

Boards of Directors' Contribution to Corporate Strategy: A Literature Review and Research Agenda

Invited for submission to the
Special Issue "Review of Corporate Governance"
Corporate Governance: An International Review
Guest Editors: Igor Filatotchev; Brian K. Boyd
Deadline: August 31st, 2008

Amedeo Pugliese^a

Pieter-Jan Bezemer^b

Morten Huse^c

Frans A.J. Van den Bosch^b

Alessandro Zattoni^d

^a Department of Business Economics, University of Naples Federico II, Naples, Italy; ^b Department of Strategic Management, RSM Erasmus University, Rotterdam, Netherlands; ^c BI, Norwegian School of Management, Oslo, Norway; ^d Strategic Management Department SDA Bocconi, Milan & University Parthenope of Naples

E-mail for correspondence: amedeo.pugliese@unina.it

Boards of Directors' Contribution to Corporate Strategy: A Literature Review and Research Agenda

Introduction

The appropriate role of the board of directors in formulating and implementing corporate strategies has been long debated (Andrews 1981a, 1981b; Judge and Zeithaml, 1992; McNulty and Pettigrew, 1999; Useem, 2003). While extant literature has well-established the importance and need for adequate board control and independence (Baysinger and Hoskisson, 1990; Jensen & Zajac, 2003), both the contribution of boards to corporate strategy and the desirability of such practice have remained an unsolved puzzle (Daily et al., 2003; Golden and Zajac, 2001). This paper is a timely attempt to open a debate about board strategic involvement. Prior studies are not uniform in identifying what kind of strategic involvement is fulfilled by boards of directors: multiple theoretical perspectives and different methodological approaches have been used, but they provide inconsistent results.

An early discussion on boards of directors' strategic contributions traces back to Fama and Jensen (1983). In their seminal work, these authors make a distinction between decision management, i.e. initiating and implementing (strategic) decisions, and decision control, i.e. ratifying and monitoring (strategic) decisions. The two tasks were ascribed to the management team and the board of directors respectively. Following their logic, scholars have viewed the potential contributions of boards to strategy as limited by their distance to day-to-day operations and lack of firm specific-knowledge (Hendry and Kiel, 2004; Rindova, 1999). Instead, a growing stream of research holds that boards of directors are in the perfect position to contribute to corporate strategy and are expected to fulfill a strategic function as members are often part of top management teams as well (Charan, 2005; Conger et al., 2004; Demb and Neubauer, 1992; Finkelstein and Hambrick, 1996; Pettigrew, 1992; Stiles and Taylor, 2002).

From a theoretical standpoint, the debate around board strategic involvement has been fueled by conflict and consensus theories (Davis, 1991; Davis et al., 1997; Muth and Donaldson, 1998; Maassen & Van den Bosch, 1999). A *conflict perspective* conceptualizes managers as self-interested agents that should be closely monitored. Following an agency approach it sees an independent board as a mechanism to counteract the potential of managerial opportunism (Davis et al., 1997; Zahra and Pearce, 1989). Board strategic involvement would contrast this view, as requirements of distance and independence impose that board members do not have close ties to managers (Boyd, 1990, 1994; Fiegner, 2005; Sundaramurthy and Lewis, 2003). A *consensus perspective* conceptualizes managers as intrinsically motivated agents who will act in the best interest of the company (Davis et al., 1997). Accordingly, various theories (i.e. stewardship and resource dependency theory) see the board as a mechanism that supports empowered managers in their strategy formulation and implementation.

