Roles of boards of directors: Oversight and overlap

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ABSTRACT

The range of themes and rationales for the understanding of the roles of boards of directors (BoDs), as discussed in the corporate governance literature, is investigated in this paper. A comprehensive survey of the literature indicates that the roles of BoDs are not well articulated, specified or even well known. Much of the literature is prescriptive. Three main roles are identified; strategy, control and service. These roles often overlap and are in some cases contradictory. This may be due to a lack of empirical research, contextual understanding and conflicting theoretical perspectives. The literature highlights the need for further empirical research, drawn from real world experiences, to understand which parts of this literature sheds light on the actual roles of BoDs.

KEYWORDS: corporate governance; board roles; literature review.

INTRODUCTION

The purpose of this paper is to evaluate the corporate governance literature in terms of how it defines, classifies, distinguishes and understands the roles of boards of directors (BoDs). This range of themes and rationales will be utilised, elsewhere, as alternate lenses to make a theoretical contribution, based on observation, of the roles of governing boards of co-operative dairy companies. Initially, the range of roles of BoDs suggested by various writers in the literature is explored. From this range three "generally agreed" roles of BoDs – strategy, control and service - are explored in-depth to understand the scope, functions and terms attributed to these roles. The sometimes overlapping and often ambiguous nature of these roles are also highlighted as is the need for descriptive theorisation of the roles of board of directors. Conclusions are then drawn.

IDENTIFIED ROLES

This section identifies the broad range of roles of BoDs articulated by various writers in the corporate governance literature in order to understand the array of roles ascribed to governing boards. Hilmer (1993) suggested that the board of directors (BoDs) key role is "to ensure that corporate management is continuously and effectively striving for above-average performance, taking account of risk. This is not to deny the board's additional role with respect to shareholder protection" (p. 71). Clarke (2004) saw corporate governance being about both risk-management and wealth creation (p. 161). In a more detailed description Locke and Scrimgeour (1999) state that good governance of local government councils deals with issues of; executive recruitment, asset management, strategic direction, legislative compliance, consultation, monitoring, and reporting (p. 21). Tricker (1993) by outlining his thoughts on the perspectives a director needs gives some indication of the roles a BoD may have:

> directors need to have perspectives that look inward at the executive management of the businesses in the company and, also, outwards to the competitive environment for the firm in its socio-economic-political milieu. They also need to look back at recent results and ahead to future strategies, policies and plans. They face a choice in how much of these activities they delegate to the chief executive and his management team; but the hiring, monitoring and, if necessary, the replacement of that chief executive is one of their major levers of power (p. 61)

These perspectives are wide-ranging, all-encompassing and difficult to specify. In a prescriptive nature many authors have suggested what the roles of boards of directors should be. Mintzberg (1983) suggested seven roles for the board: selecting the CEO, taking control during periods of crisis, monitoring management performance, co-opting external resources, raising funds for the organization, enhancing the organization's reputation and giving advice. Hung (1998) identified six major roles; linking, co-ordinating, control, strategic, maintenance, and support. Zahra and Pearce (1989) believed there were three critical board roles; service, strategy, and control (p. 291). Johnson et al., (1996) noted that research had not resulted "in a convergence around a specified role set for directors" and suggested three roles which they labelled control, service and resource dependence (p. 409). Specifically, drawing from agency, stewardship and resource dependency theories Muth and Donaldson (1998) identified three primary roles: "managerial control, managerial empowerment and co-optation" (p. 6). Dalton et al., (1999) saw BoDs roles as control, providing resources, and expertise and counsel (p. 679). In even more parsimonious fashion Hillman and Dalziel (2003) combine Zahra and Pearce's (1989) strategy and service roles and Johnson et al's (1996) service and resource dependency roles into a singular "provision of resources" role, leaving "two theoretically distinct board roles, monitoring and the provision of services" (Hillman and Dalziel, 2003: 386). Likewise Hendry and Kiel (2004) saw two roles for the BoD: "control, of which strategy and monitoring are sub-sets and access to resources which includes legitimacy and links to other organisations" (p. 515). According to Stiles and Taylor (2001) BoDs by general agreement in the prescriptive literature "have three key roles: strategy – responsibility for monitoring and influencing strategy; control – maintaining control over the management of the company; and service – providing advice and counsel to executives, and providing an institutional face to the organisation" (p. 4).

