

Building effective board-management relationships



evidence and prescriptions from New Zealand

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The recent awareness of lack of oversight in many boardrooms in corporate America has fuelled yet another debate about the role and efficacy of the board of directors as an institution in public corporations. This debate and, indeed, a variety of prescriptions offered from a variety of perspectives have been in circulation for as long as boards have existed (Stiles and Taylor, 2001). The debate has not been limited to the American context alone. In

the UK, Sir Adrian Cadbury's final report on "The Financial Aspects of Corporate Governance" in 1998 was largely influential in setting in motion a chain of events that transformed the composition and structure of British boards.

The purpose of this paper is to explore the nature of the relationships between boards and management in New Zealand. The paper is part of a larger study that considers corporate





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governance practice in two different types of industries: traditional and hi-tech. Here we present our findings from companies that belong to traditional industries. We place particular emphasis on the internal workings and dynamics of the boards in these industries, thereby moving beyond the structural debate about “who should be on the board?” We believe this addresses the question of “how should *boards* govern the corporations?” by looking directly at their functional contribution. In addition, this charges the board with the central responsibility of *governing* the corporation, and managers with managing it.

The major contribution of this paper is in investigating the board’s role as a resource via three key governance processes. First, we investigate the board’s level and sources of knowledge bases, and how they are linked or deployed toward the roles a board is supposed to play. Second, we investigate the board’s involvement in the oversight and monitoring of a company’s financial outcomes, its top management and its strategic processes and outcomes. Third, we investigate how the board’s reputation serves as a resource in and of itself to the company, which may not require the board to play any other functional role on behalf of the company. Drawing on the literature addressing boards of directors (e.g., Carter and Lorsch, 2004; Johnson, Daily and Ellstrand, 1996), we believe that these three processes characterise the dynamics of boards. After describing our research method, we contrast findings from three cases and develop useful prescriptions for governance of firms in traditional industries.

CHANGING WORLD OF CORPORATE GOVERNANCE

The emerging research on corporate governance has extensively considered the changing role of boards in modern corporations. Carter and Lorsch (2004), in their book *Back To The Drawing Board*, analysed a number of issues or paradoxes that boards around the world have to deal with and, accordingly, redesign themselves and their relationships within and outside corporations. The major issues the

authors point to are the changing expectations that management, shareholders and other stakeholders (customers, employees and suppliers) have about directors’ knowledge, and contribution to and involvement in the company’s strategic affairs.

Other works have focused on the role of the board along more philosophical lines to trace the sources of their effectiveness or otherwise. For instance, Sundaramurthy and Lewis (2003) focus on the importance of the dynamic balance between control and collaboration approaches in board-management relationships. According to the authors, a control approach protects a corporation from self-serving behaviour and reduces goal conflict, whereas a collaborative approach encourages co-operation between board and management and fosters trust and goal alignment. Acceptance, understanding and management of control-collaboration tensions promote learning and improve governance (Sundaramurthy and Lewis, 2003).

Goel and Erakovic (2003), however, highlight the seeming paradox in expecting boards to serve as monitors and mentors of corporate management simultaneously when they require rather incongruent skills. Similarly, Shen (2003) calls attention to the evolution of the CEO-board relationship. The dynamics of relationships between the CEO and the board is one of the dimensions of the governance paradox mentioned above. Following the evolutionary perspective, Shen (2003) argues how the advisory role of a board has relatively higher significance in the early period of CEO tenure while the control-focused approach is more emphasised in later CEO tenure. This approach deals with the qualitative differences between monitoring and mentoring by identifying specific epochs when each is needed, but does not provide a conceptual approach to combining them in a variety of proportions.

Our research pursues a similar path of research, attempting to tackle a specific angle of the changing world of corporate governance: relationships between boards and management in New Zealand corporations.

SETTING THE SCENE

New Zealand's model of corporate governance relies on the Anglo-American system of corporate governance where institutional investors play an important role. According to Farrar (2001), more than 50 per cent of all share capital in New Zealand is held by various institutions.

Recent international corporate failures, particularly in the US, have prompted reviews of New Zealand's regulatory framework of corporate governance. Regulatory authority has attempted to introduce the changes that are applicable to the size and specific characteristics of the New Zealand economy. In addition, many companies have decided to review their policies and introduce some new measures in their corporate governance practices. With this aim, the Institute of Directors in New Zealand has provided guidelines of best practice in corporate governance. This document, *Code of Proper Practice for Directors*, considers moral and ethical responsibility of directors (the Institute, 1999). The fundamental legal framework of corporate governance in New Zealand is regulated by the Companies Act 1993.

The New Zealand outside-based regime of corporate governance perceives the role of directors as monitoring, emphasising specific tasks in establishing goals and performance policies, appointing the CEO, and protecting the company's financial position (the Institute, 1999). In terms of board composition, New Zealand's system prefers

boards dominated by non-executive or independent directors. The roles of board chairman and CEO are expected to be separated, and the chairman should be a non-executive director.

