Diverse Roles of Corporate Board: A Review of Various Corporate Governance Theories

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The board of directors (i.e., board) has generally been perceived as the backbone of corporate governance. Board is one of the most important internal corporate governance mechanisms used by the shareholders to monitor management. Board has diverse functions and roles such as control role, strategic role, service or resource provision role and advice and counsel role. There are many theories of corporate governance to explain such diverse roles of corporate boards. Any single corporate governance theory cannot fully explain the complexity and heterogeneity of the board functions in a corporate business. Hence, this research study reviews some of the corporate governance theories with a view to understanding how board functions and how board compositions are related to firm performance. This study looks at four main theories, namely, agency theory, stewardship theory, resource dependency theory, and resource-based view theory, that have influenced corporate governance development related to board functions.

Introduction

Corporate governance has predominantly focused on the relationship between the management of firm and the board of directors (board), particularly on separating these two functions for effective professional management. It is mainly because, the board members usually may not get enough time and the management of the firm has to manage the day-to-day affairs. So, the role of board as a driver of corporate governance becomes even more pertinent. Corporate governance is constantly changing and evolving and changes are driven by both internal as well as external environmental dynamics. There are many theories of corporate governance to explain the diverse roles of corporate boards. Effective and good corporate governance cannot be explained by one theory. Hence, it is best to use multiple corporate governance theories. Any single corporate governance theory cannot fully explain the complexity and heterogeneity of the board functions in a corporate business. So, it is important to re-visit various corporate governance approaches in the light of the diverse nature of these theories with a fresh angle. This research describes the various roles of corporate board from agency theory, stewardship theory, resource dependency theory and Resource-Based View (RBV) perspectives.

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Literature Review

Corporate governance is defined as the organizational controls that govern the behavior of managers and define their discretionary powers (Charreaux, 1997). Corporate governance can also be more narrowly defined as the instruments that are in place to guarantee the maximum rate of return on investment to the shareholders and creditors of the company (Shleifer and Vishny, 1997). The broader objectives of corporate governance are: to protect the interests of shareholders and various other stakeholders including customers, suppliers, employees and society at large, to ensure full transparency and integrity in communication and to make available complete, accurate and clear disclosure to all concerned.

A good system of corporate governance will facilitate the resolution of corporate conflicts between minority and controlling shareholders, executives and shareholders, and between shareholders and stakeholders. Corporate governance typically protects investor from managers who instigate self-deal, theft of corporate assets as well as corruption (Dalton and Daily, 1999). Corporate governance stands for responsible business management geared towards long-term value creation. Good corporate governance is a key driver of sustainable corporate growth and long-term competitive advantage (Madhani, 2007). Good governance means little expropriation of corporate resources, which contributes to better allocation of resources and better performance (Madhani, 2014).

The outcome of a good corporate governance practice is an accountable board of directors who ensures that the investors' interests are not jeopardized. Board of directors is one of the most important internal corporate governance mechanisms used by the shareholders to monitor management. Perry and Shivdasani (2005) state that, "charged with hiring, evaluating, compensating and ongoing monitoring of the management, the board of directors is the shareholder's primary mechanism for oversight of managers". The board of directors has generally been perceived as the backbone of corporate governance as board contributes to alleviating agency costs to the firm by monitoring and rewarding top executives to ensure wealth maximization for the shareholders. McNulty and Pettigrew (1996) identified the various roles of board directors in terms of three main perspectives: a governance perspective (the monitoring function of the board), a strategic perspective (decisions enabling the firm to change), and the resource perspective (how the board links the firm to its external environment and enables it to acquire critical resources). Any board effect on firm performance will be highly dependent on context-specific situations such as stage of organizational life cycle (Johnson, 1997), industry homogeneity and regulation (Palia, 2000), competitive conditions (Carpenter and Westphal, 2001), technology changes (Castanias and Helfat, 2001) and general industry conditions (Finkelstein and Hambrick, 1996).

Boards have an oversight role and as such it oversees strategy and monitors the managerial decisions of the top management team (Harrison, 1987; Johnson *et al*., 1993 and1996; and Withers and Hillman, 2008). Research also states that boards serve critical functions in firms, such as monitoring management on behalf of shareholders and providing valuable resources to firms, including advice, expertise, connections to environmental contingencies, and legitimacy (Hillman and Dalziel, 2003). Board (board of directors) members may have

