

THE RELEVANCE OF BOARDS OF DIRECTORS

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Recent serious comment and writing about the board of directors has concentrated on three major issues and a number of more specific and minor questions. The three principal issues have been — employee participation¹, that is, the current discussion on the role and function of worker directors and the associated questions of management and other employee representation on the board; the developing function of the board as an auditing group², particularly the development of board sub-committees to carry out specific financial or management audits in general; and on the role of the board generally as a representational body³ dealing in some way with the conflicting interests of shareholders, consumers, employees and society at large. Specific issues which have come under review recently are the semi-state company board in Ireland⁴ and a consideration of possible changes in company law, resulting from ramification and implementation of the directives issuing from the Commission of the European Economic Community⁵.

Despite the frequency and number of these comments by employer and industry bodies, and by individual directors, there is really no evidence that boards themselves are seriously concerned about these issues. There is in any case very little information of any kind, available about boards of directors in Ireland. In preparing a research study of the Irish boards of directors⁶, the writer found that very little had been done in this area in comparison with the extensive research carried out in all other areas of business and management. This situation applied in many countries and over many years. As recently as January 1978, the Harvard Business School Division of Research noted that "difficulties of access to sensitive data have hitherto confined students of boards mostly to their own experience and to hearsay evidence".⁷ Formal academic research, and particularly doctoral research, aimed at advancing knowledge and contributing to published work on the board of directors has been limited. The research which has been done, has, in general, been unsuccessful in discovering any proven prescriptions for increasing board effectiveness.

The difficulty of access to what is widely accepted as sensitive data is a contributory factor to the inconclusive nature of board research. The possibility that the relationships between board factors and board

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effectiveness are extremely complex could require research of greater depth and insight than has hitherto been the case. It is possible that the relationships between board characteristics and effectiveness, if they exist, are so closely tied to the specific situation and individual company characteristics, that there may be no valid generalisation possible. It is also possible that board effectiveness is a random variable among companies, and this must lead to a hypothesis that boards of directors may be irrelevant; irrelevant, that is, in the context of company success or performance. In other words, since relationships have not been established in work done to date, can it be said that it does not matter for example, whether a board consists of all inside directors (executives) or all outside directors, or has an independent chairman, or separates the function of chairman and managing director, or has financial expertise available? Does it matter whether a board has or has not a worker director? There is no shortage of prescriptions, but there is a great lack of proof of the validity of any specific recommendation.

This paper advances some possible reasons for board irrelevance, based on factors which militate against board effectiveness. It is suggested in this paper that the areas to be examined in looking for reasons for board irrelevance* are, first; — the board in the organisation structure and in the context of organisation theory; second, the functions, or the prescribed activities of the board; and third, the actual history of commitment in terms of time and energy given by boards of directors in general.

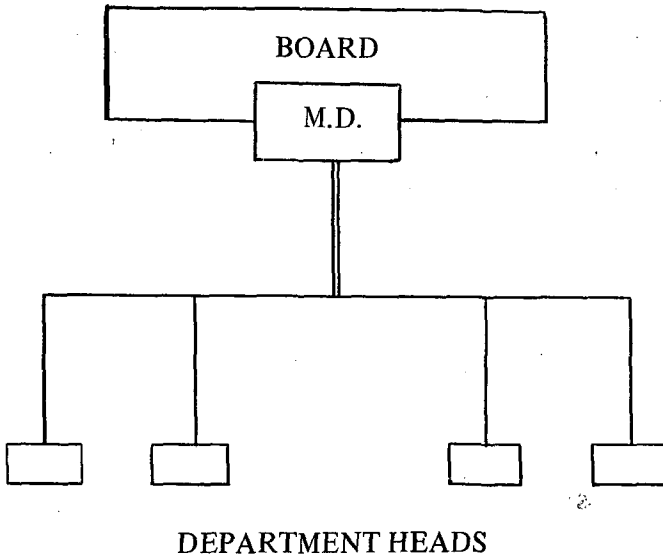
This paper draws on a variety of sources and research results particularly from Britain and the U.S. and on the writer's own study mentioned above, which was carried out in this country in 1975. Though aspects of company law may vary there is, in fact, a great similarity between boards, and in discussions about boards in the various countries. Case law built up in Britain, in the United States, and for example, Australia, indicates that the problems exercising people's minds with regard to the legal aspects of company directorship are quite similar. In matters of age distribution, outsider/executive director proportion, and degree of interconnectedness of boards (in that directors may be on boards of more than one company) there is considerable similarity in the different countries; and, of course, women are just as rare in board-rooms in Ireland as they are in other countries.