RESEARCH METHOD AND DESIGN

This paper is part of a larger research project reviewing seven New Zealand companies from different industries. Three cases are used here. We selected cases from traditional industries so we can provide transparent conclusions by eliminating hi-tech industry-specific external (and internal) factors. In addition, traditional-industry sectors still embrace the dominant economic activities in New Zealand. As a point of clarification, we define all resource-intensive (i.e., raw materials-processing industries), labour-intensive (e.g., textile industries) and scale-intensive industries (e.g., transportation, consumer electronics) (OECD, 1996; as cited in Clarke and Clegg, 1998) as traditional industries.

The companies we present here belong to three different industry sectors within the traditional industry framework. They have different ownership structures and are different in size and market input and output orientations (Table 1). Our intent is to highlight various governance issues in New Zealand companies. In selecting the companies for the research, therefore, we were looking more for a diverse rather than a representative sample. We chose three archetypical companies with a wide difference in their context and ownership structure. ▶

TABLE 1

Profile of companies represented in traditional industries			
Case	SOUTHERN STAR	SAGITTARIUS	ACRUX
Industry sector	Building and construction products	Food manufacturer	Transport infrastructure
Established	1952	1979	1990
Revenue 2003 (in NZ\$ 000)	632,300	25,000	47,700
Staff	1100	120	73
Market orientation	International	Domestic (output) International (input)	Domestic
Market status	Major producer in Australasian region	Competitive	Monopoly
Current ownership structure	Publicly listed company	Private company	Mixed public/private
Number of directors	6	4	6
BOD composition	1 inside (CEO), 5 outside directors	1 inside (CEO), 3 outside directors (all shareholders)*	All outside directors

* 60 per cent shareholding in Sagittarius lies with the board.



Research observing the nature of corporate governance relations requires an in-depth understanding of the social, managerial, economic and cultural aspects of the process

One is a publicly listed company with a more global orientation; another company is a privately owned company with a local orientation, and the third company is in a mixed ownership (local government and private) with a *de facto* monopoly position in the local market. We used pseudonyms instead of the companies' real names and labelled the companies Southern Star, Sagittarius and Acrux.

Since our research aims to explore specific organisational relationships and eventually allow for a conceptual elaboration of a large number of often-conflicting individual, organisational and contextual factors, we use a qualitative approach to our research question. Current management theories do not provide a holistic view of the phenomenon as they each tackle specific angles of the relationship, albeit in a controlled large sample. On the other hand, research observing the nature of corporate governance relations requires an in-depth understanding of the social, managerial, economic and cultural aspects of the process. Hence, a grounded-theory approach is taken as the most appropriate methodology in studying these unexplored organisational interactions. Incorporating multiple cases, this study employed comparative analyses across cases to identify major patterns.

Data was collected through interviews, questionnaires and secondary sources. Data from secondary sources (i.e., annual reports, organisational documents and companies' websites) offered general information about the company and its task environment. The major source of information was semi-structured interviews with members of the board and the top executive team.

In total, we conducted 14 interviews in three companies. Table 2 provides more details about the key respondents.

THREE PATTERNS OF CORPORATE GOVERNANCE

Our data provided in-depth insights into relationships between the board of directors and management teams, and pointed out the important issues in their interactions. The data also indicated different patterns of corporate governance in different organisations. The patterns were linked with three sets of governance processes or characteristics.

Board knowledge and knowledge acquisition processes

The first set of processes examined the directors' knowledge of the company's business operations. We asked directors and executive managers about their directors' knowledge of internal operations and external environment, about their willingness to absorb presented information and seek more information about the company, and about the importance of industry experience for the board's functioning. Table 3 shows how companies differ on four major concepts of board knowledge.

It is evident that the balance of knowledge among directors varies between the companies. Directors' knowledge in Southern Star is much more balanced than in Sagittarius or Acrux. We found that variations rely on (1) source of knowledge; (2) process of getting knowledge; and (3) directors' active or inactive role in processing or seeking information.

Southern Star directors are knowledgeable about

TABLE 2

Distribution of primary respondents by case					
Case (company)	Total interviews	BOD	Key respondents	Mgmt	Key respondents
SOUTHERN STAR	6	3	Chairman + 2 directors	3	CEO, CFO, Gen. manager
SAGITTARIUS	4	2	Chairman + director	2	CEO, CFO
ACRUX	4	2	2 directors	2	CEO, CFO