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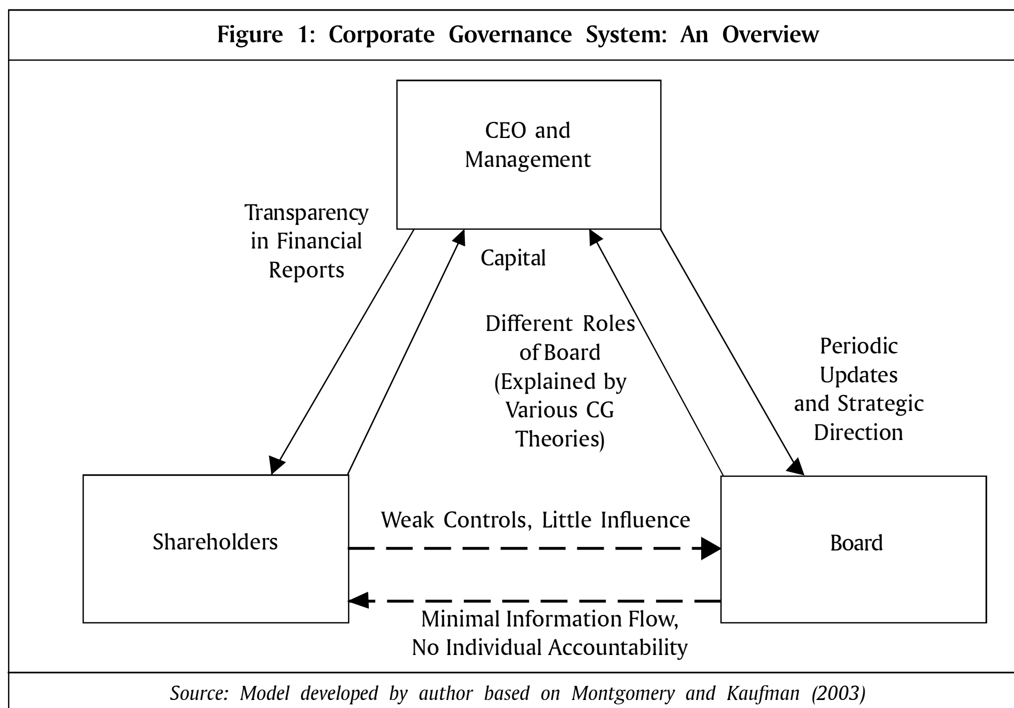
experienced or observed a crisis situation that has enhanced their awareness, attribution, and perception of the severity of crisis preparation (Trahms *et al*., 2013). In the context of bankruptcy, the composition of the board is important to the success of the turnaround process (Daily and Dalton, 1994b and 1995). Mitter *et al*. (2012) show that boards foster a higher level of formalization and detail in planning. Boards, possess knowledge of firm resources and are capable of controlling the planning and resource flows (Pajunen, 2006).

There are various theories of corporate governance to explain various roles of boards. By studying the process variables and investigating what boards do, it is possible to develop a more integrative model of all of the elements discussed in existing theories (Zahra and Pearce, 1989). This research reviews some of the corporate governance theories with a view to understanding how board functions as well as board compositions are related to firm performance. This study looked at four main theories, namely, agency theory, stewardship theory, resource dependency theory, and RBV theory, that have influenced corporate governance development. It also addresses the cause and effect of variables, such as the configuration of board members, including inside directors, outside directors and independent directors.

Board as a Key Driver of Corporate Governance System

A key determinant of the board's role is to delegate responsibilities and monitor those responsibilities delegated to the management and ensure that management is not deviating from implementing and deploying the board's recommendations and strategies. As shown in the model given in Figure 1, the lack of accountability of the board (i.e., board of directors) and inadequate or minimal information flow to the shareholders result in weak controls.

Figure 1: Corporate Governance System: An Overview



Source: Model developed by author based on Montgomery and Kaufman (2003)

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A firm's board of directors is presented with a set of roles or functions (Johnson *et al*., 1996), and how the board fulfils these roles determines its effectiveness and allows it to add value to the firm and influence the firm's results (Murphy and McIntyre, 2007). Four major roles and responsibilities of the board have been widely recognized by researchers: (1) the control role; (2) the strategic role; (3) the service or resource provision role; and (4) the advice and counsel role (Nicholson and Kiel, 2004; and Bonn and Pettigrew, 2009).

The control role of the board implies its legal duty of monitoring and supervising the firm's operations, current as well as preventive, i.e., the monitoring of business decisions and firm's plans as well as monitoring and controlling top management. This role of board is explained by 'agency theory'. The strategic role of the board does not imply that the board engages in the strategy formulation, since it is the duty of the management. The strategic role of the board relates to supporting and leading the management in realizing the firm's mission and its goals by advising, improving and enhancing the discussion on strategic issues, in particular the strategic problem solving and decision making. Here, the board acts not so much as a monitor and controller but rather is actively involved in influencing strategy and programs through their skills and expertise (Hillman and Dalziel, 2003). These roles of board are explained by 'stewardship theory'.

