

BOARD MEMBERS' CONTRIBUTION TO STRATEGIC DECISION- MAKING IN SMALL FIRMS

ABSTRACT

This article explores how the boards of small firms actually undertake to perform strategic tasks. Board strategic involvement has seldom been investigated in the context of small firms. We seek to make a contribution by investigating antecedents of board strategic involvement. The antecedents are “board working style” and “board quality attributes”, which go beyond the board composition features of board size, CEO duality, the ratio of non-executive to executive directors and ownership. Hypotheses were tested on a sample of 497 Norwegian firms (from 5 to 30 employees). Our results show that board working style and board quality attributes rather than board composition features enhance board strategic involvement. Moreover, board quality attributes outperform board working style in fostering board strategic involvement.

Key words:

Corporate Governance; Board of Directors; Small Firms; Board Strategic Involvement.

by

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INTRODUCTION

In the last few years there has been increasing interest in board activities from both academics and policy-makers, since boards do not seem to do their job properly as various scandals might indicate (Enron, WorldCom, Parmalat, etc). According to agency theory, the board serves as a control mechanism, aiming to guard against potential managerial misconduct at the expense of shareholders' wealth (Fama and Jensen 1983). However, this is not the only activity of the board. The board is involved in other activities like strategic decision-making (Huse 2007; Stiles and Taylor 2002; Useem 2003; Zahra and Pearce 1989), which is the focus of our study and has not been explored as much as other activities ascribed to boards (Gabrielsson and Winlund 2000; Van den Heuvel, Van Gils and Voordeckers 2006).

In this paper, we investigate what the board in small firms does in relation to strategic issues and what enhances board strategic involvement. We explore the effects of "board working style" and "board quality attributes" on the directors' involvement in shaping strategic decisions. Board working style refers to the organization of board meetings and board work, while board quality attributes refer to board knowledge, diversity and motivation to participate. These two dimensions are in line with process-oriented research to understand the sources of "value-creating board" (Huse 2007; McNulty and Pettigrew 1999; Zajac and Westphal 1998). We apply agency theory, the resource-based view of the firm and arguments from a cognitive perspective to understand effects of the two dimensions on board strategic involvement in small firms.

Agency theory captures a normative perspective that governance needs to handle. It specifically points out the need to reduce information asymmetry between the principal and the agent, which hinders the ability of decision-makers in the strategic

arena (Eisenhardt 1989). We propose to examine board working style that could mitigate information asymmetry. Effective governance of small firms also depends on the firm's capability of tapping board knowledge (Zahra and Filatotchev 2004). We additionally draw from the resource-based view and the cognitive perspective to examine board quality attributes.

In general, board strategic tasks denote a set of activities like shaping mission, vision and values, identifying important strategic activities and scanning the environment for trends and opportunities (Hendry and Kiel 2004: 511). Most empirical studies of board strategic involvement have so far focused on large firms (Fiegener 2005; Pettigrew 1992; Zahra 1990). The results of previous studies, however, are problematic for understanding board strategic involvement in small firms because of the differences between small and large firms (Castaldi and Wortman 1984). Small firms represent a unique setting with regard to board tasks and functioning. For example, no matter which definition is adopted, managers of small firms bear a major stake of wealth effects of their decisions (Jensen and Meckling 1976). Consequently, owners of small firms may be more concerned about firm survival, growth rate, family welfare, succession plan, personal status, etc. than retaining short-term financial returns that are a core concern of shareholders in public companies. The different focuses of interests may affect how boards perform their strategic tasks. The lack of empirical investigations regarding board strategic involvement in small firms therefore indicates a research need, which becomes more urgent when small firms have higher demand than large firms for the board's strategic contributions to the firm's survival and future growth (Daily and Dalton 1993; Huse 2000). Our study thus represents a timely attempt to acquire more knowledge in this respect.

The contribution of this study is two-fold. First, the two antecedents—board working style and board quality attributes—are more important sources of board effectiveness (boards are actively involved in tasks performance which further enhances firm growth and performance) than board composition features, which refer to board size, CEO duality, the ratio of non-executive to executive directors and ownership. In studies of large firms, board composition features have generated ambiguous results concerning board strategic involvement. For example, boards that effectively resisted green mails were found to have more outside (non-executive) directors (Kosnik 1987). However, another study shows that more outside (non-executive) directors seem to discourage corporate entrepreneurship, an important strategy for firm survival (Zahra 1996). The ambiguity seems to suggest that board composition features may not be the fundamental factor that enhances strategic involvement in large firms. This result is also confirmed in our studies of small firms. The most effective factors, as our study suggests, are board working style and board quality attributes. Second, this study improves our understanding of the difference between board working style and board quality attributes. Board quality attributes outperform board working style in enhancing board strategic involvement. As a result, owners of small firms who wish to improve board performance in the strategic arena may do better by focusing on board quality attributes as a competitive resource.

Below, we first present theoretical foundations and hypotheses. Then we describe the method and research design, with a brief overview of the survey and items in the questionnaire. After presenting the results we conclude with some research implications.

1. THEORETICAL FRAMEWORK AND HYPOTHESES

The board is expected to play a key function in shaping the strategy of the firm. *Board strategic involvement*, albeit challenged by many scholars, is widely recognised as one of the major tasks of the board (Andrews 1981a, 1981b; Baysinger and Hoskisson 1990; Finkelstein and Hambrick 1996; Golden and Zajac 2001; Huse 2007; McNulty and Pettigrew 1999; Zahra and Pearce 1990).