TABLE 3

Board knowledge and knowledge acquisition processes						
Case	Knowledge about internal operations and external environment	Source of knowledge	Process of getting information	Proactive in seeking information	Industry experience and balance in boardroom	Examples
SOUTHERN STAR						
	Balanced knowledge	Regular updates from CEO and other business managers	Monthly board meetings (rotation of sites) + strategic planning retreat	Very aggressive in seeking information	Competency overlaps	"By meeting at different sites, we develop better understanding of the business, and staff can see that the board takes an interest in what they do."
	All directors have in-depth knowledge about company's businesses					
	Customer centred	Internal experience and education	Monthly board meetings also involve: site visits, meeting the staff, site inspections & meeting principal customers			"We invite between 30-100 customers and we have a dinner. The board members move around and talk to the customers so we get a good idea of how the customers view Southern Star." "From the executive point, it's much easier and simpler to raise money for whatever reason ... if the board has an understanding of the drivers that relate to that."
SAGITTARIUS						
	Imbalanced knowledge	Regular updates from CEO	Monthly board meetings	Reactive	Competency gaps	"Apart from the chairman, our directors have never been in front of a customer."
	Directors have fair understanding of the business	Chairman				"Industry experience is important, but I [CEO] don't believe every board member needs to have industry experience. I think it's quite helpful sometimes that we have members who don't have it but have other skills."
	In-depth knowledge resides with chairman					
ACRUX						
	Imbalanced knowledge	Regular updates from CEO	Seven board meetings a year + "blue sky" planning day	Proactive (majority owner)	Competency gaps	"... the board members really don't know about our internal administrative process."
	Knowledge resides with the majority owner	Extensive directors' participation in various strategic issues	Special group (2 directors and CEO) can be set up to analyse important issues	Reactive (minority owner)		
	Minority owner has fair understanding of the business and regulatory framework	Informal but frequent contacts with other managers				
	The chairman's functions are constrained by physical distance					

all actions, events and issues in the company. The board is given an active role in governing the company. This level of board competence is achieved through internal "education" managed by the joint action of the chairman and the CEO. This is how Southern Star's chairman explains this process:

"When they [new directors] were first appointed, they didn't have a lot of understanding of the company, but each individual had a very strong history in his particular field. I slowly developed

a reasonable induction programme for them all. Through our way of running board meetings, with presentations by different management teams in the company, they pretty quickly get a feel for the company."

The process of getting knowledge is very intensive and involves serious engagement of both directors and executive management.

In contrast, Sagittarius suffers from knowledge deficiency at board level. The company's board does



Whatever industry the companies operate in, their directors' industry experience is perceived as an important condition of good corporate governance

not have an in-depth knowledge of the company's operations. Knowledge resides with the chairman who has an intimate knowledge of, interest in, and passion for the business. Two other outside directors on the board are more passive monitors of the company's performance. The chairman of the board represents a valuable source of information and knowledge for both the rest of the board and executive management. The chairman is actively involved in the day-to-day management of Sagittarius. He communicates with the CEO on a daily basis, attends executive meetings regularly and is well informed about all external and internal details of the business. This situation creates two levels of knowledge asymmetry in the company: (1) between the chairman and two outside directors; and (2) between the executive management and the board.

In the case of Acrux, a specific imbalance of knowledge exists among the directors of a board split by ownership. The board consists of representatives (two-thirds) of the majority owner and representatives (one-third) of the minority owner. The first group has an in-depth understanding of the company's goals. Therefore, their expertise and activities as directors are oriented toward fulfilling the demands of the parent company. They play an active role in seeking information about the company's operations and environmental trends from within the company (i.e., executive management and lower-level managers) and very often from independent outside institutions. Guided by the clear motive of maximising shareholder value, this group of directors imposes certain pressures on the management team and challenges it on various strategic issues.

On the other hand, the directors of the minority party have a good understanding of the business, but are not as proactive as the first group. They act more as observers, with the purpose of protecting the interests of the wider community they represent. The chairman's role additionally contributes to the existing imbalance of knowledge between the two

groups. The chairman, who has extensive knowledge of the industry, is only intermittently involved in the company's business because he does not live in New Zealand and he is closely involved with the parent company's overseas operations. Physical distance and functional dissociation constrain his ability to share information with management and other directors.

Whatever industry the companies operate in, their directors' industry experience is perceived as an important condition of good corporate governance. Industry experience of non-executive members of the board is emphasised as particularly valuable. Board members' industry knowledge enables directors to understand the ability of management and the company to influence strategic outcomes. One of the Acrux directors specifically emphasised the function of industry knowledge in evaluating management strategic options and directing the decision-making process. According to his point of view:

"It is incredibly important to have somebody else [besides the CEO] with industry experience. You never even want to have a situation where you've got only one guy who can say, 'I'm the expert here'."

Southern Star's CEO shares the same perception: "Industry experience ensures that the management are questioned about some of the things that a non-industry professional wouldn't know to ask."

In addition, intimate industry knowledge increases the overall value of the company as directors are able to provide easier access to the customer or supplier base at a board-to-board level. Industry knowledge, from this perspective, increases the credibility of directors versus managers.

Both directors and management believe industry knowledge is not the only condition of successful functioning of the board. What most of them point to is a good balance of expertise and skills in the boardroom, and respect for each other's expertise. Directors with experience in other industries or with different expertise provide challenges for the

management and other directors. This is how the chairman of Southern Star comments on the composition of his board:

“I’ve chosen pretty strong people. I always believe in managing as well as developing a board with people who are going to challenge, not by intimidating you. I believe we have a board of independent thinkers with different disciplines in their background and we have very lively discussions. I’m sure by the time we finish [the board meetings], we’ve sorted out most of the issues.”