Aside to the theoretical debate, empirical findings also provide contrasting results: on the one hand, critics have witnessed that board members have been rather passive and subject to CEO

and executives' dominance, i.e. have been rubber stamps of management teams (Herman, 1981; Mace, 1986; Lorsch and McIver, 1989; Kosnik, 1987). Instead, other studies have shown that boards are effectively involved into the strategic process (Ravasi and Zattoni, 2006; Schmidt and Bauer, 2006; Zahra, 1990; Zahra & Filatotchev, 2006;) and that boards are becoming actively involved in corporate strategy (Hendry and Kiel, 2004; McNulty and Pettigrew, 1999; Westphal et al., 2001). Moreover, scholars have reported that boards of directors have affected important elements of corporate strategies, such as the scope of the firm (Jensen and Zajac, 2004; Lane et al., 1998; Tihanyi et al., 2003), strategic change (Filatotchev and Toms, 2003; Golden and Zajac, 2001; Johnson et al., 1993; Westphal and Fredrickson, 2001), R&D strategies (Baysinger et al., 1991; Kor, 2006) and innovation (Fired et al. 1998; Hoskisson et al., 2002; Zahra et al., 2000).

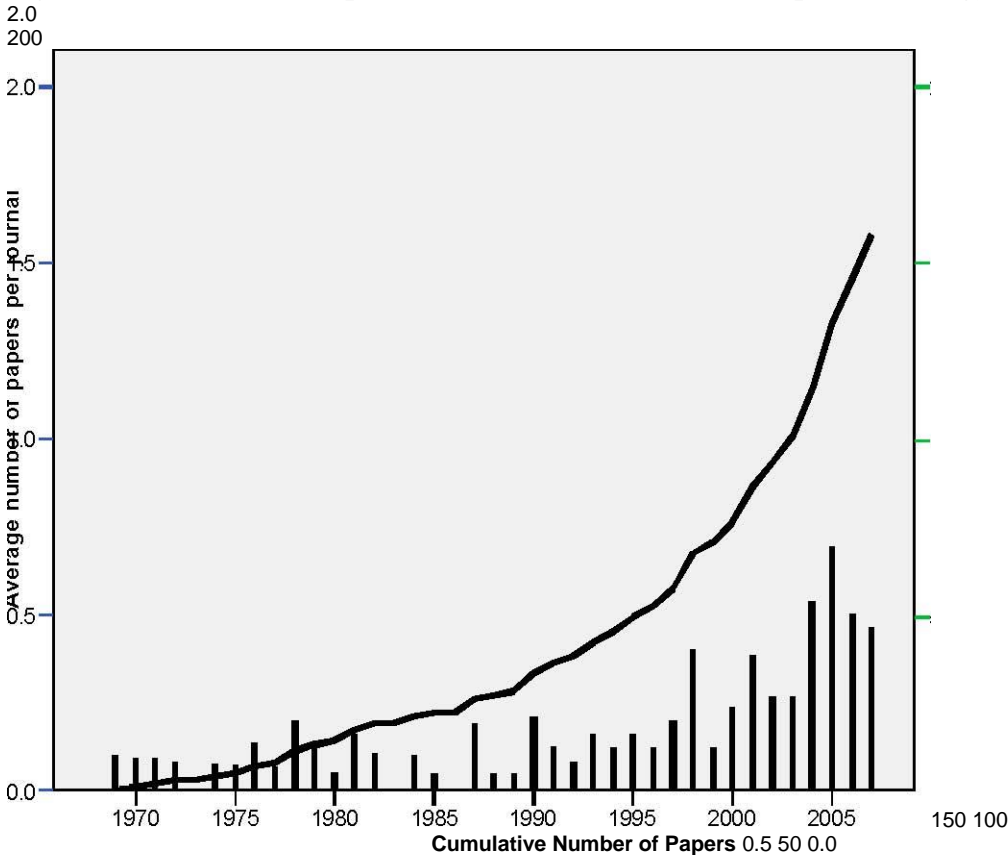
Our paper aims at uncovering what kind (if any) of strategic contributions are ascribed to boards from both a theoretical and an empirical point of view. Moreover, we address the ways in which managers manage the paradox between board involvement and board independence. Particularly, we will review and assess the stance of research in this area to recapitulate what we actually do know and which gaps need to be filled. Given the the time passed since the latest literature reviews (i.e. Dalton et al., 1998; Johnson et al., 1996; Zahra and Pearce, 1989), the changing institutional context and the ample amount of research done on boards and strategy more recently, it is the right time for a thorough reflection on achievements in this area and future directions (Huse, 2005). Thereby, we will proceed in line with Forbes and Milliken (1999:502) who gave expression to the need for new approaches that 'better explain inconsistencies in past research on boards, to disentangle the contributions that multiple perspectives have to offer in explaining board dynamics, and to clarify the trade-offs inherent in board design'.

