UNIVERSITEIT GENT

**FACULTEIT ECONOMIE
EN BEDRIJFSKUNDE**

**TWEEKERKENSTRAAT 2
B-9000 GENT**
Tel. : 32 - (0)9 – 264.34.61
Fax. : 32 - (0)9 – 264.35.92

WORKING PAPER

Corporate governance and Board Effectiveness : beyond formalism

Abigail Levrau

Prof. Dr. L.A.A. Van den Berghe

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CORPORATE GOVERNANCE AND BOARD EFFECTIVENESS : BEYOND FORMALISM[1]

by

ABIGAIL LEVRAU[2]
Vlerick Leuven Gent Management School
Belgian Governance Institute

Reep 1, B-9000 Ghent, Belgium
Tel. + 32 9 210 98 93, Fax + 32 9 210 98 90
Email **: abigail.levrau@b-g-i.be**

and

Prof. Dr. L.A.A. VAN DEN BERGHE[3]
Vlerick Leuven Gent Management School
Belgian Governance Institute
Ghent University

Reep 1, B-9000 Gent, Belgium
Tel. +32 9 210 98 96, Fax +32 9 210 98 90
Email : **lutgart.vandenberghe@b-g-i.be**

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[2] Abigail Levrau holds a degree of Applied Economic Sciences from Ghent University. She is Senior Researcher at the Vlerick Leuven Gent Management School /The Belgian Governance Institute. Her research and interests are on corporate governance, board of directors and corporate governance ratings. She is currently undertaking a PhD on board effectiveness.

[3] Lutgart Van den Berghe obtained her PhD in Economics at the Ghent University on the topic of the economic value of insurance. She is extra-ordinary Professor at the Ghent University in corporate governance. She is Partner of the Vlerick Leuven Gent Management School and President of the Research Centre for Entrepreneurship, Governance and Strategy. She is Executive Director of The Belgian Directors' Institute and member of the board of directors of numerous (international) companies.

Abstract

Mainstream research on boards of directors has been focusing on a direct relationship between board characteristics and firm performance, but up till now the results are inconclusive. Different reasons are put forward to explain this inconsistency, but it can be argued that 'traditional' board research has been neglecting potential intervening variables. In this paper we present a process-oriented model for board effectiveness by relying on the corporate governance literature and the literature on group effectiveness. We follow the input-process-output approach to extract the significant variables from literature and integrate them into a research framework for studying board effectiveness. In particular, we identify three intervening variables (cohesiveness, debate and conflict norms) which we believe mediate the effects of board characteristics on board performance. The rationale for including these 'process' variables is the belief that the interactions and relationships among board members determine to a large extent the collective outcomes of the board of directors. In this respect, the model goes beyond the traditional structural attributes of boards of directors to include behavioural or attitudinal measures of board effectiveness. It also highlights the need for a multi-disciplinary approach in empirical research on boards of directors.

Introduction

Since the mid-1980s, the issue of corporate governance has attracted a great deal of attention both in academic research and in practice. Shleifer and Vishny (1997) define corporate governance as "the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment" (p.737). John and Senbet (1998) propose the more comprehensive definition that "corporate governance deals with mechanisms by which stakeholders of a corporation exercise control over corporate insiders and management such that their interests are protected" (p.372). Since corporate governance has to do with setting priorities, delegating power and organizing accountability, it receives high priority on the agenda of policymakers, institutional investors, companies and academics. Recent American and European corporate scandals (Enron, WorldCom, Ahold etc.) set off a fresh round of debate. In the wake of these corporate failures, basic principles and rules are being reviewed and strengthened in order to reinstall investor confidence. At the heart of these corporate governance reforms is the common interest in the effectiveness of the boards of directors. This comes as no surprise as Williamson (1985) argued "the board of directors should be regarded primarily as a governance structure safeguard between the firm and owners of equity capital" (p.298). Corporate governance codes, experts and activists have long advocated changes in the board structure. The changes include, among others, the appointment of independent directors, the installation of board committees in those areas where conflicts of interest might appear and a separation of the roles of CEO and chairman of the board (Van den Berghe and De Ridder, 1999). These structural measures are assumed to be important means to enhance the power of the board, protect shareholders' interest and hence increase shareholder wealth (Becht et. al., 2002; Westphal, 1998).

The same issues have also received substantial interest in academic research. Boards of directors have been the subject of extensive research in diverse disciplines as finance, economics, management and sociology. Probably one of the most widely discussed issues concerns how to appropriately structure the board of directors and to what extent changes in the make up of the board influence performance outcomes. An impressive amount of empirical research has examined the consequences of different board characteristics, such as board size (Conyon and Peck, 1998; Yermack, 1996; Provan, 1980), outsider/insider proportion (Rosenstein and Wyatt, 1990; Kesner, 1987; Baysinger and Butler, 1985) and CEO duality (Rechner and Dalton, 1991; Donaldson and Davis, 1991) on board or firm performance. But up to date, mainstream research has failed to reveal a consistent direct relationship between board structure and performance outcomes (Coles et.al., 2001; Dalton et.al., 1998).

There seems to be a point of agreement in literature that progress in the field will largely depend on a better understanding of the inner workings of a board of directors (Hermalin and Weisbach, 2000; Pettigrew, 1992). Already a small number of empirical studies offer a worthy attempt to open-up the "black box" of actual board conduct by exploring the dynamics of power and influence as well as the behaviour of board members and their relationship with management (Leblanc and Gillies, 2005; Roberts et al., 2005; Huse and Schoning, 2004; Pettigrew and McNulty, 1995). Parallel, some scholars have attempted to model the dynamics of boards theoretically (Huse, 2005; Nicholson and Kiel, 2004a; Sundaramurthy and Lewis, 2003; Forbes and Milliken, 1999). This paper links up with this research stream as such that it is also aimed at getting a more profound insight into the concept of board effectiveness by omitting a direct relationship between board characteristics and performance outcomes. Although the accents slightly differ, we share a common belief, i.e. that board effectiveness is determined by a large and interrelated set of variables which have been - to a large extent - ignored in mainstream board research.

The purpose of this paper is to investigate - from a conceptual point of view - the interrelationship between various criteria which are presumed to be important for the effectiveness of boards. In this respect, we will pay special attention to intangible aspects of board conduct. Guided by existing board models and complemented with additional literature from different disciplines, significant variables will be extracted and integrated into a theoretical framework. This paper unfolds along the following lines. We begin to explain, more in-depth, the inconclusive results found in board-performance links. Second, we briefly explain how board of directors differ from other teams[4] in an organization. Understanding the uniqueness of boards is useful because it limits the extrapolation of constructs found in other literature, in particular regarding group dynamics. Third, we develop the research framework and, based on theoretical

[4] It must be noted that the management literature has tended to use the term "team" while academic literature has tended to use the word "group".

assumptions, we derive a number of propositions indicating relationships between the identified variables. We go on with a discussion of the limitations and boundary conditions of the model. The paper ends with our conclusions.

