Movements in the Long White Cloud of Governance

Shifts in Attitudes to Governance in New Zealand

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ABSTRACT

This research interrogates a large population of shareholders, senior managers and company directors in New Zealand as to their reasons for considering board service, their competence in governance skills areas, their beliefs as to whether board room diversity is needed and their firms' interests to recruit further independent directors to their boards.

With a considerable deference to the contributions of agency theory as the conventional cornerstone to explain the connection of directors into organizations for the purpose of governance service, this work explores the extension of agency theory by adding an additional driver for governance engagement by company directors: Commitment. Based on this research, company directors in New Zealand appear to base their interest in serving as independent directors on company boards largely on the desire to "do good". This raises the prospect of a deeper and more meaningful relationship with firms where they serve as directors. Ignorance of this important component of the director/firm relationship by the firms might render directors less willing to contribute and deprive firms of the strong support and engagement of their directors. Lack of recognition of this additional component to the fabric of an enduring committed relationship between external directors and their firms may require a different behavior of firms during the recruitment, board induction training and maintenance of the director relationship.

While the strong expression of interest by SMEs in additional independent directors is a welcome sign of rising governance standards in New Zealand's large group of such enterprises, concern emerges about the potential lack of competence by directors in several areas of governance. While directors appear to compensate for deficiencies in skills with an extra dose of commitment, significant needs for upskilling exists in this sector. It is noted that the absence of well-established, easily accessible and comprehensive director training schemes in New

Zealand conflicts with the expected large number of additional independent director recruitments in the near future.

Shareholders, senior managers and directors report a need for diversity on boards in the area of business experience, but no specific concern is expressed as to how any specific importance of gender or age while other factors, such as work experience and global knowledge, are of much greater interest. This could indicate that the status quo of only a small number of women on boards in New Zealand is accepted, but in the context of this work more likely indicates that directors will not be recruited (or excluded from recruitment) in the future on the basis of gender.

This research attempts to lay groundwork for a more intensive investigation into the true motivations of company directors when they think of an independent director mandate and while they discharge directorship duties. There now appears to be solid evidence that the historic application of agency theory does not completely describe the factors of motivation and relationship under which independent directors serve on company boards.

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CHAPTER 1: Introduction, Problem Statement and Research Approach

1.1. Background to this Research Work

In September 2008 the New Zealand economy, in common with others far bigger and significant, experienced a downturn, pushing some firms into liquidation and others into severe downsizing mode (Tosi, 2009). There are many hypothesised causal factors for this situation, but it cannot be denied that corporate governance plays a key role in a firm's success or demise particularly during such challenging times (George, 2010). Thus, researchers are inclined to view corporate governance through a critical lens focused on how corporate governance impacts upon the market growth, profit maximisation and sustainability of a firm.

Adding to the complexity of the current and future picture and further adding to the relevance of this research, governance of companies large and small in New Zealand is changing: "between 1995 and 2010, the average board size of NZ firms fell slightly, while the board representation of non-executive, independent and female directors all rose, as did the propensity of firms to establish separate audit and remuneration committees. Real chair and director fees rose sharply, especially in large firms." (Boyle and Ji, 2011, p.19). This indicates a shift in composition of directors which needs an illumination as to rationale. For instance, is there a shift to a different set of expertise or is there a desire to change diversity? Do independent directors join as 'agents' for the shareholders or for other reasons?

One of the most important aspects to good corporate governance is, no doubt, an effective Board of Directors. A prevailing view is that in order to be effective, a board should be populated by 'independent' directors although that in itself does not greatly assist any judgment of effectiveness. To better understand what makes a board effective, it is useful to understand what makes it 'tick': Why the members are there, how they got there and how they function. This work asks, among other questions, why independent directors would join a company board and contrasts

the responses with those offered by established theories, i.e. Agency Theory, that presume a certain set of legal constraints within which company directors discharge their duties.

In this case, my experiences during many directorships, Crown appointments, and leadership assignments to 'rescue' firms from poor leadership and governance in Europe, the US and New Zealand, have shaped the belief that the motivations, skills and attitudes of independent directors are not always properly understood, especially in small and mid-size firms, where independents might serve alongside founders, owner/operators and large shareholders.

It seemed to me both unrealistic and unsupported by practice that independent directors served solely on the basis of a tightly framed legal construct of agency theory to exclusively represent the interests of shareholders. When combined with the generally low pay of directors in New Zealand, many of whom serve without compensation on boards of companies owned by friends, or reflecting on the many thousand non-profit organizations in New Zealand where directors are generally under-/unpaid, it appeared that there were gaps in our understanding as to why company directors agree to serve. A compounding factor is the possibility of prosecution and personal asset forfeiture when directors allow their firms to trade while insolvent, combined with the negative exposure of a small-country media frenzy that makes it virtually impossible to escape from past failures at Feltex, South Canterbury Finance and Blue Chip.

Under these circumstances, it is puzzling as to why seasoned business people with huge corporate credibility would risk their reputations and agree to serve on a board. During interactions with fellow directors in New Zealand it became apparent that they often believed they operated for some nebulous and undefined higher good, sometimes directed at the firm as a whole and at other times incorporating external and internal groups of stakeholders as their 'principals'.

All these factors shape one of the two main problem questions to be addressed in this research: What motivates an individual to agree to serve on a board of directors, and is that motivation truly captured by a strict legal relationship between the board and the company?

In addition, there a broader issue is worth considering: Whether the Anglo-American big corporate model rules are appropriate or relevant to the wide diversity of company types, character and size in a country like New Zealand. Different cultures have different governance approaches and therefore literature based solely upon experiences with large publicly-listed firms in large countries may not be easily transfer into small country where the majoerity of firms are unlisted and thus regulated to a far lesser standard.

With fewer than 200 firms publicly listed in New Zealand, the usually heavily regulated large-firm market represents only a small portion of all firms in the country. It is characterized by monopolies or duopolies in many sectors, where very few large firms hold a commanding market share. This implies that public regulation catches only few businesses and thus may be relatively ineffectual in changing the approach to governance and accountability of firms.

The highly regulated and often widely publized governance approaches to the public sector entities reaches through the country and deeply into the smallest businesses, usually into non-profit firms supported by Governemnt or funded through Government-sponsored entities, such as health boards. Often the first organizations to publish performance data in new formats, such as the Triple Bottom Line approach to accountability, to mandate gender equality hiring and actively manage diversity on boards, sets standards throughout the country, although not necessarily through binding legislation. With the power of the public purse cascading financial support from the Government into the private sector, usually through contracts for infrastructure, non-profit work, and services of all kinds, government influence extends to the reporting quality of supported firms, their board composition and the demonstration of skills through performance

requirements under state contracts. This places the government in a position where it could indirectly change standards of performance in firms that are receiving state support. This happens in some situations, e.g.. where health boards mandate reporting from contractors that delineates governance structures and oversight, but is an under-utilized feature of government spending. In a largely deregulated economy where the Government crows over how easy it is to do business in New Zealand, it is unlikely that greater regulation will be imposed on the large number of non-listed firms in this country.

This research is limited to the unique corporate setting in New Zealand where a large number of the many SMEs are focused on agriculture, often as family-controlled firms, contrasted by the relative few 200 or so publicily listed businesses and several other large privately held firms. Although a large number of respondents in this work describe their experiences in SME-size businesses, the contributions from executives and directors in publicly traded firms, large businesses, government-affiliated enterprises and non-profit organizations, are valuable to review the current state of governance throughout the fabric of New Zealand's economic activities. Especially the public sector, involving itself in most activities of life in New Zealand and often funding hundreds of non-profit entities for related activities, plays a huge role to set in motion the implementation of new approaches to historic views on governance, i.e. the reporting of Triple Bottom Line activities, the mandatory reporting of female representation on boards, and the mandatory disclosure of a 'diversity plan' for future governance roles.

The number of SMEs in New Zealand has dropped for the first time in 2011 (MED, 2011), but is still the single largest sector of the economy, by value-added output. In this source, the definition of SMEs includes firms up up to 19 employees, still producing aboput 40% of the country's value-added product and employing 31% of the labour force. Eroding margins due to a high New Zealand Dollar appears to have affected the viability of several small business that folded after their export-focused enterprise model was no longer financially viable. With intensifying competition both within New Zealand and from foreign-based competitors, the

health of SMEs is an important consideration as New Zealand powers forward to try to achieve an enviable GDP growth rate of more than 3% in 2014/2015, unachievable for most other OECD countries.

In addition, New Zealand is home to a large number of SMEs, making it somewhat unusual among most industrialised countries with similarly high per capita incomes. In many industries, a few large and dominant corporate players participate with a myriad of these small entities in fragmented markets. Publicly mandated governance standards usually do not apply in these smaller enterprises, and commingling of interests between owners and managers is common.

The large majority (89%) of New Zealand's firms employ five or fewer people (Battisti, Lee and Cameron, 2009), and in New Zealand between 98% and 99% of businesses are SMEs, many of which are family businesses. Surveys tend to suggest that in around 25% of family firms, children work in the company, and firms often employ siblings and/or other relatives (Battisti, Lee and Cameron, 2009; Lawrence, Collins, Pavlovich & Arunachalam, 2006). An overall 89% of these employ five or fewer people (Battisti, Lee and Cameron, 2009).

The largest number of SMEs cluster in the larger population areas, such as Auckland, Canterbury (Christchurch), Waikato (Hamilton) and Wellington, where there should be a sufficient level of resourcing available to strengthen governance – if that was desired. With the majority of SMEs being less than six years old (MED,2011), while larger enterprises being significantly older, the question arises whether these 'young' firms have grown sufficient talent to lead the business into a successful future. With a drop of high-growth enterprises (defined here as "Those enterprises with 10+ employees and average annualised growth greater than 20 percent over a three-year period"), an especially important group of firms with the potential to create new high-value jobs, learning and competitive stamina for New Zealand, comes the reflection whether better governance, long-range strategic planning and leadership resourcing would have kept some of those firms alive.

Yet even for such SME businesses and despite the lack of any legal imperative, there would appear to be significant interest in appointing independent directors. The emerging strong demand by SMEs in New Zealand for independent directors demonstrates that businesses can indeed articulate their own preferences to create more independent boards – and have begun to do so (Mueller, Dana, Rennie and Ingley, 2010). This interest in independent directors requires the consideration of both sides of the fence: From a perspective of prospective directors: Why would they wish to join a board? and from the viewpoint of firms: Do independent directors add value? The former connects to a discussion of theories under which directors are supposed to discharge their duties, contrasted by findings here what truly drives directors. The latter raises the matter of what expectations companies have of independent directors and what skills and transferable experiences are most desirable for shareholders and sitting directors, when looking for fresh blood around the board room table.

With the extensive participation of senior-level managers in the leadership and governance of non-profit entities in New Zealand, where glory and monetary rewards are largely absent, the presumption emerges that other motivations must be in play here to engage the interest of these leaders. To test this paradigm shift from a dutiful servant director to an engaged one passing on the trappings of pay and recognition in lieu of some other satisfaction, this work will ask prospective directors for an extended set of motivations to join boards.

It appears illogical that prospective directors, presumably executives in their own right with experience in business matters, would all want to join company boards for the same reasons, like iron filings snapping into one direction only when touched by a magnet, based on our current view of the formal, legalistic and narrowly defined theories of governance. It is much more likely that these seasoned performers have formed their own views on how and for which outcomes they wish to contribute on boards. It is important then to identify what such factors might be so that suitable conditions can be created both to nest-in

directors at the board level but also to create a pool of candidates with the matching sets of skills.

It would appear that these independent directors are not only sought in order to fulfil a control function but also, and perhaps more importantly, provide SMEs with good quality advice on growth strategies (Read, 2007), and key skills those SMEs are otherwise lacking. Given this, it is relevant to establish whether the message has been received by shareholders and directors of SMEs in New Zealand in general and whether they plan to act on it. More particularly, how can firms in this nation of 'micro' businesses' (Devlin, 2004, p.22), effectively connect with independent directorship talent?

Therefore, it is worth asking whether governance in New Zealand (a) demands a different empowerment structure for directors, (b) is more demanding regarding the qualifications and skills directors must bring to the firm, and (c) looks for independent directors to meet skills gaps? This research then proposes that a new theoretical model might exist, in which 'commitment' by directors to their firms is a central element.

A further question then become relevant: What factors do SME owners and directors consider when planning the inclusion of independent directors on their boards?

Specifically, this research attempts to answer the following questions:

1.1.1. What is the motivation of independent directors to serve on a company board in New Zealand?
1.1.2. Do independent directors contribute positively to company boards in New Zealand?
1.1.3. Are independent directors sufficiently qualified to discharge their duties as company directors?

1.1.4. What are the characteristics and qualities of a 'desirable' independent director?

1.1.5. Are New Zealand companies looking for additional independent directors?

This work attempts to explain a perceived gap in the understanding expressed in the conventional literature about the foundations for the association of independent director with their firms, and the reality that many directors appear to serve more than a legal guardianship role on behalf of shareholders. As there currently is no widely accepted alternative theory under which such extended motivation of independent directors is defined, this research lays the groundwork for a more thorough investigations into the boundaries of the application of conventional agency theory – and the possible exploration of a frontier beyond.

1.2. Research Approach

Mindful of the range and complexity of the present body of research into corporate governance, this research applies a canonical development approach (Hindle, 2004) that involves use of the 'canon' of learning (or the authoritative statements of knowledge) for a particular discipline area as a reference point for the development of new knowledge or perspectives. It is based on the construction of hypotheses that flow from the problem statement and are interpreted in the context of a detailed literature review into director motivations and theories of engagement.

Data is drawn from responses to a survey administered to several thousand shareholders, senior managers and directors in New Zealand, in-depth interview responses and survey replies by directors of several firms in New Zealand, and the responses to interview questions of candidates for ministerial appointments to District Health Boards in New Zealand.

Quantitative and qualitative analysis has been carried out on the data. In particular, detailed in-depth validation surveys have been conducted to confirm the findings of the large survey sample population, and the findings have been analyzed to support or not support the research assumptions.

1.3. Overview of the Work

In order to reach a wider audience, this research presents by way of background in Chapter 2, an introduction to the concept of corporate governance and how and why the principles have been developed and adopted. This is followed in Chapter 3 by an overview and justification of the principal theories that have been applied to describe corporate governance practices (the descriptive function) and to evaluate their effectiveness (the normative function).

Chapter 4 provides more detailed and specific focus for the hypotheses explored through the empirical research; locating and justifying those hypotheses in a theoretical framework. Specifically, this chapter focuses on the board and its (assumed) dual role as shareholder-representative and management-monitor. Further, it explores the meaning and justification for independent directors, their motivation, skills and their selection.

Chapter 5 introduces and describes the empirical research conducted into the motivation of directors and the demand by firms in New Zealand while Chapter 6 reports on the findings from this research. Finally Chapter 7 offers some conclusions emerging from this research and avenues for future research.

CHAPTER 2: Governance Background

2.1 Introduction

Up to relatively recently, corporate governance tended to emerge only in the academic sphere: "a relatively obscure concept with narrow legalistic connotations" (Seal, 2006, p. 389), or an arcane and economic theory-driven line of research that was, for most practical purposes, largely irrelevant. How times change: Seal (2006) cites Gordon (2002) in support of his point that it was not until the revelations during the Enron meltdown of widespread problems and criminal and negligent behaviour that serious doubts were raised over the value of the 'myths' (Seal, 2006, p. 390) of governance that were routinely taught at Universities: …auditor independence… "Chinese walls"…and "efficient" capital markets' (Seal, 2006, p. 390).

Thus it is arguable that it is the intensified discussion of governance in the populist media since the turn of the century that has blurred the theoretical underpinnings of the governance theories, and which has tended to pillory directors as parties responsible for every corporate failure, including those involved in the sub-prime finance sector in New Zealand.

Therefore, to gain an understanding of the principles and roles of corporate governance, it is vital to move beyond the populist view of accusation and fault to explore it and its theoretical underpinnings. First, what is corporate governance?

A recent (and broad) definition is given by Colley, Stettinius, Doyle and Logan, (2005, p.5), "Today, the public corporation itself operates as a form of representative government. The owners (shareholders) elect directors as their representatives to manage the affairs of the business. The directors, who as a group are referred to as the board of directors, then delegate responsibility for actual operations to the Chief Executive Officer (CEO)/Managing Director (MD), whom they hire. The CEO is accountable to the board of directors, which,

collectively and individually, is accountable to the shareholders. In addition to its role in selecting the CEO, the board also advises on and consents to the selection of business and strategies of the firm, as well as oversee results. In sum, this system of authoritative direction, or government, is known as corporate governance."

More commonly and tersely, however, corporate governance is defined as "a set of relationships between a company's management, its Board, its shareholders and other stakeholders…also providing the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined" (OECD 2004, p.11). If an important aspect of this definition is 'a set of relationships' then one should ask how such relationships are supported, key objectives attained and performance monitored?

There has been a growing interest in corporate governance in the last decade (Tosi, 2008). The many recent bankruptcies and liquidations have highlighted the fact that there is no explicit contract to protect the interest of owners. Instead the interests of owners lie largely in the hands of managers (Heath, 2009). The well-publicised downturns of purportedly stellar organizations worldwide, from Enron and WorldCom in the USA, Siemens in Germany, Satyam in India, San Lu in China through to South Canterbury Finance Corporation, Feltex Carpets and Crafar Farms in New Zealand has fed this growing interest in corporate governance and the accountability and importance of directors. Many of the arguments now proposed for a greater focus on governance were advanced long before these high-profile cases emerged, but governance has now moved to a more central role when debating firms' performance and leaders' accountabilities in the future. Aside from the popular headline-grabbing discussion, e.g. for Feltex in New Zealand (Gaynor, 2010), or what individual directors did or did not do to advance their firm's fortunes in the case of the many failed finance companies around New Zealand and the criminal convictions for some of their directors, it is clear that directors occupy a central position in the development of long-term strategies for a sustainable future of enterprises.

However, it is important to distinguish between corporate governance per se and good corporate governance. As can be seen from such examples as Enron, Ansett and Parmalat, the term 'governance' is value-free. All these companies did have governance mechanisms in place: they all proved unequal to the task of achieving long-term firm performance in their particular contexts. The question then is: what constitutes good governance? Some indication can be gleaned from the following discussion.

For many years, legislation around corporate conduct stipulated direct and/or indirect compliance requirements for businesses in many developed countries. These have increased in number since the accounting scandals at the beginning of the millennium (Abdel – Kahlik, 2002; Benston and Hartgraves, 2002). Relevant legislative measures implemented by various jurisdictions have included adjustments to the auditing process, refinement of financial reporting standards, strengthened internal managerial controls, monitoring of compensation packages and development of online security and other technology standards (Bhimani, 2008). In 2002, Canada's Ontario Securities Commission passed Bill 198 aimed at achieving "better corporate governance" (Ferris, 2007, p. 31). Generally, the requirements of corporate governance legislation are aimed at encouraging ethical corporate behaviour.

Often, corporate governance addresses business practices are designed to protect the interests of passive shareholders (Aguilera and Jackson, 2003). In fact, the protection of owners/shareholders interests is often woven into the definition of good corporate governance: "If we follow the traditional Anglo-American conception of the firm as a device to further the well-being of its owner-shareholders, good governance is a matter of ensuring that decisions are taken and implemented in pursuit of shareholder value" (Keasey, Short and Wright, 2005, p. 2).

Most particularly, the degree of separation of ownership from control of the firm is frequently seen as an indicator of good corporate governance (Tosi, 2009), with

a too-close relationship seen as potentially impacting a firm's profitability due to conflict of interest (Clark, 2009). Further, where the principal director or governing body (board) does not own the firm, the owner(s) must trust not only the firm's management to act in their best interests, but also the directors. Unfortunately for business owners, this is not always the case, hence there can be tension between shareholders and boards (Shleifer and Vishney, 1997). Therefore, even for SMEs it is important to identify an appropriate and robust model for good corporate governance that will address issues of conflict and tension. As demonstrated by the historical literature, this search is by no means a recent imperative.

Berle and Means (1932) argue that a separation between a firm's owners or investors and a firm's managers has significant positive implications for industrial capitalism. As firms increased in size with the advent of modern communication and manufacturing technologies, operating costs fell. As a result, many firms increased in size and scale (Coase, 1937). Further technological advances allowed for machine-based mass production, and firms' outputs increased, causing the size, scope and scale of firms to grow even more (Clark, 2009). To address these increases in size, scope and scale, managerial organisations tended to employ a vertical integration business strategy. As a result businesses became driven less by market forces and more by administrative structures and managerial coordination (Clark, 2009). Increasingly, managers were allotted more decision making power and business owners and equity holders trusted managers to act in their best interests.

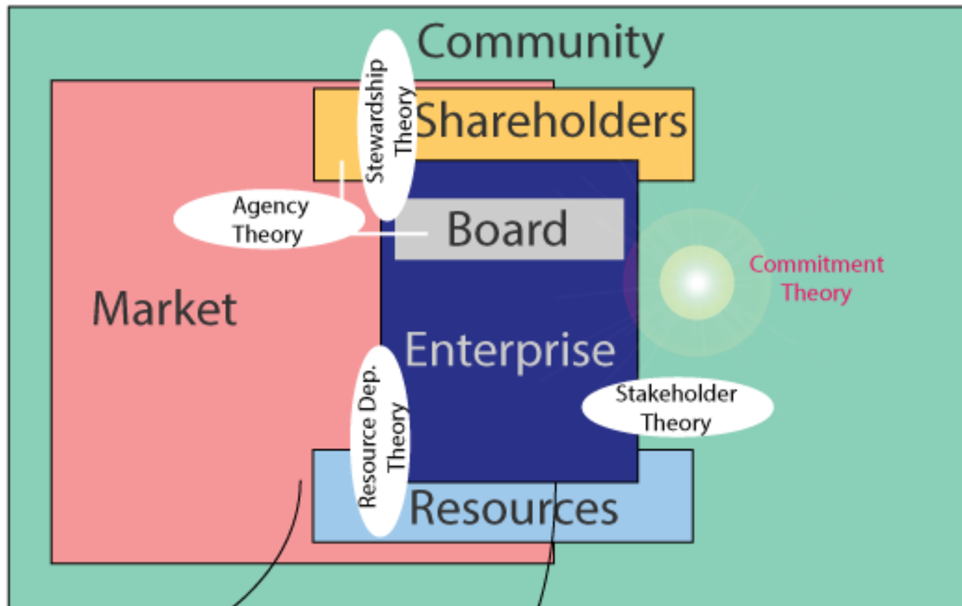
However by the late 1950s, business theorists began to notice a divergence in the behaviour of managers and the expectations of business owners and equity holders as to how those managers should behave. Galbraith (1952; 1967) described that the aforementioned developments led to businesses competing for market share instead of profit maximisation. This was a direct result, he claimed, of managers being allowed more discretionary decision making. Baumol (1959) stated that managers measured business success in terms of growth in market share, whereas

owners measured success through sales revenue and profit maximisation. Accordingly, Marris (1964) and Williamson (1964) argued that long-term growth of a firm was the management's priority, as opposed to profit maximisation. Managerial priorities could also include reputational success, job security, industry profile and other perks (Jensen and Meckling, 1976). (It is noted that absent from such priorities it is the now-prominent focus on sustainable operations that would bestow benefits on both operators and owners of firms and likely establish a more long-term valuation of a firm's success.)

Through effective governance strategies, owners seek to limit managerial 'opportunism' and prioritise owner and equity holder interests that may have inherent conflicts due to differences in their prioritization of long-term stakeholder interests. A key strategy to marginalise potentially overbearing self-interest of management is for there to be a board of directors to represent the owners' interests, and instruct and evaluate management performance (Jensen and Meckling, 1976; Fama and Jensen, 1983 as cited in Cocks, Rennie, Ingley and Mueller, 2010). It should be noted, however, that a firm's owners may not be in one accord in terms of their priorities and interests (Cocks et al., 2010). Therefore, in their paper, Cocks et al. define the relationship as one where a group of heterogeneous owners, each of whom may have conflicting interests and priorities, entrusts the firm's success to a managerial body. Thus, it is even more important that governance strategies are put in place to protect the interests of not just single owners but also multiple owners, each of whom may have somewhat different interests.

On the basis of the various theories to describe governance as a part of our society, this work tests for the presence or absence of specific ingredients effective boards might need to improve performance. It recognizes that directors are drawn into their roles and then perform due to varying, and sometimes conflicting theories, none of which has proven to cover governance exclusively.

It then follows that various ingredients contribute to effective governance and board composition. This work tests whether some of these ingredients exist and to what extent they might affect the formation of our boards in the future:



Board

Enterprise

Objective	Test
Diversity	H2,3
Motivation	H1
Level of Skill	H4,5
Type of Skill	H6,7
Recruitment	H8

The following section provides an overview of governance as part of a functioning corporate society where organizations are governed effectively. There is a particular emphasis on the origins of our current understanding of what 'good governance' constitutes.

2.2 Good Governance and its Role

This definition of good governance is greatly influenced by US formulations of the term and there has long been driven by concepts of agency theory. This in turn raises the issue of the extent to which these governance-related rules are an appropriate fit for the rest of the world. It is perhaps relevant at this point to state that best practice standards of corporate governance in New Zealand tend to be heavily influenced by what is considered as best practice overseas, particularly the UK and the US, and by the OECD Guidelines on the subject (most recently revised in 2004). Therefore, principles of the UK combined code, the Sarbanes-Oxley Act (US) and the OECD guidelines find their way into current literature on corporate governance in New Zealand. In addition, (as will be discussed at some length a little later) US definitions of corporate governance are based upon agency theory and managerial capitalism and are largely occupied with structuring governance codes of practice to ensure that managers act in the interest of the owners and shareholders rather than pursue their own best interests (Shleifer and Vishney, 1997).

The following section introduces the historical background of governance standards and, due to the OECD standards commonly applied to economic activity in New Zealand, a discussion of the OECD principles and other sources that have shaped the framework.

In 1991 in the UK, the Financial Reporting Council, London Stock Exchange and the accountancy profession moved to address low levels of confidence in financial reporting, control and standards and investor disillusionment after some enormous

and unexpected company failures. These included that of the Bank of Credit and Commerce International (BCCI) that failed owing billions after an international investigation into lending practices and lack of regulation of its activities, the Maxwell group of companies where investigations revealed millions of dollars worth of fraud and misappropriation of pension funds and Polly Peck Ltd where for years financial records had been falsified. Consequently they set up a committee headed by Adrian Cadbury to report on how to improve corporate governance practices. This committee's report (Report of the Committee on the Financial Aspects of Corporate Governance (the Cadbury Report, 1992) included a range of recommendations, the most important being the inclusion of independent directors principally to fulfil a control function in relation to decisions being made by the executive directors (Cadbury, 1992, p.21). As Jones (2003, p. 4) explains, this report was just the first of a series of reviews and studies of corporate governance in the UK but was probably the most important in establishing the approach to the issues not only for the UK but also internationally that lasted for more than a decade. In the UK, the recommendation of the Report was for a voluntary code. The Hampel committee followed in 1998 with a recommendation that the Chairman of the Board should act as a leader of the non-executive directors but did not alter the approach engendered by the Cadbury report.