However, we still lack consensus about the boundary of board strategic involvement (Herman 1981; Judge and Zeithaml 1992; Lorsch and McIver 1989; Mace 1971). Board strategic involvement is a complex and multidimensional concept that cannot be comprehended within one single theoretical lens (Ravasi and Zattoni 2006). Different researchers may view board strategic involvement from different angles. For example, according to Zahra and Pearce's study "*board strategic involvement refers to the level of attention given by director to the various areas of the strategy process. Therefore board strategic involvement covers corporate mission development, strategy conception and formulation, and strategy implementation.*" (1990: 165). This definition covers a broad area. Ruigrok et al. narrow down the area of board strategic involvement, and claim that it should include: "*evaluation and proposals of different alternatives and consider different options*" (2006: 1205). In this definition the implementation of strategy is however excluded. It also excludes a new strategy formulation from board strategic involvement, which some researchers disagree with (Henke 1986; Schmidt and Bauer 2006; Stiles and Taylor 2002). For these researchers, the board not only evaluates and ratifies existing strategies from the management, but also takes initiatives to formulate them. In addition, there is a substantive body of research indicating that,

while the board is an important factor influencing firm strategy, the CEO is also a vital or even decisive force in shaping firm strategy (Carpenter and Westphal 2001; Westphal and Fredrickson 2001). In short, the boundary of board strategic involvement is ambiguous and difficult to decide, which leaves room for further empirical examination.

In spite of the ambiguity stated above, we adopt the definition that board strategic involvement in general refers to shaping mission, vision and values, identifying important strategic activities and scanning the environment for trends and opportunities (Hendry and Kiel 2004: 511). We particularly focus on small firms and explore factors that strengthen board strategic involvement.

It is acknowledged that CEOs in small firms also desire the board's participation in the strategic domain to improve decision-making quality (Ford 1988) and enhance the firm's products and services (Schoonhoven, Eisenhardt and Lyman, 1990). Studies on board strategic involvement in small firms are still in their infancy. Board effectiveness in small firms has been investigated mainly in relation to the service and control tasks (Gabrielsson and Winlund 2000; Minichilli and Hansen 2007; Voordeckers, Van Gils and Van den Heuvel 2007) while little path-breaking research on board strategic task has been carried out and still remains a controversial issue (Huse 2000). The results of those few studies addressing board strategic involvement in small firms are somewhat conflicting. Some show that the board of small firms tends to be rather passive in its strategic involvement, and even claim that strategic participation is not the dominant activity of the board in very small firms unless there are specific contextual conditions (Dyer 1986). However, there are other studies that show the opposite (Huse 1990). This suggests that the current foundation for understanding board strategic involvement in small firms is still weak.

Overall, the board of directors in small firms has seldom been investigated, compared to the empirical studies available for large firms. Some may argue that we could infer study results for small firms from large firms and venture-capital-backed firms, which could however be problematic and even misleading (Lerner 1994).

In this study, we develop a model to examine the variation of board strategic involvement in small firms, as illustrated by Figure 1.

Insert Figure 1 about here

The main arguments are drawn from agency theory (Eisenhardt 1989; Fama and Jensen 1983), the resource-based view of the firm (Barney 1991) and a cognitive perspective (Rindova 1999; Westphal 1999). One main problem, according to agency theory, is asymmetric information distribution between the principal and the agent (Eisenhardt 1989). The principal and the agent have different exposures to information. This problem still exists between the board that represents the principal and the agent because the board works on a periodical basis while the management does so on a daily basis. Potential information asymmetry between the board and the management can hinder board task performance which depends on critical information. We argue that an effective board working style may reduce information asymmetry and hence strengthens board strategic involvement. According to the resource-based view of the firm, we argue that directors' in-depth knowledge and diverse expertise represent a source of competitive advantage, which can lead to superior board performance in the strategic arena. The resource-based view also reflects the logic of the knowledge-based perspective in governance (Zahra and Filatotchev 2004), which indicates the possibility

and necessity to tap board knowledge. In addition, directors' motivation to participate strengthens directors' desire to establish a collaborative working relationship with the CEO such that board strategic involvement is enhanced.

Board working style

Board working style relates to organizing and conducting board meetings and reflecting board work periodically. We use board working style to explore effects of meeting processes on board strategic involvement. This approach has seldom been investigated (Demb and Neubauer 1992; Lehmann, Warning and Wiegand 2004). Agency theory helps to shed light on the importance of board working style as a means of reducing information asymmetry between the directors and the managers.

According to agency theory, shareholders (the principal) relinquish control of the firm to managers (the agent) hired to run the daily operation (Fama and Jensen 1983). The management benefits from its daily operation and acquires more firm-specific information than the directors who only meet periodically (Lorsch and MacIver 1989). Firm information is therefore asymmetrically distributed between the management and the board. Asymmetric information can further cause problems for the board to effectively perform its tasks which depend on critical, firm-specific information. For example, the board control function is effective only when the board knows what to control (Levinthal 1988). Eisenhardt suggests reducing information asymmetry by investing in information systems such as budgeting systems and reporting procedures (1989). In essence, Eisenhardt tends to solve information asymmetry by designing a behavioural contract that can reveal the agent's behaviour to the principal.

We propose another way to reduce information asymmetry by investigating board working style. It is a process-oriented approach that improves information distribution through board meeting designs and evaluations of board work. There are few empirical studies linking board ability of seeking information to board performance (Rutherford and Buchholtz 2007). In this study, we explore three aspects: 1) how effective the board evaluation process is, 2) how frequent board meetings are held and 3) how long board meetings usually last.

