

THE ROLE OF NON-EXECUTIVE DIRECTORS IN CORPORATE GOVERNANCE: AN EVALUATION

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ABSTRACT

Corporate governance has become an increasingly topical issue in recent years. This has been fuelled by such corporate collapses as Enron, Worldcom, Parmalat, One.Tel and HIH. The role and responsibility of the board and directors has emerged as an important issue in examining the cause of these collapses. This has created much debate on what the role of the directors is in ‘directing’, ‘monitoring’ or ‘advising’ a company.

Research indicates that investors are prepared to pay a premium for good governance. This raises a number of questions. What is governance? How do we determine what is good governance? What role do directors have in this? Does the company’s performance improve by adopting good governance practices?

There are numerous approaches to examining what makes a good board. Quantitative techniques have included the use of such measurable concepts as the number of executive and non-executive directors, directors’ skill base (for example, accountancy, marketing etc) and frequency of meetings attended. Researchers have also attempted to measure board performance and effectiveness by using indicators such as share values and shareholder returns.

There is a lack of qualitative research in board behaviour and effectiveness. This exploratory study adopts a qualitative approach in order to provide richer data. It uses interviews to evaluate directors’ views on some aspects of corporate governance, specifically in relation to the executive and non-executive director debate. The interviews were conducted with 11 directors from a variety of organizations in the for-profit and not-for-profit sectors.

Two major themes have emerged from the analysis of the interviews. Firstly, directors are traditionally considered to be responsible for maximising shareholder wealth. However, directors are now expected to broaden their responsibilities to include other stakeholders and to consider social and environmental issues in making their decisions. The findings indicate that it is now more demanding to be a director due to

increased workloads arising from the regulatory and legal requirements. This has also impacted on director and board evaluations, multiple directorships and directors remuneration levels.

The second major theme that emerged from this study is that directors' personal experiences did not necessarily concur with governance principles and guidelines. For example, the widely recommended method of achieving 'best practice' by having a majority of non-executive directors on a board is considered too simplistic.

Further studies are required on the behavioural and personality traits, technical skills of the directors, board structure, composition and type of organization which make the best contribution to achieving boardroom effectiveness.

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DECLARATION

This thesis contains no material which has been accepted for any award of any other degree or diploma, except where due reference is made in the text of the thesis.

This thesis to the best of my knowledge contains no material previously published or written by another person except where due reference is made in the text of the thesis.

Declared by
Biserka Siladi Date

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LIST OF ABBREVIATIONS

AICD- Australian Institute of Company Directors

APRA – Australian Prudential Regulation Authority

ASX – Australian Stock Exchange

BRT – Business Round Table

CAMAC – Corporations and Markets Advisory Committee

CEO – Chief Executive Officer

CGI – Corporate Governance International

CIMA – Chartered Institute of Management Accountants

CPA – CPA Australia

CSR – Corporate Social Responsibility

IFAC – International Federation of Accountants

NED – Non Executive Director

NYSE – New York Stock Exchange

OECD – Organization for Economic Cooperation and Development

CHAPTER 1 INTRODUCTION

1.1 Background

Corporate governance has been receiving a lot of attention in recent times. High profile corporate collapses in Australia (for example; Ansett, Harris Scarfe, OneTel, and HIH) and overseas (for example; Enron, WorldCom and Parmalat) have resulted in increasing attention being paid to issues such as the effectiveness of reporting disclosures, roles of the board, internal controls, audit committees and independence of directors and auditors. Corporate governance is not a new issue; it has evolved with the growth of the capitalist system and the development of world economies (Vinten 2003).

1.2 Definition

How can we define 'Corporate Governance'? A number of definitions have been put forward. Sir Arthur Cadbury in his report (Cadbury Report 1992, p.15) adopted a broad definition that 'Corporate governance is the system by which companies are directed and controlled'. This involves the establishment of structures and processes through which management is accountable to shareholders with the objective of enhancing shareholder value.

The ASX Corporate Governance Council (2003, p.3) guidelines on 'Principles of Good Corporate Governance and Best Practice Recommendations', defines corporate governance as 'the system by which companies are directed and managed. It influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimized'. Pat Barret (cited in Horwath 2002, p.5), Auditor General of Australia at the time, suggested the following:

Corporate Governance is largely about organizational and management performance. Simply put, corporate governance is about how an organization is managed, its corporate and other structures, its culture, its policies and the ways in which it deals with its various stakeholders. It is concerned with structures and processes for decision-making and with the control and

behavior that support effective accountability for performance outcomes/results.

Adopting these broad definitions, corporate governance includes the relationship between shareholders and corporations; between financial markets and corporations; and between employees and corporations. The OECD (2004, p.11) definition is that:

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interest of the company and its shareholders and should facilitate effective monitoring.

Claessens (2003, p.4) classifies the corporate governance definitions into two categories. The first category is '... the actual behavior of corporations, in terms of such measures as performance, efficiency, growth, financial structure, and treatment of shareholders and other stakeholders'. The other is '... the rules under which firms are operating – with the rules coming from such sources as the legal system, the judicial system, financial markets, and factor (labor) markets'. This also includes corporate social responsibility (Claessens 2003). The importance of business ethics within the corporate governance framework is also examined by Healey (2003a). Poor business ethics can be very damaging to the business. Consider, for example, the plight of the accounting firm Arthur Andersen which shredded Enron related documents.

Healey (2003a, p.133) contends that the number of definitions has led to the term being 'used almost as a panacea for a range of issues only some of which rightly belong in the corporate arena'. If a business aims to make an economic profit, then it must 'compete, innovate, motivate and compensate (capital and labor)...'(Healey 2003b, p.68). If we contend that investors are expecting a return on their capital, as well as an appreciation of their wealth then their instruction to boards is to 'manage

the assets of the business in a way that maximizes long-term value' (Healey 2003b, p.68). If a business aims to make an economic profit, and investors expect a return on their capital as well as an appreciation of their wealth then one would expect that the board will manage the business to maximize the long-term shareholder value. This can lead to agency costs arising from a conflict between the interests of shareholders and managers. The managers are concerned about 'short-term' results and thus make decisions which reflect the best outcomes for themselves. Investors want to maximize their wealth; however the managers (as their 'agents') may not have the incentive to do so. This can lead to agency costs (discussed further in the literature review) incurred by the investors in monitoring the managers (Jensen and Meckling 1976).

Structures are therefore needed in place to provide for corporate governance practices (Horwarth 2002). The ASX Principles (2003, p.3) state:

Good corporate governance structures encourage companies to create value (through entrepreneurship, innovation, development and exploration) and provide accountability and control systems commensurate with the risks involved.

There is no one structure or model that would suit all businesses. This is also recognized by the OECD principles (2004 p.13) due to not only the complexity and range of activities that businesses are involved in but also legal issues depending on the country's jurisdiction, as well as social and cultural issues. The common threads in corporate governance frameworks are shareholder rights, disclosure and transparency, executive (management) and board accountability (Healy 2003a, p.134).

1.3 Why is corporate governance important?

'Corporate Governance' has emerged as a national and international issue (Cadbury 2002, Kiel and Nicholson 2003b). A number of recent corporate collapses (for example: Enron, WorldCom, Parmalat, One. Tel and HIH) have led to much discussion on accountability, regulations and professional code. (For example; Tomasic 2001; Carver and Carver 2002; Cadbury 2002; Vinten 2002; Taylor 2003). We tend to look on 'corporate governance' as a new term that has crept into our

business vocabulary especially in the last 10 years. If we are to equate accountability with corporate governance (Cadbury 1992) then in reality this is not a new issue.

In 'Management Accountability and Corporate Governance' (Midgley 1982), which contains a number of readings, it is interesting to note that the same issues were cropping up. More than two decades ago in the 'Foreword' by Barry Barker, Secretary and Chief Executive of The Institute of Chartered Secretaries and Administrators, the following opening paragraphs appear (p.vii):

Governance is a Middle English word which the Americans have brought back to us in the expressive phrase "corporate governance"- the purpose and method of how we structure and control our companies large and small.

The main questions of the day on this subject are concerned with the (firstly) accountability of boards of directors – to whom and for what; (secondly) the participation in the decision making process of all those, not just unionised employees, who are initially concerned with corporate success or failure; and thirdly the framework of law which may provide the structure and even the regulation which will promote rather than inhibit the successful development of a business enterprise.

Some twenty years on, we still have the same issues to consider. What is accountability? Who is accountable to whom? What role do directors play? What role do shareholders and other stakeholders such as creditors and employee have? How do we promote corporate accountability? What board structures work the best? What is the best mix of executive and non-executive directors?

The importance of corporate governance has also increased over recent years due to a number of contemporary developments. These as identified by Vinten (2003, p. 449) are listed below:

1. The economic analysis of corporate law – companies should be accountable to those who take the profit or bear the loss after all other claims have been met.

2. The redistributions of tasks between the public and private sectors – the economy demands full public confidence in the manner in which companies both in the public and charitable sector are run.
3. Public confidence can be assessed in terms of levels of managerial remuneration.
4. The greater role for funded pensions in increasing the flow of funds onto the capital markets.
5. The globalisation of the economy means that there is greater access to international capital markets, thereby producing greater risk exposures.
6. Fraud and abuse have led to a greater awareness of the inadequacies of governance and the need to reform.

Bosch (2002 p.271) states ‘good governance is desirable and important’ for two reasons. Firstly, ‘investor protection has increased with the enormous surge in share ownership;’ and secondly good governance can ‘increase the creation of wealth by improving the performance of honestly managed and financially sound companies’ even though it is acknowledged that conclusive proof is lacking. However surveys by McKinsey indicate that investors are prepared to pay a premium for companies considered to be well governed (Bosch 2002, p.273). Research findings from the 2003 and 2004 Horwath Reports also indicate that overall companies with good corporate governance achieved better share prices. (The research was based on the top 250 Australian companies based on market capitalisation).

The current debate on corporate governance issues has raised more public awareness and suggested that the investment community needs to be more critical of the way companies are managed (Horwath 2002). As a result of this surge in awareness by investors and shareholders, directors are being held increasingly responsible for company performance (and any public controversy); as well as being held personally accountable for their company’s legal compliance and social responsibility.

1.4 Purpose of research

Corporate governance research has concentrated on empirical studies, which attempt to link financial performance to the degree of corporate governance compliance. Board performance and effectiveness are often measured using a variety of

performance indicators such as share values and shareholder returns. This study, whilst recognizing the importance of quantitative data, concentrates on qualitative research methods. Non-executive directors are interviewed on their views regarding the impact of corporate governance on their boardroom experiences. The interviews provide a rich data source to examine directors' perspectives in depth to tease out some of the explanations and reasons not available from the share price and other similar data.

The purpose of this exploratory study is to review and examine interviewees' viewpoints on the following issues:

- The role of the board/directors/chairman
- Board composition and dynamics
- Board and director evaluations
- Directors nomination and remuneration
- Governance and company performance

1.5 Outline of the thesis

Chapter two provides further background information and a review of the relevant literature. It discusses theoretical frameworks, roles of directors, board structures, company performance and governance.

Chapter three details the research framework for this study based on the literature review and previous studies identified in chapter two.

Chapter four sets out the methodological perspective and the methods used in this study,

Chapter five presents the analysis from the data collected from the interviews conducted.

Chapter six provides the conclusions as well as suggesting areas for further research.

CHAPTER 2 LITERATURE REVIEW

2.1 Introduction

A number of changes have emerged in our corporate environment. There has been a rapid globalisation and internationalisation of business. This has included Asian, European and American corporations. Multinational companies have increased their impact on the global economy with their increases in share outputs, employment and investment. Companies are competing for limited capital resources (Kiel and Nicholson, 2003b), and the way they are governed affects their ability to attract those resources.

The structure of share ownership has changed since the 'company' format of shareholding was established. Individual shareholders are traditionally considered to be the 'owners' of the corporation (Shailer 2004, p.15). The directors are delegated the responsibility of controlling the company in the best interest of the owners. These interests mainly included the profit motive and increasing shareholder value. However whilst the terms 'shareholder' and 'owner' may be used interchangeably, they do not necessarily equate. Shareholders have actually given up the rights normally associated with ownership i.e. 'the right to operate and manage; the right to sell, dispose, pledge, encumber, or hypothecate; the right to create lesser titles in interests, such as leases, licenses, easements, or covenants; and the right to bequeath' (Rona quoted in Francis 1997, p.34). These rights can be exercised in relation to their shareholding but not to the corporation's assets since it is the board (and management) that actually exercise these rights on behalf of the shareholders. Thus shareholders do not usually actively participate in the activities (other than attending the annual general meeting) or in the control of the company (Shailer 2004).

The nature of the shareholding is also changing with the emergence of the institutional investor. The institutional investors, for example insurance companies and superannuation funds, have become powerful in demanding that the companies they invest in be properly managed. The recent collapses of various companies (such as HHH), and the losses incurred have only added more weight to the demands.

Institutional investors are increasing as a result of increased investment in superannuation and mutual funds. Depending on the volume of shareholdings held, the funds might have the potential to influence the selection of directors and influence policies due to their voting clout.

An important issue for shareholders is the level and duration of anticipated returns on their investment. Some prefer long term investments ‘with an emphasis on long-term company performance and sustaining dividends’ (Shailer 2004, p.15), whilst others prefer speculative gains on short term investments. These requirements may be in conflict with the objectives of management and/or the directors of the company. For example, the fund beneficiaries and the directors may have long-term growth objectives, but the fund managers may make decisions which will give higher returns in the short term. This is often the case where performance evaluations are based on annual reviews of the manager and the fund, or where the manager may only have a short term contract of employment. Therefore he/she is concerned with the gains to be made over that designated period. The manager in this instance is then acting more like a speculator, trying to achieve the highest returns in the shortest timeframe, rather than as an ‘owner’ with a view to a long-term investment.

Thus ‘the quality of these decisions depends not only on the ability of managers but also on the incentives that managers have to make decisions beneficial to the long-term interests of shareholders’(Healey 2003a, p.42). The theory related to this conflict of interest, and theories relevant to the corporate governance relationships between managers and owner, are discussed in the following sections.

2.2 Theories

2.2.1 Agency theory

The ownership structure of an organization will have an impact on the corporate governance structure adopted. The development of the modern corporation has resulted in companies expanding beyond the management (and capital) capabilities of the owners. The nature of the agency problems between managers and shareholders will be affected differently according to the structure adopted (Claessens 2003). Corporation ownership may be diffuse, as in the case where there are a large number

of shareholders such as in Australian, US and UK corporations. Conflicts of interests can occur between managers and shareholders. Alternatively ownership may be concentrated in the hands of one or very few owners as in family controlled businesses in Asia, thus 'the controlling owner is often also the manager or can otherwise be assumed to be able and willing to closely monitor and discipline management' (Claessens 2003, p.12).

The 'Berle-Means Hypothesis' developed in the 1930's was based on studies done on the development of the modern corporation which lead to the separation of ownership and management (Berle and Means 1932). Berle and Means (1932) discuss five major types of control of a company based on the extent of ownership. For example a family owned business will have ownership and control combined. However at the other end of the spectrum is the dilution of ownership through large numbers of shareholders who individually own a small holding, but 'who exercise virtually no control over the wealth which they or their predecessors in interest have contributed to the enterprise' (Berle and Means, p.5). Thus the shareholders, whilst perceived as 'owners', no longer had 'control' over the company's actions and professional managers were employed to run the business (Kiel and Nicholson 2003b).

In the 1970's work carried out by Jensen and Meckling (1976) resulted in a theory for understanding the implications of the separation of ownership from control. This separation of ownership and management lead to the development of 'agency theory'. The owners as principals contract executives (agents) to manage the business on their behalf.

'Agency theory suggests that professional managers can, by virtue of their superior knowledge and expertise, gain advantage of the firm's owners' (Kiel and Nicholson 2003b, p.29). In other words, managers have a conflict of interest with those of the shareholders. They are working to maximize their own personal interests rather than maximizing shareholder value. Managers as agents are thus motivated by their own personal gains. Kiel and Nicholson (2003b) present the view that agency theory was widely adopted in the 1970s' and 1980's due to the 'excesses' of the period. That is, managers were making decisions on a grand scale, takeovers of companies were very common and managers were paying themselves hefty salary packages even in

situations where the business was not performing so well. This type of behavior needed to be controlled by the ‘widespread adoption of an independent board mechanism to monitor a corporation’s management’ (Kiel and Nicholson 2003b, p.30).

Alternative governance structures and compensation schemes to minimize agency costs and protect shareholder interests have been suggested in the literature (for example, Davis et. al. 1997). Governance structures use control and monitoring devices such as audits and performance evaluations. Financial incentives including long-term bonuses (agency costs) tied to firm performance can be used to provide rewards to managers to achieve shareholders’ objectives.

Some effective governance structures for the control of managers include a board of directors, who are predominantly outsiders with no personal relationship with management, a chairperson of the board who is not an executive manager of the company; a chief executive officer whose personal interest is aligned with shareholders through stock ownership or a bonus compensation plan that is linked to shareholder wealth and so on (Donaldson 1990, p.376).

The role of corporate governance here is to protect the shareholders by monitoring managers through the board of directors. This is the view adopted by our current codes such as the ASX Corporate Governance Principles (2003).

2.2.2 Stewardship theory

In the 1990’s the ‘stewardship theory’ was extensively developed. This was diametrically opposed to the ‘agency theory’ (Donaldson 1990; Donaldson and Davis 1991). ‘This holds that there is no conflict of interest between managers and owners and that the desideratum of governance structure is to find an organizational structure that allows coordination to be achieved more effectively’(Donaldson 1990, p.377).

Managers are thus regarded as trustworthy stewards of the resources entrusted to them. They work to maximize profits and shareholder returns. ‘According to stewardship theory, the behavior of the steward is collective, because the steward seeks to obtain

the objectives of the organization (e.g. sales growth or profitability). This behavior in turn will benefit principals such as outside owners through positive effects of profits on dividends and share prices' (Davis et al. 1997, p.24). Thus the manager believes that by working toward organizational ends, personal needs are also covered – 'their interests are aligned with that of the corporation and owners' (Davis et al. 1997, p.25). In contrast to the agency theorists, the stewardship theorists focus on structures that facilitate and empower rather than monitoring and controls.

2.2.3 Stakeholder theory

Traditionally the interest of shareholders was the main focus of directors' responsibilities. This has now changed to companies taking into account an increasing number of interest groups linked social, environmental and ethical considerations (Pease and Macmillan 1993). Carver and Oliver (2002, p.60) also examine the issue that whilst shareholders generally define value in financial terms there are others who may be seeking other benefits 'such as the satisfaction of pioneering a particular breakthrough, supporting a particular kind of corporate behaviour, or, where the owner is also the operator, working in a particular way'.

This has led to development of the stakeholder theory which views that 'companies and society are interdependent and therefore the corporation serves a broader social purpose than its responsibilities to shareholders' (Kiel and Nicholson 2003b, p.31). Stakeholder theory is not new, Mary Parker Follett put the notion of stakeholder theory forward some 60 years ago (Schilling 2000). The 're'- introduction of this theory appears in the 1980's.

Freeman (1984, p.52 quoted in Schilling 2000, p.225) defines a stakeholder as 'any group or individual who can affect or is affected by the achievement of the organization's objectives'. The term 'stakeholder' may therefore encompass a large group of participants, anyone who has a direct or indirect 'stake' in the business (Carroll 1993, p.22 quoted in Schilling 2000, p.225). A direct (or primary) stakeholder may include shareholders, employees, investors, customers and suppliers whose interests are aligned with the company. An indirect (or secondary) stakeholder may be the government which is indirectly affected by the company's operations

(Kiel and Nicholson 2003b). Wheeler and Sillanpaa (1997, p.x) identified the following stakeholders to be taken into account in the governance structure:

- investors (including banks) - for putting up the cash,
- managers - to provide leadership, describe their plans and answer for their actions,
- employees - to safeguard their security, livelihoods and well - being,
- customers - to reflect their rights,
- business partners (e.g. suppliers and subsidiaries) - to avoid them being squashed,
- local communities - to safeguard their safety and economic interests,
- civil society (including regulators and pressure groups) - because they represent the common good,
- the natural environment/future generations/non-human species - unable to speak for themselves.

Management theories tend to focus on the firm's profit motives and have centered on the firm's responsibility to its shareholders (Schilling, 2003). Stakeholder theory proposes that the emphasis of managerial activity should be on the development and maintenance of all stakeholder relationships, not just the concentration on shareholders. This in turn means reassessing performance evaluation; traditionally based on shareholder wealth and profits. For example: new performance evaluation may include having measures in place for social responsibility, ethical considerations and valuing human capital. The development of the 'Balanced Scorecard' by Kaplan and Norton (1996) includes both financial and non-financial measures, focusing on long term and short term objectives. This is an example of performance evaluation attuned to the needs of multiple groups of stakeholders. The 'Balanced Scorecard' views performance from four perspectives; financial, customer, internal business process, and learning and growth.

Stakeholder theory can be seen as not necessarily supporting the view that maximising shareholder value is a top priority for business. Managers may pursue objectives that do not increase shareholder wealth (agency theory). Furthermore their (pay) incentives may not necessarily be aligned to the interests of shareholders. However managers who argue that this is due in consideration of other stakeholders'

objectives ‘may be using stakeholder claims as a smokescreen to obscure what is really their inability to deliver value to the company’s shareholders’ (Healy 2003, p.24).

2.2.4 Theories summary

The influence of agency theory has been instrumental in the development of governance standards and principles. The decision making process is delegated by shareholders to the managers i.e. the executives. Hence, due to managers pursuing their own interests, boards are involved in ‘monitoring managerial decision-making and performance (particularly through independent non-executive directors. . .)’ (Roberts et al. 2005, p.S7). The emphasis on the directors’ role is to monitor and control.