However, by 2002, scandals, including those of Enron, World Com and Tyco, put the issues of corporate misfeasance back into the sights of regulatory bodies in the UK. As the root cause for many of these was identified as poor corporate governance practices the Government initiated another report (the Higgs Report, 2003) that, while supporting the maintenance of the "comply or explain" (Pass, 2008, p. 291) approach instigated by the Cadbury Report, also advocated that Boards should be responsible for ensuring a proportion (at least 50%) of members are independent. Although there was some criticism that these recommendations were overly prescriptive (Jones, 2003, p. 8), they were incorporated into the combined code in time for the 2003 reporting year (FRC, 2003). Through all its revisions since 1998 (the main ones being in 2006 and 2009 with a renaming as the Corporate Governance Code (FRC, 2010)) the Code continues to draw on the

main tenets of the Cadbury Report, the Hampel Report and the Greenbury Report (1995, on Directors' Remuneration) and requires listed companies to disclose and justify how they formulate and structure corporate governance. The overarching principle behind the combined code is that there should be "a sound system of internal control to safeguard shareholders' investment and the company assets" (FRC, 2006) with few changes to approach or criteria (FRC, 2010, p.12-13).[1]

In 1999, and after examination of relevant practices and legal provisions in place in various member countries, the OECD published its first set of principles and guidelines for good corporate governance (OECD, 1999). These have been revised with a second version produced in 2004. These principles are described and analysed in terms of potential effectiveness for governance and company performance and, by way of illustration, mention is made of legislative instruments or provisions that reflect these principles in some way.

According to the OECD (2004) corporate governance has two principal purposes: to improve economic efficiency and growth (the macro effect) and to promote improve investor confidence at a company or firm level (the micro effect). In the preamble, the OECD explains the intention of the document: to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance' (presumably 'good' being a value to be conferred where the relevant structures and institutions achieve the desirable outcomes of shareholder and stakeholder welfare). It is arguable that corporate governance is only good where the processes, expectations and rules maximise the benefits that emanate from the range of relationships between the corporation and other interests (the range of whom depending on the theoretical construct) (effectiveness). The benefits should be greater than the costs of delivery – only then is the corporate governance regime efficient.

[1] It is important to note that this code refers to non-executive directors but clearly includes independent ones.

To this end, the document identifies and details six principles that should guide crafting and evaluation of corporate governance regimes. One of these applies on a national (macro) level (and therefore acknowledges the enabling function of political institutions) and the others on a firm or micro level. The next sections of this paper address these principles in turn and assess the extent to which they have been considered to contribute to the achievement of good corporate governance and thence maximum corporate performance. However, as a cautionary note, although they are discussed separately, there is a considerable degree of commonality and cross-relationship.

The first principle (the macro) addresses the design, emphasis and focus of the legal and quasi-legal rules that apply to all corporations in a specific jurisdiction.

> 'The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities' (OECD, 2004, p.17)

It is important to note that this principle assumes that legal rules have a role to play, ranging from setting the ground rules to specific prescriptive expectations of behaviour or performance (Maher and Andersson, 1999). A prevailing imperative is that they be both clear and market-orientated. However, market failure has been identified as a strong argument in favour of policy intervention (Maher and Andersson, 1999). Therefore, while advanced economies such as the United States and Canada might have relatively light-handed regimes (that enable rather than control) others, particularly developing nations, may have far more mandatory or proscriptive rules (Harriss et al., 1997).

Does this principle advance firm performance? Because it is at a macro rather than a micro-level the framework applies to all companies and therefore it could be

argued that the direct link to company performance is lacking. However, what is important is the implicit and explicit emphasis on 'transparent and efficient' (OECD, 2004, p.17) markets and compliance with the 'rule of law'. These emphases strongly suggest that market distortions such as bribery and corruption and other unethical and illegal management practices should be controlled or forbidden by the regulators. This in turn has potential implications for companies where management or the board takes steps to avoid the possibility of legal action or adverse publicity by controls and/or the creation of a compliant corporate culture. With fewer resources expended by the board on the proscriptive function, it is more likely that social benefit (the macro effect) will be maximised and that a broad range of investors will have confidence that their investment is safe (micro effect).

In addition, the legal framework sets general rules for behaviour and structure at the company level. Obvious examples include the determination of general and specific duties for directors (discussed below) and accountability to shareholders (also dealt with below). These have implications for the other four principles.

Finally, this principle refers to the division of responsibility between the supervisory, regulatory and enforcement bodies. The concept of 'separation of powers' is a constitutional concept: the idea that the division of responsibilities between the legislative, executive and judicial functions of Government is necessary to ensure the legal system is robust and consistent, providing a system of checks and balances. This part of the principle reflects this concept and implies that companies and society would benefit from a legal regime that was clear, consistent and fairly enforced.

The next two principles are discussed together as they both refer to shareholder rights.

> "The corporate governance framework should protect and facilitate the exercise of shareholders' rights" (OECD,

> 2004, p. 18). "The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights." (OECD, 2004, p. 20)

The first of these two principles addresses the issue of protecting shareholders rights, including the right to purchase and sell shares, receive returns on shares, information relating to their investment and vote, both in general meeting (although this is often limited to certain shareholders) and in meetings on matters affecting their shares and rights attached to them. In general meeting, such votes include the right to vote for directors, dividend, receipt of the annual report and approval of auditor and may include the right to vote on proposals made by the board that significantly affect the company – the most obvious example being a proposal to put the company into liquidation. The underlying assumption is that shareholders do have such rights – and that the regulatory framework protects them. Part 2G.2 of the Australian *Corporations Act 2001*, for example, provides for meetings of shareholders and their conduct, a set of provisions reflected in many of the equivalent legal regimes such as that of UK (*Companies Act 2006*, Chapters 3 and 4) and *Delaware Code* Title 8 Chapter 1, subchapter VII.

The second of these principles addresses the issues of shareholder rights. It not only specifies that shareholders should be equitably treated, regardless of status but also that there should be mechanisms in place to permit them to take action should their rights (voting etc) be affected. It should be noted that regulation has a part to play in creating these rights but that the effect is felt at an individual company level. Most important amongst those rights in relation to corporate governance is to seek redress should the directors fail to fulfil their duties and functions, including their duty to monitor the actions of the CEO and other members of the executive.

Legislation again provides the basis for such redress (including those of a minority member (for example the Australian *Corporations Act 2001* ss 232 (right to take action where there has been oppressive or unfair conduct) and 236 (the member's right to take a derivative action on behalf of the company). Such provisions are also provided, albeit in different forms and with differing impact, in most jurisdictions including the UK and Delaware (as the exemplar for the United States).

What is not normally reflected in companies' legislation is the issue of foreign shareholders. This tends to be an issue left to other legislation such as laws relating to foreign investment and may differ across jurisdictions. In addition, social attitudes, political policy and business culture may deter or encourage foreign investment (Kalinova, Palerm and Thomsen, 2010), and the recent debate in New Zealand over foreign ownership of land-operating/land-owning entities, such as the China Government-backed purchase of 16 large farms on New Zealand's North Island (Cheng, 2012), indicates this to be a sensitive issue.

Do these principles advance company performance? Autore, Kovacs and Sharma (2009) examined investment analyst recommendations and concluded that stronger shareholder rights are associated with positive recommendations, a conclusion that appears to suggest that shareholder rights are an important part of corporate governance and company performance. Picou and Rubach (2006) also found large contributors of capital responded positively to companies adopting corporate governance guidelines. However, Durden and Pech (2006) warn that increasing shareholder protection through legislation increases the costs of doing business and have a counterproductive effect.

More generally, for Kang and Sorensen (1999) the link between shareholder rights and company performance is not direct. They premise that the structure of ownership is related to company performance and even more, that the ideal structure for any one company depends on the 'fit' (Kang and Sorensen, 1999, p.140) between the owner types and the industry (also see Cheffins, 2002). In some cases and circumstances block ownership is better but not for all, despite the

suggestions by Stapledon (1996, p. 240-244) and Davies (1993) that at least some of those categories of shareholder are or could be good monitors of management performance.

Given that, it is of relevance to refer to the debate surrounding News Corp (an Australian media company) and its proposal to move to the state of Delaware (Hill, 2010). Hill (2010, p.13) explains that the company justified its proposal on the basis of legitimate commercial goals, including greater access to capital markets in the United States and the chance to enhance shareholder value. However, critics had another interpretation. They argued that the underlying reason for this proposal was so the controllers of the company could take advantage of the relatively weak shareholder protection provided by the Delaware code as compared to the Australian legislation, in order to strengthen managerial power at the expense of the shareholders.

The broader message from this debate relates to the question as to whether shareholder rights need to be strengthened. Hill (2010, p. 46) identifies arguments against this idea that have been raised in the American context. Essentially, these arguments are to the effect that strengthening shareholder rights (as have been mooted by way of a Shareholder Bill of Rights and a SEC rule 14a-11, 39 that would permit shareholders to not merely vote on directors but actually nominate them (Hill, 2010, p. 10)) would not improve corporate governance and thence company performance but actually militate against it by encouraging shareholders to “engage in predatory and self-interested behaviour” (Hill, 2010, p.11). Therefore, so the argument goes, it is better for company performance to impose strict limits and controls on the exercise of shareholder power.

> ‘The corporate governance framework should recognise
> the rights of stakeholders established by law or through
> mutual agreements and encourage active co-operation
> between corporations and stakeholders in creating wealth,

jobs, and the sustainability of financially sound enterprises' (OECD 2004, p.21).

This principle addresses the broader relationship aspect of companies as social actors (a concept reflected in institutional theory more than the traditional agency theory). However, and despite the broad wording of the principle, the guidelines that accompany this principle refer only to a relatively narrow range of stakeholders, these being first, ones whose rights are specified by law (such as employees (that may include the right not to be discriminated against, holidays and enforcement of employment contracts), creditors (the right to recover against the company for debt – normally provided under companies legislation or similar) and victims of tort committed by the company or an employee (under principles of attribution and vicarious liability).

The second group of stakeholders according to this definition are those who have rights against the company created by mutual agreement or contract. Again, this group is likely to include employees and creditors but may also include customers, clients and sponsorship recipients (as part of the community activities or commitment of the socially conscious organisation).

The stated objective of the principle is to encourage stakeholders and the company to cooperate in the creation and sustainability of a "financially sound enterprise" (a micro effect) along with jobs and wealth (a macro effect).

Does this principle advance company performance? Intuitively and empirically, the answer is generally: Yes. In relation to employees as stakeholders, intuitively it could be argued that without a confident and loyal workforce the intellectual capital of the company is under threat. If morale is low and suspicion high, in-demand staff members are likely to move to other employers and those who stay may indulge in sabotage and other counter-productive activities. This can also have a flow-on effect to the product market with negative perceptions as to the quality of the company's products.

Appels, van Duin and Hamann (2006) map efforts by a company in Barloworld in South Africa to instil a commitment to corporate citizenship in its workforce. Although they do not consider the increase in financial wealth of the company, they do conclude that the process had a positive effect on organisational culture and management processes. Michlitsch (2000) too emphasises the importance of high-performing loyal employees in developing long-term relationships with customers, an essential part of successful strategy.

As far as creditors are concerned, Stapeldon (1996) suggests that a poorly run company looking for capital would likely have to pay a risk premium (a requirement that would then send a signal to the market that things were amiss). Kang and Sorensen (1999) suggest that large block shareholders should demand the company be highly leveraged because that forces managers to be careful to adhere to budgetary, cash flow and informational requirements.

Finally, the implications for directors and management alike should the company fail (Kulik, 2005; Nwabueze and Mileski, 2006), help ensure that the presence and powers of creditors will promote good corporate performance. As an interesting aside, D'Aveni (1990) finds that the market prestige and reputation of top managers may itself affect organisational failure: if creditors admire and trust managers, even though a company may be performing poorly, that are more inclined to make allowances and arrangements to permit the company to continue. Where such managers have left the company, this has a negative effect on creditor patience and support.

> 'The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company' (OECD, 2004, p.22).

The purpose of this fifth principle is transparency and completeness of information. In some jurisdictions, legally mandated disclosure requirements on financial position and performance (most rigorous for listed companies) extend also to information on charitable donations and directors and/or management remuneration (for example, *Companies Act 2006* (UK) ss 412 and 413 and Australian *Corporations Act 2001* s300A). The argument is that by reducing informational asymmetry, well-designed and adequate levels and forms of disclosure permits shareholders, investors and the market generally to make both quantitative (financial performance and position) and qualitative (to do with management and director qualifications and performance) judgments about the advisability of investment, overall financial well-being of the company and ethical and social responsibility (Bartholemeusz, 2002).

Does this principle advance corporate governance? There is some criticism of present requirements on several grounds. First are those who argue that increases in the rules and expectations placed upon management, including increased levels of disclosure (Durden & Pech, 2006), reduce the effectiveness of managers and therefore, by analogy, the performance of the companies they manage. Other criticisms are directed at mandatory standards and measurements for financial reporting that, because they are at odds with financial reality, are of little or no use to investors or managers (Anderson, Herring and Pawlicki, 2005; Rayman, 2007). The other main set of criticisms relate to the growing emphasis on triple bottom line and balanced scorecard, the "other" aspects of a company's performance that are claimed by some as of equal or more importance to the markets than are financial indicators (these other including social and environmental policies and strategies) (Gelb and Strawser, 2001).

> 'The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders' (OECD, 2004, p.24).

This sixth principle is arguably the one that has attracted the most attention in the governance literature, to the effect that one might be forgiven for thinking that it IS corporate governance. The basic purpose of this principle is to ensure that the rights of the relatively weak owners or shareholders are looked after by the board in its joint role as monitor and employer of the CEO. It is also important to note, however, that the board occupies something of a hybrid position: not only as the safeguard for the interests of the owners (director primacy; Bainbridge, 2008)) but also as fiduciaries having direct responsibilities and accountability to shareholders (but see Alces, 2008 for a critique of this assumption). Therefore, the legal framework commonly identifies duties directors must observe when making decisions on strategy and direction of the company. Briefly, such duties include a duty to act for a proper purpose, a duty to act in good faith and a duty of care and diligence as well as specific duties in particular situations or contexts such as a duty not to misuse position or information, a duty not to allow the company to trade while insolvent and a duty to avoid conflicts of interest. Such duties have been codified in the Australian *Corporations Act 2010* under Chapter 2D and the UK Act under chapters 2-3 but most (the general ones) are based on a long history of case law, an approach that is maintained in Delaware.

Does this principle advance company performance? Research on the link between board monitoring of CEO and company performance and the link between the make-up of boards and company performance do not produce consistent results with Fama and Jensen (1983) (yes if independent); Baysinger and Butler (1985) (yes if independent); Coles and Hesterley (2000) (yes if independent); Beasley (1996) (yes if independent); Petra (2005) (maybe); Hermalin and Weisbach (1991) (no); Ghosh and Sirmans 2005 (no). Overall, the conclusion seems to be that the extent to which adherence to this principle advances the performance of the firm depends on more than just structural or “tick the boxes” style compliance – instead it is important that the structure is a good fit with the industry and corporate culture (Borokhovich, Parrino and Trapani, 1996).

Finally and in conclusion, does corporate governance, in accordance with the principles outlined above, improve the performance of companies? Korac-Kakabadse, Andrew and Kouzmin (2001) do not think the structures are too narrowly defined. Maher and Andersson (1999) warn that taking a single model of governance and applying it to all companies in all cultural contexts is unlikely to achieve desired results – a point supported by the growing number of researchers looking at the issues associated with comparative governance systems (e.g. Aguilera and Jackson, 2003; Li and Harrison, 2007). Instead they suggest that the effectiveness of different corporate governance systems is influenced by differences in countries' legal and regulatory frameworks and historical and cultural factors, in addition to the structure of product and factor markets.

From there it can be argued that while corporate governance might be designed on an international (or more accurately an Anglo-American) framework, it is of no use unless it works (Erturk, Froud, Johal and Williams 2004) – within the institutional and cultural framework. This is of importance not only to nationally based companies but to TNCs that look to expand into other jurisdictions (Kiel, Hendry and Nicholson, 2006; Yui and Makino, 2002).

So how are these guidelines and overseas 'best practices' reflected in the New Zealand governance framework? Generally speaking, the present framework for corporate governance is in line with those operating in other similar economies: a combination of statute, codes (quasi-law) and common law principles. The Companies Act 1993 provides for shareholders' rights (ss 120-125 reflecting Principle Two (OECD, 2004), protection of dissenting shareholders (Principle Three, reflected in such provisions as s110 (buyout for minority shareholders), 165 (right to take a derivative action), 169 (right to take a personal action) and 175 and 176 (the rights of an affected shareholder to take action over prejudicial conduct)), disclosure (Principle Five as reflected in, for example, s211 of the Companies Act and many provisions of such other Acts as the Financial Reporting Act 1993, the Securities Markets Act 1988 (as amended) which applies to companies listed on the NZX and the Takeovers Act 1993) and, finally, Directors' fiduciary

responsibilities to shareholders (Principle Six as reflected in the Companies Act ss131-138).

Common law principles mean that a company can be liable for contracts entered into on its behalf by directors or employees (such as in Hely-Hutchinson v Brayhead Ltd [1968] 1 QB 549 and Story v Advance Bank Australia Ltd(1993) 11 ACLC 629), and be liable for crimes and torts committed by a director or employee by way of vicarious liability and attribution (see, for example HL Bolton (Engineering) Co Ltd v TJ Graham and Sons Ltd [1957] 1 QB 159 and Meridian Global Funds Management Asia Ltd v Securities Commission [1995] 3 NZLR 7). In the present context the application of such principles strongly suggests that governance structures be put in place to safeguard the company and its members from the damaging financial and reputational impacts such liability may have.

However, it is the quasi-law aspect of the framework that is most important as it is this aspect that draws most closely from the UK, US and OECD principles, and that is found in the New Zealand Stock Exchange (NZX) listing requirements and in a Handbook on Corporate Governance in New Zealand, Principles and Guidelines (New Zealand Securities Commission, 2004) that was based on a Report by the New Zealand Securities Commission (now the Financial Markets Authority) in 2004 (New Zealand Securities Commission 2004a).

The Report of the Commission was an attempt to address the particular needs of New Zealand in relation to corporate governance. Briefly, the principles and guidelines included in the Handbook (Securities Commission 2004) are as follows. They are briefly described and related to the equivalent OECD principle(s) (discussed above). To avoid confusion, the principles set out in the Handbook have the letters NZSC attached.

NZSC Principle One: ‘Ethical Standards. The board of each entity should adopt a written code of ethics that affects not only the members of the board but also the entity as a whole’ (New Zealand Securities Commission, 2004, p.7) and NZSC

Principle Nine: "Stakeholder Interests,. The board should respect the interests of stakeholders in the context of the entity's ownership type and its fundamental purpose" (New Zealand Securities Commission, 2004, p.24). These related principles arguably reflect the OECD (2004) Principle One (which emphasises the need for legal compliance and transparent markets - note in particular the guideline to this NZSC principle that states that the code should deal with issues of the "giving or receiving gifts, facilitation payments and bribes" (New Zealand Securities Commission, 2004, p.7)) and Principle Four (that addresses stakeholder rights).

The guidelines to NZSC Principle One refer explicitly to "customers, clients, employees, suppliers [and] competitors" (New Zealand Securities Commission, 2004, p. 7) when describing stakeholders who should be treated fairly, while the NZSC Principle Nine describes "employees, customers, creditors, suppliers [and] the community" [whose interests should be considered by reference to] "legal obligations and relevant social, ethical and environmental factors" (New Zealand Securities Commission, 2004, p. 24). Overall, it is reasonable to assume that the Commission expects entities to consider the role and position of a range of stakeholders when making decisions.

NZSC Principle Two: "Board Composition and Performance. There should be a balance of independence, skills, knowledge, experience, and perspectives among directors so that the board works effectively". (New Zealand Securities Commission, 2004, p.9). This is a reflection of the expectations implied in the OECD (2004) Principle Six (that the board should give strategic guidance, be capable of monitoring management and be accountable to shareholders) because, as discussed elsewhere at some length, such functions cannot be satisfactorily fulfilled if the board is not capable, independent or answerable. In addition, clarity of information is essential for affirming managerial trust. Often reports can be too technical and the language used obfuscates the content of the report. This principle tries to eliminate this hindrance to communication.

It is important to note that this NZSC principle refers to both 'non-executive' and 'independent' directors (New Zealand Securities Commission, 2004, p.11), defining a non-executive as independent only where "he or she does not represent a substantial shareholder and where the board is satisfied that he or she has no other direct or indirect interest or relationship that could reasonably influence their judgment and decision making as a director" (New Zealand Securities Commission, 2004, p.11). For many theorists and writers in the field of corporate governance, and for policymakers, significant independence in members of the board is a critical measure of good governance (see also the discussion in Chapter 3).

The next series of principles included in the Handbook can all be considered reflections of the OECD Principle Six as they all provide explicit guidance and direction for boards in the conduct of meetings and decision making. The specific principles are as follows. NZSC Principle Three: "Board Committees. The board should use committees where this would enhance its effectiveness in key areas while retaining board responsibility" (New Zealand Securities Commission, 2004, p.13). As the Securities Commission says, "committees can significantly enhance the effectiveness of the board through closer scrutiny of issues and more efficient decision making in key areas" (New Zealand Securities Commission, 2004, p.13). NZSC Principle Four: "Reporting and Disclosure. The board should demand integrity both in financial reporting and in the timeliness and balance of disclosures on entity affairs" (New Zealand Securities Commission, 2004, p.15), makes it clear that financial information is fundamental to accurate and timely decisions for the board and also arguably enhances shareholder rights, the implicit theme in Principle Two (OECD, 2004) and is further endorsed by NZSC Principle Seven: "Auditors. The board should ensure the quality and independence of the external audit process" (New Zealand Securities Commission, 2004, p.20).

The fifth NZSC Principle deals with payment for directors and management: "Remuneration: the remuneration of directors and executives should be transparent, fair and reasonable" (New Zealand Securities Commission, 2004,

p.17). This principle follows from the underlying assumption that the people that control a firm will have a tendency to act according to their individual interests. Thus, these actions need to be tempered by incentives to maintain the firm's high performance within the parameters of what is desired by owners and shareholders. The sixth NZSC Principle warns boards of the need for on-going control processes to manage risk: "Risk Management. The board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks" (New Zealand Securities Commission, 2004, p.19).

Finally, NZSC Principle Eight (New Zealand Securities Commission, 2004, p.22) explicitly addresses the issue of shareholder rights (the tenor of the OECD (2004) Principles Two and Three) thus: "Shareholder Relations. The board should foster constructive relationships with shareholders that encourage them to engage with the entity". Interestingly, the narrative that accompanies this principle seeks to encourage entities to be proactive rather than passive in this context – actively encouraging participation in meetings and increasing awareness through making information on the entity easily and widely accessible.

The connection between NZX standards and SME governance activities is that NZX standards are publicized as being the "New Zealand" standard of governance and are thus understood to represent a somewhat more amplified group of companies than the mere 200 listed firms in NZ. This affects New Zealand firms interested in exporting, through the NZ Trade and Enterprise system or on their own, as they will be pushed to perform to those NZX levels of governance performance to not appear deficient in their quality of corporate governance. NZ being an export country opens new markets through free trade agreements and other government-supported activities and holds itself out to be quality trading partner, with good governance clearly being one of the factors a firm would advance to impress a foreign buyer or seller.

Devlin (2004) argues that there is little in the report (and therefore the handbook) that is tailored uniquely for the local context and leaves largely unaddressed the

need to develop relevant best practice standards for corporate governance. Amongst his concerns is that the Commission rules typically only affect the larger and listed firms in New Zealand directly, and provide only guidance for smaller or privately-held entities. This limitation is implicitly recognised in the handbook (Securities Commission 2004) where the Commission emphasises that while by virtue of requirements laid down by the NZX, listed companies are likely to be already addressing all the issues laid down by the Principles, it would 'expect' (but not be able to require) (New Zealand Securities Commission, 2004, p.4) entities that are accountable to the New Zealand public - including public issuers (companies and other entities that issue securities to the public but are not necessarily listed on the NZX (*Securities Markets Act 1978* s2(1)), state-owned enterprises and community trusts - to observe relevant Principles and all entities to work towards their implementation.

It also acknowledges the limitation for New Zealand firms that arises from the lack of a 'market place' for independent directors – a place where firms can easily identify talents that will satisfy their needs. It should be noted that this shortcoming has been addressed in part outside the context of quasi or real law. Indicatively, the www.finddirectors.com net-based independent director self-listing service (developed after the first year's data of this current research) identified the need for a director marketplace by way of the fact that nearly immediately on launch of the webpage, more than 300 prospective independent directors registered their contact details. Other similar listing services exist with the Auckland Chamber of Commerce, limited to Auckland-based candidates, the Ministry for Women Affairs, limited to women candidates, the Institute of Directors, limited to IOD members, and the Crown Ownership Monitoring Unit (COMU).

Given the framework for Corporate Governance that applies in New Zealand, it is now appropriate to examine the governance issues that face SMEs, most particularly those in New Zealand. These are discussed below. It should be noted that there is little in the international refereed literature that specifically addresses

the issues facing New Zealand SMEs; hence references are made from time to time to discussion in other publications.

2.3 SMEs in New Zealand and in Governance Literature

Generally speaking, SMEs remain underrepresented in research into corporate governance. This is startling considering that research indicates that they contribute significantly to the economy, GNP and national employment opportunities (Beckhard and Dyer Jr., 1983; Shanker and Astrachan, 1996). Furthermore, family owned and/or operated firms dominate the business sector in most major countries (Klein, 2000; Heck, 2001) and two-thirds of all firms globally are thought to be family owned and/or operated (Gersick, Davis, Hampton and Lansberg, 1997). Most of those are SMEs.

This dearth of research may be explicable in various ways, including access to relevant data, resistance on the part of those involved and inconsistency of management practice.Whatever the reason, while the focus on large firms has raised the public profile of good governance practices generally and has usefully highlighted the many failures, it crucially has not yet induced many smaller firms (where most of the corporate wealth of New Zealand is concentrated), to improve their approaches to governance.

Furthermore, particularly in their infancy, small and medium sized businesses in New Zealand often do not distinguish between management and governance. As the business flourishes and grows, multiple owners may gain more control over the business as their shares in the company increase. It is only once the business has matured that formal governance structures such as the implementation of a board of directors is typically established (Devlin, 2004). Thus, the principles we obtain from overseas, such as those in the combined code, may have little relevance to New Zealand SMEs until the firms are well established. This may take many years. Moreover, many businesses never achieve the size that renders viable

such governance structures such as those set out above (Devlin, 2004). Thus, Devlin writes, we have a strong need for a framework for what he terms an 'emerging' governance framework in New Zealand (Devlin, 2004, p.22).

In addition, as a multi-cultural country we need to take into account the differences inherent in between Pakeha (European NZ-origin), Maori (indigenous) owned and/or operated firms.and those owned and/or operated by those from other ethnic groups represented in New Zealand society (such as European and Asian). It is argued, for example, that Maori approaches to governance tend to be different to the usual Western approach. Maori academic at Victoria University, Ralph Love, claims that New Zealand firms under Maori management tend to have a longer-term focus, be more engaged with and committed to the community, and employ higher levels of caution and consultation than do those under non-Maori management. Furthermore, Maori governance tends to involve greater interaction with employees and clients than does governance in non-Maori firms (Love, as cited in Devlin, 2004). Love comments, "The fundamental difference between a Maori firm and a 'random' [presumably non-Maori] business is that Maori ones then to have a long-term strategy and a particular ability to innovate ... Maori business people are able to think 'outside the box' [and] Maori businesses are not constrained by a permanent drive to maximise assets" (Love, as cited in Devlin, 2004, p. 22). In addition, Devlin notes that, in most Maori firms, family needs, potential environmental impact and sustainability issues take priority over shareholder value.

Therefore, a set of best practice standards for corporate governance in New Zealand should reflect multicultural approaches to business governance that address the needs of all firms, including those that are family-owned. It would be a mistake to impose governance practices formulated within one culture upon a culture with supported practices of their own (Erturk, Froud, Johal and Williams 2004), even if the normative preference would be to create singular and uniformly applicable governance standard nationwide and globally. Rather, best practice principles could be formulated to incorporate Maori business strategy (if it can be

shown that it does indeed provide for a better sustainability outcome in governance) and governance practices as well as Western ones (assuming they are compatible). To justify and validate such an approach, however, there is a need for research into governance and managerial principles observed by Maori boards. As Devlin (2004, p.22) summarises: “If these claims are true, then governance and management according to "Tikanga Maori" could herald a new dawn for the teaching and practice of governance both within and beyond New Zealand”. Similarly, if superior aspects of governance practices existed amongst the norms of of other cultures well represented now in NZ, then the best of these could be extracted to help formulate a new set of best practices governance principles suited to New Zealand’s SMEs, regardless of the narrowness or breadth of cultural diversity influencing these firms.