Methodology

The literature review builds upon on prior studies in the area of board research (i.e. Brannan, 2006; Dalton et al., 1998; Hermalin & Weisbach, 2003; Finegold et al., 2007; Gabrielsson and Huse, 2004; Johnson et al., 1996; Zahra and Pearce, 1989). To get an initial overview of research on boards and corporate strategy, we electronically searched for papers in 25 top-journals (ISI-WEB ranking) in the area of strategy, organization, corporate governance, and general management. In addition, we included 3 top-journals in financial economics that are well-known for their contributions in this research area. We used the search terms 'board' and 'strategy'/'innovation' and checked all papers on their content.

We found in total 158 papers satisfying our criteria and the first one was published in 1969. Figure 1 provides a historical overview of the developments in a) the average number of papers published per top-journal per annum and b) the cumulative number of papers on boards of directors and corporate strategy published in the top-journals. As shown, the attention for board strategic involvement has been increasing and hints at the relevance and topicality of the issue at hand. Particularly, the journals "Harvard Business Review" and "Corporate Governance: An International Review" have been frontrunners with respectively 31 and 20 published papers. We are planning to analyze and categorize all papers in terms of research context, applied methodology, empirical findings and main contributions.

Figure 1: Historical Development Research on Boards and Corporate Strategy



Preliminary Findings & Intended Contributions

Our preliminary analysis hints at the following interesting issues and topics of debate that we are planning to address in our full-paper:

1. Context specificity of board strategic involvement. Prior studies have shown that different theoretical perspectives (i.e. agency, resource dependency, stewardship and strategic choice theory), different national contexts (i.e. one tier versus two tier board models, varying national legislation) corporate contexts (i.e. public versus family firms, corporate crises), and temporal dimensions (i.e. long run versus the short run) have a huge influence on the overall level of boards' strategic commitment. With our analysis, we intend to provide several clues as to where and when boards of directors are strategically involved and in which contexts such practices could be desirable.
2. Conceptual and Empirical Challenges. The extant literature shows that the strategy task of boards of directors is rather ill-defined, given the variety of conceptualizations and operationalizations of board strategic involvement. Moreover, the interrelationship between board demography, board structures and board behavior in a strategy context could be more clearly spelled out.
3. Drivers of the Interest in Board Strategic Involvement. Our analysis witnesses an increasing number of papers on boards and strategic issues. This may hint at growing awareness and interest of external stakeholders (institutional investors) claiming for more involvement of their representatives on boards. Investigating the antecedents of this trend and relationship with changing international and national institutions, might be an interesting avenue for future research.

