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Article information:

To cite this document:
Karim S. Rebeiz , (2016),"Design guidelines for boardroom's effectiveness: the case of Fortune 500 firms", Corporate Governance, Vol. 16 Iss 3 pp. 490 - 506
Permanent link to this document:
http://dx.doi.org/10.1108/CG-08-2015-0104

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Design guidelines for boardroom's effectiveness: the case of Fortune 500 firms

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Abstract

Purpose – *Boardroom's effectiveness has emerged as an issue of considerable importance in the minds of academics and practitioners, particularly in the aftermath of the highly visible corporate governance scandals of the past few decades. The purpose of this paper is to shed new lights on this topic by proposing a robust design framework for boardroom's effectiveness.*

Design/methodology/approach – *The interpretative investigation is based on semi-structured interviews administered to directors of Fortune 500 firms. The adopted thematic analysis is phenomenology, or the feelings, experiences and perceptions of events as depicted first hand by individuals with significant boardroom's experience.*

Findings – *Two central findings could be construed from this investigation. First, the optimum boardroom's configuration is not a universal proposition. In other words, there are no magic recipes, and no one-size fits all approach. Rather, the optimum boardroom's configuration ought to be framed in light of the overarching needs of the firm in relation to the dynamic forces in the external environment. Second, the design of boardrooms ought to span beyond structural aspects (i.e. the outwardly visible aspects) to also encompass two largely unobserved boardroom's phenomena, namely, the directorship personal trait factors and the directorship behavioral patterns.*

Research limitations/implications – *The findings presented herein may be contaminated with cognitive and personal biases, a common and unavoidable occurrence in qualitative research. A more integrative research approach using inductive and deductive techniques would allow for triangulation of results, thus providing an additional dose of validity and relevance to the research findings.*

Practical implications – *There has been a growing disenchantment about the* modus operandi *of the board of directors among practitioners, particularly as it pertains to large corporations with diffuse and heterogeneous shareholders and stakeholders. New design guidelines for the board of directors would directly impact on corporate practices.*

Social implications – *The design of high performance boardrooms is instrumental to shareholders, policymakers, directors, executives, rank and file employees, suppliers, customers and other direct and indirect stakeholders, as it may help avert future corporate governance mishaps.*

Originality/value – *As of today, the academic and popular literature has yet to provide unequivocal guidance for the development of high performance boardrooms. This study fills an important gap in the prevailing corporate governance literature by integrating both structural and socio-cognitive factors into the design framework of the board of directors.*

Keywords *Corporate governance, Boards of directors, Boardroom effectiveness, Boardroom performance*

Paper type *Research paper*

Introduction

Corporate governance refers to systems, protocols, procedures and institutions regulating the interaction patterns between the central organizational players to ensure the proper functioning of the firm. The board of directors is the steward of the internal corporate governance system and, as such, it is the highest authoritative body of the organization. The notion of a board of directors has emerged as an issue of significant relevance ever since the separation of ownership and control and the ensuing dilution of managerial

Received 4 August 2015
Revised 3 February 2016
29 February 2016
Accepted 1 March 2016

incentives. It is now universally accepted that every corporation, regardless of its size and vocation, ought to be run under the direction of a board of directors. The operative word "under the direction" is highly pertinent. It means that the board of directors delegates the day-to-day firm's operations to the professional managers. In turn, the board controls, monitors, advises and incentivizes management with utmost vigilance and diligence, but without infringing on management ability to effectively run the company on a daily basis (Lorsch, 1995). It is not the responsibility of the board to manage or, worse, micro-manage the firm. There should definitely be a clear demarcation between corporate management (under the jurisdiction of the CEO/management team) and corporate governance (under the jurisdiction of the Chairman/board of directors).

The boardroom's key functions are highlighted below under Directorship functions:

- understanding corporate information (e.g. financial information, report of the CEO, committee reports, and specific management proposals);
- preparing and attending meetings (e.g. board meetings, committee meetings and executive session meetings);
- selecting, assessing, compensating and replacing the CEO;
- overseeing and evaluating management and corporate performance;
- reviewing and approving important corporate plans (e.g. strategic plan, leadership succession plan and human resource plan);
- assuring ethical and legal compliance;
- acting as a sounding board for the CEO and management;
- acting as a liaison with the external environment;
- making capital allocation decisions (e.g. declaring dividends);
- communicating with shareholders and other stakeholders; and
- dealing with crises (internal/external crises and sudden/gradual crises).

The importance of designing a sound board of directors is driven by the belief that the boardroom shapes corporate leadership. In turn, corporate leadership sets the tone and the culture at the top hierarchical level and, ultimately, influences corporate performance. A well-designed boardroom translates into a high-performance team that is empowered and equipped with adequate resources to perform its oversight functions in an effective manner. For instance, a well-designed boardroom is autonomous, empowered and coordinated. It proactively secures information from independent sources rather than passively waiting for information to be provided to them by management. It also takes the self-initiative to improve the boardroom's *modus operandi* rather than merely reacting to externally bestowed regulations. Conversely, a poorly designed boardroom translates into a dysfunctional group that is uncoordinated, uninformed, weak and often subservient. A boardroom with poor performance norms would either maintain the status quo or, worse, would contribute to the destruction of the firm's economic value.