Explaining the inconclusive findings in board research

Many explanations can be given for the lack of consistent findings in empirical research on the direct relationship between the board of directors and corporate performance. In essence, they all boil down to two issues. These are (i) a lack of clear construct definition, and (ii) the reliance on incomplete research models.

First, the diverging findings have been attributed to the varying definitions and operationalizations of the constructs used in empirical research. Daily et.al. (1999), for example, identified over twenty separate ways of defining board composition. The earliest studies distinguished inside from outside directors and board composition was measured using three different approaches: (absolute) number of outsiders, industry inside-outside norm and outsider/insider proportion or dominance[5] (Zahra and Pearce, 1989). Later on, researchers increasingly wanted to capture the independence of the outside directors and have been separating independent directors from interdependent or affiliated directors, who are considered to be characterized by a lack of independence. In such an approach, board composition has been operationalized by the independent/interdependent distinction or by the proportion of affiliated directors (Dalton et.al., 1998). In addition to the complexity of uniformly defining board composition, the measurement of performance is also subject to considerable discussions (Venkatraman and Ramanujam, 1986; Hawawini et.al., 2003). Although some scholars rely on market-based measures, research on boards of directors has been dominated by accounting measures (Dalton et.al., 1998; Coles et.al., 2001). Performance measures rooted in financial

[5] Proportion was calculated by dividing the number of outside or inside directors to board size. In contrast, “dominance” denoted the existence of a large majority of outside or inside directors on the boards, and was treated as a dichotomous variable (outsider versus insider-controlled)

accounting are being criticized because they (i) are subject to managerial manipulation, (ii) undervalue assets, (iii) are influenced by accounting standards such as depreciation policies, inventory valuation and treatment of certain revenue and expenditure items and (iv) are affected by differences in methods for consolidation of accounts (Chakravarthy, 1986). Furthermore, a review by Johnson et al. (1996) has revealed a list of distinct financial performance measures on which empirical research has relied, emphasizing the fact that certain measures have additionally been adjusted to account for industry effects or risk in a different manner. Consequently, the variety in definitions and measures applied in empirical research makes comparison of studies difficult and may cause the inconsistent findings.

Second, it can be argued that the models used to study the relationship between the board of directors and firm performances are incomplete. The literature on boards of directors is characterized by a near universal focus on studying the direct effects of board characteristics on performance outcomes while ignoring the influence of potential intervening variables. In particular, Pettigrew (1992) observed that in mainstream board research: “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” (p.171). More and more, researchers hold this point of view and are convinced that it is necessary to go beyond the traditional direct approach to fully understand what boards of directors actually do, how they work, and derivatively, to what extent they affect performance (Huse, 2005; Huse and Schoning 2004; Finkelstein and Mooney 2003; Daily et.al., 2003; Leblanc and Gillies 2003; Forbes and Milliken, 1999). This criticism is however by no means limited to board research. It is also expressed in studies on demography-performance links in other contexts. In particular, in “upper echelons” research (Hambrick and Mason, 1984), scholars came to understand that the relationships between Top Management Team (TMT) demography and organisational outcomes are mediated and/or moderated by various intervening variables, such as team processes. In their recent review, Carpenter et.al. (2004) propose and challenge organizational researchers to "carefully explore the practical and theoretical meaning of TMT demographic characteristics vis-à-vis the deeper constructs they are presumed to proxy" (p.749). This actually reinforces the call of earlier authors to omit the use of direct input-output models. Priem et.al. (1999), for example, already pointed out that upper echelon theories frequently suggest mediating variables (such as group interaction processes etc.) to explain the influence of TMT heterogeneity on firm performance, but that these mediators typically remain unmeasured. "Most research undertaken from a demographics perspective implicitly views TMT processes as a "black box" that must be inferred because they are impractical to measure or cannot be directly observed" (p.947). The "black box" of organizational demography has also been described by Lawrence (1997) in terms of the phenomenon of 'congruence assumption'. Based on Pfeffer's (1983) original discussion, she noted that researchers assume demographic predictors to be congruent with subjective concepts, which therefore are irrelevant and unnecessary to include. She makes a strong case to eliminate the congruence assumption to study the actual mechanisms underlying the demography-outcome relationships. At the same time, the need for inquiry into intervening processes is strengthened by studies that have demonstrated superior explanatory power by including process variables in TMT research (Petterson et al., 2003; Papadakis and Barwise, 2002; Amazon and Sapienza ,1997; Amazon 1996; Smith et. al.; 1994). In this respect, TMT research and research on group effectiveness in general, offer an interesting starting point to explore the added-value of including process variables in board research. Still, it can be argued that the board of directors differs from other organizational teams.

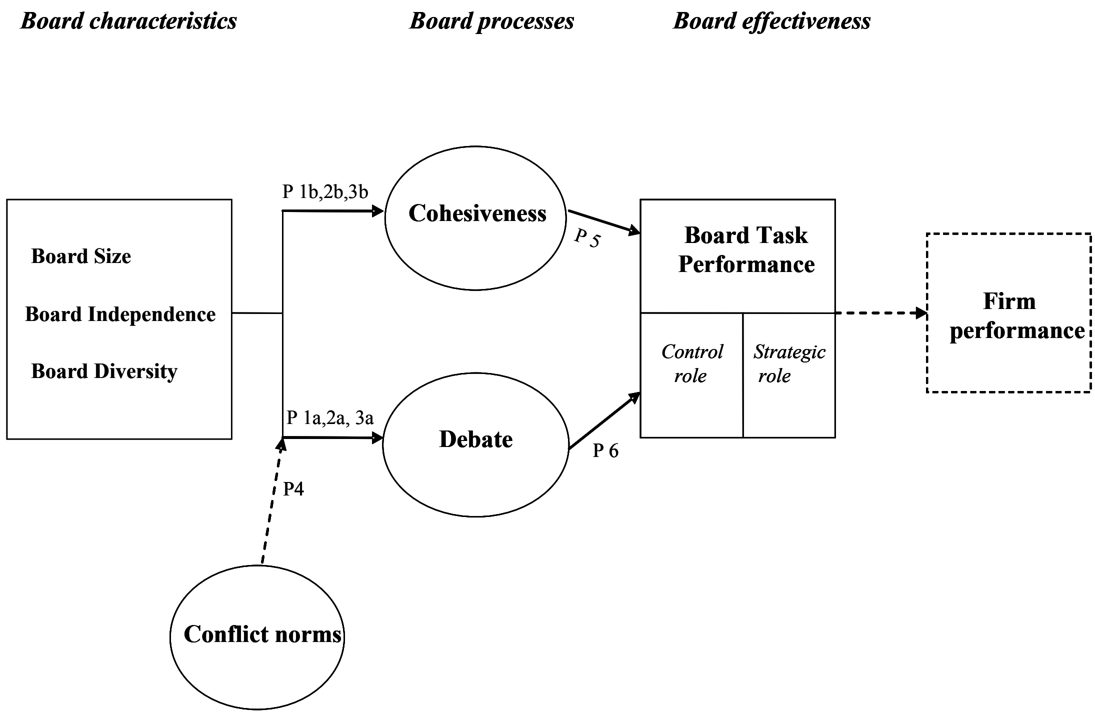
Differentiating board of directors from other organizational teams

