

CORPORATE GOVERNANCE & ACHIEVING AND SUSTAINING ENTREPRENEURIAL PERFORMANCE

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Value-Creating Boards: Challenges for Future Practice and Research

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This Element shapes the discussion about corporate governance and boards of directors. The arena for boards and corporate governance is not static. In *Boards, Governance and Value Creation* (Cambridge, 2007) Morten Huse accumulated knowledge about boards with a focus on behavioural perspectives. The present contribution reflects on what has been happening during recent years. It contributes to the literature around sustainable value creation in business and society. This Element brings an update of the content of the 2007 book, and thus provides a resource for students - as well as for reflective practitioners.



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Do boards really create values? The managerial paradox

Ordinary board behavior



- ✓ Risk aversion
- ✓ Control
- ✓ Focused on finance
- ✓ Avoiding problems
- ✓ Top-down approach
 - Decision-oriented
 - Hierarchy driven
- ✓ Short term value distribution

Entrepreneurial behavior



- ✓ Risk willing
- ✓ Innovation
- ✓ Focused on knowledge
- ✓ Seeing possibilities
- ✓ Bottom-up approach
 - Process-oriented
 - Open source and user-driven
- ✓ Long term value creation

	Generally recommended board behavior	Recommended value-creating behavior
Guidelines	Corporate governance literature	Entrepreneurship literature
Value creation for whom	External actors/stakeholders	The company/the entrepreneur
Value creation definition	Short term value distribution	Sustainable value creation
Approach	Avoiding problems	Exploring and exploiting possibilities
Risk attitudes	Risk aversion	Risk willingness
Main attention to	Finance metrics	Knowledge and capabilities
Focus activities or tasks	Control	Innovation and strategy development
Decision-making	Top-down approach	Bottom-up approach
	Decision-oriented	Process-oriented
	Hierarchy driven	Open source
Board member relations	Independent and detached: Boards as a collegium	Competence, impartial and involved: Boards as a team