However more recent studies have been examining alternatives theories such as stewardship and stakeholder. That is, managers are good stewards and ‘do not misappropriate corporate resources at any price because they do have a range of non-financial motives such as the need for achievement and performance etc.’ (Van den Berghe and Levrau 2004, p.463). Thus the directors’ role is to counsel and advise.

Stakeholder theory does not revolve around the monitoring and advisory role of directors or the maximization of shareholder wealth, rather on social responsibility and ethical considerations.

2.3 Governance standards and principles

2.3.1 Introduction

The development of governance standards and principles has been influenced by ‘social, legal and economic forces’ (Kiel and Nicholson 2003b, p. 32). We often refer to the more recent scandals such as HHH, however the influences of the earlier scandals of the 1980’s (for example, Bond Corporation, Quintex and Pyramid Building Society) also had a major impact (Carson 1996). Whilst professional managers were increasingly failing in their duties, directors were being held responsible for their lack of monitoring in legal decisions. The increase in the number of shareholders, especially institutional shareholders, has led to more investors having an interest in the performance of their shares (Cadbury 2002, Kiel and Nicholson

2003b, Bittlestone 2004). Our changing social attitudes towards employment and longer periods of retirement have meant that our retirement income is dependent on the success of how these companies are being run. We want to ensure that there is something there for our retirement (Kiel and Nicholson 2003b). How can shareholders ensure a company will be there to contribute to retirement? There are no guarantees, but adherence to good corporate governance principles will help.

Amongst all the various definitions of corporate governance, we can surmise that governance involves management, direction and control. Shalier (2004) evaluates governance practices on the basis of the following elements: predictability, transparency, accountability and participation. These elements form the basis of governance principles.

The first element, predictability, applies to consistent interpretation and enforcement of rules, procedures and regulations. The second element, transparency refers to the availability and disclosure of information. ‘Transparency in decision making and implementation reduces stakeholders’ uncertainty and so enhances predictability’ (Shailer 2004, p.12). The main focus of the third element, accountability, requires identifying who is accountable, to whom are they accountable, and for what are they accountable. The final element of participation enables stakeholders to participate in the decision-making process.

Over the years a number of organizations have been involved in preparing various guidelines and principles of corporate governance. Due to the financial scandals and corporate collapses this ‘has been generally been motivated by a desire for more transparency and accountability and a desire to increase investor confidence’ (Mallin 2004, p.19). The Australian situation has been influenced by developments in the United Kingdom, the United States and by the OECD research. These are discussed in detail below. Other important developments have also taken place in continental Europe (for example, Germany and Italy) as well as in other parts of the world such as Japan, China, and South Africa. However these are beyond the scope of this study.

2.3.2 United Kingdom

A large body of research and work has emerged from the UK, which has been in the forefront of setting up various working parties and committees to address a number of the issues raised above. Some of the major reports from the UK include:

- The Cadbury Report (1992)
- The Greenbury Report (1995)
- The Hampel Report (1998)
- The Higgs Report (2003); and
- The Combined Code on Corporate Governance (2003).

The Cadbury Report (1992)

The Committee to report on ‘The Financial Aspects of Corporate Governance’ was set up in May 1991 by the Financial Reporting Council, the London Stock Exchange, and the accountancy profession. The Committee’s Report became known as ‘The Cadbury Report’ after the Chairman Sir Adrian Cadbury. The terms of reference were to consider a number of issues in relation to financial reporting and accountability. These included: the responsibilities of executive and non-executive directors, audit committees; responsibilities of auditors and the links between shareholders, boards and auditors.

Cadbury recommended that listed companies should comply with the Code of Best Practice. Companies are required to include a statement of compliance/non-compliance of the Code in their Annual Report. The Code of Best Practice sets out guidelines for a governance structure monitoring the board and the governing process. The recommendations included increasing the numbers and powers of non-executive directors (who should be independent); the separation of the posts of CEO and chairman, and the setting up of sub-committees to independently monitor and judge management.

The Greenbury Report (1995)

The Study Group on Directors’ Remunerations was set up in 1995 in response to public and shareholder concerns about directors’ remuneration. The Group focused on large public companies and was chaired by Sir Richard Greenbury. A Code of

Best Practice was developed for listed companies to follow in determining directors' remuneration.

The Greenbury Report's review included the recommendation of remuneration committees (to consist of non-executive directors to avoid potential conflicts of interest). This included preparing annual reports to shareholders with full disclosure of remuneration policies for executive directors and other senior executives; and the length of service contracts and compensation when these were terminated.

The Hampel Report (1998)

The Committee on Corporate Governance was set up following the recommendations of the Cadbury and Greenbury Committees to review the implementations of their findings in 1995. The Committee consulted with a broad range of organizations and individuals. These findings were presented in 1998 as 'The Hampel Report' (Sir Ronald Hampel being the Chairman). The terms of reference in addition to the review of the Cadbury and Greenbury Codes included reviewing the role of directors (executive and non-executive), shareholders, and auditors in corporate governance issues.

The Committee prepared a list of approximately twenty 'Principles of Corporate Governance' which it believes can contribute to good corporate governance. These principles related to the issues of: the role of directors; directors' remuneration; the role of shareholders; and accountability and audit. Included in the recommendations were further developing the roles and responsibilities of non-executive directors, separating the roles of chief executive officer and chairman; and ensuring that nomination, remuneration and audit committees were composed largely of independent non-executive directors.

The Hampel Report (1998) reviewed the implementation of the corporate governance codes of practice and further developed the responsibilities of non-executive directors. The recommendation included that at least one-third of the membership of boards should be made up of non-executive members and that the nomination, remuneration and audit committees should be made of mostly independent non-executive directors.

The Higgs Report (2003)

In 2002 the UK Government appointed Derek Higgs to review the role of non-executive directors. The final report 'Review of the role and effectiveness of non-executive directors' was published in 2003. The terms of reference included undertaking a review to assess: the population of non-executive directors, their appointment; their independence and effectiveness, accountability and remuneration. The review focused on the effectiveness of non-executive directors in promoting accountability and company performance. The major recommendations made include:

- A clear description of the role of the non-executive director;
- A definition of 'independence' that addresses relationships that affect a director's objectivity and those that could appear to do so;
- At least half of the board of directors should be independent;
- The appointment of a senior independent director to take responsibility for shareholder concerns;
- The roles of chairman and CEO should be separate;
- The appointment of a nomination committee (consisting of a majority of independent non-executives) to conduct board appointments;
- The performance evaluation of individual directors, the board and its committees should be reviewed annually;
- The level of remuneration for non-executive directors should be sufficient to attract and fairly compensate quality individuals.

In addition to making recommendations, the aim of the review was also to encourage and lead a debate on these issues. The Report attracted much discussion and adverse reaction (Solomon and Solomon 2004; Mallin 2005).

The Combined Code of Corporate Governance (2003)

The Combined Code originally issued in 1998 'drew together the recommendations of Cadbury, Greenbury, and Hampel reports' (Mallin 2004, p.23). The new Combined Code (2003) incorporates a number of key issues as addressed by the Higgs Report (2003) relating to corporate governance principles; the role of the board and chairman; the role of non-executive directors and audit and remuneration committees. These recommendations include a revised Code of Principles of Good Governance and Code of Best Practice; relating to the recruitment, appointment and professional development of non-executive directors. Also included is 'Related Guidance and

Good Practice Suggestions’ for non-executive directors, chairman, performance evaluation checklist; as well as a summary of the principal duties of the remuneration and nomination committees. Some of the main reforms included that at least half of the board of directors should comprise of non-executive directors, the CEO should not be the chairman of the board and should be independent, board and individual director performance evaluation should be regularly undertaken, and that formal and transparent procedures be adopted for director recruitment.

2.3.3 OECD

The OECD Principles of Corporate Governance were first published in 1999. These principles were intended to provide guidelines in assisting governments in ‘improving the legal, institutional and regulatory framework that underpins corporate governance’ (OECD 1999, p.11). In addition they provided guidance for stock exchanges, investors, companies, and other parties. These principles were not binding, but rather provided guidelines for each country to use as required for its own particular conditions. These principles were published as the first international code of corporate governance approved by governments. Since then, they have been widely adopted.

In 2002, the OECD brought together representatives of 30 countries as well as other interested countries in reviewing the existing five principles. The new principles (released in May 2004) were reworked from five to six principles. The principles cover the following areas:

- I. Ensuring the basis for an effective corporate governance framework,
- II. The rights of shareholders and key ownership functions,
- III. The equitable treatment of shareholders,
- IV. The role of stakeholders in corporate governance,
- V. Disclosure and transparency,
- VI. The responsibilities of the board.

The new principles were issued in response to the numerous corporate failures that have occurred throughout the world. These scandals have undermined the confidence of investors in financial markets and company boardrooms. ‘The revised principles emphasize the importance of a regulatory framework in corporate governance that promotes efficient markets, facilitates effective enforcement and clearly defines the

responsibilities between different supervisory, regulatory and enforcement authorities. They also emphasize the need to ensure transparent lines of management responsibility within companies so as to make boards and management truly accountable' (Ingram cited in OECD Website, 2004).

Some of the main areas of revision included the strengthening of investors' rights by shareholders having a more active role in the nomination and removal of board members. Institutional investors should disclose their corporate governance policies and voting rights. External auditors should be accountable to shareholders and be independent and not be comprised by other relations within the company. A new principle on whistle blower protection has been included. The board duties and responsibilities have been expanded and clarified as fiduciary in nature.

The OECD Principles (2004, p.11) state that:

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performances are determined.

This is a very broad definition, taking into consideration that the OECD members have a diverse background of cultural and business influences. A number of countries including Australia have used these principles as a reference for their own codes.

2.3.4 Australia

Standards Australia adopted a similar format and referred to the original OECD principles (1999) in its introduction when it issued its Standards in June 2003. The standards are non-prescriptive guidelines, aimed at providing companies, government entities and not-for-profit organizations with governance frameworks.

The objective of the standards 'is to provide a blueprint for the development and implementations of a generic system of governance suitable for a wide range of entities' (Standards Australia 2003, p.6). 'The standards articulate emerging thinking in these areas and therefore drive industry towards necessary change. The effect of

the corporate governance standards flows on to impact the vitality of investment markets by bolstering consumer confidence and providing tools for all organizations to validate their governance practices' (Bezzina 2004, p.60).

The Australian Corporate Governance Standards consists of 5 standards as listed below:

- AS 8000-2003 Good governance principles
- AS 8001-2003 Fraud and corruption control
- AS 8002-2003 Organization codes of conduct
- AS 8003-2003 Corporate social responsibility
- AS 8004-2004 Whistleblower protection for entities

AS 8000-2003 Good Governance Principles provides that the major objective of good governance should be to:

- improve organizational performance,
- identify and manage risks,
- strengthen shareholder and community confidence in an entity,
- improve the transparency and accountability of an organization, and
- assist in the prevention and detection of fraudulent behavior.

This standard includes guidance on developing a governance policy, the roles and responsibilities of the board, executive and board remuneration, disclosure and transparency obligations, shareholders ownership and voting rights, as well as shareholder responsibilities. The remaining four standards covering fraud, corruption, codes of conduct and corporate and social responsibility are beyond the detailed scope of this study.

ASX

The ASX Corporate Council issued its paper 'Corporate Governance in Australia' in March 2003. Prior to this the Australian Stock Exchange Listing Rule 4.10 issued in 1995, came into effect on 1 July 1996. The new listing rule required all listed companies to provide a statement in their annual report about their corporate governance practices. This included such information as the board procedures in

nominating directors, management of business risk, the relations with the auditors and committee structures.

The purpose of the 2003 Guidelines was to create a framework for good corporate governance for listed companies, and set a greater level of accountability. The guidelines recommended that listed entities disclose the extent to which these ten core principles have been followed in their annual reports. These came into effect in the first financial year starting after 1 January 2003.

The essential corporate governance principles:

1. Lay solid foundations for management and oversight.
The roles and responsibilities of board and management should be publicly provided with accountability to shareholders to shareholders.
2. Structure the board to add value.
The board should have a range of skills and level of commitment to discharge its responsibilities and duties. The majority of the board members should be independent. The chairman should also be an independent director and not the CEO.
3. Promote ethical and responsible decision-making.
A code of conduct should be established to guide the board in such matters as conflict of interest and trading in company shares.
4. Safeguard integrity in financial reporting.
A structure of review and authorisation is required to safeguard the integrity of the financial reports. This includes the setting up of an audit committees composed of non-executive directors, and the use of external auditors.
5. Make timely and balanced disclosure.
Establish written policies and procedures to ensure compliance with disclosure requirements.
6. Respect the rights of shareholders.
7. Shareholders should be provided with effective communication regarding balanced and understandable company information, including encouragement to participate in general meetings.
8. Recognise and manage risk

A risk oversight, management and internal controls system should be established to identify, assess, monitor and manage risk. Any material changes to risk should be communicated to investors.

9. Encourage enhanced performance.

Establish performance reviews of the board, the directors and executives.

10. Remunerate fairly and responsibly.

Disclose the company's remunerations policies, including the relationship between remuneration levels and company performance.

11. Recognise the legitimate interests of stakeholders.

Establish a code of conduct recognizing the obligations to non-shareholder stakeholders such as customers, suppliers, employees, lenders and the community.

KPMG (2005) carried out surveys in 2003 and 2004 to gain some insight into the disclosure levels and other information provided by listed companies in their annual reports according to the ASX Guidelines. The 2004 Survey examined the disclosure under the following Principles: 2 (board structure); 4 (financial reporting integrity); 7 (risk management); 8 (performance); and 9 (remuneration) from a sample of 55 companies. The findings indicate that levels of disclosure have improved especially in the areas of executive remuneration, director independence and tenure, and board performance reviews. It was found that a wider level of information is available to investors and other stakeholders.

The 2004 Survey (KPMG, 2005) also concluded that there was a change in board behaviour as companies were increasingly carrying out comprehensive reviews of the board, committees and individual directors. This included using an external facilitator to 'introduce elements of rigour and objectivity in the review process' (KPMG, 2005 p.4). This suggested that this was not just 'ticking the box' to comply with the guidelines. However concern was expressed that the increased reporting obligations boards were becoming 'bogged down' with compliance (KPMG, 2005 p.4).

2.3.5. United States

The US has also produced a large volume of works especially since the collapse of such well-known business icons as Enron and WorldCom. The Sarbanes-Oxley Act

2002, and the NYSE Corporate Accountability and Listing Standards 2002 were issued in response to the need for ‘improved’ regulation. The NYSE Listing Standards Committee was set up to canvas comments from such organizations as the Business Roundtable Corporate Governance Taskforce. The Business Roundtable (BRT) is an association of executive officers of leading corporations. The BRT had released its own updated ‘Principles of Corporate Governance’ in May 2002. The Association claims in its foreword and introduction that ‘The United States has the best corporate governance, financial reporting, and securities markets systems in the world’. (If this is so, one can’t help but ask ‘Why have US corporations like Enron collapsed?’ The efficiency and effectiveness of US corporate governance practices is seemingly questionable. Their comments, along with organizations such as the American Society of Corporate Secretaries; Financial Executives International; The Council of Institutional Investors; and The Institute of Internal Auditors were incorporated into the final NYSE document.

2.3.6 Standards and principles summary

A comparison of governance principles from the OECD (30 world members); BRT (US); and ASX and Standards Australia (Australia) is provided in Table 2.1. The comparisons were limited to the principles issued between 2002 and 2004.

The OECD Principles and the Good Governance Principles issued by Standards Australia are most closely aligned. The main difference is the Standards Australia ‘Principle 3.5: The Responsibilities of Shareholders’. The ‘ASX Corporate Governance Principles’ and the ‘BRT Principles of Corporate Governance’ do not address the issue of shareholders taking responsibility for their investments and becoming actively involved the entity’s activities. The BRT Principles also provides much more detailed information on the roles of the board and senior management. The disclosure and transparency issues covered by the OECD principles, ASX principles and Standard Australia are not so clearly defined by BRT. Disclosure and communication requirements are covered in Principle IV ‘Relationship with Stockholders and Other Constituents’. Governance principles are considered important. These limited comparisons indicate that their purpose and aims are similar, regardless of the cultural backgrounds and economic situation.

A number of codes and practices continue to develop in the corporate governance area. Investors are seeking more accountability from boards and directors. This in turn has led to governments to be more proactive in setting up compliance requirements (Mallin 2004). The UK (notably the Cadbury Report 1992), the US (the Sarbanes-Oxley Act 2002) and the OECD Principles have been major players in influencing codes in other countries.

Table 2.1 Comparison of Corporate Governance Principles

OECD Principles (International) 2004	ASX Corporate Governance Principles 2003	Standards Australia Good Governance Principles 2003	BRT Principles of Corporate Governance (United States) 2002
<p>I. Rights of shareholders</p> <ul style="list-style-type: none"> A. Basic shareholder rights B. Right to participate and be informed C. Opportunity to participate & vote D. Capital structures and arrangements E. Corporate control in capital markets F. Costs & benefits of exercising their voting rights 	<p>Principle 6: Respect the rights of shareholders</p> <p>Covers A, B, and C however does cover D, E and F</p>	<p>Principles 3.4: The rights and equitable treatment of shareholders. Covers A, B, and C however does not cover D, E, and F.</p> <p>Principle 3.5: The responsibilities of shareholder</p> <p>Recommends that the shareholders take an active interest in their investment by for example: informing themselves of the activities of the entity, taking a positive interest in the structure of the board etc.</p>	<p>IV. Relationship with stockholders and other constituents</p> <p>Recommends effective and candid communication with stockholders. (B)</p>
<p>II The Equitable Treatment of Shareholders</p> <ul style="list-style-type: none"> A. Shareholders in the same class should be treated equally B. Insider trading should be prohibited C. Board members and managers should disclose material interests 	<p>Not covered</p> <p>Principle 3: Promote ethical and responsible decision making</p> <p>Recommends disclosing the policy concerning trading in company securities by directors, officers and employees.</p> <p>Recommends a code of conduct with details of conflicts of interest disclosure</p>	<p>Principle 3.4.3: The equitable treatment of shareholders</p> <p>A, B and C followed closely</p>	<p>IV. Relationships with stockholders and other constituents.</p> <p>Discusses the need to inform stockholders of directors and senior management interests</p>
<p>III. The Role of Stakeholders in Corporate Governance</p> <ul style="list-style-type: none"> A. The rights of stakeholders should be protected by law B. Stakeholders should have the opportunity to obtain redress for violation of their rights C. Performance-enhancing mechanisms for stakeholder participation D. Stakeholders have access to relevant information 	<p>Principle 10: Recognise the legitimate interest of stakeholders</p> <p>Recommends the establishment and disclosure of conduct to guide compliance with legal and other obligations to stakeholders</p> <p>Does not address the corporate governance roles that stakeholders could participate in.</p> <p>Recommends the code of conduct or a summary of its main provisions be made available publicly.</p>	<p>Principle 3.6: The role of stakeholders in corporate governance.</p> <p>A, B, C and D followed closely.</p>	<p>IV. Relationship with stockholders and other constituents.</p> <p>In addition to stockholders and investors, discusses employees, communities and government.</p>

OECD Principles (international) 2003	ASX Corporate Governance Principles 2003	Standards Australia Good Governance Principles 2003	BRT Principles of Corporate Governance (United States) 2002
<p>IV Disclosure and Transparency</p> <p>A. Disclosure should include:</p> <ul style="list-style-type: none"> i. Financial & operating results of the company ii. Company objectives iii. Major share ownership and rights iv. Board and key executive remuneration v. Material foreseeable risk factors vi. Material issues regarding employees & other stakeholders vii. governance structures and policies <p>B. Information should be prepared, audited and disclosed .</p> <p>C. Annual audit should be conducted by independent auditor.</p> <p>D. Fair, timely and cost-efficient access information.</p>	<p>Principle 5: Make timely and balanced disclosure</p> <p>Principle 9: Remunerate fairly and responsibly Principle 7: Recognise and manage risk. Principles 9 & 10</p> <p>Principle 4: Safeguard integrity in financial reporting</p> <p>Principle 4</p> <p>Principle 5: Make timely and balanced disclosure</p>	<p>Principle 3.3 Disclosure and transparency obligations</p> <p>A, B and C closely followed.</p>	<p>IV. Relationship with stockholders and other constituents.</p> <p>Disclosure of information, communications with stockholders and investors regarding financial condition, operating performance, trends in business and risk profile.</p> <p>Audit requirements are covered in III. How the board performs its oversight function.</p> <p>Refer to IV above.</p>
<p>V. Responsibilities of the Board</p> <p>A. Act on a informed basis, in good faith, with due diligence and care, in the best interests of the company and the shareholders.</p> <p>B. Shareholders should be treated fairly.</p> <p>C. Should comply with applicable law, taking into account shareholders interests.</p> <p>D. Board should fulfil certain key functions.</p> <p>E. Board should exercise objective judgement independent from management</p>	<p>Principle 1: Lay solid foundations for management and oversight.</p> <p>Principle 6: Respect the rights of shareholders.</p> <p>Principle 1 Comments on board roles and responsibilities</p> <p>Principle 2: Structure the board to add value Recommends a majority of the board be composed of independent directors</p>	<p>Principle 3.2: The role, power and responsibilities of the board Appendix A – Role of the Board</p> <p>Principle 3.2.3.2 Companies board responsibilities</p> <p>Principle 3.4 The rights and equitable treatment of shareholders</p> <p>Principle 3.2.3.1 General board responsibilities</p> <p>Principle 3.2.4 Board independence</p>	<p>II: The roles of the board and management</p> <p>A, C and D covered.</p> <p>Refer IV above</p> <p>Refer IV above</p> <p>III. How the board performs its oversight function</p> <p>Comments in details on board roles including the importance of board independence.</p>
			<p>Also discusses in detail the role of the CEO and management</p>

2.4 Role and duties of the board

The role of the board has come under significant scrutiny, due certainly in part to the recent corporate collapses and also due to the changing nature of our business environment (Cadbury 2002, Kiel and Nicholson 2003b). This has led to considerable research into the role and duties of directors. Carter and Lorsh (2004, p.8) suggest that the role that a board adopts will be dependent on the following elements:

- The board structure – its size, leadership, and the committees it requires to accomplish its role
- The board composition – the mix of experience, skills, and other attributes of its members
- The board processes – how it gathers information, builds knowledge, and makes decisions.

