AN EMPIRICAL INVESTIGATION OF PERCEPTIONS OF BOARD ROLES AMONG THE CORPORATE ELITE

Gavin Nicholson

School of Accountancy, Queensland University of Technology, Brisbane, Australia

Email: g.nicholson@qut.edu.au

Dr Cameron Newton

Centre of Philanthropy and Nonprofit Studies, School of Accountancy, Queensland University of Technology, Brisbane, Australia

Email: cj.newton@qut.edu.au

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ABSTRACT

Despite decades of research and conjecture, there is little agreement around the role(s) of the board of directors. In this paper we use confirmatory factor analysis to highlight that the corporate elite (directors and senior managers) perceive the roles of the board to involve overseeing risk and compliance, strategy, governance, developing the CEO and senior management and managing stakeholders. We further show that managers and directors perceive board effectiveness as linked to different combinations of these roles. We conclude with a discussion of our findings for theory and practice.

Key words: Boards of directors; corporate governance; board roles; scale development; confirmatory factor analysis; corporate elite.

INTRODUCTION

Following more than thirty years of research and a recent spike in academic and practitioner interest, there is little consensus as to how boards of directors add value to the corporations they govern (Daily, Dalton & Cannella, 2003). Instead, several topics fundamental to corporate governance research remain unclear. One such topic is the conceptualization of the board's role set (or, more directly, how the board influences firm performance). This role set that is conceptualised by different researchers in different ways (e.g., see Hung, 1998; Johnson, Daily & Ellstrand, 1996; Lipton & Lorsch 1992; Zahra & Pearce, 1989). In fact there is a long tradition of investigating whether boards play any meaningful role (e.g. Andrews, 1980; Mace, 1971, Vance, 1983) and different researchers conceptualise a broad range of board effectiveness from ceremonial and ineffectual bodies right through to key decision making groups fundamental to corporate survival and performance.

The purpose of this paper is to provide one of the first empirical investigations of how corporate elites conceptualise the role(s) of the board. We begin by providing three conceptualizations of board roles provided by extant literature and develop a series of competing models based on these conceptualizations. We then present the findings of a survey of Queensland's business elite to test these models using confirmatory factor analysis and hierarchical multiple regression. Our findings indicate that directors and managers both conceptualise the board's roles around topics (e.g. strategy, compliance and risk, etc.) rather than activities (e.g. monitoring, setting boundaries, etc.) and that managers and directors perceive boards to add value in different ways. Our discussion highlights that clarity around the board's role set is critical to furthering the corporate governance research agenda and, further, that the relationship between board roles and perceived board effectiveness differs between managers and directors.

BACKGROUND

Conceptualising what boards do is a complex task, further complicated by the continued evolution of a board's legal duties and societal expectations (e.g. see Baxt, 2005). Historically, boards were seen to play a largely ceremonial role best exemplified by the colourful descriptions such as "ornaments on the corporate Christmas tree" (Mace, 1970:90). This minor role in corporate life was reflected in a paucity of research on boards of directors, particularly in the management field.

Over the past thirty years, however, the management discipline has begun to highlight that boards do influence corporations in real and tangible ways; its role(s) has moved beyond the mere ceremonial. One of the earliest categorisations of board roles is provided by Eisenberg (1969), who envisaged the roles of the board as being to: (1) provide advice and counsel to the CEO; (2) authorise major corporate actions; (3) represent corporate stakeholders other than management; and (4) to select, evaluate and remove the CEO. Later, these four roles were condensed into a three-role typology by Conrad (1976), who argued that the role of the board was to: (1) be responsive as advisers to the CEO (the same as Eisenberg's role 1); (2) represent the views of stakeholders (Eisenberg's role 3); and (3) distinguish between the interests of management and the interests of shareholders and stakeholders (an amalgamation and extension of Eisenberg's roles 2 and 4).