As the dust settles on the relatively recent corporate scandals, academics and practitioners are realizing the dire consequences of malfunctioning corporate governance practices. It is noteworthy that the highly publicized corporate scandals (e.g. Enron, WorldCom, Tyco International, Adelphia Communications, Global Crossing – just to mention a few) are only visible syndromes of dysfunctional corporate governance practices. More subtle, yet pervasive, corporate malfunctioning cases would occur gradually, insidiously and outside the preview of the public and the media. The hidden aspects of ineffective boardroom practices are eminently dangerous because they may remain undetected over a significant period. As a practical example, a boardroom may over-extend the tenure of a poorly performing CEO. The possible motives may be boardroom's excessive complacency, and/or sheer incompetence, and/or intentional malfeasance, and/or subtle conflicts of

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interest and/or undue influence. The CEO would eventually be replaced, but not before significant economic and reputational damage has been incurred by the firm.

Surprisingly, however, the academic literature has yet to provide clear guidance as to what constitutes a high performance board. Most investigations have focused on the outwardly visible phenomena of boardroom's effectiveness via the thin abstraction of archival data using the dogmatic input–output deductive methodologies. Examples of input variables include boardroom's composition, leadership structure, ownership type and/or executives' compensation. Typical examples of output variables include market or accounting returns and/or firm values. As indicated by Rebeiz (2015), the quest in unraveling the directional superiority of a boardroom's structural configuration remains an elusive phenomenon in the corporate governance literature. The subtle socio-cognitive aspects of boardroom's dynamics are under-investigated; yet, they have a significant impact on boardroom's *modus operandi* (Rebeiz, 2005; Sur, 2014). According to Daily *et al.* (2003), "our knowledge of what we know about the efficacy of corporate governance mechanisms is rivaled by what we do not know". The objective of this paper is to devise a robust design framework for the board of directors. The originality of this inductive investigation is that it integrates both the structural (i.e. the visible) and the socio-cognitive (i.e. the hidden) dimensions in the quest of designing highly effective boardrooms. This study also sheds new lights on the salient determinants of high performance boardrooms.

Corporate governance for organizations with diffuse shareholders

As alluded previously, corporate governance has implicitly been recognized as an issue of considerable importance ever since the mutation of the ownership landscape owing to the development of financial markets and the creation of limited and self-regulated corporations that enjoy a status of separate and artificial entities. The seminal book "The Modern Corporation and Private Property" by Berle and Means (1932) highlights the problematic issues related to the separation of ownership and control and the resulting dilution in managerial incentives. Fundamentally, the book has served as a platform for the germination of corporate governance theories, particularly as it relates to the agency cost of the firm (Fama, 1980). Succinctly stated, the agency cost is the additional layer of cost above and beyond non-agency relationship borne by the principal (the owner) consequent to the unwarranted behavior of the agent (the professional manager). Essentially, the agency cost assumes that agents are not perfect agents, as they would deviate from rationale and sensible behavior by, for example, indulging in self-serving opportunistic behaviors.

The agency cost is particularly pronounced in the case of highly diffused and heterogeneous shareholders because of the relatively high asymmetry in information and power between the principals (the suppliers of finance) and the managers (Jensen, 1986; Agrawal and Knoeber, 1996). According to Fama and Jensen (1983) and Jensen and Meckling (1976), the agency problem would not arise if it were possible to write a "complete contract" to guard against management transgressions. However, complete contracts are impractical for the obvious reason that it would be unrealistic to anticipate all the contingencies involved in running the daily operations of the business.

In economics, attempts to reduce agency costs have predominantly focused on utility functions that align the interests of managers with those of the shareholders (e.g. the widespread use of executives' stock options). Complementarily, the proponents of the efficient market hypothesis believe that the invisible hands of the free market could further discipline the corporation via shareholders' scrutiny, proxy contests, hostile takeovers, leveraged buyouts and other external interventions (Shleifer and Vishny, 1997). The highly visible corporate scandals of the past few decades have taught us that the market is far from being efficient, at least in the strong sense. The controlling forces of the free market are often ineffective, even in well-developed capital markets (Macey, 2004).

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The stewardship theory is frequently cited as an alternative to the agency theory (Donaldson and Davis, 1991). According to the proponents of the stewardship theory, the managers are principled corporate stewards with no inherent conflict of interest. Under this paradigm, the control should be centralized in the hand of the managers because they are the organizational experts (Davis *et al*., 1997; Mizruchi, 1983). The stewardship theory fundamentally relies on trust. The trust factor is expected to enhance managerial commitment in being the loyal, faithful and vigilant stewards of the organization. In parallel, the trust factor is expected to reduce transaction costs inherent to elaborate control mechanisms. A main assumption of the stewardship theory, however, is that executives are professionally mature (i.e. competent individuals) and psychologically mature (i.e. conscientious and responsible individuals). This aforementioned assumption may often be ill-founded because it stereotypes people. The organizational players are undeniably highly complex and heterogeneous people with a plethora of personalities, attitudes and psychological predispositions. For instance, it would be utterly naïve to assume that all CEOs would readily forego their own personal wealth for the sake of the supreme interests of the shareholders and other stakeholders. From a moral-seduction perspective, one does not necessarily need to be socio-pathic in nature to succumb to the traps of greed, euphoria, hidden motivations and irrational exuberance. Specifically, Simon (1947, 1985) argues that individuals and groups suffer from "bounded rationality". In other words, they cannot be perfectly rational decision makers, one of the reasons being conscious or subconscious self-serving bias, as well as socio-cognitive deficiencies.