In conclusion, New Zealand seems ill-suited to the current “one-size-fits-all” approach that resulted from favouring corporate governance practices from Western countries like the USA. In New Zealand a much larger share of firms are “enterprises” than in larger industrialised countries such as the UK or the US. Thus, governance practices should now be revised to ensure they are appropriate and effective (i.e. applicable, realistic and user-friendly) here. This research thus focuses on governance findings in the New Zealand environment, with a heavy emphasis on small enterprises.

Furthermore, the emphasis in classic governance literature on the importance of separation between management and the board and between management and ownership is problematic. As stated above, many SMEs in New Zealand are family owned and/or operated. Family ties, friendship and firm loyalty naturally feature in their governance relationship, but while they are overlooked in evaluation of governance, their presence should reduce the divergence between the conflicting interests of the manager(s) and those of the owner(s).

That said, these arguments should not be misconstrued as an endorsement for reduced governance in these SMEs. This research shows that considerable interest

(and need) in formalised board structures exists in small and young firms. Given this, it is imperative that the same challenge previously identified by Devlin (2004, p. 22) is addressed: "It is only when a company matures and stabilises that a board of directors is practical".

The all-important and more overarching question then is: what shape should a New Zealand model for governance take and what factors should shape it? This question demands a consideration of alternative ways of looking at issues of accountability and monitoring in the context of corporate governance. This discussion is the focus of the next chapter.

CHAPTER 3: MAIN THEORIES OF GOVERNANCE

As a reminder, 'agency theory' (Jensen and Meckling, 1976; Eisenhardt, 1989; Ghosal 2005; Kang and Sorensen, 1999; Lockhart, 2007), together with other contractually based theories such as transaction cost economics (Fiss 2008), has for many decades come to dominate Governance literature, particularly in relation to the Anglo-American model of corporations and their management structures (Bainbridge, 2008; Daily, Dalton and Canella 2003).

Consequently, the overwhelming majority of outputs on governance research is based upon the main tenets of agency theory and its predecessor, managerial capitalism (see, for example, sources cited and points made in Eisenhardt, 1989a) with analysis of agency problems and their solution premised on the large Anglo-American corporation model. This includes New Zealand, a Commonwealth country with many of its corporate legislation adopted from the UK, Canada and the United States, the prevailing basis on which governance is judged for its effectiveness. However, this is not the only form, nor is agency theory universally deemed the only option for dealing with those issues. This part of the chapter contrasts agency theory with the main alternative theories that rely on two basic assumptions: that the firm or company has a much broader social function, and the principal expectation for directors is that they use their talents and skills to maximise firm performance. It is those two assumptions that should shape corporate governance structures. Stewardship theory is one such theory, but attention will be paid to others (including stakeholder and institutional theory) as the grounding for structures, rules and guidelines for corporate governance

To properly contextualise the discussion in the next chapter dealing with the position and responsibilities of directors, this the chapter explores the issues associated with traditional governance theories, particularly agency theory. Section 3.3.1 provides a legal and theoretical grounding for the theory and its etymology, and its history and prominence in the field of corporate governance. A second section critiques some of the major mechanisms that are used to minimise agency costs and maximise alignment between principal and agent (in this context,

normally the CEO) objectives in the context of the large corporation. In this section, and given the focus in other parts of this work on the issues around governance of SMEs in New Zealand, questions are put as to the applicability of traditionally formulated governance theory to organisations classified as such. The third section introduces some of the key criticisms made against agency theory, and alternative models advanced for effective corporate governance. The fourth section expands further on one such model, institutional theory, as a contra to agency theory. The final section examines the extent to which corporate governance contributes to the performance of a business entity.

3.1 Agency Theory as a Grounding for Governance

3.1.1 Agency Theory: Its Legal and Theoretical Basis

The term "agency" emerges from law, where it is used to refer to any situation where one person (the Principal) appoints or otherwise has another person (the Agent) acting on his or her behalf. The agent cannot do more than the Principal, as his or her legal capacity is bounded by that of the Principal. The Agent's capacity will usually be further restricted by the terms under which the Agent is authorised to act. There are other controls also, e.g. because the Agent almost always will have access to monies or valuable information belonging to the Principal, he or she occupies a fiduciary position: A position that carries a range of duties, including the duty to place the interests of the principal before those of the agent, (b) to account or disclose to the Principal movements of those funds, (c) a duty to avoid conflict of interest, (d) a duty to use expertise for the benefit of the Principal, and (e) a duty to be diligent.

As Eisenhardt (1989) explains, agents bearing such duties emerge in a range of social and contractual contexts, including land (land agents), insurance (insurance agents), goods (mercantile agents), partnerships (all partners are agents for their fellow partners) and contracts of service (employees) (also see Kang and Sorensen,

1999). It is particularly in the context of companies and some other organisations where agency has become a prominent and, for some, the only available framework for assessing and measuring the resilience of structures for governance.

In the case of companies, the relationship between manager and owner is a classic example of agency (Campbell, 1995; Milgrom & Roberts, 1992). Therefore the theory implies that the relationship between the "principal" (owner) and the CEO (agent) must involve control over the behaviour and decisions of the "agent" (normally through the medium of the Board of Directors). The theory is also applicable to the relationship between the directors and the shareholders. On first glance this seems both logical and a good fit – after all, separation of ownership and control has and remains the standard shape of many organisations in both the commercial private sphere and, in some cases, the public sector.

The underlying justification for agency theory in the context of corporate govenance (Berle and Means, 1932; Jensen, 1983; Spence and Zeckhauser, 1971; Ross, 1973) is that if managers have a significant level of control over a firm, and are unrestricted by market forces or internal governance mechanisms, they will tend to promote their own interests rather than those of the equity holders whenever the interests of the firm's equity holders and the managers diverge (Tosi, 2008). This conflict of interest may undermine the effectiveness of management for the enterprise. In cases such as in Enron's demise, agency theory has helped to identify which moral obligations were violated and contributed to the downfall of such firms, and the misuse of company funds by managers is a good example of violations of the moral code that binds business owners and managers. In this light, agency theory has been useful as a framework for the relationship and obligations between owners and managers.

Support for this position originally comes from Berle and Means (1932) who were influential (particularly in view of their timing - shortly after the Wall Street crash of 1939 and in the midst of the financial and social struggles that followed) in their exposition of the modern company and its growth. They traced the emergence of

the large company with diffuse shareholding to the beginning of the European industrial revolution in the late eighteenth century as a consequence of the fact that, for the first time, it was no longer possible for an individual, rich though they might be, to provide the resources necessary to maximise investment in the new technology. Instead, the money had to come from somewhere else - often those with money but lacking the technological know-how, business expertise, desire or enthusiasm to be directly involved (Kang and Sorensen, 1999). However, the very indifference of such investors had the potential to cause problems because, as Adam Smith had put it earlier (1776, p. 31):

> `The greater part of these proprietors seldom pretend[ed] to understand any thing of the business of the company; ... giv[ing] themselves no trouble about it, ... receiv[ing] contentedly such half yearly or yearly dividend, as the directors think proper to make to them‘.

Although such an arrangement set up a nexus of interest – profit, it also raised a critical issue: how investors could rely on the management to look after their interests instead of merely maximising their own. The answer was essentially that, in the absence of incentives and monitoring, they were forced to rely on goodwill, trust or confidence, and scarce resources, as such phenomena as the South Sea Bubble and much later the Great Depression of the 1930s were to attest (also see Holderness, 2003).

From the creation of the first statutory framework for companies, there was evident concern as to how activities of management could be policed (Hermalin and Weisbach, 2003). Consequently, as pointed out previously, legislation has recognised and attempted to address the split between the powers of the board of Directors and those of the shareholders in the General Meeting (SGM). Legislation has also sought to ensure that certain powers of the Directors could not be performed without approval of the shareholders, and that shareholders must be given access to important information. This has continued into the modern era and

applies even to small organisations. It is likely that it is exactly these powers granted to directors that contribute to the hesitancy of shareholders in SMEs to appoint independent directors, fearing an abuse of authority. However, history also demonstrates that merely providing a means for the SGM to balance the powers of the Board is not necessarily adequate in terms of ensuring that the interests of management and ownership are aligned. The pattern of management as business organisations grew in size was the delegation by the Board of day-to-day decisions and implementation of strategy to executive managers – most prominently the CEO. The further diffusion of shareholding in many of these larger corporations has emphasised the important role of the Board as the monitors of the CEO (employed by the Board), on behalf of the shareholders, yet financial scandals and notorious collapses have exposed the failures of some of these boards to carry out such monitoring or ignore the messages emerging from such monitoring. Ultimately then, is there some means of providing confidence to relatively powerless and ignorant shareholders that they need not watch with dismay as their investments suffer while CEOs and/or directors fiddle – or worse, float off under a golden parachute leaving the shareholders to crash and burn?

Further complicating the situation is the fact that "a corporation cannot laugh or cry; it cannot enjoy the world or suffer with it. Most of all a corporation cannot love" (Loy, 2001) – it is a fiction, enabled and shaped by law to permit a wide range of commercial activities impractical or impossible for more restricted organisational forms. As it cannot make its own decisions or institute its own processes, its actions are totally reliant on human intervention.

Economics found the answer, again drawing on the contractual principles underpinning agency: rather than a firm or company being an active player or participant in its own right (involving treatment of its internal processes as a "black box" (Campbell, 1997, p. 357; Chhotray and Stoker, 2009, p. 60), the modern corporation (or firm) is merely an efficient creation (Coase, 1937; 1960) that brings into "equilibrium" (Jensen and Meckling, 1976, p.9), through a series of implied contracts, a range of individuals with a variety of objectives, expertise,

business knowledge and attitudes to risk taking (Jensen and Meckling, 1976; Letza, Kirkbride, Sun and Smallman, 2008; Bainbridge, 2008). This not only allows consideration of the contracts that fall within the legal entity that is the company but also those between the company and other players (Campbell, 1997). This research then is concerned with how these various players, specifically directors, shareholders and management, are held together through a mutually negotiated mechanism of tangible rules and intangible emotions, relationships and commitments.

Agency theory (its application to companies credited originally to Jensen and Meckling, 1976; Blair, 1995) is thus used to describe and evaluate the mechanisms applied in companies, particularly large and listed ones, to ensure that the members of the Board of Directors and senior management (most particularly the CEO) apply their expertise, judgment and business savvy to maximise the benefit for the owners or shareholders rather than for their own. It is notable that in New Zealand, contrary to the United States, no "business judgment rule" exists (with the exception of being applied to the duty of care but outside specific legislation to govern its application), i.e. whether directors make savvy or non-savvy decisions with a genuine intent to perform well, is irrelevant. Directors are held to a rigid standard and will be liable where 'trading while insolvent' and to disclosure rules more sourced from fair standards in advertising than the realities of a business environment. This research shows however that not only these legalistic rules govern the behaviour of directors; indeed, things have moved far past this point. The theory has been and, at times still is, of significant importance in grounding a normative structure not only for business corporations (Rossouw, 2009) but also for reform of public and even certain non-profit sectors (Wallis, 1997: Hazeldine and Quiggan, 2005; Bale and Dale, 1998; O'Neill, MacIntosh and Hall, 2006).

Briefly, and very much a product of its economic parentage, agency theory requires certain assumptions to be made (albeit overlapping ones, Eisenhardt, 1989). One is rationality: All other things being equal, any person will make a decision that maximises his or her return on investments like time or money. The second such

assumption is that everyone is motivated by self-interest (although it does not necessarily mean they make decisions with selfishness or guile; McCure and Prier, 2008, p. 47). Consequently (and again assuming all other things are equal and no economic distortions are imposed), a person will work to benefit him or herself the most. Thirdly, because interests of principal and agent diverge, there must be conflict between those interests and thus a process to resolve those frictions. Fourthly, a person who is overly focused on their own benefit will have an aversion to risk. Fifthly, the theory assumes that shareholders are imperfectly informed as to the work of management. Because it is impossible for shareholders to personally observe all actions, they must incur the costs involved in ensuring the manager neither shirks his or her responsibilities or acts in his own self-interest. These costs are most often associated with monitoring, bonding, and the design of managerial incentive contracts (Brockman, Brooks and Long, 2011). Finally, on the collective level a "univocal" (Letza, Kirkbride, Sun and Smallman, 2008, p. 23) interest for shareholder/owners is assumed, meaning that any individual differences or contextual diversities are ignored.

3.1.2 Agency Theory: The Research

A veritable torrent of publications has been produced on the effectiveness (or not) of various monitoring and market mechanisms within the framework of agency theory. What follows is a discussion of a selection of these pieces and what they reveal regarding the importance of agency to corporate governance. The place to start is Eisenhardt's (1989) comprehensive review into the theory and the approaches/contexts in which it has been studied. The first important point she makes is that there are two approaches to the theory – the first being that of the positivists who focus on the role of the theory in management of large corporates (Berle and Means, 1932; Eisenhardt, 1989, pp. 59 - 60). The second approach involves a focus on the principal-agent relationship in a wide range of contexts. Eisenhardt considers the two approaches complementary rather than as alternatives.

The reason for Eisenhardt's view comes from another fundamental aspect of agency theory, i.e. the fact that an agent must be appointed by a principal to act on his or her behalf or be recognised by law as having that role. Agency theory assumes a series of contracts, either express or implied, that determine how the parties are to act and why (particularly in respect to outputs). Eisenhardt (1989) explains that while positivist researchers identify various contract alternatives that might be used, principal-agent ones focus on their relative efficiency under different conditions. This series of contract relationships may not be well understood by directors and thus could lead to conflicts. Directors may believe that they serve under rules established by thelaw, and not as per the directives of shareholders. In addition, it is also inherently inconsistent that nominee directors take directions from their 'principal' shareholders while they are supposed to act on behalf of all shareholders of the business.

As mentioned above, the positivist approach reigns supreme in the context of corporate Governance. For this reason, the survey of studies and critiques will be limited to those utilising such an approach. The exploration that follows discusses the studies in reference to the fundamental premises on which the positivist approach relies. To make it complete, the criticisms raised regarding their validity and other issues are highlighted.

First, it is assumed that there are three types of costs implicit in an agency situation, namely (a) monitoring costs (incurred by or on behalf of the Principal), (b) the agent (bonding – expenditure on resources to ensure that what he or she does accords with the wishes and benefit of the Principal) and (c) residual costs (the remaining dollar cost of divergence between principal and agent objectives (Jensen and Meckling, 1976)). Therefore, for the principal and agent to maximise the efficiencies involved in their relationship, and efficiently reduce agent opportunism and conflict (Jensen and Meckling, 1976), an effective mix of control and incentives must be present. The ideal mix depends on factors such as the environment (e.g. government policy, market forces and/or prospects) and the

structure of the organisation (including the structure and nature of ownership, and the make-up and size of the board and the characteristics of management.). In this context it is noteworthy that the New Zealand environment of predominantly small firms and the informal structure of many SMEs may not be adequately explained through this agency theory.

Insofar as the cost of monitoring is concerned, the research tends to focus on three main aspects: one, the monitoring mechanisms themselves (and that can be employed to minimise the costs involved - effectively to maximise the efficiencies of the process) and two the problems associated with the implementation of the process. The third goes more to the root of the theory - criticisms have been largely directed at the economic assumptions that underlie it. The most important of these are (a) the premises on which it relies are too narrow, (b) the theory neglects the salient non-economic influences on management decisions and actions (Mason, Kirkbride and Bryde 2006; Donaldson and Davis, 1991; Davis, Schoorman and Donaldson 1997), (c) it implicitly assumes the manager is untrustworthy and therefore must be controlled (Mason, Kirkbride and Bryde 2006; Campbell 1997), (d) the focus on overall shareholder value ignores the reality of a highly complex corporate picture of investment (Smallman, 2007) and (e), for stakeholder theorists, it denies the important role corporations play in the wider social and economic settings (Donaldson and Preston, 1995). It also does not offer any explanation how the element of sustainability of a firm is covered through the agency costing mechanism.

3.1.3. The Monitoring Mechanism

By way of introduction, monitoring mechanisms as described as an inherent part of the agency model can be divided into external (provided through the markets for capital and control in which investors and finance professionals have a role to play and regulators) and internal mechanisms (financial and internal monitoring procedures, normally via the Board). It should be emphasised that these two

categories are cross-influential as well: Internal mechanisms are highly likely to affect the markets for capital and control for the company and employment prospects for members of management, while external monitoring mechanisms (such as forced disclosures and limits on decision making by CEOs) may well eventuate from perceived shortcomings in internal systems.

External Monitoring

The markets for capital and control are seen by theorists (Fama and Jensen, 1983; Smallman, 2007) as being the most efficient external means of monitoring the internal management of a company because, they argue, the status and reputation of the executive, both in the present company and on the wider employment market, is sensitive to the wider market and therefore they would make decisions that would enhance that reputation or their position. This raises issues in New Zealand, where the public market is small with about 200 firms listed on the New Zealand stock exchange. The market required to 'monitor' company performance, its governance and quality of directors is thus so small that the vast majority of business activity in new Zealand will not be captured by any rule-making that originates in the public share market.

Question: Does such an approach only work where such a "wider market" exists? In New Zealand, in many industries a few large and dominant corporate players rub shoulders with myriad small enterprises in a fragmented market environment. If such a wider market does not exist, therefore its power to hold executives accountable is also absent. The question that arises then is: By what standards are executives/directors of New Zealand SMEs held to account?

Takeovers are the main means for obtaining control and serve as the only effective market mechanism to demonstrate to incumbent directors that their firm could do better in the hands of more competent leaders. For example, the results obtained by Franks and Mayer in two studies (1985 and 1986) suggest that unsuccessful hostile takeover bids produced management dismissals, and this was explicable

from the point of view of the board either as a reaction to failure of previous bids or because of connections between management and the bidder or because of a realization that external parties value the company higher under theirn own management. Takeovers are the last frontier of holding management and directors accountable to perform at least to market averages because a takeover bid indicates that other market participants believe the firm could do better than it does.

Even successful hostile takeover bids can lead to executive dismissals, not just because of perceived or real past failures, but because of the potential for improvement achievable from upgrading the management team. The point is that it is in a manager's best interests to thwart hostile takeovers, and this is an incentive to achieve better-than-average market performance such that firm is valued at a sufficient level to discourage takeover attempts. They would simply not be economically feasible.

Capital markets are also identified as an efficient means of providing external monitoring of the CEO and Board. Stapeldon (1996) suggested that a poorly run company would find it hard to raise finance on the market and therefore would have to pay a risk premium, thereby reducing the return to shareholders and causing them to bail out, or at least ask awkward questions. Arguably too, with the shift by investors from reliance on the expertise of insiders to the market as the indicator of corporate prosperity and performance (Gordon, 2007), i.e. the efficient market hypothesis or efficient market model (Blair, 1995, p. 107) these markets serve as objective observers, undistorted by human frailty or preference, with information available to all and costs evenly distributed.

Hence, the price paid for a company's freely traded shares is considered a good and efficient proxy indicator of its financial health, provided there is a regulated and transparent market for those equities. Financial advisors and other professionals can contribute to the efficiency by way of reducing search and informational costs

for investors while knowledgeable (powerful and large!) investors can readily move money around in response to market signals.

However, in the context of New Zealand it is relevant to note the recent replacement of the prior financial market watchdog mechanism with a new government-controlled Financial Market Authority. This new and independent Crown Entity introduces a new level of oversight in New Zealand and a new regime requiring a demonstration of competence by anyone wishing to be registered as a financial advisor in New Zealand..

This reliance on an investor market then raises additional issues in the context of New Zealand SMEs, where no objective and transparent market exists for small, unlisted and untraded firms. In this environment few shareholders would be able to price their equity on a market, due to the absence of a transparent valuation through daily market bargaining, and thus forces them to rely on representations from the directors that the entity is managed to a high performance standard. With most SMEs placing owners and managers into the role of directors, is this dialogue of accountability likely to be accurate or, given the self-interest of such directors, less-than-truthful or ill-informed?

The popularity of market-based mechanisms does not infer there have been no critics. Letza et al (2008) refers to the "competitive myopia" implicit in agency theory (Letza et al., 2008, p. 19) and its "preoccupation with short-term gains in return, profit, stock price and other performance measures" as discouraging managers (including the CEO) and the Board from concentrating on longer term strategic issues and competitiveness. This in turn forces them to act in a way that is inconsistent with the future wealth maximisation of shareholders – the very outcome agency theory is determined to achieve. It could also be argued that such a focus may serve to alienate the "big five" stakeholders (Freeman, 1984) - shareholders, employees, customers, suppliers (including capital) and communities, again having direct and indirect implications for shareholders.

The other main form of external monitoring of management is via regulation. Starting with the Companies Clauses Consolidation Act (UK) 1845, rules relating to shareholder rights were introduced (in this case via the external audit (ss101-108) and the power of general meeting to elect directors (ss90-91). This has grown over time to include such requirements as periodic and continuing disclosure (reporting to SGM and to the Stock Exchange), disclosure of directors' interests, expanded audit requirements and the burgeoning push for the presence of independent directors on the Board in an increasing range of jurisdictions (Sarbanes-Oxley Act 2002 -USA) and Listing Rules (NYSE 2010), and principles of corporate governance in the UK (Financial Reporting Council, 2010), Australia (Corporate Governance Council, 2010) and New Zealand (NZX, 2010).

Guttentag (2007) identifies several purposes of mandatory disclosure of information. In offering justification for this discussion he quotes from Healey and Palepu (2001, p. 414) that although financial reporting and other disclosure are required in most markets, "surprisingly little is known about why". Guttentag sets out to address this gap in knowledge with a detailed examination of two types of information that a company might choose (or in some cases be required) to provide. The first of these is agency information (information on executive compensation and other transactions between the executive and the company that does not affect the stock price) and the second accuracy information (other information that does affect the stock price). Benefits he identifies in mandating information disclosure of the agency type include a reduction in agency costs, and ensuring that all those who benefit from the disclosures share in their provision (thereby eliminating the problem of the free rider). The other benefit he identifies, particularly where the public ownership increases, is an increase in total social utility because, by eliminating the informational asymmetry between external and internal players, mandatory disclosure not only permits investors and other interested groups to judge that company, but also to compare it against the overall market.

Guttentag (2007) calls for some caution in relation to mandatory disclosure. Most particularly for him, a broad based and extensive regime is never costless. Therefore, he advocates that regulators should assess the company and its characteristics, including the number and spread of shareholders, in considering the need for and nature of disclosure required from that company.

Unfortunately regulators do not necessarily get so specific – a problem hinted at by the use of the term "calamity model" to describe the tendency by regulators and policy makers to increase the rules as a reaction to scandals and failures (Smallman, 2007, p. 239). Although the use of the term does not necessarily imply that such a reaction is necessarily hasty or ill considered, it does suggest it may not be as carefully devised as it could be given more thought or consideration.

Indicatively in this regard, Laufer (2006) expresses his concern over the expanded "compliance" reaction of legislators, investigators and prosecutors to "unprecedented" (Laufer 2006, p. 239) scandals such as WorldCom and Enron, when consequential reforms are promoted as a prescription against the "pathological mutation" of capitalism and a seismic shift from owners' capitalism" (Laufer, 2006, p. 240). He concludes that such increases in regulatory requirements (and the costs they involve) often do not work, finding that the amount spent on compliance by corporations may have little to do with legal adherence, let alone ethical practices or integrity, and with regulators and prosecutors relying on simplistic legal rules that fail to address the complexities involved in monitoring failures (Laufer, 2006). This implies that in the New Zealand environment, where regulation is lax or non-existent in the SME markets, future compliance and transparency improvements may not be a result of tighter regulation but of other mechanisms that resolve the reporting differentials between management, board and shareholders.

Finally, Tomasic (2006) emphasises that with the burgeoning demand being placed upon the public purse, it makes little sense and achieves little in the way of significant outcomes to rely on the regulatory and enforcement bodies to provide

comprehensive monitoring. In addition, such external measures can unnecessarily increase the "friction" (transaction costs) faced by an organisation. At the same time there has been a shift in various jurisdictions (admittedly supported and enabled by changes in regulation and rules) away from manager-dominated governance to Board-dominated (director primacy; Bainbridge, 2008, p. 11 and pp. 155-200). It is therefore from both a theoretical and a practical perspective that internal monitoring mechanisms are preferred by agency theorists to achieve the alignment as identified by the imperative in accordance with the theory. This raises issues as to the understanding and acceptance of these monitoring regimes when outside directors join a firm.

Internal Monitoring

By way of reflection, these internal mechanisms can be financial (including compensation, the term used to refer to the total package of fixed and variable incentives for performance and position that are offered to management, specifically for our purposes, the CEO), and other mechanisms that persuade the CEO and Board members to direct their actions to address the desires and objectives of the shareholders (Principals) and non-financial internal monitoring (referring to the mechanisms and processes put in place by the shareholders/Board to scrutinise, control or map the decisions of the CEO/Board or the outcomes from them). These are considered in turn.

The one that has attracted a lot of attention in the governance and agency literature is that of compensation (Matsumura and Shin, 2005) - in other words: What structure of pay, bonuses and other incentives best ensure that the members of the board, CEO or other executive of a company maximise the benefits for the owners or shareholders? This research attempts to identify to what extent compensation is a driving factor behind the motivation of external board members to serve. In the context of New Zealand SMEs, the fear of owners that external directors would need to be paid what shareholders might regard as large compensation might deter the inclusion of external board members or

reduce the number of independent directors contemplated for addition to the board. Since directors and aspiring directors in New Zealand rank compensation lowly as a motivator for accepting a directorship, pay and tangible benefits appear to be somewhat poor tools to assure a specific performance from company directors.

The underlying assumption involved in answering this question is that the bigger the disconnect between ownership and control, the more likely it is that the "controlled" is left free to pursue their own aims and serve their own interests: Hence the importance of aligning their rewards as closely as possible to those of the organisation. That at least is the theory. What forms do and should such rewards take? Jensen (1994) discussed this question and, while emphasising that it is "inconceivable" (1994, p.2) that a person will not act in the absence of incentives, he argues that those incentives do not have to be in a monetary form. On the other hand, and as an indication perhaps of the domination by economists of the field of positivist agency theory, it is frequently assumed that these incentives must be money or monies-worth (some mixture of salary, performance bonuses and stock or equity options (the last in particular being "commonly thought" (Ramsay, 1993, p.359) to align management and shareholder interest)). Others might take the form of specific benefits – including severance payments, tax reimbursements and signing bonuses (Matsumura and Shin, 2005, p.102). Therefore, the research conducted on this question has involved examinations of one or more aspects of these incentives and has attempted to assess how effective or otherwise they might be in aligning the interests of the board and/or CEO with those of the owners. This research offers independent directors a choice between several compensation schemes, including non-monetary compensation, to test whether the money or money-like compensation is indeed the vastly preferred one.

The one category of compensation that has probably attracted the most attention is equity options or grants because these are seen as the best ways to relate CEO risk and return with that of shareholders (Business Roundtable (2003) Principles of

Executive Compensation 1, as cited in Matsumura and Shin, 2005, p.109)), and thus are used increasingly to also connect directors through an alignment of benefits. Mehran (1992) in his study of investment funding policies concluded that there was a higher debt ratio amongst those companies with insider equity holdings. He interpreted this as an indication of such agents' preparedness to take risk in the interests of growing the business (thereby avoiding or neutralising the aversion to risk identified by Eisenhardt; 1989). Fama and Jensen (1983) agreed that there was a positive link between incentives and performance on the part of the executives of companies. Jensen and Meckling (1976) found that managers with substantial equity positions were less likely to resist takeover bids, a conclusion that could also apply to directors. As noted above, under the finance model, takeovers are seen as positive for investors and the economy more generally in that they both punish managers who achieve poor returns on investment, thus encouraging assets to move to the most efficient user.