These early attempts at defining board roles highlight a problem that continues to plague the corporate governance research agenda. Quite simply, different disciplines (and even different researchers within the same discipline) conceptualise what boards do in different ways. For instance, in a major work on the resource dependence nature of organisations, Pfeffer and Salancik (1978) viewed the board as a key link to the external environment and, as a result of this perspective, identified three key roles, as being to: (1) serve as a co-optive mechanism to access resources vital to the organisation; (2) serve as boundary spanners; and (3) enhance organisational legitimacy. Omitted from this typology is a role for the board in controlling or overseeing management.

In broader reviews of the field, both Pettigrew (1992) and Hung (1998) identified six themes of research into boards and managerial elites. Unfortunately, these six themes are quite different. Pettigrew (1992) categorised research as: (1) the study of 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) CEO compensation; and (6) CEO selection and succession. In contrast, Hung (1998) found that boards: (1) link the organisation to the external environment; (2) coordinate the interests of shareholders, stakeholders and public; (3) control the behaviour of management to ensure the organisation achieves it objectives; (4) formulate strategy; (5) maintain the status quo of the organisation; and (6) support management.

Even two of the most cited reviews of the corporate governance research agenda do not have a common role set as a frame of reference. In their integrative model of corporate governance, Zahra and Pearce (1989) identified the three roles of the board as being (1) service (including providing access to resources), (2) strategy and (3) control. While Johnson et al. (1996) used a similar categorisation, they instead commented that the three roles of the board were (1) control, (2) service (which included the board's role in strategic decision making) and (3) providing access to resources. More recently a number of leading researchers have argued there are only two roles of the board, controlling the organisation (including strategy and monitoring) and providing access to resources (including advising management) (e.g., see Boyd, 1995; Hillman & Dalziel, 2003).

Academic ambiguity about the role of the board is replicated in the normative literature. For example, in the US, the Business Roundtable (1978) and American Bar Association (1978) produced statements on the responsibilities, duties, functions and composition for the board of directors. In the UK, the Higgs Review (Higgs, 2003), Hampel Report (Hampel, 1998) and Cadbury Report (Cadbury, 1992) have all outlined statements on what boards should do. Closer to home, Standards Australia (2003) have released guidelines for companies wanting to implement effective governance and the ASX Corporate Governance Council (2003) has released its Principles of Good Corporate Governance and Best Practice Recommendations.

All of these reports and guidelines recognise the importance of profitability and economic viability of the corporation as well as ensuring that corporate decisions comply with the norms and standards of society. There are, however, significant differences in how these generic areas are implemented.

A summary of some of the key guidelines for directors appear in Table 1. As the table indicates, it is possible to correlate academic interest and practitioner recommendations on the roles of the board, and while there is significant overlap there is also significant divergence in emphasis. Both groups place significant emphasis on the monitoring and evaluation role of the board. Contrasting the two groups, however, we see that practitioners place more emphasis on the role of the board in setting strategic direction. Practitioners also place emphasis on very specific aspects of monitoring such as compliance.

Another point of difference involves the access to resources role. While it is the subject of much academic investigation, the role is rarely mentioned by practitioners, with the notable exception of the board's role in maintaining relationships with investors, particularly institutional investors and a rare reference about networking with stakeholders. The service or advice role of the board has not been a major focus of either academic or practitioner interest with one or two notable exceptions (e.g. Westphal, 1999).

Clarity about roles is critical, however, for investigating how boards add value; without understanding the actual process(es) by which boards contribute to firm performance we may find that directors actually fulfil multiple roles leading to confounded empirical results (Mintzberg, 1983). For example, outsiders are thought to be better able to address managerial opportunism because their independence will more likely allow them to sanction the CEO and management (Sundramurthy & Lewis, 2003). Outsiders will also, however, often bring a diversity of expertise and perspectives from which management can draw. Thus, they could be thought to increase the service role of the board. Similarly, the social networks of outsiders will be different to that of the management team, therefore we could expect that outsiders could bridge structural holes (Burt, 1992) and bring competitive advantage through access to key resources. As this simple example illustrates, understanding the process by which boards and directors add value is critical if we are to assist them to improve corporate governance.