Board evaluation is a periodic review process of the information infrastructure such as the board meeting. During this process, the board reviews contributions of board meetings, evaluates the weakness of the current meeting structure and initiates improvement plans for information provision. Consequently, board evaluation enhances the efficiency and quality of information flow between the board and the management. However, this aspect of information processing has not been widely investigated in previous research with few exceptions (Demb and Neubauer 1992; Finkelstein and Mooney 2003). These studies suggest that a formal evaluation plan helps directors to achieve what processes should accomplish by developing the right kind of communication between the directors and the management. When the board is able to gain important information about the firm, the likelihood of better strategic performance increases.

Hypothesis 1a: Establishment of board evaluation practices enhances board strategic involvement.

The number of board meetings reflects the frequency of information exchange.

Board meetings provide valuable opportunities for directors to discuss and dispute the main issues facing the firm, to accomplish their legal duties and responsibilities and to perform their expected tasks. The frequency of board meetings has sometimes been considered a measure of board effectiveness in itself, in particular, when the board's periodical working pattern is taken into account (Rutherford and Buchholtz 2007). It makes intuitive sense. The board in reality spends much less time on running the firm than its management. Information asymmetry about the firm is therefore unavoidable between them. However, as the decision-making apex, the board needs to comprehend a substantial set of firm-specific information and knowledge to make intelligible and coherent business plans to survive. This process takes time. Increasing the meeting frequency can counteract the weakness of the board's periodical working pattern and its effect on information exchange.

Hypothesis 1b: The frequency of board meetings enhances board strategic involvement.

The length of board meetings reflects the general duration of information exchange in board meetings. Discussions about relevant choices, both in terms of the strategic context or defining the competitive strategy, require that board meetings last for quite a long time (Stiles 2001). Therefore the length of board meetings may provide a "time buffer" for the directors to recognize and identify firm-specific information of critical importance. In addition, the directors also need enough time to properly utilize comprehensive knowledge they have obtained. Even if it is not proved that two-day meetings are more effective than shorter councils, we argue that long meetings may

enable the board to develop a safer procedure to reduce undesirable consequences caused by information asymmetry. Decisions made during this comprehensive procedure are perhaps more relevant and effective.

Hypothesis 1c: The length of board meetings enhances board strategic involvement.

Board quality attributes

Traditional research into corporate governance has taken the board as a mechanism to prevent managers' misconduct and protect shareholders' wealth. An increasing number of studies have broadened this view by analyzing the quality attributes of the board (Charan 1998; Forbes and Milliken 1999; Leblanc and Gillies 2005), which we categorize into three aspects: a) board knowledge, b) board diversity and c) the directors' motivation to participate. We draw our arguments from the resource-based view of the firm (Barney 1991) to explain the effect of the first two aspects on board strategic involvement, and then we use the argument of cognitive behaviour prone to collaboration (Westphal 1999) to explain the effect of the last aspect on that.

The resource-based view of the firm indicates that having unique and inimitable resources would foster firms' ability to pursue good performance. The board might be seen as a valuable asset of the firm when it is actively involved in decision-making and challenges the CEO's proposals through the interpreting, scanning and choice activity. Effective involvement in the process requires skills and the board's in-depth knowledge (Ruigrok et al. 2006; Stiles 2001).

Board knowledge reflects the degree of directors' understanding of firm operations. It entails in-depth knowledge of the firm covering information on the firm's industry, competitors, customers, technology, etc. This knowledge is a tacit asset and its utility is difficult to substitute. It is an important source of the board's ability to perform various tasks (Forbes and Milliken 1999; Hillman and Dalziel 2003). For example, Fama and Jensen argue that the presence of in-depth knowledge of the firm forms a valuable and unique resource, which is critical for the board to exercise its decision-controlling task over the management (1983). Other researchers have also noted the importance of in-depth knowledge of the firm. They argue that it helps the board focus on relevant decision alternatives (Charan 1998) and enables it to efficiently comprehend business operations and internal management issues (Forbes and Milliken 1999).

We further claim that enhancing in-depth knowledge of the firm could reduce the board's passive behaviour, under which directors seldom discuss with CEOs or challenge them, but "rubber stamp" the CEO's proposals without reflection (Mace 1971; Lorsch and MacIver 1989). In short, the board does not perform the function of checks-and-balances. The reason, as we see, could be partly due to the lack of firm-specific information such that useful and constructive communication is unlikely to occur. It is thus reasonable that the board should acquire sufficient in-depth knowledge of the firm to potentially improve board strategic involvement.

Hypothesis 2a: In-depth knowledge of the firm enhances board strategic involvement.

Board diversity refers to the diversity of directors' skills and expertise in terms

of their functional, industrial and educational background. This type of diversity is classified as a job-related diversity, and is found to be positively associated with group performance (Pelled, Eisenhardt and Xin 1999). According to the resource-based view, a board with job-related diversity enjoys a broader information pool, which ultimately enhances the board's ability to identify creative and innovative solutions (William and O'Reilly 1998). The need for diversity in expertise and skills also reflects the value of board capital, which is argued to strengthen the board's service and control task performance (Hillman and Dalziel 2003). For small firms, job-related diversity becomes more important when the executive's experience is relatively limited (Zahra and Filatotchev 2004). They thus recruit directors with rich experience, expertise and skills to deal with the complexity (Daily and Dalton 1993). These studies claim that non-executive directors are more capable of bringing the expertise and skills that small firms need. We argue that the benefit of the diversity resides in the state of mind of the board rather than the number of non-executive directors. Therefore, we choose to analyze board diversity directly.