However, Matolcscy and Wright (2007) consider that there are no demonstrable differences in outcomes for companies offering cash-based packages as opposed to those involving equity as well as cash. And Ramsay (1993) and Tevlin (1996), when discussing some of these earlier findings, also make the point that the evidence that incentive-based packages improve firm performance is weak. Ramsay (1993) further argues that a CEO with equity holdings is more risk averse than one who does not because his or her financial assets rise and fall with the fortunes of the company. This reluctance to take risks increases as that CEO nears retirement. Of relevance, too, is the point made by Gordon (2002) that, even if it is assumed that stock options are appropriate in addressing agency problems, "frankly, no-one really knows what is the optimal level of option grant" (p.1246). To this can be added the difficulties involved with valuing such grants (Australian Council of Superannuation Advisors and ISS Governance Services, 2010).

Despite such uncertainty, it has become the norm for CEOs and other managers to negotiate performance-based packages from their employing companies (Bebchuk, Fried and Walker, 2002). While they see this rise in terms of

strengthening managerial power, Murphy (2002) sees it as far more a reflection of (wrong) perceptions on the part of employing Boards of the cost of stock options in comparison to set remuneration packages. Findings on the relatively low confidence of Australian and New Zealand directors (55%; Insync Surveys Pty Ltd, 2009, p.9) that the remuneration package for their CEO was appropriate suggest also a level of ignorance of how they should be determined.

Whatever the reason for their growth, it is apparent that many of those packages have been unreflective of the company's size or the CEO's performance (The Economist, 2003). In addition, statistics indicate that the rewards claimed by CEOs under contract in some places and companies have grown astronomically. Murphy (2002, p.847) offers data showing that from 1992 to 2000, median total compensation for CEOs of S and P Industrial companies in the United States grew from $3.3 million to over $6.5 million (in 2001 figures). More significantly, over the same period, stock options swelled from 27% to 51% of total compensation. Throw into the mix a lack of adverse consequences for underperformers, the trend towards independent directors as the majority on Boards and the issues that may arise over their ability or inclination to monitor and control the CEO (LeBlanc and Gillies, 2005; Matsumura and Shin, 2005; Smallman, 2007), the advocacy under statute and/or listing requirements for a majority of independent directors if not the sole membership on selection committees (Smallman, 2007) (and the difficulties faced by those committees in obtaining comprehensive market or company information), and the effectiveness of incentive-based reward structures as a means of minimising agency costs for owners is put under serious strain.

There is also the issue of correlation – a positive correlation between CEO pay structures/size and firm or management performance does not necessarily mean that the package improves performance (Leonard, 1990). Neither does a negative. Letza at al. (2008) cites several studies (Conyon, Gregg and Machin, 1995; Gregg, Machin and Syzmanski, 1993) that failed to find anything more than a very weak link between executive pay levels and management performance. Core, Holthausen and Larcker (1999) conclude that overall CEO compensation packages (including

payment for performance) are larger where governance is weak and agency problems greater than in the case of where the Board is strong and able to implement effective governance without resorting to large financial incentives. More generally, compensation may be strongly influenced by the labour market for CEOs (The Economist, 2003), a strategy to avoid the negative feedback from shareholders and/or the media should CEO compensation be regarded as obscenely high and inappropriate, while performance may be affected by events outside the CEO's control, including technological advancements, economic climate, regulatory initiatives and competitor actions (Eisenhardt, 1989).

The other aspect of financial control comes via the argument of self-interest. Stapeldon (1996) describes it thus: left to themselves, managers have an incentive to maximise their consumption, including power, leisure and other benefits (that might include subsidised living, golden parachutes and large severance payments unrelated or even negatively related to performance). In this context, Matsumura and Shin (2005, p.102) offer the example of L. Dennis Kozlowski, ex CEO of Tyco who purportedly spent tens of millions of company money on himself, including settling his $80,000 American Express bill and the acquisition of a $6000 shower curtain.

Eisenhardt (1989, p.61) also refers to "moral hazard" that comes from a situation where the agent (CEO) does not do what is expected of them – in other words, they shirk their responsibilities (also see Bainbridge, 2008; Core, Holthausen and Larker, 1999; Heath and Norman, 2004). Such strategies clearly increase the costs of agency borne by the company and contribute to a significant disconnect between the shareholders' and CEO's objectives. It may also ultimately have a negative effect on the market (as in the case of WorldCom, for example).

For New Zealand SMEs, the matter then arises how much to pay their CEO (or manager, or other term, depending on its size). It is not necessarily a function of performance or of prospects offered in the broader market. Where the CEO (or manager or other term) is a member of the family, as is often the case, what is

being paid in other firms is of little moment. It may well be that this individual recommends (or tells) members of the board what salary he or she is going to draw. What role does or should the power to set remuneration have on the relationship between CEO and board in a SME, and to what extent should or can the members of the board refer to performance in settling that remuneration?

The other internal mechanism under the agency model is internal monitoring of management behaviour (in a world of director primacy; Bainbridge, 2008). Such a strategy will reduce the incentives that need to be provided to CEOs and other managers (reducing direct agency costs for the company) and at the same time reduce their freedom of action and autonomy (reducing their risk). However, it should be noted that this mechanism relies heavily on the availability to the monitoring (normally the Board) of reliable and complete information. Eisenhardt (1989) makes this point clearly: the more complete the information, the more positive is the relationship to behaviour-based contracts. In addition, the Board needs to be strong in relation to the CEO (Borokhovich, Parrino and Trapani, 1996) and, perhaps more importantly, to be able to obtain and use the information in an efficient and effective way (Baysinger and Hoskisson, 1990; Jensen, 1994; Coles and Hesterley, 2000).

As indicated previously, agency theory posits that the company or corporation is a nexus of contracts between a range of people and groups with widely diverging desires, purposes and abilities (both inside and outside) and those managing the company or corporation. Some researchers have studied the extent to which the structure of shareholding might affect the efficacy or otherwise of internal monitoring (Bricker and Chandar, 1998; Holderness, 2003).

There is general agreement that where the shareholding is diffuse (widely held), shareholders have little or no real power (Kang and Sorensen, 1999) and it is difficult if not impossible for such shareholders to verify that the CEO is acting appropriately (Matsumura and Shin, 2007; Letza et al., 2008). The problem is exacerbated when those at the management level own large blocks of shares as

then the diffuse (and minority) shareholders incur high agency problems and costs (Chen and Yu, 2011). Their only option is the Board. Therefore huge reliance is placed on the Board (on behalf of the shareholders) to establish the rules of behaviour and the outcomes to be achieved by the CEO who, in turn, determines the means of such achievement. With boards of companies such as Enron and Tyco held up for their failure to formulate and/or enforce standards of conduct for management (Matsumura and Shin, 2007; Kulik, 2005; Nwabueze and Mileski, 2008) and "shareholder activism" (Daily et al., 2003, p.373), in part responsible for the move under law (the Sabine Oxley Act 2002 in the United States), codes and listing requirements to independent directors, and with limits placed on their age, tenure and multi-board involvement, the Board, at least in theory, is even more emphatically the monitor of record.

There is some suggestion that the institutional or block shareholders (trustees, fund managers and the like) are in a stronger position and have more incentives as fiduciaries themselves (Stapledon, 1996, p. 240-244; Davies, 1993), to closely monitor the CEO, a reflection of "shareholder primacy" (Bainbridge, 2008, p.201 sees this as a flawed model). There is indeed some support for Bainbridge's view. Using New Zealand data, Nicholas, Sisira and Abeyratna (2011) claim that contrary to expectations, firm performance actually increases where there are low levels of block ownership and vice versa.

It is interesting to note that while Bainbridge (2008, p.13) points out that a "control block" suffices to give one or two large shareholders effective control of a company, he also concludes that most institutional investors remain passive due to the costs of direct involvement in corporate governance (also see Monks and Minow, 2000) for a similar conclusion in relation to United States institutional investors). Kang and Sorensen (1999) on the other hand, consider large-block shareholders as better monitors than dispersed ones, explaining this superiority by reference to the returns sought by such owners to cover the costs of monitoring (a more positive interpretation than Bainbridge's). Therefore, Kang and Sorensen (1999) suggest that such companies should be highly debt-leveraged as the

demands of accountability and repayment to creditors force managers to maintain good cash flow and budget carefully for each new capital venture or, more directly, persuade a manager of a particular company to act in a certain way for fear of losing a substantial shareholder or in the hope of gaining one (Kang and Sorensen, 1999). Davies (1993) goes even further in making a broader positive theoretical point with his suggestion that the growth in pension funds challenges Berle and Mean's (1932) portrayal of the agency problem of monitoring in a world of dispersed shareholders. Instead, he suggests, institutions are in a good position to claim an increased role in internal monitoring of CEOs.

However, not all investors are the same (Bricker and Chandar 1998; Stapledon, 1996; Davies, 1993; Holderness, 2003). In New Zealand where the vast majority of businesses are small, it is arguable that the board is not the only conduit through which shareholders can express their opinions. Shareholders in SMEs normally have ample opportunities to interact with management directly, frequently being part of the management team themselves.

At the same time, members of that greater family willingly or necessarily maintain their financial interest. Although some of these members may know the business well, others may not – what then is the role or influence of the shareholders of SMEs on the decisions of the CEO or equivalent?

The above discussion focuses on the role of agency theory in conceptualising and formulating the actual and "metaphorical" (Eisenhardt, 1989, p.58) contracts between the CEO and the Board/shareholders as monitors and the external market environment as providing discipline. This focus was in response to a point made in the introduction - that agency theory "dominates" the field of corporate governance literature, particularly in relation to the Anglo-American model of the large corporation. However, as also mentioned earlier, agency theory as a normative reward and control structure is not limited to the public, commercial corporation but has underpinned fundamental restructuring in the public and in some cases the non-profit sectors in certain jurisdictions (Wallis, 1997; Dale and

Pale, 1998; Mason, Kirkbride and Bryde, 2006; Millar and Abraham, 2006; Chhotray and Stoker, 2009). This is partly attributable to what Irvine (2007, p.1) termed "corporate creep", as reflected in the growing use of professional consulting providers in the non-profit sector and the growing pressures on such organisations to adopt corporate systems (Irvine, 2007, p.27) and in the push in the public sector for restructuring and reform based on agency principles.

By way of illustration of the effect of this push, and in part a further critique of agency theory in a non-large public corporative context, the next section describes its impact in the New Zealand public sector.

3.1.4 Agency Theory and its Application to the New Zealand Public Sector

Under the Labour Government 1984-1990 and steered by a small band of reformers wielding a neo-liberal economic philosophy, New Zealand embarked on a fundamental and "ferocious" (Hazeldine and Quiggan, 1997, p.18) restructuring of the public sector (also see Wallis, 1997; Bale and Dale, 1998; Farrar and McCabe, 1997). Basically, the theme underlying this restructuring was that there should be no distinction between the forces driving public versus private sectors, i.e. that both structures should assume managers were "self-seeking individual agents operating with relentless opportunism in an environment fogged by uncertainty and private information" (Hazeldine and Quiggan, p.18). These reforms created a new drive towards a governance structure that could accommodate these imperatives.

The consequences of the process were similarly fundamental. All operations deemed more efficiently or effectively carried out by the private sector were sold (including Telecom, 1990 and New Zealand Rail – subsequently bought back at a hugely inflated cost). Those deemed able to be run as commercial enterprises were moved to a for-profit corporate format (the first seven under the State Owned Enterprises Act 1987). Those avoiding this fate were considered either

politically sensitive or judged as a public service appropriate to keep under government management (e.g. health services, electricity industry), albeit with their operations and decision-making procedures subject to variously upgraded agency principles. Regulation was deliberately designed to be "light-handed" (most importantly via the Commerce Act 1986). Monitoring of SOEs was placed in the hands of a monitoring Board designed to mimic the role of the board of Directors in a privately held company. A deliberate strategy was installed with the intention of preventing the shareholding Ministers of the Crown from meddling in the business decisions so that the market forces could be permitted to work more strongly and efficiently.

The application of governance to the Public Sector in New Zealand is relevant to the private sector as often the public sector is the first to experience rule changes, which then may be extended to firms outside the public arena. By way of example, the private sector was sluggish in adopting the Triple Bottom Line reporting standard where not merely financial parameters are reported to stakeholders, but also social connectivity and environmental stewardship. Only after this standard was mandated for all public sector enterprises did its application creep into the annual reports of privately-owned firms. In a small country like New Zealand, public sector enterprises are often used to gauge the effect of experimental policies, such as non-smoking rules on the property of public hospitals, extended parental leave payments and the insistence on parity in pay between genders for equal work.

This solution for increasing accountability has not been without its critics. Hazeldine and Quiggan (1997), for example, point to the large numbers and layers of extra managers that have been employed under this corporate structure as adding costs without commensurate benefits - the very problem agency theory seeks to address. Advocates for privatisation argue that state owned corporations are neither subject to market discipline (because for political reasons they would not be permitted to fail) nor are very efficient providers of public goods (McKinlay, 1987). With the exception of Terralink (the only state-owned enterprise or SOE

ever bankrupted by its own directors and subsequently liquidated to avoid having to carry out obligations under an oppressive and ill-advised commercial contract [Note: This author was a Terralink director, brought in by the Government after that unfeasible contract had been entered into, to help design an exit strategy]), no SOE in New Zealand has ever closed shop, so it is remains unclear whether commercial reality does indeed apply to SOEs. Although arms-length commercial conduct was prescribed throughout this round of reforms, the Government has continued to use its public purse to bail out needy organizations it deems deserving or necessary, such as Air New Zealand into which the Government injected more than NZ$800 Million of equity to keep it operating as an independent airline (Braddock, 2001).

In summary then, it is clear that a significant body of governance research revolves around agency theory and its implications, not only in terms of its descriptive power (does the governance structures fit with agency expectations) but also its normative values (only if the structures satisfy those required by agency theory will they be adjudged 'good'). However, a major criticism of the theory in the context of governance stems from its tendency to view parties as self-interested and acting from purely egotistical motives. This endorses and encourages a kind of moral scepticism towards management (Heath, 2009).

It could of course be argued that such a criticism is uncharitable. Perhaps managers and owners simply have different interests, and how they manage and reconcile those interests is at the heart of agency theory (Dees, 1992). As Buchanan put it: "If, in applying principal/agent theory, it were necessary to assume that motivation is exclusively or primarily self-interested, this would greatly reduce, if not vitiate, the enterprise. However, we need not do so. Instead, we can proceed on the assumption that the conflicts of interest that give rise to agency-risks may result from a variety of motivations, on the part of agents and principals. All that is necessary is that there be conflicts of interest" (Buchanan 1996, p. 421).

Nevertheless, even if we do view agents as Buchanan suggests, agency theory still raises issues of particular importance for SMEs and family-owned/operated firms. It overlooks subjective factors such as company loyalty, familial ties and bonds of friendship, those factors identified earlier as being at the heart of SMEs and family-owned enterprises. Such loyalties may infringe on agency theory's assumption that an agent will at every chance behave opportunistically, i.e. in their own best interests regardless of what they are obliged to do (Milgrom and Roberts, 1992). This rather Machiavellian view casts human nature as largely socially unreliable. It is perhaps true that humans have a tendency to act in a way which furthers their own interests above all others, but these are only tendencies. As a version of game-theory, agency theory is subject to the same counter-evidence produced by experimental game theorists. Most notable is the large number of individuals that will cooperate in a one-shot prisoner's dilemma scenarios in the knowledge that there is no chance of reciprocation (Dawes and Thaler, 1988; Isaac, McCue and Plott, 1985; Kim and Walker, 1984).

It has also been argued that governance processes that involve a too rigid adherence to the principles of agency theory also increases the costs associated with employment contracts for the CEO and other members of the top management team, as well as of inter-party contracts where other potential agency relationships exist, such as between directors, shareholders and internal and external stakeholders (again of particular import for SMEs and family owned/operated companies). However, it does not necessarily provide equivalent benefits in the form of improved performance or growth. Good governance, Lockhart argues, ought to be grounded in such *good* outcomes. Therefore, rather than being "besotted with the explanatory power of agency theory" (Lockhart, 2007, p.69) New Zealand's SMEs should focus on governance mechanisms that can sustainably deliver high quality performance, good rates of growth, and balance the interests of stakeholders, employees, buyers, suppliers and the environment.

In summary then, business ethicists have argued that, as a framework for examining governance, agency theory has limited value given its contextual reliance (Heath, 2009; Muth and Donaldson, 1998).

Nevertheless much more research is needed to determine the extent to which agency theory based research will be of use in the New Zealand context given the large proportion of SMEs and/or family owned and/or operated firms. Moreover, SMEs in New Zealand ought to ensure that the control exerted by boards of directors is balanced with maximising performance.

The second theory (or rather two related ones) stems from agency theory and highlights the importance of costs and their calculation in identifying efficient and effective governance structures while relying on the same assumptions of self interest as does agency. These are introduced below.

3.2 Transaction Cost Economics

A theory that has influenced corporate governance research (and that is a child of Agency Theory) is transaction cost economics that emphasises governance structures. Proponents argue that the contract between principal and agent (owner and manager) cannot be complete and without cost (Williamson, 1984). Therefore, governance structures can and should put into place mechanisms for instances of decision making that are not catered for in explicit contracts (Hart, 1995).

New Institutional Economics or NIE is a variant of transaction cost economics or TCE (van der Steen, 2006). Although this focuses on the range of institutions affecting organisations, it also involves the same fundamental assumption as does agency – that of the self-interested, rationally maximising individual measured in economic terms (Rutherford, 1995). It merely relaxes some of the assumptions. For NIE, institutions themselves are and should be responses to economic stimuli, the outcome of the drive for efficiency, not of other social or political concerns.

On a state level, this is necessary because a high cost institutional structure will discourage economic growth and positive social change. Therefore, a rational regulator – responsible for setting the rules - will create a regime to allow individuals in the market to maximise their own benefit – and that can only be achieved via an efficiently operating market (the "light-handed" approach; Jwa, Seo and Choi, 2000). On an organisational level, focus on objectives; rituals and practices at the expense of performance will ultimately punish the organisation and its management in the market.

NIE has been criticised from several angles (institutional theorists and agency theorists being two) for not adding anything useful to the debate – an "empty" theory (Chhotray and Stoker, 2009). Rutherford (1995) explores some of those criticisms, principally its assumption of economic rationality as the driver of decisions. Van der Steen (2006), while applauding the ability of NIE to allow universalisation of individual political actions and its acceptance of "bounded rationality" (van der Steen, 2006, p.10-12) as a more realistic expectation than the perfect rationality assumed under agency theory, also points out its applicability in research is limited due to its failure to address process – that is, how an organisation arrives at the optimum governance structure. In New Zealand, this theory is of limited applicability as it presumes the ready availability of alternative types of performance which can then be priced out to determine whether the internal effectiveness is sufficient to trade competitively. Such a ready market does not exist in many industries in New Zealand, where very few large firms exist in some industries, immediately followed by SME-size firms in fragmented markets.

The next sections explore alternatives to agency theory and its close relatives, with particular focus on ways in which writers in these traditions address what they see as the shortcomings in agency theory in the context of governance. As a preliminary point, in contrast to agency theory, all of them see the firm (or corporation) as a player in a broader social context rather than as a nexus of logical (and limited) relationships (Christopher, 2010). This broader role implies first, that the range of relationships for a firm is both complex and subject to

constant change in a volatile market environment (Clarke, 2007). A second implication is that good governance is contextual: dependent on such factors as culture, size, ownership and the wider environment (OECD, 2004, Sison, 2000).

3.3 Alternatives to Agency Theory: Stakeholder Theory

By way of general introduction, advocates of stakeholder theory propose that instead of the firm being seen as having one overarching objective (the maximisation of shareholder wealth (Coelho, McClure and Spry, 2003), it should instead be located as a social actor responsible either legally or morally (or both) to a range of internal and external constituencies. These stakeholders can be human or non-human; direct or indirect and herein lies one of the major problems: the location and ranking of such stakeholders.

In addition, although the term stakeholder is used extensively by a wide range of organisations even outside business (public sector, local government and central government being only three), the broad range of definitions offered (see, for example Brenner and Cochran, 1991; Clarkson, 1995; Donaldson and Preston, 1991; Freeman and Reed 1983; Freeman, 1984; Mitchell, Agle,and Wood, 1997; Tsogas, Komives and Fuller, 2005; Waddock, 2002) it has been criticised (for example Kaler, 2002; Waxenberger and Spense, 2003) as vague and uncertain; doing little to assist organisations in evaluating and balancing conflicting demands that might be placed upon them.

Writers such as Donaldson and Preston (1995), Freeman (1994) and Freeman, Wicks and Parmar (2004) have addressed this particular problem; Freeman, for example, classifies shareholders, suppliers, employees, customers and the community as 'the big five' (Freeman, 1994) members of the category of "those groups and individuals who can affect (or be affected by) [business activities]" (Freeman, Wicks and Parmar, 2004) while Mitchell, Agle and Wood (1997)

propose a multi-faceted theoretical framework to establish the "principle of who or what really counts" (Mitchell, Agle and Wood, 1997, p.853).

In the context of corporate governance, advocates for stakeholder theory claim that "it is the firm's objective of unalloyed shareholder value-maximisation that leads primarily to a micro failure of governance arrangements" (Keasey et al., 2005, p.3). The stakeholder perspective recognises that there may be multiple principals (shareholders) with heterogeneous interests and objectives. This raises concerns in New Zealand where many of the small/mid-size have few shareholders, mamyn of who, are aligned in their outcome interests through family bonds. In addition, proponents consider the range of stakeholders to include, but not be limited to, owners or investors, thus offering a Pandora's Box of multiple stakeholders with divergent interests, including employees, customers, suppliers, creditors and lenders and the wider community (Jensen, 2007). Given the difficulties inherent in implementing governance strategies that protect each and every one of these divergent stakeholders' interests, the stakeholder perspective requires that, rather than remaining preoccupied with protecting shareholder interests, governance structures ought to focus instead on the long-run value of enterprises (George, 2010; Bhimani, 2008). This assumes, somewhat speculatively, that long-run sustainability of an enterprise in itself is proof that stakeholders have become unified in their support of the firm.

Of interest in this context is the recent reporting by Brammer, Jackson and Matten (2010) of evidence emerging from a European retail context that stakeholder-driven initatives are threatened by what are described as "business-led" initiatives. This might at first sight suggest that agency theory and its implicitly shareholder-interest supremacy approach is the best approach to governance. Yet, as these authors go on to explain, "business-led programmes are often and increasingly dependent on the involvement of external stakeholder groups in order to bolster their external legitimacy" (Brammer et al, p16).This finding suggests that , while some firms may firmly adhere to the contractualist approach that also apply

stqakeholder principles as a means of expanding and securing their wider support base.

However, critics have identified problems with the stakeholder approach, most specifically with the fuzziness and uncertainty implicit in recognising and managing the various interests . Illustrative of such difficulties in identification and management of multiple and potentially conflicting stakeholder demands is the particular challenge of governance in the non profit sector, a sector populated by organisations (NPOs) having a certain fundamental character that shapes the range of claimants to whom the organization is or should be accountable. This is a matter explored below.

The Non Profit Sector: Character

Two major aspects of character should be mentioned here. The first of these is the underlying social culture of the organisation (Millar and Abraham, 2006) – religious/secular; national/international; charitable/non-charitable; human/non-human focused being just some of the possible dichotomies. This categorisation can be significant when it comes to governance as the social norms and expectations can be powerful disciplines on those involved or affected.

It is arguable that “stakeholders” are of particular importance in the NPO context, justified as follows: NPOs by virtue of their definition do not have “owners” or anyone entitled to receive residual profits (LückerathRovers et al 2009; Jamali et al, 2010). Consequently, one of the pivotal foundations of the major alternative agency theory is absent (Millar and Abraham 2006). It is also arguable that the fundamental tenet – that an agent (or in the corporate context, the CEO or Manager) is self-serving – runs contrary to the traditional perception of the leader in a NPO as a person wanting to do good rather than do well, and that there are good reasons why a Board (if it has one) should wish to collaborate with a CEO or Manager rather than control (Hough et al, 2004).

Lacking a paramount objective of profit maximisation, the strategy, objectives and behaviour of NPOs are multifaceted and fluid as they respond to social and political change in an attempt to remain relevant and functional. Where, for example, a Government assumes responsibility for public health, an NPO previously active in that area might turn its attention to providing support for the families of the sick, or where tenant participation in community housing schemes is actively encouraged by Government as a weapon against local authorities (McDermont, 2007), so those affecting or affected by the NPO and its objectives (Freeman, 1984) also changes.

It is assumed that NPOs have a mission or missions (Millar and Abraham, 2006; Mueller, Williams, Higgins and Tou, 2005) or some other homogenous value(s) (Auteri and Wagner, 2006) that provide a focus for those involved at various levels and in different ways both materially and otherwise; funders, workers and users. As part of that it can be argued that for many of those individuals and groups there is a greater personal connection and even a sense of loyalty to the NPO than may be the case for commercial corporations.

However, the non-profit sector (and by analogy the stakeholders) is far from homogenous (Millar and Abraham, 2005; Pascoe, 2008; LückerathRovers et al, 2009). In addition, the characteristics of the individual organisations and the nature of the sector itself can shift over time and place. As discussed below, the resultant complexity and diversity (and the implications for stakeholders) also have implications for governance.

The Non Profit Organisation: Diversity and Complexity and the Stakeholder Purpose

There are almost as many purposes as number of NPOs. However, and in the interests of clarity, in their study of the New Zealand NPO sector, Sanders et al (2008) classify NPOs by reference to two functions: a service function (involving the delivery of such direct services or facilities as education, health, housing,

community development and the like and an expressive function (supporting advocacy for and promotion of culture, religion, professional development and policy values).

Service organisations normally have quite clearly defined roles and functions, including providing health care, managing or providing accommodation, education or some other community-based support. As the providers of funds (such as Government, local authorities and charities) often look to fund on the basis of specified outcomes, their assessment of any finding application or renewal/extension of funding will most likely take into account the extent to which the organisation has and/or can fulfil those roles and functions (that can be very specific, such as number of people settled, number of operations in particular categories performed, number of meals provided to the homeless). However, the expressive function is less easily quantified and outcomes potentially hard to assess. In addition, their sources of funds can be affected by changes in the way donors and regulators perceive them (for example as charities or as political organisations). What makes the situation more unclear is the fact that many NPOs pursue a range of activities where the boundary between them may be quite blurred (such as health and social support services as well as advocacy).

Frequently, even single purpose NPOs have at least two principal stakeholders or claimants. First, there is or are the funders who at the very least expect the NPO to do an adequate job in spending the money. However, potentially in conflict with this stakeholder is the membership and/or workforce (who may also be involved directly or indirectly in determining how the money is to be spent) (Auteri and Wagner, 2006) and/or those who benefit from the work of the NPO (Krashinsky, 1997). Where the NPO has multiple purposes, the complexity becomes greater as stakeholders with different expectations and demands cause attention of those involved to "drift" (Jamali et al 2010: 592), muddying the waters, creating tensions (Krashinsky, 1997) and reducing trust and loyalty on the part of those who consider the NPO has lost direction

Funding

Funding for non-profits comes from a variety of sectors, and can differ dramatically depending on the jurisdiction, focus (purpose) of the NPO and its size. By way of indication, Sanders et al (2008) report that in 2004, 32% of Australian NPO funding came from Government sources in the form of either grants or contract monies and for New Zealand, 25%. Other sources of funds include foundation and other large private sector donors as well as one-off or on-going individual public donations, fees or subscriptions (again for Australia and New Zealand those figures are 10% and 20% respectively from "private philanthropy" (Sanders et al, 2008: 19) and 58% and 55% respectively from fees and subscriptions.

