BREAKTHROUGH BOARD PERFORMANCE: HOW TO HARNESS YOUR BOARD'S INTELLECTUAL CAPITAL

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ABSTRACT

To date, corporate governance research agendas have tended to concentrate on one particular role that a board performs. For instance, agency theory concentrates on the monitoring role, resource dependence theory concentrates on the board providing access to resources and stewardship theory concentrates on the board's advice-giving or strategic role. While these approaches provide practitioners with useful guidelines regarding issues such as board independence, we contend that practitioners need to take care not to act on the recommendations from a single theory in isolation from the others. To address this concern, we provide a model of board effectiveness that uses the construct of board intellectual capital to integrate the predominant theories of corporate governance and illustrate how the board can drive corporate performance. We further contend that boards that wish to improve their performance need to review their intellectual capital. We conclude by linking the model to a practitioner-focused framework that identifies four key areas on which a board must concentrate to develop its intellectual capital.

KEYWORDS: Boards of directors; Corporate governance; Intellectual capital; Board roles; Board effectiveness

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The role of the board and its impact on corporate performance is a topic of increasing interest to the general community (Nussbaum, 2002). Recent high profile corporate collapses throughout the world have only intensified media (Lavelle, 2002; Economist, 2002) and institutional investor scrutiny (USA Today, 2002a; 2002b). As Tricker (2000: 5-6) contends, it appears that, "… as the nineteenth century had seen the era of the entrepreneur and the twentieth century the era of management, in the twenty-first century the focus has swung to the governance of companies…"

Despite this increased interest, our understanding of how boards impact on corporate performance is relatively undeveloped. In fact, practical corporate governance is largely reliant on normative guidelines that do not reflect empirical evidence. For instance, while the majority of corporate governance reports (e.g., Committee on the Financial Aspects of Corporate Governance, 1992) call for board independence, the academic community has failed to identify a consistent, significant relationship between board independence and firm performance (e.g., Dalton, Daily, Ellstrand and Johnson, 1998; Dalton, Daily, Johnson and Ellstrand, 1999; Rhoades, Rechner and Sundaramurthy, 2000). Therefore, if we are to understand how the board influences corporate performance, we must establish a new research direction (Hermalin and Weisbach, 2000) and begin to understand the process(es) involved (Forbes and Milliken, 1999)

Recent corporate governance research has begun to examine these questions of board process, particularly indirect processes that may link boards to corporate performance. For instance, it is suggested that the likelihood of forming an alliance between two firms is reduced by the independence of the boards involved and increased by CEO-board cooperation in strategic decision-making (Gulati and Westphal, 1999). Similarly, Golden and Zajac (2001) report that, in the governance of hospitals, board processes and demography significantly affect strategic change.

Our objectives in this paper are twofold; first, we seek to build upon this process-orientated research agenda by developing a model that links board attributes to corporate performance via the roles that a board performs. Second, we aim to outline the practical implications of this model for those boards interested in improving their impact on corporate performance. The aim being to provide practitioner-focused guidelines for boards that are based on a number of emerging academic constructs.

We commence by identifying and classifying the skills and attributes that characterise effective directors and by discussing the tasks or roles that a board must perform if it is to influence firm performance. We contend that the board influences corporate performance when it carries out not one role, but a series of roles required of it. Further, we argue that this role set will be contingent on a number of internal and external factors. The second component of the paper links this model to a practitioner-focused framework. The components of the framework are defining board roles, improving board process, key board functions and continuing improvement. We conclude by highlighting how boards that address these components can anticipate performance improvements through content development and process gains.

BOARD EFFECTIVENESS

Most governance recommendations focus on a single board activity rather than an integrated set of board roles. For instance, high profile corporate collapses around the globe have heightened calls for active boards that rigorously monitor the corporations that they govern (Guthrie and Turnbull, 2002; Economist, 2002; New York Times, 2002; USA Today, 2002a; 2002b).

In general, these calls have largely concentrated on increasing board independence, despite overwhelming evidence that board independence has no significant impact on corporate performance (Bhagat and Black, 2002; Dalton et al., 1998; Dalton et al., 1999; Rhoades et al., 2000). Similarly, few would argue that a company of independent dolts would add more value to a company than a group of less independent but experienced, knowledgeable and connected directors.

This is the case for two reasons. First, the ability to adequately monitor a large and complex organisation takes knowledge, skills and experience that are quite separate from a director's independence. Second, a director can contribute to corporate performance in several ways, for instance by providing access to resources (Pfeffer, 1972; 1973; Pfeffer and Salancik, 1978), advice and counsel (Baysinger and Butler, 1985; Kesner and Johnson, 1990; Lorsch and MacIver, 1989; Mace, 1971; Westphal, 1999; Whisler, 1984) or through assisting in the development of corporate strategy (Judge and Zeithaml, 1992; McNulty and Pettigrew, 1999). Thus, to better understand how a board contributes to firm performance, we need to understand the various roles required of it.