Arguably, regulation helps maintain a minimum level of confidence and credibility in the marketplace. Regulation, however, inherently carries with it high direct and indirect transaction costs in the form of transactional and bureaucratic costs. For instance, regulation may induce the directors to devote inordinate time on compliance issues at the detriment of substantive corporate affairs that add value to the firm. Moreover, regulation is not a panacea for malfunctioning corporate governance. If the intention is to indulge in deceitful maneuverings, then disingenuous organizational players could be resourceful in exploiting loopholes in the regulatory system. In other words, if the internal governance system is rotten, then even the most stringent externally imposed rules and policies would be powerless in averting corporate transgressions. The board of directors is undoubtedly the first line of defense and the most effective policeman against unwarranted managerial maneuvering.

Determinants of boardroom's effectiveness

Using an epistemological literature review, three overarching themes emerged as determinants of boardroom's effectiveness, namely, boardroom's composition, boardroom's leadership configuration and boardroom's size.

Boardroom's composition

Boardroom's composition has spawned scores of papers in the academic and popular literature. Specifically, boardroom's independence has emerged as an issue of considerable importance both in academic circles and in corporate practices. Boardroom's independence fundamentally addresses the appropriate mix of independent directors relative to the total number of directors. Several decades ago, a director would be considered as independent if such director does not belong to the management team. In such a case, the sole employment status differentiates the outside directors (i.e. the non-executive directors) from the inside directors (i.e. the executive directors). With the passage of time, the directorship independence has been refined to also encompass professional and personal affiliations. Specifically, an independent director is an individual who is not significantly involved in the strategic and operational conduct of the firm and who does not have parental and personal affiliations with the senior management team or other influential members of the organization. In other words, an independent directorship is

immune to personal and professional undue influences that would adversely impact on being an objective and impartial decision-making. Specifically, it is widely believed that structurally independent directors would exercise independent judgment, and, in turn, independent judgment would eventually translate into sound boardroom's decisions. In comparison, an insider dominated boardroom basically means that management is overseeing management, a situation that certainly diminishes the effectiveness by which the boardroom upholds managerial accountability. The egregious conflict of interest associated with the inside directorship position would certainly stifle the ability of the boardroom to perform its fiduciary duties on behalf of shareholders and other stakeholders. Complementarily, it would be awkward (if not virtually impossible) for inside/executive directors to evaluate the CEO with equanimity because the CEO is after all their full-time boss in the firm in which they assume the directorship position. The objective judgment of inside/executive would be impaired – consciously or subconsciously – by personal motives. In support of the aforementioned argument, Weisbach (1988) reports than an independent/outside-dominated boardroom is more likely to replace a poorly performing CEO than an insider dominated one. Rebeiz and Salameh (2006) also provide empirical evidence that a critical mass of independent directors translate into superior financial market returns for the firms belonging to the construction industry. Furthermore, Liu *et al.* (2015) indicate that independent directors have an overall positive effect on firm operating performance in China. Conversely, another stream of studies actually posits that the incorporation of inside directors to the boardroom adds economic value to the firm because they are eminently knowledgeable about corporate affairs (Baysinger *et al.*, 1991; Hill and Snell, 1988). In another twist, Hsu and Wu (2014) claim that the probability of corporate failure is lower when firms have a higher proportion of grey directors (i.e. affiliated directors such as suppliers, customers and financiers) relative to executive directors, and when they have a higher proportion of gray directors relative to independent directors. Finally, it is noteworthy that multiple streams of research find no evidence of correlation between boardroom's composition and firm performance (De Andres *et al.*, 2005; Finegold *et al.*, 2007; Volonté, 2015).

Boardroom's leadership configuration

A large body of corporate governance literature focuses on the joint leadership versus the separate leadership configuration in the boardroom. In the joint leadership configuration, one single individual is bestowed with the dual roles of being the leader of the management team (i.e. the CEO) as well as the leader of the board of directors (i.e. the Chairman). Conversely, in the separate leadership configuration, the CEO and Chairman positions are dissociated and bestowed to two distinct individuals. A dissociated leadership structure is justified from the standpoint that no members of the management team should enjoy unfettered power. After all, a sound corporate governance principle requires that the CEO should be accountable to a higher authority. In fact, every single director in the boardroom is expected to be the CEO boss. Otherwise, the CEO would operate in all impunity, a situation that may degenerate into power concentration and abuse. In support of the aforementioned argument, Rechner and Dalton (1991) argue that the separate leadership structure tends to result in higher accounting returns for the firms than the joint leadership structure. Rebeiz and Salameh (2006) indicate that the dissociation of the roles of CEO and Chairmanship of the board would result into superior market returns for the firms belonging to the construction industry. In a sharp contrast, however, Donaldson and Davis (1991) claim that the joint leadership structure actually tends to generate higher accounting returns than the dissociated leadership structure. It is noteworthy that the joint CEO–Chairman configuration is inherently efficient (although not necessarily effective) because it unambiguously directs the corporate responsibility and accountability to one single individual.

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Boardroom's size

The issue of boardroom's size is an important structural configuration because it directly impacts on boardroom's dynamics, thus group productivity (Marcus, 2008). The boardroom's size refers to the total number of directors serving in the boardroom, including outside/independent directors, inside/executive directors and gray/affiliated directors. It is often believed that a large board size may cause logistical complexities because it is difficult to coordinate between the various directors and reach a consensus in a timely manner. Moreover, an inordinately large board would adversely impact on group cohesiveness and would make it easier for the free riders to hide in the crowd. In comparison, a small board is prone to being more coordinated, cohesive, powerful and autonomous than a large board's size. In support of the aforementioned argument, Yermack (1996) argues that a small board size would yield higher market valuations than a large board size. Nevertheless, a relatively group size has the significant advantage of inviting a portfolio of expertise and skills in the boardroom. It is noteworthy that the use of committees in the boardroom would mitigate some of the disadvantages associated with large board's size because it involves a small group of highly specialized directors, and, accordingly, it is conducive to open, meaningful and frank deliberations. According to Lorsch (1989):

> [. . .] committees enable directors to cope with two of the most important problems they face – the limited time they have available, and the complexity of information with which they must deal.

