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DOES DIRECTOR'S COMPETENCIES MATTER TO CORPORATE GOVERNANCE? A REVIEW OF LITERATURE

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ABSTRACT

Prior to the various corporate governance scandals around the world director's competencies has becoming widely acknowledged as one of the important determine of corporate governance and firm performance. Competency can be defined as a specification of knowledge and skill and the application of that knowledge and skill to the standards of performance required in the workplace. Director's competencies are of paramount importance in every established organization and play integral role in the existence of corporate governance. The manners of dresses, speeches, receptions as well as corporate image of any firm workers are greatly influenced positively through directors' ability to portray the ability of competency. Where competency reign, discipline, respect for constituent authorities, well design and high output must be assured. In this situation workers feel free to execute their role with high enthusiasm which invariably increase day in day out the performance of the firms' productivity. Although director's competencies has been a subject of number of studies, particularly in developed countries. This issue has not yet fully explore in many countries. Therefore, the aim of this paper is to review the importance of director's' competencies on corporate governance. It is hoped that this paper provides some idea on the importance of director's competencies towards the enhancement of corporate governance.

KEY WORDS: *Directors' competency, competency, corporate governance, firm performance,*

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1.0 INTRODUCTION

Corporate governance can be viewed from an agency perspective. As long ago as (Berle, 1932) published “The Modern Corporation and Private Property in the United States”. The research work highlighted some of the problems that can occur when ownership of a corporation is separated from control of the corporation. For example, how do the suppliers of financing make sure that managers do not steal the capital they supply or invest it in bad projects? How do the suppliers try to ensure that the directors do not become too powerful, or use their power in ways that are not in the best interests of the corporation? Shareholder composition varies tremendously across the world. In the United Kingdom and the United States institutional investors have become very important over the last 30 years as their share ownership has increased and they have become more active in their ownership role. Institutional investors tend to have a fiduciary responsibility, the responsibility to act in the best interests of a third party generally the beneficial of the shares. Until recently, this responsibility tended to concentrate on ensuring that the investors invest in companies that not only were profitable but would continue to be so. This remains the case, Governments and interest groups have raised the question of how these profits are achieved. Why? Because corporate governance is fundamental to well run companies that have controls in place to ensure that individuals or groups connected with the company do not adversely influence the company and its activities and that assets or profits are not used for the benefit of a select group to the disadvantage of the majority. After all, corporate governance goes hand in hand with increased transparency and accountability, this increased transparency and accountability should, of itself, lead to a better flow of Foreign Direct Investment (FDI) and more stable financial markets.

1.1 DIVERGENCE UNDERSTANDING OF CORPORATE GOVERNANCE.

Corporate Governance is that it deals with the “relationship among various participants in determining the direction and performance of corporations” (Monks and Minnow 1995, p1). Corporate governance is the relationship among various participants [chief executive officer, management, shareholders, employees] in determining the direction and performance of corporations"- Monks and Minnow, Corporate Governance, 1995. Lex Donaldson (1990:376), defined corporate governance as 'the structure whereby managers at the organizational apex are controlled through the board of directors, its associated structures, executive incentive, and other schemes of monitoring and bonding'. This view was reflected by his colleague, a former McKinsey consultant, in *Strictly Boardroom* (Hilmer 1993).

The definition of corporate governance quoted above by Tricker (1994) is focused on the board room but extends the scope to include 'owners and others interested in the affairs of the company, including creditors, debt financiers, analysts, auditors and corporate regulators'. Such wider concerns reflect the audience for company financial reports, consistent with both Trickers' accounting background and the target audience for his publication. Monks & Minnow (1995) have an interest in 'relationship investing' as described by Monks (1994). Their definition of corporate governance is based on 'relationships' as quoted earlier. Monks & Minnow formed a commercial mutual fund

which they called 'Lens' to focus on under-performing corporations. As active shareholders they seek to add value to companies by relating to the boards of their investee companies as owners.

In a broader perspective corporate governance (CG) can be defined as the system by which companies are directed and controlled (The Cadbury Code, 1992). Since CG is a system CG usually deals with ways in which suppliers of finance to corporations assure themselves of getting a return of some profits and to ensure that managers do not steal the capital they supply or invest in bad projects (Shleifer & Vishny, 1986).

The OECD Principles of corporate governance (CG) described CG as a set of relationship between a company's management, its board, shareholders and other stakeholders. It provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. It should provide proper incentives for the board and management to pursue objectives that are in the interests of the company, shareholders and society as a whole, and should facilitate effective monitoring; thereby encouraging firms to use resources more efficiently. In Malaysia, the High Level Finance Committee on CG defined it as 'the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value whilst taking into account the interests of stakeholders'.