*The relevance of the board to its member is not discussed, nor its relevance to the conduct of the total business environment in an overall economic sense. The board may well have important functions here, though little research evidence has been put forward to support arguments in this area. It is true also that readers who are themselves directors may be disposed to find something valuable in an institution which has survived for so long through very extensively changing business circumstances. Though this in itself may be another mark of irrelevance, the discussion must be kept for another time.

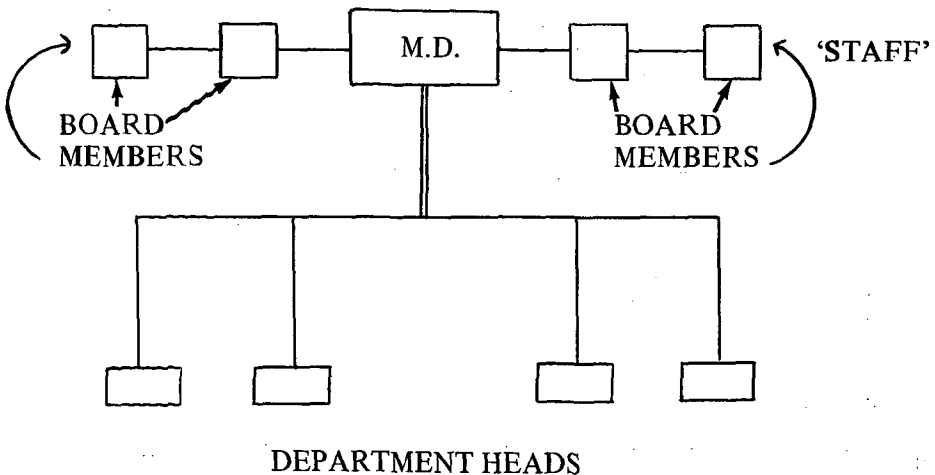
AN ORGANISATIONAL ANALYSIS

Where a group of people gather to cooperatively perform an activity, as in one view of a company, there is no natural law or organisational imperative to create a board of directors. Overall managing of the company — 'qua' group, is usually allocated to one individual who may, at one end of the spectrum be responsible to a parliament of elected group members, or at another extreme to nobody but himself — if he alone

FIGURE ONE: TRADITIONAL THEORY



BOARD SEEN AS:



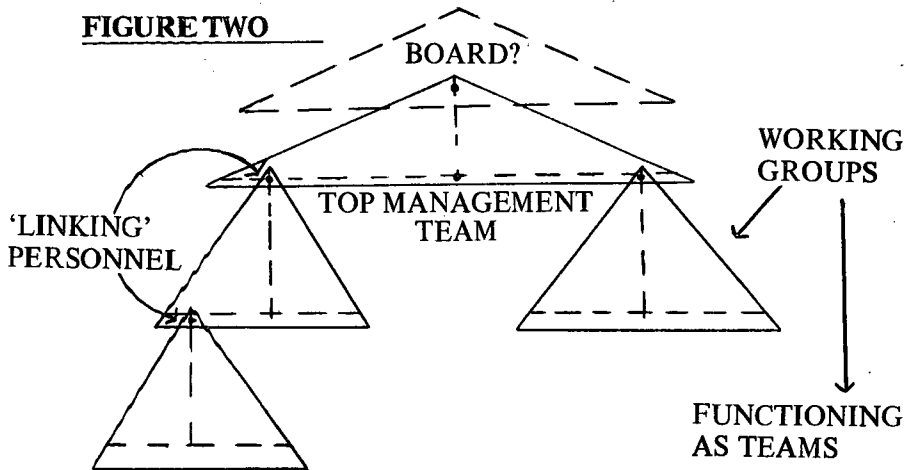
has the power to end the activity and to re-deploy the physical resources. The 'parliament' is a device to ensure that the activity is carried on to the satisfaction of some proportion of the members, which has nothing necessarily to do with the effectiveness or efficiency of the activity. Where the parliament/representative body takes on these additional concerns, it becomes concerned about effectiveness; it becomes equivalent to a board of directors, but it still remains unnecessary in the absolute sense to the framework of task performance.