RESEARCH QUESTIONS

The preceding literature overviews that different researchers perceive board roles as activities free of topics (e.g. monitoring), topics free of activities (e.g. strategy) or some combination of the two (e.g. monitoring strategy). Given the differing theoretical approaches to board roles, we were interested in understanding whether business elites conceptualised the roles as activity based or as topic based. For instance, if we take a specific board action (e.g. reviewing the budget), we wanted to understand if elites conceptualise the action as an activity (i.e. reviewing/monitoring) or as a topic (i.e. financial control/budgeting). Given the intersection of activities (establishing boundaries/delegating, engaging/advising management and monitoring/reviewing) and topics (strategy, compliance, risk management, stakeholder management/engagement, budgeting, etc.) it was important to differentiate between the two. Thus our competing research questions were:

H1a: *Business elites conceptualise board roles based on the topics with which a board is involved.*

H1b: *Business elites conceptualise board roles based on the activities with which a board is involved.*

Further, we were interested in understanding how, if at all, the role set was related to perceptions of board effectiveness. For this component of the research, we were particularly interested in understanding differences in perception across the different classifications of elites, namely directors only, directors who are also managers and managers only. Given the different motivations, experiences and understanding of board roles between these categories, our specific research question was:

H2: *Different categories of business elites ascribe board effectiveness to different board roles.*

Table 1

Summary of normative guidelines on the role of the board

Function	Specific function	ASX Principles (Australia)	Standards Australia	OECD	Business Roundtable (US)	Higgs Review (UK)	Saucier Report (Canada)
Strategy	• Input into formulation	√	√	√	√	√	√
	• Approval	√	√	√	√	√	√
	• Set organisational objectives/goals	√	√	√	√	√	√
CEO	• CEO selection/appointment/removal	√	√	√	√	√	√
	• CEO monitoring	√	√	√	√	√	√
	• CEO evaluation	√	√	√	√	√	√
	• CEO remuneration	√	√	√	√	√	√
Monitoring	• Strategy implementation	√	√	√	√	√	√
	• Organisational performance	√	√	√	√	√	√
	• Control and accountability systems	√	√	√	√	√	√
	• Senior management's performance	√	√	√	√	√	
Monitoring and/or approval	• Budgets (annual, long-term, etc.)		√	√	√	√	
	• Key performance indicators		√		√		
	• Capital expenditure	√		√			
	• Capital management	√					
	• Acquisitions and divestitures	√		√			
	• Financial and other reporting	√	√	√	√	√	√
Compliance	• Ensure legal compliance	√	√	√	√	√	√
	• Overview of policies and practices	√	√	√	√	√	√
Advising	• Provide advise CEO and senior management				√		√
Risk management	• Develop policies	√	√	√		√	
	• Ensure risks are are identified, assessed and managed	√	√	√	√	√	√
Communication/ networking	• With key stakeholders	√				√	√
	• With shareholders	√	√		√	√	√
Corporate culture/ethics	• Foster appropriate corporate culture		√	√		√	
	• Develop/ensure code of conduct	√	√				
Governance	• Adopt an effective structure to facilitate governance processes	√	√	√	√	√	√
	• Ensure effective governance practices	√	√	√	√	√	√
Key executives	• Approve appointment/removal and terms and conditions	√	√	√		√	√
	• Succession planning			√	√	√	√

METHOD

Participants

Surveys were distributed to members of the Australian Institute of Management (Queensland and NT Division). While there were more than 19,000 Queensland and Northern Territory individuals who were members of the Institute, we were only interested in investigating board members and managers who directly interacted with boards on a regular basis. Therefore, we limited the survey frame to 1356 Fellows and Associate Fellows.

There were 148 responses to the survey resulting in a response rate of 10.91%. This is a conservative interpretation of the response rate, as many survey recipients would not have been board members nor managers who directly deal with board members on a regular basis (i.e. many recipients would have been excluded from the sample frame). Together with the busy nature of our target participants, this represents an acceptable response rate.