References

- Andrews, K. (1981a). Replaying the board's role in formulating strategy. *Harvard Business Review*, May-June: 18-26.
- Andrews, K. (1981b). Corporate strategy as a vital function of the board. *Harvard Business Review*, Nov-Dec: 174-184.
- Baysinger, B., & Hoskisson, R. E. (1990). The Composition of Boards of Directors and Strategic Control: Effects on Corporate Strategy. *Academy of Management Review*, 15 (1): 72-87.
- Boyd B. K. (1990). Corporate linkages and Organizational Environment: A test of the Resource Dependence Model. *Strategic Management Journal*. 11 (6): 419-430.
- Boyd B. K. (1994). Board Control and CEO compensation, *Strategic Management Journal*, 15 (4): 335-344.
- Brennan N. (2006). Boards of Directors and Firm Performance: is there any expectations gap? *Corporate Governance: an International Review*, 14 (6): 577-598.
- Charan, R. (1998). *Boards at Work: How Corporate Boards Create Competitive Advantage*. (San Francisco. Jossey-Bass Publishers).
- Conger J. A., Lawler E. E. and Finegold D. L. (2001). *Corporate Boards. New Strategies for adding value at the Top*. (San Francisco. Jossey-Bass Publishers).
- Daily C., Dalton, D., & Cannella, A. (2003). Corporate Governance: decades of dialogue and data. *Academy of Management Review*, 28 (3): 371-382.
- Dalton D. R., Daily C. M. Ellstrand A. E. & Johnson J. L. (1998). Meta-Analytic Reviews of Board Composition, Leadership Structure and Financial Performance. *Strategic management Journal*, 19: 269-290.
- Davis G. F. (1991). Agents without Principles? The Spread of the Poison Pill through the Intercorporate Network. *Administrative Science Quarterly*, 36: 583-613.
- Davis J. H., Schoorman D. F. & Donaldson L. (1997). Toward a Stewardship Theory of Management. *The Academy of Management Review*, 22 (1): 20-47.
- Demb, A., & Neubauer, F. (1992). *The Corporate Board*. (Oxford. Oxford University Press).
- Fama, E., & Jensen, M. C. (1983), Separation of Ownership and Control. *Journal of Law and Economics*, 26 (2): 301-325.
- Fiegener, M. K. (2005). Determinants of Board participation in the Strategic Decisions of Small Corporations. *Entrepreneurship Theory and Practice*, Sept: 627-652.
- Filatotchev, I., & Toms, S. (2003). Corporate Governance, Strategy and Survival in a Declining Industry: A Study of UK Cotton Textile Companies. *Journal of Management Studies*, 40 (4): 895-920.
- Finegold D., Benson G. S. and Hecht D. (2007). Corporate Boards and Company Performance: review of research in light of recent reforms. *Corporate Governance: an International Review*. 15 (5): 685-699.
- Finkelstein, S., & Hambrick, D. (1996). *Strategic leadership: top executives and their effects on organizations*. (Minneapolis. West Publishing).
- Forbes, D., & Milliken, F. J. (1999). Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups, *Academy of Management Review*, 24 (3): 489-505.
- Fried V. H., Bruton G. D. & Hisrich R. D. (1998). Strategy and the Board of Directors in Venture Capital- Backed Firms. *Journal of Business Venturing*, 13: 493-503.
- Gabrielsson J. and Huse M. (2004). Context, Behavior, and Evolution. *International Studies of Management and Organization*. 34 (2): 11-36.
- Golden, B. R., & Zajac, E. J. (2001). When Will Boards Influence Strategy? Inclination x Power = Strategic Change. *Strategic Management Journal*, 22: 1087-1111.
- Hendry, K., & Kiel, G. C. (2004). The Role of the Board in Firm Strategy: integrating agency and organisational control perspectives. *Corporate Governance*, 12 (4): 500-520.
- Hermalin, B.E. and M.S. Weisbach (2003). 'Boards of directors as an endogenously determined institution: A survey of the economic literature', *Economic Policy Review*, April 9(1): 7-26
- Herman, C. (1981). *Corporate Power and Corporate Control*. (Oxford, Oxford Press).
- Hoskisson R. E., Hitt M. A., Johnson R. A. & Grossman W. (2002). Conflicting Voices: the Effects of Institutional Ownership Heterogeneity and Internal Governance on Corporate Innovation Strategies. *Academy of Management Journal*, 45 (4): 697-716.
- Huse, M. (2005). Accountability and Creating Accountability: a Framework for Exploring Behavioural Perspectives of Corporate Governance. *British Journal of Management*, 16: 65-79.
- Jensen M. and Zajac E. J. (2004). Corporate Elites and Corporate Strategy: How Demographic Preferences and Structural Position Shape the Scope of the Firm. *Strategic Management Journal*. 25: 507-524.
- Judge, W., & Zeithaml, C. P. (1992). Institutional and Strategic Choice Perspectives on Board Involvement in the Strategic Decision Process. *Academy of Management Journal*, 35 (4): 766-794.