It has been contended that CG practices is not a standard mode (not a "one size fits all") and thus cannot operate in any standard form but rather vary across nations and firms (OECD 2000). This variety reflects distinct societal values, different ownership structures, business circumstances, and competitive conditions strength and enforceability of contracts. The political standing of the shareholders and debt holders, and the development as well as the enforcement capacity of the legal system is all crucial to effective CG (Gregory & Simms 1999).

Generally, effective corporate governance (CG) would reflect a number of important features. First, it promotes the efficient use of resources both within the firm and the larger economy. Second, it assists firms (and economies) to attract low-cost investment capital by improving both domestic and international investor confidence. Under circumstances of good CG practices, corporate assets will be used as agreed regardless whether that investment is in the form of debt or equity. Jensen and Meckling (1976) argued that rules and procedures are needed to protect the providers of capital. In this respect, business firms must comply with laws, regulations and expectations of societies in which they operate.

2.0 DIFFERENCE VIEW AND EXPLANATION OF COMPETENCIES?

Competence is a term that is subject to such diverse use and interpretation that it is impossible to identify or impute a coherent theory or to arrive at a definition capable of accommodating and reconciling all the different ways that the term is used. The common and accepted position is that if intellectual capabilities are required to develop knowledge and operationalising knowledge is part of developing skills, all are prerequisites to developing competence, along with other social and attitudinal factors. It could also be argued that people do not have competencies independent of context. Therefore competence is governed by the context in which it is applied, so worker and work form one entity through lived experience or work (Winterton 2005).

Competency can be defined as a specification of knowledge and skill and the application of that knowledge and skill to the standards of performance required in the workplace (Learning and Assessment Strategies 2003 ANTA). Competencies are common sense, specific competencies are not critical and an ultimate competency model exists (Ledford 1995). Competencies are seen as those universal qualities that enable individuals to perform their job outside their own national as well as organizational culture, no matter what their educational or ethnical background is, what functional area their job description represents or what organization they come from (Macbeth; Baruch, 2002; Evans *et al.* 1989). Competencies are defined as the cognitive (e.g. knowledge and skills), affective (e.g. attitudes and values), behavioral and motivational (e.g. motivation) characteristics and dispositions of a person which enables him or her to perform well in a specific situations (Ley, 2006; Boyatzis, 1982). (Kagire and Munene, 2007). Competency refers to a specific behavior and characteristics of a person that result in effective or superior performance. Boyatzis (1982) defines competency as an underlying characteristic of an individual that relates causally to effective or superior performance. Competence also refers to areas of work in which a person is competent, and competency refers to the dimensions of behavior lying behind the competent performance (Woodruffe, 1991). McLagan (1997) notes that competencies are products of analyzing jobs, and they link work, people and strategy for improving performance once they are generated.

3.0 DIRECTOR'S COMPETENCIES

Competent Direction is often about thinking rather than doing and should really understand the difference between being a professional, a manager, proprietor, shareholder and a director. Each of these roles can involve a particular perspective and certain responsibilities. People also need to be alert to potential conflicts of interest. To be effective, a director must command the respect of colleagues and be listened to. Development activities should focus upon shaping and demonstrating strategic alertness and perception, thinking, decision making, communication and inter personal skills. Individuals with directorial goals should make them explicit in performance reviews and development plans. Preparation requires an understanding of the business environment,

the specific company's situation including how its directors are selected, appraised, remunerated and developed, how its board operates and the contribution a new director is predictable to make. Multifunctional and business development experience, running a department as a profit centre and demonstrating contribution to the bottom line can all improve directorial prospects. Join up inter organizational team can widen a perspective, while serving on a multinational job force or undertaking an overseas assignment can advance an international perspective.

Director's competencies are of paramount importance in every established organisation either in traditional, medieval or modern firms. Such competences play integral role in the existence of corporate governance. The manners of dresses, speeches, receptions as well as corporate image of any firm workers are greatly influenced positively through directors' ability to portray the ability of competency. Where competency reign, discipline, respect for constituent authorities, well farism and high output must be assured. In situation like this, workers feel free to execute their role with high enthusiasm which invariably increase day in day out the performance of the firms' productivity.

3.1 THE IMPORTANCE OF DIRECTOR'S COMPETENCIES ON CORPORATE GOVERNANCE

In a more globalized, interconnected and competitive world, the way that environmental, social and corporate governance issues are managed is part of companies' overall management quality needed to compete successfully. Companies that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action or accessing new markets while at the same time contributing to the sustainable development of the societies in which they operate. Moreover these issues can have a strong impact on reputation and brands, an increasingly important part of company value."

