Diamanto Politis	'Board control and innovation: An empirical study of small technology-based firms'	Boards of directors, Strategic and financial control, Innovation, Technology, Small firms	135 small technology-based firms, Sweden, 2000, CEO responses, regression	Board strategy involvement significantly influences innovation in small technology-based firms. Involvement in different tasks has influence on different types of innovation.

seen in relation to board task involvement. Predictions based on agency theory, resource dependence theory and the resource-based view of the firm are used. They found strong support for hypotheses highlighting the use of the knowledge of the board members and various board maintenance tools, such as regular board evaluations, to increase board task involvement. Actionable advice to boards in small firms is provided.

Van den Heuvel and van Gils (2008) examine the effect of the board's actual task performance on the value that boards create in Dutch SMEs. Because of the two-tier governance system, they distinguish between the value creation of the supervisory board and the executive board. A factor analysis on a wide range of board tasks resulted in six distinguishable sets of board tasks: 1) operational control, 2) behavioural control, 3) output control, 4) strategy, 5) advice and counsel, and 6) networking. The results showed that – from a CEO's perspective – the supervisory boards mainly create value through their performance on the advice and counsel tasks. Executive boards are found to create value through their performance on the advice, counsel and strategy tasks.

The purpose of the Bammens and Voordeckers (2008) article is to examine the board's control tasks in a family firm context. They provide an overview of the theoretical perspectives concerning this topic, and present exploratory evidence. The empirical findings indicate that, contrary to traditional agency wisdom, family firm boards devote substantial attention to controlling the management team. Yet the level of board control does not appear to be dependent upon the generational phase of the firm. Bammens and Voordeckers argue that those family firms that employ trust and control in a complementary manner will be most effective.

Mediating and moderating effects of board processes and working style

Minichilli, Zattoni and Zona (2008) present behavioural antecedents of board activity. They define board activity as the involvement of the board in various tasks such as control, advice, network and strategy. They adopt a behavioural perspective and hypothesize that three board attributes, i.e. board diversity, the commitment of the board members, and cognitive conflict among the board members, positively impact on the level of board activity. Our model was tested on a sample of 301 large manufacturing Italian corporations. The results support that commitment and diversity positively impact on the level of board activity; on the other hand, they did not find in the overall analysis that cognitive conflict significantly influenced board activity. However, further investigation showed that cognitive conflict may exert significant influence on some of the specific tasks of the board. The findings suggest that behavioural attributes may shed light on what determines board activities; moreover, they suggest that future study should pay more attention to the specific tasks of the board.

Nielsen (2008) investigates the effects of the board working style on the relationship between women directors and board task performance. Based on a survey of 249 Norwegian firms with between 50 and 5000 employees, we explore the proposition that women directors have influence on board dynamics and effectiveness. Our results suggest that women directors have differential impacts on three main board tasks: service, financial control and qualitative control. These effects will be influenced by mediating and moderating effects of board working style variables such as trust, maintenance activities and length of board meetings.

In their article Gnan and Zattoni (2008) address three issues that are perceived as important: the exploration of boards in small firms, the exploration of board processes, and the understanding of board effectiveness based on measures of actual board task performance. Data from a sample of small Norwegian firms were used. Constructs and relationships were validated and tested through LISREL analyses. They found that concepts related to board processes had considerable impact on actual board task performance, but also that various process concepts (e.g. commitment, information seeking and openness) have different impact on different board tasks (e.g. networking, advisory and control). Traditional board demographic variables were used as control variables, but generally they had only minor influence on board task performance. We found, however, that a measure related to the intrinsic motivation of the board members significantly influenced the board processes.

Trust and power in board–management relations

Van Ees, van der Laan and Postma (2008) write about how trust may affect board task performance. Two constructs of trust are introduced and discussed. The analysis of Dutch board behaviour indicates that disclosure trust is positively related to strategy task performance, while reliance trust negatively affects control task performance. They conclude that trust is an important concept for understanding interdependencies between (non-executive) board members and managers.

Wenstøp (2008) contributes to the understanding of the complexity of board power. She uses the concept of board power to examine the board's decision-controlling role, structure-influencing role, and opinion-shaping role. Normatively, board role performance makes sense as a measure of board power consequences; it succinctly captures what is expected from a board. According to the criteria of power, board roles are related to each other such that board power is manifested by intentional activities facilitating board control. Three hypotheses are tested and supported. The study uses survey data from Norwegian CEOs at two discrete points in time.

The contribution of boards to different types of innovation

Zona et al. (2008) analyse how board characteristics influence firm innovation. Firm innovation refers to basic innovation and entrepreneurial activities internal to a firm, such as the firm emphasis on new product development, innovation technology, and R&D investments. Drawing on agency theory, they developed hypotheses on specific board structural characteristics – i.e., board size, outsider ratio, directors' shareholdings, and CEO duality – and firm innovation. The model was tested on a sample of 301 large manufacturing Italian firms. They found support for their argument that – contrary to predictions of agency theory on CEO ownership – directors' shareholdings negatively influence a firm's propensity to innovate. The results also suggest that board size may play a role in shaping a firm's propensity toward innovation.

Gabrielsson and Politis (2008) examine the influence of board control on innovation in small technology-based firms. An analysis of 135 Swedish technology-based firms suggests that board involvement in the control over strategic decisions and outcomes can have a significant influence on innovation. The empirical results suggest that board strategic control involvement is positively associated with process innovation, while board involvement in financial control is positively associated with organizational innovation. No association is found between board control and product innovation. In all, their findings give a better understanding of how boards may contribute to value creation in small technology-based firms and also suggest some areas where further scholarly inquiry is highly warranted.

Implications for research and publications

In this article I have presented methodological issues in relation to the 'value creating board' surveys. Some illustrative studies using the 'value creating board' survey data have also been presented. The surveys have been conducted in different countries, with different samples, at different points in time, with various respondents and by different researchers. The various studies are not only individual articles, but also pieces in a big puzzle. The 'value creating board' surveys have been presented here as a benchmark for other studies.

Two main research questions have been addressed in this article. First, it has illustrated how some shortcomings in survey research about boards of directors can be overcome and, second, it has documented some of the methodological issues in the 'value creating board' surveys. Survey research may be more relevant and closer to reality than most studies using archival data, but surveys are time consuming to conduct, response rates tend to be low and they often suffer from common method bias.

The 'value creating board' surveys have been very time consuming to conduct, and they have been developed over two decades. One core aspect of these surveys is that not only do they consist of many individual and separate studies, they also comprise many pieces in a big puzzle. The knowledge from a large number of surveys and studies has been accumulated, and in this way many of the traditional criticisms of survey-based board studies have been overcome.

I have presented here some input to the validation discussions of the 'value creating board' surveys, e.g. measurements and concepts validity, internal validity, external validity and reliability. One input to the measurement and concept validity discussion is the presentation of how the different measures and concepts have evolved from earlier studies. Another input is how the different concepts are used, and how various studies support each other. Inputs to the reliability discussion are found in the presentations of the samples, response figures and response rates in the various surveys. The general response rates in the Norwegian surveys are 30%. This is an impressive figure when considering the length of the questionnaires and the targeted respondents. Reliability issues and issues about internal and external validity are addressed through the repeated surveys, various samples and the fact that the surveys were conducted in several countries. Some studies have also included measures collected from other types of data sources, e.g. formal company registers and other databases, as well as interviews and direct observations.

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18 What makes boards in small firms active?

Mattias Nordqvist and Alessandro Minichilli

Abstract

The attention to boards of directors in small firms is increasing. Traditionally they have been considered to be passive but boards in small firms are undergoing major changes. We test hypotheses of what makes boards in small firms active and allows them to contribute to value creation. Activity is seen in relation to board task involvement. Predictions based on agency theory, resource dependence theory and the resource-based view of the firm are used. We found strong support for hypotheses highlighting the use of the knowledge of the board members and various board maintenance tools, such as regular board evaluations, to increase board task involvement. Actionable advice to boards in small firms is provided.

Key words: Small firms, Board task involvement, Knowledge, Board evaluations, Norway

Introduction

We explore what makes boards in small firms active. Research on boards and governance has increased during recent years, but we still know relatively little about boards in small firms (Fiegener, 2005). Small firms have certain characteristics that make them a special case of governance in need of particular attention (Huse, 2000). The typical overlap of governance structures (Brunninge, Nordqvist and Wiklund, 2007) and scarce functional managerial competence (Cowling, 2003) are two examples of such characteristics.

Small firms are, like the larger firms, experiencing increasing external pressures to activate their boards for value creation (Corbetta and Salvato, 2004; Nordqvist and Melin, 2002). The lack of research that addresses what makes boards in small firms active is therefore a significant limitation of the current literature.

Board activity has in earlier studies been measured mostly as the number of board meetings. However, we use an alternative construct – board task involvement – as a measure of board activity. Various theoretical perspectives like agency theory, resource dependence theory and resource-based view emphasize the main board tasks of control, service and strategy differently

(Huse, 2005; Zahra and Pearce, 1989). While past research has showed inconsistent results regarding the direct link between firm performance and board involvement, we consider board task involvement as important for firm value creation (Huse, 2005).

We first investigate how traditional predictors explain board task involvement in small firms. Second, we go beyond these variables and explore the importance of the intrinsic motivation of board members (Fama and Jensen, 1983; Hermalin and Weisbach, 1998) and board working structures to provide more time during board meetings (Behan, 2004; Demb and Neubauer, 1992; Huse, Minichilli and Schøning, 2005) for board activity. This means that we also contribute to what boards themselves can control and change to increase board task involvement. We are therefore able to provide actionable advice to small firm owner-managers who are considering activating their board.

The article is structured as follows: first, we relate the empirical study in relation to previous literature on the 'usual suspects', board member motivation and board structures. We then present our sample and methods. After presenting the results, a discussion is provided before the article ends with our key conclusions, suggestions for future research and practical implications.

Active boards in small firms: Hypotheses

Board composition and the 'usual suspects'

The four dominating variables in board research are the number of board members, the insider/outsider ratio, CEO duality and shareholding by board members. These have been labelled 'the usual suspects' (Finkelstein and Mooney, 2003). The number of board members is generally expected to have an inverse U-form relationship to firm performance (Zahra, Neubaum and Huse, 2000). Optimal board size is often considered to be between five and eight members. Many small firm boards have fewer members and are dominated by owner-managers' families and friends or professional advisors (e.g. accountants or attorneys). This may lead to limited board member independence and vigilance. From this perspective, increasing the number of board members increases the ability for the board to both service and control the top management. Resource dependence theory further suggests that a large board provides access to a wider range of useful resources external to the firm. Cowling (2003) finds that the number of board members in small firms is positively related to board activity. In other words, predictions from both agency theory and resource dependence theory suggest the following hypothesis:

> Hypothesis 1: *There is a positive relationship between the number of board members and board task involvement.*

The insider/outsider ratio is used from an agency theory perspective to measure board independence. Top management team members and their families are usually considered to be financially and psychologically dependent on the CEO. As such they are considered as insiders, and they are not expected to have sufficient distance to control managerial behaviour and opportunism. Earlier studies have shown that outsiders can make boards in small firms more active (Cowling, 2003; Johannisson and Huse, 2000). From a resource dependence perspective, the inclusion of non-executive board members may increase the availability of resources for a firm, and the number of outsiders will thus accordingly be positively related to board task involvement (Zahra and Pearce, 1989). Outside directors thus have the potential to make large contributions in small firms regardless of the theoretical perspectives employed (Gabrielsson and Huse, 2005). We thus hypothesize:

> Hypothesis 2: *There is a positive relationship between the ratio of outside board members and board task involvement.*

CEO duality exists when the CEO is also the board chairperson. It has been argued in the leadership literature that CEO duality may be positively related to firm performance because it secures unitary leadership. However, a core element in agency theory is the separation of control and executive tasks. Agency theory predictions will include a negative relationship between CEO duality and control tasks. CEO duality is particularly common in small firms as a result of the overlap between the owners, the board members and the top management team. Boards are expected to be less active and more informal when there is CEO duality (Nordqvist and Melin, 2002). Zahra et al. (2000) also found that CEO duality was negatively related to corporate innovation in medium-sized companies. Therefore:

> Hypothesis 3: *There is a negative relationship between CEO duality and board task involvement.*

Shareholding by board members is considered in the agency theory literature to be one of the main criteria for board task involvement. Board members' shareholding is believed to increase their motivation to get involved in control, service and strategy tasks (Johnson et al. 1993; Zahra et al., 2000; Zahra and Pearce, 1989). Shareholding board members, since they benefit from the firm's increased value creation, are more prone to challenge the CEO and to seek in-depth knowledge about the firm and its environment (Zahra et al. 2000). This leads us to formulate the following hypothesis:

> Hypothesis 4: *There is a positive relationship between shareholding by the board members and board task involvement.*

Board members' intrinsic motivation

It is not enough that board members have knowledge and skills; they must also be motivated to use them (Forbes and Milliken, 1999). There are various reasons for board members to be active. Board shareholding, liability and personal or professional standards are suggested to be the most important motivational issues relating to board task involvement (Fama and Jensen, 1983; Hermalin and Weisbach, 1991). Shareholding is included as one of the usual suspects and is included in hypothesis 4. Liability issues are mainly related to firms in financial crisis. Personal and professional standards are related to the market for board members and managers. The reputation and value of the board members will increase in the market for board members if they do a good job. From a resource dependence perspective, this may be especially relevant for outside board members since they use their reputation, networks and expertise to provide access to resources available outside the firm (Borch and Huse, 1993). Moreover, in small firms, the often close and long-lasting ties between board members, managers and owners may mean that they feel more related to and identify more with the owner-family (Huse, 1993). This typically increases their motivation to be involved in board tasks. Gabrielsson and Winlund (2000) found evidence in small firms that committed and motivated board members mean greater involvement in both service and control tasks. Thus:

> Hypothesis 5: *There is a positive relationship between board members' personal and professional motivation and board task involvement.*

Board working structures

Boards in small firms typically meet only a few times every year and the number of hours devoted to each board meeting is limited. However, for a board to perform well it is not enough to have the very best and competent board members. The board must also have working structures that allow the board members to use their knowledge and skills (Demb and Neubauer, 1992; Forbes and Milliken, 1999; Gabrielsson and Winlund, 2000). The amount of time devoted to actual board work can significantly determine the degree to which boards fulfill their tasks (Forbes and Milliken, 1999; Lorsch and MacIver, 1989). An active board requires time for preparation and careful planning, but the number of hours spent in each board meeting is also considered to be important for board task involvement (Demb and Neubauer, 1992; Huse, 2003), and in particular for board strategy and service involvement (McNulty and Pettigrew, 1999). Spending time together in board meetings is an essential ingredient for virtuous boardroom dynamics and creative and innovative board behaviour. Time pressured board members may, as prescribed by agency theory, spend sufficient time on quantitatively related control tasks, but other board tasks may suffer due to time constraints

(Brunninge et al., 2007; Hitt et al., 1996). Longer meetings also support process orientation and a board climate where many actors can voice their opinions (Huse et al., 2005). Outside board members cannot be expected to monitor the firm (Demb and Neubauer, 1992), be involved in strategic issues or reach effective decisions (Conger et al., 1998) if not given enough time in the board meetings to discuss and evaluate various alternatives. Therefore:

> Hypothesis 6: *There is a positive relationship between the length of the board meetings and board task involvement.*

It has been argued that regular board evaluations positively support board task involvement (Conger et al., 1998; Demb and Neubauer, 1992; Lorsch, 1995). Board evaluations represent a formal routine that facilitates a process-oriented boardroom culture. Having such an evaluation system allows for regular follow-up on board members' contribution to the different board tasks, making it easier to detect inefficiencies and improve board work (Lorsch, 1995). In small firms, board evaluations may help to define board members' tasks and to enhance the relationship between the board and the top management team (Conger et al., 1998; Gabrielsson and Winlund, 2000). Moreover, they make it easier to determine whether new resources, such as knowledge, skills and relations with external stakeholders, are needed to improve the board task involvement over time. In this way, board evaluations address the possibility that the demands and focus of board work change over time (Lynall, Golden and Hillman, 2003). Thus:

> Hypothesis 7: *There is a positive relationship between regular board evaluations and board task involvement.*

Methods

A cross-sectional associative research design was used to test the hypotheses. We used a sample of 347 Norwegian firms having between five and 30 employees. The original data were collected in 2004 through a questionnaire sent to CEOs in a random sample of 3000 small firms that, according to the list of Market Select, had between five and 30 employees, and sales between five million and 50 million Norwegian crowns (just below one million and 10 million US$ – as one Norwegian crown is close to six US$). From the total of 973 responses, 498 contained questions about boards of directors and 347 included complete answers. We found that the response rates were slightly related to firm size in two ways: 1) the total response rates were highest for the smallest firms; 2) the response rates on board questions were highest for the largest firms. In our final sample we only used responses from firms that reported that they had between five and 30 employees.

The study's measures were validated through responses from a sample of 80 chairpersons in the firms where there was no CEO duality. We also compared our findings with results from another database collected in 2003 on another sample, mostly on larger and medium-sized firms, but some small firms were also included. The findings relating to firms with less than 30 employees were similar in both surveys. Norwegian law does not allow CEO duality in firms with a share capital of more than three million Norwegian crowns (about 500,000 US$). These firms must have at least three board members. The system requires employee representation on boards in firms with more than 30 employees.

Variables

Variables in the hypotheses

The dependent variable in our hypotheses is board task involvement. Three specific board task involvement variables and one summary variable were developed. The three specific variables were control involvement to explore agency theory predictions, service involvement to explore resource dependence theory predictions and strategy involvement to explore predictions from the resource-based view of the firm. The total board task involvement was constructed as the mean of the three specific board involvement tasks variables. The three specific tasks were made in two steps, and 17 items employed in various earlier studies were used in developing our board task involvement measure.

The 'usual suspects' were measured as the number of board members, the insider/outsider ratio of board members, CEO duality and the shareholding of the board members. The board members' intrinsic motivation followed measures used in earlier studies about how board members are motivated by personal and professional standards to do a good job on the board. The length of board meeting was the number of hours that ordinary board meetings lasted in 2003. The measure of regular board evaluations was taken from a list in the survey containing questions about the use of evaluation practices.

We included eight *control variables* in the study. A logarithmic transformation of the number of employees was used to measure firm size. Firm crisis was measured through a composite index of four items where the CEOs on a five-point Likert type scale evaluated the existence of firm crisis during the recent three years (alpha .70). Firm age was measured as a logarithmic transformation of the number of years the firm had existed. Degree of internationalization may influence board activity and therefore we used a mean of three items about the percentage of exports on sales, exports on revenue and workforce located abroad (alpha .80). A Likert-type scale item on industry was used as an industry characteristics measure. CEO tenure in present position was the CEO attribute variable. The percentage of ownership by the CEO, the top management team and their families was used as our ownership variable. Because most small firms are family firms, we also included a measure about family involvement. The family involvement was measured by a dichotomous variable measuring if more generations from the family were involved in the firm.

The above description reveals that the variables have been exposed to various types and degrees of validation. In most cases we used multi-items, and often also multi-respondent validation took place. In some cases, we also conducted validation analyses through other methods and other samples.

Analyses and results

Multiple linear regression analyses were used to test the hypotheses. Residual analyses were conducted, but no results were found that changed the main conclusions. Statistical conclusion validity can be found, but inferences to causal relationship must only be done with care when using cross-sectional without longitudinal data. Causal relationships will be discussed in the interpretation of the results. Correlation coefficients between the independent variables are presented in Table 18.1.

The results of the linear regression analyses are presented in Table 18.2.

Four models are displayed in the table. Equation I has the total board task involvement as the dependent variable. This is our main analysis. Equations II, III and IV are sub models of equation I and display the different theoretical perspectives. We find these interesting in comparison with our main model in equation I. Here, the dependent variables are board control involvement, board service involvement and board strategy involvement. The partial standardized regression coefficients (beta coefficients) for each of the equations in the full model are displayed in the table. The table also displays full model equation statistics and stepwise statistics. The stepwise statistics displayed are the change in F in each step of the analysis. The full model statistics show that all equations are significant with R-squares ranging from .47 to .58 and adjusted R-squares ranging from .19 to .31. These figures are higher than what is found in most studies on board tasks.

The beta coefficients for the variables numbered 9–15 correspond to the seven hypotheses. The hypotheses about the 'usual suspects' (hypotheses 1–4) are not supported. Hypothesis 5 about the board members' intrinsic motivation (beta is .40), hypothesis 6 about the length of the board meetings (beta is .11), and hypothesis 7 about regular board evaluations (beta is .25) are generally supported. However, one major difference is found when comparing the different theoretical perspectives. The length of the board meetings (hypothesis 6) is not related to the control task involvement, but the beta coefficients are significant in the equations for the service and strategy task involvement. Hypotheses 1–4 are not supported in any of the perspectives, but hypotheses 5 and 7 about motivation and evaluation are supported in all of them.

Table 18.1 Correlation analysis

	1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*	*13*	*14*	*15*
1. Size (ln employees)	–														
2. Crisis (recent 3 years)	–.08	–													
3. Firm age (ln years)	.22	–.14	–												
4. International activity	.08	.15	–.05	–											
5. Expanding industry	.01	.15	–.22	.37	–										
6. CEO tenure	.00	–.09	.37	–.05	–.10	–									
7. CEO/TMT ownership	–.23	–.04	.06	–.21	–.05	.19	–								
8. Active family generations	–.03	–.05	.17	–.09	–.00	.16	.27	–							
9. Board members (number)	.23	.02	–.01	.01	–.04	–.15	–.40	–.06	–						
10. Outsider ratio	.09	.01	.02	.03	.00	–.14	–.31	–.01	.34	–					
11. CEO duality	–.14	.05	.06	–.07	–.09	.26	.34	.19	–.28	–.16	–				
12. Board ownership	–.18	.01	.02	–.19	–.03	.10	.62	.30	–.31	–.19	.24	–			
13. Intrinsic motivation	.01	.06	.09	.03	.06	.13	.02	.05	–.09	–.11	–.06	–.03	–		
14. Length of meetings	.22	.10	.06	–.09	.04	–.09	–.15	–.08	.17	.08	–.13	–.10	.05	–	
15. Board evaluations	.01	–.14	–.02	–.03	.08	.03	.07	–.03	–.03	–.03	–.02	.01	.21	.06	–
16. Total task involvement	–.01	–.01	–.01	–.10	.14	.10	.11	–.04	–.11	–.09	–.01	.10	.46	.12	.36
17. Control tasks	.00	–.01	–.01	–.09	.11	.13	.18	.01	–.14	–.10	.06	.12	.38	.00	.24
18. Service tasks	–.00	.02	–.03	–.05	.16	.03	.04	–.03	–.08	–.08	–.02	.06	.36	.15	.27
19. Strategy tasks	–.04	–.01	.02	–.10	.08	.08	.07	–.07	–.07	–.04	–.06	.04	.39	.14	.31
Mean	2.32	1.88	2.83	3.51	2.67	7.92	57.2	.23	3.58	.65	.22	64.6	3.95	2.68	2.69
St.dev	.62	.91	.87	11.8	1.14	7.27	43.9	.42	1.42	.33	.42	42.1	.96	1.68	1.24

Pearson's product-moment correlation coefficients. Coefficient .10 = 5% two tailed significance. N=347

Table 18.2 Regression analysis

Beta coefficients in the full model	*I Total task involvement*	*II Control involvement*	*III Service involvement*	*IV Strategy involvement*
Step 1 External factors				
1. Firm size	–.005	.065	–.088	–.063
2. Crisis	.039	.016	.051	.047
3. Age	–.046	–.086	–.039	.011
4. International	–.109*	–.076	–.076	–.109*
5. Expanding industry	.092+	.073	.102	.040
Step 2 Management and ownership				
6. CEO tenure	.068	.088	.000	.062
7. CEO ownership (incl TMT and family)	.046	.100	–.023	.051
8. Family generations active in firm	–.089+	–.055	–.037	–.106*
Step 3 Usual suspects				
9. Number of board members H1	–.040	–.033	–.028	–.035
10. Outsider ratio H2	.003	.005	–.040	.026
11. CEO duality H3	–.017	.033	.004	–.070
12. Board ownership H4	.081	.080	.068	.041
Step 4 Motivation				
13. Board member intrinsic motivation H5	.402***	.338***	.321***	.328***
Step 5 Board structures				
14. Length of board meetings H6	.113*	.005	.130*	.133**
15. Regular board evaluations H7	.248***	.198***	.199***	.222***
R	.583	.500	.475	.505
Adj R2	.310	.217	.191	.222
F (sign) Full model	11.40***	7.51***	6.55***	7.605***
F change each step				
Step 1 External factor	2.11+	1.52	1.88+	1.34
Step 2 Management and ownership	3.29+	6.22***	.48	2.26+
Step 3 Usual suspects	.99	.60	.77	1.17
Step 4 Motivation	91.70***	58.83***	54.00***	57.34***
Step 5 Board structures	17.85***	8.09***	11.89***	14.52***

+ = .1-level, * = .05-level, ** = .01-level, ***= .001-level

The results displayed in Table 18.2 give a very clear picture. First, the figures with respect to the board members intrinsic motivation (hypothesis 5) and regular board evaluations (hypothesis 7) show strong and significant impact on board task involvement. And even though the validation of the constructs measuring board intrinsic motivation and the existence of regular board evaluations were limited in our study, the results were so strong that we cannot see that the overall conclusions can be changed. Second, the length of meetings (hypothesis 6), despite the different impacts on different board tasks, seems to be relevant in making boards active especially with respect to their service and strategy tasks.

Discussion

The purpose of this article is to address the lack of research that explores what makes boards in small firms active. We have made several interesting observations. First, we found that the 'usual suspects' hardly explained any of the variance in board task involvement in the small firms in our study. None of the partial coefficients between the number of board members, outsider ratio, CEO duality and the ownership by board members were significantly related to any of the board task involvement variables. This finding corresponds to results from various meta-analyses in large corporations on the impact of the 'usual suspects' on firm financial performance (Daily et al., 2003; Dalton et al., 1998 and 1999; Johnson et al., 1996). Our findings also correspond to the findings of Gabrielsson and Winlund (2000) in their study of board control and service involvement in small- and medium-sized firms.

A second key finding was the strong results about the board members' intrinsic motivation. This is not surprising when reviewing the literature on boards in large firms. It is a major point made by various authors, including Fama and Jensen (1983), Hermalin and Weisbach (1991, 1998) and Lorsch and MacIver (1989), that there is a market for board members, and that this market is a major motivational factor for the individual board members. Our study adds interesting evidence from small firms to this large firm focused literature. The work of Westphal and Khanna (2003) on social distancing indicates, however, that there will be social pressures on board members not to ask discerning questions that will be against the informal norms of the ruling elites. We found in our study that personal and professional motivation was also significantly related to control involvement. Our findings are similar to the results presented by Borch and Huse (1993), who found that board members' intrinsic motivation had a major impact on board networking involvement. Our findings indicate that it is not enough for board members in small firms to be outsiders, be present at board meetings and to have knowledge and skills. They should also, as Forbes and Milliken (1999) suggest, be motivated to use these actively in the actual board work.

A third finding was the impact of regular board evaluations. Board evaluations are considered to be a powerful tool to develop boards, and the introduction of regular evaluation systems are recommended in most codes of best practices. Few studies have empirically shown this impact. Gabrielsson and Winlund's study (2000) of Swedish small- and medium-sized firms did not find any relations between formal board evaluations and the boards' service and control involvement. We found, however, that board evaluations have impact regardless of the theoretical perspective used. Further studies should explore in more detail the impact of various elements of board evaluation systems.

A fourth finding was the impact of the length of the board meetings. One aspect of this finding is that the length of board meetings has an impact on board task involvement. Another aspect is that a prescription of effective working style will vary with theoretical perspective and board tasks. The results indicate that, on one hand, board involvement in strategy and service tasks requires long board meetings. On the other hand, control involvement seems to be independent of the length of the board meetings. This follows conclusions in studies on large firms indicating that boards' contributions to strategy to a large degree depend on creative and interactive board meetings where the board involvement goes beyond ratification and output control (Hitt et al., 1996; McNulty and Pettigrew, 1999). Control activities are less time consuming than the service to top managers or the involvement in the strategic process. Control activities typically rely on 'hard information' readily put together in formal documents and financial reporting and budgeting routines. Service and strategy activities are often more ambiguous, complex and time consuming, since they refer to broader issues with general impact on the firm and its relation to its environment (Brunninge et al., 2007).

A fifth finding is the limited explanations of the control variables. Among the few relations observed was the negative relationship between the involvement of several family generations in the firm and strategy involvement. Strategic decision-making may take place in such firms in other arenas than the boardroom, for example in family councils or informal arenas, such as family dinners, coffee breaks, etc. (Nordqvist, 2005). A negative relationship between board task involvement and firm international activities was also indicated. We have two explanations for this observation. First, the boards of small firms with heavy international activities may function as passive subsidiary boards and, second, board members may be risk averse and enforce restrictions to creative and impulsive managers that want international expansions.

We have used an empirical setting from Norway to investigate what makes boards in small firms active. It has been assumed that the small firm setting is very different compared to the setting of most studies of boards of directors, that is, large and publicly traded US corporations. Our findings are, however, similar to what could be expected from general board task literature and research. This is interesting given the assumed special characteristics of small firms, such as overlapping governance structures, lack of functional managerial competence and strong owner representation in the boardroom and in the top management team (Brunninge et al., 2007; Cowling, 2003). Our findings suggest that common practices generated from a large firm context also seem to be relevant in small firms.

Conclusion

We have explored what makes boards in small firm active and we have used various theoretical perspectives to understand board task involvement. The study illustrates the importance of going beyond the 'usual suspects'. Hypotheses about positive relations between board members' intrinsic motivation, the length of board meetings, and regular board evaluations were supported. A theoretical contribution from the study is that few differences existed across the various theoretical perspectives. Intrinsic motivation and regular board evaluations were positively related to all board tasks. The length of the board meetings, however, was not related to the control tasks, and the 'usual suspects' were not related to any of the tasks.