This section will discuss the directors' roles and responsibilities including structure and composition. The board processes, for example, on how knowledge is built, or the behavioural aspects of how decisions are made are beyond the scope of this study.

The traditional view of the board is that the board is responsible first, for the appointment (and dismissal) of the CEO and second for protecting shareholders' interests. Cadbury (2002 p. 36) summarizes the boards' main functions as:

- To define the company's purpose;
- To agree strategies and plans for achieving that purpose;
- To establish the company's policies;
- To appoint the chief executive;
- To monitor and assess the performance of the executive team;
- To assess their (the board's) own performance.

Kiel & Nicholson (2003b) also identified several key board functions similar to Cadbury (2002): strategy formulation; the service/advice/contracts role; monitoring; compliance; risk management, CEO evaluation and delegation of authority. Pease and McMillan (1993, p.6) in their guidelines for directors discuss the boards' roles as 'becoming more actively involved in policy setting, strategic planning, performance

monitoring and management support and supervision'. There are numerous lists of directors' functions available; the adoption and development of strategic plans is consistently identified as an important role (Francis, 1997).

In order to fulfil this strategic role, the board does need to have an understanding of the company's fundamental business, competitors and industry environment. A frequent criticism of directors, especially non-executive directors is that they do not have sufficient knowledge of the company's business (Mace 1986). In addition, there needs to be cooperation with management in the development of the corporate strategy. However there can be a tendency to slip 'back to the comfort zone'. Kenton (1995) points out that where directors have previously developed their experiences in functional roles, it can be quite natural to slip back into that role of looking at the day-to-day operational issues rather than stepping back and adopting the strategic approach.

The board needs to be challenging management to improve the decision-making processes rather than just 'rubber stamping' decisions made. Directors (specifically non-executive) can bring various perspectives and outside experiences to the boardroom. They can therefore more effectively review the strategies because they possess the 'ability to engage with the outside environment in a dispassionate way' (Kiel & Nicholson, 2003b p.182). The key areas within strategy responsibilities are the understanding of the industry and the company; staying informed about major operating developments; confirming the proposed strategies and management including monitoring performance and communicating with stakeholders (adapted from Kiel and Nicholson 2003b).

Research carried out by Demb and Neubauer (1992) gathered opinions from directors who identified their most important tasks as (adapted from interview responses p.43):

- Setting strategic direction/creating policy for the corporation
- Securing succession/hiring and firing of the CEO and top management
- Controlling/monitoring/supervising
- Caring for shareholders/ensuring dividends
- Deciding on the use of resources/investments and divestments

Moodie (2001, p. xv) suggests that the 'directors also variously perceive their roles as being able to add value to the discussion and the decision-making process based on individual business experience, to a broader strategic interest in the influence of the organization on the community as a whole'. That is, Triple Bottom Line awareness – social, environmental and financial responsibility. This has stirred up debate as to the extent of corporate and social responsibility beyond the older notions of only being concerned about financial responsibility.

The traditional view is that the board has responsibility and accountability to one particular group: the shareholders. Traditionally boards act in the best interests of the shareholders, which usually involves the maximisation of shareholder profits and value (Healey 2003a). This has determined the way companies are controlled and the way performance is measured. Shareholder value and the 'bottom line' are important in our financial vocabulary. Shareholders are interested in profits and the maximisation of their shareholding as measured by market value. Bosch (2002, p.290) believes that 'by elevating environmental and social considerations to the same levels as the creation of wealth the concepts of accountability is undermined'. Furthermore 'the sole common interest of all shareholders is the ongoing prosperity of the company, and while there can be many ways of achieving this objective and many different strategies, the creation of wealth in perpetuity is the sole final criterion' (Bosch 2002, p. 290).

However this traditional view is being challenged especially, for the boards of large companies. Boards are facing an increase in business growth and complexity arising from globalization and new technologies (Carter and Lorsch 2004, p.29). 'A fundamental change is taking place in the source of value in businesses from hard assets to human assets, and this also complicates the board's stewardship in ways that the governance discussion has yet to embrace' (Carter and Lorsch 2004, p.29). Carter and Lorsch (2004) argue that even though the shareholder value is widely recognized as a measure of value and performance, the growing importance of intellectual capital i.e. the human assets as opposed to the hard physical assets needs to be considered. That is, shareholder value is not the only driver of value creation and that 'recognizing employees as one of the main drivers of value creations better

reflects the reality of business in the twenty-first century' (Carter and Lorsch 2004, p. 33).

Carver and Oliver (2003) discuss a number of issues as to how a corporate board can create value. That value under current practices covers expert advice, safeguards and useful connections. The expert advice comes from the skills, knowledge and experience that the board directors have. The safeguards are that the board provides security in the form of ensuring proper disclosure of information. The connections from the directors' business contacts are a benefit to the company.

The expectations about directors' duties have increased. Recent legal hearings (for example, the HIH Royal Commission 2003) have further emphasized the responsibility of directors. Shareholders are demanding more accountability from management and directors due to the growing increase in share ownership as the ageing population invests in the share market for their future retirement. This has led to 'pressures for change' (Kiel and Nicholson 2003b, p.101). Bosch (1995, p.107) predicted that, due to increasing responsibilities and complexities in business, directors would continue to have more pressures in governing 'their organizations adequately'.

Directors themselves are looking for clearer guidelines as to how to carry out their duties. It is no longer taken for granted that being on the board is purely for prestige - a few hours work and an excellent lunch and other perks. Directors are increasingly required to spend more time in fulfilling their duties (Bosch 1995; Kiel and Nicholson 2003b). Carter and Lorsch (2004, p.3) agreed with this view that 'each board's responsibilities are becoming more challenging and time-consuming'. Potential legal actions arising from disgruntled shareholders and other stakeholders means that internal reform may be needed as 'the gap between what directors do and what is expected of them....continues to grow' (Carter and Lorsch 2004, p. 3).

The legal duties and responsibilities of directors are derived from Statute Laws and Case (Common) Law. In Australia there are a number of federal and state laws with which directors need to comply with including taxation laws, occupational health and

safety, environmental, securities and insolvency. The main source of duties is presented in the Corporations Act 2001 (Federal). These general duties are as follows:

- a duty to act in good faith (s.181)
- a duty not to gain advantage by improper use of the position (s.182)
- a duty not to misuse information (s.183)
- a duty to act with care and diligence in the performance of these duties (s.180)
- and, a duty not to trade while insolvent (s. 588G).

This legal framework means that directors have a duty of care and diligence, a duty of good faith, and a duty not to use the position or information for their own benefit or to the detriment of the corporation. In addition directors also have a fiduciary duty, a duty to act honestly. These duties do not distinguish between executive and non-executive directors or any classification of director that may be used. The legal rights, duties and responsibilities are the same for all.

Legally directors also bear the ultimate responsibility of monitoring the company business. S198C of the Corporations Act states that the business is under the direction of directors. Delegations of authority can be made, however the director is still responsible for that delegation (S190 (1)).

In summary, as directors face increasing pressures in their roles an important question arises ‘Why be a director?’ Arbouw (2004, Website) in his article asks ‘Why risk your reputation that has taken a life’s work to establish to join a board (any board) and see this frittered away by events beyond your immediate control?’ Although, legally the duties have not changed, the duties are becoming more onerous and demanding. The amount of time spent on ‘ticking the box’, i.e. compliance is taking up a lot of time without ‘adding value’ to the organization. Boards need to organize ‘themselves so that they can they can do more work in less time’ (Bernhut 2004, p.5). There is also an increased risk of potential liability due to some high profile ‘rogue’ cases such as HIH. ASIC has played a role in taking legal action against prominent figures such as Rodney Adler, Steve Vizard and Ray Williams who as directors misused their positions for their own gain. In addition, the financial rewards (further discussion on directors’ remuneration is presented below) are not there for many directors.

2.5 Structure of boards

2.5.1 Introduction

The structure refers to the number of the board members, the split between executive and non-executive directors, use of alternate directors, the number and duties of board committees and leadership arrangements (e.g. splitting the role of CEO and chairman). This section will concentrate on the executive and non-executive roles, 'balanced' board, board dynamics, conflict of interest, nomination and remuneration of directors.

2.5.2 Executive and non-executive directors

There are two classifications of director: executive and non-executive. An executive director is generally a full time employee, and a senior executive of the company who in addition to board responsibilities is also involved in the day-to-day operations. A non-executive director is one who is from outside the company. These are sometimes referred to as inside (executive) and outside (non-executive) directors. Another term often used is 'independent directors'. These are directors who are/have not been involved previously with the company as a substantial shareholder; as an ex-executive, as a consultant; as a supplier or as customer, in any interests or other relationships which are in conflict with the director's ability to act in the best interests of the company (ASX 2003, Principle 2).

Although non-executive directors tend to be considered 'independent' the definition of 'independent' may be taken further. For example: non-executive directors are dependent on the executive team for information and knowledge about the company (Stiles and Taylor 2002 p.111). They also need to work closely with the executive team, again due to their lack of knowledge (and limited time) about the company when compared with the executives (Keasey et al. 2002, p.64).

Cadbury (1992) viewed the role of non-executive directors as one of monitoring the executive directors. The report recommended a majority of non-executive directors to provide 'an independent view on corporate strategy, performance, resources, appointments and standards of conduct' (Solomon and Solomon 2004, p. 69). Non-executive directors have a managerial and monitoring role (Keasey et al. 1997, p.76). and thus have an important role in questioning decisions.

Studies conducted by Korn/Ferry and Egan (2002, 2003, 2005) identify an increasing trend to have a majority of non-executive directors. Their results indicated that this trend to appoint more non-executive directors than executive is a factor of almost 3:1. Their research indicated that the top 50 large companies in the 2005 Report had the highest percentage (79%) of non-executive directors up from 72% in 2002, and 70% in 2003. Their current 2005 findings (p.13) indicate ‘that the proportion of non-executive directors has increased markedly since the introduction in 2003 of the ASX Corporate Governance Principles’.

The issue of non-executive directors raises questions as to whether this external expertise provides a more solid basis for decisions (Clarke 1998, Keasey and Hudson 2002). Scherrer (2003) argues that outside directors (unlike inside or executive directors), in addition to providing valuable access to resources and information, also protect shareholders’ interests since they do not have the same concerns with their employment or advancement opportunities. Jensen and Meckling (1976) identified the shareholders’ and directors/managers’ relationship as one of principal and agent. The shareholders want their wealth maximized, but the managers have less incentive to do so than if they were the owners. By having more non-executive directors on board, this apparent conflict can be reduced.

A criticism of non-executive directors is that they are too busy with other commitments and are only involved with the company business on a ‘part-time’ basis. Bosch (1995, p. 106) points out that ‘the average director spends only twenty-two days per year on his duties . . . This is barely enough to perform the essential functions. . . , indeed it may be wondered whether the directors who put in less than average effort can be discharging their duties adequately’. According to Carter and Lorsch, (2004, p.45) since the average director ‘spends a little more than two weeks a year’ on the job, it is difficult to ‘develop much more than a rudimentary understanding of their companies’ workings’.

In addition, as discussed above, non-executive directors do not necessarily have a ‘hands-on’ approach, or are not necessarily well versed in the business, hence do not necessarily make the best decisions. A number of factors need to be considered as to

the effect of non-executive directors on company performance and whether culturally diverse boards are more effective. Studies to date (for example, Bhagat and Black 2002; Kiel and Nicholson 2003; Dulewicz and Herbert 2004) do not necessarily conclude that independent boards perform better. The focus on corporate governance does not necessarily have a positive impact on financial performance (Korac-Kakabadse and Kouzmin 2001). Refer to Table 2.2 Selected Overview of Research on Directors and Company Performance for a summary of these and other studies.

2.5.3 Balanced board

A 'balanced board' is considered desirable. There has been much discussion on what constitutes 'balanced'. What should the profile of the board be? It is generally accepted that diversity is important with a mix of skills and experience (Kiel and Nicholson 2003b; Korn /Ferry and Egan 2002,2003; Kakabadse and Kakabadse 2001). In terms of experience and backgrounds, potential directors need to have an understanding of how things work. Backgrounds in law, accounting and finance are considered to be useful. In addition there is also a view that a blend of personalities is important. Ideally the board should be a group of people who are prepared to speak up and ask difficult questions (Zandstra 2002). They should also be prepared to differ, respect other's views and opinions and talk through them (Kakabadse, Ward, Korac-Kakabadse and Bowman 2001; Cutting and Kouzmin 2002; Dixon and Dogan 2003). Simply legislating changes will not improve corporate governance (Kocourek, Burger and Birchard 2003) unless the directors possess these qualities.

The directors are the shareholders' representatives, yet this focus may be lost by some in the way that decisions are made. A greater awareness is required from directors including more interaction, more understanding of the business, more communication with management and more expertise. Directors are able to add value because of varied backgrounds (Carver and Oliver 2002).

It is important to note that board effectiveness depends on a number of factors. Board structures and composition have been used in a number of empirical studies looking at board effectiveness. However as McNulty, Roberts and Stiles (2003, p.2) note 'board effectiveness depends upon experience, skill and judgments of individual executive and non-executive directors and the ways in which they combine to shape board

conduct and relationships’ . Thus ‘the focus has shifted away from board structure and the balance between control and collaboration by attempting to open the black box of board effectiveness through empirical research on board processes and dynamics’ (Corley 2005, p.2).

The research carried out by Roberts et al. (2005, p.S6) suggests that board effectiveness is related to the ‘degree to which non-executives acting individually and collectively are able to create accountability within the board in relation to both strategy **and** performance’. The authors suggest ‘that a variety of behaviors – challenging, questioning, probing, discussing, testing, informing, debating, exploring, encouraging – that are at the very heart of how non-executives seek to be effective’ (2005, p.S6).

2.5.4 Board dynamics

Board dynamics is also an important element. Board dynamics is concerned with the way behavior or the social, interpersonal and group relationships impact on the board’s decision making. The nature of the board culture affects the level of non-executive and board involvement. ‘The differentiation in levels of board involvement, it is argued, stems from the effects of size and composition, the attitudes of a powerful chairman or chief executive, the nature of the board process, and the will and skill of the non-executives themselves’ (Roberts et al. 200, p. S9).

Forbes and Milliken (1999) studies (cited in Roberts et al. 2005, p.S9) also suggest that the effectiveness of boards depends on the level of social interaction between the members and the exchange of information and critical discussion. A ‘simultaneous need for control and collaboration’ (Sundaramurthy and Lewis 2003, quoted in Roberts et al. 2005, p.S9) is suggested for boards. A balance is needed between them. If control is over-emphasized then it may lead to distrust between management and the board. This in turn may lead to increasing controls and a greater requirement of information by the board, which in turn leads to management frustration and withholding of information. However an emphasis on collaboration and past success may ‘sow the seeds of complacency’. Thus the non-executives as monitors and collaborators ‘are caught between two masters - investors and executives, and somehow have to “switch” between roles in order to perform their tasks effectively’

(Roberts et al. 2005, p.S10). ‘The board of directors is the key means for ensuring both the accountability of directors to shareholders and the accountability of corporate employees to the corporation’. (Roberts et al. 2005, p.S10)

The role of the chairman is a key determinant in creating a culture of trust (Roberts 2002 cited in Roberts et al. 2005, p.S9). The authors argue that ‘the chairman’s work in managing the board, in building non-executive knowledge through induction, strategy events and various off-board meeting, in structuring the board agenda and ensuring the quality and timeliness of board papers and in chairing the meeting themselves, was “pivotal” in creating the conditions for non-executives to be effective (Roberts et al. 2005, p.S12). For example in the case of HIH, the chief executive Ray Williams dominated the company by appointing friends and associates to the board. There was no independent assessment of performance of the results or of management. Basically the board accepted whatever they were told and management was not subject to questioning or held accountable. The information provided to the board was limited and was controlled by management. Thus the non-executive directors were highly dependent on management and important matters were not included on the agenda. The chair did not involve the board in strategic matters because the CEO didn’t want the board involved. Thus by not being involved in these discussions, the board failed to understand the risks involved and did not question management about the decisions being made. The board simply followed the recommendations of the senior management. (Lipton 2003; HIH Royal Commission Report 2003)

The Roberts et al. (2005, p.S12) research contends that ‘attitudes, experience and conduct of the non-executive can contribute to (such) positive and negative board dynamics’. An example was given where a relationship can be established between an executive director and the non-executive director. If the non-executive understands the business and asks ‘brave questions’, as opposed to just asking the ‘obligatory three questions’, then the respect for that person increases. ‘This encourages executives into a greater openness and trust, which in turn builds non-executive knowledge and confidence’ (Roberts et al. 2005, p.S12).

2.5.5 Conflict of interest

Conflict of interest can arise where a director has multiple directorships and therefore acts for competing companies. From a legal point of view, it is accepted that there is no breach of fiduciary duties providing that there is no contract of employment requiring the director to provide his/her services exclusively, confidential information is not used or disclosed, and the director does not use their position to deflect business opportunities away from the company for personal benefit.

Conflict of interest is a critical issue in corporate governance. Board procedures need to be in place to deal with situations where a director may have private interests which may be in conflict with the company business. It is also the chairman's responsibility to draw the board's attention to such conflicts (HIH Royal Commission Report 2003). Corporations Law requires directors to give the other directors notice of the interest (s191) unless specifically excluded (s192). A 'standing notice' (s192) may be given, which means they are then not required to give any further notice. In the HIH case, Rodney Adler as a non-executive director was provided with an unsecured loan. The board had established an investment committee (of which Adler was a member), but none of the transactions were referred to it. The fact that he had obtained a private benefit, which should have been regarded as being in conflict with the company business, was never raised (Lipton 2003).

Bernhut (2004, p.3) in his interview with Professor Lorsch raises the 'conventional wisdom' that directors need to be independent. Lorsch argues that whilst the idea of having independent directors has 'caught on', i.e. 'you have the majority of people on a board who have no conflicts of interest with the company and can be truly focused on what's good for the company and what's good for the shareholder' (Bernhut 2004, p.3); you then have people 'who know very little about the company because they just can't have any other connections with it or the industry, and because they are doing other things, also have limited time. . . . you end with a board of part-time people who are basically amateurish in the affairs of the business'. So he continues that it would be better to have people who know more about the business, even though there may be some conflict. 'That's a price worth paying for more knowledge and expertise' (Bernhut 2004, p.3).

2.6. Nomination of directors

Companies need to be objective in the selection process for directors. The board needs to be made up of a balanced portfolio of members with the appropriate business skills. Rather than just appointing directors at the recommendations of the chairman or chief executive, or simply because 'we know so-and-so' there needs to be a more formal process in place (Jackson, Farndale and Kakabadse, 2003). The Korn /Ferry and Egan studies (2002, 2003) indicate that executive search firms are being used more to identify suitable candidates. Executive search firms can access a wider pool of potential directors with more diverse backgrounds, an important characteristic of boards (Korn/Ferry and Egan 2002, p. 25). The final approval still lies with the nomination committee.

The nomination committee's role will include: identification of the needs of the company; monitoring board composition; development of selection criteria; location of potential candidates; and presentation of recommendations (Pease and McMillan, 1993). This is supported by The ASX Guidelines (Principle 2) which recommends the establishment of a nomination committee composed of a majority of independent directors. The responsibilities include:

- assessment of board members' competencies,
- review of succession,
- board performance evaluation, and
- recommendations for the appointment and removal of directors.

2.7 Remuneration

2.7.1 Introduction

Board compensation is another area of discussion around boards and directors (Elloumi and Gueyie 2001; Fleming and Stellios 2002; Kiel and Nicholson 2003b). The Corporations Act requires that the shareholders must approve the directors' remuneration and this must be disclosed in the financial statements. This remuneration package can include bonuses, share options, retirement benefits as well as the standard salary or fees. A review and recommendation of executive packages should be handled by the remuneration committee.

2.7.2 Remuneration committee

The level of these fees and the processes by which they are determined may be assisted by the use of a committee. The committee can provide an objective review of performance and rewards i.e. by setting performance criteria and incentive programs encouraging the achievement of corporate goals. A survey by Ernst & Young and the Australian Institute of Company Directors (AICD, October 2003) found that 75% of companies surveyed relied on the advice of remuneration committees when setting directors' remuneration. The survey was conducted on 57 members of AICD.

The remuneration committee's duties include a review of the company's policies and practices for executive remuneration, current industry standards and practice, performance measures and retirement benefits. The ASX guidelines (Principle 9) recommend that the committee should be composed of a majority of independent directors with a formal charter setting out its role and responsibilities. The responsibilities include reviewing executive remuneration packages, incentive schemes, superannuation arrangements and remuneration framework for directors.

2.7.3 Directors' remuneration

The structure and level of remuneration has also been widely discussed and reported in the press. Directors themselves believe that the level of compensation, especially with the increased focus on directors' responsibilities and company performance, does not reflect this increased responsibility and risks. A survey by Ernst and Young and the AICD (October, 2003) indicated that 63 % of respondents believed that they were underpaid.