In what has been described as the classical or traditional theory of organisation a board of directors is visualised as in some way, sitting at the top of the hierarchy — in a "group M.D." role — indistinguishable from one man except when the office door is open. Within this theoretical framework the explanation for the board would be that it functioned as 'staff' to the managing director (Fig. 1). For the purposes of this discussion it does not matter if the chairman of the board is the 'real' decision-taker, transmitting decisions through the managing director. The chairman in that situation can be visualised as placed at the top of the hierarchy receiving staff assistance from the directors, including the managing director. The staff role thus suggested for the board is very much of an advisory nature, with no suggestion that it includes the "functional" authority⁸ allowed to staff in most classical management work.

It is this traditional view of organisation theory and commitment to classical principles of organisation which provides the basis for injunctions to the board not to 'manage' and not to get involved in management. Exhortations to directors to work 'through' the managing director, and as a group to provide 'advice and counsel' are recognisably derived from the same theoretical model. The board, however, does have statutory powers and responsibilities and directors may be held accountable for certain company actions. Further, the executives and business people who provide the usual population of board members are not normally amenable to taking advisory positions. The result is that the board is either dominated by a company management accepted as competent by the directors, or the board actively manages through the managing director spokesman. In neither case has the board a necessary or distinct organisational role. It becomes an idiosyncratic feature of that company's particular management system, irrelevant as a board, in that it could just as easily be a group of professional consultants on the one hand, or a part-time executive team on the other.

The modified traditional view of the organisation which has come to be known as the participative model, and which is identified with Rensis Likert,⁹ would accept — and provide a more convincing rationale for — the advisory function of staff in the organisation structure. It would go no further in providing a convincing argument

for a board outside the managing structure, and would if anything, perceive a board group as an intrusion into an effectively linked set of functioning teams (Fig. 2).



A review of more recent contributions to the development of organisation theory leads to consideration of the board's role as one of the buffering devices placed by an organisation on its boundary with its environment to protect its 'core' process. To press this concept, proposed by J. D. Thompson¹⁰, into the board context is perhaps moving too far from its limited but clear original framework. In any case, this view continues the 'managing' role of the board as largely part of the overall company system.

A view of the board which extends and modifies this 'buffering' idea can be discerned in the results of recent and entirely separate work by Jeffrey Pfeffer¹¹ and R. Laube¹² in the United States. The board is seen as a mechanism which, through its coopting ability, allows an enterprise to make an impact on other organisations which may affect it. This is done by attracting men of influence from these other enterprises and institutions to become directors.

The mechanism presumably works by providing for personal contact in a responsible framework between managers and men of wider influence. There is nothing intrinsic about board structure which provides for this any more effectively than a normal professional relationship might. It is clear also that trade associations, social commitments and political and cultural affairs provide, and are often designed to provide, for just such personal "interest-establishment" contacts and relationships. On this point, Irish directors may use their social contacts more than their

professional or industry association meetings¹³. Excluding the Irish Management Institute as a business association within the usual meaning of the term, no more than 40% of Irish directors were members of such associations. Of these, 75%, or 30% of the total, were members or associates of professional bodies, usually in the accounting field.