The article has various actionable implications for small firm owners and managers. Given that motivation has such a high influence on board task involvement, the selection of outside board members becomes critical. What is relevant is not only the fit of board members' knowledge and skills with the requirements from the firm's competitive environment, but rather the use of such skills. Therefore, the selection procedure in small firms should take into account elements besides the directors' competencies. In addition to competence, owners of small firms should make sure that board members are motivated before joining the board. The scheme of incentives for board members' motivation and commitment should also be strengthened by the introduction of regular board evaluations. We suggest that boards should regularly evaluate themselves, but also that they increasingly let outside specialized agents make evaluations that can support board development.

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19 How actual board task performance influences value creation in Dutch SMEs

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Abstract

The ways in which boards of directors can create value for SMEs has received a considerable amount of attention in the governance literature. Inconclusive results from input–output studies have asked for another approach, focusing on the influence of contingencies, board processes and actual board task performance. In this article, we examine the effect of the board's actual task performance on the value that boards create in Dutch SMEs. Because of the two-tier governance system, we distinguish between the value creation of the supervisory board and the executive board. A factor analysis on a wide range of board tasks results in six distinguishable sets of board tasks: 1) operational control, 2) behavioural control, 3) output control, 4) strategy, 5) advice and counsel, and 6) networking. Results show that – from a CEO's perspective – the supervisory boards mainly create value through their performance on the advice and counsel tasks. Executive boards are found to create value through their performance on the advice, counsel and strategy tasks.

Keywords: Boards of directors, Governance systems, Perceived value creation, Board task performance, SMEs

Introduction

Evolutions in shareholder activism and stakeholder management practices, as well as recent financial scandals within the business society, have sparked academic research on (good) corporate governance practices (Huse, 2005b). A main goal of these governance activities is creating value, both for shareholders and stakeholders (Charreaux and Desbrières, 2001; Dulewicz and Herbert, 2004; Huse et al., 2005; Lee et al., 1999; Yeh, 2005). However, the mechanisms that explain this governance-value creation relationship are far from being completely understood (Charreaux and Desbrières, 2001).

Recently, Huse (2005a) has developed a 'framework for exploring behavioural perspectives', providing a basis on which our knowledge on relationships between the different board concepts investigated in earlier research can be further advanced. More specifically, in this framework Huse (2005a) integrates contingency and evolutionary theories with board task and board process perspectives, extending his framework on board research (Huse,

2000) and including the accountability concept (Roberts et al., 2005) which is strongly related to the value creation of the board (Cadbury, 1992; Taylor, 2001).

In this article we examine the influence of board task performance on value creation. A perceived value creation measure is used. By studying the influence of actual board task performance on perceived value creation, we explicitly test one of the relationships described in the 'creating accountability framework' (Huse, 2005a). In addition, due to the two-tier structure of the Dutch governance regime with supervisory boards and executive boards, we take the opportunity to compare value creation of the two type of boards.

The subsequent parts of this article are structured as follows. In the theoretical development part, the authors first provide an overview of earlier research findings on board tasks and value creation in a SME context. Secondly, the specificities of the Dutch governance system will be discussed. Next, we elaborate on the method and present our results. The article concludes with a discussion on the research findings.

Board tasks and value creation in SMEs

Researchers have clearly illustrated the governance-added value relationship within a SME-context. However, as in the general literature, mainly the input–output perspective was used, emphasizing the added value of specific types of outside directors (Lee et al., 1999; Sapienza et al., 1996). Recently, in several (empirical) studies, the tasks that boards of directors fulfil within SMEs have been analysed. However, studies linking these tasks the value creation concept are missing.

Focusing on the different board tasks that have been identified within a SME context, Mace (1948) has already stated that boards in smaller companies can be tapped for advice and counsel. Although the findings in the first publications were mainly of an anecdotal nature, researchers prescribed specific tasks the SME's boards had to fulfil. Monitoring the performance of the CEO and the management team was one of the tasks specified (Castaldi and Wortman, 1984). In addition, strategy and service-related tasks were indicated to be important. Boards in smaller firms had to establish and revise firm policies and strategies (Castaldi and Wortman, 1984; Ford, 1988; Fox, 1982, 1983, 1984; Rosenstein, 1988), as well as advise and provide counsel (and the necessary expertise and competencies) in order to compensate for managerial deficiencies (Castaldi and Wortman, 1984; Ford, 1988; Jain and Gumpert, 1980; Nash, 1988; Ward and Handy, 1988).

During the past 15 years, research on board tasks in SMEs has advanced a lot as a result of improved theoretical developments and empirical testing. Starting from agency theory, researchers examined the determinants, importance and performance of the monitoring or control task of SMEs' boards (Deakins et al., 2000; Gabrielsson and Huse, 2002 and 2005; Gabrielsson and

Winlund, 2000; Huse, 1993, 1994, 2000; Markman et al., 2001; van den Heuvel et al., 2006). Creating external legitimacy, obtaining access to scarce resources, strategic planning, advice and networking have been identified as subtasks of the board's service task (Borch and Huse, 1993; Davis and Pett, 2000; Deakins et al., 2000; Gabrielsson and Huse, 2002 and 2005; Gabrielsson and Winlund, 2000; George et al., 2001; Grundei and Talaulicar, 2002; Huse, 1990, 1993, 1995, 1998, 2000; van den Heuvel et al., 2006). The service-related research findings are firmly rooted within a wide range of academic theories, amongst which are the resource-based, resource dependence, strategic leadership and social network theory.

Recently, Huse (2005a; 2005b) proposed that the board's control task and the board's service task can each be split in three subtasks. Within both the control task and the service task, the subtasks that have an internal focus are labelled behavioural control and advise/counsel. Tasks having an external focus are identified as output control and networking/lobbying/legitimating or communication. Strategic control and strategic participation are tasks with a strategic focus. According to Huse (2005a), being accountable for, or having a good performance on each of these board tasks will increase the board's value creating function. The goal of this article is empirically to test the specified relationship within the Dutch governance context. Moreover, the influence of several contingency factors will be briefly assessed and described, as several authors (Gabrielsson and Huse, 2005; Huse, 2000) have emphasized the importance of contingencies in analysing the findings of board behaviour studies.

The Dutch corporate governance system

Corporate governance practices are socially constructed (Aguilera and Jackson, 2003). Therefore, the functioning of a board of directors should be evaluated within the specific institutional environment in which it is operating (van Ees and Postma, 2004). The Dutch corporate governance regime is regulated in the Structure Act of 1971 (Book 2 of the Civil Code), and prescribes a structure regime for companies meeting specific criteria (Goodijk, 2005).[1] Companies meeting these criteria – mostly large companies, but also the larger SMEs – are obliged to adopt a two-tier board structure. In a two-tier structure, a supervisory board, composed of at least three independent supervisory directors, monitors and provides services to the executive board (Goodijk, 2005; Maassen and van den Bosch, 1999; van Ees and Postma, 2004). The Dutch corporate governance system differs from the governance system in some of the other countries of the European Union, as the members of the supervisory board are appointed by co-option and Dutch employees cannot become a member of the supervisory board of their company (Gerlauff and Den Boer, 1996).

For SMEs that do not meet the criteria as put forward by the Structure Act, the common governance regime is applicable. It allows the shareholders to opt for a one-tier board structure, in which the board is entirely composed of managing directors. Of the Dutch SMEs that do not meet the criteria, only a small group seems to install a supervisory board on a voluntary basis (van Gils, 2005). The need for independence of the owner-entrepreneur is the main argument to select a one-tier board structure.

Research methods

Data collection

The data collection for this study was part of a larger project on governance in small- and medium-sized enterprises – involving several countries in Europe – initiated by the 'Centre for Boards and Governance' at the Norwegian School of Management BI. The part of the questionnaire that was used in this study is based on a number of questionnaires that were used in several surveys conducted by the Norwegian School of Management in the past (Huse, 1994; Pearce and Zahra, 1991; Westphal, 1999). The sample of businesses for the data collection was drawn from the database of the Dutch Chamber of Commerce. The sample frame for the selection of companies was based on two criteria: 1) companies with 10–250 employees, and 2) industry code NACE[2] Section D; 16–36 (manufacturing industry). From this sample, 2000 SMEs were randomly selected. Questionnaires were sent out to the CEOs in winter 2004. We chose this approach because it is argued that CEOs (often the owner/manager) of small- and medium-sized enterprises are more influential and have a better understanding of their organization (Etzioni, 1961; Tagiuri and Davis, 1992). With 204 questionnaires returned the response rate was slightly over 10 per cent, which is comparable to other surveys of this type of firm.[3] On the basis of the European definition of small- and medium-sized businesses,[4] one case was eliminated from the database, leaving 203 observations in the sample to be analysed.

Measures

Board tasks

CEOs were asked to indicate their perception about actual board task performance, on a range of items covering the six sets of board tasks indicated in Huse's (2005a) article. These questions involve a range of board tasks, based on and derived from the studies of Pearce and Zahra (1991), Westphal (1999) and Huse (1994).

Perceived value creation

CEO's were asked to indicate the value creating effect of the board on a five-point Likert-type scale (not of any value for the company – extremely valuable for the company). In the creating accountability framework, Huse (2005a) refers to both internal and external value creation. In our study, the perception of the CEO – who in most cases is also the primary shareholder of the firm – is tested and thus, we mainly focus on the value that is created by the board from an internal perspective (e.g. not necessarily reflecting the perspective of stakeholders that are external to the firm).

Statistical methods

A regression analysis was performed to test the influence of actual board task performance on perceived value creation. As in the Dutch context both one-tier and two-tier board systems exist, we distinguished between the value creation effect of the executive board's task performance and the supervisory board's task performance. Two regressions were conducted, one for the group of firms having a one-tier structure and one for the SMEs having a two-tier structure. The measurements of the board tasks are identical to enhance comparability between the two types of boards.

Results

Board structure and composition

In 2004, the small- and medium-sized firms in our sample employed on average 50 people on a full-time basis. A large group of these firms are family businesses (60.4 per cent); 34.2 per cent of the respondents indicated to be a high-tech firm. Twenty-seven per cent of the SMEs opted for the two-tier board structure; all other firms solely installed an executive board. Descriptive statistics of the size of the companies in the sample as well as of the number of directors within the different structural board systems are included in Table 19.1.

Within the two-tier board structure, the executive boards are on average larger than the ones in the one-tier structure. However, the median score of both systems is the same. Further analysis of the results indicates that firms

Table 19.1 Descriptive statistics on the number of directors

	N	*Min.*	*Max.*	*Mean*	*St.D.*	*Median*
Employees 2004		10	191	50	39.6	35
One-tier board structure	148					
Executive board members		1	8	3.72	1.34	4
Two-tier board structure	55					
Executive board members		1	16	4.96	2.29	4
Supervisory board members		1	8	2.71	1.30	3

N = 203

having a two-tier board structure are significantly larger ($p<0.01$) than those opting for the one-tier structure. This may be caused by medium-sized firms needing a larger diversity of directors in order to deal with a more complex internal and/or external environment, or the availability of larger budgets with larger SMEs (compared to smaller firms) for boards of directors.

The number of directors in the Dutch supervisory boards is small; on average these boards consist of three members. Supervisory boards in Dutch SMEs mainly consist of external male directors with or without shares. The number of female directors is very limited. Also, affiliated directors and family directors only sporadically have a seat in the supervisory board.

Supervisory board members are predominantly directors or top managers from another company (87%), or persons with several directorships (18%). In order of importance, the supervisory board members mainly represent the management (56%), shareholders (42%) or family members (27%). The chairpersons in particular mainly represent one out of three important groups: management (20%), family members (16%) or shareholders (11%). In addition, several directors are independents.

Out of the 55 SMEs having a supervisory board, 12 firms installed their board because of the legal requirements of the structure regime. In comparison to the other supervisory board, they more often engage directors representing shareholders. The chairperson of these supervisory boards is more often an independent person.

Board tasks

In order to explore the different sets of board tasks performed within Dutch SMEs, a principal component analysis with promax rotation was executed on 24 board tasks measured in the questionnaire. Table 19.2 shows the six factors extracted, as well as the factor loadings of each of the board tasks. Moreover, the last column indicates the standardized Cronbach alphas of the six sets of board tasks measured; they all equal or exceed the critical value of 0.70 (Nunnally, 1967).

The results show that six sets of tasks of boards of directors in Dutch SMEs can be distinguished. Although these sets of board tasks are quite similar to Huse (2005a; 2005b; 2007), they diverge in some respects. Besides the output control and behavioural control, a new type of control – operational control – had to be distinguished on the basis of our sample. Operational control involves controlling the operational activities of the firm, such as human resources, technical, environmental and CSR issues. Thus, the operational control task closely resembles the qualitative and quantitative control tasks of the board (Huse, 2007). Furthermore, Huse (2007) states that operational control and behavioural control can be grouped together as internal control. In the Dutch sample, no distinction could be made between strategic control and strategic participation. Together with the advice and networking tasks, the strategy task comprises the service function of the board.

Table 19.2 Factor loadings and alpha values

Board tasks / *Factor loadings*	*1*	*2*	*3*	*4*	*5*	*6*	*Alphas* *Supv. B.*	*Alphas* *Exec. B.*
1 Operational control Our board is involved in following up and reassessing of:							.88	.88
– Quality of the products	**.84**	−.26	.30	.33	.28	.05		
– Human resources	**.83**	.01	.37	.34	.34	.20		
– Health, environment and safety	**.97**	−.16	.27	.35	.34	.07		
– Issues about the natural environment and pollution	**.93**	−.13	.26	.32	.32	.10		
– CSR activity of the firm	**.59**	.33	.34	.28	.57	.23		
– Technical issues	**.70**	−.18	.24	.32	.61	−.01		
2 Behavioural control The board is involved in following up and reassessing:							.77	.70
– The CEO's contribution and behaviour	.08	**.78**	.29	.23	.24	.13		
– Financial rewards	−.12	**.68**	.49	.10	.15	.38		
The board:								
– Supervises the CEO	−.13	**.80**	.27	.22	.18	.25		
– Sets management compensation	−.39	**.67**	.17	−.19	−.10	.26		
3 Output control The board is involved in following up and reassessing:							.86	.83
– Cost budgets	.25	.32	**.90**	.32	.37	.39		
– Sales budgets	.43	.12	**.83**	.33	.31	.16		
– Firm liquidity	.17	.46	**.76**	.24	.38	.51		
– Investments	.29	.45	**.66**	.27	.48	.38		
4 Strategy Our board:							.80	.85
– Actively initiates strategic proposals	.27	.22	.32	**.82**	.42	.34		
– Actively makes strategic decisions on the long term	.18	.24	.32	**.88**	.37	.23		
– Implements strategy decisions	.66	−.27	.27	**.78**	.28	.11		
– Is active in controlling and evaluating strategic decisions	.27	.28	.38	**.69**	.33	.19		

5 Advice and counsel							.78	.75
Our board contributes with advice on:								
– Management questions	.18	.35	.32	.31	**.75**	.46		
– Legal issues	.25	.09	.26	.28	**.73**	.44		
– Financial issues	.07	.42	.61	.26	**.69**	.40		
– Market issues	.50	–.15	.29	.42	**.73**	–.01		
6 Networking							.81	.78
Our board:								
– contributes to networking, that is provides contacts with important stakeholders	.21	.19	.43	.31	.45	**.81**		
– Contributes to lobbying and legitimizing, e.g. affecting important stakeholders	.28	.22	.38	.29	.38	**.83**		

N = 165
KMO Measure of sampling adequacy = .849
Total explained variance = 70.2 per cent

The measure up to which the supervisory boards and executive boards perform the different tasks was further analysed within the context of the different governance structures. Results are reported in Table 19.3.

Both supervisory boards and executive boards perform control and service tasks. However, statistically significant differences exist in the types of control and service they perform. Executive boards are significantly more involved in operational control, whereas supervisory boards are significantly more involved in behavioural control. Output control or monitoring the financial performance is performed to an equal extent by both types of boards. Assessing the performance of both types of boards on the service tasks shows that executive boards are significantly more involved in advice and counsel as well as strategy tasks compared to supervisory boards. The supervisory board in

Table 19.3 Differences between supervisory and executive boards' task performance

Board tasks	*Supervisory board*	*Executive board*[1]	*t-value*
Operational control	2.92	4.07	–8.99**
Behavioural control	3.71	2.91	5.15**
Output control	3.83	4.03	–1.36
Strategy	3.39	3.85	–3.27**
Advice and counsel	3.67	3.90	–1.97*
Networking	3.24	3.22	.121

** significance < 0.001, * significance <0.05
Likert scale; not important 1–5 very important

1 This column includes information on executive boards of firms operating without a supervisory board.

Dutch SMEs mainly provides services to the management team by advising them on specific issues. Important to notice in this context is also the limited extent to which both the executive boards as well as the supervisory boards are involved in the networking function.

Board value creation

Analysing the dependent variable, a t-test reveals that there is no significant difference ($p=0.113$) between the perceived value creation of the supervisory board ($M=3.65$) and the executive board ($M=3.89$). However, this does not imply that the way in which the two types of boards create value is similar. Therefore, we conducted a regression analysis in which we included the supervisory boards' and the executive boards' performance on the tasks that are defined in Table 19.4 as independent variables. Value creation is reflected through the perception of the CEOs and is the dependent variable. The results of the regression analysis in which we regressed the six board tasks on the value creation by the board for both supervisory boards (Superv.B.) and executive boards (Exec.B.) are indicated in Table 19.4.

With respect to the supervisory boards, the results indicate that the performance of the supervisory board on the advice and counsel task has a significant positive influence on the board value as perceived by the CEO. The perceived performance of the supervisory board on the other board tasks

Table 19.4 Regression results of the influence of board task performance on board value creation

Variables: board tasks	*Supv. B.*	*Exec. B.*
Operational control	–.04	.04
	(.11)	(.11)
Behavioural control	.14	.05
	(.12)	(.09)
Output control	.16	–.05
	(.11)	(.09)
Strategy	.00	.27*
	(.10)	(.09)
Advice and counsel	.55**	.36*
	(.10)	(.09)
Networking	.11	.02
	(.11)	(.09)
Model specifications:		
N=	50	101
R^2	.40	.29
R^2-adj.	.32	.24

Dependent variable: Board value creation (1–5 Likert-scale).
** significance < .001, * significance < .01

showed no significant relationships with value creation by the supervisory board.

In the case of executive boards, the results show significant positive relationships between the perceived performance by the executive board on the advice and counsel tasks as well as the strategy tasks. The results show that the perceived task performance of the executive board on the other tasks has no significant effects on the value creation by the executive board.

In the process of testing the model, we also incorporated the contingency perspective that is suggested by Huse (2000), Gabrielsson and Huse (2005), and Huse (2005a), among others. Given the fact that this study is conducted from a CEO's perspective on board value creation, we tested the interaction effects of several CEO-related and firm-level contingencies on the relationship between board task performance and board value creation (e.g. CEO tenure, CEO education level, firm growth, and innovation level). Of these variables, firm growth showed positive significant results as an interaction effect on the relation between a board's service and counsel task performance and the board's value creation. This would mean that the value creation of a board through advice and counsel activities is higher for firms that experience a higher growth rate. The other contingencies showed no significant results.

Discussion and conclusion

Our research objective was to examine the relationship between board task performance and perceived value creation. Due to the structural regime that is embedded in the Dutch corporate governance system, two types of boards exist; the supervisory board and the executive board (a two-tier structure). Therefore, we tested the model for the two types of boards separately. In order to achieve our objective, we included a wide range of board tasks to be able to deduct sets of distinguishable board tasks. Six sets of board tasks were found: 1) operational control, 2) behavioural control, 3) output control, 4) strategy, 5) advice and counsel, and 6) networking. These sets of board tasks greatly resemble the sets of board tasks presented by Huse (2005a; 2005b; 2007). First of all, the results of our analysis show that the differentiation between strategic control and strategic participation is not apparent and that these two sets of tasks are merged into one overall strategic task. Furthermore, in addition to the sets of tasks identified by Huse (2005a; 2005b), our results indicate that operational control can be considered as a separate set of tasks. This seems to be in agreement with the assumption that boards in SMEs are highly involved with operational (detailed) issues (Nash, 1988). The results indicate that there are significant differences between the performance of the supervisory board and the executive board on several of the sets of board tasks. This signifies that the two types of boards are not only legally and theoretically distinctive, but that their actual task performance differs in practice as well. With respect to the research objective, the results show that for some sets of tasks, the board's performance – on the advice and counsel tasks for the supervisory board, and the advice and counsel, and strategy tasks for executive boards – influences the extent to which CEOs perceive their board as one that is creating value. Next, we discuss the theoretical and practical implications of our findings, describe the study limitations, and suggest directions for future research.

Our results add knowledge to the part of the 'accountability framework' (Huse, 2005a p 67) that specifically poses a relationship between board task performance and the board's value creation. Our results do not only reinforce claims that the board's task performance influences the board's value, but also put forward specific board tasks for which this relationship holds. In addition, our study is conducted in a two-tier governance structure. Although this has presented the opportunity to study differences between supervisory boards and executive boards, it should be noted that the results may not generalize to other contexts in which a one-tier governance structure is adopted.

Another limitation is that the survey was addressed to CEOs of small- and medium-sized enterprises. Thus, the results must be interpreted taking into account that only the CEO's perspective on value creation is reflected. Assessing the value of the executive board might be easier, as the CEO is a member of it, while this is not the case for the supervisory board. Moreover, this aspect of the research design may explain why the control functions (i.e. operational control, output control, and behavioural control) do not show a significant influence on the board's value creation, neither for the supervisory board nor for the executive board. However, from an agency perspective, these tasks can be expected to be value creating for other persons or groups, such as shareholders (Fama and Jensen, 1983; Jensen and Meckling, 1976). This argument may also explain why the results do not confirm the value creation that supervisory boards are supposed to have; performing a control-related task.

A suggestion for future research can thus be derived directly from this limitation. Future research could take into account a broader perspective than only the CEO. This follows the line of reasoning of other authors who have studied organizations and boards of directors from a stakeholder perspective (e.g. Donaldson and Preston, 1995; Freeman and Reed, 1983; Hillman et al., 2001; Huse, 1993 and 1998). Different stakeholder groups are likely to have different stakes in an organization and therefore the value creating function may be different, also with respect to the board's performance of particular tasks. Furthermore, future research could extend the list of tasks included in the analysis. In the current study, only one set of tasks was included which examined the importance of the board's strategic control task. This could be a reason why, in the Dutch context, no differentiation could be made between the board's strategic participation and its strategic control task. Empirical studies examining different research contexts are needed to validate the current research findings. Finally, the effect of contingencies on the relationship between board task performance and board value creation can be scrutinized in more depth and more detail.

In conclusion, we find that – from a CEO's perspective – the supervisory board creates value through its performance on the advice and counsel task. For executive boards we find the same result and in addition, the executive board can create value through its performance on the strategy task. Furthermore, we conclude that the insignificant results with respect to the control tasks can be explained by the perspective that is adopted in this paper; the CEO's perspective. Consequentially, we suggest that further analysis, including a broader range of stakeholders along with their value creation functions, can be a fruitful area of research.

Notes

1 Having (1) their statutory chair in the Netherlands, (2) equity of minimum EUR 16 million, (3) a legally established Works Council and (4) 100 or more employees.
2 NACE is the European activity nomenclature NACE Rev.1 that was established in an EG-Regulation in order to facilitate the structuring of economical and social statistical information.
3 Comparing to the response rates for governance related questionnaires in SMEs in other countries: van den Berghe and Carchon (2002) reported a response rate of 12.5 per cent with a sample of larger Belgian firms (50–500 employees) and Corbetta and Montemerlo (1999) found a 'satisfactory response rate' (p. 363) of 6.5 per cent in a sample of smaller SMEs (<100 employees).
4 European definition of small- and medium-sized firm: (1) < 250 employees and (2) annual turnover <EUR 50 million and/or (3) balance sheet total < EUR 43 million.

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20 The board's control tasks in family firms

Theoretical perspectives and exploratory evidence

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Abstract

The purpose of this article is to examine the board's control tasks in a family firm context. We provide an overview of the theoretical perspectives concerning this topic, and present exploratory evidence. The empirical findings indicate that, contrary to traditional agency wisdom, family firm boards devote substantial attention to controlling the management team. Yet, the level of board control does not appear to be dependent upon the generational phase of the firm. We argue that those family firms that employ trust and control in a complementary manner will be most effective.

Keywords: Family firms, Agency problems, Boards of directors, Trust, Control, Belgium

Introduction

As indicated by Huse (2005), expectations regarding specific board tasks are dependent upon the attributes and perspectives of the actors who are involved in the firm. Because of the special relationships between the actors and the fact that they typically occupy multiple positions within the firm, family firms constitute a unique organizational setting in which to examine board tasks. Family firms can be defined as firms in which a family has sufficient involvement in ownership and management to determine the vision of that firm in a way that is consistent with family preferences (Chua, Chrisman and Sharma, 1999). These firms represent the predominant organizational form throughout the world and are large contributors to economic welfare (IFERA, 2003; Tagiuri and Davis, 1996). The purpose of this study is to advance our understanding of the board's control tasks in a family firm context. More specifically, we provide an overview of agency problems that are likely to arise in family firms, and present exploratory empirical evidence concerning the involvement of family firm boards in controlling the management team and how this involvement is influenced by the generational phase of the firm.

The importance of the board's control tasks is derived from agency theory which deals with the possible divergence of interests between principals and agents (Jensen and Meckling, 1976). Traditionally, researchers have assumed that family firms are largely exempt from agency problems and therefore do not need to invest in formal control mechanisms (Chrisman, Chua and Litzt, 2004). Firstly, family managers typically hold a substantial equity stake in the firm which should align their interests with those of the other owners (Fama and Jensen, 1983). Secondly, family members are assumed to care for one another and should therefore refrain from actions that might harm the interests of the owner-family (Becker, 1974). Lastly, the personal involvement of owner-managers in family firms should ensure that other managers (e.g. non-family managers) do not engage in opportunistic behaviour (Fama and Jensen, 1983).

Stewardship theory provides an alternative theoretical lens for examining the family firm governance system. Stewardship theorists contend that managers may act for the collective good of the firm, even at personal sacrifice, because they aspire to higher order needs such as recognition and self-actualization, or strongly identify with the firm (Davis, Schoorman and Donaldson, 1997). As a result, stewards can be trusted to act in the best interests of the firm. Trust represents an efficient form of governance and can be defined as 'the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party' (Mayer, Davis and Schoorman, 1995: 712). Family business scholars have argued that stewardship motives are especially prevalent in a family firm context where managers are emotionally linked to the firm and the owner-family (Corbetta and Salvato, 2004; Miller and Le Breton-Miller, 2006), and that strong levels of trust among relatives represent one of the main strengths of this organizational form (Habbershon and Williams, 1999; Tagiuri and Davis, 1996).

The above theoretical arguments seem to suggest that family firms experience little or no need for board control and that they can rely primarily on trust as a governance mechanism. Recent developments in agency theory, however, indicate that family firms are not exempt from agency problems and that board control may prove vital for the firm's long-term viability. The first development refers to the problem of honest incompetence (Hendry, 2002 and 2005). According to Chrisman et al. (2004), this agency problem can be expected to be particularly prevalent in family firms. The second development in agency theory deals with self-control problems and how these are exacerbated by parental altruism (Lubatkin et al., 2005; Schulze et al., 2001). This so-called dark side of parental altruism is unique to the family firm context, and is argued to make its governance theoretically distinct from that in non-family firms (Schulze et al., 2001). We will now provide an overview of these agency problems, and derive hypotheses concerning the significance of the board's control tasks in family firms and how it evolves over the generations.

Agency problems in family firms and board control

Honest incompetence

In order to model situations, standard agency theory has presumed that managers are fully competent utility maximizers. As stated by Hendry (2005), agency theorists have assumed that people make decisions that maximize their utility because 'if they were in any way incompetent, if they were for example apt to get confused or make mistakes that led to their taking decisions different from those that they rationally should, then their behaviour could not be predicted' (Hendry, 2005: S58). However, this assumption of fully rational or competent behaviour is not likely to be reasonable with regard to managerial decision-making which is often characterized by high levels of complexity and ambiguity (Schweiger, Sandberg and Ragan, 1986). Human beings as processors of information and problem-solvers have their limitations with regard to computational capability and the organization and utilization of memory (March, 1978; Simon, 1955). Therefore, when confronted with complex strategic issues, managers may judge situations incorrectly and take inappropriate actions (Hendry, 2002).

In his 'extension of agency theory', Hendry (2002) points to the need to incur agency costs that reduce the problems associated with limited managerial competence. Exposing managers to the scrutiny of the board, it is argued, contributes to more effective executive performance. By monitoring the activities and performance of managers and by asking challenging questions, directors can highlight apparent weaknesses in their decisions and enhance the effectiveness of their actions (Hendry, 2005; Roberts, McNulty and Stiles, 2005). This type of board control may be especially important in family firms, where selection and promotion criteria are often primarily based on family ties rather than competence (Chrisman et al., 2004; Lubatkin et al., 2005), incompetent family managers are less likely to be replaced (Gomez-Mejia, Nunez-Nickel and Gutierrez, 2001), and the management team is typically small and dominated by a single decision-maker (Feltham, Feltham and Barnett, 2005).

Self-control problems and parental altruism

A second reason why family firm boards may devote substantial attention to the control tasks concerns the potential self-control problems of owner-managers (Schulze et al., 2001). Self-control problems result from the fact that people have both economic and non-economic preferences (Lubatkin et al., 2005). These non-economic preferences can cause owner-managers – who enjoy almost unchallenged discretion over the use of their firm's assets – to take actions that are not in the best interests of the firm (Schulze, Lubatkin and Dino, 2002). An owner-manager may, for example, decide not to invest in a profitable venture when he or she feels that it might entail too much personal effort (Schulze et al., 2001). Due to its emphasis on economic rationality, the standard agency model has largely neglected self-control problems (Jensen, 1994). Seeing that exchange relationships are very likely to depart from purely economic motives in a family firm context (Gomez-Mejia et al., 2001), self-control problems are argued to be particularly prevalent in this organizational setting. More specifically, Schulze et al. (2001) have indicated that parental altruism represents a unique source of self-control problems.