In all three companies, the chairmen have intimate knowledge of their respective industries. Each has spent more than 30 years within the same industry and all were CEOs of large New Zealand or international companies. In two cases, Sagittarius and Acrux, an evident competency gap exists between the chairman and the rest of the board. The competency gap in Sagittarius is compensated for by a very close relationship between the

chairman and CEO, and the chairman’s mentoring role in growing management and the whole company. In Acrux, however, the competency gap is deepened by the chairman’s physical isolation from the rest of the board and the CEO.

Board involvement

The second set of questions considered directors’ involvement in strategy making and key business issues. We asked directors and executive managers to explain the directors’ involvement in strategy making, the way they work and their involvement in the company’s other business activities and with other managers. Table 4 shows how companies differ on four major concepts of board involvement.

It is evident that the degree and balance of involvement among directors varies between the companies. Directors’ involvement in Southern Star is much more intensive and balanced than in Sagittarius or Acrux. We found that the variations depend on: (1) the roles the chairman and CEO

TABLE 4

Dimensions of board involvement					
Case	Dominant topic at board meetings	Team work/group work	Strategy process	Ownership of final decision	Examples
SOUTHERN STAR	Financial issues	Collaboration without “group-think” Synergy Close relationship between chairman and CEO	Long-term strategy developed and decided by board Business plan developed by management and decided by board	Board of directors	“At times there is a very strong difference in opinion, but we rarely leave the board table without having sorted that difference out.”
SAGITTARIUS	Financial issues	“Group-think” behaviour Close relationship between chairman and CEO	Chairman is highly involved in strategy forming Board reviews strategy presented to it	Chairman	“I [CEO] do not think I’ve ever changed anything from when I’ve presented the strategies.” “If the chairman says, ‘I agree’, it just gets a tick in the box.”
ACRUX	Financial issues	No teamwork Coalition of two different groups Lack of close relationship between chairman and CEO	Board is involved in strategy-making process in an early phase (“blue sky planning”) and in final stage of decision making	Majority owner directors	“We’ve [majority owner directors] found it desirable to encourage correspondence outside of the board forum. We don’t like having just the CEO as the conduit between the board and management.” “It would be rare that I [minority owner director] would have contact with management in between board meetings. I read my board papers and turn up and proactively interact on the day.”



“It’s a very appropriate thing for a board to be involved in strategy. It must be involved in the making and setting of the strategy”

have in the company; (2) the directors’ perceptions of their role in the company; and (3) the type of ties that link directors and managers.

In Southern Star, the CEO has initiated the directors’ involvement in strategy forming from the early stages of the process. He believes that in the past, the board was not sufficiently involved in strategy and that its input was not strong enough. He points out:

“It’s a very appropriate thing for a board to be involved in strategy. It must be involved in the making and setting of the strategy.”

Southern Star’s board works as a team-oriented coalition of individuals. This paradox is embedded in the strong personalities of directors who are willing to take their own perception on any particular subject on the one hand and who are trying to reach consensus in their collective decisions on the other. As the CEO explains:

“There is no obvious leader, so there is not somebody who is the loudest person talking and everybody follows him. I think that is particularly so because each one of the members of the board represents a spoke in the wheel in terms of the skill set and knowledge base and background.”

Thus, synergy and collaborative efforts exist without “group-think”.

Such group dynamics are reinforced by the long-term social and business relationships directors and managers have developed over time. For example, the current chairman and CEO of Southern Star have been working together for more than three decades. They both, in different management capacities, have contributed to building the organisation from a very small manufacturer to a leading company in the industry.

Directors’ involvement in Sagittarius’ business strategy is low. The logical consequence of the imbalance of knowledge among board members is their imbalanced involvement in strategy and key business issues. Sagittarius’ CEO explains this situation this way:

“I don’t think our board contributes as much as

they could, as much as they should. Their knowledge and their expertise, in what they do in their professional daily routines, are not fully utilised in terms of what they could offer to our business. It is not voluntarily offered. It is more reactive than proactive.”

As a consequence, responsibility for the company’s governance is delegated to one person: the chairman. The relationships between the chairman and CEO are perceived as mentoring. The chairman provides guidelines to the management about future directions and he also, together with the CEO, maintains external relationships with customers, distributors and suppliers. The chairman explains his role:

“What I do as the chairman in [Sagittarius] is to add value, using my experience in the industry, to grow and mentor and develop a management team.”

The rest of the board view their role primarily as auditors of past performance. Directors’ primary focus is on financial results rather than operations or overall strategy. The board rarely tackles issues such as human-resource policies, research and development, or market expansion.

In the case of Acrux, the relationship between board and management is dominated by directors who represent the majority owner. They are very active in monitoring the management, setting organisational performance levels and developing the business. This group plays an intermediary role between the Acrux management team and the investment company, a majority shareholder, which puts constant pressure for high returns on its investment. Minority owner-directors find it difficult to influence company policy, as the two parties have different expectations of the company. There is always a tension between the bottom-line objectives and as the minority-owner perceives as wider strategic objectives. Therefore, these two groups of directors rarely work together. As the minority-shareholder director explains:

“The reality is that we cannot influence the outcomes of Acrux with a minority share-

holding. We can influence them much easier from outside than from inside the camp.”

