Boards and firm performance: Explaining a contingent relationship

Introduction

Companies are legal constructions that play an important part in modern economies. They contribute to and are influenced by the economies and societies within which they exist and operate. Statutory responsibility for the performance of companies lies with the board of directors, implying that an important role of the board is to influence business outcomes. The board also provides an important link between shareholders and managers (Berle & Means, 1932), the central role of which was summarised by Huse (2007) as "the interactions between various internal and external actors and board members in directing the firm for value creation" (p. 15), placing it at the "epicentre of strategic decision-making and accountability" (Hemphill & Laurence, 2014, p. 197).

Boards and directors have become subjects of much scholarly research and public interest, more so since the succession of high profile company failures of the early 2000s. While a large body of board and governance research has now been published (Tricker, 2012b), no consistency between any particular board structure or composition variable and firm performance is apparent. Consequently, an important question about boards remains—whether firm performance can be predicted from a given set of indicators, conjunctions or descriptions. If an answer to the "most difficult question" (Cadbury, 1997, p. 96) of whether and if so how boards could influence firm performance can be achieved, the consequential effects on economies, communities and societies is likely to be significant.

Corporate governance and strategic management

Many correlations between observable attributes that have appeared to be significant (in a normative input–output sense) to a relationship with firm performance have been identified. Most of these studies have utilised conventional hypothetico-deductive science to analyse large quantitative sets of publicly-available company data (Moore & Reberioux, 2011). Evidence to link board attributes and firm performance variables is "poor and most conclusions [are] weak" (Tricker, 2012a, p. 63), as several comprehensive reviews of the literature attest (Dalton, Daily, Ellstrand, & Johnson, 1998; Finegold, Benson, & Hecht, 2007; Hermalin & Weisbach, 2003; Johnson, Ellstrand, & Daily, 1996; Lawal, 2012; Pugliese et al., 2009).

A small but burgeoning body of board research informed by qualitative data and case-based interpretive designs has been published alongside the positivist-inspired literature, resulting in rich descriptions of what boards supposedly do and how directors behave. Data sources for these studies have included interviews and surveys, board meeting minutes and, in a few instances, observations of boards in session.

Firm performance appears to be heavily but not exclusively dependent on the selection and implementation of an appropriate strategy (Ahenkora & Peasah, 2011). Strategy itself refers to the "art of command" (Heuser, 2010, p. 5), an externally-oriented concept of determining how an organisation intends to achieve its objectives (Hambrick & Fredrickson, 2005); and strategic decisions are those that shape the future course of a company (Hickson, Butler, Cray, Mallory, & Wilson, 1989).

Improved firm performance *may* be possible when the board and management are actively engaged in strategic management together in the pursuit of agreed performance goals—as Tricker (1984) adumbrated over three decades ago. However, the appropriate role of the board remains unclear (Lockhart, 2012), even though several models have been suggested (Garratt, 1996; Hendry, Kiel, & Nicholson, 2010; Nadler, 2004; Wheelen & Hunger, 2006).

Approach to research and collection of data

This paper responds to calls for more knowledge on boards, corporate governance and strategic management by testing the efficacy of the suggestion that the board's involvement strategy management in some form is significant to the achievement of the firm's performance goals. However, the question of whether boards play a role "cannot be answered econometrically as there is no variation in the explanatory variable" (Adams et al., 2010, p. 59) suggests that an alternative approach to research is necessary.

If further insights are to be gained, attention needs to shift toward the holistic consideration of board activities and the wider context within which boards operate—the company and the commercial marketplace. Research based on a critical realist perspective (Bhaskar, 1975), and which utilises an iterative process (Andersen & Kragh, 2010) and abduction and retroduction (Williams & Karahanna, 2013) offers an alternative pathway towards new knowledge about how complex social phenomena work. In particular, it affords the opportunity to move between observed events and underlying social mechanisms that may have generated or led to the observed events.

The opening of the black box of boards, to collect primary data from firsthand observations, appears to be crucial to obtaining the deep understanding necessary to explicate how boards actually work. Stiles' (2001) suggestion that several perspectives are required to understand the nature of social phenomena reinforces the value of collecting data from multiple sources. Prior studies seeking to gain a deep understanding of how boards work (e.g., Machold & Farquhar, 2013) demonstrate that an iterative approach to discovery is an appropriate analysis technique.