As illustrated in the introduction, altruism and emotional bonds may have a beneficial influence on the behaviour of family agents (Becker, 1974; Corbetta and Salvato, 2004). Altruism may, however, also have a dark side. More specifically, parental altruism can cause owner-managers to take sub-optimal business decisions such as, for example, setting up separate departments or plants for their children, or to be excessively generous to their employed children even when these children lack the competence or intentions to contribute to firm performance (Chrisman et al., 2004; Schulze et al., 2001). Furthermore, Buchanan (1975) has argued that a positive relationship exists between a parent's level of altruism and their children's inclination to engage in shirking and free-riding. Because of the strong emotional ties, owner-managers are likely to be blind to this kind of opportunistic behaviour by their employed children or reluctant to discipline them (Nooteboom, 2002; Schulze et al., 2001).

As a result of these self-control problems, family firm stakeholders – including other members of the owner-family, lenders, and outside investors – have a strong incentive to enforce formal control mechanisms such as a controlling board of directors (Schulze et al., 2001). These stakeholders may demand board control in order to ensure that owner-managers do not avoid new ventures when it entails much effort, that altruistic tendencies do not motivate them to take actions that are detrimental to the long-term viability of the firm, and that family agents are evaluated in an objective manner (Lubatkin et al., 2005; Schulze et al., 2002). Furthermore, the owner-managers themselves are likely to be aware of their self-control problems and the detrimental consequences for firm performance and family welfare (Lubatkin et al., 2005). Therefore, in an attempt to compensate for these tendencies and in order to reassure the other stakeholders of the firm, they may take a positive stance towards board control.

This overview of recent developments in agency theory indicates that two types of agency problems, namely those related to honest incompetence and self-control issues, may be especially prevalent in a family firm context. Therefore, contrary to conventional agency wisdom, we hypothesize the following:

> Hypothesis 1: *In an attempt to limit the agency problems of honest incompetence and self-control, boards in family firms are significantly involved in controlling the behaviour and performance of the management team.*

Generational dynamics

Family firms are not a homogeneous organizational form, and one of the most important variables influencing their attributes is the generational phase of the firm. With the passing of the generations, an increasing number of extended relatives get involved in the ownership and management of the firm. Due to the fact that they have fewer opportunities for social interactions in the family system, the development of mutual trust in one another becomes more difficult and reliance on control as a governance mechanism can be expected to increase (Ensley and Pearson, 2005; Steier, 2001). In further generation firms, altruism tends to give family managers incentives to place their own nuclear household's welfare ahead of the welfare of the extended owner-family (Lubatkin et al., 2005). Family members in these firms are also more likely to have diverging strategic views and preferences compared to relatives in first generation firms (Ensley and Pearson, 2005; Schulze, Lubatkin and Dino, 2003). As a result, we expect that boards in further generation firms devote more attention to controlling the management team in order to ensure that the managers act in line with the interests and preferences of the members of the extended owner-family.

> Hypothesis 2: *Boards in further generation family firms devote more attention to the control tasks than boards in first generation family firms.*

Method

Sample

Our sample of firms is selected from the Belfirst database of Bureau Van Dijk, which contains all Belgian firms that have the legal obligation to deposit their financial statement at the National Bank of Belgium. We selected limited liability firms with an independent ownership structure and between 10–250 employees in the manufacturing industries (NACE-BEL codes 16–36). From this total sample of 5232 firms, chief executives of 2000 randomly selected firms were requested to fill in a questionnaire. The response rate equalled 7.5 per cent or 150 returned questionnaires.

From these firms, we selected family firms based on the criteria: (1) that at least 50 per cent of ownership and/or the management positions had to be concentrated within a single family, and (2) that the chief executive had to perceive the firm as a family firm (cf. Westhead and Cowling, 1998). This created a sample of 110 family firms of which only 94 could be included in our analyses due to incomplete responses. Following the argument that late respondents are expected to be similar to non-respondents (Kanuk and Berenson, 1975), we conducted several t-tests on the variables in the study to identify possible differences between early and late respondents. No significant results were found, indicating that the firms in the database are representative of the initial population.

Measures

In order to evaluate the level of control employed by the board of directors, chief executives were asked to indicate on a five-point Likert-type scale their board's performance on six control tasks (cf. appendix). All items loaded on a single factor (Cronbach's $\alpha = 0.88$), and the variable board control is the average of these six items. To determine the generational phase of the firm, the survey included a question in which the chief executives were asked to indicate the generation currently having the decision power in the firm. We recorded this variable in two categories, namely first generation firms versus further generation firms (cf. Westhead, Howorth and Cowling, 2002).

Statistical analyses

Given the rather limited number of respondents, we employed the most straightforward statistical analyses. To determine whether or not family firm boards are significantly involved in controlling the management team, we evaluated the mean value of the board's control level and its confidence interval. We employed a t-test in order to examine whether or not boards in further generation firms devote more attention to the control tasks than their first generation counterparts.

Results

Table 20.1 gives an overview of the ownership and management structure of the family firms in our sample. On average 86.2 per cent of the shares are owned by the family, and 2.1 of the 3.6 management positions are occupied by members of the family. Furthermore, on average over 20 per cent of the shares are in the hands of individuals who are not part of the management team. T-tests indicate that the ownership and management structure remains largely the same regardless of the generational phase.

With regard to hypothesis 1, we find that the mean value of the variable board control is 3.91 (median value is 4.1), and the 95 per cent confidence interval of this mean is [3.72; 4.10]. Given the fact that this variable has a minimum value of 1 and a maximum of 5, this finding indicates that family firm boards are significantly involved in controlling the management team. We thus find support for hypothesis 1. In order to test whether the level of board control is higher in further generation firms compared to first generation firms, we performed a t-test. The results in Table 20.2 indicate that the level of board control is slightly higher in further generation firms, but that the difference is not statistically significant. Therefore, we do not find support for hypothesis 2.

Table 20.1 Sample characteristics: ownership and management

Ownership (%)	*mean*	*std. dev.*	*1st gen.*	*further gen.*	*t-value*
Family-ownership	86.2	27.7	85.8	86.4	–0.1
Management					
CEO	55.4	36.1	59.6	53.1	0.9
Family managers (not CEO)	23.6	32.2	16.8	27.4	–1.7*
Non-family managers (not CEO)	0.5	4.0	1.1	0.1	0.9
Non-management					
Passive family owners	9.2	20.6	9.8	8.9	0.2
Investment companies	1.3	9.0	0.3	1.9	–0.9
Venture capitalists/Business angels	0	0.1	0	0	–0.7
Others	12.1	26.4	13.8	11.1	0.5
Management (#)	*mean*	*std. dev.*	*1st gen.*	*further gen.*	*t-value*
Family managers	2.1	1.3	2.1	2.2	–0.5
Non-family managers	1.5	1.8	1.8	1.4	1.0

* significant at 10 per cent level.

Table 20.2 T-test: generational phase and board control

	mean		*t-value*	*df*	*sig. (2-tailed)*
Board control	first generation (n = 34) 3.78	further generation (n = 60) 3.98	−1.008	92	0.316

Discussion

The purpose of this article was to give an overview of agency problems in family firms and to gain a better understanding of the board's control tasks in these firms. Researchers have long assumed that family firms are largely exempt from agency problems, and therefore do not need to incur the costs of formal control mechanisms (Chrisman et al., 2004). Based on recent developments in agency theory, we have indicated that this assumption is false and that family firm boards devote substantial attention to the control tasks. Our explorative empirical findings do not support, however, the claim that the level of board control increases over the generations. This finding may partly be due to the small sample size which increases the danger of type II errors, but the difference between the generations is relatively small in size. Future research should examine whether further generation family firms do not require a higher level of board control than first generation firms, or whether there exists a governance gap in these firms (cf. Huse, 2005; Steier, 2001).

We have suggested that board control is important in a family firm context. Family firms are not exempt from agency problems, and formal control mechanisms may increase financial performance (Schulze et al., 2001). This does not mean, however, that trust as a governance mechanism is not important in family firms. On the contrary, we support the view that stewardship motives may be especially prevalent in these firms (Habbershon and Williams, 1999; Miller and Le Breton-Miller, 2006), and that they may have a net agency advantage over non-family firms (Chrisman et al., 2004). In line with Huse (1993) and Steier (2001, 2003), we argue that hybrid forms of governance which combine trust and control in a complementary manner will be most effective. This means that trust should be well placed; that is, boards should evaluate with regard to which issues and in which circumstances family managers are trustworthy (Roberts et al., 2005). For those issues, the managers should be free to act with full discretion. Yet, for those issues where a family manager's trustworthiness is perceived to be low, board control is in order (Nooteboom, 2002).

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Appendix: Measure of board control

Respondents were asked to evaluate on a five-point Likert-type scale the board's performance on the following six control tasks. The variable board control is the average of these six items.

(1) Our board supervises the chief executive
(2) Our board ensures that activities are properly controlled
(3) Our board keeps itself informed about the financial position of the firm
(4) Our board is involved in following up and reassessing investments
(5) Our board is active in controlling and evaluating strategic decisions
(6) Our board is involved in following up and reassessing the chief executive's contribution and behaviour

21 Board activity in large Italian companies

A behavioural perspective

Alessandro Minichilli, Alessandro Zattoni and Fabio Zona

Abstract

In this article we present behavioural antecedents of board activity. We define board activity as the involvement of the board in various tasks such as control, advice, network and strategy. We adopt a behavioural perspective and hypothesize that three board attributes, i.e., board diversity, the commitment of the board members, and cognitive conflict among the board members, positively impact on the level of board activity. Our model was tested on a sample of 301 large manufacturing Italian corporations. The results support that commitment and diversity positively impact on the level of board activity; on the other hand, we did not find in the overall analysis that cognitive conflict significantly influenced board activity. However, further investigation showed that cognitive conflict may exert significant influence on some of the specific tasks of the board. Our findings suggest that behavioural attributes may shed light on what determines board activities; moreover, they suggest that future study should pay more attention to the specific tasks of the board.

Keywords: Board task involvement, Diversity, Commitment, Cognitive conflict

Introduction

Recent reviews of governance studies argue that research on boards of directors suffered from some recurrent 'fortresses' (Daily, Dalton and Cannella, 2003). Most of the existing board research consistently explored the existence of some relationships between the board demography and firm financial outcomes, through a wide reliance on archival data as proxies of board behaviour and processes.

In this respect, increasing calls are emerging to explore board processes and behaviour often than its composition and structure (Forbes and Milliken, 1999; Huse, 2005; Pettigrew, 1992; Pye and Pettigrew, 2005). The primary purpose is to explore the 'black box' of boards and directly investigate board members' attributes and behaviours, and to overcome the tendency to consider only the so-called 'usual suspects' in board research (Finkelstein and

Mooney, 2003). This does not imply that demographic variables are meaningless, but rather that looking directly into board members' attitudes and behaviours might improve our understanding of boardroom dynamics and decision-making processes.

Based on these premises, the article aims to contribute to the exploration of board activity in the context of large Italian companies. Thus, it aims to strengthen research in board behaviour approach (Huse, 2005 and 2007) using empirical evidence from large Italian companies.

Behavioural antecedents of board activity

Board activity

In the literature on boards of directors several theoretical perspectives have contributed to identify the different tasks the board is expected to accomplish (Stiles and Taylor, 2001; Zahra and Pearce, 1989). Literature on boards of directors has traditionally considered agency, stewardship and resource dependence theories as the most useful perspectives to support the main tasks the board is supposed to perform. Although a widely accepted taxonomy of board tasks is still missing, board research usually refers to control tasks, advisory tasks, strategic participation tasks and networking tasks (Johnson et al., 1996; Stiles and Taylor, 2001; Zahra and Pearce, 1989).

The control tasks refer to classical arguments from agency theory (Fama, 1980; Jensen and Meckling, 1976). In this perspective, boards of directors have a primary responsibility to safeguard shareholders' interests from management misappropriation (Shleifer and Vishny, 1997). Therefore, in an agency framework the board of directors should be a group of independent people who have the duty actively to monitor top management behaviour and decisions in order to assure the maximization of shareholders' value (Fama and Jensen, 1983).

Stewardship theory supports the advice and strategic participation tasks of corporate boards. This perspective relies on a more positive view of human behaviour than what is assumed in agency theory, and it argues that managers are not inclined to opportunism, and rather they sincerely want to pursue shareholders' interests and what is best for the firm (Davis, Shoorman and Donaldson, 1997). In this view, boards of directors are groups of competent people that help managers to take good decisions, e.g. contributing to the boardroom debate through their experiences, competences, and different viewpoints. In other words, board members perform important advisory tasks for the firm's top managers (Donaldson and Davis, 1991). The strategic participation tasks are close to the advisory tasks. Strategic participation includes the board's involvement in the different phases of the strategic decision process (i.e. initiating, formulating, evaluating, and controlling). Board members can influence strategy making by following two basic approaches: 1) setting the strategic context of the firm (i.e. setting the vision and the mission of the organization) or 2) playing the role of gatekeepers (Stiles and Taylor, 2001). With respect to this, the board contribution to the strategic decision process is considered to be an important factor leading the firm to acquire and retain a competitive advantage in the industry (Andrews, 1980).

Resource dependence theory focuses on the relationship between the firm and its external stakeholders (Pfeffer and Salancik, 1978). In this perspective, board members should be well-known and powerful professionals that utilize their personal networks in order to increase the legitimacy, the reputation and the stock of resources owned by the firm (Pfeffer, 1972; Pfeffer and Salancik, 1978). These requirements emphasize the importance for boards to perform networking tasks, and enhance external legitimacy.

The four sets of tasks we considered are among the most important outcomes that boards are expected to provide to their stakeholders. We define board activity as the way the board contributes to a firm's value creation through the fulfilment of the different tasks it is expected to perform. Thus, the board activity concept captures the overall board task involvement in control, advice, strategic participation and networking.

Board attributes and behaviour

The board members' behaviour and contribution to the board's activity can be influenced by several variables. We followed the arguments developed by Forbes and Milliken (1999), Huse (2005) and Milliken and Martins (1996), and identified three potential predictors of the level of board activity. They are the board members' diversity, the commitment of board members, and the cognitive conflict inside the boardroom (e.g. Carter, Simkins and Simpson, 2003; Forbes and Milliken, 1999).

The concept of diversity has its roots in the organizational field, and has been widely investigated as a potential predictor of team performance. Several arguments support this hypothesis. First, diversity promotes a better understanding of the marketplace, stimulates more effective problem-solving, increases creativity and innovation, strengthens the corporate leadership, and promotes more effective global relationships (Robinson and Dechant, 1997). Second, when a decision-making team diverges significantly, team members are compelled to evaluate more alternatives for decisions and to compare different viewpoints. Some studies, however, raised doubts about the beneficial effects of diversity inside decision-making groups, and described diversity inside a team as a 'double-edged sword' (Milliken and Martins, 1996; Williams and O'Reilly, 1998). On the one hand, teams with a higher level of diversity can produce a wider range of alternatives but, on the other hand, more homogeneous teams are able to reach a final decision faster and have a greater ability to reach a consensus about the decision (Hambrick, Cho and Chen, 1996).

The study of boards as decision-making teams emphasizes the positive effects of board diversity on its activity. Internal board members are a stable and homogeneous group of people that strongly influence many of the board activities. From this perspective, an increase in board diversity through the nomination of board members with different backgrounds can help the board to consider a broader range of points of view and to refine the proposals advanced by top managers. The likely consequence will be to make richer and more thorough decisions, and enjoy greater team involvement (Carter et al., 2003). Therefore, we hypothesized the following:

Hypothesis 1: *Board members' diversity has a positive impact on the level of board activity*.

The commitment of the board of directors is another attribute that is expected to influence board activity. Board commitment refers both to the board members' preparation before meetings and their critical attitude during meetings (Huse, 2007). The board members' preparation before meetings refers to their willingness and ability to participate in board meetings with a deep knowledge of the topics discussed. The board members' preparation is related to the quality of the information they receive, the time they devote to scrutinize that information, the efforts they make to collect further information beyond that provided by managers and, ultimately, the competences they own (Forbes and Milliken, 1999). The critical attitude of board members during meetings refers to the effort they devote during discussions, to the will to raise critical questions on the proposals advanced by managers, and thus to the effective use of their knowledge and skills (Judge and Zeithaml, 1992; Pearce and Zahra, 1991). The similarity and the empirical correlation between the two concepts led management scholars to use them as a single board attribute (Huse, 2005). Following the previous arguments, we hypothesized that:

Hypothesis 2: *Board commitment has a positive impact on the level of board activity.*

Whereas board commitment refers to the board members' preparation and critical attitude towards the tasks they are expected to perform, cognitive conflict refers to disagreements among board members on the content of the activity, including the differences due to different points of view, ideas and personal opinions (Forbes and Milliken, 1999). The presence of cognitive conflict inside the boardroom can increase the quality of the debate, leading board members to consider a broader range of alternatives and to take better final decisions (Forbes and Milliken, 1999). Cognitive conflict can also improve strategic decision-making because it facilitates the exchange of information among board members (Amason and Sapienza, 1997). Group members disagree because their different perspectives force them to consider different scenarios, and these differences can enhance the decision quality. Despite some increasing concerns about the potential negative impact cognitive conflict might have on group effectiveness (e.g. De Dreu and Weingart, 2003), several empirical studies have supported the previous arguments on the positive effects it has on group effectiveness. Among them, for instance, Schweiger et al. (1986) found that interaction techniques that force group members to disagree and debate the merits of different alternatives produce superior decisions. Based on the previous arguments, we thus hypothesized:

> Hypothesis 3: *Board cognitive conflict has a positive impact on the level of board activity.*

The arguments above define the model used in this article. The model is presented in Figure 21.1. We test the relationship between the board attributes we identified, i.e. board diversity, commitment and cognitive conflicts, and the level of board activity defined as the sum of control tasks, advisory tasks, strategic participation tasks and networking tasks.

Methods

Sample and collection of data

The analysis we present in this article is based on a questionnaire survey of the 2000 largest Italian industrial firms ranked by turnover. The list of the firms considered for the mailing was drawn up using public sources, such as AIDA (Italian Digital Database of Companies) and Mediobanca. A questionnaire survey was sent to the CEOs of all these companies. We received 301 responses, with an overall response rate around 15 per cent. Data related to dependent, independent and control variables have been collected through the survey. Both dependent and independent variables have been built using multiple items measured on a five-point Likert-type scale.

We collected archival data on all the firms included in the original list to check for non-respondent bias. We collected data through AIDA and Datastream, two databases that include information about the firms and their financial performance. We used the Kolmogorov-Smirnov test (Siegel and Castellan, 1981) to understand if there were significant differences between respondent and non-respondent regarding variables such as size, performance,

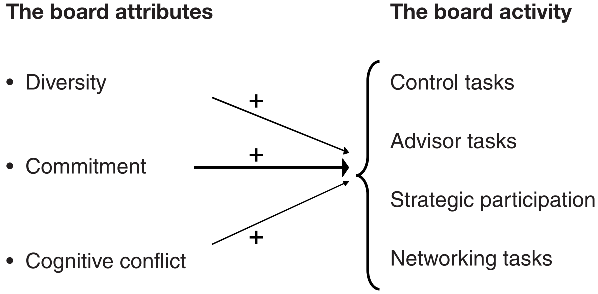

Figure 21.1 The relationship between board attributes and board activity.

and industry. The results showed no significant differences between the two groups of firms.

Dependent variable

The dependent variable has been measured as a mean of items related to the four different sets of board tasks reviewed. We considered the averaged measure as the most suitable measure for board activity, even though giving equal weight to each set of board tasks might represent a limitation. Nevertheless, given the impossibility to weight the relevance of each set of board tasks within the sample of boards we considered for the analyses, the measure of board activity can be considered an acceptable proxy of boards' involvement in their tasks. The advisory tasks were measured using five items. In particular, we asked the CEOs to assess the degree to which the board provides advice to managers on: (i) management issues (e.g. organizational structure or company strategy), (ii) financial issues (e.g. leverage, relationships with banks and other financial institutions), (iii) technical issues (e.g. new technologies or new products), (iv) market issues (e.g. entry in new industries or consumer behaviour), and (v) legal issues and taxation. The Cronbach alpha for this variable was .82.

The control tasks were measured using five items. We asked the CEOs to assess the extent to which the board: i) controls that the activities are well organized; ii) develops plans and budgets; iii) defines guidelines for divisional managers; iv) is informed about the financial position of the company, and v) verifies that the activities are done according to the plans (alpha .81).

The strategic participation tasks were measured through three items. These items aimed to estimate the degree to which the board is active in: (i) promoting strategic initiatives, (ii) taking strategic decisions, and (iii) participating in the implementation phase of long-term strategic decision-making (alpha .83).

The networking tasks were measured using two items. The first measures the board contribution in terms of contacts with important stakeholders (e.g. financial institutions, customers, authorities, etc.). The second captures the degree to which the board contributes to the company external legitimacy exerting an influence on the main stakeholders (alpha .82).

Each of the previous variables was calculated as a mean of the items we considered. To this purpose, we performed a factor analysis that showed how, for each of the variables, the single items tended to converge around a common factor extracted through the method of principal components. The same procedure has been applied to build our main dependent variable, i.e. the board activity, calculated as a mean among the values of the four variables measuring the board task performance with respect to the four tasks we considered.

Independent variables

Independent variables have been built and measured through items built using a five-point Likert-type scale. The independent variables included in the study are board diversity, commitment, and cognitive conflict.

Board *diversity* was measured by asking the CEOs to assess the board members with respect to five dimensions: i) functional background (e.g. finance, accounting, etc.), ii) experiences in other industries (e.g. chemical, mechanical, etc.), iii) educational backgrounds (engineering, management, law, etc.), iv) age, and v) personalities (e.g. leadership styles, decision-making styles, etc.). The Cronbach alpha for this variable was .70.

Board *commitment* was measured using seven items, including both the preparation and involvement concepts. The preparation has been measured by asking the CEOs the degree to which: (i) board members examine information before the meetings, and (ii) actively collect further information in addition to that supplied by managers. Involvement has been measured quantifying the extent to which board members: (iii) devote all the time needed to accomplish their tasks, (iv) are available to fulfil board activities, (v) effectively use their knowledge, (vi) make useful questions to proposals advanced by managers, and (vii) raise critical points during meetings (alpha .76).

Cognitive conflicts were measured as a mean of six items, asking the CEOs to evaluate the extent to which conflicts and disagreements emerged on: (i) the decisions to be taken during the board meetings, (ii) the firm's legitimate stakeholders, (iii) the firm's general purpose, (iv) the board working style, and (v) the decision processes. We also considered (vi) the personal disagreements among board members, and thus the level of personal conflicts inside the boardroom (alpha .91).

Control variables

As control variables we considered: a) firm level measures, such as size, industry, and listing, and b) board demographic variables, such as the number of board members, percentage of non-executive board members and CEO duality (Finkelstein and Mooney, 2003). We controlled also for the number of board committees.

Results

Table 21.1 shows the means, the standard deviations, and the bivariate correlations for the variables used in the regression analyses.

Hierarchical linear regression analyses were used. The regression analyses were performed considering three different models, with the level board activity as the dependent variable. The first model included control variables, i.e. firm's size, industry regulation, and listing. The second model also considered the board composition and structure, i.e. CEO duality, number of board

Table 21.1 Correlation analysis among the variables

	Mean	*St. Dev.*	*Size*	*Regulat.*	*Listing*	*Ceo dual*	# direct.	*% indep.*	*Commit.*	*Diversity*	*Involv.*	*Conflict*	*Board activity*
Size	6.32	1.57	–	–	–	–	–	–	–	–	–	–	–
Regulation	3.01	1.57	.07	–	–	–	–	–	–	–	–	–	–
Listing	.25	.43	.10	.03	–	–	–	–	–	–	–	–	–
CEO duality	.29	.45	–.01	–.03	.07	–	–	–	–	–	–	–	–
# board members	7.31	4.10	.21**	.11	.32**	.05	–	–	–	–	–	–	–
% non-executives	.21	.26	.13*	.10	.32**	–.07	.29**	–	–	–	–	–	–
Committee	.28	.41	.14*	.06	.55**	.06	.27**	.23**	–	–	–	–	–
Diversity	3.40	.83	.23**	.12	.29**	–.11	.08	.08	.29**	–	–	–	–
Commitment	3.39	.67	–.02	.15*	.20**	–.07	–.12	–.06	.11	.37**	–	–	–
Conflict	1.74	.74	–.04	.05	–.05	–.05	.01	–.02	–.01	–.09	–.01	–	–
Board activity	3.12	.74	.01	.16*	.17**	.00	–.07	–.05	.05	.31**	.63**	.01	–

Pearson correlation coefficient, 1-tailed: *< 0.05; **< 0.01 N=301 members, percentage of non-executives, and the number of committees. The F-change was not significant in any of these models. This suggested that these variables have a limited ability to explain variation in the dependent variable. In the last step we included the three main predictors of this study, i.e. diversity, commitment and cognitive conflict. The model was robust, with an adjusted R^2 equal to .42, and an F-change value equal to 43.46**. Table 21.2 shows the standardized partial coefficients (beta coefficients) of the regression analyses.

The table shows that both board members' diversity (.13*) and commitment (.59*) have a positive impact on board activity, while cognitive conflict is not significant. Hypotheses 1 and 2 are supported, while hypothesis 3 is not. Moreover, the third model also showed a weak negative relationship between firm size and board activity. This evidence can be explained by the tendency for larger companies having to rubber-stamp managerial decisions (Mizruchi, 1983), thus limiting the overall board activity.

To deepen the results of our analyses, we performed regression analyses considering each of the four sets of board tasks. Table 21.3 shows the results of these analyses.

Only the full models are reported in the table. A comparison among the different sets of tasks shows interesting results. First of all, commitment had a strong impact on board involvement in all four sets of tasks. The beta coefficients are .50** for the advisory tasks, .44** for the control tasks, .56** for the strategic participation tasks, and .31* for the networking tasks. Diversity was significant only for control (.14*), and partly for the advisory tasks (.11†). Finally, cognitive conflict had some significant impact only on the networking tasks (.12†).

Table 21.2 The results of the regression analyses. Dependent variable: board activity

	I	*II*	*III*
Firm size	−.92	−.52	−.11†
Industry regulation	.10	.13	.05
Listing	.18*	.32**	.10
CEO duality		−.01	.07
# board members		−.12	.03
% non-executives		−.11	−.05
# committees		−.09	−.10
Diversity			.13*
Commitment			.59**
Cognitive conflict			.05
AdjR^2	.03	.04	.42
F	3.28*	2.39*	15.78**
F change	3.28*	1.70	43.46**

The table shows standardized coefficients (β), the value of the adjusted R^2, the value and the significance of F statistic and F-change. The levels of significance are: *< 0.05; **< 0.01; † 10%, N=301

Table 21.3 A comparative analysis of the four board tasks

	Advisory	*Control*	*Strategic participation*	*Networking*
Firm size	–.08	–.14*	–.10†	–.01
Industry regulation	.02	.03	.06	.06
Listing	.08	.18†	–.01	.15
CEO duality	.11†	.02	.11†	.01
# board members	–.09	.06	–.01	.10
% of non-executives	.01	–.07	–.03	–.01
# committees	–.11	–.07	–.04	–.17†
Diversity	.11†	.14*	.06	.08
Commitment	.50**	.44**	.56**	.31**
Cognitive conflict	.08	–.04	.02	.12†
AdjR^2	.31	.28	.32	.12
F	10.38**	9.13**	10.95**	4.02**

The table shows standardized coefficients (β), the value of the adjusted R^2, the value and the significance of F statistic and F-change. The levels of significance are: *< 0.05; **< 0.01; † 10%, N=301

The results show also that CEO duality had a positive impact both on the advisory and the strategic participation tasks, while listing positively influenced the control tasks. Firm size had generally a negative impact on the various sets of board tasks. In particular, the relationship was significant with respect to the control tasks (–.14*) and the strategic participation tasks (–.10†).

Discussion and conclusions

This study contributes to the development of behavioural perspectives on boards of directors. Our purpose was to test the predictive influence of some board attributes presented in the past literature on board activity and task performance. The article has two main contributions. First, previous research has focused mostly on board demographic variables. These studies have provided inconsistent results. The inconsistence in earlier studies about systematic and significant relationships between board independence and firm financial performance have forced management scholars to suggest alternative directions of research (Daily et al. 2003; Dalton et al., 1998). In this empirical examination we thus decided to move beyond the 'usual suspects' (Finkelstein and Mooney, 2003) and to consider other outcome variables than corporate financial performance. The second contribution relates to the first, and consists of the testing of hypotheses about the assumed impact of board attributes from the behavioural literature on board activity and involvement in different sets of tasks. Our analyses showed that commitment is a key variable for board activity. Commitment was defined as the time and preparation devoted by board members before meetings, and as the involvement in board discussion with critical questions and observations. This corresponds to various qualitative and anecdotal studies (e.g. Huse, Minichilli and Schøning, 2005). It suggests that boards of directors should carefully consider the importance of creating a process-oriented boardroom culture which favours board members' preparation and efforts in board activity (e.g. Forbes and Milliken, 1999). Evidence from our analyses supported the idea that the 'usual suspects' of board research hardly explain board activity, and that the creation of an internal culture encouraging active behaviour of board members is an essential ingredient for board effectiveness (e.g. Finkelstein and Mooney, 2003; Lorsch and MacIver, 1989; Mace, 1986; Stiles and Taylor, 2001).

The empirical evidence also suggested that diversity has some positive influence on board activity. This result supported our theoretical prediction according to which board members' diversity enhances team performance since it promotes a better understanding of the marketplace, stimulates more effective problem-solving and increases creativity within a group of decision-makers (Robinson and Dechant, 1997). On the other hand, cognitive conflict showed no relationship with our overall measure of board activity, and tenuous relationships with the different tasks we included in our further analyses. This result is somehow unexpected, because previous literature suggests the existence of a relationship between cognitive conflict and board task performance, even though it also indicated that this relationship can be complex and ambiguous (e.g. Forbes and Milliken, 1999). The previous result can be determined by the measure we used for cognitive conflict, which also contains elements of affective conflict. Since affective conflict is generally supposed to be negative, our results can be influenced by this circumstance.