BOARD ROLES

Board effectiveness occurs via the execution of a role set that is conceptualised by different researchers in different ways (Hung, 1998; Johnson, Daily and Ellstrand, 1996; Lipton and Lorsch, 1992). What is clear is that the roles of the board have evolved over time. Historically, boards were seen to play a largely ceremonial role best exemplified by their description as "ornaments on the corporate Christmas tree" (Mace, 1971: 90). Defining a clear role set is difficult as different disciplines concentrate on different areas of interest. For example, Pettigrew (1992) identified six themes of academic research on the role of managerial elites (such as chairpersons, presidents, CEOs, and directors). These include the study of interlocking directorates and the study of institutional and societal power, the study of boards and directors, the composition and correlates of top management teams, studies of strategic leadership, decision-making and change, CEO compensation and CEO selection and succession. In contrast, Pfeffer and Salancik (1978) viewed the board as a key link to the external environment and identified three key roles, as (1) Serving as a co-optive mechanism to access resources vital to the organisation; (2) Serving as boundary spanners; and (3) Enhancing organisational legitimacy. Hung (1998), on the other hand, developed a typology of six roles and investigated their theoretical underpinnings. These were (1) linking the organisation to the external environment; (2) coordinating the interests of shareholders, stakeholders and public; (3) controlling the behaviour of management to ensure organisation achieves it objectives; (4) strategy formulation; (5) maintenance of the status quo of the organisation; and (6) supporting management.

The lack of a clearly agreed role set is also reflected in the business press and prestigious reports into improving governance. Cases such as Enron in the US and HIH in Australia have led to conclusions that the board is either directly responsible for corporate failure or did not take adequate precautions to avert the disaster (Brammall, 2001; Byrne, 2002; Zandstra, 2002). Whether these conclusions about board accountability are correct or not, the key outcome of such events is to concentrate the corporate governance debate on the monitoring role of the board and the importance of independent directors as a mechanism to reduce agency costs and avert corporate collapse. International normative guidelines also reflect this concentration on the monitoring role of the board. As Table 1 illustrates, these sources provide structural guidelines for best practice, which generally provide recommendations to ensure board independence.

INSERT TABLE 1 ABOUT HERE

There are, however, three board roles that receive broad support (Zahra and Pearce, 1989). The first is the role of the board in controlling and monitoring management, a role made necessary by the separation of ownership from control (Berle and Means, 1932). This role of the board has tended to dominate the literature, driven largely by growing legislated duties (OECD, 1999), fallout from corporate scandals in the 1970s and 1980s (Burrough and Helyar, 1990), and the rise of agency theory (Eisenhardt, 1989). The second widely accepted role is that of advising the CEO (Lorsch and MacIver, 1989), and the third is the resource dependence perspective, which envisages a role for directors in providing access to resources, including information (Pfeffer, 1972; 1973; Pfeffer and Salancik, 1978; Zald, 1969).

Our approach adapts this three-role set of Johnson et al. (1996) and Zahra and Pearce (1989). In addition to the monitoring, advising, and accessing resources (termed strategy in Zahra and Pearce, 1989) roles these authors outline, we have added a separate strategising role of the board. This role is normally subsumed under the "advising" role. The strategising role is included for three reasons: the increasing performance pressures being applied by institutional investors (Black, 1992), board perception of the importance of the strategising role (Tricker, 1984), and recent legal precedent that places corporate goal setting and strategic direction squarely within the board's charter (Baxt, 2002; Glaberson and Powell, 1985; Kesner and Johnson, 1990). As a result, we contend that:

P1a: Board effectiveness depends on the execution of a set of four board roles, namely monitoring and controlling, strategising, providing advice and counsel and providing access to resources; and that

P1b: Firm performance will be positively impacted by board effectiveness.

CONTINGENCY AND BOARD ROLES

While all boards are required to undertake activities within the spectrum of this role set, we contend that each organisation will need a different emphasis among these roles. Thus, this model emphasises the need to "explicitly incorporate a contingency perspective" (Heracleous, 2001: 170; Donaldson and Davis, 1994; Johnson, et al., 1996). Since a particular board composition or behaviour that is advantageous for one corporation may prove "inappropriate or even detrimental in another" (Heracleous, 2001: 170) the model accounts for these differences and enables researchers to identify necessary control variables and gaps in our understanding of how the board can impact on firm performance.

General management studies have identified that organisations need to tailor their resources, processes and structures to match their environment and strategy (see Donaldson, 1995). For example, a study of boards involved in an IPO points to the need to link with an investment bank in that context (Higgins and Gulati, 2000). Similarly, Pearce and Zahra (1991) successfully employed a contingency framework when they linked "participative" boards with high corporate performance and Pfeffer (1972) found that fitting a board design to contingency factors of debt, company size and regulation created optimal board performance (Donaldson and Davis, 1994).

The particular contingencies that will impact on board roles – corporate performance nexus would include organisational size (Daily and Dalton, 1992; Dalton, et al., 1999), diversity (Siciliano, 1996), management experience (Coulson-Thomas, 1993), industry turbulence, industry lifecycle, and firm life cycle (Johnson, 1997). It is these contingencies that moderate the relationship between board effectiveness and firm performance. Thus we propose that:

P2: External and internal contingencies moderate the relationship between board role execution and board effectiveness.