Hypothesis 2b: Board diversity enhances board strategic performance.

At the same time, the argument from a cognitive perspective suggests that board members contribute to the function of the board through their "scanning, interpreting and choice activity" (Rindova 1999) that is linked to an inner drive to do a good job, which forms collaborative behaviour between the board and the management (Westphal 1999). As a result, board task performance could be improved.

The directors' motivation to participate refers to the directors' inner drive to do a

good job. The directors' motivation to do a good job is seldom considered to be a major issue to explain board behaviour. In general, directors are believed to choose directorship on a board for reasons of financial gain. However, there are also studies showing that non-financial motivations also exist, which may have a stronger effect on the decision of directorship than the financial remuneration has (Lorsch and MacIver 1989). The non-financial inner drive could be caused by the legal responsibility (Hermalin and Weisbach 1988) or professional satisfaction gained from doing a good job (Charan 1998). This kind of motivation may enhance the CEO's understanding that the board's major concern is the firm. An environment that favours collaborative behaviour is formed.

According to the collaborative behaviour view between the board and the management, we are encouraged to identify social factors that can facilitate communication between the management and the board (Westphal 1999). The collaborative type of communication holds that the CEO trusts the board and dares to disclose information of a sensitive nature because the CEO believes that the board would not take personal advantages from it. We argue that when the directors show their motivations to join the board because of professional standards and legal responsibility to the firm rather than financial payment, collaborative behaviour between the board and the CEO is enhanced, which facilitates the creation of an open and productive communication between the board and the CEO, and consequently board task performance is improved. In addition, collaborative behaviour implies a willingness of the CEO to share information of critical importance with the board. As a result, information asymmetry is also reduced.

Hypothesis 2c: The personal motivation to participate enhances board strategic involvement.

2. METHOD

2.1 Data collection and sample - "The Small Business Survey"

Our data sample comes from the database of "Value Creating Board" based on Norwegian firms. There are three reasons for us to use the Norwegian database. First, this database provides relatively sufficient observations—497 CEO responses—comparing with similar studies based on the survey method. Second, using this Norwegian database provides some interesting results, which are unlikely to emerge from studies using dominant databases from the United States and the UK. The result of this unique database benefits small firms in general where the country effect may not be an imperative mechanism. We took particular consideration of employee numbers which, according to a legal requirement of employee representatives, may affect the generalization of our data. As a result, we carefully selected small firms with employee numbers below 30, a threshold in which the requirement is not compulsory (Randoy and Nielsen 2002). Third, our study of Norwegian boards in small firms may add values to recent studies of board roles in SMEs based on a similar database from Belgium and the Netherlands (Voordeckers et al. 2007).

Hypotheses are tested on small Norwegian firms with 5 to 30 employees, and a turnover between NOK 1,000 and 50,000,000. Data were gathered from a questionnaire, which was sent out to 3,000 CEOs of small firms randomly chosen from the database in 2003-2004. We excluded sole proprietorship and partnerships due to the missing

requirement of a board. Norwegian law requires a one-tier board in SMEs that delegates the daily operations to a separate management team (Randoy and Nielsen 2002). One reminder was sent out to those non-responding firms after the first mailing. There were 973 responses after the reminder. 476 out of 973 reported that the questionnaire was not relevant to them, hence the final responses of 497.

The responding firms had a mean of approximately 15 employees, with a yearly turnover of about 32 million Norwegian Kronas (corresponding to USD 4.9 million); 43.4% of the respondents perceive their firms as a family firm.

The board size on average is 3.46, 48.67% of whom are outsiders. In 29.18% of cases there is a CEO duality, and CEOs own on average 60.38% of the firm, which indicates the CEO is the largest shareholder of the firm. Board ownership is also measured, which on average owns about 65.58% of the shares. The last change in board membership occurred in the year 2000, which indicates that board membership does not frequently change.

2.2 Measures

Dependent variables

The dependent variable is *board strategic involvement*. It is a multidimensional concept, and is too broad to deal with (Brauer and Schmidt 2006). We aim to measure directly board strategic involvement by using 11 multiple items, which could be further classified according to different dimensions. For example, McNulty and Pettigrew study the construct of board strategic involvement by interviewing 108 firm directors, and classified three types of strategic involvement as taking strategic decisions, shaping strategic decisions and shaping the content, context and conduct of strategy (1999: 55).

It is a classification based on action in the strategic arena.

We chose to focus on the content of strategic involvement. A recent study of board strategic involvement indicates that board strategic tasks cover internal, external and strategic focuses (Huse 2005). The internal focus addresses activities in following up firm performance indicators like cost budgets and sales budgets. The external focus addresses the issues of social pressures and forces that the firm needs to consider like CSR. The strategic focus addresses the process of developing strategy through activities like formulating and ratifying strategies. The 11 items of board strategic involvement cover the above three focuses.