The additional analyses of different board tasks then gave further insights about the predictive power of the board attributes we considered on various sets of board tasks. Specifically, while commitment positively predicted all four of the board task involvement measures, diversity and cognitive conflict found only mixed support. Diversity, for instance, had an impact on advisory and control tasks only. This evidence suggests that strategic participation is likely to be stronger in more homogeneous boards, since the strategic participation process requires common background, knowledge and skills. In this circumstance, diversity seems to favour deadlocks, as board members will more likely reduce their efforts when the board is facing issues about which they do not have strong expertise. It follows results in previous studies, which similarly found that diversity might be a constraint to strategic change (Goodstein, Gautam and Boeker, 1994). With respect to the positive impact diversity had on control, it can be argued that more homogeneous groups of people facilitate collusive behaviours, and consequently hurt control. Conversely, an increase in diversity, especially through the nomination of outside board members with different backgrounds, increases board independence as people with a different background or expertise are likely to ask questions that would not come from more homogeneous boards (Erhardt et al., 2003).

Cognitive conflict, then, had a positive impact on networking tasks only. It represents a somehow unexpected result, since we would rather have expected diversity to be relevant for external lobbying. It follows what we anticipated above about the complexity and ambiguity of the relationship between cognitive conflict inside groups and group task performance (Forbes and Milliken, 1999). Moreover, since diversity has a potential to produce a higher level of cognitive conflict, when studying them at the same level a particular caution in the interpretation of results should be used.

Moreover, our analyses showed that the so-called 'usual suspects' have a limited predictive power in understanding how the board performs various service and control tasks (Finkelstein and Mooney, 2003). Among the few significant relationships we recorded, CEO duality revealed a positive impact on advisory tasks and strategic participation of boards. The benefits of clear leadership and unity of command are among the possible explanations of this evidence. Listing positively influenced the control tasks, as a consequence of the widespread diffusion of codes of best practice and the increasing attention of stock exchange authorities on governance matters (Aguilera and Cuervo-Cazurra, 2004).

Besides these evidences, our contribution supports the argument to move beyond board demography, and might suggest practical implications also. Regulation on boards, such as codes of best practice or listing requirements developed at country level, should not only consider variables related to board composition and structure, but should also include other board attributes. From this point of view, a behavioural perspective on boards can usefully complement the traditional demographic approach in the development of board working style culture (Huse et al., 2005). Moreover, our results suggest that future study may deepen the analysis to consider the specific tasks of the board, so as to gain further insights into which board attributes actually enhance the board's performance of its different tasks.

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22 Women directors, board working style and board task performance

Sabina Nielsen

Abstract

The effects of the board working style on the relationship between women directors and board task performance are investigated. Based on a survey of 249 Norwegian firms with between 50 and 5000 employees, we explore the proposition that women directors have influence on board dynamics and effectiveness. Our results suggest that women directors have differential impacts on three main board tasks: service, financial control and qualitative control. These effects will be influenced by mediating and moderating effects of board working style variables such as trust, maintenance activities and length of board meetings.

Keywords: Women directors, Board processes, Length of board meetings, Board maintenance, Board task performance

Introduction

In recent years, there has been increasing pressure from both society and investors to appoint women directors on corporate boards. As a result, the number of women in top management and board positions has increased significantly over the last decade (Burke and Mattis, 2005; Daily, Certo and Dalton, 1999). At the same time, management scholars argue the business case for diversity (Bilimoria and Huse 1997, Daily and Dalton, 2003; Robinson and Dechant, 1997). However, no empirical evidence exists to prove whether boards including women are better in performing their tasks than boards composed entirely with male directors. In addition, only a few empirical works investigate whether, and if yes, how boards with female directors differ from boards composed entirely of male directors (e.g. Pearce and Zahra, 1991).

The few existing studies that investigate performance effects of women directors test for a direct relationship between the number of women on boards and corporate performance (Carter, Simkins and Simpson, 2003; Erhart, Werbel and Shrader, 2003; Fields and Keys 2003; van der Walt et al., 2006). Yet, over the last few years the research on board of directors has advanced beyond testing for direct relationships between board composition and firm performance (Finkelstein and Mooney, 2003; Forbes and Milliken, 1999; Huse, 2005; Letendre, 2004; Pettigrew, 1992). In this article we attempt to address the existing gap in board research and answer the question of how women directors influence board processes, working styles and decisions. Our objective is to shed some light on the crucial question of whether and how women make a difference to the performance of corporate boards.

Women in boards of directors: Hypotheses

Existing research on women directors

Most research on women directors is of a descriptive nature and focuses primarily on counting the number of women on corporate boards and following the development of women representation on boards over the years (e.g. Brancatto and Patterson, 1999; Burke and Mattis, 2000; Conyon and Malin, 1997; Daily, Certo and Dalton, 1999). More analytically oriented studies are primarily concerned with the questions of why are there so few women on corporate boards (Burke, 1997a and 1997b; Singh and Vinnicombe, 2004), what are the predictors (both organizational and outside forces) for women representation on boards (Burke, 2000), is discrimination taking place and what possible intervention strategies are there at firm and national level (Arfken, Bellar and Helms, 2004; Bernardi, Bean and Weippert 2005). Other studies, primarily qualitative in nature, focus on women directors' experiences and perceptions of their role as board members (e.g. Burke and Mattis, 2000; Bilimoria and Huse, 1997; Huse and Solberg, 2006). Few quantitative studies have explored in detail the characteristics of women directors compared to their male counterparts (e.g. Hillman, Cannella and Harris, 2002; Ruigrok, Peck and Tacheva, 2007). Yet, the contribution that women make in the boardroom and their influence on board decisions and processes remains under-researched. Studies investigating the direct effects of women directors on financial performance (Carter, Simkins and Simpson, 2003; Fields and Keys 2003) find some weak evidence for a positive relationship. After more than ten years of process research in the context of corporate boards, it can be without any doubt concluded that processes intervene in the relationship between board composition and firm outcomes and performance. Furthermore, processes influence board task performance and thereby have an indirect impact on corporate performance (Forbes and Milliken, 1999). Hence, an in-depth investigation of intervening board working style is necessary to deepen the current understanding about the relationship between women on boards and board effectiveness.

Conceptual model

The progress of board research has been marked by shifts in the underlying theoretical perspectives. Early board research based on the resource-dependence perspective (Pfeffer and Salancik, 1978) emphasized the institutional role of boards in linking firms to their external environments. Later, agency theory (Fama and Jensen, 1983; Jensen and Meckling, 1976) became the primary theoretical lens for studying boards and the emphasis shifted towards their control/monitoring role. A number of extensive reviews of board theories (Gabrielsson and Huse, 2004; Johnson, Daily and Dalton, 1996; Zahra and Pearce, 1989) and fine-grained discussion on board roles exist in the literature (Hung, 1998; Huse, 2005). This article further draws on the distinction between financial and qualitative control tasks, previously introduced and tested empirically (Baysinger and Hoskinsson, 1990).

Based on the insights from board theories, a conceptual framework was developed to serve as a basis for an exploration of the impact of women directors on board performance. This model (see Figure 22.1) considers contextual (organizational level) variables, such as firm size and board equity ownership, as important determinants of board effectiveness. Furthermore, it includes team level contextual factors such as CEO tenure, board size and percentage of outside directors. The emphasis in the input variables of the model is placed on women directors, who are the focus of this article. Board maintenance activities, length of board meetings and trust are important mediating/moderating board process variables in the model. Finally, in accordance with existing literature, the model defines three types of board tasks, namely: qualitative control, financial control and service tasks. These distinct board tasks are the dependent (output) variables of the model.

The conceptual model is based on three main assumptions. First, the model assumes that board task performance mediates the relationship

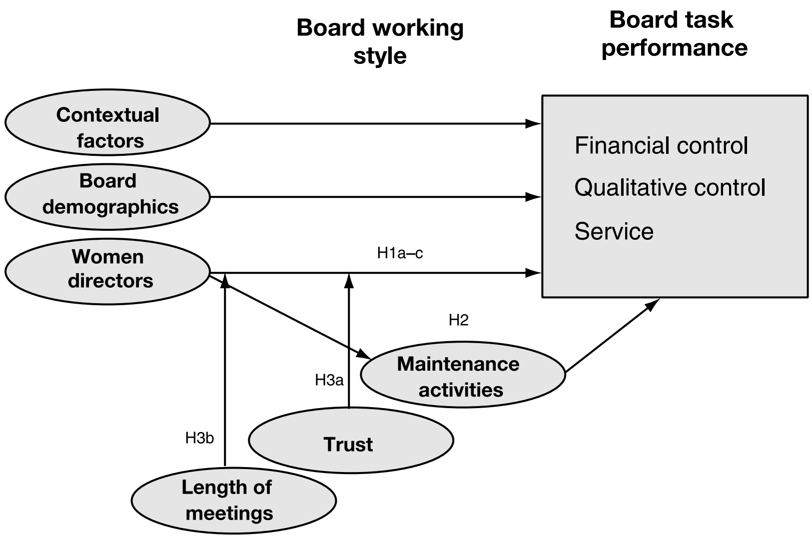

Figure 22.1 A conceptual model of women directors' influence on board processes and board task performance.

between board demographics and firm level outcome. Second, board working style mediates the relationship between board demographics and board task performance. Third, there are different types of board tasks, and the involvement in the different tasks requires differences in board demographics and board working style. This model serves as a basis for explaining women director contribution to board task performance and ultimately to corporate behaviour and performance. The present article is based on an implicit assumption that is not directly tested that a positive relationship exists between board task performance and firm level outcomes. Instead, this article focuses on the second and third assumptions of the model and tests for the hypothesized relationships.

Board task performance

From an agency theory perspective (Jensen and Meckling, 1976), boards have various control/monitoring tasks. Baysinger and Hoskinsson (1990) distinguish between financial and qualitative control tasks. Board financial control tasks refer to the board's responsibility to supervise managerial decisions regarding investments, cash flow, dividends, financial statements, etc.; that is, decisions concerning the firm's financial and accounting situation. Qualitative control, on the other hand, refers to monitoring managerial decisions regarding firm organizational practices and polices regarding safety, health, environment, etc. Previous research suggests that women directors differ from their male counterparts in terms of their background characteristics. A number of studies found that female directors are more likely to have non-business backgrounds (Hillman, Cannella and Harris, 2002; Ruigrok, Peck and Tacheva, 2007). Furthermore, women directors rarely hold executive positions and those who do are rarely in a financial or an accounting function. Rather, women executives have functions related to the 'soft' managerial issues such as human resources, corporate social responsibility, marketing, PR, etc. (Zelekowsi and Bilimoria, 2005). Accordingly, women directors may be expected to be better able to contribute to the board control for qualitative rather than financial issues. Hence, boards including women are more likely to be effective in performing their qualitative control tasks and less likely to be effective in financial monitoring.

Hypothesis 1a: *Women directors have a positive influence on the board performance of qualitative control tasks.*

Hypothesis 1b: *Women directors have a negative influence on the board performance of financial control tasks.*

According to the resource-dependence perspective (Pfeffer and Salancik, 1978), firms are dependent on their environments, and a firm's ability to secure critical resources is vital to firm survival. Corporate directors are viewed as boundary spanners who, through their existing contacts and networks, have access to important information and resources. For example, bankers are considered valuable board members for their contacts and ability to secure loans. Similarly, lawyers and politicians have valuable inside information about changes in the legal or political environment that can be crucial for firm survival. Board interlocks are another important mechanism for transferring relevant information and insights.

Women on boards are less likely to be part of close business networks and to hold interlocking directorships (Ruigrok, Peck and Tacheva, 2007). Previous research suggests that minority directors are less likely to be well connected in the managerial world and need to engage in ingratiation behaviour in order to be appointed to corporate boards (Westphal and Stern, 2006). Women directors are often appointed not for their existing contacts and membership in close business networks but rather for their acquaintance with the CEO of the firm (Burke, 1997b). Hence, women directors are less likely to contribute to the board service tasks. As a result, boards with female members have less access to critical external resources and are thus less efficient in performing their service tasks.

> Hypothesis 1c: *Women directors have a negative influence on the board performance of service tasks.*

Board processes are found to have a tremendous impact on board task performance and effective meetings are essential for the successful performance of board tasks (Zahra and Pearce, 1989). Effective meetings require that a thoroughly developed agenda is distributed well in advance, together with information that is essential for board decisions; that meetings are held promptly and issues are discussed in sufficient depth; and that minutes of the boards meetings are kept for documentation and are accessible for board members' reference. Letendre (2004) further suggests that not only sufficient time to discuss issues at hand in-depth but also a regular review of the performance of the board is crucial for the effective work of boards. Similarly, Sonnenfeld (2002) suggests that boards need to create a climate of trust, foster a culture of open dissent, challenge their own roles and assumptions and regularly evaluate individual board task performance in order to be successful in fulfilling their tasks.

Letendre (2004) brings up the idea of 'value in diversity' and suggests that female board members will bring diverse viewpoints to the boardroom and will provoke lively boardroom discussions. Women may have different views, values and ways to express and communicate their opinions. As a result, women are more likely to question the conventional wisdom and to speak up when concerned or in doubt about an issue or a particular managerial decision (Bilimoria and Huse, 1997; Huse and Solberg, 2006). Hence, boards including women may experience different board processes and dynamics compared to boards composed only of men. In support of this argument, Pearce and Zahra (1991) found that boards with higher ratios of female members, characterized as participative boards, were more likely to engage in debates and disagreement and were associated with higher perceived and objective firm performance. Furthermore, women board members may contribute to board development and board evaluation programmes.

> Hypotheses 2: *Women directors contribute to the board maintenance activities and thereby indirectly to board task performance.*

Group effectiveness literature suggests that whereas certain group processes mediate the effects of group composition to performance, other variables moderate this relationship (Cohen and Bailey, 1997). For instance, strong group norms and trust will contribute to the positive effects of group composition on group effectiveness, whereas the lack of shared norms and within group trust can be deteriorating to the performance of group tasks.

Research has previously established that the board's trust in the CEO's ability to make sound and independent decisions is essential for board task performance (Huse, 1993). Furthermore, the board trust in the CEO may have a moderating effect on the link between board composition and effectiveness. The interplay between women directors and board trust in the CEO was previously investigated by Pearce and Zahra (1991), who found that boards characterized with a trustful relationship with the CEO (high board power and high CEO power) are associated with higher number of female directors. At the same time, Westphal and Milton (2000) presented evidence suggesting that minority directors are rarely able to exert influence on board dynamics. If a certain degree of trust in the CEO exists, women directors may be in a better position to influence board task performance. However, if the power relationship between the CEO and the board is an unhealthy one, based on distrust, political factions and manipulations, the dynamics of the board will suffer and women directors will not be able to contribute to the performance of board tasks.

> Hypothesis 3a: *Women directors' contribution to board task performance is moderated by the board's trust in the CEO.*

As women and men do not always share the same worldviews and opinions, it can be expected that boards with women members will have some disagreements and hence longer discussions regarding the decisions to be made. On the one hand, this will lead to longer and less efficient board meetings. On the other hand, such communication patterns may lead to greater comprehensiveness in board decision-making. The different, opposing views may lead to discussing more profoundly and addressing simultaneously different aspects of the issues in hand and may result in better decision-making. However, if the board meetings become too lengthy this may have a negative influence on board task performance.

Hypothesis 3b: *Women directors' contribution to board task performance is moderated by the length of board meetings.*

Methods

Data collection and sample

This study is based on a survey conducted among Norwegian medium-sized companies (between 50 and 5000 employees) in 2003. The survey sample was drawn from the innovation survey in the value creating board database. A total of 762 survey questionnaires were distributed to the CEOs of the sample firms, and 249 questionnaires were returned, leading to a 33% response rate. Only minor differences were found between responding and non-responding firms in terms of ownership and firm size. The response rate of firms with foreign ownership was 25% and for firms listed on the Oslo Stock Exchange was 35%.

Variables

Ratio of women directors is measured as the proportion of women of the total number of board members. *Board trust in the CEO* is based on a multi-item measure consisting of seven different questions assessing the degree to which the board accepts various CEO judgements and decisions and mandates him/her the authority to act independently in important situations. A confirmatory factor analysis showed that all seven measures load to one factor with an eigenvalue of 3.70. The reliability analysis indicated that the seven items are appropriate measures of the construct and build one factor (Cronbach's alpha of 0.85). The trust measure was subsequently transformed into its quadratic function. *Board maintenance activities* is similarly based on a multi-item measure consisting of four survey questions pertaining to the use of instructions and board development programmes as well as regular board evaluation activities. The four items loaded clearly onto one factor (eigenvalue 2.45 and alpha 0.80). *Length of board meetings* was measured as the duration in hours of an ordinary board meeting in 2002 transformed in its natural logarithmic function.

Company size was measured as the number of company employees in year 2002, transformed into its natural logarithmic function. *Board size* was measured as the total number of board members. *Outsider ratio,* a variable expressing the ratio of the outside board members to board size, was transformed for its quadratic function in order to meet the assumption for normal distribution needed for our statistical analysis. *CEO tenure* was measured in years and transformed into a natural logarithmic function. *Board ownership* was measured as the percentage of firm equity owned by board members in year 2002.

Board service tasks was operationalized with a four-item measure using questions about the board's involvement in terms of network contacts and providing advice on legal, financial and technical issues. The four items loaded onto one factor (eigenvalue of 3.32 and alpha 0.62). *Board financial control tasks* were assessed through three survey questions addressing the extent to which the board is involved in following up and re-assessing managerial decisions concerning firm liquidity, investments and return to shareholders. The three items loaded onto one factor (eigenvalue 1.59 and alpha 0.65). The third aspect of board tasks, *board qualitative control tasks,* was measured by three different items regarding the board's involvement in decisions concerning human resources, product quality and health, environment and safety. The three items loaded onto one factor (eigenvalue 1.11 and alpha 0.75).

Method of analysis

Linear multiple regression analysis was used to test the first four hypotheses (H1a–1c; H2) regarding the direct and indirect (mediated) effects of women directors on the performance of the three distinct board tasks. First, the control variables at firm and board level were entered. Second, the explanatory variable number of women directors was added and F-test for significant change in R^2 was conducted. To test for mediating effects, the intervening variables were subsequently entered together and the overall R^2 as well as the individual coefficients were compared to those from the previous equations. Simons, Pelled and Smith (1996) outline a testing procedure for mediating effects including the following three steps: 1) the explanatory variable has an effect on the mediating variable; 2) the explanatory variable has an effect on the dependent variable; 3) the mediator has an effect on the dependent variable. If the effects of the explanatory variable are weaker when a mediator is entered into the equation a mediating effect is supported. To test for moderating effects of board processes (H3a and H3b), the product terms of the explanatory variable with each of the moderating variables were entered next to the main effects in a final set of regression models (Jaccard, Turrisi and Wan, 2003).

Results and discussion

The descriptive statistics and correlations of all variables are reported in Table 22.1. Results of the testing of the hypotheses are presented in Table 22.2.

In support of hypotheses H1b and H1c, the results suggest that the ratio of women directors is negatively related to the performance of board financial control ($\beta=-0.24$, $p<0.01$) and service tasks ($\beta=-0.16$, $p<0.05$). Some weak evidence was found for hypothesis 1a predicting a positive relationship between the ratio of women directors and the board effectiveness in performing qualitative control tasks ($\beta=0.13$, $p<0.10$). From the control variables only the ratio of outside directors was significantly related to board task

Table 22.1 Descriptive statistics: Means, standard deviations and correlations[a]

Variable	*Mean*	*S.D.*	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*
1. Company size	5.29	1.10	1.00											
2. CEO tenure	1.79	0.81	–0.08	1.00										
3. Board size	5.99	1.89	0.40**	–0.04	1.00									
4. Outsider ratio	0.67	0.23	–0.05	–0.09	–0.10	1.00								
5. Board ownership	2.40	1.61	–0.03	–0.06	–0.38**	0.08	1.00							
6. Women directors ratio	0.13	0.15	0.08	0.17**	0.16**	–0.04	–0.27**	1.00						
7. Length of board meetings	1.73	0.22	0.27**	–0.01	0.18**	0.06	–0.09	–0.09	1.00					
8. Trust	3.09	0.62	–0.07	0.15*	–0.01	0.07	–0.11	0.21*	0.03	1.00				
9. Maintenance	4.02	0.92	0.10	0.21*	0.19**	–0.12	–0.15*	0.18*	0.18*	0.16*	1.00			
10. Qualitative control	3.01	0.87	–0.03	0.11	–0.03	–0.08	0.02	0.14*	0.10	0.15*	0.40*	1.00		
11. Financial control	3.95	0.78	0.11	–0.03	–0.04	–0.11	0.12	–0.25**	0.13*	0.08	0.30*	0.28**	1.00	
12. Service	3.13	0.75	0.00	0.05	–0.22**	0.17*	0.21**	–0.18**	0.05	0.10	0.22**	0.37**	0.44**	1.00

a *p<0.05, two-tailed test; **p<0.01, two tailed test

b the following variables were transformed to meet normality requirements: outsider ratio and trust were squared, length of board meetings was transformed using the ln of (1+X) and CEO tenure and company size was transformed into ln.

Table 22.2 Multiple regressions for effects of women directors and board working style on board task performance[a]

	Qualitative control tasks			*Financial control tasks*			*Service tasks*		
1. Company size	0.00	–0.05	–0.06	0.09	0.05	0.03	0.06	0.03	0.02
2. CEO tenure	0.67	–0.00	–0.01	–0.02	–0.08	–0.08	0.06	0.01	0.01
3. Board size	–0.19	–0.06	–0.02	–0.02	–0.05	–0.15[+]	–0.16*	–0.18*	–0.20*
4. Outsider ratio	–0.09	–0.07	–0.07	–0.14*	–0.12*	–0.13*	0.14*	0.16*	0.15*
5. Board ownership	0.05	0.08	0.08	0.05	0.08	0.09	0.08	0.10	0.11
6. Women directors ratio	0.13[+]	0.08	0.20	–0.24**	–0.29**	–0.74**	–0.16*	–0.20**	–0.30
7. Length of board meetings		0.09	0.20**		0.06	0.05		0.01	0.02
8. Trust		0.08	–0.04		0.10	0.05		0.07	0.09
9. Maintenance		0.38**	0.36**		0.34**	0.28**		0.31**	0.23**
10. Women directors * trust			0.47*			0.26			–0.06
11. Women directors * length of meetings			–0.82**			0.01			–0.21
12. Women directors * maintenance			0.26			0.28			0.40
R^2	0.03	0.20	0.22	0.31	0.48	0.50	0.32	0.45	0.46
F	1.15	6.06**	5.34**	4.13**	7.47**	6.34**	4.37**	6.07**	4.95**

a standard errors are in parentheses.
b +$p < 0.10$, *$p < 0.05$, **$p < 0.01$
c n=239

performance, more specifically the outside directors were positively associated with the board service tasks and negatively with board financial control tasks. Board size was positively related to the board service task involvement, which corresponds to the predictions of resource-dependence theory. In support of the mediation hypotheses (H2), the ratio of women directors had significant positive effect on the board maintenance activities ($\beta=0.13$, $p<0.10$), which in turn were found to be positively significantly ($p<0.01$) related to the performance of all three board tasks. The inclusion of the board working style variables in the regression equation led to an increase in the negative association between women directors on the board and the performance of board financial control tasks ($\beta=-0.29$, $p<0.01$) and service task ($\beta=-0.20$, $p<0.01$). F-tests of significance indicated that entering the mediating process variables in the regression equations have led to a significant increase in the R^2 of all three regressions.

In support of H3b, length of board meeting was found to have a negative interaction effect with the ratio of women directors ($\beta=-0.82$, $p<0.01$) on the board performance of the qualitative control function. Furthermore, whereas no significant effects were found for board trust in the CEO on the effectiveness in performing a qualitative control function, a positive interaction effect of CEO trust and women directors ($\beta=0.47$, $p<0.05$) on qualitative control tasks was found in accordance with H3a. Consistent with previous findings (Pearce and Zahra, 1991), the ratio of women directors was positively related to the board trust in the CEO.

In time of vivid debates about the role of women on corporate boards, this article aimed at contributing to both theory and practice by delving into the dynamics of corporate boards and shedding some light on how women influence board working style and effectiveness in performing different board tasks. Our results suggest that the question whether women make a valuable contribution to their boards has no 'yes or no' answer. It is rather a question of *how* women can make such a contribution (Huse and Solberg, 2006) and to which task precisely. Whereas women can have some positive impact on tasks of more qualitative nature, such as the board qualitative control, they are less able to directly contribute to the board financial control task and service task. Hence, our findings do not support the proposition that women are always a valuable asset to corporate boards. Rather, our findings suggest that boards need to be aware of both the positive and negative effects of women directors and accordingly steer the board working style and select women who have the necessary backgrounds.

An important aspect of women contributions to boards that needs to be addressed in future research is the critical mass of women. Is there a certain ratio that needs to be reached in order for women to make a meaningful difference in board dynamics and task performance? Whereas the recently introduced law in Norway is based on such assumption, researchers may directly investigate the presence of a threshold or a certain ratio of women that is necessary for women directors to have positive influence on board effectiveness. In addition, future research about the effects of women on board effectiveness needs to explore further the backgrounds of women directors and directly assess the characteristics of women directors, that are valuable for the performance of each of the board roles. Women directors, apart from being female board members, bring a number of different characteristics with them. It is somewhat superficial to argue that all women will have the same impact on board working style and task performance. Instead, future research should look at what type of women with what particular background characteristics are valuable board members.

Finally, this study reinforces the notion that exploring board dynamics is a difficult yet worthwhile endeavour. The empirical evidence shows that board working style is an important intervening mechanism in the relationship between board composition and effectiveness.

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23 Board task performance in small firms

The role of personal incentives and board processes

Luca Gnan and Alessandro Zattoni

Abstract

Various calls have been made for publications that dismantle existing fortresses in corporate governance research. In this article we address three issues that are perceived as important: the exploration of boards in small firms, the exploration of board processes, and the understanding of board effectiveness based on measures of actual board task performance. We have collected data from a sample of small Norwegian firms. Constructs and relationships are validated and tested through LISREL analyses. We found that concepts related to board processes had considerable impact on actual board task performance, but also that various process concepts (e.g. commitment, information seeking and openness) have a different impact on different board tasks (e.g. networking, advisory and control). Traditional board demographic variables were used as control variables, but generally they had only minor influence on board task performance. We found, however, that a measure related to the intrinsic motivation of the board members significantly influenced the board processes.

Keywords: Board processes, Board task performance, Board incentives, Small firms

Introduction

This article presents a study aimed at determining how board processes can influence board effectiveness in respect of its own task performance. We follow a value creation perspective, i.e. we investigated how boards can contribute to value creation by their involvement in control, advisory, and networking tasks (Hillman and Dalziel, 2003; Huse, 2005; Johnson et al. 1996; Zahra and Pearce, 1989). A theoretical framework established by Zahra and Pearce (1989) and further developed by Demb and Neubauer (1992), Forbes and Milliken (1999) and Huse (2005) is used in the analysis. The basic framework implies the distinction between board members' incentives, board processes, and board task performance.

The article proceeds in four parts. First, focusing on research on boards, we present a theoretical model describing the relationships between three board dimensions: incentives, processes, and task performance. Then, we present the sample, the variables and the methods employed in the analysis. Next, the results of the study are presented. Finally, we have a conclusive paragraph with the discussion of the findings and implications for further research and practice.

Board incentives, processes and task performance

Board tasks in small firms

Boards can add value to the firm through the performance of distinct tasks, e.g. the control, the advisory, and the networking tasks (e.g. Johnson et al., 1996; Stiles and Taylor, 2001; Zahra and Pearce, 1989).

Boards of directors in most countries are legally responsible for monitoring the actions of top executives and the company's performance. According to agency theory, boards of directors are governance mechanisms aimed at solving the problems associated with the separation between ownership and control in large public companies (Jensen and Meckling, 1976). In this situation, shareholders delegate the 'decision management' tasks (i.e. initiation and implementation of decisions) to top managers, and the board maintains 'decision control' tasks (i.e. ratification of decisions and monitoring of their implementation) on management's activity (Fama and Jensen, 1983). The board's control tasks can be relevant also in small firms if diverging interests arise between majority and minority shareholders (Schulze et al., 2001) or as long as there are debt-holders, and thus a separation between risk-takers and management. Furthermore, directors can carry some competencies that may help entrepreneurs in controlling a company's performance (i.e. through budget and financial plans) (Castaldi and Wortman, 1984).

The advisory tasks are rooted in the strategy literature and have some familiarity with the resource-based view (Huse, 2005). From this perspective, a board of directors reinforces the top management team's competencies and experiences, making comments or refining their strategic proposals. Board task involvement in the strategic decision process encompasses a set of activities, such as the identification of the businesses, the definition of the firm's vision and mission, the selection of the different strategic alternatives (Pearce and Zahra, 1991; Stiles and Taylor, 2001). The active involvement in the strategic decision process of the board may contribute to the creation of a firm's competitive advantage (Andrews, 1980). In entrepreneurial ventures board members tend to be more involved in strategic decision-making than board members of large corporations (Ireland et al., 2001). Furthermore, Rosenstein et al. (1993) found that the CEOs of high technology start-ups valued the information and expertise gained from outside board members, especially in the early stages of development. Summing up, boards of small firms may engage in relevant advisory tasks, providing entrepreneurs and managers with advice and counsel on many issues.

The networking tasks are grounded in sociology and organization theory (Pfeffer and Salancik, 1978). According to this view, boards are important boundary spanning bodies helping the firm in the interface with the environment. The board should contribute in providing the firm with a stable flow of critical resources for its growth and legitimize its existence in relation to the environment (Johnson et al., 1996; Pfeffer, 1972; Pfeffer and Salancik, 1978; Zahra and Pearce, 1989). For example, some studies have shown that board membership by representatives of financial institutions can help the firm to acquire capital (Johnson et al., 1996). The networking tasks are particularly important in small firms, because small firms have fewer resources and are more dependent on external stakeholders (Pfeffer and Salancik, 1978). Furthermore, new firms typically lack historical legitimacy and can benefit greatly by the appointment of an outside prestigious director (Johannisson and Huse, 2000; Johnson et al., 1996). Summing up, boards of directors of small firms may carry out important networking tasks in contributing the creation of external legitimacy and obtaining access to scarce resources (Borch and Huse, 1993; Huse, 1990).