The service or resource provision role of the board is primarily concerned with providing access to networks and resources and maintaining the formal and informal relationships with firm's stakeholders and overcoming the inherent conflict between them (Tomšiæ, 2013). This role of board is explained by resource dependency theory. The resource provision function of the board specifically focuses on the set of resources that each member brings to the board such as use of knowledge, information, experience, abilities, etc. With this perspective the composition of the board should now be viewed not only in quantitative terms (percentage of outside directors on the board), but also in qualitative terms, because these resources (abilities, experience, knowledge and information) are very important for carrying out board functions effectively (Westphal and Fredrickson, 2001; and Certo, 2003). In this context, the advising and counseling roles of the board are also very important (Agrawal and Knoeber, 2001; Adams and Ferreira, 2007; and Coles *et al*., 2008). According to Dalton *et al.* (1999), "outside directors provide a quality of advice to the CEO otherwise unavailable from corporate staff". These roles of board are explained by RBV theory.

Role and Responsibility of Board: Major Corporate Governance Theories

This research analyzes board of directors from four theoretical perspectives, such as agency theory, stewardship theory, resource dependence theory, and RBV perspectives and describes how various roles of boards of directors (i.e., board), is linked to strategic outcomes and firm performance. These theories are explained below to describe the role and responsibilities of the board in relation to corporate governance mechanism.

Agency Theory

Agency theory originated as an economic theory propounded by Alchian and Demsetz (1972) and further developed by Jensen and Meckling (1976). Agency theory has been used by

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researchers in various fields such as accounting, economics, marketing, organizational behavior, political science and sociology (Eisenhardt, 1989). The agency relationship is defined as a contract under which one party (the principals or shareholders) engages another party (the agents or directors) to perform some services on the principal's behalf. Agency theory clarifies the relationship between the principal (shareholders) and its agents (management) in a firm, where the principal elects the board, which in turn elects the management team to execute the routine daily business decisions (Abdullah and Valentine, 2009).

Agency theory is concerned with aligning the interests of owners and managers (Fama and Jensen, 1983) and is based on the premise that there is an inherent conflict between the interests of a firm's owners and its management. Agency theory plays a 'Theory X' perspective, of motivation (McGregor, 1960) as it takes a rather pessimistic view of human behavior, where managers are assumed to be "ever ready to cheat the principals or owners unless constantly controlled in some way" (Donaldson and Preston, 1995). It depicts an agent's behavior as opportunistic and self-serving, with a motivation to satisfy their own self-serving objective (Podrug *et al*., 2010).

According to agency theory, the managers are opportunistic and self-interested and hence need to be kept under control by monitoring mechanisms or by incentive alignment (Jensen and Meckling, 1976). The agency theory expects the agents to act and make decisions in the principal's interest. On the contrary, the agent may not necessarily make decisions in the best interests of the principals (Padilla, 2002). Principals have the inability to substantiate whether its agents' behavior aligns with their best interests (Hendry and Kiel, 2004). The conflict of interest coupled with the inability to costlessly write a perfect contract between the owners and the managers reduces the value of the firm (Denis and McConnell, 2003). In the world of incomplete contract with agency problem, corporate governance aids in resolving such issues. Also, the level of contracts' incompleteness seems to increase with the level of intangible asset intensity. Particularly in intangible asset-intensive firms, managers can improve their bargaining position by developing 'manager-specific investments' (Madhani, 2015a).

Thus, the implication for corporate governance is that adequate monitoring mechanisms need to be established to protect shareholders from management's conflict of interest—also called 'agency costs'. According to Jensen and Meckling (1976), agency costs are an inevitable part of the management/ownership relationship. With good corporate governance practices this conflict of interest can be resolved to a certain extent (Gursoy and Aydogan, 2002) by promoting goal congruence (Conyon and Schwalbach, 2000; and Judge *et al*., 2003). On minimizing the agency conflict between the owners and managers and aligning their interests, the firm should function more efficiently, resulting in enhanced financial performance.

The separation of ownership and control may lead to firm managers' using their firm-specific knowledge and expertise to gain an advantage over the firm's owners (shareholders), who are absent from the day-to-day affairs of the firm. Since the managers are 'in control' of the firm, there is likely risk that they will pursue actions to maximize their own self-interest, at the expense of the owners. The agency dilemma (Fama, 1980) emphasizes that management self-interest can be detected in clear benefits such as perquisites and in less easily identified

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motivations such as the pursuit of growth at the expense of profit (Stano, 1976). With conflict of interests between the owners and the managers (also known as the principal-agent problem), the managers have an incentive to pursue objectives contrary to those of the owners. Such incentives include empire building (Williamson, 1974; and Jensen, 1986), rent seeking activities leading to extra perks and higher pay (Hart, 1995), or entrenching themselves so as to avoid getting fired when the firm performs poorly (Shleifer and Vishny, 1989). The principal, i.e., owners of the company who are the residual claimants are so dispersed that individually each owner does not have the incentive to monitor the managers. Therefore, under this scenario, the corporate governance is designed to provide checks and balances on the managers' actions (Hart, 1995).