THE INTELLECTUAL CAPITAL OF THE BOARD

Thus far we have identified how the roles required of a board will determine its effectiveness and impact on corporate performance. We turn now to examine the attributes of a board that will enable it to carry out the required role set. In particular, we utilise the concept of intellectual capital, an area of emerging interest for research scholars (e.g., Bassi and Van Buren, 1999; Bontis, 1999; Brooking, 1997; Keenan and Aggestam, 2001; Petrash, 1996; Roos, Roos, Dragonetti, and Edvinsson, 1997; Saint-Onge, 1996; Stewart, 1997; Sveiby, 1997). In developing an intellectual capital model of the board, we adapt Stewart's (1997) terminology to conceptualise it at a board level as:

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

We believe that all boards have a capacity to vary each of these group attributes to create value for the firms they govern. This is evidenced by scholarship that has pointed to the potential influence of board experience and knowledge (e.g., Castanias and Helfat, 2001), board routines and procedures (e.g., Donaldson and Davis, 1994), board relationships (Pfeffer and Salancik, 1978; Westphal, 1999) and the board's access to knowledge (Pfeffer and Salancik, 1978).

Intellectual capital provides a three-construct taxonomy to classify these individual board attributes (e.g., see Bontis, 1999; Burton-Jones, 1999; Roos, et al., 1997). These three constructs are developed to capture the intelligence found in human beings (human capital), group/organisational routines (structural capital) and relationships (or social capital) (Bontis, 1999). We contend that all boards share these three attributes. The broad conceptualisation afforded by intellectual capital is particularly appealing because it facilitates a multidimensional perspective for understanding how the board may impact on corporate performance. As outlined earlier, recent empirical studies have concentrated on the relationship between board attributes and the influence of the board on corporate behaviours such as alliance formation (Gulati and Westphal, 1999) or ability to impact strategic change (Golden and Zajac, 2001) rather than direct board attribute – corporate performance relationships. Evidence and theory development suggests that a single board attribute or demographic may impact on more than one process by which a board can influence corporate performance (e.g., Westphal, 1999; Heracleous, 2001; Forbes and Milliken, 1999). Significantly, it is even suggested that the same demographics may benefit one process and inhibit another (Westphal, 1999). Thus rather than being required to choose between board functions (for example, the monitoring role required by agency theory or the access to resources hypothesised by resource dependence theory), this approach frees the researcher to study how board attributes may in fact impact on several different functions enacted by the board. This makes intellectual capital a sound alternative for developing an integrative model of corporate governance. In the sections that follow, we elaborate each of these sub-domains of intellectual capital.

HUMAN CAPITAL: THE KNOWLEDGE, SKILLS AND EXPERIENCE PRESENT ON THE BOARD

Human capital has, along with physical capital, been seen as one of the "key resources for the firm that facilitate productive and economic activity" (Nahapiet and Ghoshal, 1998: 245). In the management context, human capital has been variously described as the "innate and learned abilities, expertise, and knowledge" of actors (Castanias and Helfat, 2001: 662) and the "tacit knowledge embedded in the minds of managers" (Bontis, 1999: 443). Human capital is often viewed as the basis for all intellectual capital, as the raw intelligence of members is exogenous to the board (Bassi and Van Buren, 1999) and so forms the basis of the capacity for directors to act.

Most boards face a myriad of tasks and a common concern echoed in the normative literature relates to a board's composition reflecting its human capital needs (Charan, 1998; Conger, Lawler and Finegold, 2001; Kiel and Nicholson, 2002). While the presence of human capital is not equivalent to the effective use of that capital, the ability of the board to provide advice to management and, arguably, to monitor management "depends on their expertise and ability to fully comprehend a firm's business situation" (Castanias and Helfat, 2001: 673). Thus, we would anticipate that a board's composition would determine its human capital and lead to different board actions/activities and outcomes.

Although human capital appears to be an important resource of the board, there is relatively little direct empirical investigation of the effect of board human capital on firm performance. Instead, studies have tended to apply human capital theory (Becker, 1964) to the CEO (Castanias and Helfat, 1991; 2001; Finkelstein and Hambrick, 1996) and top management teams (Harvey, 2000; Hitt, Hoskisson, Harrison and Summers, 1994). While there is a significant overlap between boards and TMTs, we would agree that the relatively unique group attributes of a board of directors (e.g., see Forbes and Milliken (1999) for an overview of these traits) together with the unique nature of board tasks warrants focused treatment separate from that of management. This view is reinforced by one of the few studies into board "knowledge structures" where, applying a socio-cognitive approach, Carpenter and Westphal (2001) found that differences in prior board experiences were correlated with differences in director involvement in strategy decision-making.

Human capital also has the potential advantage of differentiating a firm. Since skill differentials between directors "both in the types of skills that individuals possess, and the degree of skilfulness" (Castanias and Helfat, 1991: 160), there is a distinct heterogeneity in the skills set of the peak decision-making body of the corporation. In his classic work on the resource-based view of the firm, Barney (1991) argued that imperfect mobility and heterogeneity are key sources for competitive advantage and rent generation. Thus boards, through their unique combination of skills, are a potential source of advantage for the firms they govern.

Prior research into the human capital of managers has focused on a nested series of constructs comprising generic, related-industry, industry-specific and firm-specific skills (Castanias and Helfat, 2001). This traditional managerial focused definition can be expanded to include functional knowledge and skills (including human resources, marketing, finance and business) and areas relevant to a firm's interaction with its environment, such as law (Forbes and Milliken, 1999). We would also include a level of board-specific skills that seeks to directly measure the skill set of the directors related to a board. We propose that:

P3: The human capital of the board (i.e. the board's knowledge, skills and abilities) impacts the effectiveness of the board.