Such membership, it is fair to say, does not involve a lot of inter-firm comparison and consultation, being concerned more with standards, entry procedures and development of the profession generally. Socially however, with 80% quoting membership of the relatively few prestigious golf, sailing and 'city' clubs, directors will see a lot of each other. Sixty per cent of Irish directors in fact, felt that their most frequent social contacts were with other directors.

Looked at then, from an organisational theory viewpoint, there does not seem to be a solid rationale for the existence of a board of directors as such. While a strong case can be made for more or less delegation, for example, or for the division of functions by product in certain circumstances, no similarly arguable theoretical foundation can be relied upon to justify the setting up or maintenance of a board.

THE BOARD'S FUNCTIONS

Directors of limited companies properly consider themselves collectively responsible for the performance of their company. Though events have not yet developed to the same extent in this country, lawsuits brought against U.S. directors in respect of company actions, – or omissions – point the way society will move in allocating responsibility to those who accept directorships. Company directors, as board members, have only one responsibility, and that is to the company. Varying philosophical and moral attitudes may incline their boardroom contributions towards, for example, more or less concern for the livelihood of employees in their own, or in a competing company, or in an acquired company. These attitudes however, must not persuade the director away from acting in the best interests, as he sees them, of his own company. The required duties of directors, and collectively of the board, in order to fulfil their obligation to the company, have been variously listed by practitioners and commentators over the last forty years¹⁴. The specific recommendations vary in the extent to which they attempt detailed prescription, but the writer would suggest that the following statement expresses their underlying theme:

The directors as a board are required to attend to the affairs of the company in such a way that expected major changes in performance and possible changes in objectives can be brought to their attention in time to ensure that effective decisions can be agreed, and certain action taken.

To do this, the board will need a sophisticated understanding of company activities, and enough business and technical expertise, to at least, evaluate both current performance and management projections. This in effect, is saying that the board needs practical competence in strategic planning and decision-making.

It is relevant in the Irish context to digress briefly to consider the situation of the statutory corporation. These are among the 'semi-state' companies, — the bodies set up by statute — e.g. Electricity Supply Board, Coras Iompair Eireann, Bord na Mona, as distinct from those limited companies where all, or the majority of shares are held by a Government Minister.

As regards the role of the member of the board of these statutory corporations in Ireland, it may be said that his or her personal responsibility and legal position is substantially different from that of the ordinary limited company director. Though the board, that is the group of people comprising the board, has itself the responsibility for performance of the functions laid down in the Act, the members will tend to see themselves as normal company directors, with, however, some element of a representative role. The differences in reality are quite serious and their powers quite firmly delineated in the relevant statutes. To mention one constraint which was in the news recently, (June 1978) the prevention of the statutory board from setting the remuneration level of its chief executive interferes more than a little with the area of the board's discretion¹⁵. Effectively, however, in their ordinary performance and motivation as board members, these 'directors' will discern little difference between their functions as statutory board members and the role of the limited company director. Many of course are active in both capacities, as directors of private and public limited companies as well as of statutory corporations.

To review what this practical competence in strategic planning might involve for the board and directors, one could take one of the many 'models' developed to identify the required steps in a process of corporate planning (see Exhibit 1).

From this it will be seen that the preliminary input and deliberation in the development of the final plan is in itself a complex and demanding exercise. It is here that the board will function, if anywhere, and at a level sufficiently high to distance itself from detailed product and technological bias. The function of top management also includes planning and deliberation at this level. The chief executive and his team do not start at a lower level as in some sense "receivers of the law". The board may then be presumed either to work at a still higher level, or to be seen to work at this level in duplication of the managerial function, or to work with management in a special advisory role.

Problem: What kind of business should the company be in and what should the performance objectives be?