A five-point Likert-like scale measurement was used to record the answers. The lowest value indicates strong disagreement, and the highest value indicates strong agreement. We ran factor analysis with the maximum likelihood estimation method and Varimax rotation. Three sub-constructs are confirmed (see Table 1), reflecting the internal, external and strategic focuses. We label these three sub-constructs as *social strategy* (three items), *strategy follow up* (four items), and *competitive strategy* (four items). In particular, the *social strategy* sub-construct reflects the external focus, including items that deal with health, environment and safety issues, and CSR. The *strategy follow-up* reflects the internal focus, and it denotes a kind of watchdog-activity to check whether the strategic choices have been properly implemented by the executives. This construct includes follow-up items on cost budgets, sales budgets, firm liquidity, investments and human resources. Finally, the *competitive strategy* reflects the strategic focus, and includes the board's strategic proposals, ratifying long-term strategy, implementing strategy decisions and controlling and evaluating strategic choices.

Cronbach's alpha statistics are 0.849 for social strategy, 0.887 for strategy follow-up, and 0.904 for competitive strategy definition. These values indicate a strong consistency among items. The factor scores of the three sub-constructs were recorded for subsequent regression analysis.

Insert Table 1 about here

Independent variables

There are two types of independent variables, one is board working style and the other is the factor scores of the latent construct of board quality attributes.

Board working style includes three variables. The first is the establishment of board evaluation, measured by a five-point Likert-like scale. The second and third variables are the number and length of board meetings.

Factor analysis was used with the maximum likelihood estimation method and Varimax rotation to analyze *board quality attributes*. Three sub-constructs are confirmed: *board knowledge*, *board diversity*, and *the directors' motivation*. They were all recorded by using the five-point Likert-like scale measurement. Board knowledge is measured by four items, aiming at defining whether the board as a whole is knowledgeable about activities and key functions of the firm, critical technology, key weaknesses of the firm and development in the firm environment (Cronbach's $\alpha= 0.795$). Board diversity is measured by three items, concerning functional, industrial and educational background (Cronbach's $\alpha= 0.654$). The directors' motivation is measured by two items, assessing motivation through legal responsibility and professional standards (Cronbach's $\alpha= 0.555$). This value seems low; however, low

construct reliability is acceptable if the items measure what the construct intends to measure (Nunnally and Bernstein 1994). We intend to measure the inner drive of the board beyond financial payment; we thus view the construct of the directors' motivation acceptable. We present the factor analysis of board quality attributes in Table 2. Factor scores were recorded for later regression analysis.

Insert Table 2 about here

Control variables

We first control for board composition features, which are board size, CEO duality, the ratio of non-executive to executive directors and ownership.

Board size indicates the number of board directors with voting rights. Researchers argue that board size affects board performance (Pfeffer and Salancik 1978). Specifically, board size could be “*systematically related to the organization's apparent need to deal with important external sectors in the environment in such a way as to ensure successful operations and an adequate supply for the future*” (Pfeffer 1972: 225). Therefore, the larger the board, the better cushioning effect the board can offer. Other researchers have argued for a U-shaped relation between board size and board effectiveness (Zahra, Neubaum and Huse 2000). That is, the effectiveness of the board is diminishing after it has reached a certain size. However, as we do not expect small firms to have large boards, small firms may enjoy effectiveness due to the size effect.

CEO duality is measured by a “dummy variable” (yes or no). In small firms, the CEO and board chairperson position is usually held by one person. This practice has drawn many criticisms according to agency theory. It is a question of incentive

mechanisms; one is unable to exercise a control function over oneself. Agency theory strongly argues for the separation of the board chair position and the CEO position, thus increasing board effectiveness and firm performance (Shleifer and Vishny 1997). We control for CEO duality in the test.

Non-executives' ratio measures the ratio of non-executive to executive directors. However, the effect of this ratio is still under debate. For example, some researchers point out that non-executive directors do not affect board strategic involvement (Zahra 1996), while others found a positive and significant impact of non-executives' ratio on board performance (Hambrick and Jackson 2000) and the board resistance to green mails (Kosnick 1987). In one recent study, Filatotchev found that the number of executive directors is an important source of competitive advantage in IPO firms (2006). We control for the ratio of non-executive directors.

Ownership is measured by the equity held by all board members. Ownership functions as an incentive mechanism, which can stimulate board members with equity stakes in the firm to work hard to secure the quality of board performance in the strategic arena. As a result, performance is improved. Some studies focus on the ownership of non-executive directors (Filatotchev 2006). However, our data do not provide ownership of non-executive directors. We hope the difference made by non-executive directors could be partly captured by the previous control variable—non-executives' ratio. Therefore we only control for the total effect of board ownership on board strategic involvement.

Secondly, we control for firm age (Filatotchev and Toms 2003). The longer the firm has been established, the more robust the firm's financial resources, which may affect board strategic involvement. For a similar reason, we also control previous firm

performance, employee numbers and the year of the last board change.

We present the correlation matrix of all the variables in Table 3.

Insert Table 3 about here

3. DATA ANALYSIS AND DISCUSSION

We use SPSS to run linear regression analysis. The dependent variables include sub-constructs of board strategic involvement: competitive strategy, follow-up strategy and social strategy. In addition, we include one factor score for overall strategic involvement, representing all 11 items of strategic involvement.

There are three models. Model I runs regression analysis on the control variables. Model II includes all control variables in addition to the independent variable of board working style. Model III includes the control variables and the independent variables of board working style and board quality attributes. We present the regression analysis in Table 4 to 7.