- Johnson J.L., Daily C.M. and A.E. Ellstrand (1996). 'Boards of Directors: A Review and Research Agenda', *Journal of Management*, 22, 409-438.
- Kor Y. Y. (2006). Direct and interaction effects of top management team and board compositions on R&D investment strategies. *Strategic Management Journal*, 27 (11): 1081-1099.
- Kosnik, R. D. (1987). Greenmail: A Study of Board Performance in Corporate Governance. *Administrative Science Quarterly*, 32: 163-185.
- Lane P. J., Cannella A. A., Lubatkin M. H. (1998). Agency problems as antecedents to unrelated mergers diversification: Amihud Lev reconsidered. *Strategic Management Journal*, 19 (6): 555-578.
- Lorsch, J., & MacIver, E. (1989). *Pawns or Potentates. The Reality of America's Corporate Boards*. (Boston, HBS Press).
- Maassen G. & Van den Bosch F. (1999). On the supposed independence of Two-tier Boards: formal structure and reality in the Netherlands. *Corporate Governance: an International Review*, 7 (1): 31-37.
- Mace, M. (1971). *Directors: Myth and reality*. (Boston: Harvard Business School Press).
- McNulty, T., & Pettigrew, A. (1999). Strategists on Board. *Organization Studies*. 20: 47- 74.
- Muth M. M. and Donaldson L. (1998). Stewardship Theory and Board Structure: a contingency approach. *Corporate Governance: an International Review*. 6 (1): 5-29.
- Pettigrew, A. (1992). On Studying Managerial Elites. *Strategic Management Journal*. 13 (SI): 163-182.
- Ravasi, D., & Zattoni, A. (2006). Exploring the Political Side of Board Involvement in Strategy: A Study of Mixed-Ownership Institutions. *Journal of Management Studies*, 48 (3): 1672- 1704.
- Schmidt, S., & Bauer, M. (2006). Strategic Governance: how to assess board effectiveness in guiding strategy execution. *Corporate Governance An International Review*, 14 (1): 13-23.
- Stiles, P. (2001). The impact of the board on strategy: an empirical examination. *Journal of Management Studies*, 38 (5): 627-650.
- Stiles, P., & Taylor, B. (2002). *Boards at work how directors view their roles and responsibilities*. (New York: Oxford University Press Inc).
- Sundaramurthy G. & Lewis M. (2003). Control and Collaboration: Paradoxes of Governance. *The Academy of Management Review*, 28 (3): 397-415.
- Tihanyi, L., Johnson, R. A., Hoskisson, R. E. and Hitt, M. A. (2003). Institutional ownership differences and international diversification: the effects of boards of directors and technological opportunity. *Academy of Management Journal*, 46: 195-211.
- Useem, M. (2003). Corporate Governance is directors making decisions: reforming the outward foundations for inside decision making. *Journal of Management and Governance*, 7 (3): 241-253.
- Westphal, J. D., & Fredrickson, J. W. (2001). Who directs strategic change? Director experience, the election of new CEOs, and change in corporate strategy, *Strategic management Journal*, 22 (11): 1113-1137.
- Zahra, S. (1990). Increasing the Board's Involvement in Strategy. *Long Range Planning*, 23 (6): 109-117. Zahra, S., & Filatotchev, I. (2004). Governance of the Entrepreneurial Threshold Firm: A Knowledge-based Perspective. *Journal of Management Studies*, 41 (5): 885-897.
- Zahra, S., Neubaum, D., & Huse, M. (2000). Entrepreneurship in Medium-Size Companies: exploring the effects of Ownership and Governance Systems. *Journal of Management*, 26 (6): 947-976.
- Zahra, S., & Pearce, J. (1989). Boards of Directors and Corporate Financial Performance: A Review and Integrative Model. *Journal of Management*. 15(2): 291-334.
- Zahra, S., & Pearce, J. (1990). Determinants of Board Directors' Strategic Involvement. *European Management Journal*. 8: 164-173.