A FRAMEWORK FOR DIAGNOSING BOARD EFFECTIVENESS

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A Framework for Diagnosing Board Effectiveness

Abstract

As pressure mounts on boards to ensure improved corporate performance and monitoring of management, government and business groups have responded with a series of inquiries and reports advocating governance reform. These reports largely reflect the agency view of governance and endeavour to articulate how a board can ensure greater independence from and control of management.

While the issue of board independence is an important aspect of good governance, we contend that frameworks and models that concentrate on a single element of governance ignore the complexity of how boards work. To address this concern, we develop a holistic framework of how boards work, based upon the concept of board intellectual capital.

The framework sets out how a series of inputs (company history, company constitution, legal environment) leads to a particular mix of board intellectual capital. Board intellectual capital itself comprises five elements: (1) directors’ knowledge, skills and abilities (human capital), (2) directors’ links to the external environment (individual social capital), (3) directors’ ethics and norms (cultural capital), (4) intra-board and board-management relationships (board social capital) and (5) the company’s governance policy, processes and procedures (structural capital).

We contend that the balance of these elements will lead to a series of board behaviours. Further, the board needs to mobilise its intellectual capital to carry out a series of roles. The exact nature of these roles will depend on the company’s requirements. Thus, the governance outputs of organisational performance, board effectiveness and director effectiveness will depend on the match between the board’s intellectual capital and the roles required of it.
We conclude by demonstrating the benefits of this framework as a diagnostic tool. We outline how boards wishing to improve their governance systems can diagnose common governance problems by evaluating their own board’s capabilities in relation to the different components of the framework.
A FRAMEWORK FOR DIAGNOSING BOARD EFFECTIVENESS

Boards of directors are assuming an increased importance in business life. As the ultimate corporate decision makers, boards are charged with ensuring the effective operations of the organizations they govern. Since much of society’s work takes place within organizations, it is not surprising that this group is facing increasing public scrutiny. Understanding how boards work is not a simple task, however. If grasping how an individual will behave is difficult in itself, the complexity involved in understanding how a group goes about the task of overseeing the operations of a modern organization, often comprising hundreds or thousands of individuals, is daunting.

Despite this complexity, the board’s role in leading the organization must be understood. Since the board is ultimately responsible for corporate performance, understanding how it can in fact influence this performance is central to the business discipline and the health of our organizations, economies and society itself. To understand how a board functions and achieves a greater degree of control over governance outcomes, we need to recognize three key items.

First, we need to recognize the constraints that institutional and historical factors place on a board. Second, we must understand the capabilities of a board and how these capabilities match the role set required of the board in question. Third, we need to be able to understand how various board level interventions can result in different organizational outcomes.

Undertaking such a Byzantine task requires a range of tools that will assist in understanding how boards operate. A key tool is the conceptual framework or model, because it indicates which factors (in the board, for example) are central to the topic of interest. A framework can also show how these factors are related to one another or
which factors (or combination of factors) will cause changes to others. If we are to develop an understanding of how boards work, it is imperative that we develop a holistic framework to guide our investigations.

Models of how boards work are central to corporate governance analysis and action; they dictate the type of data collected, the analysis process employed and, from a practitioner’s perspective, the action plan that is developed. Everyone who works with boards has developed some sort of implicit model to guide their decision making. These are generally tacit models built from previous experiences that result in a “partial model”, which varies in quality and complexity depending on the model builder. Additionally, interest in corporate governance research has sparked a range of lines of research all with their own particular paradigms and models. For instance, Zahra and Pearce (1989) developed an integrative model that could be used to study how the roles and attributes of the board influence firm performance; Hermelin and Weisbach’s (1998) model was used to investigate the dynamics of the board-CEO relationship, and in particular board independence from the CEO, using firm performance as an indication of the CEO’s ability; Boyd (1990) devised a model to determine whether boards respond to different types of environmental uncertainty.

While frameworks and models are meant to be abstractions (Sutton & Staw, 1995), a key concern is that these partial models do not reflect the true relationship(s) they represent. For instance, much academic research in corporate governance has concentrated on models of agency theory and investigating the role of the board in monitoring and minimizing agency costs. This attention is also evident in the normative literature and news services that revel in detailing tales of corporate excess. Despite this interest, however, there is general agreement that little evidence exists to support many relationships assumed by the agency models (e.g., Dalton, Daily, Ellstrand, and Johnson
(1998) found no substantive relationship between board composition and firm performance in their meta-analysis of 54 studies of board composition, while in a similar meta-analysis based on 37 samples from previous studies, Rhoades, Rechner, and Sundaramurthy (2000) concluded that board composition, or more specifically the proportion of outside directors, had only a very small positive relationship with firm performance).

Our purpose in this paper is to provide a holistic framework for examining the relationships between boards of directors and corporate outcomes. Rather than concentrating on one element of corporate governance research (such as agency theory, stewardship theory, resource dependence theory, etc.) we are interested in developing a general framework that allows us to conceptualize the board as part of a governance system. Specifically, we have adapted Nadler and Tushman’s (1980) approach to model building by developing a systems view of the board–performance relationship. The framework’s basic premise is that an effective corporate governance system requires a series of components to be in a state of congruence or alignment.

In the first section, we present a broad overview of the framework, describing its main components and the relationships between them. In the second section, we detail the dynamic nature of the model and how the components interact. In the third section we demonstrate how boards can use the model to analyze problems with their own governance. Finally, we discuss the model’s implications for how we think about boards and their impact on corporate performance.

A Systems View of the Board–Performance Relationship

There are many different ways of thinking about boards of directors and how they may be able to influence corporate performance. If you ask any director or senior
manager “to ‘draw a picture of an organization,’ he or she typically draws some version of a pyramidal organizational chart” (Nadler & Tushman, 1980: 37). The board of directors, often drawn as one box, will typically sit at the top of this structure, indicating a static role and set of relationships, generally with one individual – the CEO. While this is one way to conceptualize where the board fits and what it does, it is a limited perspective. It reflects the predominant view of the board as a group designated to monitor management and control agency costs and is evidenced in the typically formal and hierarchical nature of the model.

Whether such a model is appropriate is coming under question. For a start, it ignores factors such as group and individual behaviours, relationships (both between board members and with management), impacts of the external and internal environment, informal (as opposed to formal) relationships, ethics, and the distribution of power in the board hierarchy. The hierarchical model then results in a view of the board that ignores many of these critical elements of corporate governance; it is restricted and moribund.