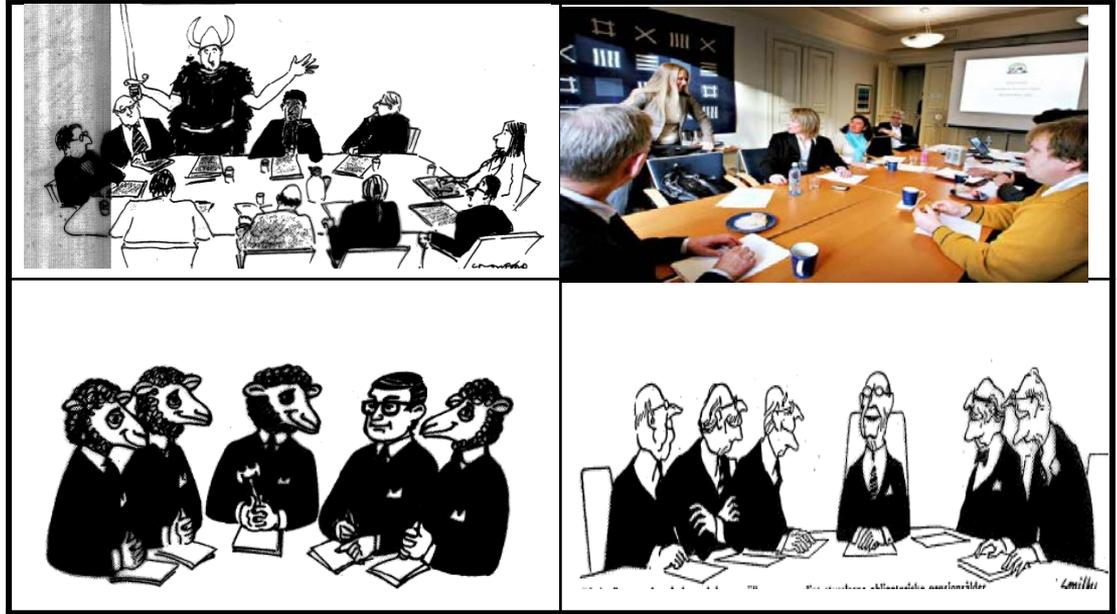


**Support
Activities**

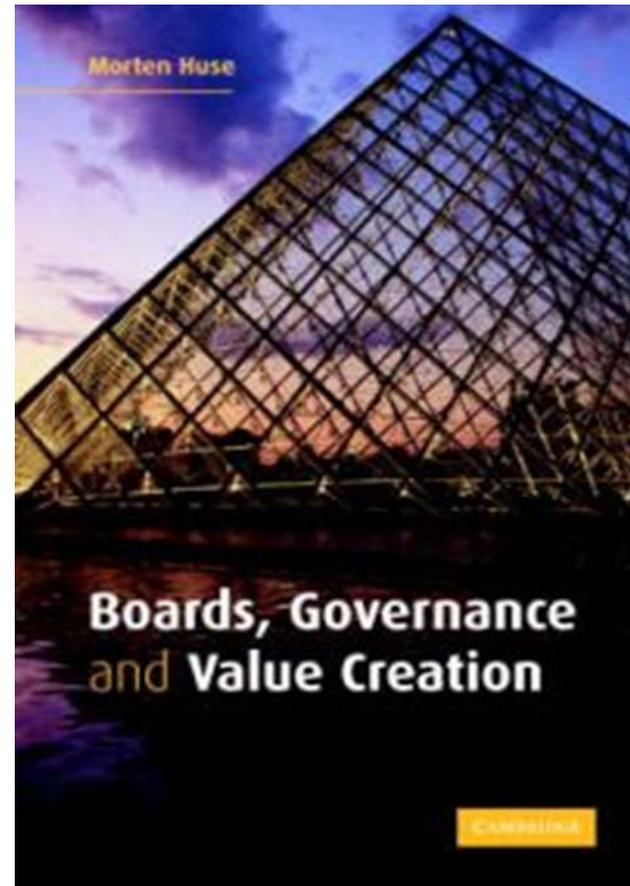


Primary Activities

Theories about Boards of Directors



How can boards contribute to value creation? A value chain perspective

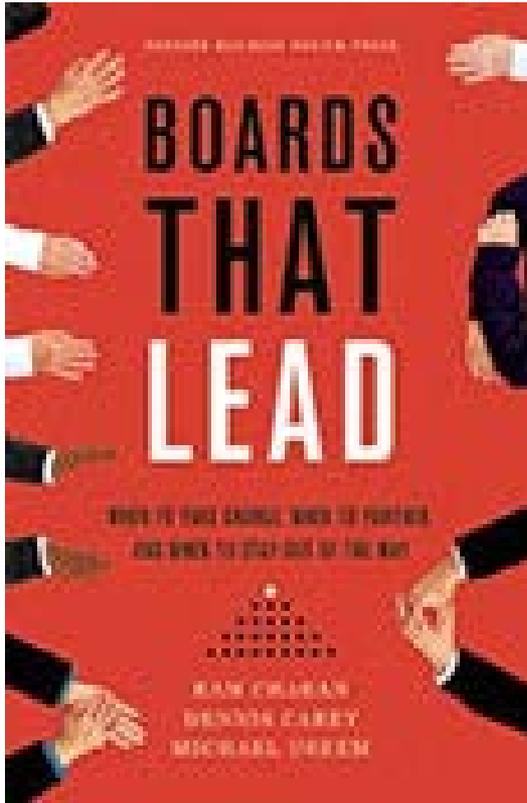


Approaching boards and value creation



- Values
- People
- Language
- Cognition
- Perspectives
- Dynamics

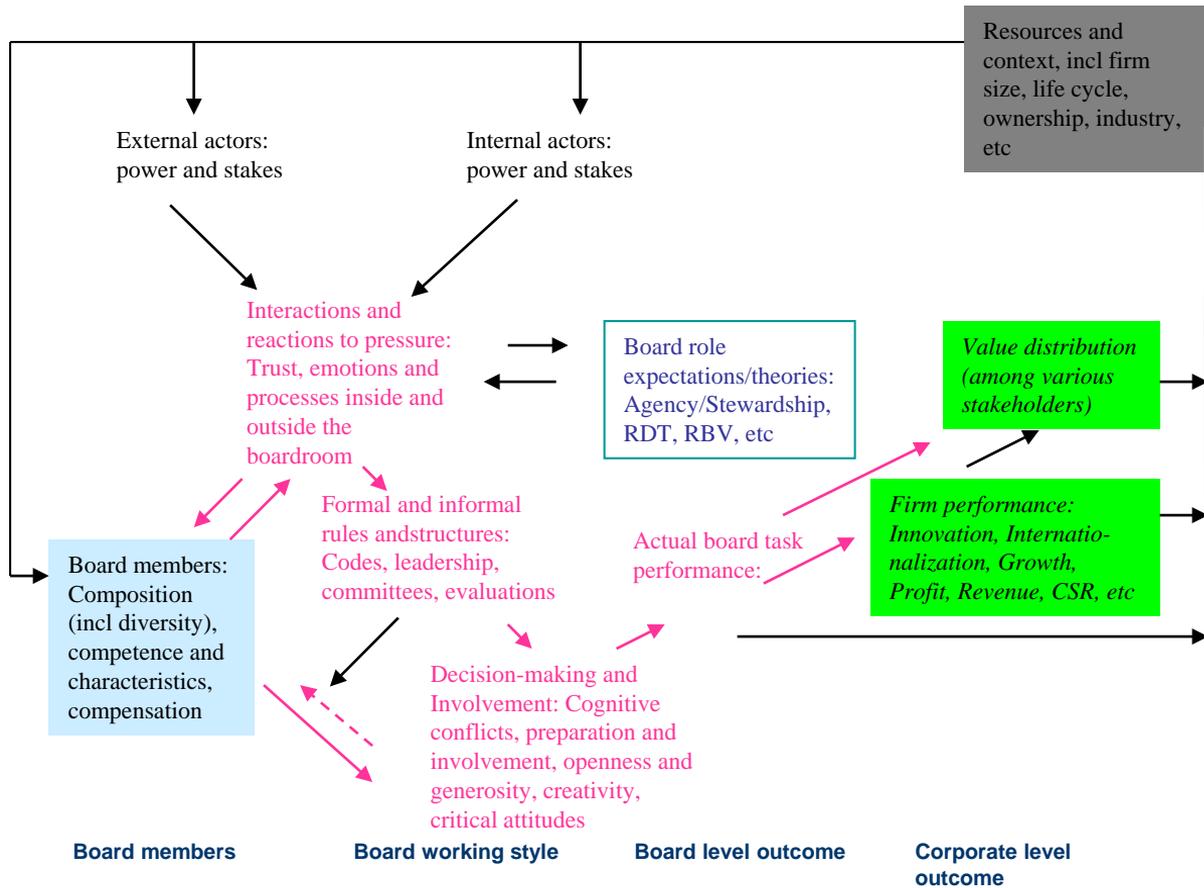
Are Boards Creating Values?



**Directors and Boards Magazine,
23.4.2014**

Is Your Company's Board of Directors Creating Value — or Destroying It?

A fundamental shift in leadership is taking place inside the boardrooms of today's publicly-traded companies. [*Boards that Lead: Corporate Governance that Builds Value*](#), a new Wharton Executive Education program for current and aspiring directors, examines the changing role and increasing responsibility for these key stewards of corporate value.



