CHANGING ROLE OF THE BOARD OF DIRECTORS: IN SEARCH OF A NEW STRATEGIC IDENTITY?

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This paper examines board involvement in strategy in order to find a justification for that role. Examples of board behavior in a variety of settings including failing firms, non-profit and employee owned companies are examined. The paper, using support from institutional theory, concludes that the need for board involvement in strategy comes from their identifying with the interests of the organization as an entity separate from its various constituents.[1]

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The issue of governance has come in for a lot of scrutiny lately. Top management changes in General Motors, Compaq, Digital, and American Express, for example, have revealed a new activism by boards. Popular interpretation has been that the boards which had sided too strongly with management are now coming back to take interests of shareholders into account (Stewart, 1993; White, 1992). The management changes and strategy redefinitions that are taking place have been linked to corporate governance issues such as the need for more outside directors, need for separation of Chairman and CEO positions (Sherman, 1988), and stock ownership by directors (Patton & Baker, 1987). However, an important underlying issue is one of boards struggling to define a role for themselves.

In the traditional view, corporate boards are elected by shareholders to represent them in governing the affairs of the corporation. By and large, boards select, compensate and monitor management. What goes under the heading of monitoring management is inevitably murky and depends on the circumstances of any given corporation and the extent to which any one group of shareholders or managers exercise "corporate control," that is, dominate the selection of board members. While there is no general theory that predicts or prescribes the actions of the board, the literature until recently has been fairly clear that boards tended to ratify or rubber stamp strategies developed by management (Louden, 1982; Mace, 1971). More recently, scholars have written about how boards can get more involved in strategy making specifically (Henke, 1986; Zahra, 1990), and on improving the board's effectiveness, in general (Tricker, 1987). In addition, they may assist organizations in unlearning previous organizational habits which may be dysfunctional (Nystrom & Starbuck, 1984), and through definition of the corporate mission, boards become active in corporate strategy formulation.

In this paper, we argue that traditional theories have provided the justification of the board's service and control roles but that a new identity is emerging for boards which has them more involved in strategy. In particular, this involvement has the board identifying equally with management, shareholders, and the needs of the organization as an institution in its own right. We propose that these divided loyalties should be developed and nurtured by means of a strategic presence on the part of the board.

BOARD ROLES AND SUPPORTING THEORY

It is important to explore this new strategic identity further since before trying to study *how* boards can get more involved in strategy, we need to understand *why* they should.

Zahra and Pearce (1989) have provided a framework for examining a board's role in terms of control, service and strategy. The *control* func-

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tion is inwardly focused wherein boards are expected to be watchdogs over management. This role involves monitoring managerial competence as well as overseeing resource allocation. The *service* role has an external focus where directors act as boundary spanners, connecting the organization to its environment by providing information and needed resources to executives. In representing a firm in the community, directors performing this role enhance the firm's legitimacy. When boards adopt a *strategic* role, the directors guide the definition of the corporate mission and are called upon to assist in the development, implementation and monitoring of the firm's strategies.

The two principal elaborations of the corporate board's role have been the agency theory and the resource dependence/stakeholder theories.

AGENCY THEORY

In this perspective, the principal (shareholder) delegates work to the agent (management), who performs the work under a contractual relationship (Fama & Jensen, 1983). Agency theorists took maximization of shareholder wealth as the primary standard for evaluating corporate performance, and asked how boards could serve to further a given corporation's performance. Thus, there was a need to control managers to ensure that their efforts maximize shareholders' wealth.

This argument has been extended to include the board's involvement in strategy for the same purpose of maximizing shareholder wealth (Zahra & Pearce, 1989), but this could lead to contradictions. The objective of strategy is the long term growth and welfare of the organization. In several situations, this may conflict with the needs of the shareholders. For instance, as Lorsch (1990) has argued, "over 50% of the shares of public companies [in the USA] are owned by institutions, many of which seem to have little interest in the long term welfare of the corporation (p.87)." They are looking for short term gains so agency theory expectations of maximizing shareholder wealth does not provide us with sufficient justification for board involvement in strategy.

Resource Dependence/Stakeholder Theories

In the resource dependence perspective, directors help the firm deal with its environment, enhance its legitimacy, and assist in achieving its goals of efficiency and performance (Pfeffer, 1972). Their contribution was in providing information and resources to enhance company performance. This theory provided the justification for the service role of the boards.

In a similar vein, the stakeholder approach to the role of the board (Freeman, 1984) expects the board to negotiate and compromise with stakeholders in the interests of the corporation. It recognizes that this

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might involve setting overall direction, but by and large, it supports a service role.

While these theories provide strong justification for the monitoring and service roles, they essentially depict the board as a relatively reactive decision-maker in the area of strategic management, responding post hoc to strategy initiatives or proposals by the firm's management. Their differences have to do with the standards to which board's resort in evaluating management's strategic plans, not with the board's role itself.