SOCIAL CAPITAL: FACILITATING INSTRUMENTAL ACTION

In addition to the knowledge, skills and abilities of directors, our model is concerned with the social ties that directors bring to an organisation. The broad nature of the construct has lead to statements such as that of Narayan and Pritchett (1999: 871) who comment: "Social capital, while not all things to all people, is many things to many people" and has meant that its validity has been questioned (e.g., Baron and Hannon, 1994; Fine, 1999). Adler and Kwon (2002) argue, however, that social capital is indeed a valid construct and it relates to the elements of social structure that form a resource for social action (Baker, 1990; Burt 1992; Coleman, 1990). We define social capital as follows (adapted from Gabbay and Leenders, 1999: 3):

> *The implicit and tangible set of resources available to assist a corporate player in goal attainment by virtue of all relevant social relationships available to members of the organisation.*

Over the past several years, a range of scholars including sociologists, political scientists and economists have begun to use the concept of social capital to investigate a broad array of questions (Adler and Kwon, 2002). This is because the breadth of the concept applies to numerous elements of social and organisational life. For instance, studies have focused on the individual (e.g., Lin and Dumin, 1986, Burt, 1997; Gabbay and Zuckerman, 1998; Seibert, Kraimer and Liden, 2001), groups and business units (e.g., Rosenthal, 1996), inter-unit resource exchange (Tsai and Ghoshal, 1998), the firm (e.g., Baker, 1990), as well as inter-firm learning (Kraatz, 1998).

Since a necessary (but not sufficient) condition of social capital is a link between individuals, these empirical investigations highlight the fact that social capital exists at several different levels in an organisation. Thus, because social structures exist within groups, between groups and between the organisation and the external environment, the social capital of the board will lie at three levels: intra-board relationships, board-management relationships (particularly between the board and the CEO and management) and extra-organisational relationships.

In addition to the location of the source of social capital, the construct itself is multi-dimensional (Nahapiet and Ghoshal, 1998; Adler and Kwon, 2002). This is because social capital is dependent on the individual "tie" or connection and the nature of that tie (e.g., see Granovetter's (1992) discussion of relational and structural embeddedness). Thus, any valid social capital measure must look to two items. The first is the network ties between actors (Scott, 1991) and configuration of these linkages (Krackhardt, 1992), while the second is the nature of these ties. Nahapiet and Ghoshal (1998: 244) see the "key facets" of these ties as being "trust and trustworthiness, norms and sanctions, obligations and expectations and identity and identification".

To summarise, the social capital of the board lies in three levels; at the intra-board level it can be characterised as a "bonding" form of social capital between directors, at the extra-organisational level it forms a "bridging" type of social capital between the board and external organisations and at the board-management level it has elements of both “bridging” and “bonding” social capital (Adler and Kwon, 2002: 19). Further, at each level of social capital, it is necessary to identify the multidimensional nature of the social capital, that is to say the physical tie and network structure and also the character of that tie.

Since social capital enables the use of resources through a tie at three levels, we have three propositions: The first deals with extra-organisational social capital whereby the board can co-opt external resources for use by the organisation. This would directly impact the access to resources role and provide responses such as information for the remaining role set. Thus we propose that:

P4: Extra-organisational board social capital facilitates the execution of board roles.

However, unlike extra organisational social capital, both intra-board and board-management social capital are concerned with the use of resources within the company. Rather than directly affecting the execution of the role set, intra-board social capital will moderate the relationship between board human capital and board roles. It is the nature and structure of the social ties that will impact on how well the board uses individual director human capital. Thus,

P5: Intra-board social capital moderates the relationship between human capital and board roles.

Similarly, board-management social capital relates to the use of the board’s human capital by the management team and we would expect that:

P6: Board-management social capital moderates the relationship between human capital and board roles.

BOARD STRUCTURAL CAPITAL: THE VALUE OF ROUTINES

In addition to board attributes captured by the two constructs of human and social capital, we note that the board's internal processes differ between corporations (Pearce and Zahra, 1991). This is because a board's routines, policies and procedures are, in effect, a set of codified knowledge that has an ability to build competitive advantage (Bontis, 1999). This codified knowledge, both explicit and tacit, has been conceptualised as structural capital (e.g., Bontis, 1998: 65; Edvinsson and Sullivan, 1996: 19; Saint-Onge, 1996: 20; Stewart, 1997: 74). It is the board's structural capital, its routines, processes, procedures and policies that facilitate the board's use of its human and social capital.

While the constructs of human capital and social capital are rooted in the attributes of the individual (Castinas and Helfat, 2001), structural capital is a function of the group, in this case the board. Board structural capital refers to the corporate governance routines of an organisation (adapted from Bontis 1999: 447). According to the Oxford Thesaurus "routine" is a synonym for "procedure, practice, pattern, regime ... schedule, method, system, order, ways, customs, habits". As Bontis (1999: 447) notes, the "construct deals with the mechanisms and structures of the organization" that can "turn individual know-how into group property". Thus, in the case of a board, the term "routines" can encapsulate the shared knowledge of the group, both tacit and explicit (see Bontis, 1999; Edvinsson and Sullivan, 1996; Saint-Onge, 1996; Stewart, 1997) that acts to facilitate the functioning of the board.