There is a growing view among researchers that we need a broader way to conceptualize how boards add value to the firms they govern (Daily, Dalton, & Cannella, 2003). For instance, innovative researchers have outlined how boards may add value by reviewing key decisions (Pound, 1985), being involved in the firm’s strategy process (Golden & Zajac, 2001), providing advice to management (Westphal, 1999), and providing access to key resources such as information (Baysinger & Zardhoohi, 1986), capital (Burt, 1983; Mizruchi & Stearns, 1988), or industry contacts (Pfeffer, 1972, 1973; Pfeffer & Salancik, 1978). These investigations have led to a growth in interest in governance issues of power (Westphal & Zajac, 1995), board
dynamics (Forbes & Milliken, 1999), and interpersonal relationships at the top of organizations (Charan, 1998).

Unfortunately, this wave of innovation does not appear to be reflected in our social structures and legal systems. Rather than embracing recent academic advances, normative and legal perspectives appear bound to the entrenched agency perspective of how a board should work. For example, the Sarbanes-Oxley Act of 2002 in the United States decrees that all listed companies must have an audit committee, all members of which must be independent, and that various other conditions relating to the independence of the auditor must be met. The Act also declares that agency costs such as loans, bonuses and profits are either prohibited or may be forfeited in certain circumstances. This trend is paralleled in the international arena. For instance, in both the United Kingdom (e.g., Higgs Review (Higgs, 2003)) and Australia (e.g., ASX Corporate Governance Guidelines (ASX Corporate Governance Council, 2003); CLERP 9 (Commonwealth Treasury, 2002)), reviewers concentrate on the agency perspective of governance and the role of independence in monitoring and controlling agency costs.³

To address this concern, we set out a general model of how boards work. Instead of describing particular elements of corporate governance (such as agency theory) or specific board behaviours (such as monitoring), in our framework we attempt to conceptualize how boards work as a total system. Thus, the framework itself is based on the proposition that effective boards require a consistent structure and management that is in alignment with organizational requirements.

This approach is based on a systems view. As social phenomena, boards display many of the attributes of natural or mechanistic systems, and we can better understand a board and how it works if we view it as a dynamic and open social system (Katz &
Kahn, 1978). As a result, this framework describes the relationships between the board and corporate performance as a set of interrelated elements where a change in one element will affect another element. Furthermore, a board is an open system, in that the board will need to interact with the firm’s environment, both the external operating (or business) environment and the internal (or organizational) environment. We follow Nadler and Tushman (1980) by conceptualizing this system at its most basic level of three elements. Inputs from the environment are subjected to a transformation process in order to produce various outputs. This is represented in figure 1.

Consider a typical board. It consists of a number of different but related components (for example, a number of policies and procedures, various relationships as well as individual directors’ knowledge skills and abilities). The board receives a number of inputs, such as information, environmental feedback, legal constraints and so on, and will need to transform these inputs into certain outputs such as board and corporate performance. As a result, the board will exhibit characteristics in line with a number of basic systems. The key characteristics are:

*Internal interdependence:* The components of the board are interrelated and changes in one component will normally have an effect on another component. For instance, a change in board policy may lead to a change in the way board members interact.

*Capacity for feedback:* Information about the board’s outputs (e.g., board effectiveness or corporate performance) can be used to control the system. Thus,
the framework explicitly recognizes that the board has the capacity to become a self-correcting system. For instance, if the board realizes it is failing to perform a specific function effectively, it can take action to rectify the situation. Unfortunately, there is no guarantee that this potential will be realized.

_Equilibrium:_ When an event pushes the system out of balance, it will react and change to bring itself back into balance. For instance, if there is a change in board composition, we would predict that there would be a period of instability while relationships and policies change to reflect the different knowledge, skills, abilities and behaviours brought about by the change in composition. Although this may take a substantial period of time (and may in fact lead to further changes at board or management level), the point is that the system will move toward a new point of equilibrium.

_Equifinality:_ This characteristic recognizes that in any system there is no one best way or, more precisely, that different board configurations can lead to the same or similar board outputs. For example, if a board needs to raise equity, it may be able to use its knowledge and skill to develop an innovative financing structure. Alternatively, it may be able to call on social contacts to provide access to the capital. In both cases, the output (raising capital) has been affected even though different transformational mechanisms were used.

_Adaptation:_ A system that survives will maintain a balance between its transactions and the environment or they will run down. Thus a board will adapt to changing environmental conditions and organizational demands or it will be forced to change (through board turnover or organizational decline). If a board is faced with changes in the regulatory environment, for example, it may need to
adapt its composition, policies or operating procedures. Boards that fail to adapt to changing conditions are at a significant risk of failure.

While the framework outlined in Figure 1 provides a simple interpretation of how systems theory may be applied to the board-performance relationship, it is too abstract to use when analyzing board performance problems. Boards interact with their organizations and environments in complex and dynamic ways, a point that needs to be reflected in a more specific framework based on this general systems example.

An Intellectual Capital Framework of Board Performance

The key advantage of a systems approach to understanding corporate governance is that it provides a framework to unify existing theoretical and empirical investigations of boards of directors and how they impact on corporate performance. In particular, it provides an avenue to develop an analytic tool that is specific enough for use in normative and academic settings, and yet still reflects the basic characteristics and concepts of a systems approach. To do this, we describe a framework that outlines the major inputs, outputs and key transformational processes that are used by a board to link these inputs and outputs.

If a board is to add value to an organization, this will occur through the transformation process. Thus, we place greatest emphasis on the transformational process in the framework, particularly the interaction of the various components that make up this process. We contend that boards and researchers interested in board behaviour need to be aware of this interdependence and its consequences if they are to understand how a board can add value. This is because the various components make up a board’s capability to add value (i.e. its intellectual capital – see below). When a board is stable, these components will be in fit or balance with one another. The various
components can fit well in the case of an effective board or they can fit badly and lead to various dysfunctions and problems. The basic premise of our framework is that an effective board will have an effective fit between the various elements of its intellectual capital in light of the roles required of it. Similarly, a poorly performing board will have a poor fit between the components of board intellectual capital and the roles required of it.

The concept of balance or fit is not a new one and models that adopt a similar approach are often termed congruence models (e.g., see Homans, 1951; Leavitt, 1965; Nadler & Tushman, 1980). We have termed our framework an intellectual capital framework for boards of directors. It builds on the work of Nadler and Tushman (1980) by applying their approach, which has come to be known as the congruence model of organizational behaviour, to the board of directors. The framework employs an area of increasing interest to management scholars, namely intellectual capital and we draw upon conceptualizations of intellectual capital from Stewart (1997) and Bontis (1999). The framework is also indebted to seminal review articles such as Zahra and Pearce (1989) and Johnson, Daily, and Ellstrand (1996), which have led to our understanding of the roles of the modern board.