The board of directors can be considered as a multi-member governing body, standing at the apex of the organization (Bainbridge, 2002). However, being a collection of individuals, boards of directors show some distinctive features which make them, to some extent, unique among organizational teams (see Appendix 1 for a summary). A first feature is partial affiliation. Board of directors usually include outside directors who are not employees of the company and do not assume management tasks. In most cases, outside directors sit on several boards and these mandates come on top of their regular 'day job'. In this respect, outside board members are only partial affiliated to the company on whose board they serve (Forbes and Milliken, 1999; Nadler et.al., 2006). Second, boards of directors are characterised by episodic interactions. Most board of directors only meet a few times a year. Although (some) board committees meet more frequently, the meetings involve only a small subset of the whole board. By consequence, board members spend only a limited time together in the boardroom so that it's quite difficult to experience intense personal contact. Besides, without little or no contact between formal board meetings, there is little opportunity to build strong working relationships (Forbes and Milliken, 1999; Nadler et.al., 2006). A third feature is limited time and information. Outside board members devote only limited amount of their time on board-related work (Lorsh and MacIver, 1989). Moreover, they heavily dependent on the goodwill of management to obtain relevant and timely information. In this respect, it is obvious, that outside directors - compared to executive directors- are restricted in their ability to become deeply familiar with the company, its people and its business (Nadler et.al., 2006). Fourth, boards of directors are commonly composed of a preponderance of leaders. Regarding the background of outside directors, most of them can present a track-record as former or present CEO (Forbes and Milliken, 1999). It is often because of their outstanding professional achievements that they have been appointed to the board of directors. At the same time, these individuals are used to sit at the head of the table and they have their own psychological needs for power, recognition, and influence. For many of these directors, the setting of a board of directors is (or might be) sensed as an unusual and uncomfortable situation (Nadler et.al., 2006). Fifth, there exist complex authority relationships within a board of directors. In contrast to management teams, the role and position of outside directors do not reflect their status in the company's hierarchy (Nadler et.al., 2006). Still, some outside directors may have more authority than others, due their status in corporate world or the business community at large. Moreover, when the positions of chairman of the board and CEO are combined, a perplexing power relationship may exist. A sixth feature relates to the changing expectations of work. Compared to other teams, the role of the board is often not well-defined and can substantially differ among companies. In addition, boards of directors are increasingly confronted with unprecedented scrutiny and (public) pressure (Van den Berghe and Levrau, 2004). As a result, many boards are struggling to agree on what their tasks are, also vis-à-vis management. Seventh, boards of directors expose an aura of formality. The format, physical setting, social rituals and conduct of board meeting create a sense of formality and status which is uncommon among other teams (Nadler et.al., 2006). Finally, boards of directors encompass a larger number of members in comparison to the size of other organizational team (Forbes and Milliken, 1999).

Presenting a process-oriented model for board effectiveness

Taking into account these distinctive features, we develop a model of board effectiveness that bridges some of the gaps in the research on boards of directors (see Figure 1). Drawing on a broad variety of sources (e.g. corporate governance literature, literature on TMT and group effectiveness, field studies etc.), we distinguish multiple intervening constructs that we believe mediate the direct impact of board characteristics on firm performance. The proposed model strongly relies on the input-process-output approach used in research frameworks for studying organizational teams (e.g. Gladstein, 1984; Cohen and Baily, 1997). Apart from that, this approach has also inspired other board models (e.g. Forbes and Milliken, 1999; Huse, 2005).

Figure 1: overview of the research framework



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Defining board effectiveness

Literature reveals that there exist multiple approaches to determine the concept of effectiveness due to the scholars' different background and their heterogeneous research purposes (Van den Berghe and Levrau, 2004; Kuo, 2004). In their seminal article Hackman and Morris (1975) set out three criteria of group effectiveness: group performance, the ability of the group to work together over time and the satisfaction of the personal needs of group members. This definition includes the classic "task" (group-produced) and "maintenance" (attitudinal) criteria and are commonly used in research on work groups (Gladstein, 1984; Jehn, 1995; Cohen and Bailey, 1997; Lemieux-Charles et. al., 2002). Applied to the context of boards of directors, board effectiveness is mainly concerned with "task" outcomes and occurs by fulfilling a role set (Nicholson and Kiel 2004). The latter is, however, still subject to considerable debate in literature. The role set is often not defined as an integrated set of activities. In contrast, based on diverging theoretical assumptions, the role of the board is conceptionalized in a multiple, and in some cases contradictory, way (Johnson et.al., 1996; Hung, 1998). Commonly accepted and used is the classification into three broadly defined roles: control, service and strategic role (Zahra and Pearce, 1989; Maassen 1999).

Regarding **the control role**, the board of directors has a legal duty to provide oversight and is expected to carry out this duty with sufficient loyalty and care. Particularly, in Anglo-American countries it is emphasised that the board has a fiduciary duty to oversee the company's operations and monitor top management performance in order to protect shareholders' interests (Lorsch and MacIver, 1989). The board's duty to monitor management and corporate performance has also been addressed in other disciplines than law. In particular, the dominant theory underlying the control role of the board is agency theory, initially the prevailing school of thought in finance and economic research This theory is concerned with resolving problems that may occur in the relationship between two major parties, the principal (owner) and agent (the manager) (Eisenhardt, 1989). First identified by Adam Smith (1776) in his commentary on joint stock companies and further elaborated in the twentieth century by the influential work of Berle and Means (1932) and Jensen and Meckling (1976), agency problems stem from the separation of ownership and control. The latter leads to a decision process in which "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" (Fama and Jensen 1983:5). Agency theorists believe that managers (agents) may pursue opportunistic behaviour which may be in conflict with the goals of the owners (principals) and hence destroy shareholder wealth. Advocates of the agency approach see the board of directors as "an economic institution that helps to solve the agency problems inherent in managing any organization" (Hermalin and Weisbach 2000:1). Put differently, the board of directors is one of the internal control mechanisms designed to address the conflicts of interest between managers and shareholders and to bring their interests into congruence (Walsh and Seward, 1990). Within this context, a board of directors is the guardian of shareholders' welfare and fulfil the critical tasks of hiring, firing and compensating the CEO (top management) and to ratify and monitor important decisions (Fama and Jensen, 1983).