Recognition of the potential importance of structural capital to board effectiveness has a long, if not explicit history (e.g., Vance, 1983; Mace, 1971; Lorsch and MacIver, 1989). In particular, significant research effort has focused on the impact of committees (e.g., Klein, 1998), most notably the audit committee (Klein, 2002), remuneration committee (Conyon and Peck, 1998) and nominating committee (Vafeas, 1999) with findings that there is a link between the presence of board committees and board effectiveness. Additionally, several other key elements of board structural capital have been examined. For instance, the board agenda has been shown to focus the work of the board (Inglis and Weaver, 2000) and that operating performance of a corporation improves following years of abnormal board activity (Vafeas, 1999). Finally, the decision making style of the board has been linked to corporate performance (e.g., Peace and Zahra, 1991).

The academic investigation of the structural capital of boards is supplemented by normative interest in the topic. The emergence of "codes of best practice" drawn up by institutional investors (e.g., the California Public Employees' Retirement System (CalPERS)), national regulatory authorities (e.g., Australian Securities and Investments Commission; Securities and Exchange Commission), stock market regulations (e.g., the requirement for an audit committee under New York Stock Exchange listing rules) and global institutional guidelines (e.g., the OECD Principles of Corporate Governance) highlight the importance placed on attributes of the board by practitioners. Likewise, advice from governance handbooks stresses the importance of policies, procedures and processes (e.g., Charan, 1998; Conger, Lawler and Finegold, 2001; Kiel and Nicholson, 2003; Lorsch and MacIver, 1989).

Board structural capital appears to work as an enabler of the human capital possessed by the board – a point we return to later. For this reason, we note that researchers can operationalise the construct in two ways. First, as a generalised construct applying to all board routines, researchers could operationalise structural capital by asking board members to gauge, using Likert-type scales, the board's assessment of its structural capital. Such items could include statements such as the following: "Board processes support the work of the board" and "Board policies inhibit the work of the board" (reverse coded). Second, where a particular element of structural capital is theoretically important for the relationship to be studied (for instance, if the audit committee is seen as critical to the monitoring role of the board) then the researcher may instead concentrate on operationalising that aspect of structural capital just as human capital researchers concentrate on a specific element of human capital, for example, functional background (e.g., Ocasio and Kim, 1999; Pelled, Eisenhardt and Xin, 1999; Westphal and Milton, 2000). Since the purpose of this paper is to outline an integrative model, not present a complete discourse on the nature and dimensions of board structural capital, we would point out that the inclusion of this construct highlights an important consideration for researchers in the field. In particular we propose that:

P7: Structural capital moderates the relationship between human capital and board role execution.

The complete model is outlined in figure 1.

INSERT FIGURE 1 ABOUT HERE

THE CORPORATE GOVERNANCE CHARTER MODEL

Based on this model, we have developed the Corporate Governance Charter model (CG Charter) as both a structure and a process to guide practitioners seeking to build more effective boards. In particular, it helps a board to drive business success by guiding a process that matches the company's governance system to organisational needs. This model is elaborated in Kiel and Nicholson (2003). The discussion here outlines the link between the intellectual capital theory of corporate governance and the Corporate Governance Charter model. As such it elaborates the theoretical basis of the basis of the Corporate Governance Charter model.

INSERT FIGURE 2 ABOUT HERE

The model contains four quadrants. The first, defining board roles, seeks to elaborate the human capital needs of the firm by defining roles for individuals and the group. This will necessarily account for firm contingencies. Since the board and management will need to work together to develop these role definitions, it will also develop intra-board social capital and board-management social capital. The second quadrant of the model, improving board process, concentrates on developing the board's structural capital through examining its processes and routines. As with the rest of the model, the intra-board and board-management social capital will develop as the leadership of the company develops shared expectations. The third quadrant specifically addresses the board roles that require elaboration. It is by performing the functions highlighted in this quadrant that the board can improve its effectiveness and corporate performance. These roles require an appropriate mix of human, social and structural capital. Of course, developing requirements in this area will need to include an examination of firm contingencies. Finally, the board needs to ensure that it will have the human and social capital needed into the future. Therefore, the fourth quadrant focuses on keeping governance an evergreen topic for the board. The remainder of the paper focuses on elaborating each of these quadrants.

DEFINING GOVERNANCE ROLES

The board (as a group) bears ultimate responsibility for the company that it governs, however it is not clear just how a board should begin to handle this responsibility. To assist in this regard, the first quadrant of the CG Charter asks that directors consider the overall philosophy of governance that the board is to adopt and how governance differs from management for this individual organisation.

The answer to this question will vary according to the particular contingencies facing the organisation. Ownership structure, stage of maturity, strategies employed and the industry and business environment are all factors that will all affect the way that a board views its purpose in governance and its relationship with management. It should also be noted that the board's view of governance could also be affected by the individual strengths and weaknesses of existing board members (i.e. the human and social capital of the board).