The chairman’s role and involvement in governance matters of Acrux, in practice, are constrained by his physical isolation from the company. Both directors and management of Acrux point this out as a major problem of their company’s governance. Communications between the chairman and CEO are irregular and usually performed by electronic means. The CEO describes the situation:

“My chairman has a variety of demands upon his time, he’s travelling the world a lot, and so 90 per cent of our communication is just by email wherever he may be. I see the guy only seven to nine times a year. So it’s not the ideal relationship. The ideal relationship of CEO to chairman is the fact that you can have a cup-of-coffee meeting every week and go through issues for half an hour or so.”

This isolation makes the relationships between chairman and CEO more formal, emphasising the importance of reporting and monitoring functions. The condition also forces the CEO to seek advice from other directors. That changes the board dynamics.

In addition to the problems of two different groupings within the board and constrained contacts between the chairman and CEO, a third predicament resides in relationships between directors and management. The CEO and financial manager maintain formal interactions with the directors and act as a filter for all communications between the company and its board. Majority-owner directors disapprove of such a practice, believing that broader interactions with other executives would help the company and shareholders achieve their ultimate objectives. One of the directors explains:

“If you were sitting on a board and you were only ever talking to the CEO, it would be pretty

frustrating stuff. I think it would be better for the company if the management sat there. I don’t know how open their internal management system is, whether they have a Monday meeting where everyone sits around. They never told us. I think that if you have an open forum, it’s good for everybody because then everyone gets a sense of which way the company is going and they get a sense of where the board is coming from.”

Firm and board reputations

Finally, we examined directors’ and executive managers’ perspectives on the company’s and the board’s reputations. We define reputation as positive associations that others make of a particular individual or a formal group of individuals. We consider it important to analyse reputation in the context of this research as a company’s reputation can reflect the quality of the relationship between board and management, between management and the firm’s business associates, as well as between the board and other stakeholders. In addition, the directors’ good reputation is seen as an external factor that can attract desirable tangible and intangible assets, and as an internal factor that can increase directors’ credibility within the company and contribute to the development of more effective relationships between the board and management.

The set of questions on reputation focused on relationships between the company and different stakeholders, and on relationships between the company’s and the board’s reputation. We adopted a specific approach, asking participants to give their perceptions on stakeholders’ likely interpretation of the company’s reputation. We believe that directors’ perceptions of the company’s reputation can influence the intensity of their involvement with the company. On the other hand, executives’ perception of the company’s reputation can influence their expectations



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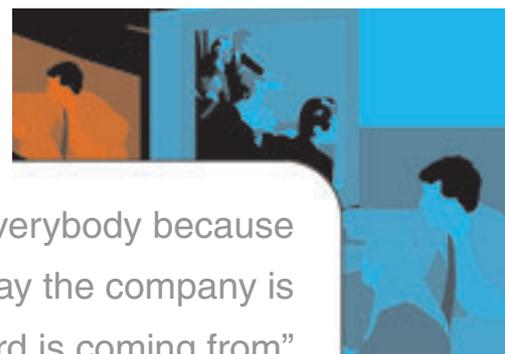


TABLE 5

Firm and board reputation					
Case	Firm reputation	Major factors	Board reputation	Major factors	Examples
SOUTHERN STAR	Reputation resides in stability A true culture of customer service Integrity and reputation of management Company's overall performance	<ul style="list-style-type: none"> • Steady returns on investment • Strong relationships with customers • Partnerships with suppliers • Respect from competitors 	Collective reputation Individual reputation	Transparency Honesty Leadership Integrity Strong code of ethics Professionalism Commitment	"We've always had a very good reputation with the investors in that we are open. We tend to always deliver on our commitments and promises and generally have a very strong support from the industry"
SAGITTARIUS	Reputation in transition Product brand	<ul style="list-style-type: none"> • Financial performance of the business • Market position 	Important to investors Individual reputation (reputation of chairman) Internal reputation	Openness Fairness Consistency Trust	"[The company's reputation] I [CEO] think is seen more as how a management has performed, rather than how the board has governed."
ACRUX	Reputation in collision Shareholder value Involvement with the community	<ul style="list-style-type: none"> • Best possible return on investment • Consultations with community 	Important to investors "Reputation of pushing boundaries"	Individual expertise High public profile Community links	"I [director] suspect that [some business partners] would probably not regard us as terribly nice people."

toward directors' input and behaviour. Table 5 describes the specific concepts of the company's reputation that emerged from the data.

Southern Star provides a good example of a reputable company. Its directors and management believe their company's reputation depends on the relationships they have established with their suppliers and customers, in particular. They also emphasise the qualities of openness and transparency as the key attributes of their relationships with various stakeholders. Both groups stress two most important aspects of reputation: the company's overall performance, and management's integrity and reputation. A director puts it this way:

"The most important factor is people, not money. Money is important, but people ... I think it's a much bigger factor than people realise in corporate governance ... it is the people."