Conceptualizing the board of directors from the principal-agent framework has been used to explain the way boards should be structured and how they should be functioning (Hermalin and Weisbach, 2003). According to agency theory, corporate governance acts as a mechanism where a board of directors (board) is a crucial monitoring device to minimize the problems brought about by the principal-agent relationship. In this context, agents are the managers, principals are the owners and the boards act as the monitoring mechanism (Mallin, 2004). As a result of the board monitoring, there will be less opportunity for managers to pursue self-interest at the expense of owners (lower agency costs), and so owners or shareholders will enjoy greater returns (or increased profits). Board acts as fiduciaries of shareholders, serving to alleviate or reduce the problems associated with the separation of ownership and control in firms (Fama and Jensen, 1983), i.e., agency problems (i.e., moral hazard (hidden action) and adverse selection (hidden information) (Millson and Ward, 2005).

The impact of agency theory on corporate governance may be studied to examine two key questions, namely, how the composition of boards of directors affects firm performance (Barnhart and Rosenstein, 1998; and Wagner *et al*., 1998) and how the leadership structure of the company (i.e., the duality of the CEO/chairman role) affects corporate performance (Dalton *et al*., 1998).

Agency theory identifies the internal control role and governance function as the principal activity of the board, and assumes that outside board members are more effective than internal directors in controlling management and protecting shareholders' interests (Boyd, 1990; and Pearce and Zahra, 1992). Accordingly, board composition also influences corporate governance and monitoring mechanism (Fama and Jensen, 1983). The basic idea is that the boards with larger proportion of independent directors, who are focused towards shareholders' interests, are able to monitor managers better and thus increase the value of the firm (Walsh and Steward, 1990; and Cohen *et al*., 2012). With a greater proportion of independent directors, a board is likely to be more independent, objective in its decision making as it reduces opportunism and agency costs and has greater monitoring potential (Fama and Jensen, 1983). As the function of independent directors is to carry out the task in the background of principal-agent problem between inside directors and shareholders, independent directors are regarded as key contributors to corporate governance effectiveness (Madhani, 2015b).

The processes by which boards are expected to impact on corporate performance as predicted by agency theory of corporate governance are presented in Figure 2.

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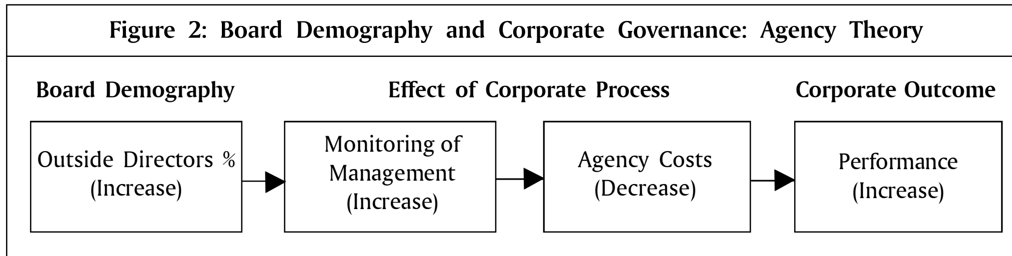
Figure 2: Board Demography and Corporate Governance: Agency Theory



Iwu (2010) analyzed the empirical literature on board and found that "most findings agree that the presence of independent directors on boards of firms actually improves governance of those firms". The independence of board members is critical to their ability to carry out the monitoring function and participate in the formulation of strategic decisions which have a considerable impact on shareholder investments (Waldo, 1985; and Fleischer *et al*., 1988). Board independence refers to the ability of the board to make decisions independently from the firm's executive management. Outside directors are considered as independent board members if they have a limited role with the firm except for board responsibilities. Outside directors can monitor the behavior of managers on behalf of the firm's owners and intervene when managers behave opportunistically by misusing firm assets (Post *et al*., 2011).