The activities attributed to each role tend to depend on the authors' theoretical persuasion and what they are trying to discover. As Hendry and Kiel (2004) note "there is often a lack of consensus on the functions that make up each role and the terms used to describe these roles" (p. 515). These roles can be contradictory (Dalton et al., 1999) and often overlap. In order to explore the corporate governance literature on roles further Stiles and Taylor's (2001) "generally agreed" roles of: strategy, control and service will be used as headings in the foregoing review to understand writers notions of the activities of BoDs.

STRATEGY

There seems to be a fairly clear consensus in the corporate governance literature that BoDs have a role to play and a responsibility in the strategic area. It is often seen as the "definitive" BoD role (Stiles & Taylor, 2001). Schmidt and Bauer (2006) note that boards are "exhorted" to participate actively in strategy formulation and execution to contribute to value creation (p. 14). What the strategy role entails, how it is fulfilled and what influences it are however far from understood (Hendry and Kiel, 2004, Judge and Zeithaml, 1992, Ingley and Van der Walt, 2001).

Ingley and Van der Walt (2001) saw the BoD's role in strategy as forming a continuum from "approving, monitoring and reviewing strategy at one end, to a leadership role of active involvement in establishing the goals, values and setting direction at the other end" (p. 176). Johnson et al., (1996) suggested a limited role with BoDs having an impact on strategy by reviewing strategic initiatives, and "in some cases" involvement in strategy formulation (p. 427). Schmidt and Bauer (2006) saw the BoDs' strategic role as made up of oversight of strategy formulation and execution including the review, ratification and evaluation of proposed strategies. O'Neal and Thomas (1995) envisaged a very wide role for the BoDs including analyzing and ratifying management's strategic plans and goals, forcing management to look ahead, setting the tone and direction of the company, anticipating and managing change and uncertainty, and involvement in strategy creation and implementation (p. 86). Under such a scenario one would wonder what management would have left to do! Stiles and Taylor (2001) suggest that the strategic role of the BoD usually includes "identifying what business the company is in, developing a vision and a mission, assessing threats and opportunities, strengths and weaknesses, and selecting and implementing a choice of strategies … [and] … ensuring the alignment of company purpose with shareholders' interests" (p. 32). Similarly Hendry and Kiel (2004) suggested that the management literature saw the role of the BoDs in strategy as "defining the business, developing a mission and vision, scanning the environment and selecting and implementing a choice of strategies" (p. 501).

Henke (1986) distinguished between "initiator" and "approving" boards while Demb and Neubauer (1992) took a different tack, outlining three different types of boards with regard to strategy. The "watchdog" board that monitored and evaluated strategy after it was implemented; the "trustee" board that have a small role in initiation, and a large role in the analyzing, monitoring and evaluating strategies, and the "pilot" board that has a substantive role in all parts of the strategy process (p. 55). McNulty and Pettigrew (1999) identified three levels of BoD involvement in strategy; taking strategic decisions, shaping strategic decisions, and shaping the content, context and conduct of strategy. (p. 55). Governance literature often assumes BoDs have very little influence on strategy formulation (Westphal and Fredrickson, 2001: 1114). Managerialist writers (Mace, 1971, Lorsch and MacIver, 1989) suggest that BoDs only undertook a strategic role in times of crisis, and "made little contribution to strategy" (Hendry and Kiel, 2004: 500). Stiles and Taylor (2001) would describe these as "passive" boards where management's recommendations "go through on the nod" (p. 32). Under a passive perspective the BoD's role in strategy would be limited to removing a poorly performing CEO and replacing them with a new one with fresh perspectives for the strategic direction of the organization (Hendry and Kiel, 2004: 511). Pettigrew and McNulty (1995) similarly distinguished between minimalist and maximalist BoD cultures, although they suggested crisis can trigger a BoDs into action (p. 857). "Active" BoDs on the other hand play some part in strategic decision-making process and BoDs are seen "as independent thinkers who shape the strategic direction of their organisations" (Hendry and Kiel, 2004: 502). The extent of participation in the active BoD may range from simply reviewing and ratifying management proposals at one end of a continuum to the other extreme where the BoD is "a full partner in developing the content of specific strategies and decisions" (Stiles & Taylor, 2001: 37). These "divided conceptualizations" between passive and active has led to "to very different conclusions regarding both prescriptions and descriptions of board behaviour" (Golden and Zajac, 2001: 1088). According to Hendry and Kiel (2004) this continuum from active to passive is an oversimplification. Logic would suggest that BoD involvement in strategy is at least contextually dependent.