Building on the work of existing corporate governance models, this framework seeks to elucidate what brings about certain board behaviours and the consequent effects of those behaviours. We contend that the interaction of the components of our proposed system produce a pattern of behaviour that can ultimately be linked to corporate performance. By examining the inputs with which a board must work, the various elements of the transformational process and the required outputs (and their interactions), we are examining the way that boards function and the behaviour of board members.
**Inputs**

The inputs to our model are the specific boundaries within which each board needs to operate. Every organization and board is presented with a different set of operating conditions or material factors that are outside of its control. Further, these inputs or “givens”, by and large determine the boundary conditions within which the board operates (Nadler & Tushman, 1980: 39). In the context of the corporate governance system, we propose four key inputs to the board-performance relationship, outlined in Table 1.

| INSERT TABLE 1 ABOUT HERE |

The first input is *organization type*, or nature and purpose of the organization being examined. Irrespective of corporate form, every organization is established to achieve an overarching purpose and this purpose can have a powerful impact on board composition, board roles and ultimate corporate performance (e.g., Johnson et al., 1996; Pearce & Zahra, 1992). More specifically, organization type will need to identify whether a company was formed with for-profit motives, philanthropic objectives, government policy objectives, some other specific non-profit objectives or even some combination of these generalized objectives.⁴

Organization type will affect the corporate governance system in two important ways. First, it will most often determine the degree to which a company has an articulated purpose that is clearly understood by all owners, directors and managers. A key but often-overlooked element of the agency dilemma is the necessity to ensure that the goals of the owners are clearly transmitted to the managers (Eisenhardt, 1989;
Organization type can have a significant impact on this problem. For instance, a for-profit company will have clearer objectives when compared with many not-for-profit companies. Second, and similarly, the organization type will determine the extent to which the ownership or membership structure of the company comprises multiple constituencies with differing (though similar) objectives. For example, in a corporate retailing cooperative, the objective of the company may be to support the owners/members in their retail distribution businesses. While this appears a clear objective, the situation is most likely complicated because the needs of large retailers will often vary considerably from those of smaller retailers (e.g., large retailers may benefit from training materials while the smaller retailers may benefit more from the corporate cooperative developing shared IT systems and support). Even traditional shareholding structures can suffer from a similar concern; the rapid rise of ethical investment funds (Dunfee, 2003; Hildrey, 2003) clearly indicates that profit is not always the single motivator of investors.

The second input is the company’s *legislative and societal framework*. All companies operate within a set of rules established by the society(ies) within which they operate. For every organization there will be a law which gives it legal existence. For most organizations this will be a general law which allows the formation of corporations by individuals or groups of people (e.g., the Delaware Corporation Laws in the United States; the Companies Act 1989 in the United Kingdom, and the Corporations Act 2001 in Australia). Most societies will have a range of such laws which provide different powers and constraints for organizations. For example, in Australia there is the Corporations Act, which creates companies, state based Incorporated Associations Acts, Cooperatives Acts etc. At the other end of the spectrum, some organizations have their own law which creates them. For example, in the United States and Australia,
universities are created by acts of the state legislatures, whereas in the United Kingdom they are created by individual acts of the House of Commons.

In a modern complex society, there will be a range of other laws which impact the governance and operations of the organization. These might well apply to all organizations such as equal opportunity legislation or privacy legislation, or to a specific category of organization such as specific mining laws. For analysis purposes, there are two key questions – what are the major legal duties of the board required by general law and, second, do any specific laws (either legislation or case law) apply to this organization.

In addition to the legal requirements that act as a governance input, there are often a series of societal customs that may play a determining factor in how the board operates. For instance, many countries have a custom of only undertaking business with trusted individuals and so companies find it necessary to appoint directors with the appropriate social contacts. Similarly, there may be cultural factors such as power distance (Hofstede & Bond, 1984) that may place significant constraints in the internal governance operations, particularly if the company is expanding beyond its traditional areas of operations.

The third major input is the organization’s constitution. While the legislative framework is the set of constraints placed on a company by society through the state, the constitution is the set of boundaries agreed by the owners or members of the organization to govern the relationships between its owners, directors and managers. Normally this will centre on issues of board process and policy that can have a substantial impact on the boards functioning (e.g., who can be an owner, who can be a director, how often various meetings must occur, powers reserved by the company in general meeting, etc.). Each of these elements can have substantial impact on the
functioning and effectiveness of the board of directors. There may also be a series of voluntary agreements that supplement the constitution and these need to be incorporated into any diagnosis.

The fourth input, company history, is somewhat different from the previous three. This is because the previous three inputs reflect the constraints within which the board operates – the purpose of the company, its legal framework, and the agreed division of powers. The fourth input reflects the broader influences of past events. It is very important to understand the major phases of a company’s development and the impact of these past events on current corporate governance expectations. For example, what is the impact of past performance, corporate culture, values, and decisions on the board’s composition and the way that it functions? Company history is often the most important input. The history dictates two key elements of the process. First, it will affect who will be on the board – organizational lifecycle, previous performance and existing director networks can all play an important part in attracting directors. Second, company history will often dictate what a board does. Legacy systems in corporate governance abound and what a board is doing and how it does it will be a result of the unquestioned history of the organization.

The final input is the organization’s strategy. In this case, strategy is taken to mean how a company uses its resources. In line with this broad interpretation, the strategic decisions taken by the organization will necessarily influence the roles that the board will need to perform and the tasks that it will need to undertake.

In summary, there are five fundamental inputs into how boards work – the type of organization and its objectives, the general legal and societal framework within which the organization operates, the agreed governance framework of the organization (e.g., its constitution), the history of the organization and the organization’s strategy.
Together these factors allow for the determination of the intellectual capital of the board.

**Outputs**

While there is significant discussion on what constitutes an effective board and governance system (e.g., independence of directors, senior executive remuneration techniques, etc.), there is less discourse on governance system outputs. Outputs themselves are what the board produces – how effective it is. Instead of considering a range of output types, research has centred on either organizational performance (e.g., meta-analyses; review articles) or a group-based intermediate variable thought to lead directly to organizational performance such as strategic activity (Westphal & Fredrickson, 2001) or accepting greenmail (Kosnik, 1987).

Interestingly, this concentration on corporate performance has largely ignored two other key levels of board output – individual level outputs and board (or group) level outputs. Thus, boards will produce outputs on at least three different levels and if we are to understand how a board can add value to an organization, we need to understand how boards can contribute to other areas of organizational success such as the functioning of individuals and groups.

**Corporate Outputs**

In for-profit organizations the desired output is firm performance, which can be measured by accounting based measures and market based measures. Accounting-based measures of performance include return on assets (Cochran & Wood, 1984; Hoskisson, Johnson, & Moesel, 1994), and return on equity (Baysinger and Butler, 1985). While, market-based measures include market to book ratio, Tobin’s $q$. 
Barnhart, Marr and Rosenstein, 1994) or constructed indices such as the Sharpe measure (Hoskisson et al., 1994).