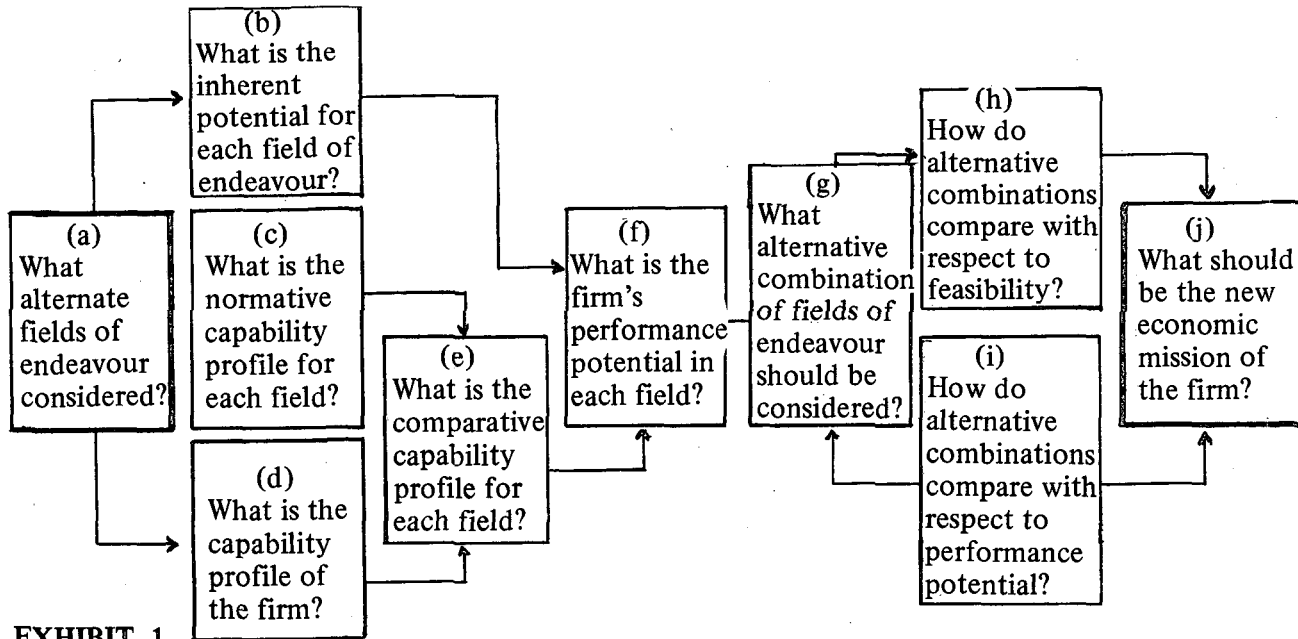


EXHIBIT 1

The Structure of the Major Strategic Decision.

F. F. Gilmore and R. G. Brandenberg, "Anatomy of Corporate Planning"
Harvard Business Review, vol. 40, No. 6, Nov./Dec. 1962.

To consider the first possibility is to look for board activity at a level higher than that of "formulating the economic mission" to use the expression in Exhibit 1. Nothing presents itself for consideration, especially since this level of deliberation includes the option of going out of business, and/or liquidating the company. The second case, that the board may be duplicating the work of management, is of course a possibility, — as is the last and more likely related idea that the board, in an "advisory" role, is doing management's work for them. None of these three instances advances the case for board relevance, and indeed it is interesting to follow up this board inclination to manage.

The lists of board functions noted earlier reflect this quandary for the board of finding a capacity to be strategically "aware" at some higher level than general management. Writing from experience and sometimes from research, commentators on both sides of the Atlantic find it difficult to avoid giving the board a directly managerial function. Puckey¹⁶, writing from extensive experience as a director, while finding himself unable to agree with the 'managerial' role identified by Professor Fogarty in an earlier review¹⁷, goes on, however, to note that the board's function is "to provide and maintain a purpose for the company". Defining 'purpose' as including . . . "both the creation of policy and the urge to translate policy into performance", he identifies four sub-purposes, as product, market, financial, and social. Adding a 'managerial purpose' he returns effectively to the managerial role which he had rejected.