The monitoring role of the board is further improved if there is a separation between the role of the board's chairman and the CEO of the firm (Finkelstein and D'Aveni, 1994). CEOs managing the firm are held accountable to shareholders though the chairman and the board (board of directors). When a CEO dominates the board through a dual role of CEO and chairman, the resulting channels of communication and lines of authority can hinder and weaken the protection sought by shareholders (Bricker, 1998; and Nicholson and Kiel, 2007). In order to minimize agency costs, an organization should split the duality role of CEO and chairman. The blending of positions creates a conflict of interest, which hinders the expectation of maximizing financial returns to the principal (McGrath, 2009). A conflict of interest provides an opportunity and financial incentive for CEOs to disregard the wellbeing of shareholders (Kochhar, 1996). CEO duality deteriorates the fiduciary oversight power of the board. When the boards are more independent (i.e., separating CEO duality), they monitor the managers better and hence the shareholder interests are protected.

As a first generation model, the agency theory identifies the board as the primary non-market monitoring device to protect the shareholders' interest. However, high monitoring alone is no guarantee of corporate performance. As agency theory seeks to establish the monitoring of management as the central role of the board, it discounts the significant impact of other board roles that can improve corporate performance. In this context, second generation models (such as stewardship theory, resource dependence theory and RBV theory) focus on the impact of other board functions, such as advising management, providing access to valuable resources or acting as tacit and socially complex resources.

Stewardship Theory

Stewardship theory emphasizes a 'Theory Y' of motivation (McGregor, 1960), and hence suggests that an overemphasis on monitoring is unnecessary for the board to impact on

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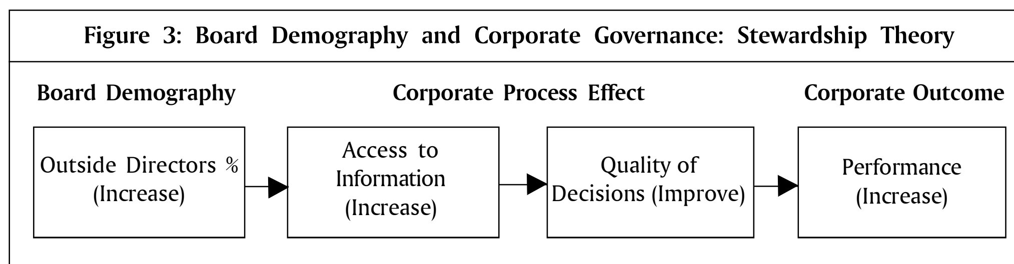
corporate performance. Stewardship theory acknowledges the existence of a relationship built upon trust between the shareholder and management, which in turn minimizes the costs of monitoring and controlling the behavior of management (Abdullah and Valentine, 2009). Stewardship theory envisages that managers are essentially trustworthy individuals and so are good stewards of the resources entrusted to them (Donaldson, 1990; and Donaldson and Davis, 1994). Stewardship theory advocates CEO duality as it rationalizes that in order to minimize agency costs, firm should not split the dual role of CEO and chairman. The CEO duality creates a harmony between the board, managers and shareholders, which is more efficient and effective in order to reach the goals of organizations (McGrath, 2009). Stewardship theory supports the management empowerment in organization.

According to this study, when senior company executives are nominated on board as inside directors, they can make superior business decisions. Since inside directors spend their working lives in the company they govern, they understand the company businesses better than outside directors. Inside directors tend to take decision with a long-term view considering their association with the firms (Donaldson and Davis, 1991). Therefore, advocates of stewardship theory contend that superior corporate performance will be linked to a majority of inside directors as they naturally work hard to maximize shareholders' profit (Gaur *et al*., 2015).

Stewardship theory is based on two premises; namely, that managers are naturally trustworthy (Donaldson and Preston, 1995) and that agency costs will be minimized usually, as senior executives (as inside directors) are unlikely to disadvantage shareholders for fear of jeopardizing their long-earned reputations (Donaldson and Davis, 1994).

The major processes by which boards are expected to impact on corporate performance as predicted by stewardship theory of corporate governance are presented in Figure 3.

Figure 3: Board Demography and Corporate Governance: Stewardship Theory



Executive (insider) directors have more knowledge about their companies and are more likely to enhance the performance of their organizations instead of non-executive (outsider) directors. Inside directors serve on boards largely to provide firm-specific information. Thus, while each inside director may have specific types of expertise as well as specific relationships or linkages with external environmental contingencies, the primary resource each provides is internally focused. Insider directors include current and former executives of the firm. They provide expertise in specific areas as well as general strategy and direction. A key concern with stewardship theory is that it fails to account for those instances where managers do not act as good stewards.

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Resource Dependence Theory

The resource dependence theory focuses on the role of board in engaging with the external environment to access critical resources. The key role of the board is its ability to link to significant resources (Korac *et al*., 2001a). It maintains that the board is an important link between the firm and the essential resources that it needs to maximize performance (Pfeffer, 1973; and Pfeffer and Salancik, 1978). Hence, the board is a potentially important resource for the firm, because of its links with the external environment (Palmer and Barber, 2001). According to resource dependence theory, the board composition may be seen as a response to the external challenges that a firm may face (Hillman *et al*., 2000).