Procedure

Analysis proceeded in three stages. First we undertook an exploratory factor analysis to better understand whether participants viewed board roles as activity or topic focused. Next, confirmatory factor analysis was conducted in order to develop an appropriate board roles scale for the roles identified in stage 1. Finally, hierarchical multiple regression was employed to determine the predictive ability of the board roles factors on board effectiveness.

Measures

Since a key component of this research was to develop scales to measure board roles, we did not begin with a firm set of constructs. Instead, we developed a series of 44 items that contained a mix of an activity (e.g. setting boundaries, engaging with management, reviewing, etc.) and topics (e.g. strategy, compliance, risk, etc.) that were based on either practitioner work (e.g. see ASX Corporate Governance Council, 2003; Kiel & Nicholson, 2003) or academic theoretical work outlined earlier.

Next, these items were subject to exploratory factor analysis to determine how the various board role items loaded onto factors. An oblique rotation using principal axis factoring extraction was requested. Investigation of the pattern matrix identified 15 items that loaded onto the five factors. These were used as the basis for developing the scale for board roles.

Board roles. Five board roles were assessed using specially developed items generated from existing theoretical approaches to defining the roles of boards. Each of the five scales were assessed using three items which were rated from 1 (no involvement) to 5 (high involvement). Example items for each scale include “Routinely reviewing the company’s compliance performance” (compliance role); “Engaging with management when defining respective responsibilities of the board” (governance role); “Periodically reassessing the company’s strategic direction” (strategy role); “Engaging with the CEO in the development of his/her performance” (management development role); and “Establishing limits or guidelines for stakeholder engagement plans” (access to resources role).

Board effectiveness. Board effectiveness was assessed using a five-item scale rated from 1 (very poor) to 5 (very good). Participants were asked to rate the effectiveness of the board from a number of perspectives including ‘strategy’, ‘compliance management’, and ‘ensuring an appropriate governance system is in place and operative’.

RESULTS

Overview of the Participants

Participants represented a wide range of company types, board size, organization size and elite status. Some 28% of respondents were from private companies (pty ltd), 11% from public companies (ltd), 6% from listed companies, 12% were government owned corporations and 33% were from nonprofit organizations. In terms of board size, 22% of participants were on a board with 4 or fewer members, 16% of participants were on boards with more than 10 members and the majority of respondents (62%) served on boards between 4 and 10 members. The spread of company size (as associated with number of employees) showed that 23% of participants' organizations had fewer than 20 employees, some 34% had 20-99 employees, 21% had 100-499 employees and 23% had >500 employees. Finally, in terms of corporate elite status, 27% of participants identified as non-executive directors, 24% as managing directors or executive directors, 20% as CEOs (but not directors) and 29% as senior managers.

Data and Analyses

Scale Development

SPSS 13.0 was used to conduct an exploratory factor analysis on the sample (N = 148) to determine how the various board role items loaded onto factors. An oblique rotation using principal axis factoring extraction was requested. Investigation of the pattern matrix identified 15 items that loaded onto the five factors at a level above .5. Descriptive statistics and correlations relating to factors are displayed in Table 12.

Table 2.

Descriptive statistics and zero-order correlations

	Scale	Mean	SD	1	2	3	4	5	6
1	Risk/Compliance	3.84	.80	(.82)					
2	Governance	4.31	.64	.48**	(.87)				
3	Strategy	4.42	.57	.40**	.35**	(.70)			
4	Management Development	3.90	.86	.39**	.36**	.49**	(.80)		
5	Access	3.54	.96	.39**	.37**	.35**	.52**	(.91)	
6	Effectiveness	3.44	.81	.10	.04	.33**	.15	-.01	(.91)

Note: Alpha coefficients appear in the diagonals

* p < .05

Using AMOS 5.0 (Arbunkle, 1986), a confirmatory factor analysis (CFA) was conducted to further assess the fit of the exploratory model to the data (Anderson & Gerbing, 1988). Our analysis also addressed issues relating to sample size, normality of data, and missing data. Initially, maximum likelihood (ML) estimation was employed in the analysis as reliable estimates have been obtained by ML estimation based on sample sizes as low as 50 (Gerbing & Anderson, 1985). This method assumes normality of the data which was an assumption that was violated in this sample (all variables: Shapiro-Wilk; p < .05). To ensure non-normal data did not influence the results, a Bollen-Stine bootstrap procedure (500 iterations) was employed. The Bollen-Stine analysis was not significant indicating that the chi-square indicator of model fit was not inflated. Lastly, inspection of the missing data revealed it was random. As per Allison (2002), an EM algorithm was used to replace missing data via MVA in SPSS1. Fit indices relating to the CFA are displayed in Table 4 and indicate a reasonable fit of the model to the data.