When the board has adopted a clear view of its responsibilities in governing the company, the directors can then move to discuss and agree the most effective way of structuring the board. For example, consideration could be given to the size of the board itself - is the board too small or too large to adequately fulfil its requirements, given the size and complexity of the organisation? The balance of executive and non-executive directors and whether independent directors are necessary is another structural issue to consider. Likewise, does the board have the optimal skills mix to deliver effective governance considering the nature of the company governed? Depending on the circumstances, the board may benefit from having a member with industry experience, legal expertise or perhaps a director representative of a key stakeholder. Such considerations are often complex and require significant discussion, prioritisation and agreement.

After determining the role of the board as a whole and its structure, including the skills and experience that should be represented on the board, it is useful for the group to consider individual roles in governance. Since directors must also be familiar with their individual duties and responsibilities, this typically begins with a discussion of the formal legal role of individual directors. At the practical level, this means being able to understand company statements of financial performance and statements of financial position, sources and methods of funding, cash flow and other financial data, as well as having a familiarity with company law and contract law, and an understanding of the nature of the business. Generally, examining the role of a director also includes the formulation of a code of conduct for board members, including appropriate behaviours both within and outside the boardroom.

The board may also wish to consider the roles of three key governance individuals, the chairman, the company secretary and the CEO. The chairman, as lead director, needs to guide the board so it acts effectively and efficiently. He/she often oversees the development of the board agenda, undertakes certain public relations responsibilities and acts to ensure that board meetings run smoothly. Typically, the chairman is the driving force behind board evaluation processes and is often the person to take on a key advisory role in the company, playing a key linking role through the development of a strong mentoring relationship with the CEO. This role is critical to governance success and boards would do well to articulate what is expected of the chairman in this regard.

A governance role that is changing in significant ways is that of the company secretary. Although the role is less important in smaller companies, it is becoming more important in larger organisations where the company secretary is increasingly charged with ensuring good governance and compliance. The CG Charter process is often a good time to delineate the responsibilities (if any) of the company secretary, particularly with respect to issues of meeting process, risk management and compliance.

The third key role often considered in the governance process is that of the CEO. A positive relationship between the board and the CEO is essential to good governance. Therefore some commentators hold that the single most important role of the board is to appoint, monitor, evaluate, mentor and replace (when necessary) the CEO (e.g., Carver and Carver, 1997). Most difficulties in the board-CEO relationship tend to occur through a misunderstanding of the relationship between the respective roles of the board and management. This problem can usually be avoided through shared understanding and development of governance roles.

IMPROVING BOARD PROCESSES

As noted above, the structural capital of the board is rooted in its processes, procedures, routines and practices and facilitates the use of the board's human and social capital. The second quadrant of CG Charter model addresses the structural capital of the board, which moderates the relationship between its human capital and board role execution. The structural capital of the board can be considered once the members of the board are comfortable in their roles and can turn to productivity issues, such as how effectively information is exchanged between members and the best communication strategies to ensure effective decision-making. Thus, the CG Charter encourages board members to consider the effectiveness of their meeting procedures, agendas, board papers and minutes as well as the board calendar of events and ensuring efficient process for board committees.

The board meeting is the lynchpin of a corporation's governance processes. Successful meetings achieve a common goal through effective communication and collective action. For meetings to be successful, it is important to recognise that each meeting has its own dynamic and outcomes depend on the personalities, needs and intentions of the people present. Similarly, outcomes are influenced by the degree of complexity of the issues under consideration, and on the legal and time restraints that govern board process. Bearing these considerations in mind, effective meetings depend on planning, orderly conduct and active participation by all board members.

Central to the planning process for all board meetings is the meeting agenda and associated board papers. A well-designed agenda aids the flow of information and shapes subsequent discussion by the board, while the board papers are the key source of information for board members. The format of individual board submissions tend to be fairly similar in well-governed organisations; typically each paper states its purpose, provides background information on an agenda item, presents major issues for consideration and makes recommendations. A full set of board papers prepared for directors should include an agenda, the minutes of the previous meeting, major correspondence, the CEO's (or equivalent's) report, including a report on risk/compliance (unless covered elsewhere), financial reports and documentation supporting submissions that require decisions.

As part of any systematic review of its corporate governance processes, a board will need to consider its workflow during the year. In general, the efficiency and effectiveness of board process will be improved by developing a structured annual calendar of major board events to ensure specific items are discussed at the appropriate time, that enough time is provided for preparatory work leading up to a major meeting and that routine (but less interesting) aspects of the board's work are not overlooked.

Another way of improving the efficiency of board process is through the creation of committees. A committee is a group of members to whom some specific role has been delegated. Committees can be used to gather, review and summarise information and report back to the full board for decision, or can be delegated specific decision-making powers. As the workload for boards has increased, there has been a corresponding tendency towards the creation of a variety of committees to deal with specific issues. They can also be useful tools for building individual director expertise in addition to alleviating the workload of the entire board. Three of the more common and generally more important committees are the audit committee, the remuneration committee and the nomination committee. No matter whether the committee's role is to make recommendations or make decisions, it is important to develop ground rules to ensure that any committees are subservient to the board.