Board processes

Boards of directors are decision-making groups that face complex tasks pertaining to strategic-issue processing (Forbes and Milliken, 1999). Boards typically meet episodically, they consist of interdependent groups of people, and they face interaction difficulties that can prevent them from carrying out their tasks. Building on previous literature (e.g. Forbes and Milliken, 1999; Milliken and Vollrath, 1991), we identify various board processes that may influence board task performance, e.g. commitment, information seeking, and cognitive conflicts.

Commitment relates to effort norms (Forbes and Milliken, 1999) and in practice is about prioritizing the necessary time to the board in meetings as well as members being available if they are needed. Directors typically are busy people facing many competing demands for their time (Lorsch and MacIver, 1989). Empirical evidence shows that the time directors devote to their boards differs considerably among firms, and these differences influence the ability of boards to meet their tasks (Mace, 1986: 107). Some boards typically consist of passive members who attend meetings and take decisions without a mental engagement (i.e. 'rubber stamp' management decisions), while other boards have members who carefully scrutinize the information provided prior to board meetings and participate actively to the board decision-making (Lorsch and MacIver, 1989: 104–105). We hypothesize that:

Hypothesis 1: *Commitment is positively related to the performance of networking tasks.*

Hypothesis 2: *Commitment is positively related to the performance of advisory tasks.*

Hypothesis 3: *Commitment is positively related to the performance of control tasks.*

Information and knowledge are important ingredients stimulating active board decision-making (Forbes and Milliken, 1999). An active board member needs both a deep understanding of the firm and the industry, and a wide perspective on the issues to be debated in the boardroom (Demb and Neubauer, 1992: 101). Beyond scrutinizing the regular information flow distributed prior to board meetings (Stiles and Taylor, 2001: 111–112), board members must search for further relevant information in order to be actively involved in the boardroom discussion (Conger et al., 1998). Information seeking is particularly important to the board's cognitive outputs, such as the board control and advisory tasks. In order to control management behaviour and to enrich management's strategic proposals, directors should have a deep and objective view of the firm (Conger et al., 1998). The information-seeking process is not as relevant in relation to the board's networking task (Forbes and Milliken, 1999), which is performed mainly by choosing outside directors who have personal relationships with important external stakeholders or have high prestige in their profession (Pfeffer, 1972). Accordingly, we hypothesize that:

Hypothesis 4: *Information seeking is positively related to the performance of advisory tasks.*

Hypothesis 5: *Information seeking is positively related to the performance of control tasks.*

Cognitive conflicts refer to task-oriented differences in judgement or issue related disagreement among directors (Forbes and Milliken, 1999). One important recommendation that governance experts share on boardroom dynamics is that boards need to have open and challenging interchange among directors (Cadbury, 2002: 88). The issues facing boards are usually complex and ambiguous and directors can perceive them differently and have different opinions on how to manage them (Dutton and Jackson, 1987). The presence of openness and the discussion of multiple viewpoints improve the quality of decision-making in groups – such as boards of directors – facing an uncertain environment (Eisenhardt and Bourgeois, 1988) or performing an intellectual task (Watson and Michaelsen, 1988). Cognitive conflicts among directors are crucial for both advisory and control tasks as they are both group decision-making outputs, while cognitive conflicts are not particularly relevant for the board's networking tasks. As we mentioned before, the networking tasks are performed mainly by choosing directors who have personal relationships with important external stakeholders of the company or who have a high reputation in the external environment (Pfeffer, 1972; Pfeffer & Salancik, 1978). Accordingly, we hypothesize that:

Hypothesis 6: *Cognitive conflicts are positively related to the performance of advisory tasks.*

Hypothesis 7: *Cognitive conflicts are positively related to the performance of control tasks.*

The board members' personal incentives

Economic literature stresses the importance of monetary incentives in influencing human behaviour (Laffont and Martimort, 2002; Milgrom and Roberts, 1992). As far as directors are concerned, monetary incentives are usually represented by share ownership (e.g. Dalton et al., 2003; Jensen, 1993). Providing board members with equity stakes may mitigate managerial self-interest by aligning interests of both shareholders and board members (e.g. Himmelberg, Hubbard and Palia, 1999; Jensen and Murphy, 1990; Jensen and Meckling, 1976). Even if some scholars state that contingent monetary rewards may have a possible negative impact on intrinsic motivation to perform well (Frey and Jegen, 2001), problems are usually due to the characteristics of the incentive plans than to the incentive plans *per se* (Baker, Jensen and Murphy, 1988; Milgrom and Roberts, 1992). Furthermore, pay is also important for keeping score and not only for gaining a large amount of money (Stiles and Taylor, 2001: 76). The motivational power of pay may in fact rest also on its role as symbolic reward (Finkelstein and Hambrick, 1988).

Beyond pecuniary incentives, other kinds of incentives can play a relevant role in influencing directors' behaviour, e.g. formal legal responsibilities and professional standards (Huse, 1993; Yermack, 2004). With regards to the legal responsibilities, board members have fiduciary duties towards their own firm. Legal requirements and sanctions vary across countries, but board members will have an incentive to avoid legal sanctions.

Board members are also evaluated by peers, and a main motivation for many board members is to meet the private and professional standards set by peers or by the cultural norms in which the board members are acting (e.g. Fama and Jensen, 1983; Hermalin and Weisbach, 1988). Directors that do not respect the professional standards may suffer a decrease in reputation which will undermine their probability of re-election or reduce the possibility of finding new appointments in other firms (Fama, 1980). Accordingly, we hypothesize that:

Hypothesis 8: *The board members' personal incentives are positively related to their commitment.*

Hypothesis 9: *The board members' personal incentives are positively related to their information seeking.*

Hypothesis 10: *The board members' personal incentives are positively related to cognitive conflicts.*

The theoretical model developed here is presented in Figure 23.1.

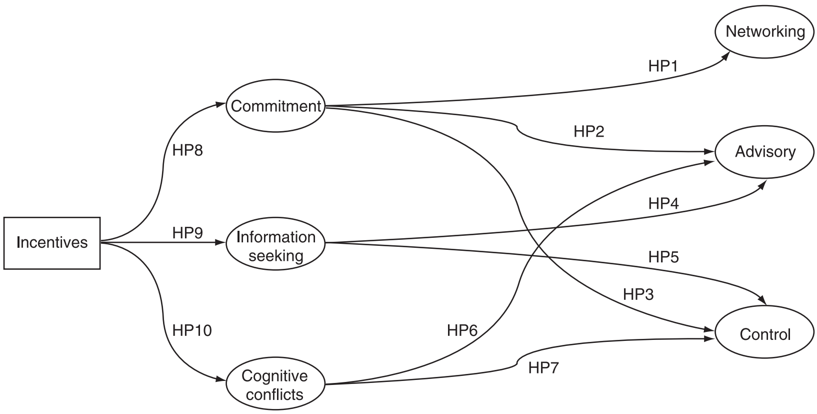

Figure 23.1 The theoretical model.

Methods

Sample and data collection

We sent a survey to random samples of small firms. The questionnaire was sent to the CEOs of 3000 firms. We received 973 responses, but in half of the cases the responses were that the questionnaires were not relevant for them, and thus only 498 questionnaires were complete. The sample was divided into four quartiles with respect to firm size. There were no significant differences with respect to responses across the different firm sizes, but the gross response rate for full questionnaires was lower in the quartile with the smallest firms and it was larger in the quartile with the largest firms. These response rates indicate that boards in general are less active in the smallest firms.

Measures

The means, standard deviations, and percentiles of observed variables from the original survey are shown in Table 23.1. We collected data on observed variables related to the independent, control and dependent latent variables (constructs) presented in the theoretical model depicted in Figure 23.1. Independent variables include both board members' personal incentives (INCENTIVES) and board processes. The board processes include their commitment (COMMITMENT), the quality of the directors' information-seeking process (INFORMATION SEEKING), and the existence of cognitive conflicts among a board's members during board meetings (COGNITIVE CONFLICTS).

Dependent variables considered in the study include board involvement in networking (NETWORKING), advisory (ADVISORY), and control

(CONTROL) tasks. Control variables considered were both board (size and CEO duality) and firm characteristics (firm age and size – measured in terms of employees and turnover).

All the observed variables were collected through the survey, and five-point Likert-type scales were used. Cronbach's alpha was used to indicate the internal consistency of each construct. All constructs in the model had an alpha value above the recommended value 0.7.

Table 23.1 Descriptive statistics

Id	*Variable*	*N*	*Mean*	*Median*	*Std. dev.*
X1	Personal ownership interests	427	4.02	5.00	1.35
X2	Formal legal responsibilities	405	3.45	4.00	1.23
X3	Professional standards	406	3.98	4.00	0.92
Y1	All board members are actively involved in meetings	420	4.07	4.00	1.14
Y2	Board members are prioritinzig to devote all necessary time to board assignement	419	3.66	4.00	1.05
Y3	Board members are always available if the board work should demand it	420	3.92	4.00	1.03
Y4	Board members scrutinize information before board meetings	422	3.37	3.00	1.08
Y5	Board members find their own information	412	3.07	3.00	1.18
Y6	Board members ask discerning questions	420	3.44	4.00	1.10
Y7	Board members ask critical questions	419	3.21	3.00	1.17
Y8	Board members discuss professional opposing views	418	4.00	4.00	1.03
Y9	Board members accept the risk they can be wrong	415	3.89	4.00	0.95
Y10	Board members explain the CEO their personal view and ideas	416	3.94	4.00	1.02
Y11	Board's contribution to networking	417	3.34	3.00	1.23
Y12	Board's contribution to lobbying	415	2.76	3.00	1.26
Y13	Board members advise on general management	415	3.47	4.00	1.17
Y14	Board members advise on legal issues	414	3.00	3.00	1.29
Y15	Board members advise on financial issues	416	3.63	4.00	1.21
Y16	Board members advise on technical issues	414	3.22	3.00	1.25
Y17	Board members advise on market issues	414	3.49	4.00	1.16
Y18	Board members monitor cost budgets	422	4.07	4.00	1.03
Y19	Board members monitor sales budgets	420	3.95	4.00	1.13
Y20	Board members monitor firm liquidity	421	4.09	4.00	1.02
Y21	Board members monitor investments	420	4.09	4.00	1.05
Y22	Board members monitor CEOs contribution and behavior	420	3.48	4.00	1.22
Y23	Board members monitor HR	421	3.57	4.00	1.13
X4	CEO/CHAIR duality	441	0.28	0.00	0.45
X5	Board size	450	3.48	3.00	1.52

Data analysis and results

To test the hypotheses we decided to use a structural modelling approach and estimated the model using LISREL. The analysis and interpretation of a structural equation model with latent variables take place in two stages: (1) assessment of the individual item dimensionality, reliability, consistency, and validity of the measurement model and (2) assessment of the causal relationships within the structural model.

Descriptive results are presented in Table 23.2. With only two exceptions there is significant correlation between the 13 observed variables related to the board task performance variables and the firm-level control variables (firm age and size).

Measurement model results

In accordance with the two-step approach advocated by Anderson and Gerbing (1988), we estimated a measurement model prior to examining structural model relationships. We modelled the eight constructs as eight correlated first-order factors corresponding to our independent and dependent variables. We tested the measurement model by examining individual item dimensionality, convergent validity, reliability, internal consistency, and discriminant validity.

The multi-item measures were subjected to a series of exploratory and confirmatory factor analyses to assess dimensionality and convergent validity (Conway and Huffcutt, 2003). The items loaded heavily on the designated factors. First, based on the results of exploratory factor analysis, we decided

Table 23.2 Board performances and control variables

	Observed variables	*Year of foundation*	*# of employees*	*Turnover*
Y11	Board's contribution to networking	–0.023	0.011	–0.024
Y12	Board's contribution to lobbying	0.061	–0.007	–0.056
Y13	Board members advise on general management	–0.002	–0.030	0.004
Y14	Board members advise on legal issues	0.021	–0.113*	–0.023
Y15	Board members advise on financial issues	0.044	0.003	0.017
Y16	Board members advise on technical issues	–0.009	–0.074	–0.017
Y17	Board members advise on market issues	0.022	–0.070	0.022
Y18	Board members monitor cost budgets	0.039	0.011	0.034
Y19	Board members monitor sales budgets	0.014	0.004	0.053
Y20	Board members monitor firm liquidity	0.038	–0.113*	–0.023
Y21	Board members monitor investments	–0.053	–0.021	0.001
Y22	Board members monitor CEOs contribution and behavior	0.020	–0.029	–0.003
Y23	Board members monitor HR	–0.013	–0.101	–0.010

** Correlation is significant at the 0.01 level (2-tailed).

Table 23.3 Measurement model results

Measurements paths		*Parameters*	*Unstardized estimates*	*t*	*Error variance*	*Sig.*	*Item reliability*
KSI1	Incentives						
	Personal ownership interests	λX11	0.300	4.490	0.110	***	True
	Formal legal responsibilities	λX21	0.510	8.510	0.084	***	True
	Professional standards	λX23	0.590	13.530	0.041	***	True
ETA1	Commitment						
	All board members are actively involved in meetings	λY11	0.740	Fixed	0.580	***	True
	Board members are prioritinzig to devote all necessary time to board assignement	λY21	0.850	13.350	0.330	***	True
	Board members are always available if the board work should demand it	λY31	0.750	12.480	0.480	***	True
ETA2	Information seeking						
	Board members scrutinize information before board meetings	λY42	0.820	Fixed	0.390	***	True
	Board members find their own information	λY52	0.860	15.950	0.520	***	True
	Board members ask discerning questions	λY62	0.690	13.390	0.660	***	True
	Board members ask critical questions	λY72	0.660	11.870	0.460	***	True
ETA3	Cognitive conflicts						
	Board members discuss professional opposing views	λY83	0.810	Fixed	0.330	***	True
	Board members accept the risk they can be wrong	λY93	0.840	18.080	0.200	***	True
	Board members explain the CEO their personal view and ideas	λY103	0.670	14.780	0.520	***	True

ETA4	Networking						
	Board’s contribution to networking	λY114	0.980	Fixed	0.160	***	True
	Board’s contribution to lobbying	λY124	0.810	10.270	0.550	***	True
ETA5	Advisory						
	Board members advise on general management	λY135	0.850	Fixed	0.520	***	True
	Board members advise on legal issues	λY145	0.840	13.750	0.440	***	True
	Board members advise on financial issues	λY155	0.930	16.550	0.440	***	True
	Board members advise on technical issues	λY165	0.550	9.080	0.330	***	True
	Board members advise on market issues	λY175	0.740	13.140	0.510	***	True
ETA6	Control						
	Board members monitor cost budgets	λY186	0.890	Fixed	0.250	***	True
	Board members monitor sales budgets	λY196	0.950	22.210	0.400	***	True
	Board members monitor firm liquidity	λY206	0.840	21.550	0.350	***	True
	Board members monitor investments	λY216	0.780	18.350	0.510	***	True
	Board members monitor CEOs contribution and behavior	λY226	0.660	12.070	0.590	***	True
	Board members monitor HR	λY236	0.650	13.030	0.310	***	True

Values of the critical ratio greater than 1.64, 1.96, and 2.32 are statistically significant at 90%, 95%, and 99% confidence level, respectively. ***$p<0.01$, **$p<0.05$, and *$p<0.1$.

to keep the entire set of 26 items for further analysis. Next, the items were subjected to confirmatory factor analysis (CFA) using LISREL. As chi-square analyses are sensitive to sample size (Cudeck and Henly, 1991), which is comparatively large in our study, we followed Bollen's (1990) recommendation of using multiple indices for interpreting the fit of the model with data. The CFA model presents a RMSEA value of 0.048 and RMSR of 0.035. All the goodness of fit indices are higher than the accepted international standards. Model fit statistics suggests that the hypothesized measurement model fits the data reasonably well. The completely standardized factor loadings ranged from 0.51 to 0.98, except one equal to 0.29. All factor loadings were significant (t-values > 2, i.e., ranging from 3.95 to 22.69, $p < 0.05$) suggesting convergence of the indicators with appropriate underlying factors (Anderson and Gerbing, 1988) for the sample.

The results for individual item reliability, internal consistency, and discriminant validity are reported in Table 23.3 and Table 23.4. All the non-fixed indicator loadings for each construct are significant. A common rule of thumb is to accept items with more explanatory power than their respective error variance (Carmines and Zeller, 1979). This criterion is met for all items.

As reported in Table 23.4, all scales demonstrate adequate internal consistency (a value higher than 0.70, as suggested by Fornell and Larcker, 1981). All estimates in Table 23.4 of the average variance extracted estimates are higher than the 0.50 threshold recommended by Fornell and Larcker to demonstrate convergent validity. Table 23.4 also shows the correlation matrix for the constructs. The diagonal of this matrix reports the square root of the average variance extracted (AVE). Our constructs exhibit adequate discriminant validity since the diagonal elements (the square root of the AVE) are, except in two cases, significantly greater than the off-diagonal elements in the corresponding rows and columns (the correlation between two constructs).

Collectively the measurement model results suggest that our measures are unidimensional, reliable, and exhibit convergent and discriminant validity. Moreover, the model fits the available data reasonably well.

Structural model results

Figure 23.2 indicates that the variance in board performance explained by the model is: 30% for NETWORKING tasks, 43% for the ADVISORY tasks, and 42% for the CONTROL tasks, which are reasonable given that a large number of factors can have an impact on board task performance. The model presents a RMSEA value of 0.046 and RMSR of 0.033. All the goodness of fit indices are higher than the accepted international standards.

- The NETWORKING tasks. The mediating variable, COMMITMENT, has a positive and significant impact on NETWORKING tasks ($\beta 41=0.55$, $t=9.30$). Hypothesis 1 is therefore supported.

Table 23.4 Measurement model results

Latent variables		*Number of items*	*Internal consistency*	*Average variance extracted*	*Correlations between latent variables*						
					KSI1	*ETA1*	*ETA2*	*ETA3*	*ETA4*	*ETA5*	*ETA6*
KSI1	Incentives	3	0.893	0.748	0.865						
ETA1	Commitment	3	0.798	0.569	0.830	0.754					
ETA2	Information seeking	4	0.819	0.534	0.850	0.710	0.731				
ETA3	Cognitive conflicts	3	0.837	0.633	0.550	0.460	0.460	0.796			
ETA4	Networking	2	0.841	0.731	0.450	0.540	0.380	0.240	0.855		
ETA5	Advisory	5	0.872	0.584	0.580	0.540	0.590	0.460	0.520	0.764	
ETA6	Control	6	0.904	0.616	0.570	0.520	0.590	0.480	0.280	0.590	0.785

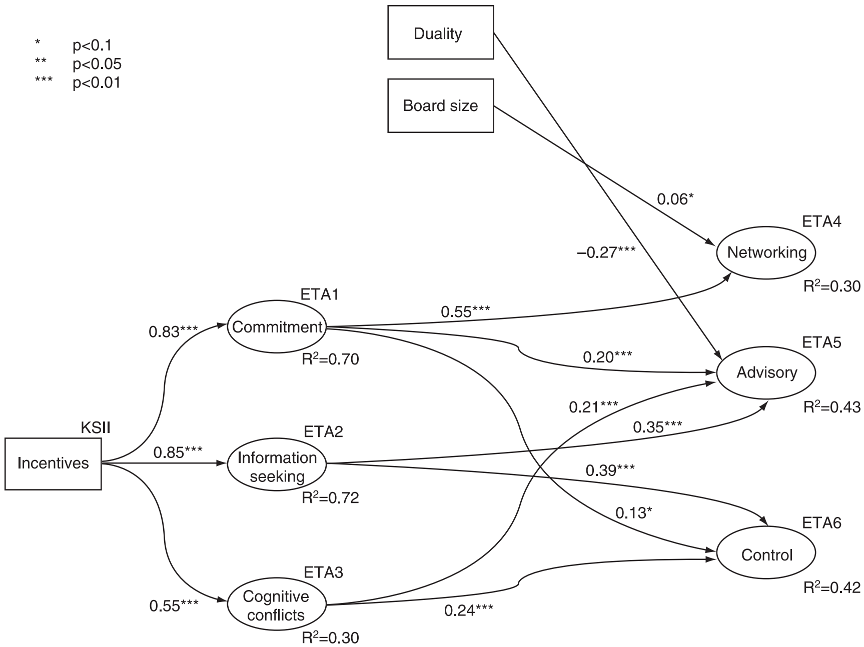

Figure 23.2 Model results.

- The ADVISORY tasks. The three mediating variables, COMMITMENT, INFORMATION SEEKING, and COGNITIVE CONFLICTS, have a positive and significant impact on ADVISORY tasks (β54=0.20, t=2.48; β52=0.35, t=4.42; β53=0.21, t=3.95). Hypotheses 2, 4, and 6 are therefore supported.
- The CONTROL tasks. The three mediating variables, COMMITMENT, INFORMATION SEEKING, and COGNITIVE CONFLICTS, have a positive and significant impact on ADVISORY tasks (β61=0.13, t=1.75, sig. <0.1; β62=0.39, t=4.97; β63=0.24, t=4.62). Hypotheses 3, 5, and 7 are therefore supported.
- COMMITMENT, INFORMATION SEEKING, and COGNITIVE CONFLICTS. The INCENTIVES variable has a positive and significant impact on COMMITMENT (γ11=0.83, t=11.87), INFORMATION SEEKING (γ21=0.85, t=14.68), and COGNITIVE CONFLICTS (γ31=0.55, t=9.73). Hypotheses 8, 9, and 10 are therefore supported.
- Board's level control variables. The board size has a positive and significant impact on NETWORKING tasks (γ42=0.06, t=1.76). The CEO duality has a negative and significant impact on ADVISORY tasks (γ53=–0.27, t=–2.47).

In addition to assessing the overall fit and path estimates of the proposed theoretical model, we compared the model with some nested possible alternative models (cf. Anderson and Gerbing, 1988). The alternative models were compared to the theoretical model based on chi-square difference tests, as well as examining any changes in fit indices. In the nested alternative models (models 2–4) a direct path was added from incentives to each one of the three sets of board tasks. The results of these nested alternative models are shown in Table 23.5. Direct paths from INCENTIVES to each one of the three sets of board tasks did not significantly improve model fit. Moreover, the standardized parameters associated with the alternative linkages (in models 2–4) were not very high. Most importantly, as compared to the hypothesized model, all of these models yielded to a worsening of fit indices and a non-significant chi-square difference, indicating that each pair of direct effects could be dropped. Thus, our final model did not include any of the direct paths tested in the alternative models.

Discussion

In this article we have focused on board processes in small firms. The research findings contribute to opening the black-box of board of directors in that they show that: (a) the traditional demographic variables used in studies of boards, 'the usual suspects', do not influence significantly board task performance; (b) the board members' personal incentives and board processes do have a strong and significant impact on board task performance; (c) the board members' personal incentives are powerful antecedents of board processes.

Dismantling the fortresses

Past research on boards of directors has been characterized by the extensive reliance on agency theory and on the use of a few demographic variables – 'the

Table 23.5 Results of structural nested model comparison

#	*Model*	*Chi-Square*	*df*	*CFI*	*RMSEA*	*SRMSR*	*ΔChi-square*
1	Hypothesized model	2020.19	375	0.92	0.046	0.033	
2	Hypothesized model and incentives→Networking task direct effect	1989.75	374	0.89	0.051	0.067	–30.44
3	Hypothesized model and incentives→Advisory task direct effect	2012.97	374	0.91	0.052	0.069	–7.22
4	Hypothesized model and incentives→Control task direct effect	2016.21	374	0.90	0.050	0.064	–3.98

usual suspects'. Recent literature reviews (Daily et al., 2003; Dalton et al., 1998; Johnson et al., 1996) have shown that previous studies on boards of directors have failed to identify any significant relationship between these 'usual suspects' and firm performance, even in the most well-researched areas. The lack of significant results pushed scholars (Daily et al., 2003) to critique the dominant approach and to call for the dismantling of the research fortresses in corporate governance studies. Following this call our study aimed at opening the black box of boards of directors through the examination of the relationship between board processes and board task performance.

Our study shows that cognitive conflicts and information are important variables that influence board advisory and control task involvement, while the board members' commitment influences the board's involvement in advisory, control, and networking tasks. These results reinforce the idea that an active involvement of board members during and between the meetings can strongly improve board task performance. Even if our study showed the strong predictive power of process variables, demographic variables may also influence board task performance. Our results show in fact that board size in small firms is positively related to board networking involvement, and CEO duality has a negative impact on board advisory task involvement. Furthermore, demographic variables may be important because they shape the context in which processes happen. Future studies should further investigate the relationship between board demographic and process variables and how they interact or jointly influence board task performance.

Boards of directors in small firms

Previous research on boards of directors has almost only used data about large US firms (Daily and Dalton, 1993; Huse, 2000). Governance scholars almost ignore corporate governance in smaller firms because of the implicit idea that they are dominated by the CEO-owner, lack formal appropriate governance structures, and do not have many outside board members (Daily and Dalton, 1993). A study on a sample of small firms shows instead that boards in small firms without a founder CEO may tend to mirror their large counterparts. They have a relatively large number of outside directors, and they separate CEO's and chairperson's positions (Daily and Dalton, 1993). Furthermore, entrepreneurs typically have relatively less general management experience than professional managers, and so the board members' contribution to board task performance can be even more relevant in small firms than in large corporations (Forbes and Milliken, 1999).

Our findings actually indicate that boards of directors can be active governance bodies helping managers in small firms. Boards of directors of small firms may play an important role in networking, advisory, and control tasks. Furthermore, we showed that, even in small firms, board processes have a strong impact on board task performance.

Our sample and research focus have been boards of directors in small firms in Norway. However, the literature and most of the arguments behind deductive studies come from boards in large US corporations. Future studies should therefore also apply our model on firms of different sizes in various countries.

The role of personal incentives

Governance literature almost ignores the importance of non-monetary incentives for directors, focusing exclusively on board equity holdings (Dalton et al., 2003; Hermalin and Weisbach, 1991; Jensen, 1993; Jensen and Meckling, 1976). Here we use an enlarged definition of the board members' personal incentives, i.e. one that includes the motivation through personal ownership, legal responsibilities and professional standards. The study's results indicate that personal incentives support positive board processes and indirectly influence board task performance. However, our study disentangles neither the effects of different types of incentives, nor the effects of monetary and non-monetary incentives on different types of directors (e.g. executive versus non-executive). Furthermore, it does not consider the competence of board members as a possible predictor of board task performance, assuming implicitly that directors are chosen for their competencies. These are among the issues that should be addressed in future studies.

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24 Trust and board task performance

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Abstract

This article is about how trust may affect board task performance. Two constructs of trust are introduced and discussed. Our analysis of Dutch board behaviour indicates that disclosure trust is positively related to strategy task performance, while reliance trust negatively affects control task performance. We conclude that trust is an important concept for understanding interdependencies between (non-executive) board members and managers.

Key words: Trust, Board task performance, Dutch firms

Introduction

In the debate about effective boards, the size and composition of boards and the statutory independence of board members have attracted most attention. A considerable amount of studies have empirically addressed the relationship between board attributes and corporate performance. The results from this research have been far from conclusive (see, for example, Hermalin and Weisbach, 2001). This ambiguity has been used to underscore the relevance of research on actual board behaviour (for example, Dalton et al., 1999; Daily et al., 2003; Forbes and Milliken, 1999; Hillman and Dalziel, 2003). Although formal board attributes may create the conditions for effectiveness, the underlying complexity of the decision-making process and the behaviour within the board may likewise affect board and corporate performance. Therefore, a new research agenda on actual board behaviour may offer new research opportunities by addressing, for example, knowledge sharing within boards and trust building, cohesion and the (ab)use of power in the boardroom.

Our research may be regarded as a first attempt to integrate the literature on interpersonal trust in working relationships and the literature on board behaviour. In this article we develop hypotheses regarding the relationship between trust between non-executive and executive board members and board behaviour in terms of board task performance. Subsequently, these hypotheses are tested with data on Dutch corporate boards. Our first results indicate that interpersonal trust affects the task performance of boards.

Board behaviour and the implications of trust

Following Forbes and Milliken (1999), boards are considered special working groups, characterized by an entirely cognitive output, complex decision-making and restrictive communication and operating procedures (see also, McNulty and Pettigrew, 1999; Pettigrew, 1992). The individual expertise and knowledge as well as the 'relational capital' of board members serve as input for the decisions of the board. The decisions of the board (board output) are part of the strategic decision-making of the company (Hillman and Dalziel, 2003).

Due to incomplete information and the complexity of decision-making, working relationships between the CEO and the members of the board or between non-executive board members and executives are characterized by uncertainty and risk. Das and Teng (2001) define relational risk as the probability and consequences of not having satisfactory cooperation (*ibid.* 253). Relational risk includes threats like dishonesty, the use of unfair strategies and tactics, and the non-compliance to tacit agreements. Non-executive board members, in particular, face relational risks as a result of their involvement with a firm. For instance, they may lose reputation or wealth due to the behaviour of top management or due to bad company performance. Moreover, they are usually not able to distinguish environmental bad luck, i.e. performance risk, from straightforward managerial expropriation. On the other hand, managers also have to rely on boards to realize their objectives. The interests of one party cannot be achieved without relying on the other.

Generally, interpersonal trust may mitigate board members' perception of relational risk within the board. Following Mayer et al. (1995: 712), trust is defined as 'the willingness to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party'. A lower risk perception may make board members and managers more confident to share information and knowledge and to be more active in board decision-making. In addition, personal needs are more easily subjugated for the common corporate objective, which reduces the probability of conflict.

In the boardroom, trust may have several antecedents. First, *ex ante* reputation breeds trust. Second, face-to-face contacts and mutually favourable experiences, in and outside the boardroom, foster trust building. Third, the risk of misplaced trust tends to be lower if more information about the trustee is available and untrustworthy behaviour can be sanctioned. Finally, social norms – building upon reciprocity, communality and social ties due to similar reference groups or social classes – breed interpersonal trust (Huse, 1993 and 1996; Westphal, 1999).