The **service role** of the board of directors primarily stems from a resource dependence view and - in second order - from stewardship theory. A careful reading of the literature however reveals that the service role of the board is not uniformly approached. From a resource dependence perspective, which is mainly grounded in sociology and organizational theory, the board of directors is seen "as a vehicle for co-opting important external organizations with which the company is interdependent" (Pfeffer and Salancik, 1978). Within this context, Mintzberg (1983) distinguishes at least four service roles of the board of directors: (1) co-opting external influencers, (2) establishing contacts (and raising funds) for the organization, (3) enhancing the organization's reputation and (4) giving advice and counsel to the organization. In particular, the latter refers to the board's potential to provide high-level advice to the CEO (Jensen, 1993; Dalton et.al., 1998). However, an alternative approach of the service role, mainly based on stewardship theory, excludes legitimacy and resource dependence functions in favour of strategic engagement. According to stewardship theory, managers are good stewards of the company assets. Managers do not misappropriate corporate resources at any price because they have a range of non-financial motives, such as the intrinsic satisfaction of successful performance, the need for achievement and recognition etc.. Given the absence of self-interested behaviour by managers, the issue becomes to what extent organizational structure facilitates the aspiration of management for high performance (Donaldson and Davis, 1991; Muth and Donaldson, 1998). As opposed to agency theory, stewardship theory represents a consensus perspective and rejects the notion that the board is a disciplining mechanism to align conflicts of interest between shareholders and managers. In fact, proponents of the stewardship school of thought see the board of directors as an important strategic device. They suggests that the board of directors can serve the CEO and management with their expertise through their active involvement in the strategic decision-making process, particularly by advising top management on the initiation, formulation and implementation of strategy (Carpenter and Westphal, 2001; see also the review by Johnson et.al., 1996). By consequence this approach blurs a clear distinction between the service and the strategic role of a board of directors.

Finally, **the strategic role** of the board of directors has historically been subject to much dispute, especially in the management literature (see e.g. the discussions in various issues of Harvard Business Review from the beginning of the 1980, edited by Kenneth Andrews). The strategic role of the board taps insights from different theoretical perspectives. In essence, two broad schools of thought on the involvement of boards in strategy can be detected, referred to in the literature as “active” and “passive” (Golden and Zajac, 2001). The passive school views the board of directors as a rubber stamp or a tool of management with little or no impact on a company’s strategy process. In contrast, the active school views the board of directors as an ‘independent’ body who actually contributes in shaping the strategic course of a company and in guiding the management to achieve corporate mission and objectives (Maassen, 1999; Hung, 1998). The board’s contribution can occurs in a myriad of ways such as through advice and counsel to the CEO, through careful refinements of strategic plans, by initiating own analyses or suggesting alternatives, by probing managerial assumptions about the firm and its environment, or by ensuring that agreement exists among executives on the strategic direction on the firm (Zahra, 1990; Zahra and Pearce, 1989). According to Goodstein et.al. (1990) the strategic role is of particular importance in critical cases such as periods of environmental turbulence or declines in company’s performance, because such events provide the opportunity to a board to initiate strategic change. As pointed out by different scholars, the active school of thought is receiving growing attention and is graining ground (Hendry and Kiel, 2004; Finkelstein and Hambrick, 1996). An overview of the three board roles and the functions that make up each role is presented in Appendix 2.

Although the literature recognizes three board roles, the importance attach to each role is not equal. As agency theory dominates corporate governance research, it is obvious that the board's control role is emphasized as the most important one and this role is well-documented by a rich body of empirical literature. At the same time, the importance of the board's strategic role is supported by a limited but increasing amount of empirical research. Several scholars have attempted to understand actual board involvement in the strategic decision-making process mainly relying on qualitative research techniques (Van den Berghe and Levrau, 2004; Short et. al., 1999; McNulty and Pettigrew, 1999; Goodstein et.al., 1994; Johnson et.al., 1993; Judge and Zeithalm, 1992; Demb and Neubauer, 1992; Lorsch and MacIver, 1989). Applied to this study, we value the view of a two-fold role set which comprises the control and the strategic role. Different arguments underpin our choice. First, previous studies on boards of directors have relied on a single theoretical perspective favouring one board role at the expense of the other, resulting in an incomplete picture (Hillman and Dalziel, 2003). In order to get a more holistic and richer understanding of what boards do, we contend that a multiple lens approach is important. Second, as argued above, the service and strategy role are not mutually exclusive as there exists some overlap with respect to the prescribed tasks performed by the board, particularly regarding the strategic decision-making process. Finally, a recent study by Levrau and Van den Berghe (2007) revealed that the strategy role was strongly emphasised (in comparison to the other board functions) in directors' perceptions. Therefore, we have opted to integrate the service and the strategy role. By consequence, *in our model board task performance refers to the degree boards are successful in carrying out their strategic and monitoring tasks*. Because of the rather confidential nature of board activities, it is not easy to measure board task performance in ways that are both reliable and comprehensive. A suggestion of Forbes and Milliken (1999) is to use certain publicly announced board actions, for example CEO replacement, as proxies for performance of the control functions. Still, this approach appears to be less suitable for the assessment of board task performance on the strategic dimension. In particular, it can be argued that is difficult to isolate the real impact of the board of directors (from the impact of management) when assessing publicly announced strategic decisions, such as a take-over. Alternatively, we suggest researchers to measure board task performance by identifying various board functions related to the strategic and monitoring role and then asking respondents to assess how well these functions are being performed. In spite of their limitations, these self-evaluation approaches have been commonly used in previous empirical studies on board effectiveness in the non-profit sector (e.g. Cornforth, 2001; Green and Griesinger, 1996; Bradshaw et.al., 1992; Slesinger, 1991).

So far, we have argued that the impact of boards of directors on company performance occurs indirect through the effectiveness of boards in performing two key roles. In the next sections, we elaborate the indirect route by proposing three group process variables that will significantly influence the task performance of boards: cohesiveness, debate and conflict norms. Moreover, we capture them in a set of propositions.