Institutional Theory

Institutional theory provides us with a basis that comes closer to concepts of strategic management. As propounded by Selznick (1957) some organizations, rather than remaining rational and impersonal, become institutionalized through a process of growth. The sociological perspective to this theory focuses on the organization being driven by internal striving, identifying with the values of the community, leadership styles, etc. (Scott, 1987; Zucker, 1987). Perrow (1986) points out some of the important contributions of this theory: 1) that it supports a variety of organizations, 2) it raises the possibility that organizations do develop an inner logic and direction of their own that is not the result of those who appear to control them, and 3) takes the environment seriously and tries to understand the organization's relationships to it. By looking at the holistic nature of organizations, this theory provides us with a framework that better explains the reason for the board's involvement in strategy (Judge & Zeithaml, 1992).

Figure 1 summarizes the relationship described above between the board's roles and the theoretical support for the role. While a priori the strategy role is supported by institutional theory, an examination of different contexts of board behavior would provide us with scenarios to appreciate the applicability of theory.

THE BOARD IN DIFFERENT CONTEXTS

In this section we shall first briefly review recent landmark court decisions recognizing a new role for the board. As much of theory has evolved in the context of growth-oriented profit making firms, studies relating to board behavior in alternate scenarios such as failing firms, non-profit, and employee owned firms can provide insights and are described.

RJR-Nabisco/Time-Warner Cases

The restructuring of many corporations in the 1980s has seen boards become more involved in strategy. For example, in the RJR-Nabisco buyout in December 1988, faced with competing bids from a management-led group and the KKR group, the board formed a committee of outside directors and

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FIGURE 1

Theoretical Support for Board Roles

Board Roles	Theory
Control: Supervision of management to ensure shareholder wealth maximization	Agency theory (Fama & Jensen, 1983)
Service: Boundary spanners linking organization with various stakeholders and resolving conflicts to further organization's objectives	Resource dependence theory (Pfeffer, 1972) Stakeholder theory (Freeman, 1984)
Strategy: Identifying with the interests of the organization by being involved in the strategic management process	Institutional theory (Selznick, 1957)

accepted the KKR bid even though it was valued as being marginally lower per share as compared to the management bid. The board felt that the firm would treat the employees better and dismantle less of the company. Thus, the interests of all stakeholders was given prominence as against giving primacy to that of shareholder wealth maximization alone (Lenzner, 1988).

In 1989, the Delaware Chancery Court allowed Time to buy Warner Communications in a friendly merger, rejecting a hostile bid for Time from Paramount Inc. Key to the judgement was looking at how the directors made the decision and that the deal had a well documented independent purpose. While the "business judgment rule" was normally used to uphold decisions meeting shareholder interests, in this case it was used to uphold a corporate strategic decision in the face of a higher monetary bid. The judge said, "The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of the majority of shares" (Dobrzynski, 1989). The court reaffirmed the power of corporate directors to reject hostile bids and pursue independent long term business strategies (Hilder, 1990).

Looking beyond the for-profit, growth oriented organizations with a separation of ownership and control, three recent studies give a different perspective to board behavior. These studies look at boards in failing

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firms, non-profit organizations and employee owned firms, to give us a clue to why boards are or should be involved in strategy.

Failing Firms

Scholars (for e.g., Herman, 1981) have pointed out that financial or managerial crises compel board activation though evidence also indicates that boards have not always risen to the occasion (Dunbar & Goldberg, 1978; Miller & Norburn, 1986). The recent corporate cases of GM and others referred to earlier drew attention as exceptions. In an exploratory study of the cases of 22 firms in crisis due to performance failures, Gopinath (1991) found that only in seven was there any indication of boards initiating action before the situation developed into a crisis. In situations where agencies other than the board (such as the banks, labor unions, etc.) took the initiative or applied pressure for action, their influence did not rest with a change of management but often extended into active involvement in strategic and operational decision making in the company in direct or subtle ways. The turnaround strategy followed is not necessarily in the best interests of the firm but aims to serve the needs of the stakeholder involved. In situations where the directors had recognized the problem and initiated action early, they had remained largely in control of events leading to the turnaround.

Nonprofit Organization

As nonprofit organizations are organized for a social purpose and not for financial gains, this fundamental difference would suggest few parallels in the roles of non-profit and for-profit boards. However, increasing resource scarcity has resulted in boards of non-profit organizations stressing strategic activities (Bryson, 1988). In a study of 240 YMCA organizations in the eastern U.S.A., Siciliano (1993) looked at four areas of strategic planning: analyzing environmental trends, formulating short-term objectives, developing and monitoring long-range goals. There was a positive correlation between boards taking the initiative in these four areas and the organization's social performance. Also, the study concludes that involvement by the board in strategic activities brought the corporation's social purpose to the forefront.

Employee-Owned Firms

In a firm under an employee stock ownership plan (ESOP) the owners, or a majority of them, are within the firm. Thus, the director's role, which agency theory prescribes as being agents of owners, needs reinterpretation when the owners are also employees. According to French (1987), employee-owners see themselves as investors.