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Agency Theory

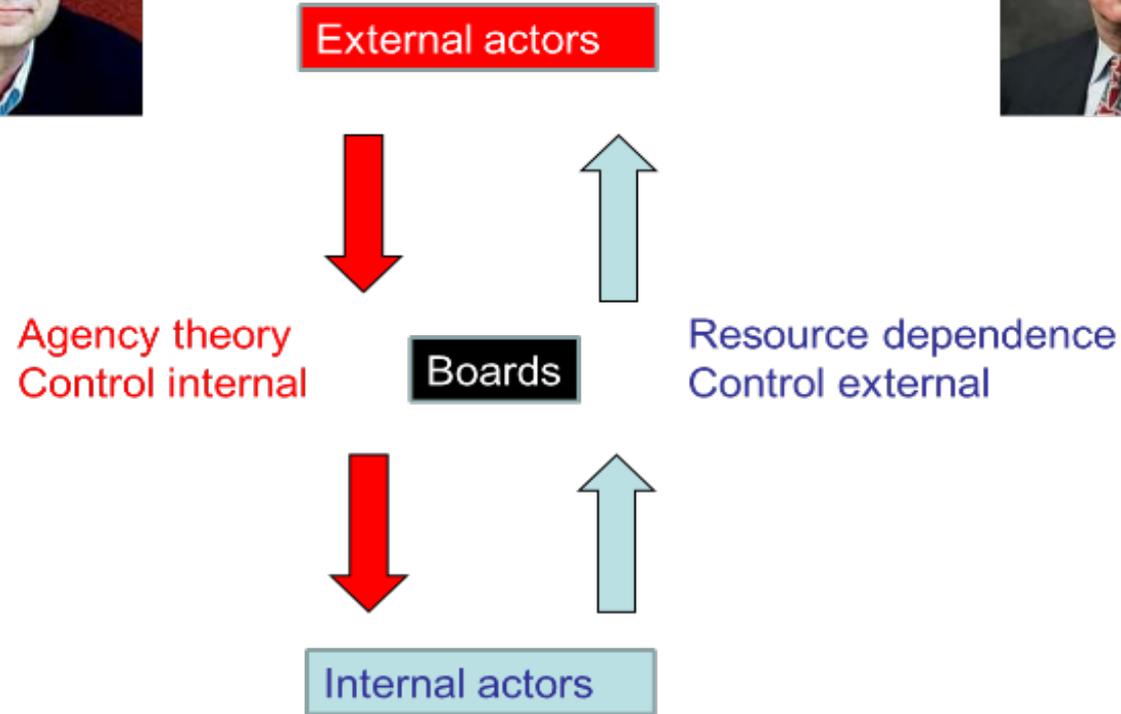


- Man is a sinner (**opportunism**)
- Adam and Eve were not allowed to be in Paradise. Because they had been eating from the tree of knowledge they could not any more see the difference between good and bad (**bounded rationality/asymmetric information**)
- Principals and agents

The History of CG and Boards



- **Boards used as a tool for external actors to control internal actors (agency theory/barbarian theories) 1976**
- **Boards used as a tool for internal actors to control external actors (Resource dependence theory)**
- **Interlocking directorates**



Values for whom?



Development or circle?

	Unitary perspectives Discrete and short term	Balancing perspectives Relational and long term
External perspectives and value creation	What is the best for the shareholders?	What is the best for the society and stakeholders?
Internal perspectives and value creation	What is the best for the management and individuals in the company?	What is the best for the firm?

2017-

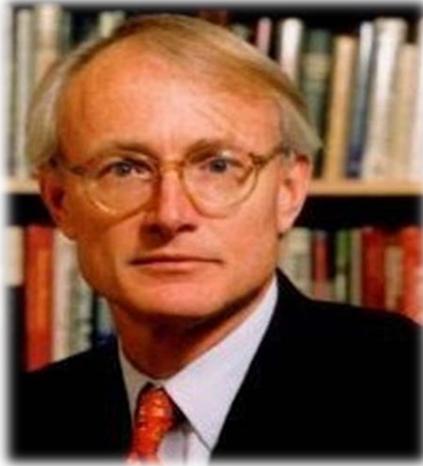
	Agency theory	The Extended Team Production theory
WHAT IS A FIRM?	Nexus of contracts	Nexus of team-specific assets
MAIN PURPOSE OF A FIRM?	Maximise return to shareholders	Value creation through team production
MAIN ROLE OF BOARDS?	Reducing costs of managerial opportunism and distribute values back to shareholders	Contribute to sustainable value creation
VALUE CREATION ACTIVITIES	Focus on down-side: Limiting the destruction of value	Focus on up-side: Supporting the creation of value (e.g. through innovation)
PRIMARY BOARD MEMBER QUALIFICATIONS?	Independent and detached	Competence, impartial and involved
STRATEGY PROCESS	Arms-length involvement in ratification and and monitoring of strategic decisions	Close involvement in the whole process: formulating, ratifying, executing and evaluating
BOARD CULTURE	Decision oriented: Characterised by criticality and a questioning attitude	Process oriented: Characterised by open and generous discussions related to diverse knowledge inputs and opposing viewpoints

Team production theory: Why boards should act as teams	Theoretical background?	Law and economics
Extensions in the extended team production theory: When and how boards should act as teams	What is a firm?	Nexus of team-specific assets
	Main purpose of a firm?	Value creation through team production
	Main role of boards?	Contribute to sustainable value creation
	Core actors?	Focus on stakeholder commitments
	Entrepreneurship and value creating activities?	Focus on the upside – supporting the creation of value, e.g. through innovation
	Strategy - Industrial economics inputs?	Boards should identify and be used where they add the most value, e.g. based on a value chain approach
	Strategy – Inputs from resource based approach?	Applying core competencies, dynamic capabilities, absorptive capacity and ambidexterity – tangible and intangible resources, e.g. social, human and relational capital
	Team literature inputs?	Process-oriented decision-making culture, including involvement, openness, generosity, creativity, critical and impartial
	Leadership literature inputs?	Leadership, e.g. goal setting, coaching, motivating, mentoring, evaluating and developing
Strategy as practice?	Understanding and regulating dynamics inside and outside the boardroom	