A report prepared by Corporate Governance International (CCH, 2005) surveyed the rates and structure of pay in 2004 for non-executive directors from a sample of 105 ASX listed entities. It highlighted the importance of providing remuneration levels commensurate with the directors' expertise and experience. 'CGI takes the view that a well-paid, alert and competent board, with non-executive directors who demonstrate their suitability and that they carry out their role effectively, is probably the cheapest form of insurance and the most effective comfort that public investors can have against expensive nasty surprises' (CCH 2005). However directors needed to be able to demonstrate their 'worth'. The report suggested a minimum of 40 working days

per annum (80 – 120 days for the chairman) is needed for the preparation and attendance of board meeting, keeping up-to-date with new developments, and updating their training and skills.

The level of remuneration is also important from the view of attracting ‘new blood’. Due to the changes in corporate governance principles and regulations, there is a greater demand for independent directors. A survey by Ernst & Young and AICD indicated that directors did not believe that they were paid enough according to the responsibilities and risks associated with the role (AICD website). Hence to ensure that high quality candidates apply for directors’ positions an increase in remuneration levels is needed.

The Korn/Ferry and Egan 2005 Study indicates an increasing trend in fees for non-executive directors. However this rate of increase is much less than that for chief executives and senior company executives. ‘There is clearly an undertow of disquiet in some settings among directors who of necessity are heavily engaged in representing the interest of shareholders, and having regard to their time commitment, skill and experience, the reward gap between the executive team whom they are strongly supervising is stark’(Korn/Ferry and Egan 2005, p.5).

2.8 Board performance

2.8.1 Introduction

The trend to monitor and measure board performance has become more widespread, beginning in Australia in the mid 90’s (Moodie, 2001). Kiel, Nicholson and Barclay (2005) identify three main reasons for the increased pressures for performance evaluations. Firstly the board is ‘held increasingly accountable for corporate performance’; secondly, there has been an increase in shareholder activism and investors are ‘more demanding of boards due to limited investment opportunities’. Thirdly ‘there is an increasing media and community scrutiny of all aspects of corporate life’ (Kiel et al. 2005, p.4). The performance of the board, as well as the performance of the individual directors is discussed below.

2.8.2 Performance measures and objectives

Whilst performance appraisals are relatively common for employees, it is another matter for directors. A common objection to board evaluation is that the directors' 'track record speaks for itself and further appraisal is unnecessary, even insulting: the only assessment they should be subject to is the vote of shareholders when their turn comes for re-election' (Kiel, Nicholson and Barclay 2005, p.6).

The Korn/Ferry 2000 Study (as cited in Moodie 2001, p.35) identified five important criteria which Australian Boards regard as essential for evaluating board performance:

- An understanding of the company's mission and strategic plan;
- A comprehension of the organization's business;
- A willingness to challenge management when required;
- The skills to appraise the chief executive;
- The special expertise that board members have to add value to the company.

This study also showed that the areas in which boards consider themselves the most effective include: representing shareholder's interests balancing the interests of different stakeholders; advising during major decisions such as mergers and acquisitions; shaping long-term strategy; and monitoring strategy implementation (Moodie, 2001). Kiel, Nicholson and Barclay (2005, p.28 refer Table 2.1) suggest that the evaluation of its performance will be influenced by the objectives e.g. 'What does the board hope to achieve'?

A board can judge its performance by: the company's share price; the performance of the chief executive; adherence to Corporations Law and regulations; and other activities in which its is involved in e.g. strategies/acquisitions. Due to the difficulty of setting up measures, Keasey and Hudson (2002) argue that the only real measure of performance is financial. However the Korn/Ferry and Egan (2002) study identifies four key areas which influence the effectiveness of the board: the relationship between the board and the CEO; independent directors with the appropriate skills and competencies; transparency; and the leadership of the chairman. These are all areas for which performance indicators can be identified. Regular evaluation can provide

benefits in improved leadership, clarity of roles and improved team work (Kiel, Nicholson and Barclay, 2005, p.12).

Appraisals systems can be difficult to implement depending on the types of boards. For example, consider the not-for-profit board. These directors are volunteering their time and expertise. Does that make them less accountable for their actions than if it was a for-profit company?

The board needs to be in agreement about the type of measures to be used, especially where appraisals have not been previously used. A gradual introduction of these measures may be useful by setting down the objectives, then compiling the results and discussing them. Starting off as a group assessment and discussing the expectations and final results could lead to individual private discussions. Such a group discussion is certainly less threatening than an appraisal on an individual basis.

Assessments may be carried out by the chairman conducting individual private meetings. This is subjective, depending on the chairman's point of view and judgment. Collective performance is easier to measure than the individual but this raises the issues of what are the relevant performance measures.

Scissons (2002) points out however that there are inherent difficulties in assessing the governance reviews of boards depending on the type of assessment chosen. For example, if a rating scale 1 to 5 is used, it is subjective. Each person has their own internal rating system which raises issues of inconsistency when these rates are averaged out, i.e. a '3' for one person is a '5' in someone else's eyes.

Alternatively, a self-assessment review may also be carried out by setting each director's own development goals, which are aligned with the board's goals and the strategic direction for the organization. The goals are discussed with the chairman, and then reviewed at the end of the time period. Again this does require certain skills from the chairman. However any self-assessment represents only one perspective, meaning that one's opinion of one's own abilities may be entirely different from someone else's opinion of those abilities.

It is important than a review of outcomes is followed up at some time in the future. In situations where the board does not get the feedback and the follow up any future reviews will not have their support, and will be considered a waste of time.

2.9 Governance and performance

2.9.1 Introduction

The impact of 'good' governance principles on company performance has been the subject of much debate and research. Studies have been carried which show that investors are prepared to pay a premium for well governed companies (Mc Kinsey 2002). However as discussed below this is not so easy to determine.

2.9.2 Relationship between governance and performance

Bernhut (2004) in his interview with Professor Lorsch examines the statement that there is a relationship between good governance and good financial performance. Professor Lorsch's reply includes that there are a number of factors that affect company performance. However he did not consider the board to be the most important one. He considered 'the biggest factor that affects a company's performance and profitability is the industry in which it's operating...(and) that the quality of management and their ability to make decisions and implement their decisions' (Bernhut 2004, p.3)

A number of studies have been carried out to determine the impact on good governance practices on performance (Parker, Peters and Turetsy 2002, Scherrer 2003, Brown and Caylor 2004). It is widely perceived that well governed companies are less likely to collapse. In Australia, examination of the HIH, One.Tel and Harris Scarfe cases have enabled the identification of a number of common failings in these collapses. Leung and Cooper (2003) identified the following common failings as evidence of a breakdown of good governance:

- Inappropriate management compensation,
- Creative accounting,
- Failure of directors and managers to exercise due diligence,
- Lack of adequate regulation, and
- Lack of independence in the audit function.

Commissioner Owen in the HIH Royal Commission Report ‘considered that there was a causal link between poor corporate governance and mismanagement’ (Lipton 2003, p.277). Some of the failings specific to HIH are:

- The dominant chief executive,
- No independent assessment of performance,
- No accountability by management,
- Non-executive directors dependent on management for information,
- Selected limited information provided,
- Lack of disclosure by directors resulting in conflicts of interest,
- Ineffective role of the board and the chairman,
- Lack of formal performance appraisals; and
- Failure to understand the issues including the strategic direction of the company.

So whilst HIH did state its corporate governance model in the annual report, it was not assessed as to its effectiveness.

Table 2.2 – Overview of Research on Directors and Company Performance

Author	Research Question (s)	Methodology	Key findings
Dalton, Daily, Ellstrand and Johnson 1998 (US)	Reviewed research on the relationships between board composition, leadership structure and financial performance	Meta-analysis of 54 empirical studies of board composition, 31 empirical studies of board leadership structure	No meaningful relationship between board composition, leadership structure and financial performance.
Millstein and Macavoy 1998 (US)	Directors and performance- focus on board behaviour	Empirical study of 154 firms based on 1991-1995 data	Substantial and statistically significant correlations between an active board and corporate performance.
Muth and Donaldson 1998 (AUS)	Examined board independence and performance based on agency stewardship theory	145 listed companies 1992-1994 Statistical analysis	Empirical results inconclusive that board independence has a positive effect on performance.
Lawrence and Stapledon 1999 (AUS)	Examined the relationship between board composition and corporate performance. Examined whether independent directors have a positive influence on executive remuneration	Empirical studies – data sample selected from ASX listed companies in 1995. Regression analysis 700 directors sampled	No statistically significant relationship between the proportion of NED's and adjusted shareholder returns Little evidence that board size affects share price performance No evidence that the proportion of executive directors influences CEO remuneration.

Author	Research Question (s)	Methodology	Key findings
Li and Ang 2000 (US)	Investigated the impact of the number of directorships on directors performance.	Empirical studies- sample consisted of 121 listed firms and 1195 directors 1989-1993 Regression analysis	Negligible affect on the firm's share value based on number of directorships- considering just the number of appointments may not reflect how a director performs in corporate monitoring
Rhoades, Rechner and Sundaramurthy 2000 (US)	Examined the insider/outsider ratio of boards and company performance. Examined the potential moderating effects of different operational definitions of monitoring and performance	Meta-analysis of 37 studies across 7644 organizations based on initial search of 59 reports with quantitative data on monitoring and performance 1966-1994	Overall conclusions are that there is a small positive relationship between board composition and financial performance. Board and their director quality needs to be further addressed in considering managerial implications of board composition monitoring as a behaviour.
Bhagat and Black 2002 (US)	Examined whether there is any relationship between board composition, board size, board independence and firm performance	934 firms using data form 1985-1995 Regression analysis	Low-profitability firms increase the independence of their boards. Firms with more independent boards do not perform better than other firms. No consistent correlation with firm performance.

Author	Research Question (s)	Methodology	Key findings
Parker, Peters and Turetsky 2002 (US)	Investigated various corporate governance attributes and financial survival	176 financially stressed firms 1988-1996 Regression analysis	Firms that replaced their CEO with an outside director were more than twice as likely to experience bankruptcy Larger levels of insider ownership are positively associated with the likelihood of firm survival
Kiel and Nicholson 2003a (AUS)	Examine the relationship between board demographics and performance	348 public listed companies ASX 1996 SPSS analysis Tobin's Q	Positive relationship between the proportion of inside directors and the market-based measure of firm performance. Board size is positively correlated with firm value.
O'Sullivan and Diacon 2003 (UK)	(1) Examined whether mutual insurers employ stronger board governance than their proprietary counterparts. (2) Examined the impact of board composition on the performance of proprietary(stock) and mutual companies	Data regression analysis 53 life insurers operating in the UK over the period 1984-1991	Mutual insurers had greater non-executive representation on their boards. Lack of consistent evidence on non-executive monitoring and impact on performance

Author	Research Question (s)	Methodology	Key findings
Dulewicz and Herbert 2004 (UK)	Investigated whether there is any relationship between board composition and behaviour, and subsequent company performance	Data based on original study of 134 responses from a cross-section of companies. Follow up data based on 86 listed companies (1997-2000) SPSS analysis CFROTA (cash flow return on total assets) ratio used for performance analysis	Board practices on identified tasks not clearly linked to company performance Limited support that companies with independent boards are more successful than others
Uzun, Szewczyk and Varma 2004 (US)	Examined the relationship between fraud and board composition, board size, board chair, committee structure and frequency of board meetings,	Constructed database for a sample of 266 companies (133 that were accused of committing fraud and 133 no-fraud) during the period 1978-2001 Regression analysis	Board composition and structure of oversight committees are significantly related to the incidence of corporate fraud. A higher proportion of independent directors indicated a less likelihood of fraud.

2.9.3 Governance and performance summary

O'Higgins (2003) examined the possibility of future collapses occurring by identifying the following 'signals of vulnerability': highly competitive environments; highly diversified, complex organizations with far-flung geographical operations; reliance on government contracts; businesses with products or services that impact on public health and safety; emphasis on profits; weak corporate governance structures and processes. From this it can be seen that even though best practices may be followed, business survival is not guaranteed, as corporate governance is only one of several important signals of vulnerability.

The measurement of 'good governance' is not easily determined. A number of measurement ratings have been developed, however they do tend to concentrate on quantifiable measures such the number and composition of boards in relation to return on investments, level of profits and other accounting measures. Whereas qualitative research covering board effectiveness, dynamics and behaviours is limited.

2.10. Multiple directorships

The question of 'How many directorships?' can a person hold effectively has also been a recent discussion issue. The trend is that with the increased demands of their role, directors need to carefully structure their workloads to carry out their duties efficiently and effectively. However the actual number of directorships that a director should hold is debatable. Li and Ang (2000) investigated the issue of whether the number of directorships held affects the effectiveness of the director. Their findings were not conclusive. The number of directorships held does not necessarily affect the director's performance.

The AICD (Website 2005) carried out a study examining the correlation between multiple directorships and company performance. The ASA (Australian Shareholders Association) has been concerned about directors' ability to carry out their roles where multiple directorships are held. The AICD study found rather that the experience is of greater benefit. 'Multiple/interlocking directorships can provide advantages to the companies involved by providing feedback information on a wider span of business activity thereby enhancing strategic decision-making' (Naughton 2002, p.12) The

workload depended on the size and complexity of issues, rather than just the number of appointments. Furthermore an individual director's experience and capacity varied significantly. Thus it was difficult to establish whether someone with two directorships managed better than someone with five. The difficulty is in 'measuring' the contribution that a director makes.

If limits were applied, more potential candidates would need to be recruited and trained. Developing new board members does take time and a director may be appointed to fill the 'quota' without necessarily being the best candidate.

Another issue which perhaps needs to be addressed is conflict of interest where a director may hold a directorship in a company which is a competitor of another. That is, it is not so much the number of directorships but which companies are involved. Invariably given the limited number of directors available, the commercial reality is that directors may act for a competing company. Under the provisions of Corporations Law, directors should disclose their interests (refer previous section).

Studies carried out by Lawler and Finegold (2005) in the US examined the impact of multiple directorships on board effectiveness. Survey data was collected in 1998 and 2003. The research consisted of a self-evaluation questionnaire asking directors to evaluate the overall performance of their board is based on financial monitoring, strategic effectiveness and compliance effectiveness. Their findings indicated that board effectiveness and board membership limits for CEOs and executive directors were significantly related. However this was not the case for non-executive directors. A possible explanation was that CEOs and executive directors were already in full time roles, thus finding additional time for directorship roles could be difficult. The experience gained from these outside positions would be of benefit however, 'a law of diminishing returns might apply, such that being on a number of outside boards could easily have an overall negative impact as the time demands outweigh the learning opportunities' (Lawler and Finegold 2005, p. 69). The impact of company performance of multiple directorships is not conclusive.

2.11 Information availability

2.11.1 Introduction

In order for directors to make decisions, the quality and timeliness of the information is important. As non-executive directors will have less knowledge about the company and the industry than the executive counterparts, relevant information needs to be provided. The challenge is to develop a management information system which is able to deal with the range of information required without overloading the board members. The other challenges are that management does not necessarily share information with the board which impacts on the decisions made.

2.11.2 ‘Knowledge is power’

As the focus (as discussed in previous sections above) has been on having a majority of independent directors on boards, the issue is how to ensure that the directors are well informed. Independent directors have limited knowledge about the company and the industry. In addition to the information that is provided to them, they also need to ‘undertake their own due diligence, to learn about the company from the public record, to understand who the other directors are, and to appreciate the corporate governance culture and the nature of the tasks ahead’ (Reiter and Rosenberg 2003, p.1).

Orientation programs for new directors are essential. Suggested information may include: company and industry background, agreements, organizations charts, contact information, corporate governance mandates, copies of policies, financial and analysts’ reports, directors’ information and so forth. Informal meetings with other directors and senior management are also important.

The provision of material for board meeting needs to be delivered in a format that can be followed. Similarly the material needs to be made available with sufficient time for directors to prepare for the meeting. The data should be presented in a consistent format so that any comparisons to previous reporting can be easily made. Information that is too detailed and too difficult to follow may cause delays in board approvals. However if the information is not detailed enough, the same problems can arise. Decisions cannot be made if the directors do not feel that they have been adequately informed. (Reiter and Rosenberg 2003).

Informal exchanges of information are also important. Directors' dinners with a guest speaker addressing a particular theme are an important way of enhancing board dynamics (Reiter and Rosenberg 2003).

It has been suggested that where there is a lack of trust between the board and the senior managers, the board will request more information and the managers provide information that is insufficient, or in such format that it is difficult to understand. As the board is reliant on the managers for information, it is crucial that timely and accurate information is provided (Tapp 2002).

2.11.3 Information availability summary

'An informed director is the first step to becoming a useful director, one who can exercise business judgment and common sense,' (Reiter and Rosenberg 2003, p.5). The onus on gathering the necessary information is on both the organization and the individual director. If the director does not have sufficient information, then he/she must be prepared to seek that information out. This is becoming more important as companies are following best practice and engaging more independents to serve on boards.

2.12 Trust between managers and directors

2.12.1 Introduction

A culture of trust is important in an organization because it 'builds loyalty, increases credibility and supports effective communications' (Beslin and Reddin 2004, p.2). Communication is important in getting the message across to the various stakeholders. There also needs to be clear channels of communication between managers and directors in order to develop this trust.

2.12.2 Trust and corporate governance

Tapp (2002) suggests that given recent financial scandals and the possibility of increased litigation directors are demanding more detailed information. 'Boards are no longer "rubber stamps"; in fact, they have become "roadblocks"' (Tapp 2002, p.1) That is, senior management is spending more time preparing for board meetings rather than getting on with the responsibility of running the business. The board on the other

hand needs to balance its questioning in fulfilling its responsibilities as steward for the shareholders, managers' monitor and advisor. There must be support between the two groups.

To improve trust between managers and directors, Tapp (2002 adapted from p.5) suggests the following:

1. The members of the board must share the vision of the shareholders.
2. The roles of the board, board chair and CEO must be clearly defined and adhered to.
3. A strong board must be created.
4. A strong management team must be created.
5. The importance of evaluation must be recognized and undertaken to ensure that each board or senior management team member is effectively fulfilling his or her role and responsibility.
6. An environment in which directors and senior managers can constructively challenge each other should be created
7. Appropriate information must be made available in a timely fashion.

2.12.3 Trust summary

By building a culture of trust and thereby sharing information, a better working relationship can be developed between managers and directors. The research carried out by Roberts et al. (2005 p.S12) identified the importance of trust in creating 'a positive dynamic relationship' between executives and non-executives. Thus executives are encouraged 'into a greater openness and trust, which in turn builds non-executive knowledge and confidence', whereas 'deteriorating board relationships (are) characterized by withholding of information and mistrust' (Roberts et al. 2005, p.S12).

2.13 Chapter summary

Corporate governance standards and principles have been extensively revised and developed in the last 15 years. These have been influenced by organization theories, notably agency, stewardship and stakeholder theory. This chapter has focused briefly

on the developments in standards and principles in the UK, the OECD, in Australia and in the United States.

The role and structure of boards has been discussed, including the importance of achieving an independent and 'balanced' board. The effectiveness of non-executive directors continues to evoke discussions and research in academia and in business.

Some of the issues in governance, company performance and board performance have also been reviewed. Table 2.2 provides an overview of the research in the relationships between directors and company performance. Overall the literature suggests that directors play a crucial role in corporate governance but the relationship between directors and company performance is more problematic. The impact of the availability of information, the way it is presented, and the culture of trust between directors and managers are also discussed.

Chapter 3 discusses how this research explores several issues not yet resolved in the current literature.

CHAPTER 3 PURPOSE OF RESEARCH

3.1 Introduction

Studies on the impact of corporate governance in organizations in academic literature have concentrated mainly on the use of quantitative data analysis. Corporate governance research has concentrated on empirical studies which attempt to link financial performance to the degree of corporate governance compliance; and attributes such as the ratio of executive/non-executive directors; board composition and size; and leadership structures. Board performance and effectiveness are often measured using a variety of performance indicators; for example, share values and shareholder returns. These studies have produced mixed results. For example, Muth and Donaldson (1998) examined board independence and performance based on a statistical analysis of listed companies; their results were inconclusive. Kiel and Nicholson (2003a) concluded that there was a positive relationship between the proportion of inside directors and the market-based measures of firm performance. Dulewicz and Herbert (2004) determined from their research that board practices on identified tasks were not clearly linked to company performance. Likewise there was limited support for the argument that companies with independent boards are more successful than others. (Further examples are detailed in Chapter 2, Table 2.2 – Overview of Directors and Company Performance.)

Despite the lack of research evidence, conventional wisdom is that financial performance is improved with the application of improved corporate governance procedures. A general belief exists that those companies with ‘good’ corporate governance structures perform better than those without. Studies (McKinsey 2002) have shown that investors are willing to pay a premium for ‘well-governed’ companies. The 2005 Horwath Report’s research conclusions indicate that generally companies with good corporate governance practices had better share price performance than those without. This was consistent with previous Horwath Reports of 2003 and 2004. So why is corporate governance important to an investor? According to Cornelius and Kogut (2003) a well-governed company has trustworthy and honest managers. ‘Good corporate governances provide shareholders and the public with reliable reports and financial information’ (Cornelius and Kogut 2003, p. 372).

However as stated, above the connection between corporate governance and performance is not conclusive. Nevertheless it does not necessarily mean that there is no connection. It merely means that as yet that connection has not been identified. Due to this lack of conclusive evidence it has been suggested that perhaps researchers are studying the ‘wrong’ aspects of corporate governance or that the manner in which these studies are being carried is incorrect or limiting (Leblanc 2001). CIMA and IFAC recently released a study detailed in ‘Enterprise Governance, Getting the Balance Right’ (2004) which examined a number of international companies from a range of industries. One of the outcomes of the study was that corporate governance ‘did not feature strongly as a key factor of success’ (CIMA and IFAC 2004, p.5). However ‘this did not imply that corporate governance is unimportant for success. Instead, it shows that good corporate governance is a necessary, but not sufficient, foundation for success’ (CIMA and IFAC 2004, p.5).