When the current owners acquired Sagittarius in 1999, the company was in bad shape and had a bad reputation. The board and new management embarked on the difficult task of developing the business and improving the company's position. The CEO explains the situation at that time:

"Our company carries a bit of baggage from the previous owner. When I started, we had a very average sales team and the reason for that was it wasn't a business that would attract good people because of the inconsistency and the reputation it had."

The board and management believe the company has significantly improved in the meantime and that most stakeholders perceive Sagittarius as a more professional and reputable business. Similar to Southern Star, its directors see multiple links between the company's reputation, its overall business performance, and management. Board reputation, which is more important to investors than other stakeholders, is linked to the individual reputations of directors, the chairman in particular. One director put a specific emphasis on building the "internal" reputation of the board, or trust between the management and the board. In a stage of transition, the board should be leading the company, but at the same time it should not be dealing outside its expected boundaries.

The directors and management of Acrux perceive their company's reputation in different lights. For

the majority-owner directors, reputation is dependent on the financial outcomes. Therefore, the shareholder value is the major factor by which the company's and the board's reputation is estimated. One of the directors explains:

"There's a bunch of rules [in the relationships with other stakeholders] here and we're going to play the game as hard as we can within the rules. It's not a case of that's what we might be able to do, or could do ... it's that's what we should do because we're managing the asset on behalf of our shareholders and our shareholders deserve the best possible return we can get out of it."

This attitude, which arises from the company's monopolistic position, enables it to exercise various power games that produce conflicting situations with other stakeholders. As a consequence, the stakeholders might perceive the company's reputation in a less positive light.

As Acrux operates in the transport infrastructure sector, both groups of directors emphasise the importance of the company's reputation in the community. They both perceive the company as "a fairly good corporate citizen", highlighting their regular consultations with the community regarding various business developments and the company investments in several community projects.

DISCUSSION

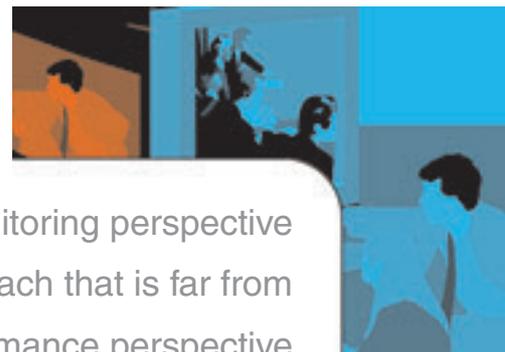
These three cases illustrate three different patterns of relationships between the board and the management team.

The pattern of relationships in Southern Star reflects collaboration between directors and managers. The board and the executive management are functioning as a team, as a cohesive group. Every issue is well studied and discussed, and conflict is acceptable behaviour. There are no dominant

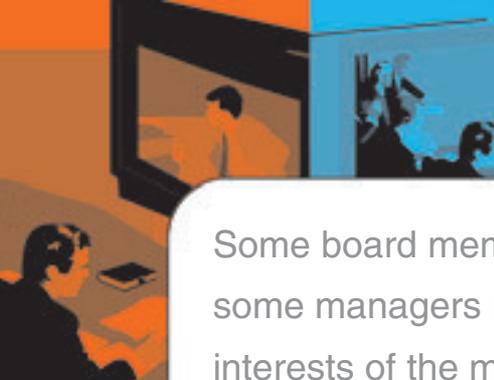
players at board meetings and the board takes an interactive approach in strategy making (Oliver, 2000) working closely with management in various stages of the strategy process. But the final decision resides with the board. The board has developed strong links with all stakeholders, customers in particular, and the company's reputation is embedded in these intensive external relationships and internal development of trust and consistency at management and board levels. This is the monitoring perspective of the corporate governance, where clear boundaries exist between the board's and management's responsibilities. But teamwork, collaboration of multiple stakeholders, and path-dependent development of the company make this monitoring a more sophisticated and multifaceted approach that is far from a classical monitoring, controlling and measuring performance perspective.

Several contextual factors support this pattern of corporate governance. First, the company operates in a mature and capital-intensive industry. It has a major position in the market and is financially successful. Second, historically the company has undergone stable development and growth without any transformational changes. It has grown mostly internally by developing related businesses. Southern Star has made recent large acquisitions within the same industry. Third, overall staff turnover is very low and, in terms of management development, Southern Star pursues a tradition of internal promotion. Among senior management, the CEO and a general manager of the largest division have been with the company for more than 30 years.