Insert Table 4-7 about here

Hypothesis 1a states that formal board evaluation enhances board strategic involvement. A positive and significant effect is identified for board strategic involvement in overall strategy (0.202), competitive strategy (0.194) and social strategy (0.154). These results indicate that formal board evaluation affects board meetings where firm strategies are scrutinized, rectified, implemented and controlled. However,

we found no significant effect for board involvement in strategy follow-up (the coefficient is -0.007). The insignificant effect could have different explanations. One possible explanation is that board involvement in strategy follow-up is less dependent on formal board evaluation. Small firms, particularly those at an early stage, may need the board's continuous effort to follow up activities of strategic importance, and to ensure the survival and growth of the firm regardless of the establishment of formal board evaluation. Small firms may thus not prioritize the establishment of formal board evaluation at an early stage of the firm. However, as the firm matures over time, the advantage of establishing formal board evaluation may be too great to be ignored.

Hypothesis 1b suggests that there is a significant and positive relationship between the frequency of board meetings and board strategic involvement. The coefficient for predicting board strategic involvement in strategy follow-up is 0.148, with significance at the 0.05 level (2 tailed). It indicates that the higher the frequency of board meetings, the more involved the board in strategic follow-up will be. This result is consistent with hypothesis 1a concerning board involvement in strategy follow-up. Namely, small firms continuously need input from board strategic follow up, and a high frequency of board meetings matches such a need. From another point of view, we could argue that the high frequency replaces formal board evaluation in the case of strategy follow up. However, the effect of board meeting frequency on board involvement in social strategy is negative (-0.145), and the effect on board involvement in competitive strategy is not confirmed either.

Hypothesis 1c suggests a positive relationship between the length of board meetings and board strategic involvement. The length is positively and significantly related to board involvement in competitive strategy (0.109), while it does not seem to

be relevant to overall strategic involvement, strategic follow-up and social strategy.

To sum up, board structural features represented by formal board evaluation, the frequency of board meetings and the length of board meetings could enhance board strategic involvement to a certain degree, but they are not able to fully explain and capture the board's contribution to strategic issues.

Hypothesis 2a states that there is a positive relation between board knowledge and board strategic involvement. Positive and significant relationships are found for board involvement in competitive strategy (0.249), strategy follow-up (0.198) and overall strategy (0.313). The effect for social strategy, however, is not significant. This may indicate that the nature of board involvement in social strategy requires less knowledge and skills to comprehend than do competitive strategy and strategy follow-up. On the whole, board knowledge is a valuable resource, which enhances board strategic performance. Hypothesis 2a is therefore supported.

Hypothesis 2b asserts a positive relation between board diversity and board strategic involvement. The coefficients are significant for competitive strategy (0.129), strategy follow-up (0.207), social strategy (0.135) and overall strategy (0.257). The hypothesis is supported. The board is made up of a group of people; in order to make the board an active and performing body it is necessary that all the required knowledge and skills be held within the board, not only on a single member level, but as a group. The diversity of background increases the pool of knowledge and hence the information availability, which contributes to the creation of innovative solutions. Board strategic performance is enhanced.

Hypothesis 2c states that there is a positive relation between directors' motivation to participate and board strategic involvement. The coefficients are

significant for competitive strategy (0.185), strategy follow-up (0.191), social strategy (0.126) and overall strategy (0.280). This hypothesis is supported. Directors' motivation explains the importance of personal attitude, which seems to outperform the incentive mechanism represented by ownership.

On the whole, the results seem to support the idea that board quality attributes positively influence board strategic involvement.

In addition, the study indicates that there is a difference between the effect of board quality attributes and board working style in relation to overall strategic involvement. According to model III across Table 4 to 7, the value of F-change is significant. We could infer that board quality attributes outperform board working style concerning board strategic task performance. The claim is further supported from the resource-based view of the firm (Barney 1991). That is, board knowledge and board diversity are valuable resources that are difficult for competitors to imitate. Structural features like the length and frequency of board meetings could be valuable resources; however, they are easily duplicated by competing firms. It is perhaps more rewarding to focus on quality attributes in order to build a board to create sustained competitive advantage.

Concerning the control variables, our study fails to show their significant impacts on board strategic involvement. In particular, board size, CEO duality, the ratio of non-executive to executive directors and ownership fail to contribute to board strategic involvement.

4. CONCLUSIONS AND LIMITATIONS

Research on boards and governance has heavily relied on a direct relationship between board composition features—board size, CEO duality, the ratio of non-executive to executive directors and ownership—and firm performance. Small samples of large listed firms, usually US-based, have been used for most empirical studies. Research on boards in small firms within a European context is less explored and many contributions are expected.

Given the need to improve our understanding of how boards fit into the broader framework of governance mechanisms, our study sought to enhance knowledge of board strategic task performance. Building on the main findings from previous research, we suggest that the board is involved in shaping the firm's strategic orientation. In particular, board working style and board quality aspects seem to contribute more to board strategic involvement than do board composition features. We may thus conclude that it is fruitful to take a different approach outside the domain of the board composition features when analyzing board strategic involvement.

There are two implications of our study. Considering board composition features, our study finds no support for their effects on strategic involvement. Our explanation is that process variables like board working style and quality attributes are more fundamental than the board composition features that affect board strategic involvement. We recognize that we should be more explicit in addressing ownership of the non-executive directors in our study, as examined by Filatotchev in a recent study (2006). Failing to address ownership of the non-executive directors may affect our findings for board composition features; however when three out of the four elements (board size, CEO duality and non-executives' ratio) fail to be related to board strategic task performance, the effect of board composition features is in doubt. In addition,

studies that found support for board composition features do not necessarily offer contradictory findings to ours. The results of such studies may change somewhat if process variables like working style and quality attributes are also included in addition to board composition features. Nevertheless, such conjecture will only be justifiable upon new empirical investigations.