The limitations of dogmatic research

Despite the sheer volume of research studies, the academic literature has yet to unequivocally establish a robust relationship between corporate governance attributes and firm performance metrics. From an epistemological perspective, the majority of the prevailing empirical studies on the board of directors have adopted deductive investigations as opposed to inductive inquiries. This normative approach would typically rely on large sets of archival data in an attempt to establish a possible linkage between specific aspects of boardroom's attributes and corporate performance (Bennedsen *et al.*, 2008; Lefort and Urzúa, 2008; Gompers *et al.*, 2003; Denis and Sarin, 1999; Yermack, 1996). The statistical analysis is an input–output process ranging from simple to multi-stage regression analyses. The statistical findings are inconclusive and inconsistent, even with the adoption of exotic and sophisticated regression models (Dalton *et al.*, 2003, 1999, 1998).

There are multiple reasons explaining the deficiencies inherent to input–output deductive research. First, archival data depict a snapshot in time. The painted picture could look drastically different in another time and another context, particularly that market phenomena and boardrooms' attributes are inherently dynamic phenomena. Second, archival data do not capture the very essence of boardroom's idiosyncratic culture, including social conformities and unspoken norms. Third, most normative research and policy setters fundamentally rely on the rational actor model assumption. The model assumes that directors are rationale and competent individuals who are immune to peer-pressure, undue influence and self-serving bias. Behaviorists question the dominant governance paradigm of rationality by pinpointing that irrationality is a natural human behavioral construct that varies in a continuum from little rationality, on one end of the spectrum, to high rationality, on the other end of the spectrum. Flawed decisions can often be made subconsciously and with the best intentions in mind. The recent corporate scandals have taught us that key organizational players could passionately and adamantly assert the righteousness of their decisions even when the evidence proves otherwise.

Equally important, normative investigations with archival data are marred with imperfections due to the endogenous nature of the variables (Hermalin and Weisbach, 2003). As stated by Rebeiz (2015), there is a simultaneous two-directional phenomenon existing between corporate governance attributes (the input variables) and corporate

performance metrics (the output variables). Specifically, boardroom attributes may impact on corporate performance metrics. In turn, corporate performance metrics may impact on boardroom attributes. As an example, Hermalin and Weisbach (1988) report that firms that perform poorly tend to increase the proportion of their independent directors in the boardroom, as they would succumb to market pressure. The reverse casualty between the input and the input variables introduce noise factors that would undoubtedly blur and distort the research findings. The problem is further compounded with "unobserved heterogeneity", whereby the identified relationships are symptoms of some unobservable factors that drive both the dependent variable (corporate performance metrics) and the explanatory variables (boardroom attributes). For all the aforementioned reasons, there is an urgent need to complement deductive research (depending almost exclusively on archival data) with inductive research (largely relying on inquiries and/or direct observations).

Research methodology

The data collection process

The adopted methodology is interpretive primary research via thematic analysis (Gephart, 2004; Boyatzis, 1998). The units of analysis are the narratives transcribed from the semi-structured interviews. Specifically, it relies on phenomenology, meaning it scrutinizes the feelings, experiences and perceptions of events as depicted first hand by individuals with significant boardroom's experience. A piloted interview was first tested with a selected group of experts. A refined standardized questionnaire was then developed for the actual interview. The interview was audio recorded and transcribed into written form. A phone interview often followed up the face-to-face encounter for further clarification or amplification of statements and comments. A reflexivity journal was used as a platform for the logging of ideas and for self-reflections. The data analysis consisted of reading and re-reading narratives to uncover the intertwined phenomena buried under the unstructured transcribed narratives. A systematic process of coding the raw data was used to identify the underlying patterns, to compare and contrast themes and to build overarching latent themes. The culmination of the thematic analysis consists of developing theoretical models that address the central research question, namely, to uncover the various determinants of boardroom's effectiveness and to formulate a robust design guideline for the entity.

The key headings of the interview are shown in Table I. The respondents are 18 individuals with at least 10 years of directorship experience in Fortune 500 corporations, thus large corporations operating in liquid and mature financial markets. The demographic profiles of the respondents are shown in Table I. The average board's attributes in which respondents served as directors are shown in Table II. Questionnaire headlines on boardroom's effectiveness are given below:

- the directorship position (control and service functions);
- the types of directors (outside, inside, and graey);

Table I Demographic profiles of respondents

Characteristics	*No. of respondents*
Male (average age: 64 years)	13
Female (average age: 59 years)	5
CEO experience	6
Chairmanship experience	5
Retired executives	8
Graduate degree	13
Only undergraduate degree	4
No academic degree	1

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Table II Average board's attributes of firms in which respondents served as directors

Average board's size	*11*
Percent independent directors	83%
Directorship experience	18 years
Boards with mandatory retirement age	72%
Dual/CEO Chairman configuration	51%
Board with lead/presiding director	89%
Directors with financial background	25%
Directors in academic/nonprofit firms	9%
Number of yearly board's meetings	8
Number of audit committee meetings	8
Number of compensation committee meetings	6

- Board's structural configuration;
- Board's *modus operandi* during normal times;
- crisis management in the boardroom;
- balance of power board—CEO;
- Board's culture and norms;
- Directors' traits;
- Board's influence on corporate performance;
- constraints to board's effectiveness; and
- increasing the board's effectiveness to govern.