A criticism of the extant research is also that ‘trying to distill a relationship between governance and performance - from outside a boardroom- is analogous to trying to find out what makes a sports team effective by sitting in a cafeteria reading the sports pages, without entering the arenas or locker-rooms or interviewing the game’s great teams and players. A board, in its simplest terms, is a decision-making body. How, when and why boards act, or fail to act, is best determined by observing boards in action, in real time, and by engaging in in-depth interviews and intense dialogue with directors themselves...’ (Leblanc 2004, p.437). Leblanc’s critique implies that studies which focus on boards and board processes can be useful in determining the relationship between governance and performance.

3.2 Research objectives

While there is an abundance of empirical studies based on various theoretical frameworks, some examples of which are shown in Table 2.2 – Overview of Research Studies on Directors and Company Performance, the studies on how boards actually work and behave are limited. Leblanc (2004, p.438) identifies three areas which need to be addressed by researchers to determine ‘with greater particularity the nature of board effectiveness and the relationship between this construct and corporate financial performance’. These areas are: firstly the independence of judgment, competencies and behaviors of the chairman of the board; secondly, the behavioral posture of the

Chief Executive Officer; and thirdly, the effectiveness of individual directors in the decision making process.

Similar areas have been identified by other researchers. For example, Zahra and Pearce (1989) suggested that further research needed to be done on how board processes operated. Stiles and Taylor (2002) also pointed out that there were few studies which examined the behaviour of directors and how they made their decisions. However it is also recognized that one of the difficulties in carrying out such research is the fact that boards operate within the confines of confidentiality. Understandably these discussions and deliberations take place behind closed doors. ‘There are good reasons for this, not the least being the danger of giving away competitive advantage or disclosing premature or misleading information that could affect the decisions of investors’ (Leblanc 2001, p.8).

3.2.1 Research objective 1

Actual observations of decision making and board processes are not feasible for this research given the difficulties of accessing the actual workings in the boardroom and the confidentiality of discussions. Board processes remain critical however, and largely rely on the behaviour of individual directors. Thus the first objective of this research is to examine the views of board directors on some aspects in corporate governance. The general question ‘What do directors believe the impact of the current focus on corporate governance has been on boards and directors?’ leads to a series of more specific questions derived from the literature referred to in Chapter 2:

- What impact do directors believe that they have on corporate governance (and vice versa)?
- According to directors, how can a board’s functions/processes be improved?
- Do directors believe a company’s performance due to the directors’ decisions?
- Can directors determine how well a board operates?
- Do directors believe that dynamics around the boardroom table are important?
- Do directors believe that the size of the board matters?’

3.2.2. Research objective 2

The second objective of this study is to examine the views of board directors specifically in relation to the executive/non-executive debate. Thus a further question for this research is: Do directors believe that it is important to have both executive and non-executive directors on the board?

This is of particular interest, due to a number of recommendations and Codes of Best Practice (for example; ASX Corporate Governance Guidelines 2003, Cadbury Report 2002, Sarbanes-Oxley Act 2002). These governance practice guidelines will supposedly, if they are followed, lead to 'better' performance. Given that we have these corporate governance guidelines, what do directors themselves think of them? How do they perceive their role in all of this? Does a non-executive director on a board really make a difference? Conventional wisdom has led to such recommendations as: a majority of non-executive directors is necessary; a lead independent director is useful; the chair and CEO should be separated; and separate committees for nominating directors, remuneration and audit functions. Has it made a difference?

3.3 Summary

In the last 15 years, corporate governance guidelines and regulations have emerged due, in part to the media focus on financial collapses; the focus on accountability in organizations; and the level of executive remuneration. A greater public awareness of famous collapses such as Enron (United States) and HIH (Australia) has led to the well-worn question 'Where was the board?'

In contrast to much previous literature which focuses on share market data and corporate governance using statistical analyses, this study will examine directors' views on some of the corporate governance guidelines and regulations that have emerged. The focus on this study is to obtain information on how directors perceive their roles based on their own personal experiences. This study attempts to address the 'relevance gap' between academic research and what the practitioners in the field are actually experiencing. This is an exploratory study as the objectives do not lend themselves to traditional hypothesis testing.

Chapter four discusses the methodology to be used to examine the research objectives of this exploratory study.

CHAPTER 4 METHODOLOGY

4.1 Introduction

This study is interested in examining directors' responses to the current interest in corporate governance, particularly on various issues relating to boards. There has been quite a considerable effort in previous research in analysing quantitative data. This researcher is interested in an approach which provides richer data in evaluating directors' views on corporate governance.

The academic corporate governance research examined in chapter 2 concentrates on the use of quantitative research methods. Generally the methods employed involve the analysis of financial data. This financial data is linked to variables such as board size and composition on the impact on share values and on directors' performance using regression or other statistical analysis. Other financial performance measures include the usual ratios such as return on shareholders' equity, return on assets, profit measures and share value. These types of measures typify the 'number' approach to corporate governance research. That is, there is no consideration given to issues that may not be so clearly identifiable such as the impact of boardroom dynamics and the interrelationships between the directors and managerial staff (Kakabadse et al. 2001).

Although the criticism of research in this area is that it concentrates on, for example, data base analysis of published sources, it is acknowledged that obtaining detailed workings of board processes and functions is difficult (Leblanc and Gillies 2005). This is also due to the problem of confidentiality of boardroom discussions. Thus the difficulty arises in dealing with such questions as 'How does the board actually work together to make a decision?'

In addressing some of these non-financial and non-quantitative issues, qualitative research methods were chosen due to the diversity and flexibility of the methods available. This chapter discusses the qualitative alternatives of data collection, the rationale for the method adopted and the data analysis procedure adopted.

4.2 Research strategy

Research philosophy can be broadly divided into three views (i.e. positivism, interpretivism and realism) depending on the researcher's philosophical thinking (Saunders et al. 2003)

4.2.1 Positivism

Researchers adopting the philosophy of positivism prefer 'working with an observable social reality and that the end product of such research can be law-like generalizations similar to those produced by the physical and natural scientists' (Remenyi et al. 1998 cited in Saunders et al. 2003, p.83). The researcher is detached from the data being collected and 'focuses on description, explanation and uncovering facts' (Ticehurst and Veal 1999, p.20). Positivism is associated with scientific, experimental, quantitative and deductive frameworks (Ticehurst and Veal 1999, p.20). Positivist researchers seek precise quantifiable observations thereby often using statistics and experiments to test their hypotheses (Neuman 1997, p.63).

Quantitative methods such as the analysis of financial data are often used to determine corporate financial performance in empirical studies. In corporate governance research, board composition measures such as the ratio of non-executive directors to board size is used in interpreting the impact of board composition to company performance. These performance measures may include return on assets, return on investment, profit margins and so forth.

4.2.2 Interpretivism

'Critics charge that positivism reduces people to numbers and that its concern with abstract laws or formulas is not relevant to the actual lives of real people' (Neuman 1997, p.63). Interpretivism, on the other hand, is based on the view that 'researchers study meaningful social action, not just the external or observable behaviour of people' (Neuman 1997, p.69). That is, the researcher attempts to 'capture the rich complexity of social situations' (Saunders et al. 2003, p.84). The interpretative approach attempts to understand the point of view from the subjects' perspective. The researcher 'interprets' the information provided based on the understanding of the situation and is therefore 'part of the research process' (Ticehurst and Veal 1999, p.20). Proponents of this philosophy argue that it is appropriate to adopt it in

business research due to the constant changes in our environment. Therefore, generalizations based on the positivist approach may not explain the uniqueness of particular situations. Interpretivism has a range of alternative names including hermeneutic, qualitative, phenomenological and inductive research (Ticehurst and Veal 1999, p.20).

There is a paucity of research on boards which uses qualitative approaches. This is recognized as a deficiency and more recent academic research is addressing this weakness (Leblanc and Gillies 2005). In analysing how boards and directors perform it has been suggested by Sonnenfeld (2004, p.114) that ‘the human dynamics of boards as social systems where leadership character, individual values, decision-making processes, conflict management, and strategic thinking,’ are important factors.

4.2.3 Realism

The third approach, realism, is also called dialectical materialism, class analysis and structuralism (Neuman 1997, p.73). Realism criticizes positivism for ‘failing to deal with the meanings of real people and their capacity to feel and think’ and the ‘interpretivism approach for being too subjective and relativist’ (Neuman 1997, p.74). Realism does adopt a ‘social reality’ like positivism but it focuses on change and conflict which may not always be apparent. It is based on beliefs, assumptions and moral values. A researcher needs ‘to understand history, adopt a set of values, and know where to look for underlying structure’ to interpret the facts (Neuman 1997, p.79).

There is limited information available as to how boards really work (Leblanc and Gillies 2005). Due to the confidential nature of meetings, it is rare for ‘outsiders’ to observe how a board operates. Observing directors ‘in action’ would facilitate in increasing our knowledge on how the decisions are made and the way the directors interact between themselves. However due to the difficulty of obtaining this access, the realism approach has only been used in limited case studies and therefore research tends to be on material that can be readily obtained from outside sources such as published reports and media releases (Leblanc and Gillies 2005).

4.2.4 Research approach adopted for this study

This research will adopt the interpretivist approach due to the complex social situations that exist in the board rooms. Clarke (1998) provided a summary of the main methodologies for research on boards of directors i.e. data base surveys, questionnaire surveys, interview surveys, and board room observation (Refer Table 4.1: Research Methodologies in Corporate Governance). Each method has its proponents. The two methods which are appropriate to an interpretivist approach are interviews and observations (Clark 1998). This research study will use interviews (refer 4.4).

Table 4.1: Research Methodologies in Corporate Governance

(Adapted from Clark 1998, p.58)

Methodologies (Research Approach)	Advantages	Disadvantages
1. Data Base Surveys based on analysis of published sources (Positivism)	<p>Broad sample, able to statistically analyze a large range of data.</p> <p>Can make generalizations from the data.</p>	<p>Focus on data readily available, may be ignoring data which may have an important impact on findings e.g. price sensitive information.</p> <p>Focus on visible issues such as directors' compensation and board membership.</p> <p>Cannot focus on internal board issues and as such ignores board processes.</p>
2. Questionnaire Surveys (Positivism)	<p>Descriptive of reality i.e. can be used to identify and describe variability in different phenomena.</p> <p>Can design the sample size, for example, depending on the characteristics of the respondents and the types of questions required to collect the data.</p> <p>Inferences about cause and effect i.e. can examine the relationships between variables.</p>	<p>Response bias thereby reducing the reliability of the data; for example if the participant has insufficient knowledge and therefore guesses an answer.</p> <p>Difficult to test causation i.e. the researcher needs to be clear about the relationships of the variables and that the measures used will enable comparisons to be made.</p>

Methodologies (Research Approach)	Advantages	Disadvantages
3. Interviews (Interpretivism)	<p>Respondents explain central relationships i.e. the interviewee is encouraged to discuss the issues important to them.</p> <p>Can explore issues interactively i.e. the researcher is able to direct the discussion.</p> <p>Can focus on decision dynamics and obtain information on how e.g. issues are discussed in the board room.</p>	<p>Access can be difficult due to the interviewees' time and reluctance to discuss issues 'publicly'.</p> <p>Can be costly and difficult to get access to large samples.</p> <p>The analysis of the data can also be difficult and time consuming due to the complexity and variations of data collected.</p>
4. Boardroom Observation (Interpretivism and realism)	<p>Relationships may be studied e.g. the relationship between the chairman and the other directors.</p> <p>Group dynamics may be observed e.g. the interaction between the board members.</p> <p>Decision making may be analyzed e.g. Does the chairman encourage discussion of the issues at hand?</p>	<p>Access may be impossible due to the confidentiality of meetings thereby exposing all parties to legal action.</p> <p>Directors may not be as candid or productive due to the presence of a third party.</p>

4.3 Deductive and inductive research approach

The deductive research process involves the development of a theory or hypothesis to test the hypothesis. The inductive approach is used when data is collected first, and a theory is developed as a result of the data analysis.

The deductive approach tends to be favoured more by positivist researchers than interpretivist (Ticehurst and Veal 1999, p.22). It is dominant in the natural sciences where research is carried out to explain causal relationships. The research approach uses 'a highly structured methodology' and collects data that 'can be measured quantitatively' (Saunders et al. 2003, p.86).

The inductive approach emerged due to the problems with rigid methodology of the deductive approach. The development of the social sciences required researchers to be able to understand the different ways people interpret their situation. This approach may be considered more appropriate for small sample studies using qualitative data gathering techniques (Saunders et al. 2003, p.88).

This research uses an inductive approach. It is an exploratory study. Previous research has been inconclusive due to the difficulty of developing hypotheses and thus gives no literature on which to base a testable hypotheses or research propositions. Thus the research questions (refer chapter 3) have been developed as ‘this format lends itself more to descriptive and inductive research, while the hypothesis format is more appropriate for explanatory and deductive research’ (Ticehurst and Veal 1999, p. 36)

4.4 Interviews

Qualitative data collection methods may include: surveys, individual interviews, group interviews or participant observation as detailed in Clark’s (1998) research methodologies above. Case studies, personal experiences, interviews, observations and visual text may be used to ‘describe routine and problematic moments and meanings in individuals’ lives’ (Denzin and Lincoln 1998, p.3). Interviews have been chosen for this study to enable the researcher to gain an insight from the directors’ personal perspectives as to the issues that affect and are affected by the current focus on corporate governance. The use of interviews is ‘based on the belief that the people personally involved in a particular situations are best placed to analyse and describe it in their own words’ (Ticehurst and Veal 1999, p.94). The purpose of the interview is to yield a variety of views from a relatively small group of directors.

There are different interview methods. Interviews are categorized as follows: structured, semi-structured and unstructured. Structured interviews are highly organized, based on predetermined and standardized questions. A formal questionnaire is used with an identical set of questions. A standardised form is also used to record the responses.

The semi-structured format enables the researcher to use questions that may be varied from interview to interview. The order and number of questions may be varied

according ‘to the flow of conversation’ and ‘the specific organizational context that is encountered in relation to the research topic’ (Saunders et al. 2003, p.246).

Unstructured interviews enable the researcher to explore an issue with more insight. These interviews are informal and enable in-depth explorations of a topic. That is, interviewees are encouraged to ‘speak by using open questions and by asking them to clarify their statements’ (McMurray, Pace and Scott 2004, p.200).

To conduct this research, semi-structured and in-depth interviews are used ‘to conduct exploratory discussions not only to reveal and understand the “what” and the “how” but also to place more emphasis on exploring the “why” ’ (Saunders et al. 2003, p.248). That is, there is an opportunity to probe and understand the meaning, attitudes, opinions and personal experiences. The semi-structured format was chosen to enable the interviewees to raise issues which may be of a particular interest to them. Thus, given that the respondents were from such a varied group it was considered useful to enable them to freely bring up issues that they felt were relevant.

The interview questions were prepared after reviewing the literature on corporate governance and directors’ roles. A number of informal discussions were held with colleagues both in academia and industry to obtain their views on the types of questions to be prepared. Colleagues in industry were also used to pilot test the interview questions to enable the researcher to practice her interview techniques and refine the questions. The final interview worksheet guide was used to enable the researcher to focus on particular areas of corporate governance.

Although a formal interview guide was used, the sequence of the questions was adapted depending on the responses. Questions were also included to further probe answers and explanations given by the subjects. In some cases prompting was thus used by the interviewer to encourage respondents to produce an answer (Gilbert 1994, p.140). Probing was also used by the researcher to obtain a fuller response. At the end of the interview, respondents were asked to mention any issues important to them that were not raised by the interviewer.

4.5 Selection of interviewees

4.5.1 Population

The population was defined as non-executive directors from various types of organizations. The only restriction to the sample was that the participant must be a current non-executive director in either a profit or non-for profit organization, listed or unlisted. The industry type or organization size was irrelevant for this research. In some cases the director was an executive in one organization and non-executive in another.

4.5.2 Sampling techniques and selection

It is impractical to survey the whole population, therefore a sample was selected. A number of different sampling techniques are available. Usually these techniques are classified as either probability or non-probability sampling.

Probability sampling uses a statistical random selection process to choose a representative sample. This sample selection process attempts to reduce bias. The conclusions (based on the statistical analysis of the data) are used to make generalizations about the total population. However the sample size also has an important impact on the findings. As a general rule the larger the sample size the lower the margin of error in the accuracy of the findings (Saunders et al. 2003, p.155). Neuman (1997 p. 222) also points out that a smaller sample can be accepted where less accuracy is required, or where the population is homogeneous or only a few variables are being considered. The conclusions made from the sample, from the statistical point of view are meant to be representative of the whole population. Probability sampling also requires an exhaustive listing of the population, which was not available for the population of directors in this research.

Non-probability sampling includes quota, purposive, snowball and convenience methods and techniques are based on subjective judgement. In these cases 'the validity and understanding that you will gain from your data will be more to do with your data collection and analysis skills than with the size of the sample' (Saunders et al. 2003, p. 171).

Quota sampling is often used in large populations for interview surveys. The population is defined into specific groups and a quota is calculated for each one. This technique is non-random, and therefore statistical analysis cannot be used in measuring certainty levels or margins of error.

Purposive or judgemental sampling involves selecting 'cases that will best enable you to answer your research question(s) and to meet your objective' (Saunders et al. 2003, p. 175). This technique is used when small samples of 'information - rich' cases or interviewees are selected. That is the sampling may focus on unusual cases, particular subgroups, diverse characteristics or typical cases which may be considered representative.

Snowball sampling is used to identify cases in a particular population. This involves making the initial contact and asking the interviewees to suggest others who may be interested in participating in the study. Thus a 'snowball' effect results as the list of potential interviewees increases. A biased sample results due to the possibility of a limited diversity of subjects as people tend to nominate others similar to them. (Saunders et al. 2003, p.176). Convenience sampling 'involves selecting haphazardly those cases that are easiest to obtain for your sample' (Saunders et al. 2003, p.177). This will also result in a biased sample, unless there is little variation in the population used.

This study uses a combination of convenience and snowball sampling. The researcher relied on her own contacts and those of colleagues to initially select potential participants (convenience sampling). Referrals (snowball sampling) were then requested from interviewees at the conclusion of the interview.

The objective of this research was to obtain in-depth information from a small sample of directors. The actual sample size is 11 participants. Kvale (1996, p.101) as cited in Taylor and Bogdan (1998, p.93) states that when asking "How many interview subjects do I need?" the answer is simply, "Interview as many subjects as necessary to find out what you need to know". The actual number of interviews/cases studied is relatively unimportant compared to the quality of the data obtained (Taylor and Bogdan 1998, p.93). Furthermore 'the rationale for choosing a small number of

interviews was justified by the fact that qualitative research, being exploratory and investigative in nature, generally involves a smaller sample than does quantitative research' (Miles and Hubermann 1994,p.67)

It is acknowledged that the sample does not claim to statistically represent the views of Australian directors. However the sample does have representation from not-for profit organizations, including government bodies; co-operatives, educational, health, and superannuation organizations; and for-profit organizations (including private, and public companies). The interviewees have varying years of experience in their roles as non-executive directors and varied types of experience (refer Table 5.1 Demographic Information).

4.6 Interview procedures

The initial interviews covered directors from both charitable organizations and SME's. As the data collection phase progressed the directors contacted had more experience in years and were also involved in public company boards. This meant that, as the researcher became more acquainted with the topics, she was able to obtain more extensive responses in the later interviews. Gilbert (1994, p.145) suggested that 'if you have a limited number of respondents it may be wise to interview those least likely to provide crucial data first'.

Interviewees were selected to gain a variety of opinions on the various topics. 'A common problem here is where respondents give those answers they anticipate the interviewer wants to hear' (Gilbert 1994, p.139). This was not considered 'a problem' here as the researcher emphasized that the interest was in the director's personal experiences with the boards he/she are or had been involved with. Furthermore the questions were of a general business nature, and did not probe into personal or awkward issues where the interviewee may feel comprised. There was no reference made to disclosing confidential information which would in any way identify the participant or the organization.

The initial contact was either a direct phone call or email to the potential participant. Where the referral came from interviewees, they themselves made the initial contact. In some cases (where the interviewee simply provided a name or the referral was from

a professional contact), the researcher made the initial contact herself. In such cases the potential interviewee was informed of the name of the person who had recommended them. An appointment of one hour duration was requested. The locations of the interviews were mostly at the director's place of work. The date of the appointments varied significantly from the date of the initial contact. In some cases the appointments were confirmed in a matter of days, and in other cases, several weeks after that initial contact.

The actual interview session on average was 45 minutes. Details of the research were fully explained to the participants. It was stressed that the interview was confidential. As required by the Swinburne University Ethics Code, all were given a formal letter confirming the purpose and details of the research and an agreement to sign. All agreed to the conditions, including having the interview taped.

An overall flow in conversation was maintained by audio taping the session. The researcher was thus able to fully concentrate on the interview at hand and to adapt the questions according to the responses given. At the completion of the interview, the directors were asked to nominate a potential interviewee who may have an interest in participating in this research. Most of the participants obliged in providing a name.

4.7 Data analysis methodology

The researcher used an interview guide worksheet when conducting the interview. As the interviews were being audio taped, major key points and/or unusual comments were only briefly noted down so as to not lose the flow of the conversation. The written points were a prompt to address or re-address issues depending on the comments made. Relying solely on these 'field notes' would have been considered 'low fidelity and low structure' (Rudestam and Newton 2001, p. 97), as it is possible to miss a point whilst concentrating on the note taking. The notes plus the audio recording enabled the researcher to go over both the transcriptions and the audio recording 'in a more methodical and complex manner' (Ticehurst and Veal 1999, p.101) in preparing the analysis.