A second implication of our study is that the most important features affecting board strategic involvement are board quality attributes. While a major part of the literature deals with structural variables of the boardroom (Daily, Dalton and Cannella 2003), this paper shows that in small firms, the board could actively perform strategic tasks when it has acquired in-depth knowledge of the firm, a broad diversity in skills, and the motivation to do a good job. This appears paradoxical in light of the current framework of norms and codes in place worldwide.

This study has some limitations, which could be improved by future studies. First, questionnaires were addressed to the CEOs, who in most cases had to judge “their boards” with unavoidable personal biases. Analysis based on responses from the Chairman or other board members would have increased the validity of the study. Second, this study does not take into consideration potential moderating effects, which could be a fruitful research direction. For example, we may wish to explore how learning activities of the board and the management team (Zahra and Filatotchev 2004) moderate the effect of board working style and board quality attributes on board strategic involvement.

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APPENDIX

Figure 1 research model

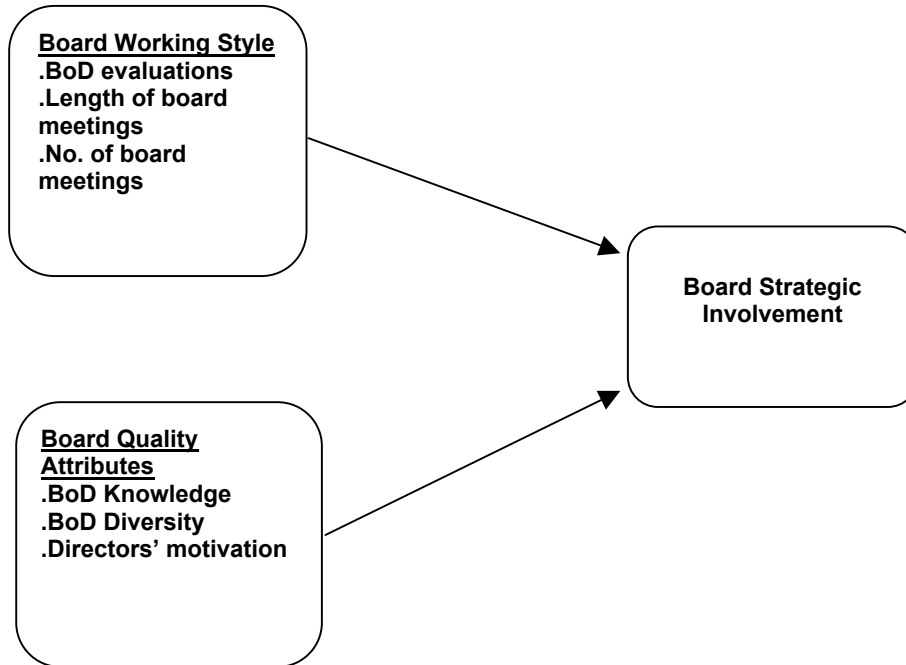


Table 1: Factor analysis on board strategic tasks (Dependent variables)

	Component		
	competitive	follow-up	social
e06a Board formulates strategy proposals	.714	.228	.199
e06b Board ratifies long term strategies decisions	.845	.258	.139
e06c Board implements strategy decisions	.766	.202	.179
e06d Board controls and evaluates strategy decisions	.832	.263	.172
e04a Involved in follow-up of cost budgets	.229	.875	.160
e04b Involved in follow-up of sales budgets	.292	.786	.125
e04c Involved in follow-up of firm liquidity	.178	.755	.209
e04d Involved in follow-up of investments	.277	.603	.252
e04h Involved in follow-up of HMS (Health, Environment and Safety)	.164	.250	.753
e04i Involved in follow-up of natural environment and pollution issues	.121	.106	.903
e04k Involved in follow-up CSR issues	.274	.226	.667
Cronbach's Alpha	.904	.887	.849

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.
a. Rotation converged in 5 iterations.

Table 2: Factor analysis on board quality attributes (Independent variables)

	Component		
	knowledge	diversity	motivation
c04a Knowledge of main activities	.668	.012	.156
c04b Knowledge of critical technology and critical competency	.816	.114	.169
c04c Knowledge of weak points in the firms	.582	.254	.186
c04d Knowledge of critical technology	.620	.255	.104
c07a Diversity in functional background among board members	.247	.600	.182
c07b Diversity in industry background among board members	.075	.551	.077
c07c Diversity in educational background among board members	.121	.609	.224
c08b Board members are positively motivated through legal responsibility/liability	.142	.134	.341
c08c Board members are positively motivated through personal professional standards	.202	.239	.949
Cronbach's Alpha	.795	.654	.555

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.

a. Rotation converged in 4 iterations.