Sagittarius is a company in transition and its pattern of corporate governance reflects the intensive involvement of the chairman in strategic processes and even various management issues. The chairman is the most knowledgeable person on the



Collaboration of multiple stakeholders makes the monitoring perspective a more sophisticated and multifaceted approach that is far from classical monitoring, controlling and measuring performance perspective



Some board members do not trust the top management and some managers may not trust that the board has the best interests of the managers, and the company, at heart

board and pursues a proactive approach (Oliver, 2000) in strategy and business development. The other board members, on the other hand, consider their function in a traditional manner, ratifying management plans and acting as auditors of past performance. Their involvement is rather reactive than active. The relationship between Sagittarius' chairman and management team can be described as mentoring. The chairman has a role of coach, guiding management through the company's transformation. The company has been undergoing change, trying to rebuild its external reputation, with the business community in particular, and its internal reputation, by building the confidence of the board in its management. Respect and trust between board and management are grounded in the chairman's expertise. This pattern of corporate governance is supported by specific contextual factors. First, the ownership structure of the company suggests such a type of governance relationship. The company is a private company and the directors own a majority of equity. Among them, the chairman is the largest shareholder. Second, the chairman's high reputation in the industry and business community has predetermined his roles with management and the rest of the board. The other board members expect the chairman to be highly involved with the company and the management appreciate the value he adds to their efforts. Third, transitional changes require the board to provide more direction and guidelines and to perform like top-level strategists.

Acrux is a company whose pattern of corporate governance reflects the conflicting interests of its two different shareholders. Majority-owner directors play a dominant role in various governing issues. They pursue a clear goal of increasing the shareholding value for their investor. Minority-owner representatives, on the other hand, are more concerned with the wider stakeholders' needs, but do not have enough formal power to realise their objectives in full. Majority-owner directors follow a proactive approach (Oliver, 2000) in strategy development trying to be involved in all external and internal processes. They constantly challenge the management by pushing the boundaries of the

company's expected performance. At the same time, they maintain superficial, but respectful relationships with the minority owner, knowing that this party might harm their interests through informal (political) means outside the company. Although, on the surface, this corporate governance triangle seems to function satisfactorily, underneath are some substantive and unresolved issues. First, there is a lack of open communication and constructive discussion between the directors and executive management. Second, there is an asymmetry of information and knowledge between the two groups of directors. Third, due to the physical isolation of the chairman, there is a lack of leadership and real collaboration in the boardroom.

RECOMMENDATIONS

The practical insights arising from this study span a variety of core areas and emerge from examining the differences between the cases presented here and correlating these with other published studies (e.g., Carter and Lorsch, 2004; Lorsch and MacIver, 1989; Conger, Lawler and Finegold, 2001; Westphal, 1999). We divide them into process issues (what the board could do internally to become more competent as a board) and content issues (what the board could do in its interaction with management and its representation of various stakeholders).

Process issues

The major aspect to improving governance is testing and building trust at various levels – primarily trust in management and in each other, but also encompassing trust in commitment to the company, trust in competency to advise, trust in caring about the welfare of the company, as well as management. While these aspects may seem obvious, many boards are ineffective because of a lack of trust of various kinds. Some board members do not trust the top management and some managers may not trust that the board has the best interests of the managers, and the company, at heart. Boards that are better at monitoring also seem to have a trust-based relationship with managers. As a result, the former are more comfortable providing honest feedback, and

the latter are less defensive about any negative feedback and do not impute any ulterior motive. In our study, it was clear that Southern Star had this trust-based relationship, which had a beneficial effect on governance, whereas Acrux did not have this relationship, which in turn inhibited governance.

We intentionally emphasise the importance of the whole management team being considered in the development of trusting and open relationships in governance practice of modern corporations. The board should be able to communicate with all top-level managers, not only the CEO. Acrux provides a good example of lack of communication (and trust) between executive management and the board. The role of CEO is ultimately important in enabling and nurturing these communications. Managers' presence at board meetings and their involvement in reporting and discussing various issues with board members encourage trust development and increase the credibility of the directors. The board should periodically revisit this issue internally and with each board member, and identify impediments to developing trust. This may also help in identifying inactive board members, who may be free-riding on the contributions of other members.

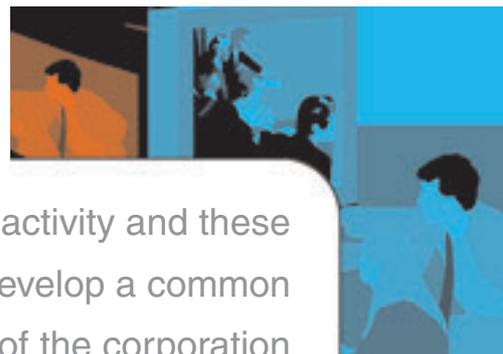
The two aspects that help in trust development are board involvement and board knowledge. Boards need to ensure the involvement of all board members internally. This is critical to build a collaborative team rather than pockets of individuals. Involvement could be both in and outside the boardroom, as in meeting key customers. Without it, boards are likely to become fragmented and unproductive. A very important part of this involvement is the visibility of the board to various stakeholders, including employee groups, in a variety of formal and informal settings. At Southern Star, for example, all directors recognise the value of their visibility to various stakeholders and invest

significant effort in responding to the company's expectations. On the other hand, inactivity in the boardroom or unbalanced involvement is clearly exemplified in the case of Sagittarius, where the chairman is the only board member actively involved in the company's affairs.