Mizruchi (1983) noted that the board is in a position to establish the parameters around the strategic decision-making process. Baysinger and Hoskinsson (1990) go further by saying that the BoDs through its possession of powers, "set the premise for managerial decision making" and that astute CEOs learn what the BoD want and "initiate and implement decisions that comport with the boards concept of strategy" (p. 72). In one of a limited but growing number of empirical studies in corporate governance research Stiles and Taylor (2001) found, contrary to the managerialist tradition, that the BoD plays a valuable part in the strategic process. They found that BoDs are not directly involved in strategy formulation but are involved in setting the strategic context and act as a "gatekeeper" for strategic proposals. Thus their findings had BoDs' strategic role sitting somewhere in the middle of the passive - active continuum (Stiles & Taylor, 2001). These findings corroborate McNulty and Pettigrew's (1999) empirical findings that although strategies are usually initiated by management the BoDs did not simply ratify executives decisions but were "able to influence processes of strategic choice, change and control by shaping both the ideas that form the content of company strategy and the methodologies and processes by which those ideas evolve” (p. 48). Stiles and Taylor (2001) found that BoDs set and maintain this strategic context by; setting and reviewing the corporate definition, the gatekeeping function, through confidence building, and the selection of the chief executive and other directors. Stiles and Taylor (2001) concluded that it “is through the manipulation of the strategic context of the organization that the board makes its major contribution to strategy, rather than through a substantive contribution to the decision-making process” (p. 47). Likewise, Schmidt and Brauer (2006) suggested that BoDs, particularly non-executive directors, “establish an internal context that shapes the preparation, championing and approval of resource allocation decisions made by the executive management” (p. 17). McNulty and Pettigrew (1999) found that the high approval of proposals by the BoD was not the managerialist notion of the BoD as a rubber stamp but due to the high level of self-regulation by management in bringing proposals forward, as rejection of proposals is very undesirable for executives (pp. 60 – 61).

The chief executive’s style and character have a large influence on an organization’s strategy. As it is one of the BoDs tasks to appoint the CEO this gives the BoD “power of a very high order, and again enforces its potential for setting the strategic context of the organization” (Stiles, 2001; Stiles & Taylor, 2001) or as McNulty and Pettigrew’s (1999) noted “the ultimate act in shaping the context, content and conduct of strategy occurs when a board fires the chief executive” (p. 66). Westphal and Fredrickson (2001) suggested that changing CEOs is a way of changing strategic direction “by selecting a CEO who has experience at implementing the strategy that board members favour” (p. 1115). McNulty and Pettigrew’s (1999) also found that part time board members had greater opportunities to challenge management in times of performance difficulty or strategic transition (p. 67). As can be seen there is large range of expectations around the BoDs role in strategy but only a limited understanding of the actual roles of boards gleaned from empirical studies.

Having set the corporate direction the BoD needs to maintain that strategy. According to Stiles and Taylor (2001) the board ensure management maintain focus on the strategic framework by "gatekeeping" where the board acts as a screening mechanism ensuring an alignment between the strategic direction outlined by the board and the strategic actions undertaken by management. This gatekeeping mechanism (refusal) may be seldom used but as Stiles and Taylor (2001) argue "the board's *potential* for refusing to sanction management's proposals affords it strong latent power … and management's reluctance to face tough questioning or appear foolish under fire in the board room ensures that strategic proposals are of a high standard" (p. 44).

Closely related to Stiles and Taylor's (2001) notion of "setting of strategic parameters" is Hendry and Kiel's (2004) concept of "strategic control." Hendry and Kiel (2004) outline what is involved in strategic control:

> Strategic control involves the board exerting a continuous process of formal and informal influence over management, beginning early in strategy development and involving iterative consultation from development through to implementation and evaluation. It also involves the board evaluating management based on their strategic proposals pre-implementation as well as on the financial results post-implementation (p. 511).