In a study of ESOP firms, Murray (1990) found that union-appointed directors represented the local union officials. The directors did not see their role as simply that of fiduciary trustees; they were as concerned

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about preserving jobs as they were about profits. They were apparently attempting to modify the role of "director" in conformance with what they perceived to be their own unique set of responsibilities. Thus, with the union representatives taking care of the employees'/shareholders' interests, the rest of the board was viewing its responsibility in terms of the entire organization.

A NEW STRATEGIC IDENTITY?

The traditional roles for the board predominantly involved control and service. These roles stemmed primarily from the board acting as a linkage between shareholders/stakeholders and managers. As the board represented the former and supervised the latter, it tried to ensure a commonalty of interest. To the extent that boards were involved in strategy, it was minor and in a reactive mode through ratification of management decisions or proposals.

The "Organizational" Interest

The changing environment of today requires a perspective of looking upon the organization as an institution whose interests may be separate from those of shareholders/stakeholders. Specifically, in the RJR-Nabisco and Time-Warner cases, we have seen the power of the board in overriding shareholder interests and identifying with the "organizational" interest. In the case of failing firms, we have noted that boards which do not take the initiative to safeguard the "organization" find that they lose control of the process of revival and stakeholders pull the firm in different directions to suit their needs. Similarly, in the case where employees are the owners, the board leaves representation of shareholder interests to union-representatives and looks for the company as a whole. In non-profit organizations, boards feel an increasing need to be involved in strategy for the organization's successful performance.

Board As A Buffer

The corporate board of directors remains a mysterious link or buffer zone between the interests of a firm's shareholders and the actions of its managers. The traditional model, premised as it is on the observations of Berle and Means (1932) about separation or ownership and control, identifies the board with the strategic policies of top management and so tends to ignore its separate role altogether.

However, we are beginning to see boards behave differently along with calls for boards to be more involved in strategy. Corporations like Westinghouse are now willing to sit across the table and talk with Calpers (the California Public Employees Retirement System, a major shareholder) about policies and prospects for the future. The Grand Metropolitan plc, in response to the recommendations of the Cadbury Com-

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FIGURE 2

Changing Identity of the Board

	TRADITIONAL MODEL	EMERGING MODEL
Underlying assumption	Commonalty of interests between shareholders, management and the corporation to be maintained	Interests of shareholders and management may diverge from that of the corporation
Board identity	Represent the Owners (Link between owners and management	Represent the Organization (Strategic responsibility to the organization)
Board Role	Control, Service	Strategic decision-making, Control, Service

mittee (1992) publishes a statement on corporate governance and directors responsibilities in its annual report.

It is our argument that the developments we are witnessing are symptomatic of a search for identity for the boards of directors who are seeing themselves distanced from stakeholders and are identifying with the needs of the strategy of the organization as an institution in its own right. If a board's *identity* is looked on as its distinguishing generic characteristic, its *role* would be the various parts it plays in different circumstances. Fig. 2 presents the distinction being drawn between the traditional view and the emerging view. From a passive role focused on control and service derived from their position as a link between shareholders and management, boards are now moving into strategic decision making in addition to service and control. This is derived from their new identity as representing the organization.

Divided Loyalties

The involvement by the board in strategic activities could pose a contradiction because the directors still owe their position to the manage-

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ment and the shareholders (legally and administratively), and yet are expected to rise above these loyalties. The result of this contradiction is that boards often do not have a clear understanding of their roles. Lorsch comments that only a minority of directors feel that they are legally accountable to shareholders alone and "wonder how they can balance a responsibility to the shareholder (now largely an institution that has only short-term interests in the company), with a concern for the firm's long-term health and ability to compete" (1990, p.86). A recent survey of corporate boards in the UK points out that little consensus emerges concerning what contribution is expected from members of boards (Coulson-Thomas, 1991). When boards fail to recognize their expanded strategic role, their fiduciary duties may be considered breached and the firm's future may be in jeopardy.

Defining the board's role by means of a board mission statement is one way to address this contradiction and bring to the forefront their separate loyalties. In a recent article dealing with the mission statements of boards, it was recommended that as a minimum these board mission statements should address for whom and for what the board should be held accountable. As the authors explain, "the mandate for the board should address both how the board functions in the relationship between the company and the external environment, and how the board relates to corporate management" (Demb, Chouet, Lossius, & Nenbauer, 1989, p.67).

We would suggest extending this mandate to emphasize the board's need for identifying with the interests of the organization and the expanded strategic role this entails. While it is difficult for a board, which often owes its composition to the CEO, not to go along with management, they may consciously need to develop divided loyalties in order to perform their strategic role, in the long-term interest of the company.

CONCLUSION

Increasingly, boards are getting more directly involved in setting the strategy of the corporation. In this role, the traditional guiding principle of maximizing shareholder wealth does not give clear direction for decision making any more due to the often conflicting interests of the stakeholders. Boards would find themselves better grounded if they focus on meeting the interests of the organization as a distinct entity separate from but bounded by the interests of the stakeholders. In doing so, boards would find this institutional interest to be the best justification for their role in strategy and also help to evolve a new clearer identity for themselves.

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