[1] Items loading onto each role-related factor are displayed in Table 3.

Table 3.

Items and standardized estimates resulting from CFA

Item	Risk/ Compl-iance	Govern-ance	Strategy	Manage-ment Develop-ment	Stake-holder
Periodically reviewing the company's risk management performance	.73**				
Engaging with management in the development of compliance indicators	.78**				
Routinely reviewing the company's compliance performance	.85**				
Defining the respective responsibilities of the board in the governance system		.64**			
Engaging with management when defining respective responsibilities of the board		.86**			
Periodically reviewing the performance of the board as a whole		.77**			
Approving the company's key performance indicators			.65**		
Periodically reassessing the company's strategic direction			.63**		
Routinely reviewing the company's performance against business plans			.76**		
Engaging with the CEO in the development of his/her performance				.71**	
Engaging with the CEO when developing the management remuneration policy				.85**	
Establishing limits or guidelines on the management remuneration policy				.73**	
Establishing limits or guidelines for stakeholder engagement plans					.86**
Approving high-level stakeholder engagement plans					.86**
Routinely reviewing the performance of stakeholder engagement activities					.93**

** Significant at $p < .001$

Table 4.

Goodness of fit statistics for confirmatory factor analysis

Goodness of Fit Statistics	Value
Chi-square	139.68
DF	80
Chi-square/DF	1.75
CFI	.95
RMSEA	.07
Standardised RMR	.05

Test of predictive ability of the model

Several hierarchical regression analyses were performed to investigate the predictive ability of model developed above on self-reported board effectiveness. This analysis was conducted for four groups within the data (i.e., directors only, directors who are also managers, managers who are not also directors, all managers, and all directors and managers). Results of regression analyses are displayed in Table 5.

Table 5.

Hierarchical multiple regression analyses showing main effects of board roles on board effectiveness

		Model Predictors/ Board Roles				
	R2	**Compliance β**	**Stakeholder β**	**Management Development β**	**Governance β**	**Strategy β**
Directors only	.17	.17	-.09	-.39*	-.10	.46**
Directors who are managers	.26	.20	-.09	.15	-.05	.36
Managers only	.13	.17	-.40**	.09	-.07	.24*
All managers	.12**	.15	-.26*	.16	-.09	.27**
All participants (i.e. managers and directors)	.12**	.09	-.18*	.04	-.02	.33**

* p =< .10; ** p < .05; *** p < .001.

Directors. For directors, entry of the model (i.e., compliance, governance, access, management development and strategy) at step one did not account for a significant increment on variance of board effectiveness, $R2 = .17$, $F(5,29) = 1.20$, ns. Despite the lack of significance for the model, the data indicated a significant association between the strategy role and higher board effectiveness, $\beta = .46$, $p < .05$. Within this analysis, compliance, access, and governance roles were not significantly associated with higher board effectiveness although the management development role was significant at alpha = .10, $\beta = -.39$, $p = .1$ in a negative association. Overall, this result indicates that directors perceived the strategy role as significantly predictive of board effectiveness and the role of management development as negatively related to board effectiveness.

Directors who are also managers. Results revealed that entry of the board roles as a set on step one did not account for a significant increment on variance of board effectiveness, $R2 = .26$, $F(5,23) = 1.65$, ns. Further inspection reveals that none of the board roles were significantly associated with perceptions of board effectiveness.