Table 3, Correlation Matrix

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1 Competitive strategy	1															
2 Follow-up strategy	0.060	1														
3 Social strategy	0.032	0.034	1													
4 Knowledge	.262**	.200**	.139**	1												
5 Diversity	.219**	.246**	0.074	.116*	1											
6 Motivation	.248**	.186**	.182**	0.027	.105*	1										
7 Existence of regular board evaluations	.251**	.123*	.180**	.132**	.140**	.141**	1									
8 Number of board meetings 2002	.117*	.156**	-.142**	-.103*	.116*	-0.012	.113*	1								
9 Length of board meetings hours in 2002	.163**	.104*	-0.046	-0.037	.129*	0.046	0.053	.142**	1							
10 Board size	-0.047	0.010	-.138**	-.194**	0.081	-0.041	-0.002	.364**	.186**	1						
11 CEO duality	-0.013	-0.041	.159**	.111*	-.139**	-0.064	-0.023	-.215**	-.112*	-.397**	1					
12 Non-executives' ratio	0.021	-0.013	.103*	.132**	-0.068	0.094	-0.006	-.230**	-.116*	-.411**	.234**	1				
13 Ownership of the board	-0.039	-0.022	.145**	.186**	-.129**	-0.051	-0.010	-.230**	-.123**	-.365**	.353**	.197**	1			
14 Year of foundation	-0.058	0.066	-0.061	0.049	0.005	-0.021	0.007	-0.028	-0.033	0.028	-.102*	0.043	-0.006	1		
15 Previous performance	-0.007	0.044	-0.036	-0.077	0.061	0.031	0.092	.097*	.099*	0.017	0.037	-0.034	-0.043	-0.027	1	
16 Number of employees 2002	-0.013	0.008	-0.053	-.139**	-0.043	0.011	0.063	.217**	.114*	.274**	-.099*	-.121**	-.165**	-.120**	.130**	1
17 Last change in the board composition	0.024	0.027	-.158**	-0.088	0.032	0.047	.111*	.215**	.215**	.370**	-.289**	-.190**	-.231**	.219**	-0.047	0.080

** Correlation is significant at the 0.01 level (2-tailed). * Correlation is significant at the 0.05 level (2-tailed)

Table 4: Regression analysis on overall strategic involvement

	Model 1 (standard coefficients)	Model II (standard coefficients)	Model III (standard coefficients)
Board size	-0.128	-0.097	-0.030
CEO duality	0.023	0.031	0.057
Non-executives' ratio	-0.047	-0.034	-0.057
Ownership of the board	-0.022	-0.001	0.022
Year of foundation	-0.073	-0.065	-0.039
Previous performance	0.090	0.044	0.021
Number of employees (2002)	-0.043	-0.062	0.012
Last change in board composition	0.048	0.007	0.013
Length of board meetings (hours in 2002)		0.100	0.071
Number of board meetings (2002)		0.031	0.041
Existence of regular board evaluations		0.308**	0.202**
Knowledge			0.313**
Diversity			0.257**
Motivation			0.280**
<i>Adj R²</i>	-0.007	0.093	0.351
<i>F Change</i>	.772	10.998 **	36.848**

** significant at the 0.01 level (2-tailed). * significant at the 0.05 level (2-tailed)

Table 5: Regression analysis on competitive strategy

	Model 1 (standard coefficients)	Model II (standard coefficients)	Model III (standard coefficients)
Board size	-0.167	-0.137	-0.088 *
CEO duality	-0.007	0.001	0.012
Non-executives' ratio	-0.060	-0.052	-0.071
Ownership of the board	-0.102	-0.085	-0.080
Year of foundation	-0.093	-0.084	-0.066
Previous performance	0.087	0.047	0.036
Number of employees (2002)	-0.065	-0.079	-0.033
Last change in board composition	0.063	0.025	0.023
Length of board meetings (hours in 2002)		0.124*	0.109*
Number of board meetings (2002)		-0.003	0.006
Existence of regular board evaluations		0.262**	0.194**
Knowledge			0.249**
Diversity			0.129*
Motivation			0.185**
<i>Adj R²</i>	0.007	0.083	0.192
<i>F Change</i>	1.257	8.518**	13.190**

** significant at the 0.01 level (2-tailed). * is significant at the 0.05 level (2-tailed)

Table 6: Regression analysis on strategic follow-up

	Model 1 (standard coefficients)	Model II (standard coefficients)	Model III (standard coefficients)
Board size	0.000	-0.018	0.025
CEO duality	0.052	0.057	0.078
Non-executives' ratio	-0.021	0.004	-0.009
Ownership of the board	0.021	0.042	0.063
Year of foundation	0.042	0.048	0.066
Previous performance	0.044	0.027	0.008
Number of employees (2002)	0.046	0.026	0.080
Last change in board composition	0.062	0.040	0.047
Length of board meetings (hours in 2002)		0.063	0.040
Number of board meetings (2002)		0.143*	0.148*
Existence of regular board evaluations		0.067	-0.007
Knowledge			0.198**
Diversity			0.207**
Motivation			0.191**
<i>Adj R²</i>	-0.016	0.002	0.124
<i>F Change</i>	0.45	2.609*	13.533**

** significant at the 0.01 level (2-tailed). * is significant at the 0.05 level (2-tailed)

Table7: Regression analysis on social strategy

	Model 1 (standard coefficients)	Model II (standard coefficients)	Model III (standard coefficients)
Board size	0.019	0.074	0.089
CEO duality	-0.016	-0.020	-0.003
Non-executives' ratio	0.030	0.008	0.004
Ownership of the board	0.113	0.101	0.127
year of foundation	-0.044	-0.052	-0.041
previous performance	0.000	-0.017	-0.031
Number of employees (2002)	-0.040	-0.030	-0.004
Last change in the board composition	-0.102	-0.098	-0.090
Length of board meetings (hours in 2002)		-0.093	-0.109
Number of board meetings (2002)		-0.146*	-0.145*
Existence of regular board evaluations		0.194**	0.154**
Knowledge			0.035
Diversity			0.135*
Motivation			0.126*
<i>Adj R²</i>	0.007	0.052	0.081
<i>F Change</i>	1.253	5.321**	3.783**

** significant at the 0.01 level (2-tailed). * significant at the 0.05 level (2-tailed)