On the other hand, the outputs for not-for-profit organizations are many and varied. The issue for these organizations is whether they are meeting the expectations of their members rather than their financial performance. But even for outputs measured by financial performance, for what period of time should the board take responsibility? The next quarter? The next annual results? Or results over a five year period? The answer to this question should be defined by the board, and agreed by the owners/members.

To illustrate the importance of paying more attention to the outputs (or dependent variables) of any governance model, we need look no further than the hypothesized relationship between the board and corporate performance. There is widespread agreement that the board works with and through the CEO (and her/his management team) (Tricker, 1994; Lorsch & MacIver, 1989; Conger, Lawler & Finegold, 2001). As a result, it is reasonable to assume that any relationship between the board and corporate performance will be mediated by the effectiveness of the management team and so attempts to identify direct relationships between corporate performance and boards is somewhat naïve, particularly when carried out in a cross-sectional analysis.

As Figure 2 demonstrates, if we have an effective board and an effective CEO/management team the organization should produce positive performance. In a
similar fashion, if there is poor board effectiveness and poor CEO/management effectiveness there will be poor corporate performance (we would argue that this condition is unsustainable, either the board and/or the management team will change or the organization will cease to exist).

The corporate performance outcome represented by the other two quadrants is more complicated. Generally, we would anticipate that an effective CEO/management team would result in effective corporate governance. However, should a board prove sufficiently dysfunctional it may well overwhelm management’s effect on performance and lead to poor corporate performance (as attested by some celebrated examples such as the board of NRMA Ltd in Australia airing its dirty linen in the press). Thus, the nature of this relationship is indeterminate.

The remaining quadrant which represents an ineffective management team and an effective board is also indeterminate. The starting point is to assume that poor management will be associated with poor corporate performance. However, if a board acts immediately as “firemen” to bring the situation under control ((Lorsch & MacIver, 1989: 97-102), then poor management may not translate into poor performance. If this is the situation (i.e. good board and poor management team), it is possible that the board may be undertaking management functions. In any event, we would expect that an effective board would, over time, either be able to mentor the management team to overcome the performance issues or indeed replace management. The nature of these three quite different boardroom solutions highlights the difficulty with studying this important area – understanding the time lag between board action and corporate performance effects.
Board Outputs

While corporate performance is, of itself, an important output from the system, quite clearly the functioning of the board (as a group) and the senior management (as a group) will impact on the corporate outcomes. Thus understanding how the transformation process impacts on the board level of performance is an important consideration. The group dynamics involved can have a powerful effect on a team’s effectiveness and so assessing board outputs as a key output is an important consideration.

Individual Outputs

Similarly, corporate outputs are influenced by individual outputs. Encouraging and creating personal responses such as job satisfaction, sufficient eustress (i.e. positive stress) and even specific affective effects may be desired outputs in their own right.

The Board as a Transformation Process

Having defined the inputs and outputs of the board system, the next step in describing the framework is to outline the transformation process itself. Given the existing constraints on the organization, how does a board implement effective governance so as to achieve positive performance for the board, individuals, and the organization itself?

There are various ways to think about this process. For example, scholars and practitioners often discuss the “independence” of boards, the skills base of boards and even their social contacts. At this point in the development of the corporate governance agenda, it is probably right to conclude that there is no one best or right way to describe the different components of the board. The challenge is to identify useful approaches to describing boards and how they work, so that complex constructs can be simplified.
Such an approach can also aid in the identification of patterns and phenomena that may at first appear to be random activities.

Our approach views boards as bundles of intellectual capital that operate through a role set determined by the organization’s internal and external environment. We have chosen to view a board as a mix of intellectual capital because this construct can be conceptualized to capture all the essential elements of board composition that contribute to effective performance. Intellectual capital itself is a concept of emerging interest for research scholars (e.g., see Bassi & Van Buren, 1999; Bontis, 1999; Brooking, 1997; Keenan & Aggestam, 2001; Petrash, 1996; Roos, Roos, Dragonetti, & Edvinsson, 1997; Stewart, 1997; 2001; Sveiby, 1997).

In applying intellectual capital to the board of directors we have adapted Stewart’s (1997: xix-xx; 66-68) terminology to define it as

The intellectual resources such as knowledge, information, experience, relationships, routines, and procedures that a board can employ to create value.

In our framework, the board and its intellectual capital are the fundamental means for transforming inputs into organizational performance. It is necessary, therefore, to understand the key components of the board and the fundamental dynamics that show how these components interact to perform the transformation process.

**Board Intellectual Capital Components**

The definition of board intellectual capital outlined provides a wide variety of board attributes that impact on effective governance. These attributes all fall within one of four major sub-domains: (1) human capital, (2) social capital, (3) structural capital, and (4) cultural capital. We will discuss each of these individually (see Table 2 for
overviews of these components) and highlight how each sub-domain may reside at the individual or board level.

The first component is the board’s human capital – that is, the individual knowledge, skills and abilities possessed by directors. In undertaking any review, emphasis should be placed on the knowledge, skills and abilities of board members relevant to the organization rather than general business acumen. Analysis of human capital would include a description of the basic functional, industry, board-specific, organization-specific and organizational specific knowledge, skills and abilities of the directors. For example, what is the level of industry experience possessed by this board? Is there knowledge of this particular organization? What about requisite functional knowledge (e.g., merchandising in a retail corporation)? And so on.

The only way that the board can carry out the functions required of it is by individuals applying their knowledge, skills and abilities to the tasks at hand. This makes the board’s human capital the starting point in understanding the transformation process. The board’s human capital dictates the upper limits of its capability – no amount of teamwork, processes or even ethical behaviour can substitute for a lack of basic ability. Rather, all other elements of intellectual capital (or lack thereof) impede the use of human capital. Ineffective processes, dysfunctional relationships and inappropriate ethics can only serve to reduce the efficacy of human capital. For instance, ineffective processes may inhibit the flow of information to the board and so its human capital cannot be deployed. Similarly if poisonous personal relationships exist (either between board members or between the board and management) then the
board may not interact effectively and, once again, the board’s deployment of human capital is degraded.

Figure 3 demonstrates this relationship. The longer arrow signifies that the maximum capability of the board is dictated by the human capital of its members working together under optimal conditions – the level of knowledge, skills and experience that the board can bring to bear if it were to function perfectly. The second arrow represents the performance of a hypothetical board. The first point to note is that the hypothetical performance will always be less than the potential performance. The second point is that the other three sub-domains of capital – social capital, cultural capital and structural capital, will determine the performance gap.