The respondents represent a heterogeneous group with varying frames of reference and frames of relevance.

From the onset of the interview, it was made clear that good governance, as defined in the study, should not be confused with market returns or accounting returns. Rather, good governance is succinctly defined as the effectiveness of the board of directors to devote significant time, exert sufficient effort and, ultimately, make sound and principled business decisions in its controlling and servicing functions in conformity with the fiduciary responsibilities of being the trusted steward of the internal corporate governance system.

The structured interview relied on standardized questions to increase the consistency of idiosyncratic descriptions and to elicit responses directly related to the research question. In answering the questions, however, the respondents were given discretionary latitude to further elaborate on their own directorship experiences free of the inhibiting constraints of rigid rules. Fixed-response questions were avoided because they would not capture the full and real story inside the confines of the boardroom, particularly as it relates to complex social phenomena regulating behaviors and attitudes. Conversely, an informal conversational style was encouraged because it would stimulate a psychologically supportive and safe environment for a meaningful exchange of ideas and information. To further encourage candid discussion, the respondents were assured that confidentiality of individuals and firms would be enforced throughout the study.

The coding types and procedures

Two types of codes were used to label the narratives, namely, data-driven codes that are substantive in nature with no a priori hypothesis (i.e. ex-post codes) and theoretically driven codes from the corporate governance literature (i.e. ex-ante codes). The utilization of ex-post codes was motivated by the desire to increase the likelihood of identifying new phenomena and concepts not yet captured, articulated or depicted in the existing corporate governance literature. In addition, the development of codes without preconceived theoretical concepts would mitigate contamination of categories with noise

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factors not relevant to the research question. *In vivo* codes were also used in case the selected text segment provided a good conceptualization of the phenomenon. The sole reliance of ex-post codes is, however, epistemologically naïve because it disregards the inevitable conscious or subconscious theoretical presuppositions of observations held by the investigator. Moreover, it would virtually be impossible to conduct a robust analysis without prior assumptions. Precisely because of the theory-ladenness of observations, the ex-post codes were supplemented with ex-ante codes having a sound theoretical basis in the prevailing corporate governance literature.

Three sequential stages of coding characterized the adopted thematic analysis, namely, open coding, axial coding and selective coding. The open code process consisted of categorizing data via the labeling of a node representing a phenomenon found in the text corpus. Two criteria were used in developing overarching categories, namely, internal coherence within a category and strong distinctions across categories. The encoding process was not linear in nature. Rather, it was a cyclical process that used multiple trials through the test-retest method using appropriate time-lapse intervals, which culminated in the refinement of codes. The de-contextualization and re-contextualization of data was primarily done to increase the reliability of the codes.

The second phase of coding, namely, axial coding, consisted of using coding paradigms that interconnect categories by integrating central phenomena, causal conditions, underlying motives, contextual factors, intervening conditions and interaction patterns. The objective of axial coding was to devise the theoretical framework of the research model. The third phase of the process culminated with selective coding. As its name implies, selective coding consisted of choosing a central core category and intertwining it with other categories to conceptualize the research paradigm.

Atlas.ti software was used as the platform to systematically organize, classify, simplify and reduce raw text data into variables, and subsuming them into categories. The software also facilitated the weighing, evaluating and visualizing the linkage between ideas and concepts. The process started with the line-by-line coding to the raw text corpus with the intent to generate as many codes as possible. The process of encoding the narrative was exercised with care to separate relevant information from noises. Full and equal attention was devoted to each line with the intentional dilution of data with seemingly irrelevant information to avoid discarding unnoticeable, yet overarching, themes in subsequent analyses. In an effort to further increase the validity of the analysis, two knowledgeable readers were entrusted to encode the same text independently. The extracted data were stored separately for further processing.

The contingent nature of boardroom’s structural configuration

In a landmark meta-analysis study, Dalton *et al.* (1998) posit that the quest for unraveling the optimum boardroom’s structure is not an easy endeavor by any means. As discussed previously, investigations linking boardroom’s attributes with corporate performance are marred with contradictory and confounded conclusions. Notwithstanding the inherent limitations of dogmatic research with archival data, it is further posited in this investigation that the structural design factors are contextual and, therefore, cannot be applied to generalized situations. Specifically, the optimum boardroom’s configuration depends on the idiosyncratic needs of the firm in relation to the pressures emanating from the external environment. Five illustrative cases are used herein to illustrate the contingency factors in boardroom’s structural design: external transactional variability, external transactional complexity, market pressure and media scrutiny, internal organizational complexity and country customs and traditions.