Here we see the line between the BoDs strategy role and their control role now becoming quite blurred. Baysinger and Hoskisson (1990) outlined two ways of controlling strategic decisions - strategic and financial controls. Strategic controls involve evaluating management's strategic plans and their performance against those plans. Financial controls involve financial targets and the ability of management to meet them. Hendry and Kiel (2004) by combining organizational control and agency theories argue that BoDs use a combination of financial and strategic controls over management to not only reduce management's self-interested actions but to also shape strategic direction. They believed firm context and the balance between these two controls indicates the nature and extent of BoDs involvement in strategy (Hendry and Kiel, 2004: 515).

To continue the interdependent nature of roles the following activities can be viewed as strategic as well as service roles. Carpenter and Westphal (2001) raised the notion of BoDs as “strategic consultants” by providing advice to top managers on strategic issues (p. 642). Forbes and Milliken (1999) in what they described as a “service task” see a BoD role in providing advice and counsel to the CEO by active participation in the formulation of strategy by “generating and analyzing strategic alternatives during board meetings” (p. 492). Stiles (2001) saw a “boundary spanning” role for non-executive directors within their strategic role by reducing environmental uncertainty through their access to external information that is used in strategic discussions (p. 645).

Of central importance in understanding the BoDs’ role in strategy is an understanding of how strategy is developed. The majority of governance research ignores the emergent nature of strategy (Stiles, 2001). Mintzberg and Waters (1985) saw the common breakdown of strategy decisions into formation and implementation as “seriously limited” (p. 257). Mintzberg (1994) went further and termed as a grand fallacy that “the strategy-making process can be formalized” (p. 110). Burgelman (1983) for instance believed “strategy formulation and implementation are intrinsically intertwined, incrementally evolving processes; that intended strategies are often different from realized strategies and that different organizational contexts are associated with different strategic processes” (p. 1349). According to Burgelman (1983) and Mintzberg’s (1994) concepts of strategy calls for greater participation by BoDs in strategy formulation is very unlikely.

The literature suggests a broad range of possible BoD roles in the area of strategy. Hendry and Kiel (2004) note that the BoDs role in strategy is both “complex and dynamic” and “a range of internal and external contingency factors affect board involvement in strategy" particularly in "times of crises such as a sudden decline in performance [or] CEO succession" (p. 510). An understanding of how strategy is developed and the context of the strategic decision making process from directors' perspectives would seem important in understanding the BoDs strategic role.

CONTROL

The second of the broadly agreed roles of the BoDs is control. It is this role that receives the most attention from all sources; the popular and business press, shareholders, regulators and researchers. Keasey and Wright (1993) believed that the supervising or monitoring of management and ensuring accountability of management to shareholders and stakeholders as key elements of governance (p. 292). Corporate scandals and the dominance of agency theory and its effect on governance codes and legislation lead to this being the most prominent of the director's roles (Van den Berghe and Baelden, 2005). This emphasis stems from the dominant managerialist belief in the corporate governance literature that management control their BoDs and not vice-versa.

Fama and Jensen (1983) suggested that the separation of decision and risk-bearing functions (ownership and control) is wide spread because of the benefits of specialization of management and risk-bearing (p. 302). Fama and Jensen (1983) break the decision process into four steps; initiation, ratification, implementation and monitoring (p. 303). The initiation and implementation steps they term as "decision management" and the ratification and monitoring they term as "decision control" (Fama and Jensen, 1983). "Decision management is naturally the responsibility of senior management, whereas decision control becomes the responsibility of the board of directors" (Baysinger and Hoskinsson, 1990: 76). Hillman and Dalziel (2003) suggested from an agency perspective, the control role (which they refer to as "monitoring") is important as it reduces agency costs involved with managers pursuing their own interests at the expense of shareholders (p. 384).