Cohesiveness and debate as intervening variables

Despite of certain distinctive characteristics, boards of directors are, like top management teams, confronted with complex ambiguous tasks. Much of the work that boards of directors must do in order to produce effective outcomes involves cooperative decision-making and joint efforts. Board members are required to work together by mutual interaction, sharing information, resources and decisions. In this respect, the board of directors is considered to be a collegial body and only if board members coalesced into a group collective judgment can emerge (Charan, 1998). However, it is only the last decade that scholars began suggesting that the board should transform itself from a loose aggregation of individuals into an effective team (for example, Nadler, 2006 and 2004; Carter and Lorsch, 2004; Conger et.al., 2001). For boards of directors becoming a team, who operates collegial, we argue that a minimum degree of cohesion among the board members is required. Our view that cohesion aids collaboration and communication among board members, and as such influences performance outcomes, is also suggested and reinforced by research on other teams. Organizational demography literature has emphasised cohesiveness as a potential intervening construct and it is one of the most extensively studied variables in group settings (Bettenhausen, 1991; Williams and O'Reilly, 1998). Group cohesiveness is defined as "*the degree to which the members of the group are attracted to each other and are motivated to stay in the group"* (Shaw 1976:197). The concept is affective in nature and is characterised by a sense of connectedness. In particular, cohesiveness is considered to play a vital role in any exchange relationship (Austin, 1997) and it can be argued that it also has relevance in the context of boards of directors. To the extent board members like each other and like the group, they can be expected to interact and integrate more easily. Moreover, qualitative research on boards of directors (e.g. Van den Berghe and Levrau, 2004; Finkelstein and Mooney (2003)) has revealed that directors value the chemistry of the board and the team spirit of their colleagues as important elements of board effectiveness. Ideas as "team spirit" and "teamwork" have been linked to the concept of cohesiveness (Seashore, 1977). Lastly, the board model put forward by Forbes and Milliken (1999) has also suggested that cohesiveness may exert an influence on the task performance of boards of directors. Researchers can operationalize cohesiveness by using the four-item cohesiveness index from O'Reilly et.al. (1989). In addition, directors can be asked to evaluate statements such as "members of this board respect and trust each other", "board members also socialize with each other outside board meetings" etc.

Considering the board of directors as a decision-making group, we propose a second intervening construct namely debate. Debate is defined -consistent with Simons et. al. (1999)- a*s an open discussion of task-related differences and the advocacy, by different board members, of differing approaches to the decision-making tasks*. The expression of cognitive conflict during discussions is considered to be a critical component of decision-making groups: "debate is critical in liberating relevant information and shaping effective courses of action" (Eisenhardt et.al., 1997:43). Since the complexity of board's tasks overwhelms the knowledge of one person, board members are supposed to share their own, unique experiences or perspectives via discussions or other forms of interaction (Schweiger et.al., 1989). In particular, board members must find ways to let their views aired, to challenge one another's viewpoint without breaking the code of congeniality. Debate facilitates the generation of ideas and provides the opportunity to critically assess multiple alternatives and to question false assumptions (Eisenhardt et.al., 1997). Debate has some overlap - but is not identical to - the concepts of task conflict, which can also be found in studies on top management teams and cognitive conflict, which is also proposed in Forbes and Millikens' board model. Task or cognitive conflict exists when there are disagreements among group members about task issues, including differences in ideas and opinion on how best to perform the content of the task (Jehn, 1995). The difference with debate boils down to the fact that the concept of task conflict is essentially based on a perception of difference or disagreement which does not necessarily need to be expressed verbally (Simons et. al., 1999). Next to the recognition in literature of including debate as an intervening process variable, when studying decision-making groups, the issue has also been emphasised by the directors themselves. A recent study by Levrau and Van den Berghe (2007) revealed that directors perceive the occurrence of objective debate as one of the key criteria for board effectiveness. Their findings are consistent with the evidence of a qualitative study by Finkelstein and Mooney (2003). They noted that during their interviews, all directors mentioned the importance of constructive conflict in discussing diverse views among themselves and with the CEO. Debate, as a construct, can be measured by extending the scale from Simons et. al. (1999). In particular, board members can be ask to rate statements such as "discussions during the meetings are constructive", "when discussing an issue directors state clear disagreement with each other", "different directors propose different approaches to the issue", "directors openly challenge each other's opinion" and "discussions of the issue become heated".

The effects of board characteristics on board processes

Board size refers to the number of board members. It simply represents a board's structural and compositional context. Hambrick & D'aveni (1992) state: "at a basic level, the resources available on a team result from how many people are on it" (p.1449). Board size is a well-researched characteristic as it is considered to have an important impact on the functioning of a board. Still, the effects produced by board size are not unambiguous as they can be both positive and negative. In many studies, board size is recognized as a proxy for directors' expertise, and in this respect, board size is synonymous with cognitive capability (Amason and Sapienza, 1997). Larger boards have the potential to provide an increased pool of expertise because their members likely have a broader variety of backgrounds and may represent more specialized knowledge and skills (Smith et.al., 1994). For this reason, larger boards are better equipped (compared to small boards) to process large amount of information (Eisenhardt and Schoonhoven, 1990). The possibility for boards to draw on a larger pool of expertise likely contributes to the quality of the discussions in board meetings.

Jensen (1993) however contends that board size is not unlimited. There exists a turning point where the benefits of an enlarged board will be outweighed by the costs in terms of productivity losses. As size increases, boards may be confronted with some traditional group dynamic problems associated with large groups. In fact, larger boards of directors become more difficult to co-ordinate and may experience problems with communication and organization, a proposition borrowed from organizational behaviourists (see for instance Hackman, 1990; Eisenberg et.al., 1998). By consequence, too large boards may be inhibited to have a fruitful debate. Besides, having a high number of board members around the table may hamper the board's ability to identify, extract and use its members' potential contribution. Given the limited time available during board meetings, there might be too many members to hear from and to persuade (Patton and Baker, 1987).

Finally, larger boards - as any large group - may find it difficult to establish the interpersonal relationships which further cohesiveness (Shaw, 1976). The problem of developing intense personal contact in larger boards will also strengthened by the episodic interactions among the board members. By consequence, they are prone to develop factions and coalitions which can increase group conflict and hence inhibit cooperation among the directors (Goodstein et. al., 1994). Thus, we offer the following propositions :

Proposition 1 a : the effect of board size on debate will be positive but when the size becomes too high, the impact on debate will be negative

Proposition 1 b : the larger the size of the board, the less cohesiveness the board members will experience

Board independence refers to the degree of independent outside representation on the board of directors (Van den Berghe and De Ridder, 1999). An increase in the number of independent directors relative to executive directors is one of the commonly prescribed remedies to improve corporate governance (Walsh and Seward, 1990). The ratio of outside independent directors is frequently used as a measure of the extent to which a board is able to act independently, especially from management. Particularly, the agency perspective presumes that independent directors - irrespective of the way they are defined[6] -, engage in a critical assessment of management proposals and that they take a dispassionate stand vis-à-vis management interests and values (Kosnik, 1987). Because of their non-employment status independent directors are supposed to identify with the interests of the shareholders as well as to operate in the best interest of the company in an unbiased and object way (Van den Berghe and Baelden, 2005). In other