Case 1 – external transactional variability

In case the prevailing macro-economic environment is highly dynamic, the appropriate structure is a joint leadership configuration, a relatively small board’s size, and a relatively

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large number of inside directors. Such a boardroom's structure is favored because the overriding priority of the firm is to be cohesive, coordinated, nimble and agile. First, the joint leadership configuration is warranted because it ensures a unity of command. It is devoid of potentially acrimonious conflicts between strong-minded individuals, and the decision-making process in the boardroom would usually be smooth, expeditious and efficient. Second, a small board size is warranted because it is conducive to intense interpersonal interactions between directors, thus group cohesiveness. Third, the inside directorship position further contributes to group cohesiveness because such directors are executives of the same firm. The inside directors intimately know each other and share a common identity due to frequent and intense interactions. As a way of comparison, the outside directorship position is not conducive to group cohesiveness by virtue of their part-time employment statuses in the firm in which they assume their directorship positions. Because their interaction patterns are episodic, outside directors lack the frequent and intense interaction factor needed to achieve a minimum threshold of cohesiveness. It is noteworthy that a group requires sufficient time to get acquainted (i.e. group forming), to experience and cope with conflicts (i.e. group storming), to comprehend the group expectations and unspoken norms (i.e. group norming) and to eventually operate at the optimum level (i.e. group performing).

Case 2 – external transactional complexity

In case the external transacting environment (such as the industry) is highly complex, an organization would opt for a large board's size with a relatively large percentage of outside directors because the overarching priority of the firm is to take advantage of an integrative decision-making style inherent to an all-inclusive, multidimensional and diverse board of directors. Moreover, the outside directorship position could provide a fresh and different perspective during boardroom deliberations. Through their own experiences in their respective industries, outside directors are prone to think "outside the box", and they are in a good position to further stimulate the discussion and induce the CEO to seek out different and, perhaps, more creative solutions to organizational challenges. A firm may also wish to increase the proportion of gray directors in the boardroom for strategic cooptation purposes, including assimilating valuable, complementary and rare resources from the transacting environment.

Case 3 – market pressure and market scrutiny

In case the market is characterized by strong shareholders' activism and intense media scrutiny, then the firm would opt to increase the percentage of independent directors in the boardroom because the outside directors are perceived as being detached and impartial overseers of the corporation and, thus, largely immune from self-serving biases, political maneuverings and other predispositions that may impair the integrity of the decision-making process in the boardroom. In this situation, the overriding priority of the firm is to project an image of credibility and legitimacy to the external world while evading unwarranted media attentions and avoiding unnecessary legal entanglements.

Case 4 – internal organizational complexity

In case the internal environment of the firm is complex (e.g. complex products, services and/or processes), a critical mass of inside directors would be desirable in the boardroom because such directors are organizational experts. As stated by one interviewee, "the inside directors are intimately knowledgeable about the intricacies of the corporation and, as such, their opinions are utterly invaluable during boardroom's deliberations". In comparison, the outside directors are usually uninformed overseers of the corporation. They devote the bulk of their times to the firms for which they work full time, and, in the process, they often lack the time to secure independent information, let alone to engage in due diligence for the firms in which they serve as directors. In addition, the flow of information provided to the outside directors is typically channeled via the CEO main office.

The outside directors would only receive complete, relevant and timely information to the extent the CEO is ready to share this information with them. As stated by Rebeiz (2001, 2002), the framing, filtering and screening of information by the CEO (either consciously or subconsciously) provide ample opportunities for information deficit and information bias. In a nutshell, the presence of inside directors in the boardroom would add value because their sheer presence compensates the information and knowledge deficiencies inherent to the independent directorship position.

Case 5 – country customs and traditions

The configuration of the board of directors, particularly as it relates to the positioning of external and internal directors, evolved differently in various parts of the world due to vastly divergent customs, values and traditions. A typical positioning formula in Anglo-Saxon countries is the unitary boardroom. Under this model, both inside and outside directors intermingle and operate under one boardroom umbrella, thus the designation unitary boardroom. An alternative positioning system, predominantly adopted in Germanic countries, is the two-tier board model configuration. Under this model, the organization uses two separate boards, namely, the supervisory board (consisting only of outside directors) and the management board (consisting only of executives to the company, meaning the inside directors). In effect, the two-tier board model separates the executive directors from the non-executive directors to reduce the potential adverse effect of work affinity that could develop between the executive directors (i.e. the inside directors) and the outside directors. In other words, such a configuration is intended to magnify the outside directors' psychological detachment from the management team. Nevertheless, the separation of the management board and the supervisory board would hinder the flow of information between the inside directors (the organizational experts) and the outside directors (the impartial overseers of the corporation).

The hidden socio-cognitive variables in the boardroom

Directors' personal traits

The board of directors comprises an amalgam of directors with highly heterogeneous personal characteristics. The collective socio-cognitive variables significantly influence the dynamics in the boardroom and the quality of the decision-making process. Ultimately, a well-designed board comprises directors with four "Cs" personal trait factors, namely, character, competency, cohesiveness and commitment.

Character. Character is a stable and enduring trait that has far-reaching implications on espoused values, anchored frames of references and other attitudinal predispositions consequential of human choice behavior. One desirable character trait for directors is honesty and trustworthiness. The directors ought to be deeply principled individuals who embody the highest standards of personal and professional integrity. Integrity has indeed taken renewed importance in the aftermath of the highly visible corporate scandals. One respondent states that "deeply principled directors are essentially courageous individuals. They ask probing question to the CEO and they make emphatic statements without being intimated by peer pressure". A second respondent adds that "directors with noble traits are intrinsically altruistic and, therefore, predisposed to cooperate and work collectively by placing the principled interests of the corporations above any other considerations". A third respondent states that "principled directors would repel any self-serving biases, conflicts of interests, emotional attachments and other types of unwarranted attitudes during key boardroom's deliberations". It is noteworthy that the summation of the character factors borne by the different directors would ultimately influence the boardroom's culture. Certainly, a culture of trust would greatly diminish the negative feelings that might arise during heated and passionate boardroom's debates. Stated differently, trust promotes a healthy cognitive conflict amongst directors, as well as between directors and executives (including the CEO). Furthermore, a trustworthy boardroom reverberates positively in the

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marketplace because shareholders, employees, creditors and other constituents would generally yearn for transparent, reliable and sound corporate governance mechanisms.