Table 3. Why, when and how boards should act as teams

Firm value creation

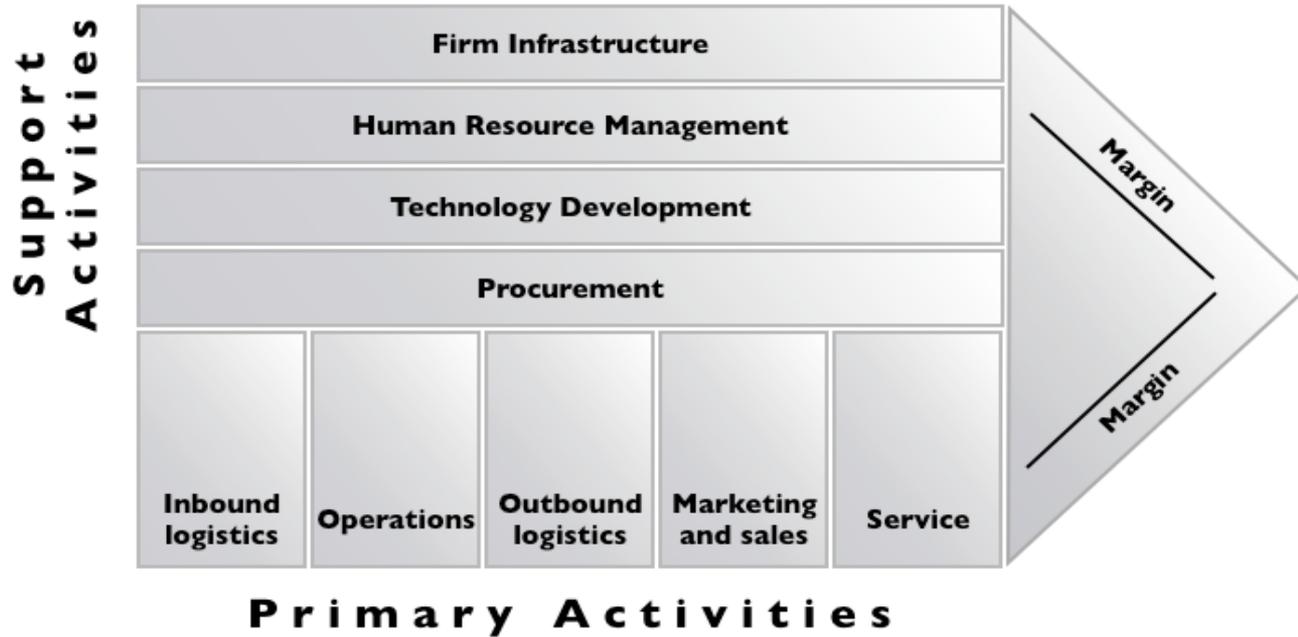
	Internal value creation	External value creation
Economic value creation	Internationalization, merger, restructuring, innovation, competitive advantage	Financial performance, earnings, dividends, growth
Social value creation	Employee well-being, workplace safety, workplace ethics, programs for employee training	Corporate responsibility and ethical behaviour, product quality and customer satisfaction, environment sustain.



USING THE CORE STRATEGIC MANAGEMENT LITERATURE

- a. Value Creation: Sustainable value creation (competitive advantage/rent) in the firm**
- b. Creating Values throughout the Value Chain**
- c. Resources and Core Capabilities**
- d. Absorptive Capacity and Ambidexterity**
- e. Strategy implementation (leadership, structures and evaluations)**

PORTER'S VALUE CHAIN



Value Creating Boards



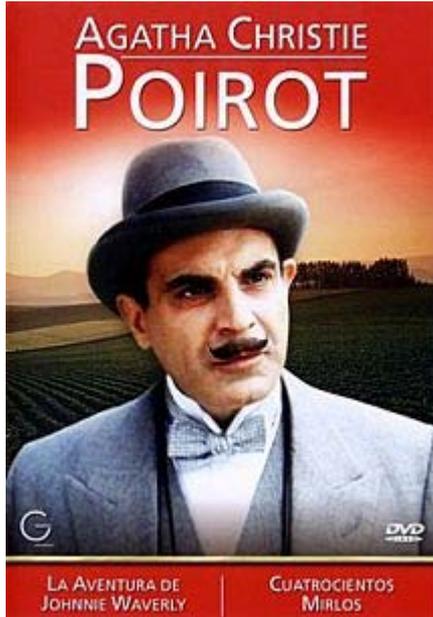
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Value creating board tasks