Koontz¹⁸ notes that boards "actually enter into company management" and also states "this means simply that the board should undertake certain managerial functions itself". Vance¹⁹ identifies an evolutionary progression from the 'constitutional' through 'consultative' and 'collegial' to the 'communal' board, which, as his explanation indicates, is a progression towards more decision-taking by the board.

The Irish directors studied²⁰, were asked to identify the extent to which their board made decisions. This they identified on a five-point scale, as follows:

1.	2.	3.	4.	5.
The Board makes the DECISION	The Board actively participates in DECISION	The Board has some say in DECISION	The Board ENDORSES management decision.	The Board NEVER deals with this.

Somewhat more than seventy per cent of the directors placed their board as either *making*, or *actively participating* in the decision, in respect of the following areas (selected from the eighteen presented in the study):

1. Definition of major company policy
2. Setting or reviewing principal objective
3. Appointment of the chief executive
4. Remuneration of senior management
5. Final commitment to major shareholders
6. Safeguarding of corporate assets

There is little doubt that the directors see their boards as leaning heavily on the managerial side of the functions listed. Factor analysis carried out on the responses of individual directors to the eighteen functions presented, points to four overall functions for the board. One of these, which the writer terms "Direction", encompasses the guiding and supervising roles. Practically, it is easy to understand that businessmen would wish to present themselves as contributing in that way, but given the complexity of the strategic decision process, outlined earlier, it is not easy to understand how their contribution could really be up to that level. Unless the board is to be more than a talking shop, something more than Drucker's 'legal fiction',²¹ each director — all of whom on the board are equal — must have something worthwhile to offer to these complex deliberations, something more than their management already contributes. It is not good enough to suggest that an expert, objective "business policy/consulting" viewpoint, or incisive analytical role, satisfactorily describes this board contribution. That viewpoint describes exactly the kind of vision the owners wish their fulltime executive to develop and maintain. It is that viewpoint or role, for example, which is the declared educational objective in business administration degree courses, especially at postgraduate level. There is no question that boards might find such a broad 'policy' viewpoint valuable, but there is no reason to accept a management which if not itself capable, could not obtain such advice if necessary, outside a board structure.

Management, as executive directors on the board, do in fact prepare their case outside board meetings. Irish²² results show that there is a greater willingness among directors to admit that a caucus of inside directors exists as the proportion of outsiders on the board increases. Personal communication with directors suggests to the writer that this practice is fairly widespread, and it can be reasonably proposed that it is a rational management response to the difficulty of getting worthwhile strategic discussion under way at board level. It would appear therefore, that between what might be expected from the board and what can actually be done at board meetings, there exists a gap. This is unbridgeable within the theory now available.

THE COMMITMENT OF THE BOARD

To state the obvious, the "fulltime" board, or the board composed of fulltime directors, is in fact, management. This discussion will concen-

trate on the more usual board which consists of some management, if only the managing director, and also a proportion of non-executive directors.

Boards will, in general, meet little more than nine times in a year, that is, monthly except during the June–August vacation period. Only twenty per cent met more than twelve times²³. Meetings usually last less than three hours, and more often than not proceed in a relatively informal fashion.

Directors agree almost unanimously that they seek, and achieve, consensus at board meetings. This finding, again from the writer's research, supports other studies carried out elsewhere. In following up this response with a number of directors the most likely meaning of consensus appears not to be the strict 'unanimity' of the dictionary; but acceptance of a strong case and an unwillingness to be recorded – or remembered – as disagreeing with a majority opinion. Combining this with a further finding that more than half of the boards were perceived by their directors as 'insider – (i.e. executive) dominated' reflects a somewhat reserved commitment to the board.