Regarding the measurement of trust, several indicators of perceived trustworthiness are distinguished in the literature. For instance, trust has been grounded upon competence, benevolence, honesty, integrity, fragility, deterrence, resilience, goodwill, etc. (for example, Barber, 1983; Hosmer, 1995; Nooteboom, 2002; Ring, 1996; Ring and van de Ven, 1992). However, this method of measuring trust by distinguishing types can be criticized (Gillespie, 2003). First, trust and trustworthiness are empirically different factors (Mayer et al., 1995). Second, assessing trustworthiness does not necessarily include accepting vulnerability or risk. Third, vulnerability implies that trust is not merely the willingness to trust but also includes the action that comes along with it (Mayer et al., 1995). To meet this criticism, we propose to highlight the importance of information exchange and joint problem-solving in the board, in the measurement of trust. Consequently, the willingness to be vulnerable by being actually involved as a board member can be measured by two distinct domains of trusting behaviour, respectively 'reliance' and 'disclosure' (Gillespie, 2003: 10). Non-executive board members frequently rely on the skills, knowledge, judgement and actions of the executives. Reliance also translates into delegation and giving autonomy. The reliance trust of non-executives is build upon the perception that executives are trustworthy because of their competence and ability. As such, reliance trust particularly, but not only, mitigates perceptions of performance risk. The disclosure trust of non-executives, on the other hand, refers to sharing work-related and sensitive information with executives, promoting interdependence and joint initiatives. Disclosure trust builds upon notions of reputation, goodwill, relatedness and affection and thus particularly mitigates perceived relational risks. Both reliance and disclosure trust are expected to improve the quality of board decision-making as they transform into behaviours that enhance the quality and nature of information exchange, influence and control. Individuals, unwilling to engage in trusting behaviour, will attempt to minimize their vulnerability, thereby increasing the likelihood of misunderstanding or misinterpretation.

Board task performance and research model

In the following, we focus the discussion towards board task performance. In the literature, board task performance is described in terms of generic roles in strategic decision-making (Dalton et al., 1999; Zahra and Pearce, 1989). In this article, we will distinguish among the control tasks, the strategy tasks and the networking tasks. The control task of the board primarily rests in agency theory and reflects internal control mechanisms that safeguard the interests of dispersed shareholders (Fama and Jensen, 1983). The board accepts, rejects or refers strategic decisions, including decisions about hiring, compensating and replacing managers or management teams (Barnhart et al., 1994). The strategy tasks and the networking tasks of the board concern the board's provision of essential services and resources in strategic decision-making, such as offering advice, legitimacy and counsel, i.e. the strategy tasks, as well as links to other organizations, i.e. the networking tasks (Tricker, 1994).

Figure 24.1 indicates that interpersonal trust affects board task performance, amidst other variables. We are interested in the direct relationships

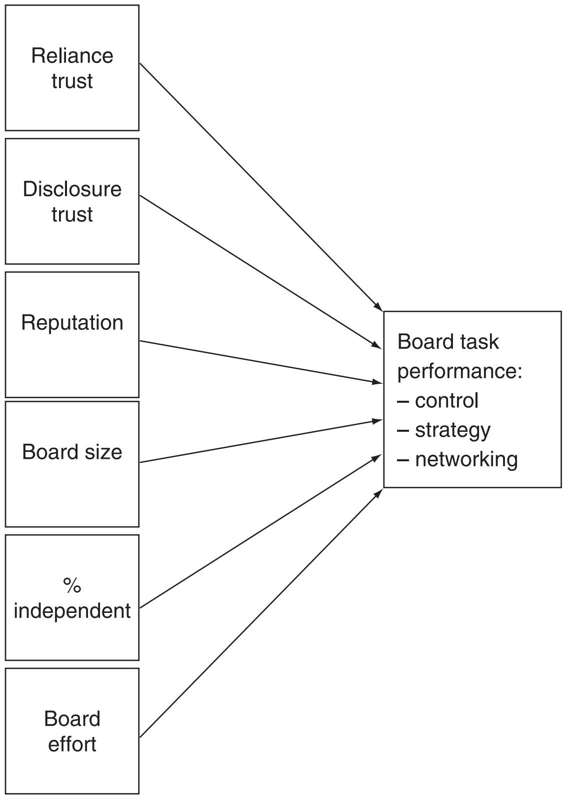

Figure 24.1 Board task performance and trust in the boardroom.

between trust and board task performance, the other variables are control variables, here. In our analysis, the antecedents of board task performance are consequently determined by reliance trust, disclosure trust, board member reputation as a proxy of the firm's relational capital, the size of the board, the composition of the board and the amount of effort put into board decision-making.

For the control tasks, non-executives need to build on the quality and expertise of executives. This is even more salient, as control generally takes place *ex post*. Reliance trust is the non-executives' subjective expectation that executives are able and competent and will strive for good company performance. This reduces the perceived need to monitor the behaviour of executives. Therefore,

> Hypothesis 1: *Reliance trust is negatively related to board control task performance.*

On the other hand, the strategy task is favourably affected by the willingness of non-executives to share information, participate in decision-making and disclose their own expertise *ex ante*. Disclosure trust, in this respect, increases the willingness of non-executives to actively engage in strategic decision-making and to disclose their expertise to the well being of the firm. Thus,

> Hypothesis 2: *Disclosure trust is positively related to board strategy task performance.*

Data and measurement

In The Netherlands, the structural regime (*Structuurregeling*) is the focal point of corporate control. The structural regime applies by law to public limited liability companies with more than 100 employees and an equity position of at least 11.4 million Euro. The Dutch structural regime is characterized by a two-tier board structure, consisting of a management board (*Raad van Bestuur*) in charge of the day-to-day operations of the firm and a supervisory board (*Raad van Commissarissen*). Dutch corporate law requires that all members of the supervisory board are non-executives. Under the structural regime the statutory scope of the supervisory board's control is substantial due to the widespread prevalence of legal devices for diluting voting power of shareholders and separating control rights from cash flow rights (Chirinko et al., 2004). In addition, under the current Dutch structural regime, until 2004, board members were selected by co-option, which contributed to the existence and dominance of the 'old boys' network' across Dutch boards through interlocking directorates (van Hezewijk and Metze, 1998).

To test our hypotheses, we collected a customized database on board behaviour in The Netherlands, covering information on trust and board tasks and characteristics. For that purpose, a questionnaire covering about 100 items, mostly in the form of statements, was sent in December 2003 to the CEOs and chairpersons of the boards of 849 Dutch firms. The firms were selected from the REACH database, which captures company information from the Dutch Chambers of Commerce. We selected companies with a turnover larger than 1 million Euro, a workforce larger than 100 employees and both incorporated (in Dutch, *BV, NV*) and other legal structures (foundations, co-operatives). For information purposes, the availability of the annual reports for the years 2000, 2001, and 2002 was an additional requirement. We corrected this sample for firms listed on the same postal address, firms that did not have an address and firms that did not have a supervisory board. For 21 firms the addresses were not up-to-date and 18 firms indicated that they did not want to cooperate for various reasons. Two mailing rounds resulted in a return of 136 questionnaires, a total response rate of 8.2%, by March 2004. The data analysed in this paper came from 86 CEOs and 43 board members that responded to our questionnaire (n = 129). The majority of the respondents are from firms within the structural regime, i.e. this applies to 74% of the respondents in our sample.

Finally, as board behaviour is a sensitive and heavily debated topic in The Netherlands, we guaranteed complete anonymity to the respondents in advance. Anonymity implies that respondents could not be identified by their firms or by their connections to other respondents.

All variables in our analysis are constructed from the statements in the questionnaire. The CEOs and chairpersons of the supervisory boards were asked to indicate to which extent they agree or disagree with statements about issues of boards and corporate governance. The design of the questionnaire was focused on the attributes, relationships, processes and performance of boards and used as much as possible validated questions to identify the constructs under consideration. The statements were measured on a five-point Likert-type scale. The variables in the data analysis were mostly derived from factor analyses by which each scale was computed by dividing the total sum of item scores by the number of items.

Three board tasks are distinguished: the strategy, the network, and the control task. The different items of each role are validated by previous studies (Westphal, 1999; Wijbenga, 2004; Zahra and Pearce, 1989). The network task variable involves two items, Cronbach alpha is 0.72. The strategy task variable consists of five items, Cronbach alpha is 0.8. The control task variable is based on seven items, Cronbach alpha is 0.67. All alphas are above the lower limits of acceptability (generally considered to be about 0.60).

The two trust variables measuring reliance and disclosure trust respectively, are constructed from a validated set of questions from Gillespie (2003). Disclosure trust is based on three items, reliance trust on four items. The Cronbach alphas are 0.70 and 0.68, respectively.

As has been explained with the help of Figure 24.1, in our analysis trust affects the working relationships within boards, amidst other variables. This research firstly takes into account board size, i.e. the number of directors in the supervisory board and secondly, formally independent directors, defined as the ratio of independent directors and the total size of the board. Dutch corporate law forbids insiders to hold a position on the board, but quasi-insiders, experts and other non-employee members who act in the interest of the incumbent management, frequently hold positions on Dutch supervisory boards. In this study, independent directors are those board members who cannot be attributed to any particular stakeholder group. A third variable, hours of contact, describes the number of formal (annual) meeting hours of the board, which is taken as a proxy of board effort. Finally, firms may tap into the reputation of board members to improve their own corporate image or to enhance credibility as a business partner. As such, board members provide relational capital. The five items on the reputation scale are from Goel and Luoma (2001) and Cronbach alpha is 0.74.

Data analysis

Formal tests, not reported here, confirm that we have to be careful with the assumption of normally distributed variables. This implies that the correlations between the variables are calculated by using Spearman's rho statistic. Table 24.1 reports these correlation coefficients.

From Table 24.1 we can conclude, first, that reliance trust is not significantly associated with any of the board tasks, whereas disclosure trust is positively associated with the control tasks and the strategy tasks of the board. Second, a significant but low positive correlation between the trust concepts exists. Third, networking and board member reputation are positively associated, which is in line with expectations. Fourth, the number of independent board members is positively associated with the control tasks and negatively associated with the networking tasks. Both findings are in line with expectations.

In order to gain some additional insights into the causality of the relationships between trust and the three sets of board tasks, Table 24.2 reports the results of OLS regressions of the three board tasks on these variables. Board size, the ratio of independent directors, board effort and reputation serve as control variables in these regressions.

From Table 24.2 we conclude from the adjusted R-squares that board task performance is, to some extent, explained by our choice of independent variables. Furthermore, the significance of some of the coefficients reveals interesting causalities. First, a favourable reputation of board members is important if board members are to get involved in strategy and networking activities. Reputation and prestige of board members strongly signals the appreciation of existing business networks and may therefore open doors that would remain closed otherwise. Second, independent members are less likely to perform networking activities. In the Dutch context, independent directors are independent from any stakeholder group. The results indicate that the fewer independent directors sitting on the board, the more the network task may be advanced. This can be explained because our definition of independence places these directors strictly outside the prevailing business networks. Third, board effort does not affect task performance. Fourth, disclosure trust is important in control and strategy, which is partly in line with hypothesis 2. The disclosure of personal or sensitive information is positively related to the strategy and control task performance of the board as the significantly positive coefficients indicate. Fifth, and in line with hypothesis 1, reliance trust negatively affects board task performance as it negatively affects board control and does not affect the other tasks.

Obviously, our results are constrained by the limitations of a study of this kind. First, the statistical analysis is exploratory. Second, the response rate is rather low, which is typical for research on boards as it is generally hard to get data on the workings of boards. Third, although we have been able to identify theoretically meaningful constructs from the data, the construct validity is sometimes low and subsequent research is needed. Fourth, as with many

Table 24.1 Correlation matrix

		Mean	*SD*	*1*	*2*	*3*	*4*	*5*	*6*	*7*
1	Control tasks	4.48	0.54							
2	Networking tasks	3.20	0.89	0.08						
3	Strategy tasks	3.11	0.70	0.38**	0.26**					
4	Board size	5.24	2.16	0.14	–0.15	0.03				
5	Reputation	3.56	0.62	0.11	0.34**	0.17	–0.04			
6	Independents	0.51	0.38	0.20**	–0.18*	0.09	0.09	–0.15		
7	Disclosure trust	4.08	0.63	0.35**	0.04	0.22*	–0.13	0.01	0.02	
8	Reliance trust	3.68	0.67	–0.17	0.11	–0.01	–0.11	0.13	–0.25**	0.19*

* Correlation is significant at the .05 level (2-tailed)
** Correlation is significant at the .01 level (2-tailed)

Table 24.2 Board task performance

	Control	*Strategy*	*Networking*
Constant	1.16**	0.92	2.29**
Reputation	0.09	0.32**	0.28†
Board size	0.02	0.02	–0.05
Independence	0.11	0.18	–0.46*
Hours of contact	0.00	0.01	–0.01
Disclosure trust	0.20**	0.25*	0.05
Reliance trust	–0.10*	–0.06	0.07
N	119	123	124
F	5.51**	3.43**	2.82*
Adj. R^2	0.19	0.11	0.08
Jarque-Bera	14.61**	0.19	1.58

White heteroskedasticity-consistent standard errors and covariance
† Significant at the .10 level
* Significant at the .05 level
** Significant at the .01 level

similar analyses the problem of common-method variance applies (Harrison et al., 1996). We have dealt with it by making clear distinctions between the issues that are relevant in this study and by thoughtful questionnaire design.

Discussion and conclusion

The ambiguity of current research evidence concerning the performance of boards provides an important rationale for our analysis. By focusing on the interdependencies between (non-executive) board members and managers and, in particular, on the role of trust, this paper offers a new perspective on the notion of effective corporate governance. Rather than the formal attributes, the development of interpersonal trust between board members may affect the task performance of boards. Although this result is in accordance with the evidence from the literature on team decision-making, it is new in the context of the literature on corporate governance in general, and the literature on board task performance in particular. As such our paper indicates that the introduction of these themes and concepts into the research on corporate boards can be interesting and productive. In particular, disclosure trust, i.e. the willingness to share personal information or lose face in discussions with managers, and – consequently – to be involved with the corporation, is related to board task performance, as hypothesized. Reliance trust, defined as the willingness to accept the managers' expert decisions at face value, is found to have a negative impact on the boards' control tasks, which also confirms our hypothesis. We thus conclude that trust is needed in order to generate the free exchange of knowledge and information and the predictability of behaviour, and that this may be a real dilemma many board members are facing.

In line with the exploratory nature of this paper, there are many interesting topics for subsequent research. First, there is definitely a need to improve the construct validity of the trust and control concepts we have identified. In this respect, this paper only provides a first start for subsequent empirical research. Second, while this paper is confined to a more or less static approach of measuring and relating characteristics of trust, the issue of trust building in boards ideally requires a dynamic approach. In this respect, the dynamic interaction between board activities, corporate performance and trust building within boards needs further consideration. Following Sundaramurthy and Lewis (2003), the concepts of so-called trust building cycles could be explored further by analysing whether or not these cycles can somehow be attributed to the trust concepts of reliance and disclosure, introduced and identified in this paper. A final interesting issue for subsequent research emerges from the popular notion that (too much) trust can hamper the performance of the board. Our results indicate that this conclusion needs adjustment, in the sense that it is particularly the amount of reliance trust that negatively affects monitoring performance. We do not find any significant evidence that disclosure trust harms the performance of the board. To the contrary, there is a significant positive relationship between disclosure trust and the strategy task performance. With respect to the control task, we could argue, by paraphrasing Daily et al. (2003: 376), that effective boards successfully 'build and maintain trust in their relationships with executives, but also . . . maintain some distance so that effective monitoring can be achieved'.

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25 Consequences of board power

Pingying Zhang Wenstøp

Abstract

This article contributes to the understanding of the complexity of board power. I use the concept of *board power* to examine the board's *decision-controlling role, structure-influencing role*, and *opinion-shaping role*. Normatively, board role performance makes sense as a measure of board power consequences; it succinctly captures what is expected from a board. According to the criteria of power, board roles are related to each other such that board power is manifested by intentional activities facilitating board control. Three hypotheses are tested and supported. The study uses survey data from Norwegian CEOs at two discrete points in time.

Keywords: Board power, Board roles, Decision-control roles, Structure-influence roles, Opinions-shaping roles

Introduction

In this article a novel use of the board power consequence is used to understand board role performance. The concept of *board power* can be defined as board capability of getting things done (Pearce and Zahra, 1991; Pfeffer, 1981). This article specifically examines board role performance as a consequence of board power.

That board power consequences include a control element is quite obvious and intuitively compelling, and there is a general agreement on this point. A board role is defined as a set of activities assigned to or expected of the board, which affects the relationship between the board and the management. The board has the legal responsibility for prudent action on behalf of owners, and performs the fiduciary duty of monitoring management. However, when board control is solely taken as the manifestation of board power, empirical studies show inconsistent results (Daily, Dalton and Cannella, 2003). Developing a systematic approach to measuring board power consequence is, therefore, a matter of practical importance that has gradually grown more urgent.

The article contributes to our understanding of the complexity of board power consequences. Board power is manifested by three types of board role performance that could be viewed as an instrumental capacity for getting things done, which is beyond board control.

Board power consequences

The definition of board power – the capacity for getting things done – contains three basic criteria of power.

The first criterion is that power in general is a *relational* concept; hence board power needs to be seen as relational. It is a relation between the board and the management. The interaction between the board and the management is analysed through board role performance.

The second criterion of power is the *control* element in power consequences. To intuitively claim that a power has been enacted, we should be able to observe the manifestations of control (Dahl, 1957). The analysis of control is one central element in most empirical studies of board power.

The third criterion is the *intentionality*. The focus on the intentionality has gained an important position in analysing power (Bachrach and Baratz, 1962 and 1963; Giddens, 1979; Lukes, 1974; Mann, 1986; Russell, 1938). In particular, the board is claimed to be a powerful board when it also shows intentional activities to facilitate board control.

In short, board power is a relational concept. We can study board power consequences through searching manifestations of board control, which the board has intentionally carried out. I present the model of board power consequences in Figure 25.1, which specifies relationships among board roles underlying the three criteria of power.

Control

In Dahl's classic study (1957), power is something that relates to observable conflicting interests between two power agencies, *A* and *B*. If *A* does not exert

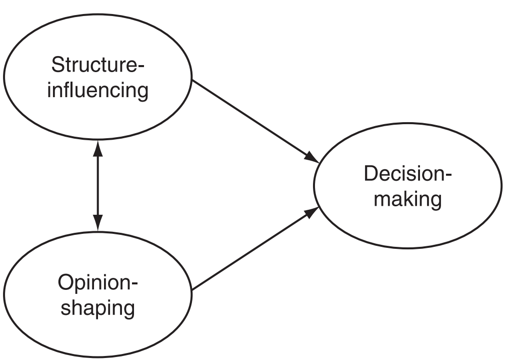

Figure 25.1 The model of board power consequences.

a sufficient amount of power over *B*, then *B* will choose according to its own preferences.

Decision-controlling role

Dahl advocates examining the manifestation of power through specific decision-making issues (1957). This approach to power underscores the idea of the board's decision-controlling role. It is a role that prescribes the board's responsibility in taking prudent actions in key decision-making areas. Despite the fact that we lack the specification of what 'prudent actions' may entail, it is generally regarded as activities of selecting and rewarding CEOs and other top managers, evaluating strategies of acquisition, and so on (Zahra and Pearce, 1989). Agency theory is probably the most applied theory underlying the understanding of board control in such areas. This theoretical perspective claims that managers would impose costs on shareholders due to conflicting interests between the management and the board. Setting up the board is aimed at controlling conflicting interests. This requires the separation of the decision-making tasks of the management from the decision-controlling tasks of the board (Fama and Jensen, 1983). According to agency theory, the board is responsible for ensuring that decision-making issues made by the firm managers are in line with shareholders' interests.

Empirically, concrete decision-controlling issues entail, for example, recruitment of CEOs (Carpenter and Westphal, 2001; Ocasio, 1999), top management compensation arrangements such as the adoption of long-term incentive plans (Zajac and Westphal, 1995), policy related to financial investment such as investment in research and development (R&D) (Baysinger, Kosnik, and Turk, 1991), anti-takeover policy such as the adoption of 'golden parachutes' (Singh and Harianto, 1989), and so forth. In a wider perspective, these issues represent observable activities that the board undertakes in exerting power over the management, which is termed as the board's decision-controlling role in this article.

We should be careful of treating the board's decision-controlling role as the only manifestation of board power consequences. The mere analysis of board control does little to account for the intentionality involved.

Intentionality

Where do we look for intentionality? According to Dahl's framework, we argue that the observable conflicting interests implies a power wielder's intentionality in exerting power. It may very well be the case for most decision-making issues. However, we do not look for conflicting interests; we assume their existence in a power relation. And we assume that the conflicting interests present the reason for control. Nevertheless, there are cases where conflicting interests are less obvious and even unobservable. Hence, the analysis of control becomes problematic if we remove the assumption. For example, Westphal (1998) shows in his study that the CEO effectively manipulates the board by using persuasion and ingratiation, which greatly reduces observable conflicting interests between them, and which, however, manifests the CEO's intention of exerting control over the board.

Therefore, it is reasonable to look for intentionality by searching for issues with less obvious and even unobservable conflicting interests. One way to do so is to search for structural influence activities proposed by Bachrach and Baratz (1962, 1963) and Lukes (1974). The other way is to search for advice and opinion giving activities (Mann, 1986; Pfeffer, 1981, 1992; Russell, 1938).

Structure-influencing role

Some researchers approach intention by analysing 'non-decision-making issues' (Bachrach and Baratz, 1962 and 1963). They claim that Dahl has left out an important but less apparent face of power, which is external to the decision-making issues with less obvious conflicting interests. This face is termed non-decision-making issues (Bachrach and Baratz, 1962 and 1963; Giddens, 1979; Lukes, 1974).

Bachrach and Baratz and Lukes specifically direct the research attention towards the structure of meetings where decisions are made. Together Bachrach, Baratz and Lukes represent a view that might be called structural determinism. They emphasize structural constraints on the application of power; a topic which was further advanced by Giddens (1979). By establishing a link between actors and the structure, Giddens made the structure view clearer through his 'duality of structure' framework (1979). Giddens recognizes structural constraints, but at the same time he also pays attention to structural voluntarism, which addresses actors' sense-making activities. Structures that are constituted by knowledgeable and creative actors facilitate the actors' application of power. While these structural aspects can and often do influence decision outcomes, they are not necessarily arbitrarily chosen. Looking at the cases where tactical and strategic deliberation is involved in such structural preparations is therefore crucial in an overall assessment of board power.

From the view of structural determinism, the board meeting structure constrains board power. For example, the board meeting is a periodical and not a day-to-day event. Such a working structure inevitably reduces the chance of the board to exert power over the management. However, from the view of structural voluntarism, the board is able to influence the meeting to facilitate board control. For example, some researchers suggest a tactic of engaging in constructive conflicts and avoiding relational conflicts, to guide discussions effectively (Eisenhardt, Kahwajy and Bourgeois, 1997; Finkelstein and Mooney, 2003; Forbes and Milliken, 1999), and others suggest a deliberation of debating to enhance a better decision-making process (Eisenhardt et al., 1997; Simons, Pelled and Smith, 1999).

The essence of developing various actions in board meetings is to ensure directors' active participation. In particular, the board's raising critical questions and scrutinizing information initiated by the management could be taken as intentions of the board to facilitate the board's control over decision-making issues. We can thus hypothesize the following relation between the structure-influencing and decision-controlling roles of the board:

> Hypothesis 1: *Board structure-influencing role enhances board decision-controlling role.*

Opinion-shaping role

The intention of the board in exerting power over the management could also be represented by opinion shaping, which is treated as an ultimately relevant element in power (Russell, 1938). It represents a philosophy of launching a war without fighting.

Opinion shaping largely hinges on the capabilities to influence decision-making issues. Therefore, observing conflicting interests is not the core of identifying power manifestations. This capability depends on the power executers' professional knowledge as well as their social capital (Hillman and Dalziel, 2003). In the context of the board, it is reasonable to assume that directors have mastered sufficient knowledge in their professional areas, and that their opinion-shaping role is therefore highly related to their social capital, which in essence is about networking.

Opinion-shaping through networking serves three purposes. One is to facilitate the management to reduce the firm's interdependency by securing external resource provisions (Pfeffer, 1981). Second, networking provides learning opportunities for CEOs from their peers who sit in their boards. In particular, when a CEO is newly recruited outside the firm, the board has a higher chance of influencing the CEO's opinion. Third, it provides a psychological type of resource such that the board's decision-controlling role becomes more effective. That is, networks between the management and the board facilitate trust building between them (Westphal, 1999). It is particularly important when the CEO – the main advice seeker – may have to disclose problems to the board and admit the CEO's limitations in solving them. We thus suggest the following hypothesis about the relation between the opinion-shaping and decision-controlling roles.

> Hypothesis 2: *Board opinion-shaping role enhances board decision-controlling role.*

The board's structure-influencing and its opinion-shaping roles are not isolated from each other; they are positively correlated with each other. In evaluating key decision-making issues, the board would, in general, collect and analyse different information. Advice and opinions based on information which is privy to board networks may encourage directors to raise critical questions in board meetings. Similarly, a decisive manner in asking probing questions in board meetings may become reinforced when such a manner is also shared among other directors in their networks. The following relationship between the structure-influencing and opinion-shaping roles can thus be hypothesized:

> Hypothesis 3: *Board structure-influencing role is positively correlated with board opinion-shaping role.*

Method

Structural equation modeling (SEM) is used to test the board power model. SEM is a system for specifying causal relations and quantifying their strengths through a system of linear regression equations referred to as structural equations (Barney, Wright and Ketchen, 2001).

Samples and data sources

Survey data was used as input to the analysis. The data are from the database of the Value Creating Board project at the Norwegian School of Management (Sellevoll, Huse and Hansen, 2007). To increase the validity and reliability of the three constructs (Kelloway, 1998), replication of SEM analysis was performed using two different sample sets; one is from a 2003 survey, and the other from a 2005 survey. In practice, survey replication has not been widely used, probably due to the difficulty of obtaining survey data. The database of the Value Creating Board project allows the replication of the SEM analysis using two samples.

The 2003 survey was sent in October 2003 to 1530 Norwegian firms. The survey sample includes all firms listed on the Oslo Stock Exchange in 2002. In addition, it includes the 1000 largest Norwegian public limited corporations (ASA) and private limited firms by share (AS), which are outside the Oslo Stock Exchange in 2002. Finally, it contains smaller-sized AS firms with employee numbers less than 30 randomly selected in 2002. There are 488 CEOs who answered the questionnaire, which gives a response rate of 32 per cent.

The 2005 survey was sent out in October 2005 to 3300 firms. This survey sample includes all firms surveyed in 2003 that still existed in 2004. It also contains all firms listed on the Oslo Stock Exchange in 2004, and the 1000 largest ASA and AS firms in 2004. Last, it contains 1500 smaller-sized AS firms with employee numbers less than 50 randomly selected in 2004. By the time when this article was written for an Academy Management Meeting in 2006, most data of smaller-sized AS firms had not yet been processed for the statistical analysis. Thus, the actual survey sample is reduced to 1485 firms for this article. There are 411 CEOs who answered the questionnaire, with a corresponding response rate of 32 per cent. No evidence of biased response against the firm size is found for the two samples.

The final usable sample size is 452 and 388 for the 2003 and 2005 surveys respectively, which is considered as adequate. Although the analysis lacks smaller-sized firms in the 2005 sample, the structural model is not size dependent, and therefore it is not considered to be a problem.

Measurement

Multiple constructs

Direct questions concerning power may be biased by self-reporting, thus impairing the validity of the measurements (Cannella and Lubatkin, 1993). The application of multiple constructs is one remedy for this (Clark and Watson, 1995). A perceptual type of multiple constructs was used in both surveys. CEOs were asked to indicate to which degree they agreed with statements about performance of board decision-controlling, structure-influencing, and opinion-shaping roles. A Likert-type scale ranging from 'disagree' to 'agree' was used as an instrument to record the strength of agreement.

There are three constructs: the board's decision-controlling, structure-influencing, and opinion-shaping roles. The decision-controlling role includes items which indicate how the board manages the firm budget, investment policy, liquidity, and recruitment. The structure-influencing role includes items which address how the board raises critical questions concerning information presented and suggestions initiated by the CEO. The opinion-shaping role contains items which describe how the board contribute to and make use of board network building.

Cronbach's alpha statistics were used to check the extent that the items of a construct are related to each other. An alpha value between 0.60 and 0.70 is deemed to be on the borderline of acceptability, but may be lower if the construct is complex. The 2003 alpha value for the decision-controlling role construct is 0.68, for the structure-influencing role 0.85, and the opinion-shaping role 0.80. To enhance the consistency of the construct, one additional item is chosen for the decision-controlling role, and one is chosen for the opinion-shaping role from the 2005 sample. The corresponding alpha values have therefore improved to 0.81, 0.83, and 0.81. All these values are based on CEO responses for both samples.

To further investigate the reliability of the three constructs, alpha values based on the board chairperson responses in the 2003 sample were computed. In the 2003 survey 200 board chairpersons answered the same questions as the CEOs (in the same firm). The alpha values are 0.63, 0.85 and 0.73, respectively. The reliability of the three constructs thus appears to be acceptable for further SEM analysis.

Likert-type scales

A five-point Likert-type scale was used in the 2003 survey, but in order to increase response variability (Nunnally and Bernstein, 1994), the 2005 survey used a seven-point Likert-type scale. It is unproblematic to transform a seven-point scale back to a five-point scale. It can be done by monotonic transformation, preserving the original rank-order properties of the data (Nunnally and Bernstein, 1994).

Analysis and results

LISREL 8.7 was used to run the analysis. A key feature of this software program is that it adds exploratory factor analysis to confirmatory factor analysis in one statistical procedure. Description of the data and two covariance matrixes for the 2003 and 2005 samples are presented in Table 25.1.

The results of parameter estimations are presented in Table 25.2. The results contain factor and regression analysis of the constructs.