Consequently, a longitudinal multiple-case study design (Rashid, 2011), founded on a mixed-method approach (Onwuegbuzie, Johnson, & Collins, 2009) to field-based (Alam, 2005) data collection and iterative analysis was adopted for this research, in search of new insights. Two large, New Zealand-based firms agreed to participate in this research on the condition of complete confidentiality. Data sources included firsthand observations of board meetings over a twelve-month period; semi-structured interviews with the chairman and chief executive; three years of confidential source documents used by boards; and, over twelve years of published (public) and private records. Primary and secondary data were inspected, coded and collated for analysis.

Initial analysis

A first-order analysis of primary data was undertaken to identify strategic decisions (the unit of analysis) and associate sequences of board activity, discussion and lead-up decisions to subsequent strategic decisions. In total, 358 decisions were identified, nine of which were strategic (using pre-determined criteria). Relevant data was also collated onto a synthetic timeline framework to provide a visual representation and an analytical chronology (Pettigrew, 1990). The framework developed by Taitoko (2002), and subsequently used by Lockhart and Taitoko (2005) (henceforth, the LT framework) was used. The post-decision data was also reviewed, to identify monitoring activities and consequent performance inflections (if any). Once loaded, associations between seemingly disparate attribute, relationship, action and decision data (especially data indicating a possible relationship between board activity and consequential outcomes including performance inflections) were apparent.

Variations in the level of engagement in strategic management were evident both in the data and the analysis. Sequences of decisions were observed and the culmination of each decision-making sequence was expected to be the strategic decision itself. Notwithstanding the different board practices in use, and different levels of engagement by individual directors and the boards as a whole, both of the boards utilised an incremental approach to decision-making, an observation that supports Bourgeois and Eisenhardt's thesis (1988).

Towards a conceptual model

Following the first-order analysis, more in-depth analysis was undertaken to search for associations between strategic decisions and performance inflections, and investigate underlying director interactions, behaviours and competencies. The goal of this second-order analysis was to gain a sufficiently deep understanding to assess the validity of the postulated mechanism (that the board can exert influence via its active involvement in strategic management).

The thematic analysis (Vaismoradi, Turunen, & Bondas, 2013) of the collated dataset revealed the "rich patterns, archetypes and relationships" (Leblanc, 2003, p. 42) including different levels of board involvement in strategic management and decision sequences. Seemingly relevant data were crosschecked (Kisely & Kendall, 2011) against at least one other source (Huettman, 1993).

When the board was actively engaged in the strategic management practices of strategy development and strategic decision-making in the manner conceived by Wheelen and Hunger (2006), changes in firm performance often followed, but not universally nor predictably so. Activity that preceded each inflection was analysed in search of associations between decisions made by the board and subsequent performance inflections that may have occurred. Where the possibility of an association was identified—even tenuously or contingently so—additional analysis was undertaken. An iterative cycle of conjecture and testing (informed by both guidance in the literature and *a priori* knowledge) was completed.

While each strategic decision, decision sequence and tentative association with performance identified in the data was unique, patterns emerged as the analysis proceeded through subsequent cycles of conjecture, testing and reflection. Associations between strategic decision sequences and performance inflections were noted in four of the nine strategic decision instances.

The analysis also revealed that contributions by boards intent on exerting influence from the boardroom were dependent on the active engagement of the board in several strategic management tasks, but not exclusively so. Possible antecedent factors identified in the literature informed this analysis, in search of evidence to indicate whether the emergent themes of interest conjectured from the literature were present and had been activated, or not. Evidence, in the form of displayed behaviours or interactions indicating the presence (or activation) of each theme of interest was identified, checked and recorded.

The analysis suggested that when the purpose of each business was clearly defined and communicated; when the boards were committed to its achievement; and, when the boards were engaged in the development of strategy together with management, strategic decisions were made in an appropriate context of core purpose and agreed strategy.

The second-order analysis of the decision sequences for which associations with subsequent performance inflections were identified revealed common patterns of activity and relationships. Throughout the four decision sequences, individual directors were observed to be 1) skilful, knowledgeable and capable, 2) they participated actively in boardroom discussions, having prepared adequately, 3) maintained a focus on the company's purpose, strategy and performance goals, 4) worked collaboratively to make decisions together; and, 5) displayed a commitment to exert control and make adjustments as needed.

The collective and harmonious exercise of these five observed themes appears to have been material to effective contributions. These five observed themes—skill, involvement, future focus, collaboration and adjustments—are conjectured to be empirical expressions of underlying mechanisms that were imperceptible directly (Bunge, 2004). The underlying mechanisms (henceforth, behavioural characteristics) that are suggested to coincide with the observed themes are strategic competence, active engagement, sense of purpose, collective efficacy and constructive control.