The literature under control role also envisages a broad range of board behaviours. Mizruchi (1983) argued that “even when board members make no decisions whatsoever, as long as they have the ability to remove management, then they have control” (p. 429). According to Stiles and Taylor’s (2001) research this is only done in the “most drastic of circumstances” however this lack of use “does not detract from the fact that the latent power this option gives the board acts as an important discipline to top management” (p. 78). Forbes and Milliken (1999) go a little further than Mizruchi (1983) and saw the control task as the BoDs’ legal duty to “monitor management on behalf of the firm’s shareholders and to carry out this duty with sufficient loyalty and care” (p. 492). Johnson et al., (1996) described the BoDs’ control role as a fiduciary role in monitoring managers for stockholders, which would entail the BoD having responsibilities for hiring and firing top management particularly the CEO, determining executive pay and monitoring management to “ensure that they do not expropriate stockholders interests” (p. 411). According to Dalton et al., (1998) the control role “requires the board to monitor and evaluate the CEO and his or her top management team and company performance in general, as well as protect shareholders’ interests” (p. 273). Stiles and Taylor (2001) stated that the control role “refers to the key responsibility of the board to safeguard the company’s assets and resources, to ensure survival, and to avoid corporate trauma or consistent poor performance” (p. 27). Included in Hillman and Dalziel’s (2003) monitoring role are the monitoring of the CEO, monitoring strategy implementation, planning CEO succession, evaluating and rewarding top management (pp. 384 – 385). Molz (1985) developed a typology of corporate control by BoDs forming a continuum with managerial control at one end and social control at the other.

Baysinger and Hoskinsson (1990) identified two forms of control systems – strategic and financial. Strategic control involves the assessment of strategic initiatives and the financial performance implications of those initiatives. Financial control involves financial targets and the ability of management to meet them. Hendry and Kiel (2004) also noted that those BoDs that emphasize strategic control shape the context, content and conduct of strategy by evaluating alternatives and continuously monitoring progress both formally and informally (p. 511). Again we see an overlap of roles, strategic and control in the literature.

Dalton et al., (1999) saw control as one of the critical BoD tasks and outlined a number of internal and external controls by which a company is disciplined. Internally, the BoDs require adequate financial controls to be in place (p. 157). Stiles and Taylor (2001) identified two broad forms of control for BoDs – operational and strategic. Operational control is involved with three things; monitoring and analysis of performance against operating budgets, reserved powers and finally the audit committee. Strategic control has been covered above. A lot closer to a strategic role for the BoDs Hendry and Kiel (2004) saw control, which they divide into strategic and financial, as a "broad mechanism to shape strategic direction, and to facilitate innovation and organisational renewal" (p. 515). The firm's context and the balance between strategic and financial control indicates "the nature and the extent of board involvement in strategy" (Hendry and Kiel, 2004, p. 515).

Monitoring plays an important role in control. According to Van den Berghe & Baelden (2005) monitoring involves ensuring the accuracy of financial information, the adequacy of internal controls as well as regularly evaluating situations to ensure you have control over them (p. 681). A BoDs' ability to monitor will also depend on directors' competencies, such as experience, expertise, knowledge and application (Carpenter and Westphal, 2001, Hillman and Dalziel, 2003).

Through a company's constitution and policies the BoD has "allocative control" of resources for the large decisions which "constitutes effective economic control" of the company (Stiles & Taylor, 2001: 121). The amount of authority that is delegated to management by the BoD, usually through the delegation policies, is also an important control role (Van den Berghe and Baelden, 2005) as these policies require certain decisions to come before the BoD for authorization. Schmidt and Brauer (2006) saw as a central part of the BoDs role is ensuring "that the firm's executed strategy, that is, its actual resource allocation decisions, are consistent with the announced strategy" (p. 17).

Director independence from management is seen as important in the control role of the BoD. According to agency theorists a majority of outside directors are regarded as crucial, although some inside (management) directors are required as an internal monitoring function due to outside directors' "information asymmetry" (Johnson et al., 1996: 417). Muth and Donaldson (1998) suggested an independent board provides a mechanism for shareholders to retain the control associated with ownership rights" (p. 6). It is thought that directors with a personal, professional and/or economic relationship with the CEO are potentially less effective monitors of management (Johnson et al., 1996: 416). Johnson et al., (1996) found in reviewing the corporate governance literature that there was no consensus regarding how to determine director and hence BoD independence and that there was little evidence of a relationship between BoD independence and company performance. Aligning management and director compensation with shareholders' interests is seen by agency theorists as an important role of the BoDs to reduce agency costs and to increase monitoring (Westphal, 1999).