Company boards of directors are bodies entrusted with power to make economic decisions affecting the well-being of investors' capital, employees' security, communities' economic health, and executive power and perquisites (Banks, 2004). Hence, boards of directors have the ultimate internal authority within a company (Renton, 1994).

The history of boards of directors came to the forefront of corporate life in the mid-eighteenth-century in Britain, when the state or the crown created them to ensure business stability (Tricker, 1984). Prior to that time, the only way to do business was as a sole trader or partnership. Within this simple structure, when a business became insolvent, the owner and family held all liabilities (Tricker, 2003). When the concept of joint-stock limited companies with separate legal entities between the owner and the company (called 'separation of ownership and control') was introduced, the owner or shareholders were able to elect a manager of a firm (Garratt, 1997). The owners of such firms were no longer responsible for managing their firm's operations on a daily basis. Rather, daily

operations were in the hands of the firm's team of professional managers (Taschler, 2004).

The progression from control by owners to control by managers was first analysed by Berle and Means (1932), leading to what has become known as the 'agency theory' (Jensen & Meckling, 1976; Fama & Jensen, 1983). Agency theory argues that the separation of ownership and control in modern corporations has resulted in a potential conflict of interests between the owners and their managers, in which managers may seek to act in their self-interest rather than the interest of the shareholders. Westphal and Stern (2007) added that in many instances firm managers could use their knowledge and managerial expertise to gain advantage over the firm's owner. Furthermore, Ezzamel and Watson (2005) argued that with growth in business size and complexity of operations, shareholders are not able to monitor their firm's managers. Abbas (1990) suggested that one way to resolve this problem is to align the interests of both shareholders and managers. To do this, shareholders need to appoint boards of directors to represent them to oversee the firm (Monks & Minow, 2001). Their appointment is based on the assumption that each of the board members is fully accountable for their actions on behalf of the owner (Garratt, 1997).

In the literature, most definitions see boards of directors as groups of individuals elected by shareholders of corporations to oversee companies (Abbas, 1990; Donaldson & Davis, 1994; Bainbridge, 2002, 2008; Abdullah, 2004; Kemp, 2006) and to ensure that the corporation is managed effectively (Young, Stedham & Beekun, 2000). Due to the important role of boards of directors in modern corporations, legal requirements for incorporation typically state that a board of directors is set up to meet specific legal requirements when acting on behalf of shareholders in the firm's decision-making (Ezzamel & Watson, 2005; Adams & Ferreira, 2007). Board members, therefore, carry out various legal obligations to perform their fiduciary duties² in the best interests of shareholders (Afterman, 1970; Andarajah, 2001; Sulaiman, 2001). Such duties include hiring and firing of the CEO and top management (Hermalin & Weisbach, 2002); providing strategic directions (Walt & Ingley, 2001; Kemp, 2006); and assessing resources (Hillman, Canella & Paetzold, 2000). In these ways, the board's success in discharging its duties directly influences shareholder values (Abdullah, 2004).

In the growth of reliance on boards of directors to bring stability to large businesses from the 1950s to the 1970s, boards of directors were not seen as a crucial part of the corporate governance process, because, at that time, the board was only part of a CEO's team (Banks, 2004). Earlier researchers (e.g. Mace, 1971; Vance, 1983; Monks & Minow, 1991) claimed that earlier boards were passive, compliant and unproductive, and made little contribution to a firm's strategies. Banks (2004) argued that these boards were often more for status than overseeing the welfare of the business. Board members also tended to be 'yes men' (Stiles & Taylor, 2001), generally providing 'rubber stamp' approval of virtually every matter requiring a decision (Banks, 2004). In this situation, CEOs played the dominant role in company decision-making (Hamilton, 2000). This pattern remained relatively unchanged until an awareness of corporate governance began to develop in the 1970s. In the years following the above developments, boards of directors have become increasingly complex. Many scholars have argued that globalisation of economies and

rapid advances in information technology have presented potent challenges for boards (Conger, Lawler III & Finegold, 2001; Cadbury, 2002; Keil & Nicholson, 2003; Carter & Lorsch, 2004). For example, Conger et al. (2001) and Dalton and Dalton (2005) felt that globalisation has led to sharp increases in the numbers and types of businesses. This has now led to many boards facing enormous challenges in dealing with their global business and operating in diverse governance and cultural situations (Gevurtz, 2002). For example, Arewa (2005) stated that the new corporate culture was also relevant in shaping how boards of directors confront the challenges that a particular business environment may pose. Although their links to a corporation may be remote, they still have to protect the long-term competitiveness of their company (Alfonso, Jikich & Banez, 2005).