The interviews were transcribed verbatim as opposed to selective transcriptions. This ensured that no data was lost, even though it was very time consuming. Upon

completion of the interviews the researcher was faced with many pages of transcripts and her own field notes. The next step was to present the data in a reduced and cohesive format. Each interview was given a code. As each transcription consisted of several pages of words, it was useful to 'remove' the irrelevant words. The remainder was sorted out in categories as determined by the questions and evaluated accordingly.

The difficulty for the initial data reduction was in summarizing the data based on set categories which were guided by the initial questions asked. However, depending on the interviewee the format did not always follow the 'structured' worksheet used by the researcher. This meant that information provided was not in the same format for each interviewee. This thus involved 'rearranging' the data so that all the 'answers' were summarized in the same order. The comments were searched for patterns for common words or phrases, and for common ideas and concepts. This enabled comparisons to be made between the interviews. Differences in comments were also noted. For example under the category of 'board size', the interviewee's comments could easily be compared by simply scanning across the sheet. This technique enabled the researcher to see at a glance where comments differed.

A further difficulty was that interviewees mentioned issues which were of particular interest to them. The advantage of this was that 'the data is generated from the individual's own framework and not from one that is imposed by the researcher' (Hussey and Hussey 1997, p. 255). However it was very time consuming to make sense of the differing comments. Further the comparing and contrasting the comments was not so clear cut. This meant some additional individual categories needed to be raised.

Each transcript was summarized into the categories based on the questions originally chosen. Based on these questions, headings were developed and the points were summarized under these headings. These were identified as the key variables. The summary focused the interviewees' responses on the particular interest areas covered by the research. This meant that all information provided was summarized in each case. In addition, this was further analysed to be able to determine as to how often the interviewees made reference to these categories. This avoided the problem of

omitting references which may be repetitive, but which were still important for the data analysis in highlighting the frequency of the comments.

The summary consisted of a matrix, using 'a visual format that presents information systematically, (so) the user can draw valid conclusions and take needed action' (Miles and Huberman 1994, p.91). Thus it was possible to make comparisons between the interviews. Key themes and relationships were identified from the matrix for the initial analysis and evaluation. Further interpretations were made and conclusions developed (Saunders et al. 2003, p.395)

In carrying out this analysis, it is necessary to consider data quality in respect to validity, bias and reliability. The validity 'refers to the extent to which the researcher gains access to their participants' knowledge and experience, and is able to infer a meaning that the participant intended from the language that was used by this person' (Saunders et al. 2003, p.253). This will depend on the researcher's approach in the interview. As the interviews were semi-structured, meanings were able to be probed with additional questions to clarify an answer. The summaries have been prepared according to the researcher's interpretation of the responses given. This involved formulating the meanings given into briefer statements, thus rephrasing in a few words (Kvale 1996, p.192). Gilbert (1994) suggested that the analysis of an interview is based on assumptions made by the researcher based on the language interpretation. Furthermore errors or bias arise from 'misdirected probing and prompting, ignoring the effects of interviewer characteristics and behaviour, neglecting the cultural context in which the researcher is located, and problems with question wording' (Gilbert,1994, p.148). However, even though these summaries were made they were not used to make generalizations about the entire population. As explained above, the sample of interviews was not representative and therefore such conclusions could not be made. In terms of the reliability of the data, since the research was based on a small sample and was non-standardised in the sense of the flexibility of the sample selection and questioning, it would be difficult to exactly replicate the results. The purpose of carrying out the research was to obtain the interviewees' personal perceptions, i.e. what they believed and thought was relevant in order to gain further insight into corporate governance practice. The results of this exploratory research

can be used to develop questions and hypothesis which can be tested in further research.

4.8 Summary

A qualitative approach was chosen in this thesis. This enabled the researcher to select a small sample of directors from varying business backgrounds to obtain their views on a number of theoretical issues raised in the literature review. By adopting a semi-structured approach, the researcher was able to lead the interview to cover specific areas of interest. Interviewees were also given the opportunity to include views on topics in which they had a particular interest, which the interviewer had not addressed. Using data reduction techniques of summarising and categorising, the interview transcripts were analysed to establish themes and meaning.

The results and analysis are covered in chapter five.

CHAPTER 5 RESULTS AND DISCUSSION

5.1 Introduction

This chapter details the results of interviews with directors in this exploratory research. The interviews were designed to elicit directors' perceptions of the issues discussed in chapter two and three. The interviews were designed to obtain in-depth information from a small sample of non-executive directors. The sample consisted of 11 participants, where each participant had to be a current non-executive director in any type or size organization. The sample does not claim statistically to represent the views of Australian directors. However there is representation from not-for-profit organizations, including government bodies, co-operatives, educational, health and superannuation organizations; and for-profit organizations including private and public companies, listed and unlisted.

The majority of the participants have over ten years experience in both for profit and not-for profit sectors. The sample also included three non-executive directors involved (or who have been involved) in large publicly listed companies such as ANZ Bank, Woolworths and Australian Unity.

All participants have not-for-profit, experience suggesting that some may use the not-for-profit board to gain experience to move to other sectors notably the for-profit. Some participants (the more experienced) indicated that they provided their expertise to these boards due to the lack of business direction and efficiency in some of these organizations and an interest in being involved in community work.

The sample was gender balanced. It is acknowledged that this sample is not representative of the population of non-executive directors. In addition, in this sample it was noted that the more experienced directors were 'older' males. Surveys carried out by Korn/Ferry (2005) indicate that the majority of directors (including non-executive) are predominantly 'older' (that is around 55 years of age and older) males.

The demographic summary of the interviewees is presented below.

Table 5.1 Demographic Information

	Description	Number
A. Gender	Male	6
	Female	5
B. Organization type	Not-for-profit (NFP)	5
	Profit & NFP	6
C. Experience as chair	NFP or Profit	5
D. Experience as non-executive director	Less/equal to 10 years	4
	Greater than 10 years	7

As discussed in chapter four, the interviews were audio taped and then transcribed. The transcriptions were then summarized according to the categories identified and presented in a matrix format. This was then used to ‘highlight the main concepts, themes, and issues from the interview’ (Stiles and Taylor 2002, p.29). The questions were chosen to focus participants’ answers to the researcher’s particular areas of interest. Some issues were raised by the respondents themselves, without any questions or prompting from the researcher, for example, multiple directorships, board information and trust. The issues identified are presented below.

5.2 Results

The data analysis procedure is explained in chapter four. The interview data resulted in a number of categories being developed. These categories were:

- Role of the board/director.
- Role of the chair.
- Executive and non-executive directors.
- Balanced board.
- Nomination of directors.
- Board dynamics.
- Multiple directorships.
- Board evaluation.
- Directors’ remuneration.

- Company performance.
- General issues

The detailed analysis of each category with the participants' responses is provided below. The interview questions are provided in Appendix 1. The participants' responses are given in *italics*.

5.3 Role of the board/directors

The role of directors and boards has come under more scrutiny in recent times. Schultz (2002, p.4) asks 'What has propelled boards onto centre stage?' Various answers include the globalisation of business, the changes in technology, the availability of information, the impact of institutional investors and demands from individual shareholders. The question of 'Where was the board?' has been asked in cases of recent corporate collapses such as HIH (Australia), Enron (USA) and Parmalat (Europe). Much discussion has taken place on what the role of the board and its members should be in light of these failures. This is very much a global issue, including a new focus on 'emerging economies' in Eastern Europe, Russia and China.

In reality, the definitions of the roles and the legal responsibilities have not changed. However, in light of current financial upheavals in the corporate world, there appears to be more awareness of potential legal actions. This is the case both in the popular press (for example the much published case of Williams and HIH) and in academia. Professional consultants have also sprung up offering advice and information on tackling 'corporate governance' requirements. For example, PriceWaterhouse Coopers in conjunction with CPA Australia have issued guidelines in their Corporate Governance Toolkit: for small and medium enterprises 2nd Edition. The kit 'focuses on the practical application of governance principles for small and medium enterprises and provides straightforward guidance' (CPA 2005, forward).

The legal duties were not addressed in detail in the interview as this was considered beyond the scope of this dissertation. This thesis focuses on directors' views of their roles (responses are given in *italics*) within the current legal framework, not on the framework itself. The only reference made to legal duties was that the legal duties of executive and non-executive directors, irrespective of the type of board are the same as outlined in the Corporations Act 2002 (Cwlth).

The respondents identified that the role of the board includes: setting strategic plans; monitoring and ratifying business plans; monitoring the performance of the organization; and selecting/dismissing the CEO. They noted that focus needed to be on high level issues such as market performance, risk management, profitability and organizational outcomes or performance. The emphasis is on a *'reviewer'* type role, to *'play the devil's advocate'* in questioning the CEO (and other executives); and *'to throw up other options'*. However this does not include getting involved with the day-to-day operations. These comments were consistent with the general duties of directors as discussed in the literature review (refer chapter two).

The board has a collective responsibility for the organization (Harper 2005). The directors are usually seen as 'stewards' of the company, mainly responsible to the shareholders. After all it is the shareholders who effectively elect the directors to manage the business on their behalf. The 'traditional view' is that the responsibility of the board is to maintain the share value for the owners. This is changing somewhat with other stakeholders such as creditors, employees and the community demanding more of companies. That is, it is no longer acceptable to just be concerned about shareholder wealth.

Corporate social responsibility (CSR) is now also creeping into the debate as to how far the directors' duties should extend. Two public inquiries (the Parliamentary Joint Committee on Corporations and Securities, and the Corporations and the Markets Advisory Committee - CAMAC) are currently examining issues such as: the extent to which directors need to consider other stakeholders besides shareholders; whether the law should require directors to consider other stakeholders; and whether some form of reporting would make companies more socially responsible (Beerworth 2005). This research did not address CSR specifically. However one of the respondents commented on directors being required to be aware of the impact of environmental issues when making decisions, especially in the case of mining companies. Another example given by the same respondent demonstrated how companies now have to factor environmental issues into their strategic and operational plans, and thus into board decisions. The concern was that directors' duties were being further extended, and the imposition of obligations was unrealistic due to time constraints and possible

lack of specialized knowledge, notably in the case of non-executive directors. The APRA regulations for the insurance industry require non-executive directors to sign off on governance standards which were considered *'unrealistic'* since the reliance was on management to provide the information. That is, the non-executive would need to get involved in the operational aspects of the business to be totally satisfied with the information provided.

The literature review indicates that ultimately it is the board's responsibility 'to ensure the company's continuing prosperity' (Harper 2005, p.7). Whilst improving and increasing shareholder value is seen as an important function for the board, arguments have also been put forward that a longer time period should be taken. According to Healey (2003a) and Cadbury (2002) decisions are often made so that the shareholder value in the short term is favourable, without taking into consideration the long time implications of certain decisions. This short-termism has resulted from the emphasis on the fixation of current share prices, and current profits. This impacts on the decisions that CEOs (and directors) make to achieve positive results during their tenure (which is often short term i.e. less than 5 years). However as companies exist in perpetuity, a longer term perspective is necessary which should take into account environmental and social impacts. This includes 'CSR' (discussed above); and 'Triple Bottom Line' reporting which advocates financial, social and environmental performance reports.

The participants agreed that the board needs to take and accept the ultimate responsibility for the performance of the organization; therefore the directors need to be *'informed, knowledgeable and satisfied with the system'*. Individual directors also need to ensure that they understand their responsibilities and actively participate in the board discussions by making a contribution based on their particular skills and experience. Directors were not expected to be familiar with the day to day operations. It was necessary to look at issues *'from a strategic and a monitoring and an over viewing process, and they're the skills you need, rather than knowing the ins and outs of every activity and operation that a company does'*. So *'an enquiring and diligent mind'* was needed. Directors were considered responsible for the company's performance; therefore it was essential that active participation of all members occurred in meetings. However one of the respondents pointed out this did not always

happen, as it depended on the director's particular skill base. This meant that there would be occasions when a particular director may have limited input at a meeting. An interesting point raised by one of the respondents was that a director (or the board) may be required to *'step'* into an executive role if the executives have been incapable of carrying out their duties. This was given as an example where decisions needed to be made at short notice and there was no other option because *'the executive dropped the ball'*. However, this was not a desirable situation for a director, apart from having no other option at short notice, and it is not really remunerated. Academic literature does not appear to address this situation i.e. where the directors take a 'more active' role because of extenuating circumstances. There has been some limited discussion on directors firing /replacing a CEO not performing to expectations. However, a director actually 'taking over' a role within an organization is inconsistent with the majority of literature examined.

Another respondent emphasised that a distinction needs to be made between small and large companies. In a larger company the management team tends to be well skilled. However in a small company, the level of expertise in all areas may not be there. Such companies will therefore seek expertise from their directors i.e. directors with those particular skills that the company's own management may be lacking are targeted. Companies seek *'a director that will cover an area of weakness . . . For example; it's common to seek a lawyer or a tax expert on their board because they simply can't afford to have it within the company. . . sometimes directors can provide a level of expertise quite cheaply* (in comparison to employing a consultant from one of the accounting/legal firms). This seems to blur the distinction between executive and non-executive directors. Non executive directors are by definition not part of management but in small companies they may act as if they are.

Typically the smaller company's director's fees would represent a greater portion of profit than for a much larger organization. The smaller companies thus need to have *'more value'* from its directors i.e. a greater input of expertise is expected. An interesting point raised was whether director's fees could be scaled according to profit or perhaps revenue levels. This suggests determining remuneration on a performance basis as for CEOs.

As the board is required to make decisions *'in the best interest of the organization'*, it is important for the board to be well informed. The provision of *'adequate'* information for board meetings was raised by several of the respondents. The information needed to be sufficiently detailed and clear. Due to time constraints, especially for the non-executive directors, the clear presentation of this information was paramount (refer chapter 2 for further discussion). The level of information will depend on the issue at hand, however the *'quality'* and not the *'quantity'* were stressed. This also led to a discussion on the timeliness of the reports. That is, the importance of having time to review complicated matters and documentation; and time to be able to obtain additional information that didn't *'bog down the organization with trivial requests'*.

It was also pointed out that directors cannot really claim that they were not informed, because *'it's their responsibility to be informed'*. That is if a director is not happy with the information provided, questions should be raised prior to or at the meeting. Access should be made available to executive officers to clarify any issues. Since responsibilities and potential liabilities have increased, directors need to ensure that their decisions are supported with documentation.

One respondent's view was that: *'I think the philosophy I have is the more you know, the better your contribution, and therefore I would assume that a good director would actually set out to be extremely well informed. That can take out a lot of time.'* Thus it was necessary for directors to be prepared to raise questions. *'Some of the most useful things are that are ever said at board meeting are highly intelligent questions. Why are we doing this? . . . I've seen good questions asked by directors lead to management sit there a bit sort of stunned.'*

5.3.1 Role of the Chair

According to Harper (2005, p.155) the role of the Chair includes:

- providing leadership to the board;
- taking responsibility for the board's structure;
- providing adequate information to the board;
- planning and conducting board meetings;
- prioritising and focusing key tasks;

- board/director evaluation
- overseeing the induction and development of directors;
- supporting the CEO

Respondents noted that the way in which the meeting is conducted by the chair has an impact on how the decisions are made. Some noted that the conduct of the meetings varies according to the specific circumstances. Sometimes this required a more authoritarian approach in conducting the meeting. For example, in a situation where a particular member may be dominating a meeting because of a particular issue that they want to pursue, the role of the chair is to ensure all views are heard and considered. Thus the skill of the Chairman was important to ensure: *'a smooth approach to the agenda, that all members participate, and that there is a good communication channel between himself/herself and the CEO'*.

A board should acquire 'a collective personality' (Harper 2005, p.146). However within a group of people, invariably personal agendas and personality conflicts can exist to 'deflect the board from its proper function' (Harper 2005, p.146). The respondents agreed that the board needs to be able to function as a group and that it is important for the chair to be able to steer the discussions to ensure that a decision is made. The skill of the Chair is to have an understanding of the personalities and their behaviour and *'be able to assess how other people are thinking'*. This also involves being able to reach a decision based on some sort of consensus given that many different (and opposing) views may be expressed during a meeting. Being able to resolve these conflicts involves a degree of collaboration and compromise. The Chair needs to be the facilitator and encourage discussion and discourage the pursuit of personal goals.

Some respondents mentioned that the Chair's role in inducting new directors and establishing a relationship with them is important. As non-executive directors have a limited involvement with the organization, e.g. relatively short time availability, an induction is essential to enable them to learn about the company. This was also consistent with the literature (for example, Harper 2005; Kiel and Nicholson 2003b).

5.4 Executive and non-executive directors

The majority of the respondents agreed that it was necessary to have a majority of non-executive directors on the board. This was now *'established wisdom'* in Australia. One respondent, whilst not formally disagreeing, felt that *'the jury could probably still remain out on that'*. Two of the respondents disagreed with the viewpoint that a majority of non-executive was preferable. It was *'nonsense about the importance of non-executive directors'* and; that it would not necessarily *'protect us from corporate crime by insisting on a certain proportion of non-executives'*. This view was also presented by another respondent. *'I don't think it's a big deal, I think those who try to make an issue whether you have or don't have executive directors, making an issue for the sake of writing an article when it doesn't really matter much'*. The quality of the individual was considered more important than whether they were an executive or non-executive director. For example, the director's skill, experience, and being part of an integrated team were important qualities.

Other respondents offered a range of advantages in having non-executive directors. Non-executive directors are independent of the organization, they have an independent viewpoint and are able to ask questions and probe further about an issue. They are also able to bring in experience from 'outside' the organization. It was also acknowledged that difficulties can arise because of the lack of detailed knowledge about the business. Hence *'the problem with independent directors is just that we're independent'*. However whilst it is not necessary to have all the knowledge and background, *'you want your fellow directors (to have) a willingness and a capacity for them to quickly try to get on top of the core business to a level, where you can develop a strategic approach'*. Therefore if the non-executive directors have some difficulties in understanding all the complexities of the business it is *'important for them to ask questions'*. Furthermore, by having a reasonable amount of knowledge and understanding about an organization, if the CEO raises certain issues they can be considered on reasonable grounds.

Respondents also acknowledged some other disadvantages associated with non-executive directors including: the lack of knowledge; the difficulties experienced in strategic planning (due to not being sufficiently knowledgeable about the

organization, the industry, etc); not getting involved in *'important'* decisions due to this lack of knowledge; too much time spent on compliance rather than leadership; micromanaging the business thereby leading to much frustration from management *'that the board is more concerned about minding the shop than growing the shop'*. These views were consistent with the discussion in the literature review.

This led to the question of 'Is there a difficulty in being an executive in one organization and a non-executive in another? The question was asked to determine whether a director who may be an executive in his/her own organization, had difficulties in not getting involved in the day-to-day operations of the organization for which he/she is a non-executive director. That is, not pursuing issues which were really for management to resolve. (A suggestion has been made in literature that directors need to learn to 'direct', and not continue 'managing' as they would in their roles as executives). Initially it may be difficult, however overall *'the separation of power between management and directors is not an issue'* as they were two separate roles in different organizations. The responses here were that in fact there were advantages in being in such a role, because as non-executive director with executive experience the person was aware of the type of issues that may arise. As an executive in another organization it *'enables you to better understand what the issues are from a management point of view and be able to monitor and review how management are undertaking their job'*. However a comment was expressed that if a former executive from the same company is appointed to the board as a non-executive director, it may be difficult to *'let go'*. (This may also be a behavioural and personality trait for example, in the same league as managers who have difficulty in delegating and end up completing the tasks themselves).

A CEO being involved as a director in other companies was considered a good idea *'to develop a sounding board for some of their ideas . . . to be able to identify parallels in another industry that might be able to bring back into their own'*. However this was in direct contrast to a comment that a particular director who is from another firm and comes in with a management perspective, and is actively involved in a number of boards doesn't necessarily *'make them a good director'*.

The role of Chair and CEO was also raised. The ‘acceptable’ thinking in Australia is that these roles should be separated, with the role of Chair being undertaken by a non-executive director to avoid a conflict of interest. Donaldson and Davies (1994) suggested that corporate performance would improve because of more independent decision making. However some of the respondents pointed out that this was not always the case. For example in the US, where the roles are combined, this combined role does work. The corporate scandals of Enron and WorldCom involved firms which did have a separation in roles; however this did not prevent their subsequent failures. Academic research does not conclusively support the view that splitting the role results in better performance (Daily and Dalton 1997, Sonnenfeld 2004).

Overall the interviewees’ remarks were consistent with the literature on the roles of executive and non-executive directors. There is a general consensus that a majority of non executive directors is necessary for an effective board. However, a couple of the respondents stated that whilst the regulators were advocating for a majority of non-executive directors, they did not necessarily support this view. A director’s skill and experience was considered more important. Thus the appointment of directors was sometimes based due on the skills lacking in an organization. This was especially the case in a smaller organization where directors were in a more advisory position such as providing specialist taxation knowledge.

The respondents acknowledged that an outsider can bring experience, knowledge and networks to the organization. Thus a non-executive should be appointed according to the skills required by the board i.e. to achieve ‘a balanced board’ (refer below for further discussion). In some organizations a non-executive may also be appointed because of the lack of experience and skills base available within the organization. This is more likely in a smaller firm, where current employees’ skills are lacking or simply the smaller firm cannot afford to employ all the specialists required.

5.5 Balanced boards

A ‘balanced’ board makes an effective board. A balanced board involves having a mix of skills and personalities to build a team that will debate the issues and challenge viewpoints to ensure decisions are made in the interest of the organization. Demb and Neubauer (1992) suggest that a board needs to be able to be able to make critical and

independent judgements. Therefore it needs to have ‘a depth of understanding about the company and the industry, a breadth of perspective that brings the larger context into focus, involvement with and commitment to the objectives of the company’s businesses, and a sense of detachment from any encumbering affiliation’ (1992, p.101).