The second component of a board’s intellectual capital is its social capital or the implicit and tangible set of resources available to the board by virtue of social relationships (adapted from Gabbay & Leenders, 1999: 3). This is because board members can add value to the firm by providing access to scarce resources such as information (Baysinger & Zardhoohi, 1986), capital (Mizruchi & Stearns, 1988), power (Scott, 1991), and industry contacts (Pfeffer, 1972). Thus, to determine a board’s social capital we need to understand what key relationships the board members hold, the nature of these relationships (e.g., is there a high degree of trust?) and the resources that are available as a result of these relationships. Since our key level of analysis is the board, it is important to note that social capital does not only reside in relationships outside the company. Thus, there will be three types of social capital in every board. First, there will be intra-board social capital. This capital is the “store” of goodwill that exists between board members and will determine the productivity of exchanges in (and
outside) the boardroom. Second, there is the board-management social capital. As with the intra-board social capital, this is the store of goodwill that exists between the members of the board and individual senior managers, most notably the CEO. The level of capital in this relationship will again determine to a large extent the effectiveness of exchanges between the board and management. Finally, there is extra-corporate social capital. This element of social capital is more complex than the other two because not only does it relate to a relationship between corporate actors (i.e. board members and external parties who can supply resources such as finance, information, key inputs, etc.), but the nature and extent of resources that the external party can supply. Thus, in a government corporation, for example, an important element of social capital may be the information a director can garner from his or her contacts within a relevant government department. In this case we are focused on both the nature of the relationships between the parties (i.e. the director and the government employee) and the attractiveness of the resource (in this case the information that can be gathered legally and ethically).

The third component of board intellectual is its structural capital or its explicit and implicit codified knowledge (Bontis, 1998: 65). Structural capital includes the various procedures, policies, routines, processes and methods that the board has developed in order to function. This structural capital can be codified and/or tacit and can be broadly categorized either as a routine, a policy or element of board culture. The first categorization of structural capital, routines, would include various mechanical aspects of the governance function such as how the board papers are developed, how the agenda is compiled, how minutes are taken and distributed, and so on. These routines can be either explicit (i.e. documented) or implicit (i.e. undocumented, but a known expectation). The second categorization, board policies, will generally be
recorded in either the minutes of the meeting where the policy was passed or consolidated into a form of board charter or policy manual. As a result, board policies will tend to be explicit. Board policies are concise statements regarding the board’s expectations with respect to specific issues ranging from behavioural/ethical expectations to more routine matters. The third and final categorization of board structural capital is the board’s culture. Board culture is a term used to describe the underlying values, beliefs and norms of the board (Schein, 1992). This will tend to be implicit and govern “the way we do things around here” (Deal & Kennedy, 1988: 4). Together, the routines, policies and culture of the board set out a shared set of structures that can minimize (or conversely exacerbate) the process loss of the board.

The final component of the board’s intellectual capital is its cultural capital or the resources captured through social identification with the values, norms and rules sanctioned by the dominant institutions (Lin, 2001: 43), for example, transparency, honesty, and so on. It is subtly different from social capital in two ways. First, cultural capital is captured by virtue of social identification (i.e. the identities or social categories by which people define themselves, e.g., gender, occupation (Tajfel, 1981)), not of relationships (although in certain circumstances there will be an overlap of the two). Second, cultural capital deals with the degree to which board members share norms, values and rules within the operating environment, not each other (as in board culture). The board’s “embeddedness” in the predominant culture can allow it access to resources to impact the transformation process. For instance, individual board members’ reputation for honesty can allow them access to sensitive information even where they do not share a direct relationship with the person who is providing the information (which, by definition, is a requirement of social capital).
Boards can therefore be conceptualized as a set of four components – the human, social and cultural capital of individual directors and the social and structural capitals of the board as a whole. The value of the proposed framework, however, does not lie so much in identifying these various components. Rather, it lies in identifying the nature of the interaction between them. Thus, the critical point is nature of the dynamics and relationships between the various components. To demonstrate this issue, we must turn to the concept of board dynamics and congruence or fit.

**Board Dynamics and Intellectual Capital Fit**

Thus far the framework has outlined the transformational process of the board as a set of four interrelated components or capitals. This approach has not offered a view on the dynamics of the system, most notably the behaviours of individuals within the governance system. We view these behaviours or board dynamics as the interplay between the various components of intellectual capital. These one-off actions result from the interplay between the board’s capitals and are different from the components themselves. The various capitals represent different stocks (or levels) of capability that reside in individuals or the group and they enable the board to add value during the transformation process. In contrast, board dynamics represent activities undertaken by system actors to change the stock of a board’s capital. Board dynamics are the “sparks” that fly from the interplay between the “flints” of intellectual capital. They occur because of a change in a capital component. Similarly, a dynamic will itself lead to another change in the capital of the board.

A practical example can clarify the difference. Suppose a new director joins the board. In this case, the human capital of the board (knowledge, skills and abilities of the directors) has changed. After undergoing an induction process, the director believes that the induction could be improved by structuring a series of one-on-one meetings...
with the CEO and senior managers. The director will then undertake a behaviour, for instance, raising the issue at a board meeting, which we view as a board dynamic. This behaviour or dynamic will lead to a change in some component(s) of the board’s intellectual capital. In this example, if the induction process changes as a result of the discussion, there has been a change in the board’s structural capital. If the induction process is not changed, then the discussion (i.e. the dynamic) will either build or erode intra-board social capital. Either way the dynamic or behaviour is a result of, and results in, changes in the board’s intellectual capital.

As this example highlights, the degree of fit or congruence between the various elements of board intellectual capital is critical. This congruence can be defined as the level of alignment or balance between the requirements of one component in the system with the requirements of another component. Board dynamics that are normatively described as “good” will be the result of congruent intellectual capital; the various components make demands on each other that are consistent and achievable. In contrast, “poor” board dynamics will result from incongruence or poor fit between the elements.

Consider another relatively simple example involving the board’s human capital and structural capital. The type of information presented to the board and the way that this information is presented (i.e. structural capital) will make demands on a director’s knowledge, skills and abilities. Since directors have a set level of human capital, the better the match (or fit) between information presentation and director ability, the “better” will be board dynamics and task execution. To be even more specific, it is unlikely that the board of a small non-profit company would have the same ability to comprehend complex financial information as a large finance company. While both
companies need to understand their financial situations, we would expect a difference in how this understanding is met.

The human-structural capital dynamic covers more than the interplay between information presentation and knowledge, skills and abilities. Similarly, each set of relationships or interplays in the model will have a number of characteristics. While a detailed review of each and its potential impact on effective governance are beyond the scope of this paper, Table 3 highlights the key elements of each relationship.

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**Insert Table 3 About Here**

Analyzing the detail of each of these fits will require other more specific sub-models that can be found in existing organizational behaviour and corporate governance research. As an example, Westphal (1999) identified that when directors are social contacts of the CEO, they are more likely to provide her/him with advice. Thus, the social capital will influence the application of the human capital of the board. The complete framework will allow the analyst a view of collective system fit, in as much as there is a degree of fit between the individual components of board capital. The intellectual capital can only be assessed, however, in light of its total alignment with the board’s role requirement. Thus the final component of the transformation process is board roles.