Providers of funds to NPOs are clearly potentially important stakeholders as their decisions as to the level of funds (if any) and the purpose to which they must be put may be crucial to the viability and on-going success of the NPO (Mueller et al, 2005). Where Government is a major contributor, and with the emphasis in new institutional economics on the contractualisation of the relationship with the NPOs (as in the instance of corporatization of the public sector as discussed earlier), high levels of accountability and transparency will be expected (Steane and Christie, 2001). This requirement challenges to some extent the notion that NPOs are independent of government, (State Services Authority of Victoria, 2007). Large or significant donors are also arguably in a position to influence governance practices (Fama and Jensen, 1983; Williamson, 1983) while small donors and members may not be (depending on the size, operation and form of the organisation).

Size

Non-profit organisations range from very large and/or multi-national structures (the International Red Cross and World Vision being two obvious examples) to very small, this latter group potentially involving only a very small number of active individuals (also often volunteers) (sometimes referred to as "micro" (Clark, Kane, Wilding and Wilton, 2010)). Although detailed statistics on the size range of NPOs

is scarce, some indication of size can be obtained from the percentage of NPOs staffed entirely by volunteer labour – a predominant state of affairs - (and based on the assumption that a small NPO is likely to be in this position whereas a larger is more likely to have paid staff). In New Zealand some 90% of the 97,000 NPOs rely solely on voluntary labour. In Australia, the percentage is even higher, with only 5% of the approximately 700,000 organisations with paid employees. Finally, in the UK, Clark et. al. (2010), report that 22% of 171,074 voluntary (NPO) organisations in 2008 employed staff – most of those in the organisations classified by them as large or major.

The overwhelming implication from this predominance of volunteer participation in NGOs (that often includes members of the board, if there is one (Steane and Christie, 2001)), is that those involved are committed to the ideals or objectives of the organisation – why else would they give their time and expertise? (Taylor, Chait and Holland, 1996). Such individuals are stakeholders because they are interested in the survival of the organisation. In addition, because those volunteers have chosen to be involved in the organisation for reasons other than remuneration, it is arguable that they are motivated to monitor the organisation to ensure that it fulfils its objectives. However, not all volunteers are the same and their motivation may be a function of the nature of the organisation itself. They elect to join an organisation for a variety of reasons, including the desire to do good for society, family involvement (eg children or partner), social reasons or for other personal purpose.

More directly relevant to the issue of governance, it is likely that only larger NPOs are likely to have a board or equivalent with smaller ones relying on a committee structure at the most. Even where the NPO has a board, membership per se is no good indicator of either commitment or value. Election can be a result of demonstrable contribution but can also be a function of personal relationships, popularity or power. The talents and expertise of members may be poorly used and governance concentrated in the hands of a few or one (Taylor et al, 1996).

Also critical to governance is regulation. Obviously, the rules applying to listed companies are not relevant; nor are members of a board or committee subject to statutory rules re directors' duties or liabilities. However, although it is estimated that less than half of all NPOs in Australia are incorporated (some 380,000 out of a total of 700,000 (Lyons, 2009)) and only around 20% of the 97,000 in New Zealand (Statistics NZ, 2005), the larger NPO is very likely to be structured as a separate legal person (in Australia most commonly as an Incorporated Association (under the various state-based Acts having that purpose and focus)) and in New Zealand an Incorporated Society (under the *Incorporated Societies Act 1908*) (one good reason being that tax advantages and Government funding opportunities normally require incorporation). All these statutes require that incorporated organisations operate under a constitution (that, inter alia, spells out the procedures to be followed in making decisions) and, in the interests of accountability, have their annual accounts independently audited. Members then have access to those audited statements which are also filed with the responsible statutory body such as the Office of Fair Trading (NSW) or Consumer Affairs (Victoria) (both Australia) and the Registrar for Incorporated Societies (New Zealand).

As well as organisational-oriented regulation there is regulation affecting activities of NGOs (including that specifying obligations of those running events, those protecting the safety and rights of employees and volunteers, specific requirements over fund-raising activities etc (Pascoe, 2008). There have been concerns expressed over the burden posed to small business and small NPOs in particular as a result of this regulation (Pascoe, 2008). In addition, such regulation can pose a challenge for governance as small NPOs may lack the expertise, funds and strategies to manage the consequential legal risk.

As a final note, and by way of addressing the perceived shortcomings of stakeholder theory in this context, various researchers have proposed a range of alternative frameworks for evaluating governance in NPOs. Although these other frameworks will not be explored, by way of an idea of the range, Millar and Abraham (2006) discuss and offer critiques for four of these, including the

integrated model proposed by Zahra and Pearce (1989), the conceptual framework devised by Bradshaw, Murray and Wolpin (1992), the Six Dimensions Framework formulated by Jackson and Holland (1998) based on research by a team from the University of Georgia, and Nicholson and on Kiel's Intellectual Capital framework. Also, Cahill, Armstrong and Storey (2001) propose a framework to foster social capital formation, while Mueller et al (2005) offer the Gap Evaluation Tool or GET as a self-evaluation tool for NPOs to test themselves on their governance and management practices.

Somewhat compatible with the stakeholder perspective is stewardship theory. Stewardship theory emphasises that those responsible for managing an enterprise should (and largely do) see themselves as stewards entrusted with the ambitions, needs and wants of those who rely on their expertise and knowledge. This theory and its implications are explored below.

3.4 Alternatives to Agency Theory as a Framework for Governance: Stewardship

In many ways this theory stands in contrast to the more prescriptive nature of agency theory, and has had little impact upon corporate governance research or measures designed to improve it when compared with agency theory and transaction cost economics (Cadbury Report, 1992; Combined Code 1998, 2003, 2006; Greenbury Report 1995; Hampel Report 1998; *Sarbanes-Oxley Act 2002*). However, it is useful to compare its approach in terms of what it implies for governance of companies.

Basically, in accordance with this theory, structures should allow executives to act more autonomously towards maximising the owners' financial gains than is currently the case (Donaldson and Davis, 1991), thus giving wider latitude to operators of the business when they act in the interests of the owners.
More specifically, Muth and Donaldson (1998) describe the stewardship model as one "based on manager as "steward" rather than the entirely self-interested

rational economic man of agency theory" (Muth and Donaldson, 1998, p.5-6). Mason et al. (2007) agree, explaining stewardship theory as "present[ing] a view of governance that diverts from economic interpretation of relationships within an organisation" (Mason et al., 2007, p.290). Instead, it recognises physiological and situational factors. Physiological factors include identification and power while situational ones include management philosophy and power. Mason et al. (2007) (a view echoed by Davis, Schoorman and Donaldson, 1997 and Lockhart, 2007) stress that trust is implicit in such a model because managers are assumed to take the necessary steps to maximise the interests of the organisation, and Donaldson and Davis (1991, p.51) state that it also assumes that generally managers aspire to do a good job. It is doubtful that the Stewardship theory finds a lot of support in SMEs in New Zealand as it presumes a relative independence of the operators from the shareholders. In the largely family-controlled organizations such a separation does not exist and thus an autonomous management only survives the next family outing where the patriarch/matriarch instruct the next generation managers as to the best and only way to run the business.

Finally, Davis, Schoorman and Donaldson (1997) place stewardship in a completely opposite ideological position to agency – a steward, they say, is one whose interests align with those of his or her principal while an agent is one whose interests are at odds with those of his or her principal.

Arguably too, such an approach envisages the organisation as an organic being reflecting a nexus of interests (as opposed to a structure offering a nexus of contracts as in the instance of agency theory). It is the responsibility of management to recognise and mediate between those interests so as to maximise overall satisfaction.

Stewardship theory therefore premises that structures within the company should be designed not so much to control but to enable (Olson, 2008). This requires the understanding by various participants of the respective interests and the development of a coping mechanism by which those interests are recognised and

harmonised. Admittedly, this is a challenging presumption during time of governance stress, i.e. when complex governance decisions about cessation of trading, changes in shareholdings and other material corporate events are made, although Segaro (2012) argues that in the case of family-run and owned SMEs, stewardship principles "moderate the curvilinear relationship between family ownership and internationalisation. Specifically, higher levels of stewardship orientation strengthen the relationship" (Segaro, 2012, p.155).

The above is perhaps an important point given the critique levelled against stewardship theory by Albanese, Dacin and Harris (1997) in the course of a debate with Donaldson et. al, in which they argue that stewardship assumes that content of preferences for actors is more important than the principle of rationality itself and that rationality as defined by stewardship advocates is a bounded concept remote and unaffected by any other considerations or factors (such as trust, relationships or underlying ethical constructs) and therefore inevitably assuming narrow, self-serving and extrinsic outcomes for such actors.

Instead, they suggest, the robustness of agency theory lies in its determination to assume individuals make decisions about preferences in a rational fashion (ie, make those choices that maximise individual utility). However, this does not preclude or deny that the factors that shape the utility are subject to other factors such as personal preference, relationships or ethical beliefs.

However, an alternative viewpoint on the relationship of these two theories is to see them not as opposities but as complementary, or as Elsayed (2010) explains:

> the assertion of both agency theory (CEO non-duality structure) and stewardship theory (CEO duality structure) may be valid under certain conditions. Thus, existing theories might need to be treated as complementary viewpoints, each of which draws upon a part of the whole picture, because depending on just one single perspective is

> more likely to result in misleading conclusions about the structure as a whole" (2010, p. 80)

This perspective is interesting as it throws open the entire question as to whether and in what circumstances is the mantra of separation between board and CEO truly valid and necessary.

3.5. Alternatives to Agency: Institutional Theory

Despite the recognition by advocates of agency theory that incentives and other control/monitoring mechanisms must reflect the wider context in which they are implemented (Li and Harrison, 2008 and 2008a), they still seem to have some degree of sameness to them. For example, as discussed earlier, reform of the public sector in New Zealand and other jurisdictions involved clear delineation between "ownership" and "management" of public sector commercial and non-commercial government activities (Wallis, 1997; Hazeldine and Quiggan, 1997; Farrar and McCabe, 1997; Bottomley, 1996 (referring to Australia)). Agency structures are implicit in funding of public sector organisations in the United States (Provan and Milward, 2001), and there have been moves to see them embedded in corporate governance guidelines and rules in a range of different jurisdictions. However, at the same time, governance practices, structures and organisations still develop and operate in different ways in different jurisdictions.

If the assumptions underlying agency theory are pure, how are these differences explicable? More importantly, are alternatives to structures of control and monitoring based on the concepts of agency theory valid and supportable of good governance?

3.5.1. Institutional Theory: Philosophy and Justification

In institutional theory, "institutions consist of cognitive, normative, and regulative structures and activities that provide stability and meaning to social behaviour. Institutions are transported by various carriers—cultures, structures, and routines—and they operate at multiple levels of jurisdiction Institutions are composed of cultural-cognitive, normative, and regulative elements that, together with associated activities and resources, provide stability and meaning to social life" (Scott, 1995, p. 48).

More specific to the application and relevance of this theory to corporate governance, Morgan, Campbell, Crouch, Pedersen and Whiteley (2010) explain that:

> The field [in which] we are interested can be defined in how the forms,outcomes, and dynamics of economic organisation (firms, networks, markets) are influenced and shaped by other social institutions . . . and with what consequences for economic growth, innovation, employment, and inequality. Institutions are usually defined . . . as formal or informal rules, regulations, norms, and understandings that constrain and enable behavior.

By way of further introduction to the discussion of the theory and its relevance to governance, Kulik's (2005) discussion of agency theory is helpful, since it refers to Enron as an example of what can go wrong. Kulik spent over half a page listing accolades received by the "highly respected" company (Kulik, 2005, p. 349) and its CEO (Ken Lay), including awards for innovation and media attention and then asked how this was explicable given the simultaneous "excessive non-sustainable acquisition of pay and perquisites" (Kulik, 2005, p. 350). He offers two explanations. The first is that the executive used agency to determine and validate the self-serving behaviour. Basically then, provided members of the executive observed the boundaries set by the board and responded to the signals identified

by incentives (in which they played a major part on designing), they had no cause or motivation to consider the wider implications of what they were doing. His second reason is that agency reasoning contributed to an agency culture – the means whereby the flawed incentives and monitoring mechanisms became "instilled in members' values, beliefs, assumptions and expectations" (Kulik, 2005, p. 353). Thus behavioural standards and self-aggrandisement attitudes of the members of the executive percolated all the way down.

Ironically this picture (of a failing company wedded to principles of agency) may well demonstrate that governance is often not just about economic rationality. Institutional theorists would critique agency principles to maintain that it is not possible to appreciate corporate governance at all without also appreciating the broader economic, social and political environment. In Enron's case those broader economic (deregulation of the electricity market and lax audit requirements); social (within the organisation a culture of greed, laissez-faire leadership and outside it an atomistic focus) and political (celebration of the market, political cronyism and the value attributed to the large business organisation) characteristics of the environment allowed and encouraged the rot to set in.

More broadly, Li and Harrison (2008, 2008a) in their papers on corporate governance of multinational companies, argue that research into the subject has failed to consider the wide variation in governance structures across countries and by assuming consistency fail also to offer useful insights into how governance can be improved. This vexing issue of comparison across different systems has also been raised by Li (1994, 2007), Cioffi (2000), O'Sullivan (2003) and Aguilera and Jackson (2003).

One obvious example of such variation is implicit in the two tiered board, common in Germany, to insider dominated boards in Japan to mixed ones in the United States, the UK and other members of the Commonwealth. To this range, outsider dominated boards could be added (increasingly the tendency in the United States as a consequence of the Sarbanes-Oxley Act 2002 and changes to the listing

requirements of the various major exchanges (NYSE and NASDAQ (Alces, 2010))) and in the UK (after the Cadbury Report), Australia and New Zealand, as well as those dominated by lending institutions (Li and Harrison, 2008) or those with employees as mandated members (Aguilera and Jackson, 2003; Buher, Rasheed and Rosenstein, 1997). The limitation of this approach in New Zealand is, again, found in the largely fragmented market of privately held firms where many of the public company regulatory interventions do not apply.

In an attempt to address and clarify the comparative picture, Millar, Eldomiaty, Choi and Hilton (2005) classify governance systems according to a 'triad' (Miller et al., 2005, p. 163). They document the differing roles, behaviour and influence of players, including financiers, regulators and markets within these three categories and stress that these non-economic influences significantly affect the capabilities and behaviour of companies. Specifically, the three types they identify are the Anglo-American (the focus of much of the agency theory oriented corporate governance literature), the Communitarian (European dominated) and Emerging Market (covering much of Asia and Eastern Europe).

Shareholding patterns also differ. In some countries such as the UK and the United States they may be dispersed or diffuse (Coffee, 2005) or in some cases in the hands of large institutional shareholders (pension funds and the like). This pattern is different in other countries such as Japan (Coffee, 2005), France, Finland and Sweden with banks (Buher et al., 1997; Aguilera and Jackson, 2003), families and 'core investors' (Li and Harrison, 2008, p. 608) playing major roles.

Thirdly, different jurisdictions may not have the markets that are deemed requisite for agency theory to work well. Although active and significant markets for control, stock and management are highly developed and generally free in countries in the west, the same cannot be said for developing and transition economies where governments are moving from interventionist to regulatory regimes but are also wrestling with issues of flawed or absent market mechanisms

and potentially anti-market histories and attitudes (Harriss et al., 1997; Kirkpatrick, Parker and Zhang, 2003; North, 1997).

Finally there are the manifest differences in CEO package design and size that are not totally attributable to relative pricing structures in the wider markets. Cornish (n.d.) reports that in the United States the mean mix of fixed, short-term incentives (bonuses etc) and long-term incentives (stock options and the like) is 30, 24 and 46% respectively, far more inclined towards long term than the other two jurisdictions in the survey, the UK where the percentages are 42, 19 and 39 and Australia with 52, 17 and 31. Although the detailed breakdown for New Zealand companies is not available, Jiang, Habib and Smallman (2008) report that for these CEOs the average fixed component in 2004 was 58%.

As for size, Jiang et al. (2008) report that the mean cash compensation (including bonuses and other short-term incentives) paid to New Zealand CEOs was NZ$524,340, a far cry from the Australian average a mere year later of Aus$2 million (Australian Council of Superannuation Advisors and ISS Governance Services 2010) and in the United States of around US$11.2 million. It might be crude analysis but these figures and proportions suggest that some of the expectations as per the agency model do not work universally and therefore, perhaps the model itself does not have universal application.

3.5.2. Institutional Theory as a Contra to Agency

For those seeking an explanation of such variations and a means of assessing relevant structures, institutional theory seems to offer some answers. What is this theory? Selznick (1996) explains that it is "a voice of resistance to [a]…culture of short-sightedness, offers guides to thinking about corporate responsibility, and brings into question the goal of maximising profits or returns on capital" (Selznick, 2006, p. 272). Instead of treating the corporation (or company or firm) as a passive nexus for enabling contracts between self-interested economically rational beings

(the basis of agency theory), institutional theory gives it a much broader role as an adaptable social system (Mason, Kirkbride and Bryde, 2007), thereby also empowering those involved in such organisations to respond to other groups within that organisation and outside. The theory subsumes stakeholder theory (Parkinson, 2003) with its assumption that stakeholders of various types, power and location affect both formal and informal processes within the organisation, and further acknowledges that stakeholders (or more generally participants) have a culturally-oriented impact on the institutions that control behaviour and reward outcomes. Before exploring this theory further, some preliminary questions need to be addressed.

In what respects does this theory differ from agency? The first departure is in respect of some of its fundamental assumptions and ideas. Briefly, in this context (and depending on which strand of the theory), "institutions" refer not only to the organisations themselves (Selznick, 1996) but also to those social concepts that underlie them or as North (1995, p.23) explains, they are "the rules of the game…they are comprised of formal rules (statute law, common law, regulations), informal constraints (conventions, norms…and self-imposed codes of conduct) and the enforcement characteristics of both". Chhotray and Stoker (2009, p. 64) specify that those rules and constraints have three key characteristics: they have the ability to govern relationships between individuals and groups, are either voluntarily accepted or enforced by some external agency and are predictable.

North (1995, p. 23) describes "neo-classical economists [including those wrestling with issues of agency]… impliedly assum[ing] that institutions …do not matter, and that static analysis embodied in allocative efficiency models should be the guidance to policy" (also see Chhotray and Stoker, 2009, p. 159 for their point that economic theory often overlooks the relationship between the legal system and economic development). Therefore, the only reason for their consideration would be due to their effect - negative, neutral or positive – on the cost of transactions, and therefore their implications for the principal objective: maximising shareholder (short-term) wealth.

In addition, institutional theory has a reflective function. It can inform institutional design (Harriss et al., 1997, p. 2). More generally, there is implicit acceptance that a framework of formal 'rules' may be the best option within a particular cultural or economic context to cope with market failure (Harriss et al., 1997). Such failure could be found in a weak equity market (where participants are unrestrained in their misuse of information – insider trading), cultural norms or where weakness of the economy and its vulnerability to domination by transnational business organisations prompt a Government to respond with changes to formal rules – including regulations criminalising certain market behaviours, providing import controls or offering other sorts of protection (including minimum and maximum incomes, levels of foreign ownership or other participation in business (Nwabueze and Mileski, 2008). Finally, as Mason et al., (2006) explain, in incorporating informal restraints, the theory immediately moves beyond the boundaries assumed by agency theory (that the contracts between the agent and principal will be determined by agreement and enforcement/control) to look at other relevant factors.

A second departure from agency theory relates to the treatment and nature of choice. A fundamental assumption for agency theory is that individuals make decisions based on rationality (basic cause and effect) (Albanese, et al. 1997), primarily economic. The sum of such choices then becomes the choice of the collective. Institutional theory sees the situation as more complicated. North (1997, p.18) posits that choice is multifaceted because 'ideas and ideologies' also play a part (consistent also with post-structural ideas of a human as a social product, shaped by his or her socio-temporal environment (Foucault, 1973). Institutions may reduce the levels of uncertainty that might otherwise result from those ideas and ideologies (North, 1995) but does not eliminate them. According to (Rutherford, 1995), Commons (1934) takes the matter of ideology further, presenting its evolution as a process of modification to 'habitual assumptions' (Rutherford, 1995, p. 445) – a manifestation of social learning without which no progress would be possible.

Therefore, if the influence of those ideas and ideologies is such as to prompt a decision-maker in an organisation, including a corporation, to reach the conclusion that maximising the satisfaction of members and outside groups is achieved through increases in charitable donations or sponsorship of the arts, it is difficult to then conclude that economic rationality is paramount (in accordance with pure economic theory anyway although Jensen and Meckling (1976) might argue differently). However, ignoring these other facets to the decision-making process will not make them go away.

3.5.3. Institutional Theory – Its Meaning and Scope

Are there variations in how theorists define or view this theory? Due to the relative complexity of the theory as compared to agency, there is no single approach taken by those researching in the area (Letza et al., 2008). Nor is the distinction between the various strands that clear. There is also some dissension by institutional theorists about what should be studied and how findings can be explained.

Old Institutional Theory

First, there is the so-called 'old' institutional theory that recognises the firm or company as dynamic, responding to influences from the outside and inside (Rutherford, 1995) that may be functions of economic stimuli but that do not have to be. This strand places the organisation at the centre of the analysis, referring to it as the institution (Selznick, 1996; Leaptrott, 2006) and focuses on the "purposive efforts of individuals to respond to environmental pressures" (Leaptrott, 2006, p. 216). The driving motivations for these individuals are the rituals and formality (the internal processes) and values of the organisation (such as employee satisfaction and social ethos). It is important to stress that in terms of this strand of the theory that external regulatory, political and social pressures are only important for

governance in the form they appear in internal practices and behaviour. Also, history matters as it is history of the organisation (subject of course to change) that determines current internal structures and practices.

<u>New Institutional Theory</u>

New institutionalism (although Rutherford (2005) refers to it as "old") shifts focus from the company as the institution to the cultural context in which companies operate. Therefore, external and internal social and political influences (including status, group, reputation, ideology and power) (Rutherford, 1995) are also important in both describing and evaluating corporate governance structures. It draws on organisational theories and the social, political and economic role of the firm to understand and formulate governance "aligned with the concepts of citizenship, participation and legitimacy" (Parkinson, 2003, p.491). Consequently, such research focuses on identifying those influences and tracking their effect. In addition, there is the underlying premise that organisations must reflect social norms, lest their legitimacy, resources or even survival is threatened (Nwabueze and Mileski, 2008; Li and Harrison, 2008), a premise that supports a normative model, not merely a tool for description.

In a very real sense, this new institutionalism is reminiscent of post-structuralism with its focus on individuals, groups and organisations with a multiplicity of identities and meanings (for example an organisation as employer, producer or social player and an individual as voter, employee, group or team leader, investor and consumer of products and services) and 'myths' or the abstractions, languages and symbols that permit individuals to manage their material world (Smith, 1998). As Selznick (1996) explains it, formal structures such as companies validate, support and maintain myths by responding to external and internal institutions through policies, practices and processes.

This strand of the theory seeks to explain isomorphism (DiMaggio and Powell, 1983) of organisations in a particular cultural context – the notion that within a context organisations and their governance are more likely to display similarities than they are differences. Usefully, van der Steen (2006: 15-18) identifies institutional isomorphism as having three mechanisms – that is, means whereby the relevant culture is created and changed (also see DiMaggio and Powell, 1983). These are coercive (a function of formal and informal pressures from regulatory agencies but also industry organisations, investors, customers and competitors; the tendency for organisations to respond to uncertainty by imitating successful ones (mimetic isomorphism) and professional and management norms (normative isomorphism) and a function of educational theories and approaches and monitoring processes.

How then do the various strands of institutional theory manage the issues associated with corporate governance differently to agency? This is addressed in the following section. As part of this discussion, some aspects of agency theory as discussed earlier that are seen as problematic for institutional theorists are highlighted.

3.5.4 Governance Problems – the Institutional Solution

The first major set of problems is a function of the emphasis under agency theory on a narrow range of economic factors as a means of measuring firm success and CEO performance. These include short-term market indicators, including return on investment, share price and dividend policy, for Letza et al. (2008, p.19), the outcome of "competitive myopia". Various issues with this emphasis have been identified. First, it fails to acknowledge that the world is riddled with uncertainties (McNair and Watts, 2006) and factors that are not easily controllable by the CEO (or anyone else in the company). Institutional theory offers an opportunity to

identify and control political, economic and other uncertainties (through practices such as benchmarking (McNair and Watts, 2006) and workforce training and policies) and to permit future strategy and policy in light of pending environmental changes.

An example to illustrate this point is research and development of new drugs. In the short-term, the interests of shareholders of a drug company are best served by investment in drugs that have a ready and easily accessible market, minimal development time and expenditure and quick and cheap approval horizon. However, society is not best served by such a focus (as the global disease profile is constantly changing) and, because many drugs involve much pure research, costs and an extended timeline before launch, the long-term interests of shareholders are not best served either. There are also the potentially adverse effects of publicity on deadly or significant side effects or reactions that can bring a drug producer down (Thalidomide, a drug from the 1960s that caused gross birth defects in thousands of victims, still provides a salutary lesson today).

Secondly, there is the matter of remuneration for CEOs. As identified above, some (although not all) research suggests that the link between the remuneration of CEOs and company performance is unclear (Tevlin, 1996; Ramsay, 1993; Murphy, 2002). Nor is the optimum mix or size easy to establish with any degree of certainty (Gordon, 2002; Matolcscy and Wright, 2007). Some researchers find a positive correlation (Fama and Jensen, 1983) but others find it to be weak or non-existent (Jensen and Murphy, 1990; Tevlin, 1996). One explanation for this might be that the mix is wrong (Murphy, 2002). Another might lie in the assumption that there should be a positive link.

Even more problematically, linking return for the CEO to company performance (through stock-based and bonus type incentives) may encourage the CEO and other members of management to respond to the market signals by manipulating financial data (Fogarty and Markarian, 2009; Zhang, Bartol, Smith, Pfarrer and Khanin, 2008). Such manipulation can include retiming of expenditure, restatement

or recalculation of income (Catanach and Rhoades, 2007) or other more significant creative accounting mechanisms Haldeman 2006 (discussing Enron); Tran (2002) (referring to WorldCom).

Consider, for example, the CEO with independent wealth. A large compensation package might be offered to encourage that person to become CEO and there may be a positive correlation between compensation and performance. However, that correlation is of little value as an explanatory tool because that person has little to no reliance on that position for their financial well-being. At best, size and structure of the package may be seen by the market as a proxy for board confidence in that person and by the individual as an indicator of esteem and trust (Davis, 2010). In other words, there are real difficulties in reaching a conclusion that the package size caused the positive performance. More fundamentally and of direct strategic importance, a narrow focus on package and an unquestioning assumption that it will improve performance is arguably a factor in the astronomical growth in compensation levels (The Economist, 2003; Davis, 2010)

Institutional theorists therefore look to other motivations. As referred to above, such personal concerns as status, power, group and reputation (Rutherford, 1995) are also considered important drivers for CEOs to work to maximise performance of the company or other organisation. To this could be added personal interest, ambition, the desire to do good and cooperate with others for the common good.

Another set of problems for agency theory is associated with the premise that agents needs persuading (and perhaps can only be persuaded), via an appropriate set of incentives, to put their self-interest aside in favour of that of the principal. Yet individuals might make decisions for other reasons! Lockhart (2007) attacks the stringencies of, and 'obsession' with, agency theory for blinding the monitors and the CEOs themselves to the place of trust in the relationship. Ironically, such lack of trust may prompt the CEO to be more risk-averse than the shareholders – a problem identified by agency theorists - and pursue achievable easily measurable and straightforward short-term goals rather than long-term objectives, again an

agency problem. In addition, for Alces (2008) a significant effect of this structure of incentives and control has been the effective elimination, with very narrowly defined exceptions, of a fundamental underlying concept of the company - the fiduciary – again seriously challenging any suggestion that trust has any part to play in the modern company.