In addition, board members must be knowledgeable about their corporation and its context. The board needs to develop a conceptual understanding of core competencies of the corporation (including its core technologies) and comprehend how these competencies translate into corporate strategies, as well as how strategies deliver financial outcomes. In other words, the board's knowledge must have as much of a conceptual basis as an operational one. Thus, at the process level, boards must focus on knowledge diffusion, assimilation and reproduction systems. Governing a corporation is an essentially cerebral activity and these knowledge systems should be used to develop a common understanding of the value-adding engine of the corporation. This would lead to an engaged and collaborative board and a better basis for monitoring in the board. Of course, boards must have multiple knowledge bases, incorporating both internal and external alternate sources of information. But our point is that a commitment to developing involvement and knowledge systems would spur sustainable long-term initiatives at the board level, suited to their specific context.

Finally, to close the loop on the governance process, an annual or bi-annual performance appraisal of board members – a peer and external review – is critical. It needs to be pointed out that only one firm in our sample (Southern Star) has a formal performance appraisal of its board members. We believe a formal performance appraisal sensitises the need for accountability of individual board members.

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Collaboration within the boardroom and the development of close working relationships between the CEO and the chairman increase the board's effectiveness and create synergy

Content issues

It is vital that the board must develop an overarching goal for governance. This goal must outline the approach the board will adopt toward the corporation as an entity, its assets, as well as its top managers. This goal must be developed by the board on its own, without involvement of the top management – although once developed, the goal may be shared with top management. The goal needs to cover at least four key areas: (1) the boundaries between governance, board responsibility and management representation of the company to stakeholders; (2) a stance toward monitoring top management, including succession plans; (3) education about the corporation's mission, vision, values and competencies; and (4) delivery of the board's unique resources and competencies to the corporation.

The process of developing an overarching goal serves to bring the board together, as well as familiarising board members with each other's skills. Differences among board members (especially when they belong to different owner or stakeholder groups) could be ironed out in the process. Ultimately, boards must serve the corporation for which they are constituted, rather than represent the individual constituencies that members represent. In our study, Acrux provides an example of a split board, where two groups of directors guard interests of their respective shareholders, very often undermining the interests of the company.

Boards play a critical role when they take ultimate responsibility in developing the "big picture". This is the natural outcome of the knowledge management process outlined earlier. Boards should develop alternative visions for the future and the corporation's role/place in each of those scenarios. None of the three companies from our sample exemplifies a full and critical commitment of board members in designing the company's future. Although all three boards have strategic annual retreats where directors and executive management discuss various strategic issues, their respective CEOs do not believe their boards are sufficiently involved in developing and establishing the big picture.

CONCLUSION

The dominant theme emerging from our study of corporate governance in three companies in traditional industries is the importance of a trust-based relationship between management and the board, based on the board members' knowledge of the firm and its context, and their involvement in the process of governance. This relationship helps the board do a better job of monitoring top management, protecting stakeholder interests and, where required, offer advice and other resources. This is evident from the contrast between the three cases presented here. Where both the CEO and the chairman expressed a high degree of satisfaction with their relationship in terms of knowledge and involvement, the monitoring function was well served. Where this did not happen, the resulting mismatch and friction compromised the monitoring function. As shown, internal "education" of directors, their commitment to learn and their regular exposure to various stakeholders improve the process of knowledge acquisition, lessen the competence gaps and promote trust building between directors and management.

The second major insight emerging from the contrast between the cases presented is the need for the board to work as a group. This need may seem obvious, but achieving it may require a lot of effort. Where only some members are knowledgeable about the issues, their involvement and participation suffer, compromising the monitoring function. Collaboration within the boardroom and the development of close working relationships between the CEO and the chairman increase the board's effectiveness and create synergy. The board should be able to serve as a sounding board with best solutions emerging from active debate among *all* board members. The active participation of only a part of the board may generate "group-think" behaviour. This creates a false impression of informed consensus, when it is actually a reflection of passive agreement. This does not serve the investors and management well.

The third major insight refers to the increasing need for a board's greater involvement in long-term

strategy making. Our research findings and recommendations advocate a critical role for the board in designing the company's future. Both shareholders and management expect the board to be active in developing ideas, refining possible solutions, deciding the final strategy and reviewing the process of strategy implementation. Finally, our research shows that directors' reputations can be considered as an additional factor in analysing contemporary governance practice. Here the individual directors' reputations (embedded in personal integrity, leadership, commitment and individual expertise) and the collective reputation of the company (built on strong financial performance, market position and respectful customer service) can contribute to the development of more effective relationships between the board and management on the one hand, and the board and the company's investors on the other.

The findings reported here are part of a larger study on corporate governance in a wide variety of industries and ownership variations in New Zealand. Also, a large number of not-for-profit organisations (e.g., NGOs and trusts) implement a similar model of governance as corporate entities in New Zealand. Our conclusion can also be applied for their boards of directors. For the specific recommendations, however, further study needs to be done on these organisations' specific contexts. While we are quite optimistic about the overall quality of governance in New Zealand in general, in this paper we propose some steps to improve the boards as governance bodies, with the implicit co-operation of management. We make one overriding presumption in this effort, however: that both boards and

managers are really interested in better governance of the corporation. Because of their unique, relatively rarefied perch in the corporate hierarchy, no real change can occur if boards and managers do not commit to a need for a change.

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