Managers who are not directors. Entry of the model (i.e., compliance, governance, access, management development and strategy) at step one did not account for a significant increment on variance of board effectiveness, $R2 = .13$, $F(5,63) = 1.87$, ns. For managers, however, there was a perception that the stakeholder engagement role was negatively related to board effectiveness, $\beta = -.40$, $p < .05$. Further, the rating of the strategic role neared significance in the prediction of effectiveness, $\beta = .24$, $p = .09$.

All managers. Results revealed that entry of the predictors as a set accounted for a significant increment on variance of board effectiveness, $R2 = .12$, $F(5,92) = 2.55$, $p < .05$. Further inspection of the results revealed that the strategic role was perceived as positively related to board effectiveness, $\beta = .27$, $p < .05$. The ratings of managing stakeholders neared significance in a negative association with board effectiveness, $\beta = -.26$, $p = .06$.

All directors and managers. Entry of the board role predictors as a set accounted for a significant increment on variance of board effectiveness, $R2 = .12$, $F(5,127) = 3.53$, $p < .01$. Further inspection of the results revealed that the strategic role was positively related to board effectiveness, $\beta = .33$, $p < .01$. The ratings of managing stakeholders neared significance in negatively predicting effectiveness, $\beta = -.18$, $p = .1$.

In summary, the data indicates that all categories of the elites believed the strategy role was positively associated with board effectiveness. In contrast, though, managers (particularly managers who are not directors) perceive board involvement in stakeholder management as negatively associated with board effectiveness whereas directors did not appear to have a strong association between this role and board effectiveness. Interestingly, directors perceive their role in management development as negatively related to board effectiveness which was opposite the effect that managers perceived.

DISCUSSION

These results have important implications for the research of corporate boards of directors. First, they indicate that members of the corporate elite perceive the roles of the board as defined by topics rather than activity. Academics have struggled with developing an agreed series of roles which boards undertake. This research is an important first step as an empirically verified instrument capable of measuring what boards and senior managers believe they do.

The consequence of this finding is that several conceptualisations of board roles are NOT how managers and board members primarily perceive their activities. Business elites perceive their roles as topic not activity driven. For instance, referring to the "monitoring" or "advising" role of the board is largely erroneous; it is more important to understand what the board is "monitoring" or "advising" on. Therefore researchers interested in board-performance relationships may have more success in delimiting their research questions to specific topic based mechanisms rather than a broad activities (such as monitoring or advising) as has been the dominant approach in the governance research agenda. Similarly, practitioners and public policy makers may have greater success by employing specific topic-based interventions than broader, activity-based interventions.

Second (and although largely indicative) the results highlight that different categories of the business elite have a different perception of how boards add value to the corporations they govern. While both groups perceive the strategy role as positively associated with board effectiveness. In contrast managers perceived board involvement with stakeholders as negatively associated with board effectiveness which may be explained as a fear of part-time board members disturbing existing communication channels and relationships. Interestingly board members perceive their role in management development as negatively associated with board effectiveness, although this may be a reflection of boards where heavy involvement in management development being associated with a poorly performing organisation or a poor CEO selection (and hence poor rating of board performance). Management, in contrast, rated performance of the role as positively (though not significantly) associated with board effectiveness.

Limitations and Future Research

While this research does provide empirical support for the research questions, conclusions would be significantly strengthened with a larger survey. Such an approach would overcome objections about the regional and professional affiliations of participants. Similarly, a larger respondent group would allow for increased statistical power that we suspect would enhance the findings of this research, particularly around differences in perception of board effectiveness between managers and board members.

Future research will also need to examine if business elite perceptions match with more objective measures of board performance. While there are obvious benefits in understanding how managers and directors view their roles and the relationship between these roles and perceptions of effectiveness, this research has not addressed relationships between board roles and more objective measures of board or company performance.

CONCLUSION

Understanding how boards add value to the corporations they govern is an important topic for governance researchers, practitioners and policy makers. To date, academic output has largely assumed the composition of a board role set or relied on theoretical conceptualisations of the role set. This paper is a first step in understanding some components of the "black box" of corporate governance. It highlights that the corporate elite view the role of the board as activity focused and, further, that different classes of the elite view board effectiveness as deriving from different roles.

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