Arguably, part of this trust issue has to do with the group to which the CEO or director as agent is held accountable. Certainly, one of the most important relationships for a commercial organisation is that that exists between its owners and its managers (the focus of agency theory and also one recognised under institutional theory and stakeholder theory). However, it is not the only one. In a world of capitalistic choice, without satisfied customers, the long-term future of the company is bleak; without capital from lenders or prospective shareholders any expansion or developmental plans are unlikely to succeed; without goodwill from community and regulators/law enforcers the company may find itself the target of social criticism or unwelcome investigatory attention. Yet a focus on short-term present shareholder interests may discourage the CEO from expending resources on cultivating these other relationships.

For non-profit and public sector organisations this range of interests is even more marked (Mason, Kirkbride and Bryde, 2007; Hazeldine and Quiggan, 1997; Wallis, 1997). Ethical and professional considerations too might spur CEOs and other decision makers to act in certain ways. In this context and given the discussion above on the application of agency theory to New Zealand's public sector reforms, it is useful to consider Shick's concern (Allen Shick was invited by the New Zealand Treasury and State Services Commission to provide an independent and unbiased assessment of the New Zealand reforms) over the effect over-enthusiastic adherence to agency and other aspects of contractarianism might have – specifically that it "may diminish public-regarding values and behaviour in government" (Wallis, 1997, p. 493).

In addition, regulatory bodies, most importantly governments, may react to adverse publicity or events with the calamity model of action – again having potentially problematic and costly effects for companies. Campbell (1997), in his criticism of the direction of company legislation in the UK and similar jurisdictions, considers that the focus in the reform process on technical aspects of agency theory (again a lack of trust) has led to a "derogation of ethics as the basis of the obligations of company executives". This "ethical emptiness [has led] to [their]…. flatly exploitative actions" (Campbell, 1997, p. 345).

Overall, it is claimed that institutional theory offers a rich alternative to the narrow-minded, static approach offered by agency theory (Letza et al., 2008). By drawing on a range of social science disciplines (including sociology, psychology, economics, law, politics and others) it is possible to increase understanding of what motivates individuals and groups within an organisation (Van den Abeele, 2007); explain how and why managers and directors make decisions (Yiu and Makino, 2001; Campbell, 2007), thereby ensuring appropriate process and structure; explore the role of ideologies, ethics, power and personalities in determining direction and decisions within hitherto univocal groupings (Letza et al., 2008; Li and Harrison, 2007; Mason et al., 2007; Mtar, 2010); create robust models for governance in different settings and for different purposes (Mason et al., 2007, Nwabueze and Mileski, 2006; Bates, 1995) and establish the institutional mechanisms to maximise individual and social welfare (Kahn, 1995; Jwa et al., 2000).

By way of illustration of this argument, it is useful to discuss briefly Nwabueze and Mileski (2008) and their analysis of Swissair, a partly government-owned company "renowned as a flying bank and…national symbol" (Nwabueze and Mileski, 2008, p. 584). They point to findings that the Swiss business sector was effectively controlled by 300 people through a network of interlocking directorships (Steger and Krapf, 2002). Although there was a legally required separation of powers between the board and the management of this company, the board was populated by business colleagues and friends and political appointees. Business people on the

board were also involved in other companies - whose board members were on Swissair's board - and Swissair was regarded as "source of national pride" (Nwabueze and Mileski, 2008, p. 584), an important consideration for the political appointees.

Given these realities, to challenge the decision of the CEO of Swissair to pursue a strategy of acquisition in the extremely volatile global aviation industry of the time (the 1990s) was to threaten the very structure of Swiss corporate governance. As a result, the Board failed to ask the right questions and the company ultimately failed in 2002.

Nwabueze and Mileski (2008) explain that agency theory would be inadequate in explaining how managers and directors in a situation like that prevailing at Swissair could deal with non-shareholder interests. Clearly here political considerations, social pride and social and business networks were much more important than either economic concerns or risk management (given the volatility of the aviation market of the time). Therefore, they opted for institutional theory given its ability to acknowledge that individuals within organisations may be driven by factors other than economic.

3.5.5. Institutional Theory: The Criticisms

Not everyone is positive about the contribution to governance research offered by institutional theory. First, and as a general point, it should be noted that certain of the criticisms levelled against stakeholder theory also can be levelled against institutional theory. For the proponents of shareholder theory (Friedman, 1970), the danger posed to business through the diffusion of responsibility and the difficulty of establishing with any degree of assurance, exactly who or what factors or interests should be considered of importance to governance.

Other criticisms are more specific to institutional theory in general, to its specific strands and to its application or use. General criticisms include its persistent conceptual confusion (Peters, 2000). Even the short introductions above to two main strands hint at this confusion, while Peters (2000) considers that the approaches or strands are actually contradictory. Also, there is lack of consensus as to how individuals interact with institutions in making judgments about policies and actions. While, as Peters points out, March and Olson (1989) 'argue vigorously' (Peters, 2000, p.5) that preferences are affected by the person's experience with the institution (endogenous), others argue that they are exogenous or not affected by any such experience. In addition and as also indicated above, there are different meanings applied to institutions themselves – from old institutional theory with the focus on the organisation as a formal institution and the new – with its far broader and less distinct meaning.

Old institutional theory has been criticised on several fronts. Noorgard (2001) for example, explains that the environmental backdrop is seen as static and unchanging, a point also made by Van der Steen (2006). To this could be added the difficulty involved in defining the important aspects of that external environment, their respective influence and therefore a lack of rigour in results from empirical research. Thirdly, the focus on formal and clear structures and their implied rationality, system and discipline (Selznick, 1996) has been criticised as inconsistent with the loose, changing and disorganised reality (Selznick, 1996). By way of contrast, new institutional theory (as defined above) has been criticised for its lack of focus and clarity. In particular, Rutherford (1995) describes Commons' (1943) interpretation of the ideological evolution as adaption to change, as lacking detail and precision.

Finally, Aguilera and Jackson (2003) are of the opinion that while institutional theory is a response to the 'under socialised' characteristic of agency theory (as being overly dismissive of 'institutional embeddedness' and its effect on corporate governance), they consider that institutional theory suffers by stint of going to the other extreme – that it is 'over socialised' (its model or models too abstract to

deal with conflicts and cooperation at firm level). In seeking means to make institutional theory concepts work (their particular focus being the different corporate governance structures and practices in different jurisdictions - which is where we started this discussion), they prefer an 'actor-centred' approach; hence governance will be the function of the characteristics, interactions and preferences of these three stakeholders but also as moderated and influenced by institutional factors.

The above discussion clearly signals the importance placed on strategies and mechanisms to maximise the performance and responsiveness of management of organisations (especially companies). While it is acknowledged that the main group with an interest is this responsiveness is that of the owners (normally shareholders) institutional theory in particular acknowledges also that other groups are affected by the organisation and in fact it may not be in the company's best interests to ignore that. Institutional theory also posits that such consideration is not only an expectation but a given – the economic rationality assumed under agency theory is coloured by political, social and behavioural considerations.

The final theory to be explored due to its relevance to corporate governance is resource dependence or dependency theory (Pfeffer and Salanick, 1978; Christopher, 2010; Muth and Donaldson, 1998). This is worthwhile discussing separately from those above due to its potential significance in addressing the particular issues of governance in SMEs.

3.6 Alternatives to Agency Theory: Resource Dependence Theory

A theme that emerges again and again, no matter what the theoretical construct, is that in the interests of good governance, boards should protect the interests of owners, by way of selection and monitoring management conduct, but also, and perhaps more importantly, by determining strategy and providing and exploiting

vital resources that will permit the company to thrive and grow (Bennett and Robson 2004; Gabrielsson and Huse 2005).

To enable this wide range of functions to be executed this theory assumes that the board have at its disposal expertise, experience, networks and contacts, and skills and, if not, will take the necessary steps to acquire them (Muth and Donaldson, 1998). This range of resources is described as 'board capital' (Christopher, 2010) but, he also points out, is largely ignored by agency theory with its focus on monitoring. This theory is largely disproved for New Zealand as this research shows that the quality of skills around the board table is less-than-excellent, and thus the 'buy-in' of skills is not widely practiced, given the 'closed system' of board appointments we see in the old boys network of director recruitment in New Zealand.

The questions then arise: How does a board acquire the necessary skills, expertise and experience, and what does that say about the constitution and size of a board in any given situation?

Pfeffer (1972) and Pfeffer and Salancik (1978) explains that a board looking to satisfy its vital governance functions will look to attract directors who can contribute: Whether that contribution supports that provided by existing members or offers new and innovative skills or other advantages. In a sense similar to the situation under stewardship theory, once a new member is on the board, the organization "expects the individual will come to support the organization, will concern himself with its problems, will favourably present it to others, and will try to aid it" (Pfeffer and Salancik, 1978). The proof of the benefits arising from such aid and support comes in improved firm performance (Boyd, 1990; Dalton et. al. 1998; Pfeffer, 1972) and, theoretically at least, the constitution and size of the board will be optimal for the purpose: a small firm might rely on very few multi-skilled members while a large may realise growth and innovation by way of a well-resourced board boasting a range of talents and connections (Christopher, 2010) .

It is also possible to suggest that the selection of a manager that can enrich the resources available to the board may also improve firm performance (Christopher, 2010; Toms and Filatotchev, 2004). In such an instance, the gap between the board and manager so carefully cultivated by agency theory may be narrowed in the overall interests of the firm.

Arguably, and as mentioned at the beginning of this brief introduction to the theory, it is for SMEs more than any other size of enterprise that resource dependency theory is most relevant as a framework in which to both describe and evaluate governance structures and practices. In particular, the costs in having a large number of directors (to include the range of talents and skills to enable survival and growth) are likely to be prohibitive to SMEs. Therefore, survival and growth becomes more the result of some game of chance than of logic and business nous.

Finally, and by way of summary and conclusion to this chapter, Daily et al. (2003) explains that "the overwhelming emphasis in governance research has been on the efficacy of the various mechanisms available to protect shareholders from the self interested whims of executives" (Daily et al., 2003, p. 371). However, governance is not just about management decision-making. Rather it can be argued that its underlying purpose has long been much broader - encompassing the range of steps and strategies that are instrumental in improving company performance.

The theories expounded as alternatives to agency theory – as described in the latter part of this chapter attempt to shift attention from the protection mechanism: Monitoring, that is the focus of agency theory, to firm performance – arguing that to achieve this over the long term it is necessary for governance mechanisms to acknowledge and manage the broad and complex relationships a firm as social actor must foster and do those for the long-term benefit of the firm. The board of directors plays a vital and central role in such identification and management.

The following chapter explores issues around the composition of boards of directors, specifically the importance, characteristics, role and success of the independent director (which is increasingly seen in various jurisdictions (including the US, UK, Australia and New Zealand) as the best means of maintaining the gap between the board as monitor and manager as monitored mooted by agency theory as pivotal to governance) and the best means of addressing principle six (OECD, 2004). Another aspect to be explored is the motivation for individuals to become directors on the assumption that firms benefit the most (maximising performance) where there is a good fit between director motivation and firm needs.

It should be noted that most of the cited research on independent directors focuses on large corporates. This is an important point as the reservation could be raised as to its relevance to the issue of governance of SMEs that is such an important theme of this work. However, it also has another implication: raising questions as to the relevance of independent directors to many firms in the New Zealand business context. In particular, with the propensity for New Zealand firms to involve family in ownership and management, or to be so small that directors also act as managers of the same firm (with the consequence that independent directors are still more a rarity than the norm, at least for SMEs), it is important to ask why such directors are increasingly being sought by such firms.

CHAPTER 4: COMPOSITION OF BOARDS

4.1 Purpose of the Chapter

As is the case with chapters 2 and 3, the purpose of this chapter is to provide background, context and rationale for the empirical research documented and reported in chapter 4. Therefore, the hypotheses to be tested in the research are validated and supported by reference to research findings and questions explored previously.

4.2. Overview

An effective Board of Directors has been identified as pivotal for good corporate governance and performance of companies both in the private and, increasingly, the public sector (Bainbridge, 2008; Bale and Dale, 1998; Borokhovich, Parrino and Trapani, 1996; Coles and Hesterley, 2000; Hazeldine and Quiggan, 2005; Petrovic, 2008). Published research has centred largely on empirical indicators of the effectiveness of its monitoring and control of the Chief Executive Officer (CEO) as the head of the management team of a large publicly traded corporate such as return on investment, control of CEO incentive packages and performance in the markets for control and finance.

In particular, the presence and role of independent directors have raised questions about the ability of such directors to improve corporate governance more generally through control and oversight of the CEO. Of relevance to that question is the troubling realisation that the three biggest US Bankruptcies ever – Enron, WorldCom, and Conseco – occurred in part because of accounting practices that the boards either were not aware of or did not understand (Lawler and Worley, 2011.)

The definition, role and effectiveness of independent directors therefore provide the focus for the discussion in the first part of the chapter. As part of this, and based on the at best ambivalent findings of research into the area, an explanation is offered of the growth of independent directors by reference to institutional theory. Fundamental to such effectiveness is motivation: the reasons why individuals join and participate in boards, and criteria: why particular individuals are deemed desirable potential directors. These aspects are explored in the second part where reference is made also to experiences reported by such directors.

However, two important preliminary points should be made. First is a matter of definition. Caution has to be exercised when discussing research on the role and success of independent directors as the term is not used in a consistent way. Consequently in the discussion that follows, attempts are made to emphasise where there are inconsistencies in the terminology. More specifically, and despite theorists and regulators using these terms to refer to different things (Harvard Law Review, 2006; Clarke, 2007b), the term has been associated with (or in some cases encapsulated by) non-executive directors (who may be insiders or outsiders), outsiders (who may alternatively be tied or 'grey' (Felo, 2001)), non-employees (who may again not be independent but instead be insiders or grey), non-interested (who may have no financial ties to the company) and disinterested directors. Furthermore, some authors have discussed independent directors without offering any definition, increasing the uncertainties surrounding the literature.

On the other hand, McCabe and Nowak (2008), in their analysis of views held by Australian public separate company board members (both executive and independent) on their experience with independent directors, draw a distinction between non-executive directors who are considered to be independent and those who are not (2008, p.549). In drawing this distinction they emphasise that independence is more a state than compliance with a set of rules. Independence is not truly achieved unless the director can display independence of mind (the confidence to disagree with management and the level of understanding sufficient

to support that confidence), independence of information (the ability to source information from somewhere other than management or at least have the skills to critique that information), independence of income (to remove the fear of removal of financial support should their role on the board be terminated) and independence from the organisation (a lack of reliance on the company for business or employment – essentially any connection that might influence objective decision making.) In addition though, questions have been raised as to what true independence entails. For example, and given the concern that shareholder interests be supported and safeguarded, does or should independence means independence also from shareholders? Swan and Honeine (2010) argue that "if protecting shareholder interests is the task non-executive directors are facing, than surely alignment with and not independence from shareholders is ideal"(Swan and Honeine, 2010, p11).

In light of the above, it is of interest to consider the definition of independence in the OECD principles. The term "independent director" is defined in the 1999 principles as "board members not…employed by the company and not…closely related to the company or its management through significant economic, family or other ties. This does not prevent shareholders being board members" (OECD, 1999, p.24). By the time the principles had been revised in 2004, the definition had been expanded to exclude directors of affiliates of the company from the definition of independent (OECD, 2004, p. 64). However, it is perhaps important to remember that the OECD principles did not come out of the blue but both built on and reflected practice and principles already in place. The trend for some time in various jurisdictions (most particularly the UK and the US) had been towards the presence of independent directors.

Secondly, one significant aspect stands out from the rhetoric on corporate governance and the function of the Board. This is the assumption that conclusions can be drawn that are universally applicable and by analogy, that a unitary approach can be applied in determining optimum characteristics and mix of members on the Board of Directors and optimum incentives that will attract that optimum mix.

Several problems arise in this regard. Firstly, the focus in the published literature on the Board of large, publicly traded companies tends to ignore, or at least diminish, the different roles and direction of directors in different types of organisation most disregarded is the small to medium size company that may have very different objectives, priorities, characteristics and focus to the large corporate (Bennett and Robson, 2004; Mueller, Dana, McDonald and Maier, 2006). Ironically perhaps, the statistics suggest such disregard is rash: it is estimated that some 95% of enterprises across the OECD are small to medium and furthermore, provide some 60-70% of employment (Ministry of Economic Development, 2007).

Secondly, directors tend to be classified not so much in accordance with behaviour but more by reference to their connection to the company. Increasingly, and in accordance with agency theory, affiliated directors are considered less effective monitors than independent, a position that is at odds with stewardship theory that indicates that such directors are eminently capable of providing alternative perspectives and expertise (Arosa, Iturralde and Maseda, 2010).

Thirdly and relatedly, treating the Board as some sort of monolithic "black box" (Neill and Dulwicz, 2010) without understanding the characteristics and motivations of the actual individuals on that Board carries the risk of obscuring the true picture of how decisions are made by those individuals and therefore, potentially, the danger signals that forewarn of problems adversely impacting the present effectiveness of the Board and possibly its future (sparked by, for example, the departure of valued Board members).

Although not exactly on point, the conclusion drawn by Taylor, Chait and Holland (1996) on non-profit organisations is also relevant to the matter of motivation of directors. They explain that the boards of such organisations are often "a collection of high-powered people engaged in low-level activities" (Taylor et al., 1996, p. 36). With little personal accountability, little experience in working as a team or in dealing with issues of governance they may offer little of positive value

to the organisation. “The stakes remain low, the meetings process-driven, the outcomes ambiguous and the deliberations insular.” (Taylor et al., 1996, p.36) It would be too easy, therefore, for such individuals, regardless of the laudatory purpose they had in joining such a board, to withdraw commitment and enthusiasm to the point of departure and thereby having a potentially negative impact on board effectiveness and organisational performance.

As a starting point, it is perfectly conceivable that the motivation for directors can vary significantly by reference to their context. More generally, motivation can differ as between small and large businesses, individual director categories and between businesses in different industry contexts. In other words, it is very possible that a one-size fits all approach is unsuitable in determining why Directors join boards and therefore the incentives that will attract them, maximise their effectiveness and encourage them to stay. It is also very possible that some directors, as suggested in chapter 1, may be motivated to serve not because of personal advantage but because they wish to provide some advantage to the firm and its members.

4.3 Independent Directors and the Board

4.3.1 Context

Despite the fact there is a strong body of opinion that the focus should really be on best directors with the term ‘best’ encompassing individuals that have the ability to think autonomously and objectively regardless of their other interests (business, social or personal, it is generally accepted that a high degree of board independence strengthens the board and improves its effectiveness As mentioned previously, statute law and codes (both examples of institutions) are increasingly blunt in demanding independent directors for listed companies, often requiring an arbitrary number on publicly listed firms’ boards, although no such obligation exists for the boards of unlisted firms.

In many jurisdictions, the presence of such directors on the board of public and/or listed companies is thus considered de rigueur in this first part of the twenty first century. In Switzerland 81.3% of board members are independent directors, in Canada 73.6%, and the USA 68.5% (Maier, 2005) and considered to provide an important guarantee of integrity and accountability (Pass, 2004). In its first published Principles of Corporate Governance in 1999, the OECD emphasised the important role for independent directors (OECD, 1999, p. 24) and included a strong recommendation that non-executive members should have a role to play in important decisions (OECD, 1999, p. 24). Six years on and an international study concluded that director independence was considered by many respondents as the most important corporate governance issue (Ritchie, 2007). To meet the new demands and challenges many corporations are seeking to renovate their corporate governance policies and practices, including policies around requirements for independent directors. Recent reviews and proposals for corporate governance reform such as those put forward in the Turner Review (Financial Services Authority, 2009) and the Walker Report (Financial Reporting Council, 2009) (UK) and the US Department of the Treasury (2009, dealing with executive compensation) focus primarily on improving director independence in relation to executive remuneration and compensation policy but the proposed reforms would have the potential to address other aspects of independence such as managerial capture as well.

As something of a diversion, and in light of the wide diversity of contexts (see discussion in chapter 3, particularly in relation to institutional theory) and firm characteristics nationally and internationally, how can this consistency of demand be explained? One possibility is to consider this growth within an institutional framework.

4.3.2 Institutional Theory and Board Composition

Institutional theory predicates governance as an 'articulated system of meaning' (Fiss, 2008, p. 391) and that company strategy, processes and behaviour reflect such meaning. If prevailing theories and logics on distribution of power in the organisation and on the 'natural' (Fiss, 2008, p. 391) order assumes a proportion of independent directors on boards as a norm, what does that say about their spread and the rationale for their presence?

As explained in chapter 3, the theory seeks to explain how various rules, practices and other structures (or institutions) have evolved in the way they have, and new institutional theory, in particular, looks at how institutions associated with organizations become more homogeneous over time.

Assuming board composition, along with the regulations and rules that drive it, can be defined as an 'institution', it is possible then to explore how two related influencers (legitimacy and isomorphism) (DiMaggio and Powell, 1983; Meyer and Rowan, 1977; Scott, 2001) have caused widespread acceptance and adoption of independent directors as the norm.

Briefly, legitimacy is defined as "a generalised perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman, 1995, p. 574). Novel organizations might incorporate characteristics that society deems appropriate or expected in the environment because by doing so helps them gain legitimacy and obtain resources needed for survival (Scott, 1995; 2001). Ashforth and Gibbs (1990, p.181) point out that "management may choose to identify the issue in question with other actors, values, or symbols that are themselves legitimate".

The concept of isomorphism as applied in institutional theory demonstrates how organizations may be similar (DiMaggio and and Powell, 1983; 2003; Scott, 1995)

(although strategic choice, which allows for decisions to be made in response to external pressures and forces such as those exuded by regulatory agencies (Stevens and Slack, 1998) is also highly relevant). It must be stressed, however, that this evolution may not be economically rational.

For example, sometimes institutional change occurs through diffusion of practices from one organization to another as organizations attempt to gain legitimacy by copying practices of other companies in their sphere who they see as successful (DiMaggio and Powell, 1983). The homogeneity that results from organizations fashioning their own practices based on those of peer organizations is sometimes referred to as mimetic isomorphism (DiMaggio and Powell, 1983). The institutional logic behind this cultural-cognitive element of institutions is that of orthodoxy—a shared understanding among members of a group as to what constitutes established practice (Scott, 2003).

Specifically to board composition, certain practices of corporations may be diffused to other organizations within a sphere —for example, within an industry, a country, a group of countries or even worldwide—through a process of mimetic isomorphism as organizations strive to attain and maintain legitimacy within their reference group. As indicated in chapter 2, Li and Harrison (2008) found that cultural attributes of a country influenced the proportion of outside directors that are found on boards.

Another factor that can influence institutions is regulation (leading to coercive isomorphism (DiMaggio and Powell,1983)). Laws and sanctions have a direct impact as organizations have little discretion to avoid such change and conform to avoid sanctions and loss of legitimacy (Scott, 1995; 2003).

In the context of board of directors, new laws directing specific types of board composition (such as the requirement for independent directors of listed companies in the US, UK, Australia and New Zealand (see chapter 2) would be an example of such a coercive force for homogeneity (Duchin et al.2008)).

A third force for isomorphism (normative isomorphism) (DiMaggio and Powell, 1983) emerges where normative structures suggest a need for change driven by a sense of what would be most appropriate (Scott, 1995; 2003). Normative forces can include the influence of professional organizations or affiliations through which what might be considered superior practices are diffused throughout the organization's reference group.

Again in relation to boards, normative influences could occur through professional associations relating to governance or by way of director training and credentialing. Professional associations may raise potential problems associated with board of director composition and identify solutions that may be diffused through organization managers or directors affiliated with these professional associations. Dahya and McConnell (2007) report that companies in the UK increased proportions of outside directors in response to a recommendation of the Cadbury Report that boards should have at least three (even though these recommendations have never been made law). They find that the increased proportion of outside directors is positively associated with company performance. Selekler-Goksen and Oktem (2009) found evidence that family companies in Turkey changed their board composition in response to codes of best practices developed in other jurisdictions.

An organization's reference group is that against which an organization compares itself and within which it strives to maintain legitimacy, is often referred to as the organizational field (Meyer and Rowan, 1977). It can be observed that with globalization, organizational fields are expanding beyond the local or national level. This suggests a greater ability of institutions to become diffused from one nation to another.

So why are independent directors considered so valuable? Many in the financial, institutions and academic worlds see the independent director as an important agent against self-interested management groups and shareholder lobbies.

However, it would seem, no consistent message as to the effectiveness of independent directors has emerged.

The hypotheses to test are:

H2 = Independent directors are considered to contribute positively to the board.
H3 = Director contributions are not seen to be equally important by directors and shareholders.

It should be noted that H3 refers to directors rather than independent directors (which of course means that respondents are asked to judge the contribution of insiders as well as independents). The reason for couching this hypothesis as such is that shareholders may find it difficult to distinguish between the relative contributions of these two groups. This is particularly so as, and as discussed previously, independent directors on New Zealand boards are still below what is the norm in other countries, and are only mandated for publicly listed firms. With >98% firms in New Zealand unlisted, such regulatory mandates do not extend to the vast majority.

However, based on the assumption that directors were much more likely to be in a position to make such a distinction, and as independent directors interact more with the other board members than with shareholders, directors might be in a better position to determine whether independent directors add value to boards in New Zealand. independent directors provided the focus for relevant questions asked during the follow-up interviews. Overall, a reasonable question to ask is, if it is demonstrated and accepted that independent directors deliver value, even where their inclusion is optional, firms might decide on the inclusion of outsiders on the board.

4.4 Rationale for independent directors

By way of introduction to this section it is worth referring to the OECD (2004) where it states that "The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders" (OECD, 2004, p.24)**.** Clearly, its three main roles are to determine strategy, monitor management and to account to shareholders for the use of company assets and resources (Carver and Oliver, 2002). In achieving those roles, the Board is responsible for ensuring legal requirements are met (including those specifying the form of financial and other reporting to shareholders and, if listed, the requirements of the particular exchange or other body involved in determining rules). The growing support in the courts, specialists and some business groups led to the mandating of independent directors as an integral part of the governance structure in the *Sabarnes-Oxley Act 2002* (Wallison, 2006, p.1).

By reference to those roles, and in an attempt to clarify the situation as to whether and what independent directors contribute to the company, the following section documents the arguments that have been made for independent directors by reference to two principle roles and qualities often attributed to them – improving shareholder value (an aspect not only of accountability but also of strategy) and monitoring of management (also inclusive of strategic guidance).

4.4.1 Improvement in Shareholder Value

One of the important rationales for independent directors is that they increase shareholder value (Harvard Law Review, 2006; McCabe and Nowak, 2008; Petra, 2005). Gordon (2007, p.1471) considers this to be a function of a focus on market value as a proxy for firm performance. As independent directors are less 'wedded' (Gordon, 2007, p.1471) to inside accounts of company prospects and less worried about the personal implications for them of public disclosure of sensitive

information, they have the potential to create significant value from the efficient allocation of resources not only for their own company but right through the economy. In particular, and in an ideal world, these directors are independent thinkers who can play a decisive role in influencing strategic decisions. Also in an ideal situation, shareholders can rely on independent directors to validate disclosure, provide an objective view in relation to the operations of the company and to participate in conflict resolution.

Black (2001) indicates that independent directors can help shareholders identify disclosure problems while Lorsch and MacIver (1989) argue that firms can be evaluated and monitored by such directors. In addition, Byrd and Hickman (1992) point out that they can effectively protect and endorse the interest of minority shareholders. Gupta and Fields (2009) find that the stock market responds more negatively to resignations of independent directors than to resignations of internal directors, suggesting that investors value their specific contributions.

Matolcsy, Stokes and Wright (2004) argue that firms with substantial growth options can enhance their value by appointing a higher proportion of independent directors to the board. They also point out where company has potential growth options, "outside directors do add value (1) in their first year of appointment and (2) where they have three or more other board positions" Matolcsy et al. (2004, p. 38).