[6] In countries where the Anglo-American system prevails and thus where the manager *de facto* calls the shots, independence is defined with respect to the management. In contrast, in many Continental European countries with concentrated share-ownership, independence is seen primarily in relation to the dominant shareholder.

words, due to the absence of close ties to the company, independent directors are able and better placed to approach issues at a distance and to speak up more freely. In addition, the literature on director interlocks suggests that independent directors bring along important information about business practices and policies, due to their experiences on other boards. This information may further enable problem-solving and facilitates discussions (Carpenter and Westphal, 2001; Rindova, 1999). In contrast, the contribution of executives sitting on the board is believed to be less straightforward. Although executive directors may bring along firm-specific information, which is presumed to lead to a more effective decision-making process (Fama and Jensen, 1983; Rosenstein and Wyatt, 1990), their willingness to be actively involved in candid discussions has been questioned. It is argued that executive directors' objectivity will be impaired by their dual role as full-time manager (Kosnik, 1987). Especially their ties and loyalty to the CEO, in addition to the fear of retaliation which could harm future working relationships or career perspectives, may prevent executive directors to openly voice disagreement during board discussions (Baysinger and Hoskisson, 1990; Patton and Baker, 1987).

At the same time, increasing board independence, by attracting more independent directors may hamper the integration of board members. By definition, independent directors are not employees of the company and do not assume management tasks. As most boards of directors meet only a few times a year, outside independent directors interact less frequently with each other and with the executives. Moreover, they are less close-knit because they have affiliations with different firms. Thus, we offer the following propositions :

Proposition 2 a : an increase in board independence will increase debate

Proposition 2 b : an increase in board independence is negatively related to cohesiveness

Board diversity refers to the degree to which a board is heterogeneous with respect to informational demographic attributes (Jehn et.al., 1997). In particular, board diversity reflects differences in knowledge, experience and skills (due to educational, functional or occupational backgrounds, industry experience etc.). In the case of boards of directors, the issue of diversity is introduced by the resource dependence perspective. By recruiting outside directors with different backgrounds or who represent specific organizations, boards of directors help to link the company to its external environment and as such secure critical resources (Pfeffer, 1972). In addition, the interest in board diversity is growing, by no means under the pressure of major institutional investors (see for example, TIAA-CREF's policy statement dating from 1997) and other shareholder activists. Directors themselves also stressed the importance of having a diversified mix of people on the board of directors in order to be effective (Levrau and Van den Berghe 2007). However, up to date the concept of diversity is a rather unexplored domain in empirical board research (Carter et. al., 2002). In contrast, research on diversity in other settings has a long-standing history. Although the issue of diversity has not been approached in a uniform way, two streams have been identified that influence the way diversity is conceptionalized. One stream of research approaches diversity from a moral-ethical perspective and focuses on the social inequity in order to identify discriminatory practices in the workplace. A second research stream studies diversity from an organizational and economical perspective in order to examine the effects of diversity on work-related outcomes (Janssens and Steyaert, 2003). Especially the latter points out robust relationships which can to some extent be extrapolated to the context of boards of directors.

Diversity among board members is assumed to improve debate due to the obvious reason that diversity is commonly associated with different life experiences and hence diverse perspectives (Eisenhardt et.al., 1997). In fact, research on group heterogeneity suggests that creativity is positively related to skill-based heterogeneity because diverse perspectives can produce and consider a broad array of solutions and decision criteria (Schweiger et.al., 1986). This is of particular relevance when groups are confronted with complex, non-routine tasks, as it is the case with boards of directors. From a different point of view, research has also shown that board members who are in a minority position have the potential to provide unique perspectives and challenge the conventional wisdom among the majority in the board (Westphal and Milton, 2000). For example, when the majority of board members represents a particular functional background (e.g. finance), the opinion expressed by a board member with a different background (e.g. marketing) may shed another light on the topic, and hence, change the discussions.

Although the results of empirical research on the cognitive capacity of groups are consistently positive (see the reviews by Milliken and Martins, 1996 and Williams and O'Reilly, 1998), if boards become too diverse, debate may be hampered by difficulties in understanding of alternatives, attributable to differences in language or background (Pelled, 1996). Board members with the same background share a language which reflects similarities in interpreting, understanding and responding to information. Directors who are not familiar with this shared language may find it difficult to communicate (Zenger and Lawrence, 1989). In addition, heterogeneous boards have a greater potential for disputes (Goodstein et.al., 1994), are less able to agree on means and objectives (Golden and Zajac, 2001) and by consequences, it may be difficult to research consensus.

At the same time, based on socio-psychological research, greater heterogeneity on boards likely has a negative impact on cohesiveness. An explanation can be found in the social categorization and similarity/attraction theory. The first refers to the process of self-categorization. The basic assumption of the social categorization theory is that individuals seek a positive self-identity. Therefore, on the base of demographic attributes, individuals classify themselves and others into social categories. This process permits the individual to define himself in terms of a social identity and to compare himself to others (Tajfel, 1982). Individuals are perceived as in-group members if they have similar features and out-group members otherwise. There is a tendency then to evaluate the members of other categories more negatively which results in stereotyping, polarization and anxiety (Tsui et. al., 1992). According to this theory, individuals tend to prefer homogeneous groups of similar persons. Diversity, in contrast will trigger the process of social categorization. The more diverse a board is composed, the greater the chance directors will be confronted with individuals of other social categories, resulting in increased hostility which may have detrimental effects on the cohesiveness within the board. A similar prediction is grounded in the similarity/attraction paradigm. According to this perspective, individuals who perceive themselves similar to others tend to empathize with and feel attracted to these other persons (Byrne, 1971). Similarity can appear on all kinds of attributes ranging from demographic variables to attitudes and values. Being similar reinforces a person's attitude and beliefs while dissimilarity is considered negatively (Tsui and O'Reilly, 1989). Empirical research on groups already supports these predictions. In particular, diversity on attributes like gender, race and functional background have been found to negatively influence affective outcomes such as commitment, cohesiveness (or social integration), satisfaction etc. at both the individual and group level (see Milliken and Martins, 1996 and Williams and O'Reilly, 1998 for a review). Applied to a board context, diversity, irrespective of the way it is uttered/expressed, yields dissimilarity among the members which lowers interpersonal attraction and liking. Thus, we advance the following propositions :

Proposition 3 a : the effect of board diversity on debate will be positive but when the board becomes too diverse, the impact on debate will be negative