‘Diversity is crucial to any board’. This statement aptly sums the respondents’ views on balanced boards. The necessary skills depended on the type of business/organization and its location. Desirable skills include industry experience, customer knowledge, technologically savvy, marketing, legal and financial competency, being politically connected (in the case of being reliant on grant monies); as well as a mix of gender, age, ethnicity and personalities.

Comments were made that boards did not necessarily have that diversity as board members were still predominantly middle-aged, Anglo-Saxon white males. The Korn/Ferry International and Egan Study (2005) confirmed that the majority (90%) of directors were male and that the average age of all non-executive directors was 59. Gender and ethnicity diversity was an issue. Different perspectives can be obtained by having members belonging to different demographics. For example, *‘if business interests are in Asia or in Europe; (you) need to have people with the necessary experience in being able to deal with these cultures as the way things are done in one place doesn’t necessarily work in another’.*

Personal qualities such as integrity, professional credibility and interpersonal skills are also considered important. One respondent also included having *‘wisdom, judgement and public respect’.* *‘I don’t think you can really have a board led by people who don’t have public respect, they need to have the dignity that ensures that they are looked upon with respect by the community the company/organization serves.’*

The respondents’ views were in agreement with the literature on the importance of having a variety of skills, personalities and backgrounds on a board. However it was also acknowledged that this was not always the case in practice especially with respect to gender, ethnicity and age of board members.

5.6 Nomination of directors

The literature suggests that the nomination of directors needs to be done professionally (refer chapter two). However the manner by which directors are nominated does not always follow an objective selection process. Whilst the respondents agreed that a professional approach was needed, it was also recognized that it was not so easy to implement at times. There is a difficulty in finding the 'right' person for the role. *'Board members are not easy to find in my experience'*. This was more apparent in not-for-profit organizations due to the voluntary nature of the role. Directors volunteered their time and effort because of their personal interest in a particular organization. In the case where members of an organization (for example, a University Superannuation Fund) were eligible to be on the board, the nomination process was again restrictive.

Directors are sourced from different means such as advertisements (often the case for government boards); registers (e.g. CPA Directors Register or the AICD Register); using head-hunters; as well as from existing director networks. Companies are increasingly using head hunting firms. The advantage here is that they can identify potential members from a wider base giving *'you comfort that you've looked at the field'*. A criticism of these recruitment firms is that they *'adopt the same practices (as the companies themselves because they are made up of much the same type of people); so it's just transferring the same issue into a different forum and is not really being open, and recruiting on a skills basis. So the company can now say they've employed a head hunting firm, but nothing's really changed'*.

Director networks are sometimes more successful in recruiting a new director because of an existing relationship. That is, that person is known to someone and personal recommendations are still important in the smooth operation of the board (refer to discussion above). Respondents varied in their views on the 'old boys networks' (and 'old girls' networks). Where directors drive the appointing process and are too close personally then the process becomes a *'closed circle and it becomes almost self-fulfilling in its own way'*. A comment was made that it therefore led to situations that directors were reluctant to challenge each other, but did challenge management. *'As long as boards do not take diversity and their nomination process seriously, then I think that risk will remain, the risk of failure of the director's role remains a very*

serious risk for organizations whilst you have the good “old boys” sitting around the table’. A positive comment on the other hand was that there is ‘nothing wrong with the saying “old boys’ club” . . . because what you need most around the board table is trust and confidence in your fellow director and we tend to get that from people we know, and we’ve worked with’. In some cases directors may be chosen because of their ‘name’ i.e. ‘we need people who are all well networked’.

In general, the respondents agreed that a wide range of skills (refer discussion above ‘balanced boards’) and backgrounds should be considered. *‘You should actually have a sort of map of what you have already got on the board and then look to see what you’re light on and then go out to all those different channels and find someone who’s a good fit with that’.*

In practice, it is not an easy task to nominate directors. Whilst consultants are used, these are not always successful and hence personal networks are still an important source. This has both positive and negative implications. On the positive side, the person is known, but on the other hand achieving a ‘balanced board’ through diversity of perhaps personalities and backgrounds may not be achieved.

5.7 Board dynamics

The role of the chairman is important in board dynamics. (Refer also to the discussion above on the directors’ roles above). Individual personalities may be overbearing with a particular issue that they may wish to pursue, that is they have a ‘bee in their bonnet’ about something. The chair needs to be able to diffuse this, and ensure that the discussions stay ‘on track’ and that everyone is given an opportunity to make a comment.

Participants stressed that the dynamics by which boards operate can be clearly linked to the board selection process. An organization needs *‘ a mix and it’s very, very hard to make sure you’ve actually got the matrix of skills and experience, as well as **personalities**, somebody to reflect the markets you want, where you currently trade or want to trade’.* Obtaining this balance is not always easy especially in organizations where members are eligible to serve as directors. The *‘old practice has been that boards like to take on people that they feel comfortable with, that are to a similar style*

to them'. However whilst we *'don't want a bunch of clones, we do need a group that can work together'*. So while there may be different views, the board needs to be able to discuss these and get a resolution. In addition to a diversity of skills, a balance of personality types is important. Directors need to be *'questioning'* people, as well as a mix of introverts and extroverts.

Board size also has an impact on the dynamics of the board. The behavioural characteristics of a group do change with the changes in numbers as well as the personalities involved (Demb and Neubauer 1992; Van den Berghe and Levrau 2004). It is considered difficult to prescribe the size of the board. Most respondents initially responded with *'depends on the organization'*. However when asked for a 'number' then the response was along the lines of *'large numbers makes the discussion unwieldy'*; *'seems to work better when a few people are away'*; and *'if it's too big you get too many silent people'*, *'so they feel obliged to say something for the sake of saying something'*.

Comments as to the actual number of directors ranged mostly from 6 to 10. It's *'easier to engage a smaller group of 8-10 people than it is if you had 24 people'*. *'The smaller the board the more content I am, because the smaller the group the more effective it is. If it's too big people cannot participate and it's just distracting'*.

One respondent did not consider a large number of directors to be an impediment; rather it *'reflects the diversity of the business'*. Furthermore *'if you have a lot of board members, you get all your papers out early . . . ask questions . . . (then the) board meetings themselves become a rubber stamping exercise because the papers have been read, the issues have been addressed outside the board meeting'*. This comment does raise further questions as to the board processes and what can be settled outside the board meeting and what should be brought to the board's attention.

The general consensus was that a smaller number of members yielded a better forum for discussion. A large group could be an impediment to discussion by the time everyone had their say. Or alternatively, members may simply make comments for the sake of saying something thereby 'wasting' time on irrelevant points. Thus the group dynamics were affected by the size of the board.

5.8 Multiple directorships

The number of directorships undertaken by an individual depends on a number of factors e.g. the size of the organization, the role undertaken (director or chairman), and the person's current obligations and responsibilities to their employer and business. The respondents agreed generally that the actual number does need to be limited as it is *'not possible to do a proper job'*. However this limit was difficult to quantify. *'The difficulty about it is that companies are never consistent'*. Directors need to allow extra time for sensitive issues and crisis. These limits should be *'self-imposed'*, depending on the individual's commitments and not legislated. Furthermore, *'added complexities and burden means having 4 or 5 chairman's roles as in the past is not so easy to accomplish given that there is a lot more work involved in being a Chair compared to just being a director'*. Other similar comments included:

'You need to put in a lot of time on actual issues'.

'You need to put in a huge amount of time in understanding the customers, the industry, the future, the trends, and you can't do that if you've got 6 to 8 boards'.

'There are quite a number of professional directors in Australia who've got too many board commitments'.

'They're not paying enough attention to what's going on in their own companies'.

'With the additional burdens that are being placed on directors, I don't think I could now do as many boards as I did ten years ago'.

Overall it appears that directors contributing properly to their duties will self limit the number of boards. The amount of time that is required to prepare for a board also varies from individual to individual. It was considered unrealistic to legislate solely on the number of boards involved, as being a member of for example, a small family company may not necessarily involve the same commitment as for a large public company.

5.9 Board evaluation

The comments on evaluation of the board's performance arose with some of the respondents following a discussion on company performance. Accountability and

measurement of achievements is important and therefore some sort of board evaluation was necessary. *'These days there's more tendency for boards to have some sort of review processes'*. Annual reviews are considered important, either an individual review of each director or a review of the board as a whole. However there are difficulties in individual evaluations. Other difficulties include developing and deciding on the performance measures to be used, and deciding who should carry out the evaluation e.g. the Chair, fellow directors or an outside consultant. Since perceptions of performance differ, different conclusions may be reached depending on the assessment tool and the evaluator.

It appears that even when a board evaluation process points to a problem; the problem resolution is itself problematic. For example; a difficulty may exist in *'getting rid of directors who have outlived their useful life'*. The problem here is that the other board members may not want to offend anybody so *'there's unwillingness . . . to confront one of their own, because the fear is maybe one day they'll confront me, and so if I don't confront them, they won't confront me'*.

The evaluation process is also useful in identifying areas that a new or even an existing director may need further information in the form of 'training'. This process of learning about the business is especially important for a new director. Formal induction courses need to consider the time factor involved. Whilst in theory it is good, in practice with busy schedules and demands of other work commitments it is not always easy to arrange. Given that the individual selected is considered to be skilled in some areas required by the board, he/she should be able to acquire knowledge about the board and the organization fairly quickly. One respondent stressed that directors were expected to have a certain level of skills and experience, and therefore:

'I wouldn't call it training because I'd like think that they have had their training before they got here. . . I think this area of training is a little bit tired in the perspective that some people, particularly bureaucrats have, that everything will be better if everybody is more knowledgeable and they all produce their reports. . . . if you just follow these prescriptions, the sort of person you need as a director, you will eliminate 90 % of the people who have got what it really take to make a difference to the company . . . and the only

people who qualify are those that have never taken a risk in their lives, never had anything wrong, and you finish with a bunch of bureaucratic types sitting around the room, who meet all the prerequisite requirements, none of which actually demonstrate a track record of success in anything’.

The process of evaluation for boards, directors and CEOs is receiving increasing attention due to ‘legal, market and societal pressures’ (Kiel et al. 2005, p.3). The respondents agreed overall that reviews were useful; however there were difficulties in setting out the appropriate protocols on individual assessments. Evaluation processes are used to assist directors in enhancing their performance. Overall the participants considered it important to attend an induction course; however the attendance of training courses for directors had mixed responses.

5.10 Directors’ remuneration

Two aspects of directors’ remuneration were considered. Firstly, respondents considered whether remuneration levels are ‘adequate’; and secondly whether the level of remuneration has an impact on the director’s commitment to their role.

In the for-profit sector, the level of remuneration should reflect the responsibility levels depending on the size and complexity of the organization. A large listed company will be quite different from small unlisted company. Both will be different from a not-for-profit organization. Thus comments provided included: *‘you get what you pay for’* and *‘remuneration is a factor and you can’t expect highly qualified, highly experienced directors if you are not paying them’*. One of the respondents considered directors to be *‘gravely underpaid’* given the increase in legal responsibilities, the length of time required for the preparation and attendance of meetings, and requirements for non-executive directors to sign-off reports for regulators. This increased level of burden, and the perceived increase in likelihood of being sued were deterrents for some in taking up directorships. A professional non-executive director with a good track record would expect and can *‘extract significant fees’*. Therefore if the board is targeting someone like this, they will expect to remunerate the potential director to reflect *‘the risks and liability attaching to directorships’* as well their experience. One of the respondents pointed out that there

were inconsistencies in remuneration levels with level of responsibilities that non-executive directors were expected to carry out. The directors' *pay by comparison to chief executives is ridiculous and if I look at the time involved, the responsibility and risk, directors should be paid a fair bit more*'. These comments are consistent with the Korn/Ferry and Egan Study (2005) which found that there was a gap in fees between executives and non-executive directors.

In the case of not-for-profit organizations, directors may join the board because of a '*passion*' they have for '*giving something back to the community*'. Another reason for joining occurs if someone is interested in building up a portfolio of experience. Being a director of a non-profit organization may be a starting point (refer Table 5.1) Thus the level of remuneration is irrelevant if the aim is to either satisfy a '*passion*' or gain some experience.

One interesting comment related to the public sector and not-for-profit boards was that by providing some remuneration there is an incentive for directors to continue in their roles. This may be the case even if the remuneration is small e.g. a small director's allowance to cover expenses and reimbursements to attend a company director's course this '*may be one of the reasons why it is difficult to get rid of a couple of them!*' This should not imply that no remuneration be paid, rather that directors be elected for specific terms, with a limit on the number of consecutive terms if it is perceived that directors remain on boards for excessive periods.

Some respondents suggested the level of a director's commitment and dedication should not be impacted by remuneration. However whilst this may be the case for not-for profit organizations, the professional director's expectation is that the fees be commensurate with the expertise demanded of the position.

5.11 Company performance

A number of studies have been carried out attempting to link company performance with such variables as board independence (for example, Guy, Nicholson and Kiel 2004; Bhagat and Black 2002; Lawrence and Stapledon 1999). Most studies reviewed deal with for-profit organizations and use the usual performance indicators such as share value, profit margins and return on investment. The regulatory changes (such

as the ASX Corporate Governance Council 2003, ‘Principles of Good Corporate Governance and Best Practice Recommendations’) covering for example, composition of boards, the use of committees, and increased disclosures were introduced to improve (in theory) governance and thereby improve company performance. These principles focus on the boards of directors. It is the directors’ responsibility to run the company however, ‘*companies don’t succeed or fail simply because of the directors*’. One of the respondents provided the following paragraph:

‘ . . . If a company does really well it will never be exclusively due to a manager or exclusively due to a board, because the two work in parallel or at least in sync . . . If the management are capable, the board can guide or modify management or change management but the board will never drive high quality performance itself . . . But the board could stuff up, the board could refuse to give approval. . . to provide the resources that are needed for management do this great job they’re wanting to do. Then the board can be a distinct drag on performance, just as management can be a drag, so the two have got to recognize their partnership and a contribution from each makes for operation performance’.

Thus a company’s performance is due to a number of factors. This was seen as depending on strategies implemented, having the right systems (and people) in place, the business structure, as well as external factors such as actions of suppliers, competitors and government. A clear policy was also seen as important and thus the decisions made will ‘*fashion the direction that the organization follows*’. A board needs to grasp opportunities: ‘*Visionary directors identify market opportunities, or weaknesses or issues or change requirements and do so with good timing*’.

The impact of directors’ decisions on company performance can be ‘*devastating and significant*’. These decisions are dependent on what information is brought to the board and how that information is presented. Inconsistent and incomplete information leads to ‘*unproductive meetings where you spend your time actually arguing about the trees rather than the wood*’. Directors should also be prepared to ask the challenging questions and request any additional information considered necessary. The relationship between the board and management also had an impact, since

directors are relying on the information presented to them. So probing questions needed to be asked to *'test the quality of your management as well'*.

5.12 General issues

There is a higher expectation of directors following high profile corporate collapses and the jailing and fining of company directors (for example, Rodney Adler - FAI/HH; Steve Vizard – Telstra and his own private companies). People are becoming more aware of the governance issues and directors' responsibilities due to the improvements in communication and technological advancements. However there were some comments about the relationship between good governance and the level of regulations that need to be followed. More regulation does not necessarily mean better governance. The current focus of governance is perceived to have led to an increased emphasis on compliance: *'ticking the box,'* to meet ASX corporate governance requirements without really following up the issues. A number of comments that reflected this included:

'A compliance culture can be a focus on statutory performance only and not on market risk and opportunities and strategic issues where you tick boxes and you take the ASX guidelines . . . you miss opportunities'. And a further comment on compliance: *'the pendulum has swung too far that way and we'd probably need to balance that out a little bit more'*.

'There is a danger of being distracted from running the business because we are too busy dotting the i's and crossing the t's'.

'Limited time spent on how the company was actually operating.'

'Regulators have imposed heaps more requirements. The courts are imposing additional requirements on directors (and) expecting higher levels of risk'.

'Legislatures are carrying laws that require the directors to be liable for a whole range of things which I think it's fairly difficult to expect them to be liable for'.

An interesting comment was made that being a regulation-based business culture *'clever lawyers'* are used to get around regulations. *'Principles actually require a higher level of morality and ethics to get around that'*. This respondent suggested that

a culture based on principles would be preferred as there is a greater sense of accountability. However this accountability requires changes in attitudes and behaviours of management and directors (Cornelius and Kogut 2003). Principles have been used to provide guidelines and recommendations on corporate governance, and are not always legally binding.

Some respondents felt that the ‘governance debate’ really has not made a significant difference to how their board is operating. They nominated, such recommendations as having better control over management, establishing committees (nomination, remuneration and audit), increasing the number of independent directors and the establishment of ‘good’ governance practices. A number of those issues were already being addressed and followed by the board. *‘It’s a lot of common sense at the end of the day’.*

Others felt that the impact of the corporate governance focus has been to introduce a fear factor, where potential directors are reluctant to join boards due to the fear of litigation. The concerns here were that directors were being expected to discharge their duties beyond the interests of shareholders. Another issue of concern was that directors’ reputations are at stake:

‘You need to be aware of the sort of board you may want to be associated with’.

‘I know of directors who are comfortably off, people that have retired recently. However they won’t take board positions because they think they will be the bunnies who will get sued; and they’re not prepared to put their lives and works at risk, and their reputation. And yet these people have probably great skills. One of the consequences can be that the only people who take on director’s roles are those who don’t have any assets (as they have) little to lose and are desperate for a job’.

Thus it may be difficult to fill director’s positions. The most suitably qualified individuals are no longer readily available to take up director’s roles. In addition to this, there was some concern about the level of remuneration provided given the increased perceived risks as discussed above. Furthermore, *‘if there is a fear factor and they are trying to look under every rock, they’re thinking that they have to be the*

manager as well. They're forced into a management function rather than overseeing the company as a whole'.

A contrasting view was that 'the fear factor in people getting involved in directorships is over-inflated. I think it's important that you have acted with integrity and for protection you can document you've acted with integrity and that's what the governance stuff is'.

A number of respondents mentioned the importance of trust. The trust factor was important in the relationship between directors themselves, as well as between directors and management. As the non-executive directors were dependent upon management (and the executive directors) for information it was important to be able to rely on that information. *'Need to have the confidence in the executives, that you are getting the information that is required'*. This also again raises the issues of whether directors are being expected to take on more responsibility, and become more involved in the management function. Trust was also important between fellow directors in situations where the board relied on one of its committee. For example, *'If you are not on the audit committee you have to trust implicitly that your colleagues are doing the right thing because if they go down, they'll take you with them'*.

Directors are also concerned with the amount of compliance that is required i.e. the 'ticking of the boxes'. This is seen as consuming a lot of time and not allowing the directors to concentrate on actually overseeing the running of the business and improving the company's performance. Further concepts such as the separation of the chair and CEO roles, and the increased director independence improving company performance were not seen as major issues. Corporate governance practices advocate a greater role for non-executive directors on boards; however it was pointed out that the ability and skill of the person were perhaps more important.

5.13 Summary

The extensive data obtained from the transcripts has been summarized and presented above. The data provided a range of personal opinions based on the director's experiences on a number of issues. The results indicate a number of concerns that directors have with their roles. A major concern is the increased expectation that

directors are becoming involved more in the management of the company. This is in contrast to the academic literature which clearly emphasis the development of strategy, the monitoring of management and the advisory role.

In the next chapter the results presented are further analysed and conclusions developed.

CHAPTER 6 CONCLUSIONS

6.1 Introduction

This research was motivated by board level management and direction of companies attracting much attention in business circles. This has been brought about in part by the failure of a number of well known companies, the remuneration debate especially in regards to outgoing executives in times of poor company performance, the growing concerns about accountability and transparency, and investors' concern over their investment returns (especially with the increase of institutional investors representing large holdings of client's superannuation funds).

This increased attention on accountability and transparency has led to a number of countries issuing corporate governance regulations. Some of these are enacted in law for example, in the US the Sarbanes Oxley Act 2002. In Australia, the ASX Corporate Governance Principles 2003 require an explanation if the recommended principles are not being followed, and similar non-legal requirements exist in some other jurisdictions.

These corporate governance guidelines tend to concentrate on such issues as board structures and composition, the number of non-executive directors, the use of committees, especially audit and risk management, nomination and remuneration, and the number of meetings attended by directors. These are used to reach a conclusion that if these guidelines have been followed, then good governance has also been achieved.

However, there is now some questioning in relation to how these guidelines and regulations actually aid the corporate governance issue. Extensive research studies have been carried out examining the relationships of various variables to company performance. Researchers have attempted to find some sort of link via statistical analysis such as regression analysis, Tobin's Q and other formulae between, for example, the number of independent directors and company performance. The criticism of these studies is that the way these studies have been conducted has not yielded definitive results.

More recently researchers such as Leblanc and Gillies (2005) have examined qualitative issues that may impact on the way a board makes its decisions. Behavioural concepts normally rest with the social sciences. However it is being recognized that board dynamics and behaviour have an impact on board decisions and should be examined in a business context.

Given the paucity of qualitative research, this exploratory research examines the views that directors have on their roles and on some of the governance issues. A number of interesting viewpoints, not always in agreement with current conventional wisdom, or the current academic literature have emerged. These are discussed below. The categories were developed from the results of the interviews detailed in chapter five 'Results and discussion'.

6.2. Role of the board/directors/chair

The general consensus is that the role of the board is to set strategic plans, monitor and review the performance of the organization, and appoint/dismiss the chief executive officer. Further, the board meetings need to focus on such issues as performance and risk management, not day-to-day or operational matters. From a legal viewpoint, all directors have the same responsibilities.