Studies by Dahya and McConnell (2007) and Duchin et al. (2008) identified conditions under which increased utilization of independent directors is positively associated with organizational performance. Exogenous changes in board structure exploit shifts in regulatory environments and provide evidence that increase in board independence precede improvements in firm performance.

However, empirical evidence suggests that the presence of independent directors on the board is not necessarily always positive. There are also suggestions that their effectiveness is limited to specific roles and functions. Duchin et al. (2008)

found the effect of outside directors on firm performance was small on average, while Baysinger and Hoskisson (1990) suggest that their presence can harm the innovation and creativity of the organisation. Finally, while Baglioni and Columbo (2011) consider that their presence is merited because such directors do a better job at monitoring due to the lack of a direct link to the CEO (explained elsewhere), in terms of performance, these authors maintain it is positively affected by executive directors and negatively by independent.

More specific to the non-profit sector, where directors are volunteers and work without compensation, the recruitment of independent directors is thought to come with certain disadvantages. Independent directors may not only lack specific knowledge to support innovation, but they are also hard to retain (Brody, 1996; Pati, 2007) and recruit (Pati, 2007). In general it is advisable to recruit directors who have a connection to the organisation as they are more likely to be available for recruitment, and will be more motivated (Taylor, Chait and Holland, 1991). Unfortunately many independent directors do not have such connections and those directors who are insiders are seen by some to be more easily recruited, easier to retain and have stronger motivation (De Andres-Alonso, Azofa-Palenzuela and Romero-Merino, 2009).

Overall, it would seem, the effect of outside directors on firm performance varies according to the information environment of a firm: outside directors are effective when the cost of acquiring information about a firm is low, but less so when the cost of acquiring information is high. This also tallies with the monitoring role under agency theory where, despite some documented mix of expertise and views amongst board members in some jurisdictions (Aguilera and Jackson, 2003; Buher, Rasheed and Rosenstein, 1997; Alces, 2007), it is assumed that monitoring the decisions of the CEO is most efficiently achieved by members fully informed about the business and its business environment (Nowak and McCabe, 2003). Therefore, for many companies in the United States, industry expertise and experience in independents are priority characteristics (Fama and Jensen, 1983; Peterson and Philpot, 2007).

The whole issue of monitoring by independent directors is addressed below. It should be emphasised as a preliminary point, that for some researchers, effective monitoring leads to good firm performance (Fama and Jensen, 1983; Baysinger and Butler, 1985; Coles and Hesterley, 2000; Beasley,1996) but not for all (Petra, 2005 (maybe); Hermalin and Weisbach,1991 (no); Ghosh and Sirmans 2005 (no)).

4.4.2 Oversight of Management (particularly CEO) performance and reward (monitoring)

Shareholders of a company have problems ensuring that those responsible for the management of that company do not maximise their own short-term benefits (as agents) at the expense of the owners' long-term interests (as principals) (Donaldson and Davis, 1991; Jensen and Meckling, 1976; Fama and Jensen, 1983; Borokhovich, Parrino and Trapani, 1996). Bhagat and Black (2002) argue that there is a "conventional wisdom that the board's principal task is to monitor management, and only independent directors can be effective monitors." (2002, p. 231). It is in this context, therefore, that independent directors are identified as particularly important (Cadbury Committee, 1992; Fama and Jensen, 1983; Lawrence and Stapledon, 1999; Helland and Sykuta, 2005). A cohort of independent directors on a board can minimise the likelihood of board capture by management and mitigate the potential for conflicts of interest among board members that may influence the independence of non-executive board members, their orientation towards, and their relationships with, management and other stakeholders. Siagian and Tresnaningsih (2011) identify another advantage of independent directors that arises from the above: their ability to exercise independent judgment and resist the influence of management actually reduces agency costs from monitoring.

At the same time, and as indicated in chapter 3, the presence of independent directors is regarded by some as a reliable means of maintaining the gap between

the monitor and the to-be-monitored entity and activities. Most particularly, that monitoring comes via management of remuneration and incentive packages for CEOs. This issue has been identified over a long period as being of major concern. Epstein and Roy (2005) refer to complaints by investors that CEO remuneration is both excessive and de-linked from firm performance while more recently Hindery (2008) refers to it as a "cancer" at the heart of America's financial ills.

The theory is as follows: While inside directors may be in the Executive's "pocket" (Ryan and Wiggins, 2004, p.479) an independent director or group of directors has the power, strength and incentives to appraise the evidence of performance and resources prior to making decisions on remuneration and incentives (Fama and Jensen, 1983). In addition, they are less impressed than internal directors might be of the desire to boast to the market that the CEO to whom they offer the job is anything less than the best (The Economist, 2003). The alternative is for the size of CEO packages to soar out of control (The Economist, 2003), damaging the market perception of the company, fomenting discontent amongst investors and employees and possibly setting the company up to fail.

There is a further aspect of monitoring too that should be mentioned as it is also highly relevant to firm performance (particularly in the world of theories such as stakeholder and stewardship that shift attention from shareholder value as THE focus for governance to the whole gamut of interest groups and constituents): with the prominence of the "triple bottom line" reporting standard and "balanced score card" review process, the societal pressure is on companies to report not only on financial results but also on their social responsibility and environmental sustainability. Epstein and Roy (2005), using the results from a survey conducted by the Wall Street Journal/Mercer Human Resource Consulting in 2003, consider that companies have been slow to react to this trend when assessing performance of their CEOs with such assessment still closely aligned with financial results. Epstein and Roy (2005) argue that the balanced score card emphasises the importance of a multi-dimensional evaluation (Epstein and Roy, 2005). Arguably, independent directors can offer a valuable input in this regard – with their position more

unaffected by past events (as shaped by financial performance) - than that of insiders, and with the skills and experience to help change the future (the non-financial considerations) they can offer a new outlook and fresh ideas.

Keeping in mind the touted benefits involved in having independent directors on the Board of public companies, it is appropriate now to look at the position of such directors. As part of this examination, I seek to identify the characteristics of those individuals who are appointed, how they are recruited and their experience once they are appointed. In the course of this examination, reference will be made to the points made above in an attempt to establish whether it is the fact of independent directors or their experience that makes the difference in their effectiveness for their companies.

As a reminder, the definition of an independent director can be approached in one of two ways. First is a definition of who cannot be treated as such (OECD, 2004; NYSE, 2011, s303A.02) including a person who has close business or family ties with the company in question. The other way of defining independence is through ability and preparedness to demonstrate it – of thought, action and links (Van den Berghe and Baelden 2005; Ritchie 2007; McCabe and Nowak 2008; Reiter and Rosenberg 2003). Researchers have introduced other factors that could affect a director's independence. Based on a sample of U.S. listed companies that misstated their financial statements in 1999, 2000 or 2001 with a matched sample of non-misstating companies, Sharma and Iselin (2006) posited that outside independent directors may not be independent if they have a developed certain relationships with management. Such relationships can develop with a director's long tenure on the board and through lucrative director compensation. Most studies focus on a simple view of director independence, however defined (see Sharma and Iselin, 2006). The literature appears to simply take some quantitative measure of independence, such as number or proportion of non-executive directors on a board, yet director independence is not a simple concept that can be reduced to a number.

Also by way of review, and depending on the jurisdiction, boards of listed companies may be required to have a stated proportion of independent directors (as is the case for the NYSE) or offer justification if it does not (as in the case of the UK, New Zealand and Australia). The differences in the rules pertinent to different jurisdictions (as well as the wider legal and market context) are inevitably going to have consequences not only for the characteristics of the persons appointed/elected to these positions but also for the means of their recruitment. Hence findings in this context should be treated with some degree of caution when drawing wider conclusions. The principal findings reported are therefore explored where possible for their broader implications.

For this reason, it is appropriate and highly relevant to consider the board composition of companies in New Zealand, first through a discussion of the SME experience with boards of directors and secondly with respect to independent directorships more generally. A fundamentally important part of this exploration is the matter of its evolution and how that evolution may have been influenced by the companies' interrelationships with their environment as they seek to maintain legitimacy within their organizational field.

4.5 Directors in the New Zealand Context: SMEs

By way of reminder, and reflected in the OECD (2004) Principles and in various rules and guidelines in place in other jurisdictions, a properly constituted board of directors, is thought to be the cornerstone of corporate governance and to have a significant impact upon the progression of a firm (Cocks et al., 2010; Pearce and Zahra, 1992; Forbes and Milliken, 1999; Hillman & Dalziel, 2003). Logically, conflict between the board and owner, as referred to above, is avoided when the owner of the firm is also the principal director, as it ensures an absence of conflict of interest. Since this is common in New Zealand SMEs, their governance structures tend to remain informal and they may resist evolving towards a more formal governance arrangement.

However, even in contexts bearing the potential for conflict, there has been very little research on governance strategies involving implementation or constitution of boards of directors in SMEs (van den Heuvel, Van Gils & Voordeckers, 2006). Furthermore, the small amount of published research on governance in SMEs leaves the definition and role of a board of directors vague. This is a mistake given that shareholders, directors and managers of SMEs often are the same individuals or are taken from a small pool of family members or friends (van den Heuvel, van Gils and Voordeckers, 2006).

In addition, and despite the potential importance of the board in the governance of New Zealand's SMEs, findings indicate that they have not been well structured or used in the past if indeed in some cases they even exist (Read, 2007). Citing Nigel Williams (ANZ managing director of institutional, corporate and commercial banking), Read maintains that (a) 31% of small and medium firms in New Zealand lack a board of directors and (b) many firms remain as sole proprietorships and are not registered as limited liability companies and that a vast majority of registered companies probably do not have a board (even aside from the fact that they technically must appoint a board upon registration of their firm). This, Read claims, could be holding many companies back from achieving their potential, with resultant impact on New Zealand's SME performance and sustainability. Read writes further, "Nigel Williams says there is a lot of talk about the need for New Zealanders to be world champions not only in the sporting and cultural arenas, but in business too and a key way to facilitate New Zealand's growth in the business arena is the proper utilisation of boards in New Zealand firms" (2007, p.66).

Yet it is likely that a board of directors is just as, if not more, important in small and medium businesses as it is in larger firms because the presence of a board can result in improved company structures, firm continuity and good financial results (Zahra and Pearce, 1989; Borch and Huse, 1993; Johannisson and Huse, 2000). Corbetta and Tomaselli (1996) argue that the presence of a board of directors can have a much greater impact on a small or medium sized firm's prosperity than on

larger firms, “a well-functioning board of directors can in fact be a critical resource for both family and business” (p. 404).

What is generally agreed is that any board, including that of an SME, should protect the interests of owners and investors (Fama and Jensen, 1983, as cited in van den Heuvel, van Gils and Voordeckers, 2006). In their paper, van den Heuval et al. (2006) found that boards of family-owned Belgian SMEs had two main roles: *service* and *control*. The service role included building organisational reputation, formulating organisational strategy, networking and maintaining relations and advising management. The control role was proposed as a strategy to close the divide between owners and managers. Hence the Board’s role in controlling the firm includes evaluating and controlling management performance, providing access to extra resources, determining the manager’s responsibility, maximising the shareholder value and determining the salary/compensation of management.

In addition, it seems obvious that boards should be both effective and efficient yet a profound concern is emerging over the workload and related costs and commitments associated with board meetings (such as with the Directors in the case of ASIC v Healey and Ors [2011] FCA 717 (the *Centro* case). [2] In this instance, Directors were expected to read and absorb copious pages of board memos and agenda documents – a task they argued was impossible. However, these need not be enormous. The Wal-Mart Board, for one of the largest companies in the world, meets in person only four times a year (Lockhart, 2007a). Vafeas (1999) actually concludes that firm performance suffered from too frequent board meetings. Overall, there seems no doctrinal norm for numbers of board meetings for any particular size or nature of company and it could be argued that in the case of SMEs, on-going communication amongst members renders it unnecessary to have very frequent formal board meetings.

The Directors of the Centro Group were found in breach of the Corporations Act 2001, ss 180(1) (statutory duty of care) and 344 (statutory duty to ensure compliance with financial reporting duties). Justice Middleton rejected the argument made by the Directors that they were entitled to rely on advice by the auditors (PriceWaterhouseCoopers) and the CFO as to the effect of a new accounting standard and stated firmly that they were required to form their own opinion as to the compliance of the accounts (in this case A$2 billion was wrongly categorised as non-current liabilities).

The monthly meetings that are typical of current business practice here could be construed as being intended to establish a 'NZ standard' of monthly board meetings. This could be over-governance, a state unfavourably described by Lockhart as 'intense governance' (2007, p. 68). More specifically, intense, frequent involvement of a board can pose prohibitive levels of cost for a firm and divert the attention of the CEO and top management team from improving the firm's performance.

Certainly, there are cases where the managers of companies have not worked in the owners' best interests due to lack of effective oversight by a board: Enron, WorldCom and Lehman Brothers are examples of firms where management embarked on an unchecked course of action that wrecked their firms and destroyed significant shareholder wealth. However, as illustrative as those examples might be in demonstrating the impact of poor governance, these cases still form a tiny minority of all companies. Lockhart confirms that "if this were not the case then business in free economies would have long since perished" (Lockhart, 2007, p. 68). Therefore, he argues that boards must take their hand off the brake and allow the CEO a measured hand in steering the company: "if the CEO cannot be trusted for any more than four weeks at a time – then get one who can" (Lockhart, 2007, p. 68).

Also of direct relevance to the governance of SMEs are the motivations that drive managers. As pointed out earlier, the general assumption that emerges from the body of governance literature is that the board must control and supervise management to ensure it acts to benefit the owners of the firm (the shareholders). Underlying this assumption is the premise that if appropriate mechanisms are not in place, the manager will act in his or her own self-interest (Milgrom and Roberts, 1992). This assumption ignores the influence of such factors such as friendship, cooperation, familial ties and interpersonal or person-firm loyalty that might affect the manager/owner relationship.

Yet these are the very factors that are often significant in SMEs and even more for family-owned firms. As identified in chapter one, many New Zealand companies fall into both categories, so factors such as loyalty to the firm, a sense of responsibility that comes from being one of only a handful of employees and friendships between owner(s) and manager(s) are relatively more important to their relationship in New Zealand SMEs than are control and supervision.

4.6 Directors in the New Zealand Context: Independent Directors

The New Zealand Stock Exchange (NZX) has proposed that the boards of directors of listing companies include at least two independent directors on board with at least 1/3 of board members being independent directors.

To the extent that companies do not already have a higher proportion than this, this new regulation - a coercive force in institutional theory terms - would undoubtedly change the landscape of independent directorship in New Zealand, although the effect would be mitigated by the small proportion of firms that are subject to NZX rules.

The reality is that a large number of firms in New Zealand are unlisted. However, even for them, and despite their tendency in the past not to have a board at all or rely very little on it, the voluntary inclusion of independent directors is emerging as a matter of significant importance. Hossain, Prevost and Rao (2001) found that the proportion of outside directors on New Zealand boards increased significantly after the passage of the Companies Act 1993 that codified the duties of directors, a codification that included more detailed instruction on director's duties and provided that they could be sued for breaches of duty (Hossain et al., 2001, p. 124). The authors also observed a positive association between the proportion of outside directors in New Zealand firms and firm performance.

Overall, while the coercive aspect of this legislation was directly related to board duties and consequences of failure to properly perform those duties, the enhanced rigor of the legislation appears to have had the effect of increasing the use of outside directors, a move that has had the additional and desirable effect of improving firm performance.

Taking five firm characteristics into account: Inside share ownership, variance of aftermarket returns, operating history, leverage, and firm size, and examining initial public offerings (IPOs) by 110 New Zealand issuers,[3] Mak (2006) concluded that firms without any operating history used more independent directors, and that greater variance of aftermarket returns and lower inside share ownership are also related to a higher proportion of outside directors.

His finding that firms without operating history are more likely to have a higher proportions of independent directors suggests that newer firms may be in a better position to have a board that is increasingly seen from the normative standpoint as most appropriate (ie, one with independent directors), or that shareholders of such firms believe their credibility during the early years might be improved through the showcasing of more independent directors.

Consequently, recent discussion not only in New Zealand but also elsewhere tends to focus not so much on whether there is a need for such membership but how it is to be achieved. Governments and other officially commissioned reports look for ways of increasing the overall percentage of independent directors in a range of companies (Higgs, 2003) and companies routinely announce their new independent director appointments. Yet there remain those who warn of the danger of accepting without question and without exception the assumptions that such a presence is necessary.

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[3] New Zealand SMEs would normally be classified as 'exempt companies' (Financial Reporting Act 1993, s6A: stand-alone companies with no more than NZ$1in assets, no more than NZ$2 in turnover and no more than 5 employees). Such companies, like proprietary companies in other jurisdictions, cannot normally solicit money from the public sources. To do so, requires they be 'issuers'- Companies that are larger and often listed on the NZX..

This work moves beyond the picture presented by statistics and publicity to examine the phenomenon that is the growth of independent directors First, a brief overview of the history of independent directors is offered, this being followed by a review of the present regulatory framework within which companies in various jurisdictions are called upon to implement a policy of increasing the proportion of independent directors on their Boards. It should be noted that most of the discussion will focus on publicly listed companies (sometimes referred to as public companies although this is not necessarily strictly accurate. However, in the interests of clarity the term 'public' will be used throughout this section to refer to this category of companies).

There are two reasons for this focus: one is that this is the category on which most relevant research is conducted (and relevant information on practice available). The second reason lies in the fact that corporate governance for public companies more generally remains a hot topic. The third part of the section therefore examines the arguments raised for the inclusion of independent directors on the board of public companies while the fourth looks at the motivation and characteristics of those who are likely to be appointed with particular emphasis on the differences in demands and requirements faced by those in small and medium enterprises (SMEs) as compared to those in the large corporate. The final section conclusion identifies areas that might benefit from further research.

4.6.1 Historical Background

The traditional view of the board of directors is of a group of individuals (traditionally middle-aged men) with significant experience in the market within which that company operates and with significant experience of the workings of that company. Consequently, the membership of such boards was also traditionally and overwhelmingly constituted by insiders, who might include family members (if a family company) friends, professional advisors (lawyers or accountants) or substantial shareholders or their nominees (Gordon 2008,1468). Even as late as

the 1980s when the idea was more likely to be debated in political and business circles, the very notion that outsiders should be included was to some conservative thinkers an anathema. After all, what could such individuals possibly contribute to a company they didn't understand?

Consequently, such a presence was resisted in some other jurisdictions dominated by the Anglo-American model of a unitary board (having the roles of both supervision and management). Amongst those can be listed Australia and New Zealand as well as the United States and the UK. Critics of the idea cited a range of reasons for their position. Some objections to the idea of independent directors are listed by Zandstra (2007), albeit recently, but likely to be very similar to those voiced 20 years ago. Inter alia, those include the fact that for many such directors their interests are artificial (lacking strong links between the company's wellbeing and their own) a characteristic that reduces their motivation to maximise performance; they may lack experience and understanding of the business environment; they may well have a seat on a range of boards, reducing loyalty and adversely affecting their focus on the company and its wellbeing. In addition, and depending on the individual, they may perceive the position of director as a chance to strengthen or maintain social or business networks, affecting the degree to which they are truly independent (Zandstra, 2007, p.3).

Despite such objections, however, and as stated earlier, the independent director is a must for the boards of public companies in a range of jurisdictions, increasingly mandated or encouraged by legal and quasi-legal rules. As pointed out before, the OECD's promulgation of guidelines in 1999 was the first trans-national display of determination to have independent directors on the boards of public companies. However, that does not mean it was the first move to promote their presence. In order to provide an overview of these earlier steps while not being too complicated, three exemplar legal/regulatory frameworks will be considered, these being in turn the UK, United States and Europe.

4.6.1.1 UK

In 1991 in the UK, the Financial Reporting Council, London Stock Exchange and the accountancy profession moved to address low levels of confidence in financial reporting, control and standards and investor disillusionment after some enormous and unexpected company failures. These included that of the Bank of Credit and Commerce International (BCCI) that failed owing billions after an international investigation into lending practices and lack of regulation of its activities, the Maxwell group of companies where investigations revealed millions of dollars worth of fraud and misappropriation of pension funds and Polly Peck Ltd where for years financial records had been falsified. Consequently they set up a committee headed by Adrian Cadbury to report on how to improve corporate governance practices. This committee's report (Report of the Committee on the Financial Aspects of Corporate Governance (the Cadbury Report, 1992)) included a range of recommendations, one being the inclusion of independent directors principally to fulfil a control function in relation to decisions being made by the executive directors (Cadbury, 1992, p.21). As Jones (2003, p. 4) explains, this report was just the first of a series of reviews and studies of corporate governance in the UK but was probably the most important in establishing the approach to the issues not only for the UK but also internationally that lasted for more than a decade. In the UK, the recommendation of the Report was for a voluntary code. The Hampel committee followed in 1998 with a recommendation that the Chairman of the Board should act as a leader of the non-executive directors but did not alter the approach engendered by the Cadbury report.

However, by 2002 some major financial scandals, including those of Enron, World Com and Tyco, put the issues of corporate misfeasance back into the sights of regulatory bodies in the UK. As the root cause for many of these was identified as poor corporate governance practices the Government initiated another report (the Higgs Report, 2003) that, while supporting the maintenance of the 'comply or explain' (Pass, 2008, p. 291) approach instigated by the Cadbury Report, also advocated that Boards should be responsible for ensuring a proportion (at least

50%) of members are independent. Although there was some criticism that these recommendations were overly prescriptive (Jones, 2003, p. 8), they were incorporated into the combined code in time for the 2003 reporting year (FRC, 2003). Since then, there have been a series of reviews of the Code (now retitled the Corporate Governance Code (FRC, 2010)) but little has changed either in terms of approach or criteria (FRC, 2010, p.12-13). It is important to note that this code refers to non-executive directors but clearly includes independent ones. A similar approach has been adopted by the Australian Stock Exchange (Australian Stock Exchange, 2007). While the New Zealand code (New Zealand Exchange, 2010) requires that at least 25% of directors should be independent (rule 3.3.1) it leaves it to the company to identify those who fall into that category.

4.6.1.2. USA

In America, the trajectory and outcome of initiatives to improve corporate governance through the participation of independent directors has been somewhat different. Despite a lack of any requirement or strong recommendation, their presence was already well established by the turn of the century. Bhagat and Black (1998) estimated that in 1991 more than two-thirds of the 957 largest United States companies had a majority of independent directors on the Board while also making reference to the fact that Spencer Stuart in their survey of 100 of the largest companies in 1996 reported that no fewer than 50% had a maximum of two insiders on the board. Gordon (2007, p. 1476) cites studies that put the proportion much higher than that – in a study conducted by Korn/Ferry in 2003 65% of respondent companies reported fewer than three insider directors. One year later that had increased to 91%. In his lengthy article, Gordon documents their rise with their overall membership of large public company boards increasing from some 20% in 1950 to 75% in 2005 (Gordon, 2007, p.1465). He posits the reason for this as a change in the function of the American Board from the end of World War II – from advisor to monitor (2007, p.1469). This, he considers, made director independence critical. In addition, with a shift in focus for a company from

stakeholder concerns during the 1950s to shareholder wealth maximisation in the 1980s and 90s, the conflict of interest for insiders and a growing faith in an efficient market hypothesis, as opposed to the expertise of the insiders in growing market value, meant that outsiders were painted as the objective mediators of the shareholder interest.

However, the financial and confidence shock sparked by the Enron and similar collapses were to spark a fundamental shift in the mechanisms used in the United States to assure good corporate governance. One of the first steps taken by the Federal Congress post Enron was the passage of the *Sarbanes-Oxley Act 2002*. One of its main provisions (s301(2)) is the requirement that audit committees be composed entirely of independent directors, and it also by analogy mandates the membership of such directors on the board. Consequently, and shortly after the passage of this legislation, both the New York Stock Exchange and Nasdaq moved to require boards of listed companies to have a majority of independent directors (Wallison, 2006, p. 1; Ritchie, 2007). These rules are quite prescriptive: the NYSE Company Manual s303 A.01 specifies that at least 50% of the members of the board of a listed company must be independent; s303A.02 of the specifies remunerative caps (applicable both before and during the time a stated individual is a Director) and other quite detailed criteria that are either met or not in determining whether or not the requirement for independence is satisfied.

4.6.1.3. Europe

Insofar as continental Europe is concerned, the historical background is again different. This is largely due to the use of a two-tier board structure as found in the Netherlands, Germany, Austria, Finland and Denmark (Jungmann, 2006). With a management board (made up of those with industry and company experience and often working in the firm) and a supervisory (of those representing stakeholder interests) there was far more room and logic for the inclusion of independent directors).

However, there was little in the way of guidance or mandatory rule at a national level as to the determination, role or status of the members of the supervisory board, a situation that largely remained unchanged until recently despite some moves in certain jurisdictions (Germany in particular (Enriques and Volpin, 2007, p.130)) to increase their power and profile. Enriques and Volpin attribute this lack of legislative enthusiasm to the difference in the characteristics of shareholdings in United States companies (widely dispersed) with European (relatively concentrated) but could also be a function of the existence of the supervisory board. In 2004 the EU "moved to promote the position of independent directors in both a unitary board situation and on the supervisory board in the instance of a two tier structure" (Country Monitor, 2004). However, a year later, the sentiment moved past encouragement when the Commission of the European Communities recommended to the European Parliament that a set of definite rules (similar to the American model) be adopted. The recommendation also admitted the possibility of the "comply or explain' approach as applied in the UK and other jurisdictions (Ritchie, 2007; International Finance Corporation, 2008).

These various initiatives, be they recommendations, code, rules or law, all reflect acceptance of, and enthusiasm for, independent directors on the boards of companies. The following section provides detail of how they have been incorporated into the law of various jurisdictions and/or how they are implied into relevant institutions.

4.6.2 Legal and Structural Framework

Company legislation generally provides for a separation of powers between a Board of Directors (responsible for "risk and compliance, strategy, governance, developing the CEO and senior management and managing stakeholders" (Nicholson and Newton, 2010, p.204)) and Shareholders in General Meeting (SGM) with the collective responsibility (or more accurately, right) to elect directors to safeguard their investment in the company, appoint the auditor to

examine the truth and fairness of the financial reports and to participate in certain important decisions such as the liquidation of the company or a change to the company's constitution. This arrangement places Directors firmly in the driver's seat – described by Bainbridge (2008) as "Director primacy".

Arguably, however, this situation is not universally applicable, only applying to a relatively large company with a large number of shareholders – or what can be described as a diffuse shareholder model. In such a case, with no one shareholder having sufficient power to influence the deliberations of the Board, the Directors in making decisions (at least theoretically) have as their main focus the benefit of the company as a whole (and as prescribed as a director's duty within such legislative frameworks as the New Zealand *Companies Act 1993* (particularly s133), the *Corporations Act 2001* (Australia (s181) and the UK *Companies Act 2006* (ss`171-3) as well as by way of the common law in the three named countries and in the United States (relevant cases in the last named including In Re the Walt Disney Corporation No. 15452 (Del. Ch. Aug. 9, 2005) and Stone v Ritter 2006 Del. LEXIS 597, 30-31 (Del. November 6, 2006).

This places such directors in a hybrid position, first as Agent acting for the shareholders in relation to the decisions made by the Board, and as Principal in controlling and monitoring the conduct and decisions of the CEO (Bainbridge, 2008). As will be explained later, this position may influence motivation to join, act and leave a Board, and therefore the arrangements under which such a Director acts.

There are several other models that, depending on the shareholding profile, can be applied to companies and demonstrates again the danger of assuming a 'one-size-fits-all' governance model. First, there is what might be described as a concentrated ownership model (where there is a high proportion of institutional shareholders but where the shares are publicly traded).