In addition, rapid advances in information technology and the Internet have changed the business environment (O'Brien & Robertson, 2009) and the roles of boards. For example, the Internet has become a major business tool, which makes the timeframe for decision-making shorter and faster (Wilson & Lombardi, 2001). As a result, Conger et al. (2001) urged that speed in action is critical to the effectiveness of the board. At the same time, as more corporations use the Internet to disseminate their financial information, the public is now able to gather more information about corporate performance (Xiao, Jones & Lymer, 2002). The ease of access to Internet stock trading has thus enabled more individuals to become shareholders of corporations (Taschler, 2004). This has led to many corporations having large and diverse types of shareholders. In effect, company governance has become more complex than ever before. In these ways, information technology has changed the functions of boards, creating situations that have never been faced before. Banks (2004) argued that if boards are unaware of the impact of technology development, especially concerning the technical aspects of business, they are unable to query or challenge company management effectively.

Given such unprecedented change, many scholars assert that demands and expectations are increasingly being placed on boards of directors, especially in assessing corporations dealing with massive transformations in a global economy (Hillman, Keim & Luce, 2001; Ingley & Walt, 2003). These impacts were discussed earlier by Garratt (1997) in his book *The Fish Rots from the Head*. He urged that in the new business environment, board roles extend far beyond taking care of shareholders' interests. The board instead has to be:

1. A driver of company business while keeping it under prudent control;
2. Sufficiently knowledgeable about company activities;
3. Sensitive to various pressures; and
4. Focused on the commercial needs of the company while taking care of other stakeholders including employees, business partners and society.

In consequence of this argument, Carpenter and Westphal (2001) maintained that the persistent challenges faced by boards of directors today are to bring meaningful contributions to corporate strategy and performance. Stiles and Taylor (2001) argued that boards today are called on to choose strategic and tactical initiatives to address emerging opportunities and challenges under circumstances in which the ultimate outcomes of decisions are largely unpredictable. To face these new challenges, boards will need to include individuals with requisite skills of a world-class standard (Coulson-Thomas, 2008). For example, in an earlier study Moran and Riesenberger (1994) suggested that in

global economics, leaders should have a global mindset and diverse backgrounds. These include: having a long-term orientation; facilitating organizational change; creating learning systems, motivating employees to excellence; negotiating conflicts; managing skillfully the foreign employment cycle; leading and participating effectively in multicultural teams, understanding their own values and assumptions, accurately profiling the culture of others, and demonstrating knowledge of, and respect for, other countries. Hence, it is becoming clear that boards of director characteristics of the past will no longer be adequate in today's environment. Rather, the emerging business environment now demands a new set of leadership skills that require various leadership competencies and which are realigned towards the future of the company (O'Brien & Robertson, 2009)

3.2 THE ERRAND OF BOARD OF DIRECTORS

The Board of Directors is elected by the shareholders, and its primary responsibility is to oversee the management of the Company to ensure that the interests of the Company and its shareholders are served. Directors will provide guidance to management and exercise their business judgment in what they believe to be the best interests of the Company and its shareholders. Directors will perform their duties in good faith and with that degree of care which an ordinary prudent person in a like position would use under similar circumstances.

Directors must comply with the Code of Ethical Business Conduct and the Officer Code of Ethics of the Company.

- A.** Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.
- B.** Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.
- C.** The board should apply high ethical standards. It should take into account the interests of stakeholders.
- D.** The board should fulfil certain key functions, including:
 1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
 2. Monitoring the effectiveness of the company's governance practices and making changes as needed.
 3. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
 4. Aligning key executive and board remuneration with the longer term interests of the company and its shareholders.
 5. Ensuring a formal and transparent board nomination and election process.

6. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
 7. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.
 8. Overseeing the process of disclosure and communications.
- E.** The board should be able to exercise objective independent judgment on corporate affairs.
1. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination of board members and key executives, and board remuneration.
 2. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.
 3. Board members should be able to commit themselves effectively to their responsibilities.
- F.** In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.

4.0 CONCLUSION

Director's competencies are of overriding significance in every established organisation either in customary, prehistoric or modern firms. Such competences play fundamental role in the existence of corporate governance. The conducts of dresses, speeches, response as well as corporate image of any firm workers are greatly influenced positively through directors' ability to portray the ability of competency. Since the board of directors are the agent of the shareholders have been identified as the key corporate governance control mechanism, though an internal one, it is only appropriate that board effectiveness should be an area where more research on its roles, functions and organisation should be further to be effective, they need capable directors (both executive and non-executive directors including those that are truly independent), with good leadership and high ethical standards.

However, where competency reign, discipline, respect for constituent authorities, well devise and high output must be assured. In situation like this, workers feel free to execute their role with high enthusiasm which invariably increase day in day out the performance of the firms' productivity.

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