KEY BOARD FUNCTIONS

Perhaps the most difficult challenge for directors is to consider objectively the effectiveness of their boards. By examining the critical functions of the board in the corporate governance system, the third quadrant of the CG Charter model guides directors through areas of fundamental importance to every board. In discussing board roles and board effectiveness above, we defined four board roles (monitor and control; advice and counsel; access to resources; strategy control) that result in board effectiveness. These four roles encompass the key board functions dealt with in the third quadrant including strategy formulation, the service/advice/contacts role, monitoring, compliance, risk management, CEO evaluation and delegation of authority.

The first of these key board functions is strategy formulation. The board's objective in strategy formulation is to ensure that the strategy of the company will lead to the long-term creation of shareholder wealth or other stated major goals of the organisation. However, the level of board involvement will vary from company to company. For example, the board may see its role as developing the strategic questions for management to answer, while another approach sees the board setting broad objectives for management to implement.

The next key area for the board to consider is the role directors play in providing advice to the CEO. As already noted, the board-CEO relationship is central to corporate governance. It provides the link between the direction of the company provided by the board, and the day-to-day implementation of that direction that is the responsibility of the CEO. The board should be a key source of knowledge and experience for the organisation it governs. Therefore, it is important for the board to share its experience with management, particularly, the CEO, to serve the interests of the company.

The board also has an important function in accessing resources. All companies, whatever their size or the nature of their business, need access to outside resources if their businesses are to succeed. These resources vary enormously from company to company, but fall into two main categories, information (e.g., industry or competitor data) and physical resources (e.g., investors to support an IPO, an extended line of credit, bank loans for expansion). Developing business networks and working to promote the reputation of the firm are two other important ways that a board can add value to the company. By acting in an open, professional and ethical manner in their dealings with people outside of the organisation, board members also raise the profile of the firm and enhance its reputation.

Monitoring is an important role of the board, and the monitoring of an organisation's performance is widely recognised as necessary for ensuring business goals are being met. Monitoring involves both the financial and non-financial key performance indicators of a company. Coupled with this is the added pressure on directors to ensure that they are monitoring their organisation's compliance with the many laws and regulations and risk management procedures that impact on its operations. Compliance means that a company is acting legally and that company officers are performing their duties in the interests of the company as a whole, while the term risk management includes the identification of all significant risks faced by the company and ensuring that appropriate policies are in place to moderate the impact of these risks. Thus, risk management can be regarded as the two-fold process of evaluating a company's exposure to critical events, and treating, monitoring and communicating responses to those threats.

The final function that a board needs to consider is its duty with respect to delegating authority. Given the complexity of the business environment, it is impossible for the board to be the sole decision-making body in the company. Instead, each board needs to work on developing an appropriate method and level of delegation of authority. Obviously this will again vary with the context facing the board but, in all circumstances, the board needs to clearly articulate and document the delegations it makes.

CONTINUING IMPROVEMENT

As well as being confident in the roles, functions and processes of the board, our experience is that directors are continually searching to find ways of ensuring that their board adds value to the organisation it governs. Accordingly, the fourth quadrant of the CG Charter model deals with the processes and procedures necessary for ensuring continuing improvement and corporate renewal. As such, this quadrant involves the human, social and structural capital of the board, in dealing with issues such as director protection, board evaluation, director remuneration, director development and director selection and induction.

Good corporate governance requires that directors are free to pursue their duties without fear of litigation, since in recent years directors have come to feel increasingly vulnerable as they undertake their duties. A governance system that does not inform its members of their obligations (and then appropriately protect them from litigation) risks making board decision-making processes ineffective as directors concentrate more on personal exposure than corporate benefit. Given the fact that directors are increasingly likely to face the threat of legal action, most companies put in place Directors and Officers Insurance as a means of protecting their board members. Exposure to risk can be minimised if directors are aware of their legal obligations, document all board decisions thoroughly and conscientiously and consult with experts, in particular legal advisors, to keep informed of changes in the law.

We contend that a key way for a board to improve is through critical evaluation. While the evaluation of board performance has become a subject of growing interest over the past decade, many boards do not routinely undertake a formal evaluation process. A Korn/Ferry (1998) survey found that while one-third of US companies formally evaluated the performance of the board on a regular basis, only 19% of the survey respondents evaluated individual directors (although 75% thought they should do so).

The first stage any board evaluation process is to set meaningful goals against which the performance of the board is to be measured. By doing this, the board is continually working to ensure its adoption of best practice. In addition to assessing the board as a whole, the assessment of individual directors can add substantial value to the organisation. However, assessment of directors should be viewed as a tool to diagnose the needs for individual director development rather than as a "report card".

A commitment to director development is a commitment to the continuing improvement of an organisation. It is a process that adds value to the company by enhancing its intellectual capital and serves to build confidence with shareholders and other stakeholders. Director development benefits individuals, boards and the companies for which they work. The power of the board as a competitive weapon depends on the quality and diversity of its directors.

Similarly, choosing the right board members is a major component of ensuring ongoing corporate renewal. To ensure best practice in corporate governance, it is recommended that formal policies on director selection emphasise the distinction between governance and management, state explicitly what is required of an effective director (including skills and attributes), and establish a process that ensures that these qualities form the basis of the selection process.

When a director is appointed, it is vital that the appointee be appropriately briefed about his or her new role. Survey evidence indicates that nine out of every ten directors have no preparation at all for their role on the board, and another two thirds of directors indicate that they received no formal assistance after their appointment (Coulson-Thomas, 1993). Therefore, it is important for a board to establish a system of induction that familiarises the new director with both the duties of the position and the operations of the firm, as well as encouraging director development and introducing the concept of performance evaluation as an essential aspect of board process.