**Board Roles and Contingency Factors**

An effective board is one that can successfully execute the role set required of it. Therefore, a sophisticated understanding of roles and the interplay between the roles and the company’s environment is central to any assessment of board effectiveness. Current research has investigated the board’s role in controlling the organization
(Monks & Minnow, 1995), monitoring management (Bainbridge, 1993; Byrd & Hickman, 1992; Fama, 1980; Westphal, 1999; Zahra & Pearce, 1989), providing advice to directors (Baysinger & Butler, 1985, Kesner & Johnson, 1990; Westphal, 1999), assisting in development of corporate strategy (Judge & Zeithaml, 1992; McNulty & Pettigrew, 1999) and providing access to resources (Pfeffer, 1972, 1973; Pfeffer & Salancik, 1978). These examples form part of an extensive stream of governance research that has advanced our understanding of how boards work from the perspective of executing an individual role.

Two interesting points emerge from the literature. First, while early research tended to characterize boards as largely ceremonial bodies (Mace, 1971; Herman, 1981), more recent normative and academic literature portrays the board as an increasingly active body seen as ultimately responsible for corporate success (Cohan, 2002; Sonnenfeld, 2002). This more recent portrayal is also a result of changing societal expectations of the board. Second, as a general rule, research has concentrated on how the board’s execution of a single role affects organizational performance rather than a relationship between execution of an integrated role set and performance.

This absence of an integrated approach has resulted in the board’s role set being conceptualized in several different ways (e.g., see Hung, 1998; Johnson, et al., 1996; Lipton & Lorsch, 1992; Pettigrew, 1992; Zahra & Pearce, 1989). While differences in terminology and classification systems persist, there is general agreement on three key activities that a board needs to fulfil (e.g., Johnson et al., 1996; Zahra & Pearce, 1989). These three roles of the board are: (1) controlling the organization (including monitoring management, minimizing agency costs and establishing the strategic direction of the firm); (2) providing advice to management (which may include providing advice on strategy and is sometimes classified as a component of the control
role), and (3) providing the firm, through personal and business contacts, access to resources (including access to finance, information and power).

The ability of the board to execute these three roles will, we contend, determine how effectively the board governs the company. That is not to say, however, that all firms share the same governance needs. In fact, the nature and balance of board roles will vary depending on the inputs, that is the company’s context and evolution (Johnson, 1997). For instance, if a company is the subject of alternative monitoring forces such as concentration of share ownership (e.g., Dalton, Daily, Certo, & Roengpitya, 2003: 21), the board may add greater value by providing salient advice to management and access to resources than by monitoring. Alternatively, in complex companies the board may need to take a much stronger role in controlling the company. Stable industries and companies such as regulated utilities may require highly specialized boards, such as those that possess key government contacts. Other more competitive industries may require a better-rounded set of roles to be effectively implemented (Pfeffer, 1972). Figure 4 provides an elaborated set of contingency factors.

The Alignment Proposition

The final task in explaining the framework is to highlight the critical nature of system alignment. In essence we propose that the board’s effectiveness depends on the alignment between the various board capitals and its required role set. Rarely will effective corporate governance be the function of a single component within the framework (e.g., human capital or social capital). Instead, effective governance results
from a mix of intellectual capital that enables the board to carry out a set of roles dictated by the company’s individual circumstances. The challenge in governance is, therefore, to understand the roles required of the board and then match the intellectual capital of the board to those roles.

As a key input in the framework, strategy dictates that a board also requires alignment with the internal and external environment. By definition, the board will be most effective when it can respond to external environment demands such as changes in legislation, the competitive environment and broader socio-economic trends. Board effectiveness will also depend on the relationship between the board and the governed company. For instance, there will need to be a certain degree of fit between the board and the culture, people and systems of the organization. By and large, this fit will be evident both as key impacts on the required role set and on the fit of specific elements of intellectual capital.

An important implication of the framework is that diagnosing corporate governance problems involves a holistic understanding of the entire system. This overarching view of the system allows for a deeper understanding of the concerns facing a board and a consequent analysis of fit is more likely to determine the cause(s) of those problems. Importantly, as highlighted in the system characteristic of equifinality, the framework also recognizes that different combinations of the key components can be used to achieve the same outputs. Therefore, the problem is not to find the “one best way” of governing, but rather to understand how effective combinations of intellectual capital fit together and lead to congruence with a firm’s needs.

This complexity means that understanding fits and identifying the combinations of elements to produce fit is not necessarily self-evident. A number of the combinations
that lead to fit have been explored in the literature, for instance the relationship between
effective monitoring and the characteristics of board members. The existence of this
empirical basis means that in many cases the level of fit can be defined and sometimes
even measured. However, the framework provided here provides assistance in
understanding from a holistic viewpoint as to factors that lead to effective board
components and the relationships between them. The implication is that when involved
in problem diagnosis, the researcher or practitioner needs to be aware of the critical
aspects of relevant corporate governance theories to evaluate the fit in a particular
system.

As a result of this complexity, the intellectual capital model provides a general
organizing framework. Board specialists and researchers will require more specific
“submodels” to help them define high or low fit in specific circumstances (Nadler &
Tushman, 1980). Examples of submodels that might be used in the context of this
framework include: (1) agency theory to assess the fit between monitoring, human
capital and board-management social capital, (2) stewardship theory to assess the fit
between providing advice, board-management relationships and cultural capital, (3)
resource dependence theory to assess the fit between providing access to resources and
the social capital of individual directors, and (4) institutional theory to assess the fit
between the board’s inputs and its other organizational components. These theories are
not meant to be a comprehensive list of submodels, but provide insight into how the
general model comprises extant corporate governance research.

The other key attraction of the framework is that it recognizes the trade-off
between the various attributes of a board. Boosting a board’s human capital may come
at the expense of its board social capital (e.g., recruiting new members for specific skills
may lead to process loss as a result of a larger board or it may even lead to a
deterioration in board relationships (i.e. intra-board social capital)). Thus, it provides an organizing framework for the researcher in terms of research design and interpretation of data and for the practitioner in terms of essential areas for investigation and intervention.

Figure 5 illustrates the general framework for board analysis that we have described. The board can be conceptualized as a system that transforms inputs into outputs – a process that is facilitated by its intellectual capital and is contingent on the roles required of it. The fit between these components is the crucial dynamic that we need to understand if we want to know how boards work. With the model described the next section outlines how it can be used to analyze board problems.