Resource dependence theory focuses on major strategic actions of organizations that influence and control interdependencies with other organizations in their environment. The need for interdependencies is mainly influenced by the resource scarcity of organizations as they cannot produce all the resources they need, and, accordingly, they depend on external resources. Uncertainty clouds the organization's control of resources and choice of strategies, and impedes simple day-to-day functioning. Hence, in order to survive, organizations must cope effectively with uncertainty (Pfeffer and Salancik, 1978). Resource dependence theory proposes that corporate boards are a mechanism for managing external dependencies (Pfeffer and Salancik, 1978), reducing environmental uncertainty (Pfeffer, 1972) and reducing the transaction costs associated with environmental interdependency (Williamson, 1984).

In the resource dependence role, as directors link the organization with its external environment, a board may act to reduce uncertainty. Directors also bring resources to the firm, such as information, skills and access to key constituents (e.g., suppliers, buyers, public policy decision makers, social groups). The extent to which board directors benefit the firm depends on whether their inclusion in the board provides access to valuable resources and information, reduces environmental dependency, or aids in establishing the legitimacy of the organization (Daily and Dalton, 1994a; Gales and Kesner, 1994; and Certo *et al*., 2003). Key resource dependence attributes of the board include enhancing the legitimacy and public image of the firm; providing expertise; providing advice and counsel; linking the firm to important stakeholders; facilitating access to resources; building external relations; and aiding in the formulation of strategy and other important firm decisions (Hillman and Dalziel, 2003).

According to resource dependence theory, an important resource provided by the board directors is the relational capital which comprises various formal and informal ties of the directors. A well-connected director has better access to the information which helps the firm in strategic decision making (Mizruchi, 1996) and also aids in disseminating information across firm (Burt, 1980; and Useem, 1984). For example, the networked directors can bring information about effective corporate governance, efficiency enhancing technology and innovative compensation structure to the firm (Larcker *et al*., 2013). Network ties of a director can also help a firm by leveraging their social and business contact for resource exchange and facilitate collusive competitive behavior among closely linked firms (Pennings, 1980). Helmers *et al*. (2014) showed that interlocking of board among Indian firms enhances Research and Development (R&D) investment and patenting of firms.

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According to the resource dependence theory, the board as the boundary spanners provides scarce resources which originate from the firm's external environment (Pfeffer, 1972) that increases the firm's value (Zahra and Pearce, 1989). Outside directors are boundary spanners who can attract valuable resources to a firm as well as help a firm establish external links with stakeholders and other organizations (Wang and Dewhirst, 1992; and Mallin and Michelon, 2011). The outside links and networks that board members exercise may positively benefit the development of business and long-term prospects (Pfeffer and Salancik, 1978).

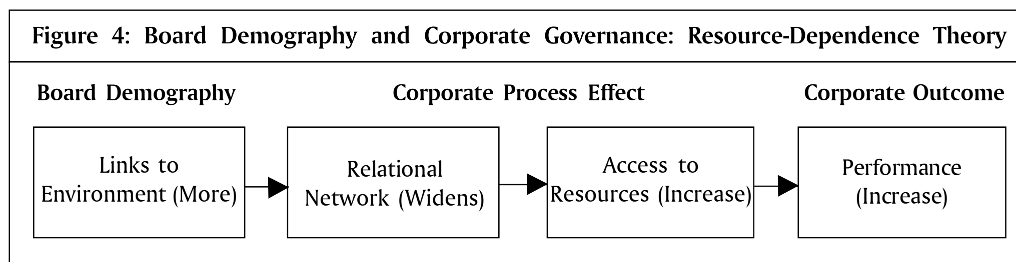
According to resource dependence theory, organizations attempt to exert control over their environment by co-opting the resources needed to survive (Pfeffer and Salancik, 1978). Board directors thereby enhance the prospects of a firm's business (Carpenter and Westphal, 2001). According to the resource dependence theory, boards have a larger role in terms of securing resources from the external environment than simply monitoring firm management (Hermalin and Weisbach, 1988). The resource dependence theory focuses on the need for environmental linkages between the firm and outside resources. In this perspective, directors serve to connect the firm with external factors.

Outside directors primarily provide resources needed to deal with external factors. There are four primary benefits that result from environmental linkages of boards: (1) provision of specific resources, such as expertise and advice from individuals with experience in a variety of strategic areas; (2) channels for communicating information between external organizations and the firm; (3) aids in obtaining commitments or support from important elements outside the firm; and (4) legitimacy (Pfeffer and Salancik, 1978).