Competency. Today's large, modern and global firms are more complex than in the past. They operate multiple businesses in terms of products, services and geographies. In the process, they adopt elaborate organizational mechanisms and processes. The complexity factor is exacerbated by the fact that modern and global firms invariably use sophisticated technologies and often indulge in convoluted financial and operational dealings. As the result, the directors are expected to scrutinize reports (a notable example being the "Report of the CEO), to attend lengthy presentations and to indulge in lengthy deliberations before making informed decisions". For all the aforementioned reasons, the directors should possess significant cognitive competency. As stated by one respondent, "competency is not only limited to functional skills (e.g. finance, accounting, law, marketing, and engineering). It also encompasses conceptual skills, communication skills, and interpersonal skills". In light of today's dynamic and complex global marketplace, the directors are indeed expected to be emotionally intelligent, culturally insightful and seamlessly adaptable to various contexts and situations.

Cohesiveness. Cohesiveness refers to the extent of interpersonal bonds that emotionally connect directors to one another. As stated by a respondent:

> [. . .] a boardroom may have wonderful directors on a segregated basis, but if they cannot function as a unit and with a clear sense of corporate accountability, then the boardroom is utterly worthless.

Another interviewee adds that "in a cohesive board, all members of the board are valued and treated on an equal footing. No member of the board has authority over another one". The importance of a cohesive/coordinated board is also underscored by the fact that it generates a powerful boardroom team that would counterbalance the inordinately high power of the CEO and other influential members of the management team. It is important to note that a cohesive boardroom does not imply group think behavior. The Chairman, or the lead director, ought to encourage directors to play devils' advocates, or to indulge in dialectic debates. Such practices would lead to a productive exchange of ideas that might otherwise remain hidden during the boardroom's meeting. Equally important, such initiatives would minimize potential biasness in the decision-making process.

Commitment. The directorship position is a seat of intense intellectual inquiry and challenge. It entails monitoring the performance of the corporation continuously, and not just sporadically. Accordingly, the directorship position entails significant investment in time and energy. The importance of commitment is further underscored by the fact that the directors are usually busy individuals who are often consumed by the high demands and pressures of their own full-time jobs. Frequently, they assume multiple directorship positions across a wide spectrum of firms, industries and countries. As stated by a respondent:

> [. . .] a person who decides to join a boardroom lightly and without sufficient regard to the commitment required for boardroom duties is doing a great disservice to the firm because the stakes are inordinately high.

A second respondent adds that "a director who indulges in satisficing (i.e. expeditious and hasty decision-making) contributes to the erosion of corporate value". A third respondent adds that:

> [. . .] the commitment of an individual to the directorship position spans beyond time and energy investment. It also entails emotionally connecting with the organization and wholeheartedly adhering to its core values and embedded principles.

Boardroom's behavioral patterns

The behavioral patterns in the boardroom influence the leadership *modus operandi* and, ultimately, impact on corporate performance. One important behavioral pattern is the periodic and formal evaluation of the CEO. According to Lorsch (1995):

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> [. . .] evaluating the CEO annually is central to effective monitoring mechanisms for several reasons. Fundamentally, it is a major step towards empowering the board because it delivers a clear message to both the CEO and the directors that the former is accountable to the latter. It also provides outside directors with an impetus to engage in an open and frank discussion about the CEO's and the company's performances at least once a year.

As stated by a respondent:

> [. . .] the outcome of the CEO evaluation is beneficial to both the CEO and the outside directors. The CEO would receive valuable feedback from highly knowledgeable individuals. In turn, the outside directors would gain a better understanding of the organizational culture and its transacting environment and, accordingly, would become more effective monitors.

The CEO compensation is another important behavioral pattern. As Jensen and Murphy (1990) put it, "it not how much you pay CEO's, but how you pay them" that shapes leadership behavior and, ultimately, organizational culture. The agency theory asserts that the compensation scheme should align the interests of the CEO's with those of the shareholders. Expectancy theory further suggests that CEO's would be incentivized to perform at superior levels if they perceive that effort would lead to good performance (the effort to performance expectancy), that rewards are contingent on performance (the performance to reward expectancy) and that these rewards are valued, relevant and instrumental to both the managers, the shareholders and other stakeholders (the valence of outcomes). Often, however, well-formulated incentive plans would fail to meet their economic objectives because of flawed implementation. For instance, the adoption of executive stock options and other similar incentive mechanisms would, a priori, be considered as viable alternatives to complex, costly and rigorous monitoring mechanisms because they judiciously align the objectives of the executives with those of the shareholders. Nonetheless, the syntactic nature of accounting standards could induce disingenuous executives to exploit loopholes in the financial reporting process with the aim of grossly inflating reported earnings, thus significantly increasing the value of the stock options and other similar equity-based incentive plans. Although assets are not outright expropriated, the transfer of wealth incurred by artificially boosting earnings could easily exceed direct asset theft. In other words, the executives would unjustly and inordinately enrich themselves at the detriment of the shareholders, the file and rank employees and other stakeholders. Fundamentally, a sound executive compensation scheme requires two sine-qua-non conditions, namely, a well-designed incentive plan and a well-executed incentive plan.