'Strategic competence' refers to the specific application and expression of competence displayed by directors as they performed agreed strategic management tasks. It encapsulates the capability, intelligence and cognition possessed by directors; and, their ability to apply relevant expertise and knowledge to perform tasks effectively (Hogan & Warrenfeltz, 2003).

The psychological state from which individuals exhibited a demonstrable commitment to the board, the company and the performance goals of the company; and, high in-role performance (Dawsey & Taylor, 2011) has been termed 'active engagement'. It includes the intentional participation of directors, through adequate preparation before meetings and discussion and debate and, when appropriate, strategic decision-making during meetings.

The term 'sense of purpose' (Waddington, 2010) describes the commitment to action (Boone, 2002)—the motivation and resolve of individual directors to contribute the work of the board (selection of goals, formulation of strategy, making of strategic and other decisions; monitoring of performance; and, application of controls) with the agreed long-term purpose of the company as the guiding principle.

Collective efficacy (Chou, Lin, & Chou, 2012) refers to the characteristics of cooperation, situational awareness, social exchange, and cohesion displayed by the directors as they worked together to make decisions and secure management commitment to implement the board's decisions. While empathy encompasses many these characteristics, the ability to understand and share feelings alone—even in a collective sense—was insufficient to produce actions (Akgün, Keskin, Cebecioglu, & Dogan, 2015).

Constructive control refers to the appropriate actions of the board as a collective of directors in response to the various inputs provided to them including reports; tacit knowledge (Guzak & Rasheed, 2014); answers to questions asked during meetings; and, prevailing circumstances. Constructive controls are analogous to those used by a coach providing guidance rather than punitive or destructive responses.

Despite the irregular interactions and the lack of structural or process consistency apparent in the data, the board's active and sustained involvement in strategic management tasks appears to have been an important antecedent to effective contributions. If the work of the board is conceptualised as a stratified mechanism (incorporating selected strategic management tasks and underlying behavioural characteristics), corporate governance can be re-described as shown in Figure 1 below.

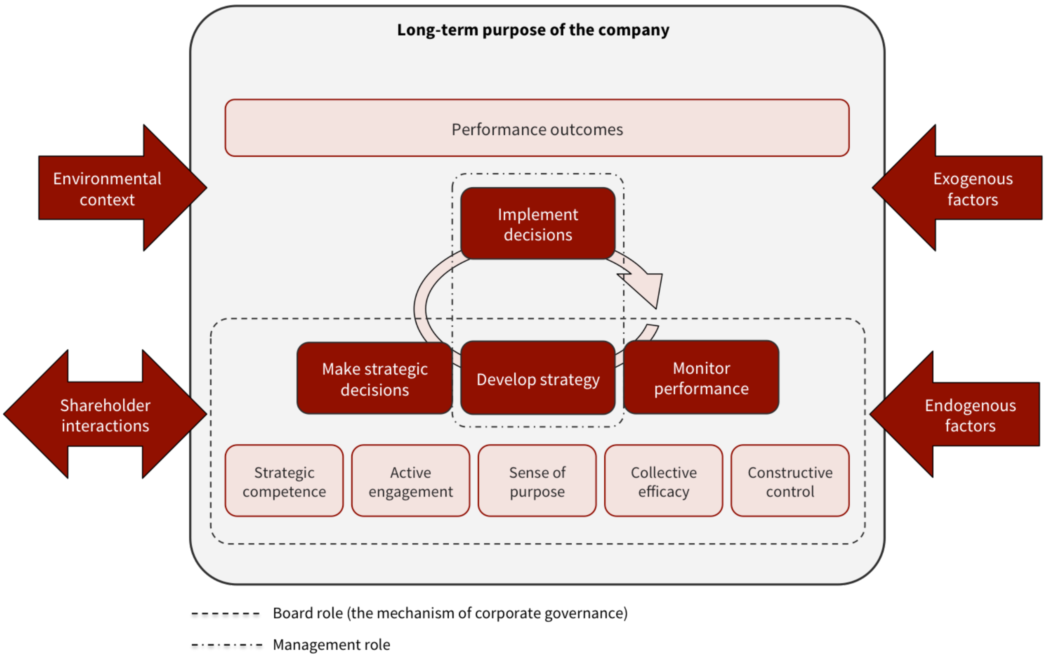

Figure 1: A suggested mechanism-based model of board–performance relationship

Discussion

The mechanism-based model suggested here extends several models proposed in the literature—notably those by Tricker (1984), Charreaux (2008) and Wirtz (2011). Tricker's proposal located strategic management at the nexus of board–management interaction, and Charreaux and Wirtz associated the concepts of 'mechanism', 'board' and 'corporate governance'.