Outside directors can bring to a firm the independent advice that directors can offer (Charan, 1998) and the significant role that they can play in facilitating access to much-needed resources (Mizruchi, 1992 and 1996). It also signals a firm's intent to pay greater attention to its external environment and legitimacy. The external board members provide access to valuable resources, information and network that can protect the firm from adversity. Under resource dependence theory, the board would be regarded as a visible link with the firm's external environment (Pfeffer and Salancik, 1978).

The processes by which boards are expected to impact on corporate performance as predicted by resource-dependence theory of corporate governance are presented in Figure 4.

Figure 4: Board Demography and Corporate Governance: Resource-Dependence Theory



Resource dependency theory focuses on the role that board directors play in providing or securing essential resources needed by the organization through their linkages to the external

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environment (board helps the firm to secure organizational resources through its external environment linkages) (Pfeffer, 1973). Outside directors may serve to link the external resources with the firm to overwhelm uncertainty (Hillman *et al*., 2000), because managing effectively with uncertainty is crucial for the existence of the firm. According to the resource dependency rule, the directors bring resources such as information, skills, key constituents (suppliers, buyers, public policy decision makers, social groups) and legitimacy that will reduce uncertainty. Thus, According to Hillman *et al*. (2000) the potential benefit of connecting the firm with external environmental factors and reducing uncertainty is decreasing the transaction cost associated with external dependency. This theory supports the appointment of directors to multiple boards because of their opportunities to gather information and network in various ways.

Resource-Based View Theory

The RBV sees the firm as a bundle of tangible and intangible resources (Penrose, 1959; and Wernerfelt, 1984). A firm's resources can be the basis of sustained competitive advantage if the resources are valuable, rare, imperfectly imitable, and not substitutable (Barney, 1991). The requirement of RBV for 'valuable, rare, inimitable and non-substitutable' resources could also be applied to the unique combination of resources within the board. A board's characteristics, such as its members' knowledge and experience, are much harder for competitors to imitate than to imitate other aspects of board composition such as size or the ratio of executive/outside board members. These are easier to imitate and therefore less significant for creating a sustainable competitive advantage. RBV theory is linked to board characteristics in terms of idiosyncratic resources that may prove to be sources of competitive advantage to firms. In contrast to agency theory, with its emphasis on managing conflicting goals among managers and shareholders within the firm, the RBV underlines the role that the board directors can play in bringing unique resources to the firm.

RBV emphasizes governance structure and the board composition as a resource that can add value to the firm. The board of directors (i.e., board) might be seen as a valuable resource of the firm when it is actively involved in strategic decision making. Effective involvement in the process requires skills and the board's in-depth knowledge (Stiles, 2001; and Ruigrok *et al*., 2006). Board knowledge reflects the degree of board directors' understanding of firm operations and includes profound knowledge of the firm's industry, competitors, customers, technology, etc. Board members provide different perspectives and experiences from other firms and industries. Outside directors have greater breadth of knowledge and experience from external sources than insiders (Wagner *et al.*, 1998). Under RBV, the board would be seen as a unique, tacit (i.e., invisible), socially complex (i.e., based on team effort), and internal resource which can help a firm to enhance performance (Hart, 1995).

The presence of in-depth knowledge of the firm creates a valuable and unique resource, which is critical for the board to exercise its decision-controlling task over the management (Fama and Jensen, 1983). Such in-depth knowledge of the firm 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). This knowledge is a tacit intangible asset and its utility is difficult to substitute and hence it is an important source

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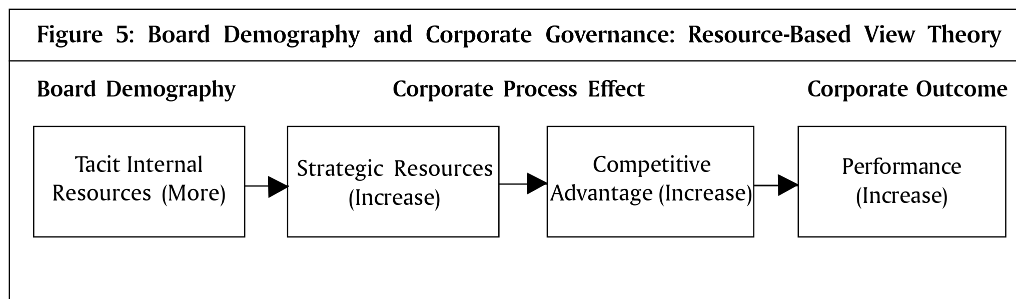
of the board's ability to perform various tasks (Hillman and Dalziel, 2003). According to the RBV of the firm, directors' in-depth knowledge and diverse expertise represent a source of competitive advantage, which can lead to superior board performance. This diverse expertise includes scarce resources such as business and financial sector knowledge (Kakabadse *et al.*, 2001), strategic expertise (Zahar and Pearce, 1989; and Golden and Zajac, 2001), and better governance (Khanna and Palepu, 2004).