Proposition 3b : the greater the diversity in the board of directors, the less cohesiveness the board members will experience

The moderating role of conflict norms

In addition, we expect that the strength of the relationship between board characteristics and debate, may depend on current norms regarding conflict. Norms are a set of informal, unwritten rules derived from shared beliefs which regulate board members' behaviour (Shaw, 1976; Wageman, 1995; Nadler, 2004). Although individuals behave differently, they care about how they are perceived by other group members and strive to comport themselves in accordance with group norms (Bainbridge, 2002). Bettenhausen and Murnighan (1985) consider norms as "standards against which the person can evaluate the appropriateness of behaviour,… providing order and meaning to what otherwise might be seen as an ambiguous, uncertain, or perhaps threatening situation" (p.350). In particular, conflict norms refer to standards that "*encourage an openness and acceptance of disagreement*" (Jehn, 1995). Conflict norms are suggested as a necessary condition for the emergence of debate (Faulk, 1982). Without these norms, the board of directors is unable to take advantage of its diversity and available expertise. Only if there is an atmosphere in which board members can freely express their opinions, open discussion will emerge. It is likely that directors will hesitate to be a 'devil's advocate' if board norms do not allow critical questions being asked. Conversely, when a board of directors is characterized by a willingness to challenge and the utterance of viewpoints is expected, board members may feel encouraged to become actively involved in board discussions. This view is reinforced by the findings of a recent study by Levrau and Van den Berghe (2007). They revealed that many directors emphasized the importance of an open board culture where it is considered appropriate to engage in a vigorous debate. In addition, Amason and Sapienza (1997), found in their study on top management teams a positive impact of 'openness' on task conflict. Also Huse (2005) includes board culture in his research framework and has found in a recent study of Norwegian firms that 'openness and generosity' (one of the measures of board culture) was positively related to specific board roles. In essence, while board size, independence and diversity provide the potential for debate, conflict norms represent the catalyst that unlocks this potential. Relying on Jehn's (1995) example, researcher could operationalize conflict norms by asking board members to rate statements such as "differences of opinions are accepted in the board", "disagreement is detrimental to getting the work done by the board", "critical questions are tolerated in the board", “disagreement is dealt with openly in the board” and “directors try to avoid disagreement at all costs”. Based on the above mentioned argumentation, we offer the fourth proposition :

Proposition 4 : the greater the conflict norms, the stronger the relationships between board size, independence, diversity and debate

Indirect effects of board characteristics: the board processes-task performance link

The strategic as well as the control role of the board include complex and interactive tasks which require a minimum level of interpersonal attraction, or cohesiveness, among the board members in order to perform these tasks effectively. In particular, the performance of these tasks depends on mutual trust and professional respect and this is more difficult to sustain when boards are more fragmented (Forbes and Milliken, 1999). Genuine collegiality in the boardroom is required which breathes confidence that board members are respectful listening to each other point of view and are committed to working through the board tasks in a collective way. Empirical research on other groups has already found a positive relationship between cohesiveness and performance outcomes (Cohen and Baily, 1997). Higher cohesive or integrated groups experience higher levels of member satisfaction (Bettenhausen, 1991), a higher productivity (Shaw, 1976) and a lower turnover rate (O’Reilly et.al., 1989).

Still, it can be argued that the impact of cohesiveness on board task performance is not simply linear. In fact, group studies have demonstrated that a high level of cohesiveness may lead to a pressure to conform with group standards and a striving for unanimity at the expense of critical thinking and questioning of assumptions, a phenomenon known as ‘groupthink’ (Janis, 1983). Also boards of directors may be vulnerable to the danger of groupthink to the extent politeness and courtesy is emphasized over critical oversight and quality strategic decision-making (Jensen, 1993). In this respect, board members are failing to examine alternatives, to be either self-critical or critical to others, and being selective in gathering information (Bainbridge, 2002). Based on these assumptions, we advance the following propositions:

Proposition 5 : the effect of cohesiveness on board task performance will be positive but when cohesiveness is too high, the impact on board task performance may be negative

As noted before, in most boards, directors are faced with complex strategic and monitoring issues. By relying on their specific expertise and backgrounds they may have different viewpoints on how to accomplish these issues and especially on what trade-offs need to be made. In view of reaching a consensus, board members are deemed to challenge and critically oppose each other's ideas. Research by Schweiger et.al (1986) suggests that the presence of debate improves group performance by formalizing and legitimizing conflict and by encouraging critical evaluation. According to Eisenhardt et.al. (1997) debate "provides a more inclusive range of information, a deeper understanding of the issues, and a richer set of possible solutions" (p.43). Simons et.al. (1999) argued that when team members are confronted with other opinions they are forced to reconsider their viewpoints with information they have not thought of before. Furthermore, team members might see the benefit of evaluating alternatives and of taking a broader approach to decision-making. Hayashi (2004), for instance, found that teams who's members share and exchange knowledge tend to perform better. Also results of empirical research regarding the effect of task conflict on performance outcomes have proven that this type of conflict is generally beneficial. Task conflict is productive in groups performing non-routine tasks (Jehn 1995) and it enhances the quality of decisions (Amason 1996, Pelled et.al., 1999). Based on this evidence, we advance the following proposition:

Proposition 6 : debate will be positively related to board task performance

Limitations and boundary conditions of the model

The model we have developed is characteristized by several limitations and boundary conditions. Caution is also required in empirical testing. First, the model that we propose is primarily developed for one-tier or unitary boards. Although the unitary board of directors is internationally the most prevalent, it must be noted that some European countries have a two-tier board structure, for example Germany, the Netherlands and Denmark. As both systems are grounded in varying legal and historical contexts, it is clear that a unitary and a two-tier board differ substantially in their composition, operations and responsibilities. In one-tier boards, executive as well as non-executive directors convene to form one board. In such a system, executives perform a double function: as board members they are involved in board matters while as executives they are responsible for the operations and the daily execution of board decisions. In a two-tier system, the supervisory board is formed of non-executive directors only and in some cases also includes employees. Its main duties lie in supervision, control and (strategic) advice. The second tier is formed by the board of management and is responsible for execution of the strategic decisions. It is defensible to take these differences into account in exploring board processes and consequently in determining the effectiveness of boards.

Second, the proposed relationships within our framework are not exclusive. In spite of the fact that the identified intervening variables are separate constructs, we acknowledge the possibility that they can influence each other. For example, when board members air their ideas in open discussions, the danger of groupthink diminishes. Conversely, boards that are more fragmented, may be hampered in conveying debate while directors feel less motivated to make an effort to contribute. In addition, it can be stated that not all of the relationships may be one-directional and for instance, board outcomes reciprocally impact board structure. When the strategic or monitoring tasks are not carried out in a sufficient manner, the board will likely decide to change the composition of the board. Still, it is more difficult to predict the exact nature and strength of these relationships among the variables.