Contributions	Inbound logistics	Operation	Innovation and development	Resource allocation	Risk management and implementation	Outbound logistics
Tasks	Legitimacy, network, lobbying	Advisory and support	Strategic management and collaboration	Strategic control and decision-making	Internal control and compensation	Output control, CSR-control and embedding
						

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Independence – usual suspects



- Insider/outsider ratio
- CEO duality
- Board members' shareholding
- Number of board members



Independence?

- Each director or as a group?
- Independence from what and whom?
 - Insiders vs. outsiders
 - Who are insiders?
- Single or double independence?
- Information independence



Brett Ryder

Resources, Competencies and Capabilities

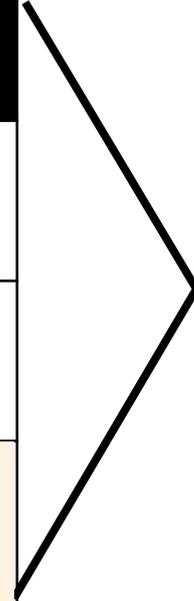
- Tangible vs. Intangible Resources
- Core Competencies
- Dynamic Capabilities
- Absorptive Capacity
- Ambidexterity
- Open innovation

Resources, Competencies and Capabilities?

Characteristics of board members/ resources



Inbound logistics	Operation	Innovation and development	Resource allocation	Risk management and implementation	Outbound logistics
Legitimacy, network, lobbying	Advisory and support	Strategic management and collaboration	Strategic control and decision-making	Internal control and compensation	Output control, CSR-control and embedding
Social capital	Functional and general competence	Diversity and relational capital	Decisions-making and analytical	Human capital Business and board experience	Integrity, negotiating and mediating



Board as a team: Use of Knowledge and Skills



David Nadler, His article, "From Ritual to Real Work: The Board As a Team" [Summer 1998], written when he was chairman of Delta Consulting Group, addressed a subject, executive team development, that was one of his core expertise areas.

As consultants on strategic change to the senior leaders of more than 100 public and private enterprises, we're well aware that the higher you go in the organization, the more difficult teaming becomes: that's just the nature of the beast. Yet, the goal of turning the board into an effective, productive team is not only possible — it's essential.

Decision vs. Process-oriented

	Decision-oriented	Process-oriented
Tasks	Controlling	Embedding
Culture	Independence	Criticality, creativity, cohesiveness, openness, involvement
Time spent by board members	Fast – short meetings, little time	Slow – long meetings, much time
Board composition	Barbarians - Small and homogeneous	Strategists - Large and heterogeneous
Board-management relations	Distance, Distrust, vicious circles	Closeness, Trust, virtuous circles
Outcome	Pre-determined – short term	Open – long term

Board Leadership

- **Board chair vs. CEO leadership**
- **Structures vs. leader**
- **Leadership roles**
 - Chairperson
 - Figurehead
 - Representative
 - Supporter/mentor
 - Strategist
 - Expert
 - Coach/leader/motivator



"That's my gut feeling. Now I'll recognize any other guts."

Board instructions

- Board meeting structures
 - Number of meetings
 - Length of meetings
 - Away-days (two-days meetings)
 - Annual agenda
 - Standard meeting agenda
- Notice, information, minutes and voting
- Ethics and whistleblowing

How often does your company, your board or your team, get away from the office together?



Getting away for facilitated board and corporate retreats pays dividends.

Board maintenance mechanisms

- Board evaluations
 - Purpose of board evaluations
 - Who does what for whom and how
- Board development seminars
- New board member introductions



Board Evaluations: making a fit between the purpose and the system

Alessandro Minichilli*, Jonas Gabriellson and Morten Huse

Board evaluations can contribute to effective boards and improved corporate financial performance. The increasing interest in the practice of board evaluations, however, calls for a more systematic and careful approach than has been employed in the past. While most attention has primarily been focused on the content of board evaluations, this article outlines the features of various possible board evaluation systems. Based on state-of-the-art research on boards and governance, we contend that a comprehensive board evaluation system needs to include decisions about: (a) the agent who evaluates the board; (b) the content, or what the evaluation should deal with; (c) the addressee and other stakeholders for whom the board is evaluated; and (d) how the board is evaluated. These key decisions should not be seen as independent of each other as they have consequences for the kind of system that will be adopted. Following this argument, we present four different board evaluation systems: (i) board-to-board, (ii) board-to-market, (iii) market-to-board and (iv) market-to-market. The key message we communicate in this article is that there must be a fit between the purpose and the system of board evaluations. There is no universal or "one best way" to evaluate boards of directors. Board evaluations will not meet their purpose unless there is a fit between the agents, the addressees, the content and the modalities of the evaluation. It is important to know who is doing what for whom and how.