Each director in the board brings to the organization unique attributes (Kesner, 1988; and Kosnik, 1990). By observing these attributes, it is possible to predict what kinds of resources a given director is likely to bring to the board. The resources the directors bring to the board, through their knowledge, experience and abilities, determine the board's potential and should be seen as essential for creating an effective board. All the resources provided by the board are crucial for the success of the firm and act as the key support for its existence. As these resources can enhance the performance of the firm, one can say that because these resources are provided by the board, the board can enhance the performance of the firm.

The processes by which boards are expected to impact on corporate performance as predicted by RBV theory of corporate governance are presented in Figure 5.

Figure 5: Board Demography and Corporate Governance: Resource-Based View Theory



Board members bring a wide variety of resources to the firm, and this makes each board distinct. This variety of experience, abilities and knowledge suggests that a board's resources are distributed heterogeneously across firms. Although maturity, leadership and analytical judgment are expected of all directors, differences among directors are perhaps most visible in terms of their individual experience or occupational attributes (Baysinger and Butler, 1985). These differences reflect the heterogeneity of resources such as expertise, skill, information and the potential linkages to other external constituencies. The linkage between the characteristics of executives and the strategies and decisions they derive and implement was studied by Hambrick and Mason (1984). According to RBV theory, boards should be understood as contributors of resources to the firm. The RBV of the board hinges on the idea that the board directors provides resources and information external to the firm, and reduce environmental dependency (Daily and Dalton, 1994c). The primary resource they provide are internally focused (Hillman *et al*., 2000).

Using RBV of the firm, Erakovik and Goel (2008) investigated the relationship between the board and the management and how it can provide a competitive advantage to a firm, in comparison to other firms. The board of directors is like a resource for an organization, by

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virtue of their capability to provide expert advice on strategic issues. The board is expected to play a key function in shaping the strategy of the firm. Board strategic involvement is one of the major tasks of the board (Andrews, 1981a and 1981b; Baysinger and Hoskisson, 1990; McNulty and Pettigrew 1999; and Huse, 2007). According to Zahra and Pearce's (1990) 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".

According to RBV, the combination effect of firm and strategic tasks of board can build specific resources for the firm and become a dynamic capability. When complementary resources work well, the value they create is greater than that which could be created by any individual resource in isolation. Board strategic tasks include 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). A dynamic capability view (Teece *et al*., 1997; Adner and Helfat, 2003; Teece, 2007; Augier and Teece, 2009; Helfat and Winter, 2011; and Hodgkinson and Healey, 2011) has evolved from the resource-based theory of strategy (Amit and Schoemaker, 1993; and Barney, 2001) and offers a more dynamic view to competitive advantage.

Dynamic capabilities refer to a firm's ability to integrate, build, and reconfigure internal and external competences to address changing environments (Teece *et al*., 1997). As such, it is the capacity of an organization to purposefully create, extend, or modify its resource base (Helfat *et al*., 2007). Dynamic capabilities can be understood as higher-order abilities (managerial property) and routines (organizational property) that help in creating, reconfiguring and balancing of organizational resources and capabilities (internal perspective), and in identifying, knowing and realizing opportunities, while analyzing threats (external perspective), thus linking the external and internal company's environment. Board dynamic capability deals with the corporate level change to address the changing environment.

Conclusion

The process by which the boards as a part of corporate governance mechanism contribute to the performance of the organizations they govern through their various roles and responsibilities is necessarily a complex one. Various researchers have developed diverse corporate governance theories based on their own reasoning and analysis of corporate governance issues and problems. Thus, it is difficult to produce one theory that is valid for any time and situation as board of directors have multiple roles to play simultaneously. In addition, when the current corporate governance theories are analyzed, it is found that they provide the best practices for the physical aspects of the governance, namely, board leadership structure, involvement of independent directors, board composition, etc. It does not touch on the moral, integrity and ethical aspects of the board of directors.

In fact, it appears that the relationship between the role of board and its underlying attributes is substantially more varied and complex and hence sole reliance on any single governance theory is not adequate. Hence, the present corporate governance theories cannot

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fully explain the intricacy and heterogeneity of corporate business. As the current corporate governance theories are not able to describe the best corporate governance practice, there is a need to use a combination of a few corporate governance theories such as agency theory, stewardship theory, resource dependency theory and RBV perspectives. Researchers have started applying multiple theoretical perspectives on the functioning of boards which consider several board tasks so as to capture the richness and variety of boards' roles and activities.

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