---

**Board Problem Diagnosis**

Since boards and their directors face constantly changing circumstances they are continuously involved in identifying and solving problems; they are constantly assessing their effectiveness against desired levels of performance in order to identify problems and develop interventions designed to align actual and desired performance levels. To assist in this process we have developed a ten step generic problem solving process that uses the intellectual capital framework to identify governance problems and generate possible interventions (adapted from Nadler & Tushman, 1980: 48)). In this section we describe each step in the process and demonstrate how the intellectual capital framework can be applied to a real world governance problem. The steps are:
1. **Symptom identification**: the first stage involves collecting data on the problems that the board faces. At this stage, the investigator is seeking to identify data that indicate that there is a problem(s), rather than where the problem lies or what the problem actually is. This is because symptomatic data may indicate where to look for more complete data rather than lead to the immediate identification of problems.

2. **Input specification**: With the symptoms identified, the next stage in the problem solving process is to identify the key influences on the board’s transformation process. This will involve collecting data on the type of organization that the board governs, the legislative and societal framework within which it operates, the constitutional and voluntary agreements governing its operation along with an assessment of historical influences. This stage will also involve understanding and elaborating the strategy of the organization – its vision, mission and values along with supporting objectives and strategies.

3. **Output identification**: After examining the system inputs, it is necessary to identify the desired system outputs. As previously outlined, these outputs may occur at the individual, group and organizational level. First, it is necessary to outline the organizationally preferred outputs. Second, it is necessary to gather data to ascertain the board’s realized output for comparison with the desired outcomes.

4. **Problem Identification**: After gathering actual system outcomes, it is necessary to identify the divergence between desired and actual outcomes. While this may build upon step 1 of the process (i.e. the symptom identification) it is a more rigorous analysis with the objective of problem (as opposed to symptom) analysis. Thus, the problem(s) may occur at several places in the governance
system. Note that this comparison will tell us where the problem exists, but not necessarily its cause(s).

5. **Describe the Board’s Intellectual Capital:** With the problem identified, the next step begins to investigate its cause(s). The starting point is a description of the four key components of board intellectual capital. This involves describing the board’s human capital, social capital, structural capital, and cultural capital, including the nature and essential characteristics of each component.

6. **Describe the Board’s Role Set:** The next step involves understanding the roles currently being undertaken by the board.

7. **Assess Board Role Fit:** Following a description of the board’s role set, it is necessary to begin assessing the fit of the company’s governance system. The first step is to review the fit between the board’s role set and company needs. A review of the internal and external operating environments and alignment with strategy can inform this stage.

8. **Assess Intellectual Capital–Board Role Fit:** Step 8 involves assessing the positive or negative fit between the components identified in the previous three steps. This assessment is undertaken by applying submodels or theories (e.g., agency theory, stewardship theory, resource dependence theory, etc.) to the data collected in steps 5 to 7.

9. **Develop hypotheses:** With components and fit assessed, this step involves developing an understanding of the relationships between the patterns of fit and the firm outputs. In essence, this stage links the problem identification of step 4 with the analysis of fit in steps 5 to 8. The outcome should be a proposed linkage between the elements of the board’s intellectual capital, its required role set and the observed company outputs.
10. **Develop action steps:** The final step in the problem solving process is to develop a series of action steps aimed to resolve the problems caused by the lack of congruence. As with any problem solving approach, it will be necessary to implement and monitor the impact of the chosen course of action.

The intellectual capital framework and the associated ten-step problem solving process are aids in understanding and managing the complex relationships that exist within the governance of modern organizations. Since both companies and social systems are unique, dynamic and indeterminate it is impossible to provide a generic solution to governance problems. The model and process do, however, allow practitioners a framework for making interventions and determining the consequences of those interventions.

**Future Directions**

In many ways, this framework raises more questions than it answers. By presenting a novel perspective on boards, many questions remain unexplored. Are all the key components identified in this framework? Are the relationships outlined the key elements for understanding how boards work? These specific questions highlight the often-overlooked fact that directors are a small social group that is part of a highly dynamic system – a complex and evolving array of political, social, legal and economic factors (Leighton & Thain, 1997). While these and related questions are valid challenges to our framework, we hope that it provides a starting point for such a discussion. In fact, the lack of a generalized problem-solving framework suggests that we do not have a basic functional understanding of how boards work (Nadler & Tushman, 1980) and we hope the framework presented here goes some small way to
advancing our understanding. Having a framework to understand how a board works is normally a prerequisite for social science research – and this has been our starting point.

Hopefully, this framework may also lead to an understanding of the generalized types of problems that a board might meet and the patterns of causes of those problems. While all governance situations are in some ways unique, a key question on which we need to focus is: Are there basic problems that all boards face? Is there some method of categorization that we can use to diagnose these problems and suggest remedial interventions? Similarly, it may be possible to isolate specific conditions, such as regulated industries where a board role may be more or less important (e.g., Pettigrew, 1992). Alternatively, it may be possible to link a particular element of board intellectual capital with the provision of a specific board role(s). The application of the model will, we hope, lead to benefits in our governance systems.

From a practitioner perspective, the framework can provide a useful device for assessing board performance and has the potential to improve corporate performance through the resultant improvement in board role execution. The intellectual capital framework may assist boards and their advisers to assess their particular board composition needs and to construct the relevant process-related interventions that can improve board performance.

Summary

Corporate governance has begun to assume an increasingly important place in organizational life. As the ultimate decision-making body in organizations, the board is inexorably linked to organizational performance. This article has attempted to present a generalized framework and process to assist us to conceptualize how boards work and what we can do to improve board and consequent firm performance. It is a way of conceptualizing boards, but clearly not the only way of thinking about boards.
Similarly, we would not claim that it is the definitive framework for analyzing boards. Instead, we hope this framework can assist researchers to investigate the complexities of boardroom life, assist policy makers develop laws and regulations which will improve organizational performance, and help directors and their advisers to develop and maintain effective boards.
REFERENCES


Figure 1: Simple board transformation framework
Figure 2: Board/Management Performance Interaction

MANAGEMENT PERFORMANCE

<table>
<thead>
<tr>
<th>Poor</th>
<th>Good</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poor</td>
<td>POOR</td>
</tr>
<tr>
<td>Good</td>
<td>GOOD</td>
</tr>
</tbody>
</table>

BOARD PERFORMANCE

- Initially uncertain depending on nature of management’s flaw(s).
- However, after an indeterminate period an effective board will rectify the situation, leading to good management performance after an indeterminate time lag

Uncertain – depends on whether poor board performance will override good management performance
Figure 3: Representation of process loss in board capability

Board’s potential performance determined by the sum of human capital

Gap due to inadequate structural, cultural or social capital

Board’s actual performance
Figure 4: Contingency factors impacting on board role requirements
Figure 5: The board intellectual capital framework