A further area for the board to consider is director remuneration. This issue has been the topic of much public debate, especially where public companies have allowed directors' salaries to increase while firm performance stands still or even declines. While the issue is a complex and sensitive one, director remuneration offers an important leverage factor that can stimulate good governance within the board. There is no one best remuneration system for directors so companies should tailor their own remuneration packages to suit their specific requirements.

CONCLUSION

Since the board is the peak decision-making group in corporate life, understanding how they can impact on corporate performance is one of the most challenging and important tasks facing management researchers. As Stiles and Taylor (2001: 7) highlighted in a recent book:

> *The problem in trying to assess the contribution of boards to the running of organizations, and hence the expectations we realistically have of them, lies in the fact that basic grounded research is 'still in its infancy' (Pettigrew, 1992). There is a dearth of strong descriptive data on how boards of directors perceive their role and in what respects they can influence the performance of the firm.*

By understanding how a board's skills, resources and attributes allow it to discharge its roles, we believe that management researchers can further understand the hitherto elusive links between boards of directors and corporate performance. The intellectual capital taxonomy and contingency basis of our model provides a framework for researchers seeking to understand these elusive tasks.

Future research based on the intellectual capital model we have developed here has the potential to inform high profile governance debates, such as the role of, and need for, independent directors. This direction will complement recent advances in process-orientated research into corporate governance and allow for an elaboration of recent research into organisational demography manifested in various organisational groups.

From a practitioner's perspective, clarifying the attributes of a board that contribute to effective role execution has the potential to improve corporate performance significantly. An intellectual capital approach may assist boards and their advisers in assessing their composition needs and constructing relevant process-related interventions to improve board performance. We have attempted in this paper to convert the intellectual capital model to a practitioner-focused framework that can assist those boards seeking to improve their performance.

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TABLE 1: GUIDELINES/REPORTS FOR BEST PRACTICE

COUNTRY	GUIDELINE/ REPORT	RECOMMENDATION			
		Size of board	**CEO duality**	**Outside directors**	**Independent directors**
UK	Higgs Report (Higgs, 2003)	Should be of a size that the balance of skills and experience is appropriate for the requirement of the business	The two roles should be separate	N/A	At least half
US	NACD Blue Ribbon Commission (NACD, 2000)	Board to determine	The two roles should be separate	N/A	Substantial majority
Canada	Toronto Stock Exchange Committee Report (1994)	10-16, board to determine	The two roles should be separate	N/A	Majority must be unrelated
Australia	Bosch Report (Bosch, 1995)	Nomination committee to devise criteria	The two roles should be separate. If combined, an independent non-executive director as deputy chairman is recommended	Majority	One third
International	OECD Principles of Corporate Governance (OECD, 1999)	N/A	N/A	Sufficient number	N/A

FIGURE 1: INTELLECTUAL CAPITAL MODEL OF THE BOARD

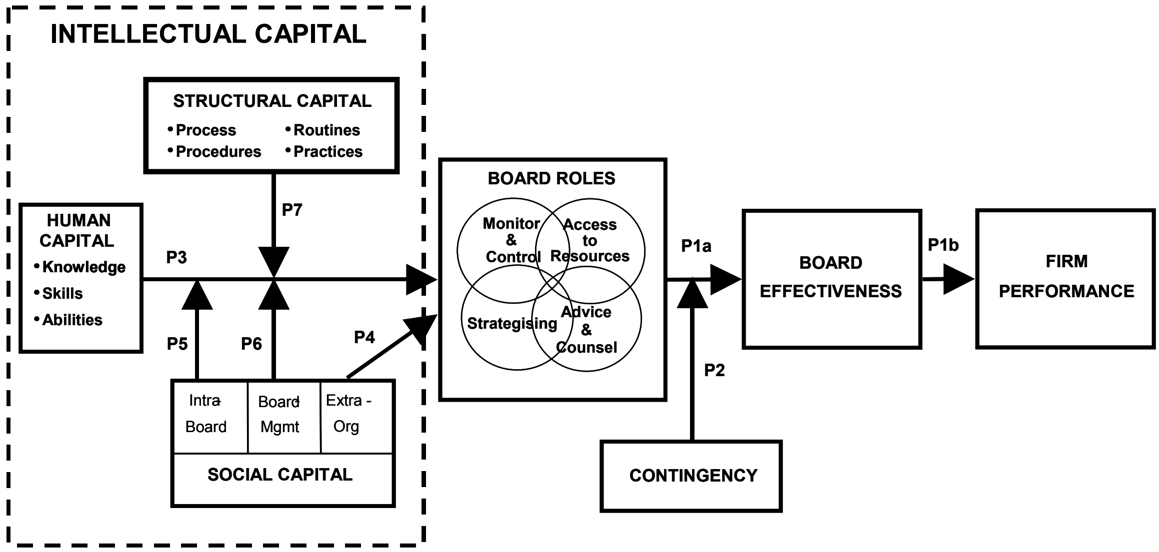

FIGURE 2: THE CORPORATE GOVERNANCE CHARTER MODEL

Source: Kiel and Nicholson: 2003