While the extent of commitment will be a function of individual energy and ability the board meeting does not then seem to generate the strong feeling and stirring argument to be hoped for at the summit, nor does it command the sort of time commitment which infrequent and critical strategy discussions would call for. One day per month²⁴ would be an average figure for the time directors estimate that they are involved in a particular directorship. This includes the 2–3 hours spent at the meeting. This reported (and otherwise assessed) figure is untuitively acceptable, and indeed may be a high self-reported figure. Other surveys of manager use of time show that managers actually spend very little time on uninterrupted desk-work or study²⁵. While the inside director/executive does come to the board meeting from full-time involvement in company life, the outside director may in fact find him no more formally prepared or equipped to discuss the particular issues than he himself is.

The author's experience, over a decade of working with experienced graduate managers in general management and business policy case discussions, is that even with a "canned" case, where data and background have been selectively edited and presented to support analysis and aggressive discussion, a couple of hours preparation is rarely sufficient to thoroughly explore the major issues. Where the director, to be effective, must himself select, arrange and edit the information which he needs – not which management needs – and then analyse and evaluate, the preparation should take considerably more time.

It may be argued that the outside director, after a number of years' exposure to the strategic issues affecting the company's business, will need much less time to adequately prepare himself, than will an analyst coming to the situation without prior knowledge. Although it will always be a reflection of individual director ability, it is difficult to see the point of calling a meeting which is expected to last, say two and a half hours, if it takes so little time to prepare for it.*

It may be that each member attends to the area of his own interest or special competence trusting each other to do the same, and therefore that major issues will be attacked from all – or a sufficient number of – the important angles. But management cannot afford to wait for another forum which will bring arguments together and develop conclusions. They must themselves examine all of the possibly relevant considerations.

As an examination of the quality of management thinking, the meeting may have a purpose, but the board is not the only possible – or ideal, – place for this. From another point of view, one day of even expensive consultant time on a regular retainer basis might be expected to cost much less than the combined fees and other expenses of the outside directors. Another pointer to the sort of commitment to be expected of directors to their board work is the proportion of total income obtained for their directorships. In respect of their remuneration, it will be accepted that this cannot be directly proportional to commitment, since voluntary work is known to command frequently more attention and interest than the bread-winning activity. On the other hand, the expression "you get the advice you pay for" is a worthwhile generalisation in the professional sphere – "if you pay peanuts, you get monkeys".

Forty-five per cent of outside directors said that their remuneration was "purely nominal". For only 10% was it a significant proportion of total earnings, and thirty-five per cent felt that it was "useful but not significant". Depending on what was understood by "useful" – and the writer is inclined to feel that a figure of say £1,000 before tax in total earnings of perhaps £12,000 – £15,000 would come into this category – the indications are that the financial reward is not likely to stimulate commitment.

Also in this study, directors were asked about existing and preferred personal characteristics of board members in so far as they saw these as explaining performance. From a list of eleven 'dichotomised' characteristics, e.g., "maturity . . . immaturity", "enterprising . . . cautious",

*Much of this could be said, with equal validity about most regular meetings. Preparation may be less important for representational, bargaining, or political assemblies.

respondents were asked to select and rank five as being those characteristics which most explained director (their colleague's) boardroom performance. 'Completed homework' was ranked fourth and fifth by respectively seven and eight per cent of respondents. That is, eighty-five per cent did not select it at all, and those who did placed it low on their list. As a preferred characteristic for the selection of colleague directors, it received very slightly more notice.

CONCLUSION

To summarise, the position taken at the beginning of this article, that the board of directors may be both ineffective and irrelevant, must be seriously considered. In neither an organisational or functional decision-making sense can there be seen a clearly established case for a board. On the contrary, there are strong grounds for an opposite view. In practical terms of personal commitment, directors would seem to have accepted the basic irrelevance of their role, as far as the conduct and direction of their company's affairs is concerned.

There is some evidence that boards are moving towards an auditing role²⁶, which implies either that management is poor enough to need direction, or so good as to need watching. This latter may apply to some boards, and society may be sufficiently suspicious to look for an extension of the practice to all boards. The arguments presented here, however, cast doubt on the practical ability of the board to do either of these things, custodial or managerial. The real function of the board continues to elude research, but pragmatic trade union disinterest²⁷ in board participation may have a very rational basis.

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