However a few of the respondents gave examples of where this role is not so clearly defined. The boundaries are shifting depending on the circumstances. In fact, depending on such variables as the company structure, size and business environment, that involvement can be much deeper. For example if the business is in the start-up phase, and certain expertise is needed which is possessed by one of the directors, then that director takes a more active role. A distinction also needs to be highlighted between small and large companies. In a smaller company, the level of expertise required for complex issues may not exist. Management experience may also be lacking in start-up businesses such as venture capital and private equity boards where directors become part of the decision-making team (Carter and Lorsch 2004). These smaller companies may not have the resources to employ a full-time executive or a consultant. Hence the director's capabilities may also be used to extend his/her role to operational issues such as tax consulting. In a larger company, where the

management team has more members, and tends to be more highly skilled, this role becomes more advisory. These results for different types of smaller companies need further research. If they hold true for large numbers of small companies then current thinking on the role of directors needs to be changed to reflect the lack of separation between directors and management.

Another interesting point raised was that the extent of the directors' involvement also depends on the CEOs behaviour. Some CEOs actively seek a greater involvement from the board, by allowing/encouraging directors to ask management for information. In such instances, the CEO may choose not to follow the advice, although valuable insights can be gained by discussing a different approach. Other CEOs feel threatened if directors are seen as becoming too involved. The CEO may feel that he/she is losing control. This is a power and control issue. This indicates that directors may need assistance managing the board/CEO relationship. Further research is needed in examining the impact of behavioural and personality types, and the relationships between CEOs and directors.

All the respondents agreed that the role of the Chair is very important as it is the link between management and the board. That role includes providing leadership to the board, being able to conduct effective meetings, board evaluation and supporting the CEO. It was also noted that an authoritarian Chair can destabilise the board (and management). This is an issue not currently raised in the literature. Further research is needed to analyse the relationships between the chair and the rest of the board. It may result in the development of protocols to assist board chairs in working well with the rest of the board and management.

6.3 Executive and non-executive directors

In the literature it is generally considered important to have a majority of non-executive directors on the board. Non-executives are considered to be independent of the executives and therefore are able to monitor management's role. This stems from agency theory that managements are in conflict with shareholders' interests and will make decisions which best serve their own purposes.

A few of the respondents either disagreed or were not totally convinced that a majority of non-executive directors is preferable. Comments were made on the lack of conclusive research. That is, it was not clear if company performance is improved by having a majority of non-executive directors. The quality of the individual's skills, experience and being part of a team is considered more important. Further research would clarify what board composition is optimal in various circumstances and whether better decisions are made as a result of various mixes of executive and non-executive directors.

6.4 Balanced boards

A mix of skills and personalities is considered necessary for a balanced board. However, achieving diversity is not always possible with respect to gender, ethnicity and age. A diversity of skills can be built up by seeking directors from appropriate backgrounds, in for example, accounting and marketing. However, for example, the behaviour of a professional expert on the board may not always be consistent with his/her training and expected skill set. The role can change people's behaviour. An example was given where an accountant turns out to be a good strategist in addition to finance skills. The additional skill set in this case is positive. However, it is also possible that the technical operating skills brought to the board by some directors may not be transferable to the strategic environment and decision-making context of the board. Thus the matching of the skills criteria to a potential candidate may not be so straightforward.

Personality styles are a factor; mavericks who are not afraid to question are important in promoting a lively discussion. Directors also need to have respect for other board members' views. Clearly, there is a need for further balance here, between constructive questioning and criticism on one hand, and respecting and learning from opposing views on the other. Technical skills from various backgrounds are not sufficient; strong interpersonal skills play a role in creating a balanced board. This issue is further discussed in section 6.6.

6.5 Nomination of directors

The nomination of directors appears to be following a more professional approach by using the services of external consultants and head hunters. Even though a potential

candidate may have been identified by the board, it is a useful exercise to compare that candidate to those selected by the consultants. Director networks are still considered important in sourcing potential candidates. This is in part due to the fact that personal recommendations are still important, although it perpetuates the 'old boys' club'.

The potential problem identified here is that more professionalism is needed in directors. That is, directors must be much more aware of directors' legal and other obligations in the current environment. 'The old boys' club' mentality of choosing potential directors from personal networks may result in directors not necessarily being up to date. Even with the use of a 'Nomination Committee' as recommended by the ASX Principles (2003), the nomination process may be dominated by personal connections. Membership of the 'old boys' club' should not be the criterion (Leblanc and Gillies 2005). The difficulty is in keeping the nomination process transparent.

The nomination process is sometimes more difficult in the case for not-for-profit organizations. The difficulty is in finding potential directors with expertise/skills in business. As these are voluntary positions the 'passion' is not always matched by the business acumen. However, the need for competent directors is often even more compelling for not-for-profit organizations, whose lack of funds may result in less experienced managers. Such managers would need strong board support.

A number of respondents discussed the difficulty of finding suitable candidates. Two major reasons emerged. Firstly the remuneration levels are not attractive, especially since directors' responsibilities are being more closely scrutinised. Secondly there is a 'fear factor'. The expectations of directors have increased and there is a greater risk of being sued. Thus potential directors who are currently senior executives are re-examining their positions. It takes a long time to build up a successful profile; however it doesn't take long for it to fall into tatters. People want to protect their reputations and will do a much more thorough due diligence on the company before accepting a directorship.

The behaviour and personality of individuals also need to be investigated when considering potential boardroom candidates. Whilst most respondents concentrated

on having a mix of skills such as accounting, law, marketing etc, behavioural patterns also needed to be observed as further discussed in sections 6.4 and 6.6.

Overall finding suitable candidates who are now prepared to serve as directors is becoming more difficult. Further research could investigate how directors could be identified and induced to serve on boards. For example, would training (for example AICD courses) or a legislated reduction in liability of directors acting in good faith create more opportunities?

6.6 Board dynamics

The dynamics of board behaviour has an impact on the decision making process. It is recognized that in addition to the practical skills and experience a person may have, their contribution is also dictated by their personality type. The study concentrated mostly on the types of technical skills that a board should have. However some respondents emphasised that personality or interpersonal skills is perhaps more of an important issue. One of the respondents with extensive experience both in for-profit and not-for profit organizations, including a variety of roles as senior executive, non-executive director and chairman, felt that we should not ‘pigeon-hole’ people according to their job/skills classification.

A smaller board was generally considered more workable than a larger group. A better relationship was able to be established between the members and the flow of conversation was overall considered to be more fruitful.

It may be necessary to reduce the dominance of a particular individual and give everyone an opportunity to make a comment. However, a ‘dominant’ discussant should not be automatically silenced. It depends on the topic. This may be an area where that individual is highly qualified, experienced and interested. He/she can pursue the topic in much more detail than the others due to his/her superior knowledge. Therefore, it is unrealistic to expect everyone to participate equally all the time.

Boards need to be cohesive but cohesion may result in ‘group think’. There is a tension between cohesion, and questioning and challenging decisions. The research

by Leblanc and Gillies (2005) indicates that dynamics may be a more powerful influence on board decisions than is currently recognized in the debate on corporate governance.

A board is made up of a 'small' number of people. The way in which the board operates will depend on the personal interrelationships of the members. Directors' competencies in their professional/technical field and independence can be readily determined. However for a board to be effective and be able to make decisions the directors need to be able to work together. This means that there is a need for interpersonal skills such as being able to work in a group and respecting each other views. The behavioural characteristics of directors have not been extensively researched to-date. Such research could prove fruitful in suggesting how boards could improve their performance.

6.7 Multiple directorships

A number of the directors commented on the recent media discussions on imposing limits on the number of directorships held by one person.. Establishing limits on directorships is not considered necessary. Limits depend on the size and type of company, as well as the individual's personal commitments. A 'one limit fits all' regulation would be unlikely to improve boards.

Overall the views were that directors themselves will monitor their own workloads. Those who had been directors for several years commented on the fact that they themselves would not take on as many directorships as they would have in the past. The reasons given were that more time outside the boardroom is required in preparing for meetings and there are more compliance issues with a wider range of responsibilities.

"Too Many directorships?" a study conducted by Competitive Dynamics and the AICD (2005) indicates that Australia has a low incidence of multiple directorships. The Study surveyed 656 directors across ASX Top 100 listed companies. Its findings were consistent with the comments made by the directors above, indicating that rules alone do not 'fix' corporate governance. Directors need to recognize their own skills and experience enough to self-limit the number of directorships.

6.8 Board evaluation

In general board evaluations were considered useful in identifying areas that the board needs to improve. The process of carrying out that evaluation varies. For example, the use of an external consultant as a facilitator is in many cases considered to be appropriate, but other boards simply self-evaluate. Board performance evaluation is also considered necessary given that the board should be accountable to the shareholders. ASX (2003) Corporate Governance Principle 8, recommends regular reviews individually and collectively. The respondents in this research study supported the use of evaluations.

There were mixed reactions on providing training courses for directors. The importance of inductions was agreed to by all respondents. However there was disagreement about the degree of induction needed. A couple of respondents felt that formal director training was only useful in the case of an inexperienced director, someone just starting out. A director was nominated because of her/his skills so only an induction to the organization was necessary, not formal training in how to be a director.

However given the rapid and constant changes in corporate governance, this could be a reactionary stance. Directors need to be fully cognisant of new legislation, regulation, standards of performance and so on. ASX (2003) Corporate Governance Recommendation 2.4 suggests an evaluation of skills, experience and expertise in determining director competencies. Recommendation 8.1 (ASX 2003) commentary and guidance suggests that a company should implement an induction program. New board appointees 'cannot be effective until they have a good deal of knowledge about the company and industry within which it operates' (ASX 2003, p.47). The Principles do not set out any formal qualification requirements. Formal and continuing training is an efficient way of ensuring that directors have current knowledge. This increase in training may also lead to a formal educational program such as the AICD Directors' Course being a requirement for board membership. Such a requirement could be incorporated into future principles.

6.9 Directors' remuneration

The level of director's remuneration compared to the level of responsibility and time involved in carrying out duties is not well matched. In the for-profit sector, a professional non-executive director would expect a level of remuneration commensurate with the size and complexity of the organization. There is a gap between the salary packages of CEOs, senior executives, and the chair and directors: the chair and directors are under-remunerated. This salary gap is considered inconsistent with the level of responsibility that the board has, especially since management is accountable to the board. Further research could develop this theme, and also examine whether higher pay leads to higher performance.

In the case of not-for-profit organizations, the reasons for joining were more along the lines of 'giving something back to the community'. There may be some small reimbursement of expenses, but remuneration was not an issue. However, given that the level of responsibility is the same as in the case for-profit organizations; not-for-profit directors have some personal risk in accepting such directorships. This does suggest that further studies need to examine the skills and experience of directors from not-for-profit organizations compared to for-profit organizations.

6.10 Company performance

There is much discussion and research on linking company performance to board size and composition and other variables. The difficulty is how to exactly determine what the influences are. As there are so many factors, it is not possible to simply say that a majority of non-executive directors will improve performance. There are a number of factors which are beyond the control of the board such as economic factors, government legislative changes, ability to attract and retain the right people, global resources limits etc.

Directors' decisions are important and can have long lasting effects on the company's direction depending on the strategies adopted. However management decisions also need to be considered and directors cannot review the minutiae of every management decision. There is a growing 'expectation gap' between the increasing legal and regulatory requirements that the directors are expected to fulfil and what can actually be achieved. A major issue here is the amount of time and the information provided.

Non-executive directors have inadequate time and knowledge to be able to meet all these requirements. The directors in this study recognise the limitations in what they do.

The directors interviewed for this study all agreed that there is no one factor linking corporate governance to company performance. This is supported by a large volume of literature (refer Table 2.2). In addition to examining variables such as board structures and processes, economic influences and other external factors will also have an impact.

6.11 General issues

Directors expressed concerns that the level of regulation had increased to such an extent that the emphasis on compliance is leading to ‘ticking the box’, rather than running the business and thereby missing opportunities. This did not necessarily lead to better governance. In contrast, some felt that the ‘governance debate’ was overkill and that their boards had already established good governance principles which were really ‘a lot of commonsense’. This indicates a need for balance. Checklists are important for boards lacking expertise or resolve. However boards already doing it right feel aggrieved because of a feeling of being taken down to the lowest common denominator. Regulators need somehow to achieve a balance between a ‘compliance’ culture and a culture of running a business in a risky environment.

The importance of trust was raised in several interviews. The trust factor was important between management and the board, and also amongst the directors themselves. Since non-executives directors relied on information provided to them by management it was important to have confidence in the material provided. This has also been raised in the corporate governance literature. Directors also need to trust other directors in order to have vigorous and at times uncomfortable debated during board meetings. Without such trust, debate may be curtailed, with less than optimal decisions a possibility.

The quality (and the quantity) of the information presented to boards was also of concern to directors. Whilst questions could be asked, directors relied on the integrity of the material provided. A major problem with the information provided was that

there was too much material included in board papers which was not necessarily relevant. This meant that directors were spending time wading through reams of paperwork and not getting down to the more important business decisions. Further research is needed on how board information systems could be improved to provide more balanced and relevant information to board members, whilst at the same time not excluding critical information.

The legal duties and responsibilities were briefly examined in Chapter Two. A brief overview of the duties was summarized. The important point to note here is that the legal rights, duties and responsibilities are the same for all directors regardless of sector. There is some concern expressed about non-executive directors in not-for-profit organizations. Often these roles are voluntary, with perhaps some reimbursement of minor expenses. Further these directors do not always have a business background, and have volunteered their services for community work. Some of the respondents in this research suggested a need to draw a distinction in responsibilities between directors from not-for-profit and for-profit organizations. Should not-for-profit directors be held to the same standards as for-profit directors? This is a difficult issue, as dimensions such as accountability to stakeholders are equally important to all organizations. Further research could examine whether different standards should apply to directors in different sectors.

This also raises some issues in relation to the level of directors' remuneration. Not-for-profit organizations require 'good' directors to ensure limited resources are used to maximum utility. Therefore these organizations should consider paying sufficient remuneration to ensure that competent individuals apply as directors. In our current business climate, due to the proliferation of legislation, being a well-meaning concerned citizen is not enough. Not-for-profit directors need to have the necessary skills set to discharge their duties in an appropriate manner.

6.12 Contribution of this study

In this exploratory study, the views of non-executive directors have been presented on some of the issues concerning corporate governance. As this is small study, not based on random selection, it is difficult to generalise the findings. Thus whilst the findings are not representative of the population, nevertheless the results and the issues raised

by the directors themselves indicate a growing interest and concern in corporate governance.

The objective of this exploratory study is to present non-executive directors' views based on their own personal experiences in the boardroom, with the aim of identifying issues of concern which are not always at the forefront of the corporate governance debate. The research has identified some issues of concern. These include: the need for further debate on whether boards should have a majority of non-executive directors; the need to balance technical skills and interpersonal skills when appointing directors; the need to balance board cohesion with vigorous debate and questioning in the boardroom; the need for independence of mind during discussions; the increasing demands of legislation and regulation placed on directors which they feel cannot be sensibly achieved; the implied expectation that directors will act as 'de facto' managers by knowing all the operating details of the organization.

The research suggests regulation and legislation is not enough. There is a 'gap' between what the legislators/regulators consider is necessary and what the practitioners (the directors) feel needs to be adopted. Roberts et al. (2005) also raise the issue that there is a 'relevance gap' between practice and research. The question of 'relevance' of research to practitioners is an important issue. Studies (Brennan 2004; Das 2003) indicate that there is a divide between academia and practitioners. The debate focuses on the relevance of academic management research. The readability of academic journals is questioned (Brennan 2004), and the lack of interaction with managers (especially senior managers) in the evaluation 'of the research question in terms of its relevance and significance' (Das 2003, p.30). Aram and Salipante (2004, p.190) point out that 'knowledge becomes 'relevant' when it is 'context specific' for practitioners'. That is knowledge for practitioners 'must be customized, connected to experience and directed to the structure and dynamics of particular situations' (Aram and Salipante 2004, p.190). A major contribution of this study is to address this relevance gap, albeit in a limited way.

Some of the directors expressed concern about the level of regulation and legislation. Directors are expected to sign off on a number of issues, which in reality they rely on management to provide. Regulators are sometimes perceived as perhaps well-

motivated in ‘doing the right thing’, but not really understanding of how companies are run.

6.13 Limitations of the research

This research study used a small sample of directors. This was not representative of the population. The selection was not randomly chosen. The criteria were that the interviewee had to be a current non-executive director, irrespective of the type of organization or length of service. The researcher used her own contacts and those of colleagues to approach potential interviewees. The directors who responded did so because of their own interest in participating in the research. They were also asked for names of contacts who also may be interested. The problem with this method of selection is that ‘similar types’ of personalities may dominate the research.

Qualitative research was chosen due to the richness of the data and as it explores issues not amenable to survey or stock market research. However there are biases common to such research. For example; the way a question is asked or the interviewer’s body language may prompt the interviewee to respond in a certain manner. Furthermore, there is a bias in the interpretation of the data. The summarizing of the transcripts will have the researcher’s preferences for certain expressions and words. Similarly the selection of quotes to illustrate a particular viewpoint will also have a bias inherent to any text interpretations.

6.14 Future Research

A much broader study could be undertaken in specific categories for example, non-executive directors in not-for-profit organizations, in government organizations, and in family companies. As there is already a large volume of research on publicly listed companies, it would be beneficial to have a clearer understanding of directors’ roles in other types of organizations. Such research could address the similarities and differences of the roles in different organizations and consider also the legal requirements for different organizations.

Further research is also required on the behavioural aspects of boards. Researchers have recently started examining board processes by attending actual board meetings (Leblanc and Gillies 2005). However this also needs to be expanded by others in their

respective countries. Leblanc (2004) has commented on the need to go beyond the quantitative research, which is yielding a mixture of results, to perhaps a more qualitative approach as to how boards work. Expanding this current research into a wider study of board dynamics and decision making would be a start in developing a better understanding of corporate governance.

Other areas for future research have been raised throughout this chapter as part of the discussion of results.

6.15 Conclusion

The purpose of the study was to examine directors' views on some of the issues of corporate governance and the executive/non executive director debate. Qualitative research was chosen first, due to the large volume of quantitative data research already carried out, and second to give richness and depth to the study. By interviewing directors face-to-face, as opposed to sending out questionnaires, directors were able to express their own personal views.

Directors' roles include monitoring management and providing advice. However directors also make major decisions in their own right. The extent to which directors will be involved in these three roles will depend on the company performance, the complexity of the business, the industry, the relationship with the CEO and whether or not shareholders are looking for short-term or long term-results.

Directors are jointly responsible for the company due to the complexity of business; individual directors may have more specialized roles. For example, as discussed above in a 'smaller' company, a director may be more actively involved in the operational issues due to lack of experience in management. Thus the divide between management's role and the directors may not be as clear as generally indicated in the literature.

Generally the directors' role is to enhance shareholder value. This indicates that the directors are accountable to shareholders. However the current trend also includes 'corporate social responsibility'. Boards are increasingly being expected to accept responsibility to other stakeholders such as customers, suppliers and employees. The

directors in this study expressed some concerns in being expected to keep abreast with a large volume of regulations (for example health and safety, and environmental issues) affecting other stakeholders besides shareholders.

Board independence has been extensively discussed in the governance literature and used as a basis for governance principles as in the ASX Corporate Governance Principles (2003). This is supposedly achieved by having a majority of independent directors on the board. However the number of independents does not necessarily lead to a 'better' board performance or improved company performance. Some directors in this study pointed out that it is the individual's skill base that is important. Further, the 'cost' of having independent directors is their lack of knowledge of the company (and possibly the industry) and limited time.

The research has bridged some of 'the gap' between academia and practice. Some views were expressed at the lack of input from practitioners in preparing governance guidelines. Respondents have argued that, regulations have been imposed by those without sufficient knowledge of how companies are actually run. This has also been noted by other researchers (Aram and Salipante 2004; Brennan 2004; Das 2003).

Whilst there is much discussion and research on the relationship between improved corporate performance and some variables of corporate governance, this has not yet conclusively been established.

This research has gone some way to exploring corporate governance and corporate performance in a broader context. Further research could explore the relationship in more detail.

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APPENDIX 1

INTERVIEW QUESTIONS

Roles

1. What is the role of the board?
2. What is the role of the director?
3. What makes a good ‘balanced’ board?
4. Do you believe it is important to have both executive and non-executive directors on the board?
5. Does the size of the board matter?

Functions/Processes

1. Strategy formulation is often considered to be the function of the board. What do you think is the appropriate involvement of the board compared with management?
2. How important are the board dynamics around the board room table?

Performance

1. How can a board add value to the organization/company?
2. Is a company’s performance due to the director’s decisions? Why?
3. Can non-executive directors improve performance? Why?
 - a. Consider the impact of such guidelines as issued by the ASX.
 - b. Are we jumping on the ‘bandwagon’ that a majority of non-executives is a requirement for a company to continue performing well/better?
 - c. Are we simply meeting ‘quota’ requirements rather than appointing directors on experience?
4. Does the number of board appointments impact on directors’ performance?
 - a. Time constraints
 - b. Increased experience
5. Does the level of remuneration of board appointments impact on directors’ performance?

APPENDIX 1 CONT'D

Other issues

1. What do you see as the key issues with board governance in Australia?
2. What impact do you believe corporate governance has on directors?
3. What impact do you believe directors have on corporate governance?
4. Are there any other issues which you consider are important?

APPENDIX 2 – ETHICS APPROVAL

11 April 2005

Professor Louise Kloot
Faculty of Business and Enterprise
Swinburne University of Technology

Dear Louise

The Faculty of Business and Enterprise Ethics Sub-Committee has now approved your Ethics Application 2005/0¹⁵ entitled: 'The role of non-executive directors in board governance: An evaluation.'

We wish you well with your research project.

Yours sincerely



Dr Michela Betta
Chair
Faculty of Business and Enterprise
Ethics Sub-Committee

Quality Learning,
Innovative Research