Keywords: Board of directors, evaluation of the board, corporate governance rating/index

Board evaluations

The contemporary waves of corporate crises have resulted in several novel ideas and perspectives of how to improve the performance and effectiveness of boards. Among them, there have been requests for more systematic board evaluation practices, relying on the belief that board evaluations can help to prevent corporate failures and to provide a process for boards to identify performance gaps (Kiel and Nicholson, 2005). A formalised system for board evaluation is, furthermore, one of the main requirements in many of the corporate governance codes that have mushroomed as a result of increased shareholder activism. However, the features of board evaluations have been neglected both in theory and in practice, and two decades of research

on corporate governance have regularly underestimated the issue of board evaluations (Conger et al., 1996; Ingle and van der Wal, 2002).

There are several reasons which push towards a generalised adoption of more systematic board evaluations. The first is that boards of directors are increasingly changing from "patrons" to "potentates" (Lorsch and MacVicar, 1989). Boards have long been considered mainly as "ornaments on the corporate Christmas tree" whose relevance was confined within a purely legalistic perspective (Mace, 1971). From this perspective there has been a widespread assumption that boards generally do not work effectively and at best are only rubber-stamps or window-displays. What has happened in the recent past is a rather different story. Board members are increasingly

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Value Creation throughout the Value Chain

	Inbound logistics	Operation	Innovation and development	Resource allocation	Risk management and implementation	Outbound logistics
VALUE CREATION →						
TASKS →	Legitimacy, network, lobbying	Advisory and support	Strategic management and collaboration	Strategic control and decision-making	Internal control and compensation	Output control, CSR-control and embedding
RESOURCES →	Social capital	Functional and general competence	Diversity and relational capital	Decisions-making and analytical	Human capital Business and board experience	Integrity, negotiating and mediating
GROUP EFFECTIVENESS →	Preparations and involvement	Openness and generosity	Creativity, preparations, cognitive conflicts, cohesiveness	Decision-orientation	Critical attitudes, preparations, cognitive conflicts	Independence
LEADER →	Figurehead	Mentor and supporter	Leader and motivator	Strategist	Chair	Liaison and moderator
STRUCTURES →	Recruitment evaluations	Introductions and training	"Away.days" Development evaluations	Rules and structures	Work descriptions Committees Alone meetings	Ethics- and stakeholder documents Report evaluations

Value chain (industrial organization)	Inbound logistics	Operation	Strategy development, innovation and renewal	Decision-making	Risk management and control	Value distribution
Board tasks (team production)	Legitimacy, lobbying, networking	Advising, supporting, mentoring	Strategic participation	Monitoring, making major decisions	Internal controls, crisis management	Output control and embedding
Board competencies (resource based)	Social and cultural capital	Human capital	Relational capital and diversity	Analytical capital	Board and business experience	Integrity and negotiating capital
Board culture (group effectiveness)	Loyalty, identity and involvement	Openness and generosity	Process-orientation: Cohesiveness, creativity and cognitive conflicts. Team	Decision-orientation	Critical attitudes, commitment, time and availability	Independence. Board as a collegium
Board leader (leadership)	Figurehead	Mentor and supporter	Motivator: Coach and leader	Chair and strategist	Coordinator, devil's advocate and listener	Liaison and representative
Board structures (materiality)	Coordination		Preparations, dedicated meetings	Protocols	Internal control systems, incentive schemes	Stakeholder / ethics document
Board development	Recruitment evaluation	Introductions	Development evaluation		Training	External evaluation
Board meetings (strategy as practice)	Outside the boardroom	Outside the boardroom	In the boardroom	In board meetings	Between board meetings	All board members

Table 4. Board evaluations: A value chain and board characteristics vocabulary
The empirical relationships in the table is influenced by chapter 9 in Huse 2007.