The long-term purpose of the company provides the contextual frame within which both the board and management operate; strategic management tasks are allocated and performed; agreed performance goals of the firm are pursued; and, performance is monitored and verified, in accordance with agreed priorities and statutory requirements.

Effective board contributions are dependent on the harmonious exercise of the five behavioural characteristics identified. If any one or more of these characteristics is *not* exercised, the board's effectiveness and, therefore, any influence beyond the boardroom was compromised. High firm performance may still occur (and did, as the analysis showed), but not as a consequence of any contribution by the board.

The reference to 'harmonious exercise' of the behavioural characteristics should not be interpreted as implying any particular interaction or association in a formulaic sense. The directors' actions and behaviours were expressions of social agency, choice and bias as they attempted to make sense (Mattsson, Corsaro, & Ramos, 2015) of complex information. The actions and behaviours of directors were both idiosyncratic and inconsistent, depending on the specific circumstances and preferences (perceived to be) to the fore at that time.

Notwithstanding the board's intent to exert influence beyond the boardroom through the mechanism of corporate governance, the effective execution of strategic management tasks did not necessarily lead to the achievement of the long-term purpose, desired performance goals, or even performance inflections occurring in any predictable or repeatable manner. The literature indicates that the effectiveness of board contributions is contingent on management's implementation of decisions made by the board (Tricker, 2012a), and several (probably many) other factors that can be usefully grouped as the environmental context; shareholder requirements; and, other endogenous and exogenous factors.

Consistent with the understanding that emerged during the review of the literature, the analysis showed that the board–management interaction and the board–performance relationship were too complex to be described in straightforward structural, process or policy terms. That no single board structure, process or policy framework was apparent in the data provides empirical support to the conclusions of other contributors—Kiel and Nicholson (2003); Huse, Hoskisson, Zattoni, and Vigano (2011); and, Larcker and Tayan (2011), in particular.

Importantly, the analysis indicated that the board's work can be reconceptualised as a set of activities related to three strategic management tasks in particular—the development of strategy; the making of strategic decisions in the context of approved strategy; and, the monitoring of strategy implementation and verification of performance in accordance with approved strategy and statutory compliance requirements. While proponents of agency theory assert that independence between the board and management is necessary for objective decision-making, the preceding analysis suggests that proximity and engagement may be more helpful to the timely and effective completion of strategic management tasks.

This learning, that the board should be actively engaged in strategic management, does not mean that execution of these tasks is predictive of outcomes in any repeatable manner, or is causal to firm performance. Though the relationship is contingent and contextual, the existence of a relationship between board activity and the achievement of performance objectives via strategic management is significant.

Concluding remarks

This research sought to advance beyond the current impasse that has troubled much governance research by attempting to explain how boards influence desired performance objectives. The value that boards can contribute appears to be dependent on director competencies and behaviours, and what boards do. The board's involvement in strategic management including the consideration of strategic options, development of strategy, making of strategic decisions in the context of approved strategy, and the monitoring of strategy implementation and verification of firm performance appears to be significant, possibly central—in the companies observed at least. However, desired performance outcomes may still occur in the absence of such board contributions. Further, board effectiveness remains contingent on the actions of management, and many other endogenous and exogenous factors.

This research adopted a counter-factual approach to the study of boards and corporate governance. Commonly separated elements were consolidated, marking a return to the conception of owner–board–management interaction proposed by Berle and Means (1932), and the central role of strategic management in corporate governance described by Tricker (1984).

While the findings described in this paper encourage closer integration of the largely separate corporate governance and strategic management discourses, further research is required. In particular, an even deeper understanding of the circumstances within which influence is exerted; underlying attributes and mechanisms; and, the contingent effects of management and others are needed. The efficacy of the suggested mechanism also needs to be tested in different jurisdictions, and types and sizes of companies. Consequently, this paper does not signal the arrival at any particular destination. Rather, it provides a waypoint on a journey of discovery to enhance the understanding of what boards actually do and how influence can be exerted from within the boardroom, in the pursuit of knowledge of how high company performance can contribute to economic growth and, ultimately, improvements in societal well-being.

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