Although a meta-analysis by Dalton et al., (2003) did not find support for this notion. An overemphasis on the control role has been criticized as overshadowing the BoDs' performance role (Van den Berghe and Baelden, 2005) and this may be a possible conflict of BoD roles. The issue arises as to whether directors can maintain their independence for their control role while having the management's trust for their strategy and service (advice/counselling) roles.

SERVICE

The final BoD role explored from the literature is the service role. Again writers envisage a broad range of activities under this role. Dalton et al., (1998) saw a limited "service/expertise/counsel role of the board which essentially holds that directors may provide a quality of advice to the CEO otherwise unavailable from other corporate staff" (p. 273). Forbes and Milliken (1999) enlarged the BoDs' service role from providing advice to participating in strategy formulation and providing "expert and detailed insight during major events" as well as "generating and analyzing strategic alternatives" (p. 492). Zahra and Pearce (1989) envisaged an even larger service role involving "enhancing company reputation, establishing contacts with the external environment, and giving counsel and advice to executives" (p. 292). Johnson et al., (1996) distinguished between a service role and a resource dependence role. The service role involved the BoDs' advice and counsel to the CEO and initiating and formulating strategy. Johnson et al., (1996) saw the resource dependence role as "a means for facilitating the acquisition of resources critical to the firm's success" (p. 411). Stiles and Taylor (2001) expand this third role (which they refer to as the institutional role) further by drawing heavily from a resource dependence perspective. The institutional role is:

> concerned with the board as the perceived apex of the company, the figurehead in terms of public perception and accountability [and also includes] the board's ability to span boundaries and form networks with other companies and influential bodies (for example,

> the government), thus enhancing credibility and legitimacy and potentially securing scarce resources more efficiently (p. 27)

Stiles and Taylor (2001) believed it is important for the BoD to have strong external relationships to build corporate legitimacy, smooth access to scarce resources, and to allow shareholders and stakeholders to take a longer-term view of the company (Stiles & Taylor, 2001: 90 - 91). Hillman and Dalziel (2003) also saw a very wide role for the BoD in the provision of resources to the firm. Amongst the resources brought to the organization are; providing legitimacy, bolstering its public image, providing expertise, advice and counsel, linking to important stakeholders and entities, facilitating access to resources such as capital, building external relations, diffusing innovation and aiding in the formulation of strategy (p. 386). According to Hillman and Dalziel (2003) the provision of resources is directly related to the performance of the firm as they reduce dependency, diminish uncertainty, lower transaction costs, and “ultimately aid in the survival of the firm” (p. 386).

One of the major resources that BoDs facilitate access to is capital, therefore this considered an important service role of the board. The BoD has a role in meeting with institutional shareholders, the Annual General Meeting (AGM) and financial reporting (Stiles & Taylor, 2001). As outlined BoDs also have roles with stakeholders other than shareholders (Freeman, 1984). Stiles and Taylor (2001) found in their empirical research that this was seen as an important role for BoDs, although the “weak version” of stakeholder theory predominated. Again in the service role we see a broad range of possible activities for the BoDs and the overlapping and contradictory nature of the roles.

FURTHER RESEARCH

The wide range of roles posed in the corporate governance literature and their seemingly overlapping and often contradictory nature suggests that the current literature and theories of corporate governance are as yet inadequate to understand the roles of governing boards (Lockhart, 2006, Stiles and Taylor, 2001, Johnson et al., 1996). This concern is magnified when it is considered that the vast majority of literature is based on the study of large publicly traded companies (Daily et al., 2003, Turnbull, 1997, Forbes and Milliken, 1999, Van der Walt et al., 2006, Cornforth, 2004). There appears to be a need for descriptive data on how BoDs actually function (Schmidt and Brauer, 2006, Letza et al., 2004, Levy, 1997, Leblanc, 2004, Rindova, 1999)

CONCLUSION

In conclusion, the range of themes and rationales relating to the possible roles of BoDs in the corporate governance literature were explored. Three main roles were identified; strategy, service and control. Although there has been much written about the roles of BoDs there seems, as yet, to be little consistency over the components of those roles. There appears to be a great deal of overlap between roles and some parts of the roles seem contradictory. This lack of understanding may be due to a dearth of empirical research, lack of contextual understanding and conflicting theoretical perspectives. Analysis of data, drawn from real world experiences, will be required to understand which parts of this sometimes conflicting and contradictory literature provides understanding and explanations of the actual roles of governing boards.

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