Third, we have integrated only a limited number of process variables into the model of which we believe are the most relevant for studying board effectiveness. More specificially, we have distinguished three intervening variables, namely cohesiveness, debate and conflict norms. However, there exists a variety of other process variables that have been identified in (group) literature but that are not included in our board model. Examples are internal task process (Ancona and Caldwell, 1992), use of knowledge and skills (Forbes and Milliken, 1999), decision-making attention (Golden and Zajac, 2001) and decision comprehensiveness (Simons et.al., 1999). Nevertheless, they also offer interesting avenues for further research, particularly from the angle of the decision-making process. It might be worthwhile to explore to what extent these variables contribute to our model of board effectiveness next to the ones that we have selected.

Fourth, it must be noted that the static nature of input-process-output models of group effectiveness has raised critical questions and there is a plea to pay more attention to the dynamic nature of group systems (Ruigrok and Tacheva, 2004). Demb and Neubauer (1992) already touched upon this issue by introducing the 'reinforcing loop' in order to conceptionalize the findings of their directors' poll. Although we value their approach, mapping board models that way, it is not evident to detect the determining variable that reinforces either positive or negative cycles of board behaviour. Perhaps longitudinal research methods may shed more light on this interdependence nature of dynamic board systems.

Fifth, in our model board effectiveness has been defined as a dual role set, supported by the underlying theories However, as the theoretical foundations provide at the same time complementary and conflicting propositions on the role and responsibilities of the board of directors a question arises as to their varying usefulness. Lynall et.al. (2003), for example, stated that "it is not a matter of choosing one theoretical perspective over another but, rather, of identifying under which conditions each is more applicable" (419). A first attempt to identify the conditions which determine the extent the board prefers one role to another is covered by Zald (1969). In his paper he points out four factors (i) structure of external groups (e.g. concentrated ownership), (ii) dependence of the company on its directors, especially the need for financial support, (iii) the directors' knowledge of the company's operations and (iv) the general health and conditions of the company (e.g. crises and transitions). Building on the work of Zald, Zahra and Pearce (1989) identify additional internal and external contingencies such as company size and life cycle, type of business, CEO style, industry type etc.

Finally, some researchers strongly plea to incorporate such a contingency perspective in board research in a more substantial way (Heracleous, 2000; Nicholson and Kiel, 2004b). In fact, these researchers advocate the idea that a company should tailor its governance structures and processes to its environment. Previous research on high-tech, venture-backed companies for instance, has already revealed how governance structures and processes differ from more traditional companies (Van den Berghe and Levrau 2002). By consequence, it can be stated that specific board attributes that are beneficial for one company may turn out to be detrimental to another. The contingency perspective might be of particular relevance when testing our model for board effectiveness on different types of firms.

Conclusions

In this paper we have pointed out that research on boards of directors traditionally focus on a direct link between board characteristics and performance outcomes, while ignoring potential intervening variables. Recently, a handful of scholars have tried to fill this void by proposing process-oriented board models as an indirect route. We rely on this stream of research by presenting a new theoretical research framework for evaluating the effectiveness of boards. In fact, our model develops a rationale to explain how specific board processes may influence board outcomes which in turn may affect corporate performance. In developing our model we have integrated the corporate governance literature with literature on group effectiveness. While there is an extensive amount of research on boards and a large body of work on group effectiveness, very little integrative studies can be found. Supported by qualitative findings of recent empirical field studies on boards of directors, we extract the significant variables from literature and integrate them into a theoretical model of board effectiveness. Relying on the input-process-output approach, we have explored variables that we believe are critical in determining the effectiveness of boards. We go beyond the structural characteristics of boards of directors to also include behavioural or attitudinal measures of board effectiveness. We have argued that cohesiveness, debate and conflict norms may be intervening variables which mediate the relationships between board input and board outcomes. In doing this, we have tried to clarify the inconsistent results found in empirical research on boards. Furthermore, specific relationships have been proposed. Empirical research is required to confirm the model and to validate the proposed relationships. We believe this kind of research may help to explain the differences between successful boards and board failures.

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APPENDIX 1

Table 1: characteristics differentiating boards as teams

	Boards as teams	**Typical teams**
Affiliation	Outside directors may be members of more than one board; this is not their "day job."	Members work for the same organization.
Interaction	Directors spend little time together, making it difficult for them to build working relationships.	Members spend considerable time together, experience intense personal interaction.
Time and information	Limited time and information available to mastering issues of a complex company.	Constantly immersed in company's business.
Leaders as members	Majority of members may be CEOs, who are used to leading, not following.	Most members are not accustomed to sitting at the head of the table.
Authority relationships	Lines of authority complex and unclear; chairmen/CEOs both lead and report to boards.	Members' roles on the team often reflect their status in the company.
Changing expectations	Difficult to achieve consensus in a climate of unprecedented scrutiny and pressure.	Usually created with a reasonably clear charter –such as completing a project- in mind.
Formality	Physical setting and social rituals reinforce aura of power and privilege.	High degree of formality is rare, generally reflects the culture of the company.
Team size	Average number of members is rather high	Average number of member is rather low

(source: adapted from Nadler et.al., 2006)

APPENDIX 2

Table 2: a board of directors' role set

	Control role	Service role	Strategic role
Board Responsibilities	• Maximizing shareholder's wealth • Primarily the board has to monitor actions of agents (executives) to ensure their efficiency and to protect principals' (owners) interests	• Boards are a cooptative mechanism to extract resources vital to company performance • Boards serve a boundary spanning role • Boards enhance organizational legitimacy • Boards serves as 'sounding board' for management	• Boards are rubber stamps ('passive' school of thought) • Boards are an important strategic device contributing to the overall stewardship of the company ('active' school of thought)
Board Tasks	• Selecting, rewarding and replacing CEO • Monitoring/evaluating company performance • Articulating shareholders' objectives and focusing the attention of key executives on company performance • Reducing agency costs • Ratifying and monitoring important decisions	• Scanning the environment • Representing the firm in the community • Securing valuable resources • Providing advice to the organization and CEO • Involvement in strategy formulation and implementation	• Satisfying the requirements of company law ('passive view') 'Active' view : • Guiding management to achieve corporate mission and objectives • Involvement in the strategic decision making process
Theoretical perspectives	Legalistic Agency Theory	Resource Dependence Theory Stewardship theory	A broad range of theories e.g. managerial hegemony theory and stewardship theory
Theoretical origins	Law Economics & Finance	Organizational Theory Sociology Psychology	Organizational Theory Sociology

(Source: adapted from Zahra and Pearce. 1989)