Inputs
- Organization Type
- Legal Framework
- Constitution
- History
- Strategy

Board Intellectual Capital
- The Individual
  - Human Capital
  - Individual Social Capital
  - Cultural Capital
- The Team
  - Board Social Capital
  - Structural Capital

Board Dynamics

Context
- Internal Environment
  - Board Roles
    - Controlling the organization
    - Providing advice to management
    - Providing access to resources
- External Environment

Outputs
- Board Effectiveness
  - Team effectiveness
  - Individual effectiveness

Organizational performance

The Team
The Individual

Board Effectiveness

Organizational performance

Human Capital

Individual Social Capital

Cultural Capital

Structural Capital

Board Social Capital

The Team

The Individual
### Table 1: Key inputs to the board performance relationship

<table>
<thead>
<tr>
<th>Input</th>
<th>Definition</th>
<th>Critical Feature for Analysis</th>
</tr>
</thead>
</table>
| Organization Type          | Underlying purpose of the organization (e.g., government corporation, listed corporation, not-for-profit organization, statutory authority, university etc.)                                                    | 1. Is there a unified articulated organizational purpose shared by owners, boards and managers?  
2. Are there multiple constituencies within the ownership or membership structure?                                                                                                                                |
| Legislative and Societal   | Society endorsed rules that govern the operation of this organization                                                                                                                                                                                                               | 1. What are the major laws and societal customs within which the board must act?  
2. Are there any specific legal duties/framework/customs for this organization?                                                                                                                                                  |
| Framework                  |                                                                                                                                                                                                                                                                         | 1. What are the legality enforceable elements of board operation specified by the company’s Constitution?  
2. Are there any other agreements that impinge on the board’s function?                                                                                                                                                          |
| Constitution               | Governance agreements that govern the organization that were agreed by the corporate owners                                                                                                                                                                               | 1. What have been the major stages or phases of organizational development?  
2. What is the impact of these stages on board makeup and functioning?  
3. How do the current corporate culture, values, behaviours and decision-making processes affect board performance?                                                                                                                 |
| History<sup>1</sup>        | Patterns of past activity, behaviour and effectiveness of the organization that may effect current board structure and functioning                                                                                                                                      | 1. What is the organization’s core mission?  
2. What strategies has the organization employed to achieve its core mission?  
3. What objectives have been set for organizational performance?                                                                                                                                                                |
| Strategy                   | Strategy is the way in which a company uses its resources                                                                                                                                                                                                                  |                                                                                                                                                                                                                               |

<sup>1</sup>Adapted from Nadler & Tushman, 1980
### Table 2: Key Components of Board Intellectual Capital

<table>
<thead>
<tr>
<th>Component</th>
<th>Human Capital</th>
<th>Social Capital</th>
<th>Structural Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Definition</strong></td>
<td>Innate and learned abilities, expertise and knowledge (adapted from Castanias &amp; Helfat, 2001: 662)</td>
<td>Implicit and tangible set of resources available by virtue of relevant social relationships (adapted from Gabbay &amp; Leenders, 1999: 3)</td>
<td>Explicit and implicit codified knowledge (e.g., routines, policies and procedures) (see Bontis, 1998: 65)</td>
</tr>
<tr>
<td><strong>Resides in</strong></td>
<td>• Individual Directors</td>
<td>• Individual Directors</td>
<td>• Board</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Board</td>
<td>• Individual Directors</td>
</tr>
<tr>
<td><strong>Key Dimensions</strong></td>
<td>1. General knowledge</td>
<td>1. Network of extra organisational contacts – scope of resources and nature of contacts</td>
<td>1. Documented board policies including Manuals, Charters and Guidelines</td>
</tr>
<tr>
<td></td>
<td>2. Industry experience</td>
<td>2. Relationship(s) with CEO, both as a board and as individuals</td>
<td>2. Board culture</td>
</tr>
<tr>
<td></td>
<td>3. Organisational experience</td>
<td>3. Implicit board procedures and norms</td>
<td>3. Individual work norms</td>
</tr>
<tr>
<td></td>
<td>4. Board experience</td>
<td></td>
<td>2. Individual morals</td>
</tr>
<tr>
<td></td>
<td>5. Company specific knowledge and experience</td>
<td></td>
<td>3. Individual motivations</td>
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<tr>
<td></td>
<td>6. Functional experience and knowledge</td>
<td></td>
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<tr>
<td></td>
<td>7. General business knowledge and experience</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fit</td>
<td>Key Questions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Human Capital/Structural Capital</td>
<td>• Do the policies, procedures and culture make best use of the board’s knowledge, skills and ability as a group? Do policies, procedures and culture make the most of each individual director’s knowledge, skills and abilities?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Human Capital/Social Capital</td>
<td>• Is there sufficient trust on the board for the most to be made of director’s capabilities? Do relationships encourage the use of the board’s talents by management? Do Directors understand how they can put their contacts to work for the company?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Human Capital/Cultural Capital</td>
<td>• Do the values, norms and beliefs of the board support the best use of the board’s capabilities? How do the group’s values, norms, and beliefs affect a director’s willingness to use his /her capabilities?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social Capital/Structural Capital</td>
<td>• Do policies, procedures, and culture build trust in the boardroom? Between the board and managers? Between the board and external organisations?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social Capital/Cultural Capital</td>
<td>• Do the values, norms, beliefs of the group match those of society? • Do the individuals share values, norms, beliefs? • Do these match management’s values, norms, beliefs?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Structural Capital/Cultural Capital</td>
<td>• Do policies, procedures, culture match societal expectations?</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 3: Analysis of Intellectual Capital Fit
**ENDNOTES**

1 The framework outlined in this paper can apply to boards, or groups legally charged with the responsibility for an organization, be this a for-profit, a not-for-profit, or government corporation. Such organizations are created by a variety of statutes in most sovereign states. The key hallmark of such organisations is that the final legal responsibility for the direction and control of the organization rests collectively in a team of people and not just an individual. Hence the term “board” in the paper refers to such teams.

2 Agency costs arise in organisations where the owners are not the managers of the firm. Typically, the interests of the owners (maximising shareholder returns) do not wholly match the interests of managers. Given various attributes of the management-shareholder relationship (such as information asymmetry) the owners of the firm will need to employ mechanisms to minimise their losses from this lack of alignment. One way of minimising losses is to implement a board of directors to oversee shareholder interests.

3 Encouragingly, issues such as board performance reviews (Higgs) and structuring the board to improve performance (ASX Guidelines) are appearing on the agenda, but they tend to be a minority and not clearly defined.

4 For example some for-profit organizations have specific social objectives (e.g. the Body Shop) while some not-for-profit organizations (e.g., Greenpeace) have specific elements of their operations that are undertaken to make a profit to spend in other areas.