The factor loadings in both samples are significant for all three constructs: decision-controlling role, structure-influencing role, and opinion-shaping role. The first item of the directors' involvement in controlling cost budget is not significant in any of the samples. However, taken as a whole, the quality of

Table 25.1 Covariance matrix for construct items

Questions 2003	*Mean*	*s.d.*										
1a	4.00	0.97	0.94									
1b	4.07	0.97	0.50	0.95								
1c	4.19	0.91	0.50	0.55	0.83							
1d	4.12	1.21	0.25	0.20	0.24	1.46						
2a	3.47	1.03	0.28	0.20	0.16	0.21	1.06					
2b	3.24	1.03	0.21	0.21	0.17	0.17	0.78	1.07				
3a	3.25	1.11	0.19	0.20	0.24	0.29	0.19	0.18	1.23			
3b	2.68	1.13	0.08	0.09	0.15	0.29	0.06	0.06	0.84	1.29		
Questions 2005	*Mean*	*s.d.*										
1a	4.88	1.72	2.95									
1b	5,18	1,56	1.58	2.44								
1c	4,50	1.78	1.75	1.54	3.16							
1d	5.25	1,56	1.31	1.36	1.60	2.41						
1e	3,42	1.68	0.83	0.90	1.09	0.85	2.81					
2a	5.11	1.36	0.56	0.59	0.55	0.76	0.46	1.84				
2b	4.61	1.48	0.54	0.43	0.66	0.67	0.49	1.45	2.20			
3a	4.45	1.67	0.68	0.84	0.64	0.77	0.62	0.74	0.60	2.80		
3b	3.72	1.62	0.64	0.60	0.69	0.66	0.66	0.43	0.46	1.71	2.62	
3c	3.99	1.64	0.64	0.73	0.82	0.68	0.64	0.57	0.59	1.59	1.45	2.69

Table 25.2 Results of parameters estimations[a]

	2003	*Parameters*	*Standard deviation*	*2005*	*Parameters*	*Standard deviation*
Board decision-controlling role	1a	0.66 (not sig.)	–	1a	1.24 (not sig.)	–
	1b	0.77 (12.69)	0.06	1b	1.20 (13.46)	0.09
	1c	0.71 (12.64)	0.06	1c	1.35 (13.34)	0.10
	1d	0.34 (5.22)	0.06	1d	0.76 (8.18)	0.09
				1e	1.14 (12.97)	0.09
Board structure-influencing role	2a	0.90 (13.60)	0.07	2a	1.25 (15.44)	0.08
	2b	0.87 (13.27)	0.07	2b	1.16 (13.68)	0.09
Board opinion-influencing role	3a	1.31 (7.32)	0.18	3a	1.38 (17.46)	0.08
	3b	0.64 (6.44)	0.10	3b	1.22 (15.77)	0.08
				3c	1.18 (14.76)	0.08

Structure model of constructs[b]		GFI	AGFI	R^2		GFI	AGFI	R^2
Board structure-influencing role	0.29 (4.91)	0.98 >0.95	0.95> 0.90	0.13	0.27 (4.36)	0.97 >0.95	0.95 >0.90	0.27
Board opinion-shaping role	0.18 (3.31)				0.36 (5.59)			
Correlation between structure-influencing role and opinion-shaping role	0.17 (3.36)				0.37 (6.90)			

a. N= 452 in 2003 sample, N=388 in 2005 sample. T-values are reported in parenthesis.
b. Standardized solution is reported with t-value in parenthesis. GFI is goodness fit index, AGFI is adjusted goodness fit index.

the construct of decision-controlling role is satisfactory. The results from each sample show that board structural-influencing role is significantly and positively correlated to board decision-controlling role. Further, board opinion-shaping role is also significantly and positively correlated with the decision-controlling role. The positive correlation between board structure-influencing role and board opinion-shaping role is significant as well. R^2 is 0.13 and 0.27 for the 2003 and 2005 sample, respectively.

When evaluating the model fit, Chi-square statistics, χ^2, is problematic. It increases with the size of the sample (Kelloway, 1998). Three alternative fit indices were used: the root mean squared error of approximation (RMSEA), the goodness fit index (GFI), and the adjusted goodness fit index (AGFI).

The RMSEA value for the 2003 sample is 0.055, with 90 per cent confidence interval values (0.033, 0.077). The lower bound value 0.033 is below the critical value 0.05, and the upper bound value 0.077 is also below the critical value 0.08. The statistics indicate a good fit (Jøreskog and Sørbom, 1993). The RMSEA value for 2005 sample is 0.051, with 90 per cent confidence interval values (0.032, 0.069). Both samples give a reasonably good fit based on RMSEA.

The critical values of GFI and AGFI are 0.95 and 0.90 respectively. A higher value than the critical one indicates a good fit (Jøreskog and Sørbom, 1993). In the study, The GFI and AGFI values for the 2003 sample are 0.98 and 0.95 respectively. Corresponding values for the 2005 sample are 0.97 and 0.95. This indicates a good fit.

In addition to the above fitness indices, the SEM of board power were further assessed through two nested model comparisons (Kelloway, 1998). The first alternative is a two-factor model, where board structure-influencing role and board opinion-shaping role are combined into one construct, while keeping the construct of board decision-controlling role unchanged. The second alternative is a single common construct model where all three constructs are combined into one construct, meaning that there is no need to classify board power elements. The two alternative models failed to offer better fit indices. Therefore the original structure model has a good fit for both samples.

Consequently, the hypotheses 1, 2 and 3 are supported. Specifically, board structure-influencing role and opinion-shaping role not only strengthen board decision-controlling role, but also are positively associated with each other.

Discussion and conclusion

The concept of board power in this article is defined as getting things done, and its consequences are analysed through three distinctive board roles – the board's decision-controlling, structure-influencing, and opinion-shaping roles.

The article has two contributions to our understandings of board behaviour. First, board power is manifested by control that is facilitated by intentional activities. Logically, the article provides argument for why we should look for board activities outside the board control area when we analyse board power.

Second, the finding provides practitioners with an alternative way to evaluate board control. In general, a direct assessment of board decision-controlling role performance is difficult to obtain due to various reasons.

Though some researchers argue that the board composition may serve as a proxy of board control, the empirical results are inconsistent when using this proxy (Daily, Dalton and Cannella, 2003; Wagner III, Stimpert and Fubara, 1998). Others argue that ownership could enhance the effect of board control due to the incentive mechanism; still the empirical results are not satisfactory (Daily, Dalton and Rajagopalan, 2003). We need to find other measurements of board control. This article suggests an alternative approach. That is, by evaluating board structural-influencing and opinion-shaping roles, we would infer how well the board may have performed its decision-controlling role. We may use this approach to check board control measured by other methods such as board composition.

However, there are certain limitations in this article. First, the board structural-influencing role is only restricted to the discussion style in board meetings, and the opinion-shaping role is restricted to networking. Future research could relax this constraint by uncovering subtle activities such as persuasion and ingratiation (Westphal, 1998). Another limitation of the study is the usage of the perceptual type of constructs. There are different types of multiple constructs to counterbalance the self-reporting bias, such as structural and behavioural types of constructs (Finkelstein, 1992; Golden and Zajac, 2001). For example, the structural type of constructs would explore various structural positions that enable intentional activities to facilitate board control. If different types of constructs lead to a similar result, then the board power model proposed in this article will be strengthened.

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26 Boards of directors and firm innovation

An empirical analysis on large Italian companies

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Abstract

In this article we analyse how board characteristics influence firm innovation. Firm innovation refers to basic innovation and entrepreneurial activities internal to a firm, such as the firm emphasis on new product development, innovation technology, and R&D investments. Drawing on agency theory, we developed hypotheses on specific board structural characteristics – i.e. board size, outsider ratio, directors' shareholdings, and CEO duality – and firm innovation. We tested our model on a sample of 301 large manufacturing Italian companies. We find support for our argument that – contrary to predictions of agency theory on CEO ownership – directors' shareholdings negatively influence firm propensity to innovate. Our results also suggest that board size may play a role in shaping firm propensity toward innovation.

Key words: Boards of directors, Agency theory, Firm innovation, Italy.

Introduction

This article addresses how the board may influence firm innovation. Published studies on boards of directors have focused mainly on the relationship between board structural characteristics and firm performance, providing mixed support for the expected positive association between these two variables (Dalton et al., 1998; Dalton et al., 1999). Only a handful of studies have analysed in more detail the relationship between boards of directors and firm innovation.

Firm innovation refers to basic innovation and entrepreneurial activities internal to a firm, such as the firm's emphasis on new product development, innovation technology, and R&D investments (Zahra, Neubaum and Huse, 2000). The firm's emphasis on corporate innovation strategies is considered to be an important driver of a firm's competitive advantage in the long term (Hill and Snell, 1989) and of its financial success. In this article we aim to contribute to the literature on boards of directors by focusing on how a board's structural characteristics may influence a key determinant of firm financial performance, i.e. firm innovation. In the development of our hypotheses we refer to the agency theory. We tested our hypotheses on a sample of 301 large Italian manufacturing companies.

The article is divided in four parts. In the first part we present the theoretical model. The second part describes the sample, the survey and the variables. The third part outlines the results of the regression analysis. In the last part of this article we discuss the results and the implications for future studies on board of directors.

Boards and firm innovation

Extant research on board of directors has emphasized its potential contribution to the firm's value creation (Huse, 2000; McNulty and Pettigrew, 1999; Zahra and Pearce, 1989). Several theoretical perspectives have underlined the specific roles the board may play. Drawing on stewardship theory, some scholars have pointed out the board's contribution to strategy making: board members are to be considered advisors, whose main task is to contribute to the CEO's decision-making through their experience, competence and skills (Davis, Schoorman and Donaldson, 1997; Donaldson and Davis, 1991). The resource dependence theory has underlined how the firm may manage environmental uncertainty through linkages between board members and its external stakeholders; in this perspective, board members are to be considered as network providers who – increasing the firm's legitimacy, reputation and stock of resources – may boost firm financial performance (Pfeffer, 1972; Pfeffer and Salancik, 1978). In sum, according to the resource dependence perspective, the board performs a critical task, namely the networking task. Agency theory emphasizes the need to monitor the top managers of the firm in order to protect shareholders' interests from managerial opportunism. In the agency framework, the primary duty of the board is to monitor top management (Fama, 1980; Fama and Jensen, 1983; Jensen and Meckling, 1976). In the present article we adopt the agency framework to investigate the role of the board in firm innovation.

According to agency theory, an independent board may be beneficial to firm innovation, since it may mitigate the potential agency problem of under-investment in R&D, new product development and innovation technology, that is in all those activities which may sustain the firm performance in the long run (Alchian and Demsetz, 1972; Baysinger, Kosnik and Turk, 1991; Hansen and Hill, 1991). In fact, agency problems may arise in decision-making related to innovation depending on two different factors. First, innovation brings about information asymmetries. For instance, in relation to R&D spending – a major driver of firm innovation – it has been noted that 'information asymmetries between managers and shareholders increase in tandem with R&D investments (because of the specialized knowledge required, greater complexity of processes, difficulty in judging the appropriateness of managerial decisions within a short-time frame and the like' (Balkin, Markman and Gomez-Mejia, 2000; Gomez-Mejia, Larraza-Kantina and Makri, 2003: 228). Increases in information asymmetries weaken the shareholders' ability to value managerial decision-making and – as a consequence – the board becomes even more critical as a monitoring mechanism.

Second, the different risk propensity of shareholders and managers represents another reason for the board to exert its monitoring activities. Innovation is highly uncertain: for instance, the outcomes of R&D expenditures are neither immediate nor certain (Lee and O'Neill, 2003) and the innovation initiatives are risky and pay off only in the long run. However, shareholders may positively value firm risky initiatives since they may protect their investment through portfolio diversification strategies; on the contrary, managers invest their overall human and financial capital in a single firm and are prevented from pursuing any diversification strategy. As a consequence, risk-averse mangers tend to favour short-term payoffs (Hansen and Hill, 1991) and avoid innovation and risky initiatives (Kor, 2006). The board may contribute to mitigate this potential agency problem (Baysinger et al., 1991; Kor, 2006): as long as the boards are under the influence of the CEO, the risk aversion of the CEO will more likely be reflected in the firm's decision-making. On the contrary, 'an independent board could remind managers that developing and maintaining innovative capability is a priority of the firm' (Kor, 2006).

Hypotheses on boards and innovation

The number of board members is believed to be an important attribute of board composition (e.g. Hermalin and Weisbach, 1991; Pearce and Zahra, 1991). Board members are expected to monitor top managers and to support them in strategic decision-making. A greater number of directors should guarantee a wider access to external resources (Pfeffer, 1972; Pfeffer and Salancik, 1978) and a wider set of competences (Zahra, et al., 2000). However, we expect that a high number of directors entails several disadvantages, such as free-riding and factionalization (Golden and Zajac, 2001). Moreover, larger boards tend to be associated with higher levels of cognitive conflicts (Forbes and Milliken, 1999). All of these factors may weaken board unity and negatively affect its ability to discipline CEO decision-making. Therefore, we hypothesize that:

> Hypothesis 1: *There is a negative relationship between the number of board members and firm innovation.*

Predictions from agency theory explain why the presence of outside board members is usually considered to be positive for board task involvement, and consequently for the strategy task. Outside board members are not employees of the firm. Therefore, they are less likely to be dominated by firm executives and by the CEO in particular (Conyon and Peck, 1998). Published studies have shown that the proportion of outside directors is positively associated with directors' strategic involvement, since their contribution benefits from their broader knowledge of different companies (Zahra et al., 2000). Therefore, we hypothesize that:

> Hypothesis 2: *There is a positive relationship between the ratio of outside directors and firm innovation.*

A further element in the board structure refers to the proportion of directors with shareholdings. Agency theory suggests that pecuniary governance mechanisms make directors' interests more aligned to those of shareholders. It is particularly true for outsiders, whose incentives for value creation rely on equity links with the firm itself. According to Johnson, Hoskisson and Hitt (1993), directors' motivation should be reinforced by equity ownership in the firm, since it enhances the self-interest directors have when they are stock owners of the firm. Therefore, directors with shareholdings should support innovation projects aimed at improving firm performance. We thus hypothesize:

> Hypothesis 3: *There is a positive relationship between the proportion of directors with shareholdings and firm innovation.*

CEO duality refers to 'a board leadership structure in which the CEO wears two hats – one as CEO of the firm, the other as chairperson of the board of directors. The alternative – which may be reasonably referred to as an independence structure – describes the case in which different individuals serve in these capacities' (Rechner and Dalton, 1991: 155). According to agency theorists, CEO duality weakens the board's ability to fulfil its monitoring function and may induce conflict of interest (Dayton, 1984; Rechner and Dalton, 1991). In sum CEO duality may reduce board independence and its ability to discipline CEO propensity to under-invest in innovation initiatives. Therefore, we hypothesize that:

> Hypothesis 4: *There is a negative relationship between CEO duality and firm innovation.*

Methods

Sample and survey

We tested our hypothesis on a set of 301 large Italian manufacturing companies. Our data were collected through a questionnaire, which was sent to the 2000 largest companies ranked by turnover (response rate: 15%). All items were close-ended. To check for non-response bias, we collected archival data from AIDA and Datastream. The Kolmogorov-Smirnov two-sample test (Siegel and Castellan, 1988) provided consistent evidence across multiple variables (turnover, total assets, total earnings, ROI, ROE) that respondents and non-respondents came from the same population.

Dependent variable

We asked the CEO to measure – on a five-point Likert-type scale – the extent to which the firm makes R&D investments, pursues new product development, and realizes technological innovation (Zahra, 1996). Our dependent variable was constructed as a mean of these three items. The Cronbach alpha for this measure is 0.78, which is acceptable according to standard criteria.

Independent variables

Independent variables were also gathered through the questionnaire. Independent variables include board size (number of directors), outsider ratio (number of outside directors divided by total number of directors), percentage of owner-directors (number of directors with shareholding divided by the total number of directors), CEO duality (dummy variable; 1 = CEO duality).

Control variables

We controlled for listing, the presence of venture capitalists as owners, firm size (Ln number of employees), firm age, industry (dummy variable; 1 = hi-tech industries) (David et al., 2001; Goodstein, Gautam and Boecker, 1994; Kochar and David, 1996). We also controlled for CEO's characteristics: CEO tenure (number of years), CEO ownership (percentage of on firm equity) and CEO age (number of years) (Barker and Mueller, 2002; Wu et al., 2005).

Results

Table 26.1 provides the means, the standard deviations, and the Pearson product moment correlations for the variables used to predict innovation. To test our hypotheses, we used a linear regression analysis (OLS estimator). Results of regression analysis are presented in Table 26.2.

The first model showed a predictive power of some of the control variables. Specifically, the standardized Beta coefficients for firm industry, venture capital ownership and listing were respectively .25**, .12† and .11†. Conversely, firm size and firm age were not significant. The second model included the variables aimed at controlling for the CEO characteristics: our results show that firm innovation is positively related to CEO tenure (.16*). The third

Table 26.1 Correlation analysis

	Mean	*s.d.*	*Innov*	*Firm size*	*Firm age*	*Ind.*	*VC owner.*	*List.*	*CEO tenure*	*CEO owner.*	*CEO age*	*Board size*	*Out. ratio*	*BM shareh*
Innovation	3.34	.85	–	–	–	–	–	–	–	–	–	–	–	–
Firm size	6.33	1.50	.16	–	–	–	–	–	–	–	–	–	–	–
Firm age	44.5	32.4	–.02	.25	–	–	–	–	–	–	–	–	–	–
Industry	.45	.49	.29	.24	–.10	–	–	–	–	–	–	–	–	–
VC owner.	.08	.28	.19	.07	–.09	.15	–	–	–	–	–	–	–	–
Listing	.24	.43	.17	.15	.00	.07	.20	–	–	–	–	–	–	–
CEO tenure	16.24	12.71	.15	.06	.18	–.00	–.11	–.08	–	–	–	–	–	–
CEO own.	.08	.19	.04	–.08	–.04	.09	–.01	.00	.33	–	–	–	–	–
CEO age	53.5	9.2	.13	.09	.07	.01	–.07	.00	.49	.24	–	–	–	–
# Directors	7.1	3.7	–.05	.23	.17	–.05	.09	.32	–.03	–.09	.08	–	–	–
Outs. ratio	.46	.33	–.00	.18	.04	.01	.16	.31	–.06	–.15	.08	.43	–	–
BM share	.19	.29	–.15	–.12	–.06	–.03	.03	–.08	.04	.13	–.17	–.12	–.12	–
CEO duality	.29	.45	.05	–.05	–.00	–.09	.00	.04	.29	.36	.30	.06	–.06	–.11

Pearson correlation coefficients, 1-tailed: for correlations greater than .13, $p < .05$; for correlations greater than .17, $p < .01$

Table 26.2 Results of the regression analysis for innovation

	I	*II*	*III*
Firm size	.08	.06	.09
Firm age	–.00	–.03	–.02
Industry	.25***	.25***	.24***
VC ownership	.12†	.14*	.15*
Listing	.11†	.13*	.16*
CEO tenure		.16*	.16*
CEO ownership		–.05	–.06
CEO age		.07	.06
Board size			–.12†
Outsiders ratio			–.06
Board members shareholding			–.14*
CEO duality			.00
R^2	.13***	.16***	.20***
Adj R^2	.10***	.13***	.16***
R^2 change	.12***	.03*	.04*

The table reports the standardized coefficients β, the R^2, the adjusted R^2, the R^2 change, the F-value, and the significance levels: † $p < 0.10$; * $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$.
Dependent variable: Innovation

model included our independent variables related to the board structure (R^2 equals .21). Among the board variables, the percentage of owner-directors proved to be negatively related to firm innovation (–.13*), whereas we expected a positive relationship (Hp 3). In line with our expectations, the board size (i.e. number of directors) was negatively related to firm innovation, however, the coefficient is only slightly significant (–.12†).

Discussion

In this article we have studied how board structural characteristics influences firm innovation. Drawing on agency theory, we developed hypotheses aimed at showing how board independence may boost firm innovation. Moreover, we tested our hypotheses on a sample of 301 large Italian manufacturing companies. Our results showed that board members' shareholding is negatively related to firm innovation. Moreover, we found only weak support for the hypothesized relationships between board size and firm innovation.

Our main finding relates to the negative relationship between directors' shareholdings and firm innovation. The agency framework led us to hypothesize that board members' shareholdings may positively influence firm innovation. However, our results contradict our hypothesis: by showing that directors' shareholdings are negatively associated with firm innovation, our results suggest that when a high proportion of directors own shares, the board as a group may be characterized by a higher degree of risk aversion, thus reducing the level of firm innovation. This result is at odds with expectations derived from agency theory. We believe that one possible explanation is to be found in the different positions occupied by the CEO and by directors. For instance, the CEO is responsible for running the firm: in the agency framework the main issue is to divert his decision-making from opportunistic behaviours and protect shareholders' wealth. However, when it comes to directors' shareholdings, the picture may change significantly. As long as board independence is critical to monitor the CEO and to reduce the risk of under-investments in innovation initiatives, directors' shareholdings may reduce directors' independence and divert their judgement from the necessary independence, with negative consequences for risky initiatives such as firm innovation. Future studies may deepen our understandings of how directors' shareholding influences firm innovation.

Our results showed only a weak support for the hypothesized negative relationship between board size and firm innovation. According to our argument, a high number of directors is likely to increase the cognitive conflicts and factionalization in the board, and reduce the board effectiveness in curbing CEO risk aversion. This result seems to suggest that smaller boards of directors may be more effective in confronting the CEO and monitoring top management in respect of firm innovation, i.e. decisions which entail high risk and uncertainty.

This paper contributes to the literature by showing that some board structural characteristics do influence firm innovation. However, these results are only explorative and more in-depth analysis is needed in order to reach a clear understanding of the role of board of directors in firm innovation. In particular, drawing on our results, future studies may deepen our comprehension of how firm innovation may be affected differently by the CEO and directors' shareholdings.

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27 Board control and innovation

An empirical study of small technology-based firms

Jonas Gabrielsson and Diamanto Politis

Abstract

In this article we examine the influence of board control on innovation in small technology-based firms. An analysis of 135 Swedish technology-based firms suggests that board involvement in the control over strategic decisions and outcomes can have a significant influence on innovation. The empirical results suggest that board strategic control involvement is positively associated with process innovation, while board involvement in financial control is positively associated with organizational innovation. No association is found between board control and product innovation. In all, our findings contribute to a better understanding of how boards may contribute to value creation in small technology-based firms and also suggest some areas where further scholarly inquiry is highly warranted.

Keywords: Boards of directors, Strategic and financial control, Innovation, Technology, Small firms

Introduction

Commitment to innovation is becoming increasingly important for the development and competitiveness of small technology-based firms. Innovation creates opportunities for expansion, growth and profitability (Zahra, Neubaum and Huse, 2000) and is often an important way of achieving competitive advantage (O'Gorman, 1997). Firms who fail to update and renew their product offerings, technology platforms and business models will, on the other hand, sooner or later be squeezed out of the market by more innovative organizations (Bettis and Hitt, 1995; MacPherson, 1997). Consequently, a strong commitment to innovation seems crucial for the long-term growth and prosperity of technology-based firms.

A growing body of research suggests that a strong and vigilant board can have a significant impact on firm innovation (Baysinger, Kosnik and Turk, 1991; Markman, Balkin and Schjoedt, 2001; Zahra, 1996; Zahra et al., 2000). Following this stream of research, our overall aim in this article is to examine how boards' involvement in the control over strategic decisions and outcomes influences innovation in small technology-based firms. The reason for our interest in this issue is that there is very limited knowledge about whether small technology-based firms can actually improve their capacity for innovation by having an active board of directors (Gabrielsson and Huse, 2002). Smaller firms have in general a small managerial hierarchy and the organization can be characterized by an informal structure combined with an orientation towards action (Mintzberg, 1979). This large degree of flexibility makes them effective in spotting and seizing new venture opportunities based on changes in technology and customer demands. However, successful innovation requires formal planning and focused commitment of resources, especially in small entrepreneurial firms (Markman et al., 2001). Smaller firms are in this respect often naïve about planning and the development of strategy, sometimes even ignoring essential management activities such as performance reviews and strategic discussions (Deakins, O'Neill and Mileham, 2000; Fiegener, 2005). An active board of directors could in this respect discipline small technology-based firms to focus efforts and commitment to innovation to make sure that strategic decisions are in line with long-term goals and objectives (Barrow, 2001; Gabrielsson and Huse, 2002). However, as indicated above, the actual effect of board control on innovation in small technology-based firms is still relatively unexplored despite the importance of this knowledge for both theory building and practice.

The rest of the article is structured as follows. The next section presents a literature review, where we define the key concepts used in the study and then develop our hypotheses. Thereafter follows the method section where we present the sample and variables used in the study. This is followed by a presentation of the analysis and results. The article ends with a discussion of the results and their implications for theory and practice.

Board control and innovation: Hypotheses

Innovation

Innovation is generally seen as the result of novel and creative combinations of knowledge and resources (Prahalad and Hamel, 1990; Schumpeter, 1934). At the firm level, innovation is often associated with the introduction of new products or services in different markets. Moreover, innovation can assume many forms, such as new production methods or new organizational systems and structures (Damanpour, 1991; Utterbach, 1996). In this study we recognize innovation as a multidimensional concept which consists of a full range of organizational activities that promote long-term value creation (Garcia and Callantone, 2002).

Successful innovation, however, does not come easily. The choice to organize efforts and commitment to innovation in technology-based firms is rather subject to severe tensions between the competing demands for short-term cash generation and long-term value creation. Technology-based firms base their activity mainly on the exploitation and refinement of advanced technological knowledge (Autio and Yli-Renko, 1998), while innovation instead requires a strong emphasis on the exploration of new possibilities and alternatives. Managers may in this respect make decisions that do not maximize the long-term value of the firm and instead choose to divert resources to projects or goals with shorter payback periods (Jones and Butler, 1992). This bias often prevents the active exploration and pursuit of new innovative opportunities in favour of refining and extending existing competencies and technologies where exhibiting returns is more certain (March, 1991).

Boards of directors and decision control

The centrality of board decision-making in guiding organizational action is an established conception in literature on boards and governance. According to this view, the board of directors operates at the apex of the organization with a considerable potential to influence the direction and performance of the company (Mintzberg, 1983; Zahra and Pearce, 1989). One of the most fundamental ways for boards to aid the long-term development of the company is through 'decision control', which encompasses involvement in board activities such as performing high-level reviews of strategic plans, evaluating past decisions, and monitoring executive and firm performance (Fama and Jensen, 1983; Fiegener, 2005). By doing this, the board is expected to add value to the company by delegating decision management to agents with valuable relevant knowledge (the executives) while providing external control and by assisting the CEO in determining strategic objectives.

Board control and innovation

Literature and research on organizational control systems generally recognizes two types of control that may influence innovation in an enterprise: financial and strategic controls (e.g. Baysinger and Hoskisson, 1990; Hoskisson and Hitt, 1988). Financial controls are based on objective decision areas such as the organizational budget, equity, liquidity and finance. These controls are clear and unambiguous, which provides an opportunity to agree on objective performance standards well in advance of any performance evaluation (Hoskisson and Hitt, 1988). The use of objective financial criteria also introduces a high degree of discipline into the control process and can to some extent enhance precision in decision-making. However, this kind of performance assessment is often unable to account for information that is difficult to quantify, and is also often based on short-term rather than long-term performance dimensions (Li, Li, Liu and Wang, 2005). As such, a heavy emphasis on financial decision control by the board of directors may not encourage visionary thinking and creativity in the organization, and thus can be expected to stifle rather than support innovation in small technology-based firms.

Strategic controls, on the other hand, are based on strategically relevant decision criteria that are more subjective, for example decisions related to external market and user needs and new products (Hoskisson and Hitt, 1988). As such, these types of performance assessments highlight the need for imagination and creativity and recognize the more long-term dimensions of business enterprise (Barringer and Bluedorn, 1999). Strategic controls are thus also often qualitative types of control. They also emphasize resource sharing and cooperation between groups and subunits by facilitating an organizational climate where frequent communication about the firm's initiatives and situation are encouraged (Kerr, 1988). Strategic controls can consequently be expected to be more consistent with supporting innovation in small technology-based firms.

Based on the discussion above, we expect boards who are highly involved in strategic decision control to be highly committed to innovation. For boards who are highly involved in financial decision control we expect the opposite relationship. This leads to the following two hypotheses:

Hypothesis 1: *Board involvement in financial decision control is negatively associated with innovation in small technology-based firms.*

Hypothesis 2: *Board involvement in strategic decision control is positively associated with innovation in small technology-based firms.*

Method: Sample and variables

Data collection

We designed the empirical study as a questionnaire survey. Firms in three technology-based industry sectors were selected to design an appropriate sample for the study: i) manufacturing of electronic machines and components, ii) manufacturing of electronic communication equipment, and iii) manufacturing of optics/medicine/photo. We also followed the standard definition for small firms in the European Union (10 to 50 employees). Here we only selected privately held firms and excluded proprietorships and partnerships as they are not legally required to have a board of directors.

Our selection criteria led to an initial sample of 451 technology-based firms. Mail addresses to the firms were collected from SCB's (Statistic Sweden's) register of Swedish companies. Questionnaires were mailed in early spring 2000 to the CEO of the companies. A control question was included in the questionnaire to verify that it was the CEO who answered the questions. After two reminders we received 135 responses, which corresponded to a response rate of approximately 30%. A non-response analysis revealed no statistically significant differences between respondents and non-respondents with regard to industry branch.

Measures

Innovation

In line with our frame of reference we conceptualize innovation as consisting of product, process and organizational forms of innovation. To develop measures for innovation, 12 survey items were taken from Huse (1994). Respondents rated their firm's actual emphasis on each item using a five-point scale. The 12 survey items were then subjected to principal component analysis with varimax rotation. Based on the analysis, we created innovation measures using multi-item indices where average scores of the items in each of the three factors were used in the analyses. A detailed report of the principal component analysis can be found in the appendix.