In the process of interacting with each other, the CEO and the directors should always endeavor to become partners in the full sense of the word with all what it entails in terms of candor, transparency, trust and mutual respect. As stated by one respondent, "an impersonal, detached and distant board-CEO interaction is certainly not a propitious indicator". Another interviewee adds that "an overreliance on independent advisors may undermine the partnering between the directors and the CEO". Adams and Ferreira (2007) actually provide some evidence that collegial boardrooms have more success in achieving an open and constructive dialogue with the CEO than neutral and confrontational boardrooms. Rebeiz (2001) indicate that the partnering depends on the style and character of the CEO (e.g. introvert versus extrovert personality) in relation to the collective identity of the directors.

Ultimately, the design of a highly effective board is not a static endeavor. It is rather a dynamic endeavor that is sustained through boardroom's periodic self-evaluation. By indulging in an exercise of self-discovery (i.e. unraveling inner strengths and weaknesses as well as potential areas of improvement), the directors are forced to take their duties more seriously. This exercise would force active involvement in the boardroom. As stated by a respondent, "boardroom's self-evaluation entails active involvement from all directors. Accordingly, the free-riders would no longer be able to hide in the crowd and rely on their reputations alone". In other words, self-evaluation triggers a healthy change of behavior

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and attitude in the boardroom. A second respondent adds that "a self-evaluation exercise would help the board clarify its objectives and enhance its legitimacy". A third respondent indicates that "a well-conducted self-evaluation exercise would enhance inner group cohesiveness in the boardroom, as well as improve the interaction pattern between the directors and the executives and, notably, the CEO". Indeed, the CEO (and other members of the senior management team) would react more favorably and constructively to their own evaluations when the boardroom sets the good example by "walking the talk". The boardroom's self-evaluation process is a multi-level endeavor. At the macro level, the board would indulge in an introspective exercise of self-reflection as one unified team. At the intermediate level, the evaluation is conducted for the key boardroom's committees (e.g. the audit, the compensation and the nominating/governance committees). At the micro level, the directors would evaluate one another's individual performance. This peer evaluation process should be carried out candidly, openly and constructively. The benefit of this self-evaluation exercise would, however, depend on the level of enthusiasm and the extent of commitment that the directors bring to the process.

Future research directions

The tenet "fiduciary relationship" has consistently been uttered when referring to boardroom's effectiveness. Fiduciary relationship implies an interaction pattern based on trust and loyalty. The words "trust and loyalty" are regrettably nebulous. They do not explicitly specify the party of interest. One perspective posits that the "trust and loyalty" paradigm should be the exclusive privilege of the shareholders. Another broader perspective advocates the incorporation of other key stakeholders into the "trust and loyalty" paradigm. The elusive dilemma shareholders' primacy versus stakeholders' primacy is still unsettled in both the academic literature as well as actual corporate practices. This situation leaves the majority of directors perplexed and often uncomfortable about the prospect of debating this important issue in the open, particularly during boardroom's deliberations. Ultimately, it is paramount for the board of directors to have an unambiguous and shared understanding of its mission and mandate, especially as it relates to what specific party (or parties) the "trust and loyalty" paradigm should unequivocally be directed to. In the absence of a shared and explicit understanding of its overriding purpose, the board's capacity to govern effectively and efficiently is severely impaired.

Complementarily, future research endeavors would clearly and explicitly delimitate between the board's control task and the board's service task. In that respect, Forbes and Milliken (1999) advocate an integrated functionality approach in studying boardrooms' effectiveness by differentiating between the duty to oversee management and the duty to assist and provide advice and counsel to CEO and the management team. A different, yet related, theme is the strategic role of the board. According to Brauer and Schmidt (2008), the strategic role of the board is an empirically understudied phenomenon in corporate governance. Daily *et al.* (2003) ranks the strategic role of the board on top of the list for future research endeavors. Pye and Pettigrew (2005) consider that research on the strategic role of the board is inalienable. A clear and explicit understanding on the board's strategic role would significantly enhance the board's ability to govern.

Conclusions

The first conclusion of this investigation is that the optimum structural configuration of the boardroom is not a universal concept. It is rather a contingency factor that depends on the idiosyncratic needs of the firm and the dynamic forces in the external environment. The second conclusion of this study underscores the importance of incorporating socio-cognitive variables into the design framework of the board of directors. Socio-cognitive variables indeed significantly influence boardroom's dynamics and, consequently, the quality and integrity of the decision-making process in the boardroom.

Fundamentally, four "Cs" distinctive directorship traits depict a high performance boardroom, namely, character, competency, cohesiveness and commitment. The boardroom's design parameters should also take into account the attitudinal predispositions that activate and sustain boardroom's behavioral interaction pattern. Specifically, it is incumbent on the directors to effectively partner with the CEO, yet maintain emotional detachment in advising, evaluating and compensating the CEO. This delicate balancing act of partnering, yet staying psychologically independent, is not an easy endeavor by any means. It requires directors who are malleable and who can maneuver with tact and elegance in different contexts. In the final analysis, if the boardroom and its key committees comprise the right directors, and if such directors are empowered and provided with adequate resources to carry their fiduciary duties in all autonomy and free of all forms of undue influences, then the boardroom could take the self-initiative to adjust all what is wrong in terms of structures, mechanisms, processes and other pertinent issues related to the proper functioning and governance of the firm.

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