Board decision control

In line with our frame of reference, board involvement in decision control was divided into two dimensions: financial decision control and strategic decision control. A five-point scale consisting of six items developed expressly for this research was used to gauge board involvement in financial and strategic decision control respectively. These items were based on the theoretical work of Fama and Jensen (1983) and Baysinger and Hoskisson (1990). We conducted a principal component analysis using varimax rotation to validate the two scales. The items loaded significantly on the expected factors with eigenvalues exceeding 1.0, and combined these two factors explained 68.0% of the variance. This procedure led to the financial decision control being measured as the mean of three items ($\alpha = .75$), and strategic decision control being measured as the mean of three items ($\alpha = .76$). A detailed report of the principal component analysis can be found in the appendix.

Control variables

Three variables were included as statistical controls in the analysis because of their potential impact on innovation in technology-based firms: 1) environmental dynamism, 2) firm age, and 3) past firm performance.

Environmental dynamism. The first control variable measures the dynamism in the operating environment of the firm. Environmental dynamism refers to the continuity of changes in the firm's environment (Zahra, Neubaum and Huse, 1997). Highly dynamic environments are generally expected to encourage innovation and entrepreneurial behaviour, but also to intensify rivalry by encouraging new firm entry into the market (Miller, 1983). We therefore expect dynamic environments to be positively associated with innovation. The perceived level of dynamism was measured by the mean of five items on a Likert-type scale ($\alpha = .71$). These items were taken from Zahra et al. (1997).

Firm age. The second control variable was firm age. This variable was included as organizational aging can have effects on firms' innovative outputs (Sørensen and Stuart, 2000). Firm age was measured as the number of years that has past since the firm was founded.

Firm performance. When firms perform well they create slack resources that may be used for innovation and new venturing activities (Cyert and March, 1963; Zahra et al., 2000). Therefore, we included a control variable that measured the firms' operating profit margin. The measure used was the three-year average of the firms' operating income divided by their sales revenue (i.e., return on sales, or ROS).

Methodological limitations

We acknowledge that our study may have some potential methodological limitations. The most important limitation is perhaps that our design is cross-sectional, which makes it impossible to resolve issues of causality. Basically, this means that the contrary interpretation that increased emphasis on innovation in the firm may warrant a higher involvement in board control can be just as tenable from our data. Moreover, the study is based on empirical innovation and board data from Swedish technology-based firms. Sweden has, for example, recently been ranked as having the best innovation climate among all EU nations according to the EU Commission's European Innovation Scoreboard (Arundel and Hollanders, 2005). There are also strong jurisdictional and cultural differences between different countries that can have an impact on the conduct and behaviour of boards. These country specific contingencies may limit the generalizability of our findings to other countries. Additional studies, with longitudinal designs and conducted in different countries, should hence be done to test the robustness of our results across contexts.

Analysis and results

Multiple regression analysis was used to test the hypotheses. Before the analysis we ran Harman's one-factor test in order to assess whether common method variance presents any problems in the present study (Podsakoff and Organ, 1986). The Harman test, however, produced multiple factors and consequently there were no signs that common method bias may pose a serious problem in our data. Table 27.1 presents means, standard deviations and correlations among the variables used in the regression analyses. Table 27.2 presents the regression analysis.

Our first hypothesis was that board involvement in financial decision control is negatively associated with corporate innovation. In this case, we did not find any association between financial decision control and product or process innovation. Moreover, and contrary to our initial expectations, we found a positive association between board involvement in financial decision control and organizational innovation, $p < .05$. Consequently, hypothesis 1 was not supported.

Table 27.1 Means, standard deviations and correlations

	Mean	*Std.dev*	*1.*	*2.*	*3.*	*4.*	*5.*	*6.*	*7.*
1. Product innovation	3.29	.96	–	–	–	–	–	–	–
2. Process innovation	3.04	1.0	.59**	–	–	–	–	–	–
3. Organizational innovation	3.55	.79	.43*	.55**	–	–	–	–	–
4. Strategic decision control	3.31	.93	.16	.25**	.18	–	–	–	–
5. Financial decision control	3.77	1.00	−.01	.16	.25**	.17	–	–	–
6. Environmental dynamism	3.05	.66	.30*	.35**	.23*	.09	−.01	–	–
7. Firm age	24.8	17.8	.13	.16	.00	.04	.00	−.19*	–
8. Past firm performance	−.54	30.3	−.05	−.15	−.07	−.04	−.17	.03	−.23*

**. Correlation is significant at the .01 level (1-tailed)
*. Correlation is significant at the .05 level (1-tailed)

Table 27.2 Regression analysis

	Product innovation β	*Process innovation* β	*Organizational innovation* B
Environmental dynamism	.29**	.40**	.22*
Firm age	.13	.16	.00
Past firm performance	−.03	−.11	−.04
Financial decision control	−.04	.12	.25*
Strategic decision control	.15	.18*	.10
R^2	.13	.26	.14
Adj R^2	..08	.22	.10
F (F-sign)	2.9*	6.9**	3.2**

The table reports partial standardized coefficients (β), multiple R, R^2. adjusted R^2 and significance level * p < .05, ** p < .01

Our second hypothesis was that board involvement in strategic decision control is positively associated with innovation. In this case, we did not find any association between strategic decision control and product innovation. Neither could we find any association between strategic decision control and organizational innovation. However, the results from our analysis show that board involvement in strategic decision control is positively associated with process innovation, p < .05. Consequently, hypothesis 2 was partly supported.

Table 27.2 also shows that the statistical control variable environmental dynamism has a positive and significant association with all innovation measures. This finding corresponds to previous studies that have found that the external environment is a main predictor of a firm's innovative behaviour (Miller, 1983; Zahra, 1996). Given the results, the level of environmental dynamism should at least be taken into account in future studies of innovation in small technology-based firms, as the external environment seems to significantly influence the firm's emphasis on innovation-intense strategies.

Discussion of findings

In this chapter we have examined the influence of board control on innovation in small technology-based firms. Innovation was conceptualized as consisting of product, process and organizational forms of innovation. Board control was conceptualized as board involvement in the ratification and monitoring stages of strategic decisions (Fama and Jensen, 1983). Based on literature and research on organizational control (e.g. Baysinger and Hoskisson, 1990; Hitt et al., 1990; Hoskisson and Hitt, 1988), we divided decision control into two dimensions: financial and strategic decision control. The overall findings support our expectation that board involvement in decision control has an impact on innovation in small technology-based firms. However, the findings also show that the two different kinds of board control influence different forms of innovation. A more detailed discussion of the empirical findings will now follow, together with some suggestions for future research.

Financial board control and innovation

The main problem of applying financial principles and methods of control to promote innovation is often seen as that of dealing with the unknown (McGrath and Macmillan, 1995; Wilson, 1975). There was, however, no support for our first hypothesis that higher board involvement in financial control should negatively be associated with innovation. On the contrary, we found a positive association between financial board control and organizational innovation. The result is very interesting, not least as financial controls generally are expected to discourage a creative and innovative organizational culture (Barringer and Bluedorn, 1999). Hence, it seems that boards involved in financial decision control can play an important role in influencing the design of organizational systems aimed at supporting innovative activities in small technology-based firms.

The counter-intuitive finding may be explained by the fact that efficient financial controls can generate increased potentialities for slack resources, which in turn can be put into human resource policies and administrative structures aimed at stimulating organizational learning and experimentation (Hill and Stewart, 2000). Moreover, it is often argued that 'petty accounting' should be avoided when using financial controls to promote innovation (Kaplan and Norton, 1996; Wilson, 1975). Our choice of a rather broad conception of financial control – encompassing board involvement in decisions related to the organizational budget, liquidity, equity and ownership – may in this respect also explain parts of the result. Another potential explanation could be due to the size of the organizations under study. The problems of allocating different proportions of the organizational budget across different departments and multiple product lines that exist in large diversified corporations (Bower, 1986) may not be so apparent in small technology-based firms. Small firms have, for example, a less complex organization than larger diversified corporations, and they usually also operate in fewer product markets and in more local geographic areas (O'Gorman, 2000). This means that there is less distance between the shaping of strategic decisions and the actual implementation of these strategies. The effects of organizational-wide resource allocation decisions may consequently be stronger and more easily detected in smaller and less structurally complex organizations that have a more narrow focus. However, these are merely speculations which provide several avenues to explore the association between control and organizational innovation in future research.

Strategic board control and innovation

Strategic controls are generally expected to encourage innovation (Barringer and Bluedorn, 1999; Hitt et al., 1990; Hoskisson and Hitt, 1988). Accordingly, our second hypothesis was that increased board involvement in strategic control is positively associated with innovation. In our regression model there was only partial support for this hypothesis. What we found was a positive and significant association between strategic board control and process innovation. The findings imply that boards in small technology-based firms can play an important role in influencing the development of novel production and operation strategies aimed at making the organization's production as effective and efficient as possible. Hence, boards that are highly involved in strategic control facilitate new process technologies to enhance the business process and ultimately lead to competitive advantage and profitability.

We should also briefly mention that we did not find any significant associations between board control and product innovation, neither positive nor negative ones. This finding suggests that boards' involvement in the control over strategic decisions and outcomes has limited influence on new products or new variations to existing product lines in small technology-based firms. One explanation for the finding could be that the development of new product offerings often requires strong entrepreneurial leadership, technical support from independent specialists and close collaboration with customers to get things going (MacPherson, 1997; Von Hippel, 1988). Hence, product innovation in small technology-based firms seems to be contingent on other issues rather than strong supervision provided by the board of directors.

Interestingly, seen in combination, the above-mentioned findings may cast some light on the role of the board in supporting the innovation process in small technology-based firms. A high emphasis on process innovation could intuitively be expected as an alternative to product innovation. For example, while launching new products can put a firm ahead of its competitors and enable the charge of premium prices, the development of novel process technologies may instead lead to lower costs due to gains in productivity, material utilization and output reliability (O'Gorman, 2000). However, as can be seen in the correlation matrix, product and process innovation are highly correlated with each other in our sample ($r = .59$). This means that the development of new products often goes hand-in-hand with investments in new process technology development. Small technology-based firms that renew or diversify their product ranges may hence also need to update process technology in order to be able to make the different types of new products. Boards of directors seem in this respect to shape the strategic development of the firm by overseeing that the firm's production equipment supports the introduction of new products.

Board involvement in financial versus strategic decision control

An additional issue that is worth mentioning is that there is no significant correlation between board involvement in financial and strategic control. This suggests that boards do not put high simultaneous emphasis on both financial and strategic control. From this observation, we can conjecture that the actual involvement in financial versus strategic board control will mirror the concerns and interests of the dominant coalition, or at least represent some compromise among competing coalitions (Cyert and March, 1963; Mintzberg, 1983). What is interesting to note is that although it is well accepted in contemporary theories of organizations that bargaining and trade-offs characterize organizational decision-making, it is less well recognized that negotiating processes also characterize major decisions of boards of directors. Instead, most organizational and economic theorists have viewed boards as guided by a rational optimizing decision-making behaviour untouched by political processes in and around the boardroom (Ocasio, 1999). In a behavioural perspective, however, the position of the board in allocating attention and resources cannot always be regarded as non-problematic (Huse, 2005). Instead, various coalitions of actors can be expected to compete for influence over decisions and allocation of resources, such as the organizational budget, in any business organization (Bower, 1986; Cyert and March, 1963). The emphasis on various forms of decision control in the boardroom can hence be expected to be a matter of trade-offs between the often-competing goals and objectives of organizational actors. How various coalitions in and around the boardroom actually influence board involvement in financial versus strategic decision control is, however, a largely unexplored issue, something which warrants further scholarly attention.

Conclusions

To conclude, this chapter has contributed to literature and research in two important ways. First, the chapter has provided empirical results of how boards' involvement in the control over strategic decisions and outcomes influences innovation in small technology-based firms. The empirical results suggest that board involvement in the control over strategic decisions and outcomes may promote innovation, but that different kinds of decision control influence different forms of innovation. The empirical results suggest that board strategic control is positively associated with process innovation, while board involvement in financial control is positively associated with organizational innovation. In all, the findings indicate that the board of directors in small technology-based firms can be seen as a potential resource that can promote innovation by bringing discipline and rigor to the strategic planning process. Second, we have developed constructs to assess boards' actual involvement in decision control. The developed constructs are based on the theoretical work of Fama and Jensen (1983) and Baysinger and

Hoskisson (1990). To our knowledge no existing operationalizations of board involvement in decision control exists, something which makes the developed constructs interesting for further research in this area. Based on these contributions, we believe that the present study is an important step in research that seeks to open up the ‘black box’ of board behaviour and how board involvement in the control over strategic decisions and outcomes may contribute to value creation.

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Appendix

Factor analysis of innovation measures

Items[1]	*Product innovation*[2]	*Process innovation*[2]	*Organizational innovation*[2]
Being the first company in the industry to introduce new products	**.75**	.43	.09
Creating new products for fast market introductions	**.68**	.36	.24
Creating new variations to existing product lines	**.78**	−.07	.20
Increasing the revenue from new products less than 3 years old	**.73**	.35	.06
Being the first company in the industry to introduce new technology	.21	**.84**	.14
Being the first company in the industry to introduce technological improvements	.24	**.78**	.27
Creating innovative technologies	.14	**.84**	.23
Investing heavily in cutting edge process technology-oriented R&D	.14	**.68**	.36
Developing radically new technology	.27	**.76**	.20

Items[1]	*Product innovation*[2]	*Process innovation*[2]	*Organizational innovation*[2]
Developing systems that encourage initiatives and creativity among employees	.14	.20	**.80**
Encouraging innovation in the organization	.11	.30	**.84**
Supporting an organizational unit that drive innovation	.19	.20	**.72**
Eigenvalue	1.36	5.83	1.22
% of variance explained	11.30	48.56	10.15
Cronbach	.81	.90	.78

1 Items follow a 5-pointscale (1 = very low emphasis vs. 5 = very high emphasis)
2 Absolute loadings of .50 or higher are significant

Factor analysis of board control measures

Items[1]	*Financial control*[2]	*Strategic control*[2]
Involvement in the ratification and monitoring stage of strategic decisons related to . . .		
. . . the organizational budget	**.75**	.18
. . . equity capital and ownership	**.84**	–.08
. . . liquidity and finance	**.86**	.09
. . . markets	.32	**.76**
. . . customers	–.05	**.87**
. . . products	.01	**.77**
Eigenvalue	2.41	1.69
% of variance explained	40.15	28.16
Cronbach	.75	.76

1 Items follow a five-point scale (1 = very low emphasis vs. 5 = very high emphasis)
2 Absolute loadings of .50 or higher are significant

Part V

The value creating board

Implications for practice

28 How boards contribute to value creation

Morten Huse, Jonas Gabrielsson and Alessandro Minichilli

Abstract

Research about boards and governance has generally had limited practical implications. In this article we present some of the practical implications from the 'value creating board' research programme. Challenges for practice and organizational behaviour include how boards may contribute to value creation throughout the whole value chain, the importance of board leadership and how systems for board evaluations can be developed. We indicate that the emphasis on the 'value creating boards' may have some of the features of a new research stream or field of research.

Key words: Value creation, Value chain analysis, Board leadership, Board evaluations, Organizational behaviour

Introduction

There are many observations and reflections which indicate that active boards can destroy values rather than creating them. Such indications are also studied in the 'value creating board' research programme. However, when discussing these observations, we first need to make some clarifications. A first clarification is about what is meant by value creation. Another clarification is related to organizational behaviour and the human side of corporate governance.

We cannot take it for granted that all shareholders and investors have the same notion of value creation, and value creation can be more than short-term changes in share prices on the stock exchanges. For example, a company can be completely destroyed by active boards that try to satisfy the short-term interests of certain investor or shareholder groups. Innovations, venturing, competence and resource development can be destroyed by active boards or board members that are more concerned about value distribution to investors than value creation in the company. It can also be questioned whether the present emphasis on boards and firms as tools for 'faceless' and 'heartless' investors[1] in reality creates value for society and employees (Huse, 2003).

Understanding organizational behaviour and the human side of boards and governance has implications in several ways, including the importance of understanding the identity and contributions of various actors (including the board members), understanding of the dynamics and interactions inside and outside the boardroom, and understanding of actual board task performance (Cyert and March, 1963; Huse, 2007). Individuals do not always have clear and unambiguious objectives, and decision-making is often based on bounded rationality, and limited and asymmetric information. Major decisions in organizations are often results of political processes and strategizing, and we cannot assume that objectives are made *ex ante*. Decisions are often monitored by routines that have been developed from norms and values – probably more than from knowledge about value creation.

We will present here some reflections about how boards may create value. The objective is to challenge the ongoing public corporate governance debate and to show that a deeper understanding of actual organizational and board behaviour is needed than that which is demonstrated in mainstream board and governance research (Gabrielsson and Huse, 2004). Our approach in this article is to summarize conclusions in three articles from the 'value creating board' research programme which all integrate research and practice. The reflections and conclusions in the three articles build on a series of seminal articles in understanding actual board behaviour including Mace (1972), Fama and Jensen (1983), Zahra and Pearce (1989), Pettigrew (1992) and Forbes and Milliken (1999). Contribution from studies of board processes (Huse, 2008a) and the 'value creating board' surveys (Huse, 2008b) are also included.

The rest of the article is outlined in four sections. In the first section, we present an article about value creation through the whole corporate value chain (Huse, Gabrielsson and Minichilli, 2008). This article combines different concepts about actual board behaviour into a system similar to Porter's (1985) value chain approach. In the second section, an article about the board as a team and team leadership is presented (Gabrielsson, Huse and Minichilli, 2007). A team production approach is introduced and the leadership role of the board chairperson can be compared to that of a coach. The third article presents a system for board evaluation (Minichilli, Gabrielsson and Huse, 2007). In the final section, we summarize and outline implications for research.

Value creation through the whole value chain

Despite recent developments and trends in corporate governance, boards still seem to function very much as consultants for the management. During the late 1980s and the 1990s, we experienced the evolution of the shareholder supremacy paradigm which led to the introduction of nominally independent board members. The expected role of these barbarian-like board members was to ratify important decisions and to create value for shareholders who in relation to the firm were, in most cases, distant and faceless – and sometimes also heartless. However, recent research has found that the observations by Mace (1972) are still true, and various institutional forces uphold a managerial hegemony (Ocasio, 1999; Westphal, 1998). Furthermore, we have seen a renewed attention to boards' contribution to value creation throughout the whole value chain, and not only to external stakeholders through value distribution (Monks and Minow, 2004; Taylor, 2001). In this situation, knowledge and accountability become important key concepts to understand and reflect upon.

The value chain approach is presented in Huse et al. (2008) and is illustrated in Figure 28.1. The figure is built on the concepts and relationships found in the 'value creating board' research programme and surveys (Huse, 2008b). It illustrates that values may be created in various parts of a company's activities, e.g. in inbound logistics, resource allocation, innovation, operation, implementation and outbound logistics. The grouping is made to match the various sets of board tasks that are presented in Huse (2005), and there is thus a link between each of the tasks and the different parts of the value chain (see e.g. Huse (2007) or various studies presented in the previous part in this book). This implies that boards may, for example, contribute in relation to inbound logistics through legitimacy, networking and lobbying tasks. They may contribute to innovation, for example, through strategy development, collaboration and mentoring activities, to operations through advisory tasks, and so on. In practice, this will mean that in board evaluations the first question should be with which tasks boards should be involved, in order to create value, and the next question will then be what kind of competence among the board members are needed if the board should meet these tasks. However, it is not enough that board members have knowledge and skills (Forbes and Milliken, 1999), these must also be used. The board culture describes how the board members' knowledge and skills can be used. We have found how various types of board culture relate to different types of board tasks (see e.g. Huse (2007) or various studies presented in the previous part of this book). Furthermore, the boardroom culture can be developed through board leadership and structures. Board leadership and structure may be perceived as the extremes on a scale. The board chairperson can have various leadership roles as, for example, figurehead, supporter, coach, strategist and chair (Gabrielsson et al., 2007). Sometimes no leadership is needed, but only structures. Figure 28.1 indicates that board evaluation is an important structure for value creating boards. The listings of the leadership roles in the table are only indications, but we have found relations between various structures and board task performance (see e.g. Huse, 2007, or various studies presented in the previous part of this book). Board leadership and evaluations will be presented more in detail in the two coming sections.

Understanding board tasks from a value chain perspective helps us to understand that the board may fulfil several tasks at the same time. This goes beyond the arguments that board tasks primarily depend on firm contexts, such as the firm's life cycle, including experience of crisis (Huse, 1998; Lynall, Golden and Hillman, 2003); company size (Gabrielsson and Huse, 2005; Huse, 2000); ownership structure, including ownership type and dispersion

Contribution in value chain	Inbound logistics	Operation	Innovation	Resource allocation	Implementation	Outbound logistics
Board tasks	Legitimacy Networking	Advisory	Collaboration Strategic development Mentoring	Strategy ratification	Internal control	Output control and negotiation
Board members	Liaisons and resource providers	Consultants	Mentors and collaborators	Decision-makers and analysts	Evaluators and controllers	Negotiators and advocates
Board culture	Commitment	Commitment Cognitive conflicts	Commitment Cognitive confl Cohesiveness Creativity	Critical attitudes Cognitive conflicts	Critical attitutes Commitment Cognitive conflicts	Critical attitutes
Board leadership Structures	Figurehead Evaluation	Supporter Evaluation	Coach Introduction "Away-days"	Strategist Instr., Descr, Eval., Intro	Structures Comm., Descr., Instr, Eval., Intro	Chair Comm, Instr, Eval.

Figure 28.1 The value creating board: A value chain approach.

(Johannisson and Huse, 2000; Zahra, Neubaum and Huse, 2000); industry and industrial environment (Huse, 1990); national, geographical and cultural differences (Aguilera and Jackson, 2003); and CEO tenure and characteristics (Shen, 2003). However, the context may have an impact on how the contribution in various phases should be balanced. The value chain approach is still novel, however, and requires empirical investigation.

Team production and board leadership

Dominant theories of board and governance have not explicitly acknowledged the leadership role of the board chairperson. Most studies have emphasized the board's formal leadership structure at the expense of guidelines for how to improve the competence, integrity, and constructive involvement of directors working as a team. Most of the time, the critical issue of board chairperson leadership has been reduced to questions about whether the CEO should be removed from the chairperson position or not. On the other hand, the few studies that have been conducted on the actual content and process of board leadership have largely been descriptive and without strong conceptual foundations. The aim and focus of this article should be seen in light of recent developments in corporate governance research.

Traditionally, research on boards and governance has been rooted in an investor-based shareholder supremacy model, emphasizing formal structures and paying limited attention to processes and relationships inside the boardroom (Gabrielsson and Huse, 2004). There is now a development in the field with scholars rapidly moving away from abstract input-output models and instead showing an increasing interest in the role of leadership and behavioural dynamics in the boardroom (Huse, 2005). Two complementary streams of research seem to have influenced this development. The first stream of research has explored, mostly by semi-inductive research designs, actual board behaviour and has opened the 'black box' of the boardroom in order to understand conditions for effective governance (e.g. Gabrielsson and Huse, 2004). Attention has particularly been directed towards the interactions and activities of board members and how they gain trust in each other through experience and shared social connections (Huse, 1998; Westphal, 1999). The other stream of research has argued, from a much more strict theoretical point of view, that business organizations should be conceptualized as a nexus of team-specific assets invested by shareholders, managers, employees, and others who hope to profit from team production (Blair and Stout, 1999). In this team production perspective, effective corporate boards ensure that board members have the requisite know-how to replicate and consolidate the corporation's value creating team (Kaufman and Englander, 2005).

Interestingly, results from both these streams of research point towards the need to see effective boards as cooperative teams comprised of diverse members reflecting the core capabilities of the firm. Both research streams also point towards the critical importance of effective leadership in the boardroom where a skilled and competent leader can ensure that the characteristics of an effective team are present. Building on these two streams of research, this study incorporates behavioural studies of boards and governance (Huse, 2005) with a team production approach (Blair and Stout, 1999). The result is a novel approach for understanding the role of the board chairperson in creating an effective team of directors. The concepts and relationships in this study were tested on the 'board member' sample in the 'value creating board' surveys (Huse, 2008b). Based on these contributions, we believe that this study is an important step in research that seeks to understand better the role of team production and team leadership in corporate governance.

The arguments in Gabrielsson et al. (2007) may have some implications for understanding board chairperson leadership. The findings suggest that it is not enough to be moderator, figurehead, mentor/supporter, decision-maker, and strategist. If the board of directors should work as an effective team, then the board chairperson must take an active role as coach and team leader in the boardroom. The empirical results emphasize critical leadership attributes (e.g. the ability to motivate and use the competence from each board member, having an open and trustful leadership style, working very well together with the CEO, and working continually with developing the working structures and processes in the board). Together, these leadership attributes are helpful for creating an effective team of directors.

The importance of the identified team leadership attributes warrants explicit articulation that board and board chairperson effectiveness go hand in hand. The chairperson should support the other board members and bring out the potential that is in the board as a team. He or she must have an open leadership style that allows for robust levels of discussion with contributions from all board members. The board chairperson should put effort into creating a common purpose, commitment, a set of rules, plus roles and responsibilities for the team of directors. All board members are there to contribute to the direction and performance of the company. It is the task of the board chairperson to see that this also becomes a reality. In this reality a thorough system for board evaluations may be a valuable leadership tool.

A system for board evaluations

The key message in Minichilli et al. (2007) is that there is no universal or 'one best way' to evaluate the board of directors, and that board evaluations will not meet their purpose unless there is a fit between the agents, the addressees, the content and the modalities of the evaluation. It is important to know who is doing what for whom and how. The increasing interest in the practice of board evaluations, however, calls for a systematic and careful approach. While past attention has primarily been focused on the content of board evaluations, we outline in Minichilli et al. (2007) the features of an integrated board evaluation system. We contend that a board evaluation system would need to include: 1) the agent who evaluates the board; 2) the content or what the evaluation should deal with; 3) the addressee and other stakeholders for whom the board is evaluated; and 4) how the board is evaluated. The key problems and some possible alternatives are presented in Table 28.1.

The table suggests how board evaluations refer to the 'who' does 'what' for 'whom' and 'how' questions. It includes: 1) the addressee (for whom); 2) the agent of the evaluation (who); 3) the evaluation content (what); and 4) the modalities of the evaluation (how). The agents are those who perform the evaluation. The addressee questions include to whom the evaluation report will be communicated. The evaluation content refers to the 'what-to-evaluate' questions, while the modalities are about how the board activities are

Table 28.1 Key elements in a system for board evaluations (from Minichilli et al. 2007)

Key problems	*Some possible alternatives*
THE AGENT OF THE EVALUATION *'Who' evaluates the board?*	• Self-evaluation (the board itself) • Board committees • Consultants • Researchers • External agents
THE CONTENT OF THE EVALUATION *'What' should be evaluated?*	• Board tasks (different types of control and service) • Board membership (e.g. directors' education and professional background, capabilities, presence and preparation, independence and nominating system) • Board culture and processes (e.g. cognitive conflicts, trust and emotions, interactions and social ties) • Board leadership and structure
THE ADDRESSEE OF THE EVALUATION *'To Whom' the evaluation is targeted*	• The board itself • Internal board committees • Academics, researchers • External board committees • Owners, investors, etc.
THE MODALITIES OF EVALUATION *'How' to evaluate the board*	• Open discussion (e.g. in board meetings, or in special meetings dedicated to board development) • Self-evaluation scheme • Standardized scheme/questionnaire • Reports to authorities, etc. (including annual reports) • Benchmarking • Interviewing (e.g. board members, the management, shareholders and other stakeholders) • Participant observation by the evaluator in board meetings

measured. Each of the elements are presented and discussed in Minichilli et al (2007), and four typical evaluation systems were identified and illustrated.

Board evaluations clearly have several advantages, but these advantages are far from fully exploited. We argue that two conditions are necessary to induce the adoption of a board evaluation system. The first is internal, and refers to the benefits that both a self-reflection on board activities and professional advice by specialized companies can give in empowering the board of directors. The second is external, and relates to the rewards markets give formal board evaluations. We anticipate that the immediate future will be characterized by a fast spread of the board initiated evaluations, either for internal or external purposes. We also expect to see market initiated evaluations. Their diffusion will open both interesting opportunities for potential evaluators, and most likely create a dynamic evaluators' market. It will also set new standards of accountability for the companies involved and their boards, with important effectiveness consequences for the whole corporate governance system.

Implications: A new school of research

In this article we have presented some of the implications for practice from understanding value creating boards and the human side of corporate governance. Corporate or firm value creation has been emphasized as a contrast to value distribution to 'faceless' and 'heartless' investors. A value creating board will consciously seek to create values through the whole corporate value chain (Huse et al., 2008). This approach makes it important to identify different sets of board tasks and how they make contribute to value creation. We have also illustrated the importance of using a team production rather than an agency theory approach (Gabrielsson et al., 2007). Team production theory has implications for understanding the board as a decision-making team, to understand the decision-making culture and the team leader. Combining the importance of value creation and the board as a team, we also see the chairperson's role as a coach as an import step in value creation. Finally, we have also seen how a system for board evaluations can be developed based on our work with the 'value creating board' research programme. Our work identifies that although there is no best way of designing a value creating board, not all ways are equally good. However, we have found that board evaluation is a tool that all boards can benefit from, but the evaluations will not meet their purpose unless there is a fit between the agents, the addressees, the content and the modalities of the evaluation system (Minichilli et al., 2007).

The 'value creating board' research programme has also made various contributions to research. We have just mentioned how it combines research and practice in its exploration of the 'black box' of actual board behaviour. It shows how research about boards and corporate governance can have implications for practice. Another contribution is how it has acted as a building block for a stream of scholars studying boards of directors. While much of the research on boards of directors either has been fragmented or builds on a few simple assumptions – often influenced by the US inspired 'publish or perish' syndrome – we have seen through the value creating board initiatives how knowledge has been accumulated. We have seen that a core set of seminal contributions have been identified and used by a large group of scholars. This group has started to meet and discuss their research about 'value creating boards' and organizational behaviour. Regular meeting places have been the annual Norefjell workshops and the European Academy of Management meetings. A fast-growing number of publications are thus also in progress.

Note

1 A 'faceless' investor is an investor that cannot be identified by the company, and a 'heatless' investor is an investor that cannot identify with the company and only evaluates financial return.

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Keyword index