Two different iterations of the Board may be associated with the concentrated ownership model. First there is the situation that prevails where the large institutional shareholders take no direct role or interest in the governance of the company (Monks and Minow, 2000). The second is where they do – sometimes through the right to appoint a nominee director or directors. It should be noted in this context legal obligations of all directors (that would include nominees) lie primarily to the company (for an explanation see below). However, it is still reasonable to assume that such directors will have particular motivations for serving on the Board that differ from those elected by the shareholders as a whole, assuming of course that they actually participate in the running of the company. That is not always the case. Aspects of this and its implications for motivation are discussed further below.

Secondly, and of most importance for the immediate purpose, there is a limited ownership model, a term that can be applied to small to medium sized enterprises with a corporate structure. In this context, it is important to remember that the definition of SMEs varies considerably across jurisdictions. In the United States, for example, different criteria are used to identify SMEs depending on industry sector. For example, companies in manufacturing or mining are normally considered SMEs if they have fewer than 500 employees, but in the wholesale trade industries that figure is lower at only 100 (University of Strathclyde, 2010). More generally, the New Zealand Ministry of Economic Development (MED, 2007) reports that for member countries in the European Community a business with fewer than 250 employees is deemed an SME, but in Australia that figure is 200. Finally the MED (2007) defines a business with fewer than 20 employees as an SME.

Legislative provisions in different jurisdictions also indicate differences in treatment. Although these do not tend to refer to SMEs per se, they differentiate between companies that will often also be SMEs and those that are not. The New Zealand Financial Reporting Act 1993 s6A, for example, excludes subsidiaries from its definition of a non-reporting company (s6A) (that while not exactly the same as an SME, being companies with 5 or fewer employees and $1 million in assets and $2

million in turnover). In the UK, the Companies Act 2006 ss 382 and 465 define a small company as having fewer than 51 employees plus turnover of no more than 6.5 million and balance sheet total of no more than 3.26 million (the figures for a medium being 250, 25.9. and 12.9 250 respectively (University of Strathclyde, 2010) while the Australian Corporations Act 2001 provides that a small proprietary company is only so if two of the following three criteria are satisfied: turnover below Aus$25 million, assets below Aus $12.5 million or fewer than 50 employees.

These variations in size and definition raise potential difficulties in making international comparisons or drawing conclusions as to motivations of directors. In addition, the concept of an SME is far from homogenous, including family and one-person companies, start-ups and fast growing entrepreneurial ventures (Gabrielsson and Huse, 2001). Nevertheless, SMEs can be considered to have certain common characteristics. First, they are closely held and independent of other businesses. Not only does this mean that their structure and decision processes are relatively informal and direct as between the directors and the shareholders (as compared to the large public corporate) (Bennett and Robson 2004) but also, a shareholder's ability to trade may be subject to legal or constitutional restrictions and/or subject to the Board's discretion as per the Companies Act 1993 (NZ) s84, the Australian Corporations Act 2001 s1072G and the model Articles of Association under the UK Companies Act 2006 for companies limited by shares and Subchapter S of Chapter 1 of the United States Internal Revenue Code (sections 1361 through 1379) that grants preferential "single tax" status to the "S" corporation that ceases should an ineligible foreigner acquire its shares. The main consequence of these restrictions on the transfer of shares is that their membership tends to remain stable and constant which also often means that the group of directors will also be stable.

Secondly, and according to the OECD (2000), SMEs are most likely to emerge in the service industries, including business services, IT, research and development, marketing, business consulting and human resource management. To this can be

added retail and agriculture. It is also suggested that SMEs tend to thrive in those sectors characterised by high levels of innovation and entrepreneurship (Carree, van Stel, Thurick and Wennekers, 2002).

Thirdly, SMEs are commonly owned by a small group of shareholders (often members of a family and/or close associates) (Bennett and Robson, 2004; Dana and Smyrnios, 2010) and are also commonly run by a director or directors who come from those ranks (Gabrielsson and Huse 2001; Dana and Smyrnios, 2010). It is also possible that outsiders such as providers of specific expertise (Bennett and Robson, 2004). Again, the characteristics of any given director of a limited shareholder company are likely to shape motivation, and again, these are likely to differ significantly from those of directors of companies fitting other models.

A derivative of the above model is where although the shareholding may be wider than under a limited shareholder model, it is still comparatively narrow. Such businesses may be on a growth trajectory, the range of shareholder expectations wider and the pool of director talent broader than in the instance of a company fitting a limited shareholder model as described above (being more likely to have independent directors).

Of course, the expectation that a board will have independent directors also assumes that there is a pool from which such directors can be drawn. This raises questions of motivation – why a director would agree to serve. This is one of the main foci for this work and is explored via the third hypothesis to be tested in the empirical study (see chapters 5 and 6 for details).:

H1 = Directors are motivated by the chance of doing good rather than by other benefits of a directorship[4]

Rationale: As pointed out previously, principles of agency theory drives the prevailing model used to explain the method by which directors are anchored into

[4] This hypothesis is identified as number one although discussed and contextualised after hypotheses two and three, given that it is the main focus of the empirical research.

the structure of a firm. As it reflects a rigid application of a legal duty to represent shareholders, it is valid to ask whether this theory adequately explains how directors in New Zealand firms understand their relationship, rights and duties, with the businesses in which serve or wish to serve as company directors.

Analyzing the expressed intentions of prospective and sitting company directors in New Zealand as to their motivations to serve on boards may thus allow a determination whether this model is indeed adequate to explain the relationship between director and firm.

4.6.3 Motivation

The next sections explore differences in motivation that have been posited for directors under each of the models identified above, beginning with the diffuse shareholder model. As a cautionary note, it should be emphasised that research into this question does not necessarily differentiate between inside and outside or independent directors.

4.6.3.1 Director Motivation: Diffuse shareholder model.

By way of reminder, this model describes the large publicly traded corporate with a broad and diffuse membership and where increasingly, the exemplar governance structure requires an independent Board of Directors to monitor and control the CEO on behalf of the body of shareholders (Jensen and Meckling, 1976, Fama and Jensen, 1983).

By way of introduction to this analysis, Neill and Dulwicz (2010) stress the difficulties involved in gathering data on the operations and effectiveness of boards. This they attribute to a growing tendency to keep such activities secret. However, they believe that a deeper understanding of what actually goes on in the Boardroom is vital to an assessment of effectiveness. The rationale for their position is the detrimental effect on potential caused by "process losses" (Steiner

1992 as quoted in Neill and Dulwicz 2010, p. 294) that are defined as "the sum of coordination loss due to the difficulty in coordinating efforts of multiple individuals, and motivation loss (Neill and Dulwicz, 2010, p. 294). Board effectiveness, they posit, is reliant on such social-psychological processes as group interaction, information exchange and critical discussion – not easily achieved for a Board that meets only infrequently. The importance of such processes is also recognised by Ingley and van der Walt (2003) who refer to Forbes and Millikin (1999) for support for their position that boards achieve maximum effectiveness when members are attracted to each other and are motivated to stay and contribute their expertise to the organisation.

Significantly, Silva (2005) states that Board of Director motivation in this context has 'never' (Silva, 2005, p.1) been studied and moves to address this lack by using a sample of 1200 outside Directors on Boards of Fortune 500 companies to analyse the relationship between directors' pay and equity holdings and their evaluation of CEO performance. She concludes that financial motivation (in the form of remuneration) for Directors is negatively correlated to their use of quantitative measurements in assessing CEO performance but that their ownership of stock is positively correlated (a conclusion in line with that of Hermalin and Weisbach 1991 as a reflection of agency concepts).

In reference to the particular issue of motivation, two points from this study are worth noting. First, she reports on the results of a survey in which respondents were asked to indicate levels of accountability, autonomy and significance in relation to such statements as "I feel my participation…is valued" and "being a board member is important to me." She hypothesises, and tentatively concludes, that support for such statements was highest amongst those who were better at supporting shareholder interests (Silva, 2005, p. 5).

Secondly, and despite the above, the emphasis in Silva's analysis is on financial forms of motivation – salary and related payments and/or stock. This suggests that for her at least, the main reason for directors to join and participate in boards is

money or at least the promise of some in the future. This assumption aligns with that of Ramsay (1993) and Jensen (1994) on the question of incentives for agents. Given the compliance and management expectations placed upon directors, particularly in large companies, perhaps this is only fair (Bush, 2005).

However, this position raises interesting issues for motivation. Arguably, inside directors would assume positions on the Board because it is part of their role in the company (such as that of the Chief Financial Officer) or because they hold equity in the company either through purchase or, more likely in the case of a senior executive, as part of their compensation package. Silva (2005) points out that while both inside and outside directors are dependent on management for their compensation package, a position that potentially affects the ability of the board to act independently, inside directors as employees are even more restrained due to their reliance on the CEO for their continued employment. Therefore, not only is the motivation of such directors to join the Board directly linked to their employment (and therefore to their remuneration) but also their motivation while on the Board is affected by their on-going dependence on the CEO.

Outside or independent directors might join for a variety of good reasons. Cortese and Bowrey (2008); McCabe and Nowak (2008); Pass (2004); Peterson and Philpott (2007); and Spencer Stuart (2009) all report that a large proportion of independent appointees come from business backgrounds, including serving or ex CEOs/Directors of other companies. In addition, Higgs (2003) and McCabe and Nowak (2008) warn of a tendency for existing board members to approve the candidature of those most like them. Such directors might join as a result of their business, social or other links with existing members of the board (Nwabueze and Mileski, 2008) and as a means of increasing their business power or influence (Borokhovich, Parrino and Trapani, 1996).

Reasons for such individuals to resign are analogous to the above. Arthuad-Day, Certo, Dalton and Dalton (2006) studied the impact on director turnover of

negative financial restatements. Although their focus was the forced rather than willing departure of directors, it is reasonable to assume that a negative event would encourage the directors to jump the sinking board. Conyon (1998) studied a large sample of UK firms and found that CEOs were influenced by levels of pay and company performance in making decisions to stay or go. Logically, directors would be similarly influenced, a supposition supported by Asthana and Balsam (2010).

Appointment to the board of those who do not fit this profile does occur. One motivating factor for such membership is maintenance of founder-family control or influence over a listed company (Demott, 2008). Demott (2008) suggests a link between poor performance of boards as a result of such involvement (possibly because top management may consequently be recruited from a limited talent pool) and of even more concern, discusses misuse by family directors of the position to gain inappropriate benefits (in the case of Tyson foods). This strongly suggests that the motivation of some such members in maintaining the role as director may be less than honest.

Not all individuals accepting such roles do so for dubious reasons: a wish to inculcate particular ethics or values into corporate decisions or strategy (Kemp, 2006), contribute to a drive to bring a sense of social responsibility or broader cultural expertise to the Board (Agrawal and Knoeber, 2001; Cunningham, 2010) or as part of a move to introduce ethnic or other diversity (Women on Boards, 2006; Spencer Stuart, 2009). Such directors are not necessarily driven by money (He, Wright, Evans and Rowe, 2009).

However, and as a cautionary word, such super-independents frequently must look to the CEO to overcome their lack of experience or background and "old hands" (Ritchie, 2007) for information and support, or what Hooghiemstra and van Manen (2004, p.317) label the "independence paradox" (also see Cunningham, 2010 and Demb and Friedrich Neubauer, 1992). Kemp (2006) also offers a list of reasons for their failure to perform well - including friendship and other ties to other

directors, shareholders and members of the management team, and lack of knowledge, expertise and time.

The above suggests that the motivation of such individuals in accepting a position as independent directors might be for a range of laudatory and other purposes. However, it is all too easy for new members to become part of the crowd (Van den Berg and Baelden, 2005; Kemp, 2006), pay "more attention …to personal gain than [to] fiduciary duty (Bosch, 2001 as quoted in Kemp, 2006, p.58) or disillusioned, prepare an exit plan.

In this context, Le Blanc and Gillies' (2005) exploration of director experience is of relevance. What they uncovered indicates a significant problem with disfunctionality of boards. *Inter alia*, respondents considered that the board, particularly the independent members, was seen as a low-value impediment to the CEO's performance rather than as a valuable aspect of management and strategy, and even more worrying, cited the lack of trust between the Board and management, lack of commitment on the part of their fellow directors, strong personality conflicts and problems with the way Board made decisions. Throw into the mix the potential liability faced by directors (Mueller et al., 2006; Reuters, 2009) and the "substantial settlements" (Wallison, 2006, p. 3) directors of Enron and WorldCom were forced to pay for failing to catch and address fraud, and the impact on reputation and wealth of poor company performance and increased risk (Asthana and Balsam, 2010) and the question is not so much why would people join boards but more, why would they stay?

4.6.3.2 Director Motivation: Concentrated Shareholder Model

Although many of the same points re motivation in the above model also apply here, there is one difference that should be explored: That of the nominee director. By way of clarification, in this context the term nominee applies to any situation where a director represents the interests of a shareholder or group of shareholders. Particularly in cases where the interest of that shareholder(s) is hidden, the nominee director often does no more than provide his or her name to

the company documents for purposes of legal compliance and takes no part in the proceedings of the board – the classic "sleeping" director. Motivation for such nominees is clearly not interest or involvement in the company or its affairs: it is quite possible they are giving their consent in return for money – or receiving "rent" for their name.

It is also possible that the director be appointed specifically to represent the interests of a large shareholder – normally an institutional shareholder. As Monks and Minow (2000) and Bainbridge (2008) point out, although the ownership of a "control block" of shares is sufficient to hand control over the company to those large shareholders, the reality is that few such shareholders do use their voting power due to the costs involved in directly monitoring the CEO. However, the appointment of a nominee director to represent a sectional interest (including that of the institutional shareholder) is frequently an option. This also raises particular issues of motivation.

It is important to remember that the duties of a director, any director, lie first and foremost to the company, including shareholders en masse. Not only does relevant legislation and case law charge directors with exercising their duties for a proper purpose (see above) but also to act in good faith, including avoidance of conflicts of interest (for example, New Zealand Companies Act 1993 s131; Australian Corporations Act 2001 s184; UK Companies Act 2006 (particularly s175); Greenhalgh v Arderne Cinemas [1951] Ch 286. Also see discussion in Black, 2001). It is perhaps the last duty that has most significance in relation to motivation. Nominee directors are potentially torn between maximising the interests of all shareholders and the interests of the shareholder(s) responsible for their appointment and on whom they rely for its continuance (Salem and Teh, 2008, in reference to the situation in Malaysia). Although there may be means whereby they can record their conflict yet still be involved in Board decision-making, that conflict can still be the elephant in the rooom.

So far, the focus has been on motivation for directors in the case of large, listed corporates. However, despite (or perhaps because) of the fact smaller unlisted companies are not exposed to market scrutiny or its sometimes-fickle wind of fancy, issues associated with motivation can if anything be more critical. These are considered in the following sections.

4.6.3.3 Director Motivation: Limited Shareholder Model

Before these are discussed, some initial points should be made. Firstly, very small SMEs (sometimes referred to as "micro-enterprises" (MED, 2007) in particular, may have only one director/operator/manager/owner who is recognised as a director only because the business has either been created as a corporatised sole tradership, or because it has transitioned from a non-corporatised entity but nothing else has changed. These one person companies are given legal recognition under, for example, the New Zealand Companies Act 1993 (s10), Australian Corporations Act 2001 (ss114 and 201A); the UK Companies Act 2006 ss7 and 154 and the Delaware Commercial Code, Title 8 (Corporate Law) subchapter I s101 and subchapter IV s141(b). These types of SME, although important, offer little in the way of data for study into motivation of directors. Instead, it is those which have some structural separation of ownership and control through an officially designated Board of Directors that have been the subject of some research. It is those ones, therefore, that provide the focus for the discussion that follows.

Secondly, in his analysis of the state of research into the subject of boards and SMEs, Huse (2000) identifies the issue of motivation for directors to join the boards of small companies as an important part of any agenda (Huse, 2000, p.279 and 280). Included amongst the important questions he considers need to be asked are what are the reasons for, and the profile of, independent directors, what persuades individuals to serve and how do differences in company profile and size affect what directors do and are?

Despite this call, there is little direct and broad-based research into factors that cause individuals to join and participate. However, some research has been conducted on aspects of membership and operation of such boards, research that goes some way to revealing the answers to such questions, at least in the context in which it is conducted.

By way of introduction, Bennett and Robson (2004) refer to Dalton, Daily, Ellstrand and Johnson (1998) in making the point that boards of smaller companies should be more influential than those of large companies. They are in a less complex and compliance-driven environment and deal with fewer vested interests (such as diffuse shareholders and capital markets). In exploring the justification for this position, Bennett and Robson (2004) examine boards of SMEs and their links to business performance by reference to three theoretical frameworks: resource dependence, counselling and control.

As explained in chapter 3, the concept of "resource dependence" refers to the board as a source of expertise, resources and networks (Bennett and Robson 2004; Gabrielsson and Huse. 2005) while counselling recognises the advice/stewardship and guidance roles of directors (Bennett and Robson, 2004). Finally, control refers to the monitoring function of the board. As Bennett and Robson (2004) point out, with the close relationship if not the complete or partial overlap between management and directors that is common in small SMEs, there is little space or need for control. However, with one of the "most important transitions" (Bennett and Robson, 2004, p. 98) being a shift from a one-person management model to a wider board along with a possible separate management team, control over the "management" function becomes both more necessary and more possible.

Mueller et al. (2006) develops this theme, making the point that where only a small pool of people are engaged in both operating and directing a business (such as where the Manager is also on the Board) it is very difficult for such a person to distinguish between the needs and demands of both roles and therefore lose

effectiveness (a reflection of control and counselling issues facing SMEs (Bennett and Robson, 2004).

However, and despite the economic and social importance of SMEs, particularly in the innovative and entrepreneurial industries (Carree, van Stel, Thurick and Wennekers, 2002), growing the board by way of new members motivated by self-interest may actually reduce its effectiveness (Demott 2008).

In this context, the findings of a recent study into Australian family businesses (of which some 80% are companies) (Dana and Smyrnios, 2010) are revealing. According to this report, only 42% of respondents have a formal Board of Directors with only 45% meeting at least four times a year (Dana and Smyrnios, 2010, p. 14), a finding that suggests that for SMEs boards are not necessarily considered an important part of the governance structure.

Moreover, 85% of boards have no non-family members, mainly to maintain privacy (at 52.5%) (Dana and Smyrnios, 2010 p.15). This finding is supported by Gabrielsson and Huse (2005) with their point that "suspicion and family politics are common ingredients in the selection process" (Gabrielsson and Huse, 2005: 33). Although the second most frequently offered explanation was that the necessary skills were available in the family, this still only made up 29% of the responses (Dana and Smyrnios, 2010, p.15). As 58.4% of owners do not require family members to have outside business experience prior to joining the business, the question of what skills are available remains unanswered. Although Dana and Smyrnios (2010) do not specifically discuss the motivation for Directors of such companies the above statistics hint that directors are there because they are expected to be or because they see it as the means of safeguarding their financial or family position.

Although in some respects seemingly at odds with the above, three other sets of findings also offer some useful indicators of motivation for such directors. First is the set of issues and challenges facing family businesses, the most important of

which are communication between family members (at 40%), letting go of leadership/ownership control (40%) and providing liquidity to permit exit (37%) (Dana and Smyrnios, 2010, p.15). When these findings are combined with that showing that 60% of younger family members are not as interested in actively managing the business as are the older (Dana and Smyrnios, 2010, p. 16) and that 45% of owners are actively planning to sell (Dana and Smyrnios, 2010, p. 23), it suggests that there is a tendency for the family-based businesses to be viewed as the source of a retirement income stream rather than as the basis for on-going family cohesion. These findings give some indication of motivation for directors: the desire to maximise returns and levels of efficiency even if it means alienation of the business from the successive generations.

There is growing support for the argument that the appointment of well-qualified external directors offers positive benefits for SMEs, improving the effectiveness of the board and potentially the performance of the company (Barrow, 2001; Bennett and Robson, 2004; Berry and Perren, 2001; Feigener, 2005; Gabrielsson and Huse, 2005; Mueller et al., 2006), particularly in the context of a slightly broader shareholder base and or a company on a growth trajectory (Barrow, 2001 in relation to high tech SMEs). Those benefits include increasing the ability of a company to manage the external environment, reducing uncertainty and a means of co-opting resources (such as finance, expertise and intellectual property) that will permit it to grow and thrive (Bennett and Robson, 2004; Gabrielsson and Huse, 2005) (an aspect of resource dependency). In addition they can improve accountability of management (Keyt, 2004) (an aspect of the control function), provide guidance and advice to management (Fiegener, 2005) (counselling) and give space to management to focus on the business decisions - or those areas where they have the expertise and talent (Barrow, 2001; Fiegener, 2005).

A venture capitalist, for example, is motivated by the desire to see the company grow (and to realise his or her investment in the shortest possible time). Therefore, he or she does not just maximise his or her short-term return but also fills a mentoring role for other members of the board (Barrow, 2001; Gabrielsson

and Huse, 2005). Professionals such as accountants or lawyers will be paid for their time and expertise and would therefore be expected to be motivated by both financial reward and a desire to enhance their market reputation and expand their client base and demand. Finally, and more generally, as in the case of diffuse shareholder companies, individuals may be motivated to join due to their support for the objectives and philosophy of the company. Of relevance in this context is Fuller and Tian's (2006) identification of SMEs as well placed to pursue corporate social responsibility as "competitive advantage" (but contrast this with Fassin (2005) who sees evidence of unethical behaviour in entrepreneurial businesses. Perhaps the lack of broader management experience on the part of the owner of a SME now in a growth phase offers an opportunity for unscrupulous or self-serving behaviour on the part of an independent appointee to the Board – or vice versa).

Yet, and in conclusion, the ability of even willing SMEs to recruit and retain independent directors is limited (Mueller et al., 2006; Dana and Smyrnios, 2010). Although some research suggests that potential directors may be happy to 'do good' (however that may be defined) rather than merely do well, SMEs remain at the bottom of their lists of potential or actual employers (Mueller et al., 2006). This has been attributed to the relatively low status and low stakes for SMEs and their boards, especially when the potential legal exposure is also taken into account (Mueller et al., 2006). This raises issues for SMEs into the future because, while as indicated above, research reveals that independent directors can add value in a wide range of ways, potential candidates may be unwilling to serve unless the company is manifestly stable, low risk and with a good reputation (Mueller et al., 2006) – potentially a chicken and egg situation!

Various reasons can be offered for a Director to leave the board of an SME. Obvious ones include retirement (particularly where the SME is a family concern and either passed on to the succeeding generation (Dana and Smyrnios, 2010)), sold or closed due to lack of interest, market or finance (Featherstone, 2009; Dana and Smyrnios, 2010) or where (such as in the case of a venture capitalist) the arrangement has come to an end. However, although little research appears to

have been done on this situation, one that is of potential importance in the context of SMEs and the one that would be unlikely to arise in larger companies, is board/member politics.

Because of the close relationship and necessity for mutual trust between members of the company (who often constitute the board as well), small corporations are sometimes regarded as 'quasi-partnerships'. Hence, a breakdown in the mutual trust and confidence or board/management deadlock may lead to the court ordering the company be wound up (liquidated) on just and equitable grounds (as per Australian Corporations Act 2001, s 461(1)(k), the Companies Act 1993 (New Zealand) s241(4)(d) and the UK Insolvency Act 1986 s 121(1)(g)) such as in the cases of Ebrahimi v Westbourne Galleries [1973] AC 360, Carpenter v Carpenter Grazing Pty Ltd (1985) 4 ACLC 18, Re A and BC Chewing Gum Ltd [1975] 1 W.L.R. 571 and Re Yenidje Tobacco Co Ltd [1916] 2 Ch 426. Given the fundamental and terminal consequences of winding up, a director faced with the possibility of the company going into complete meltdown might take the difficult decision to fall on his or her sword or be forced or choose to leave an untenable position.

Given the focus of the previous discussion it is useful by way of contrast to consider the issue of motivation in a purportedly quite different context (although this is debateable), this being in Non-profit Organisations.

4.6.3.4 Director Motivation: The Case of NPOs

Cleave and Inglis (2006) suggest that there are five factors that determine the participation of individuals. The first of these is attitude towards the organization. Second is the size of the organization. The third factor is a person's social background as a person's education and gender can influence preparedness to volunteer as a board member. Fourth relates to personality: ideal board members will have 'enduring traits such as emotional stability' (Cleave and Inglis, 2008). The last factor relates to a person's situation, such as whether an individual has been approached to join the board. Overall, Cleave and Inglis (2006) concluded that

individuals who have some type of identification and connection with the organization and its values and goals will be more likely to serve.

It is more likely too that such individuals will be effective: Taylor, Chait and Holland (1991) found that effective directors on boards of universities had previous connections to the colleges before they joined, and thus were effective shortly after being appointed. Respondents in their survey cited ‘loyalty to the college’ and ‘respect for the college’ as motives for joining the board.

A further study highlighted by Cleave and Inglis (2006) examined the motives of board members of a sports organization. Their findings from the survey resonate with the common themes emerging from the literature: that motivation comes from enhancement of self-worth, learning through community, helping the community, developing individual relationships, unique contributions to the board, and self healing. In their findings, volunteer board members rated the community foci highest. Hence board members were altruistically motivated because they carried a concern for others rather than themselves.

Overall conclusions as to motivation for directors to join boards, participate in their deliberations and make decisions to leave are hard to draw and dangerous to generalise (given the broad range of organisations that have them and the characteristics unique to each). With the drive for the economically and socially important SME sector to lift its corporate governance game, SMEs offer a fertile area for further research (Huse 2000).

4.7 Characteristics of Independent Directors

It is clearly not just motivation that shapes the contribution of independent directors on a board of directors. Specific characteristics of those directors are also of importance. Aspects of these characteristics are explored below.

4.7.1 Characteristics: Self-confidence

Two hypotheses directly address examine the opinion such individuals have as to their own expertise and/or commitment. Specifically, those hypotheses are:

H4 = Directors consider themselves more than 'average' competent in all aspects of contributing to a board.

H5 = Directors report that their level of 'commitment' exceeds their level of competence in other areas.

Rationale: A reasonable presumption is that if sitting directors have all the skills they might need to be effective directors, other directors (including those from outside) would not be required. In that case, the interest of shareholders to identify, recruit and engage independent directors would be muted. To some extent at least, the maintenance and development of desired skill sets are subjective: Existing directors who maintain awareness, commitment and responsibilities are likely to retain their positions.

As stated above, research consistently highlights the importance of establishing and maintaining a strong board of directors (George, 2010; Cocks et al., 2010; Pearce and Zahra, 1992; Forbes and Milliken, 1999; Hillman and Dalziel, 2003). However, there is a broad range of desired or ideal types. Boards of large for-profit and non-profit firms might be formal in their operations and take care to accord with statutory or regulated procedures (McNamara, 2010). They often have small executive committees and possibly many members, some of whom are highly visible in society (McNamara, 2010).

By way of contrast, boards of small non-profit or for-profit firms might be informal, with informal operating methods. McNamara writes that there are many similarities between non-profit boards and for-profit boards. Both types of board

have similar fiduciary responsibilities among members. In addition, both have to conform to operating rules and regulations set by the state and by the firm itself. For-profit board members usually are paid and tend to deal closely with decisions the firm's financial operations with a view to maximising the firm's profits. However, board members on non-profit boards are volunteers. They are not paid, except for expenses and do not seek to maximise profits but instead are often involved with fundraising (McNamara, 2010).

Such variability can affect board attributes and, ultimately, its contribution to organization performance. As some indication, Norburn (1986) reported how certain variables in industry settings, growth, turbulence, and decline, helped to shape directors' characteristics, abilities, beliefs and skills. He found that directors in growth industries demonstrated certain characteristics, including wide exposure to other cultures, and an inclination to use participative decision styles. In turbulent industries, directors valued career mobility, had little international exposure, and were people-oriented in their managerial styles. In declining industries, directors were motivated by monetary rewards, had little international exposure and were older than directors in other industries.

Appreciation of the characteristics or likely characteristics of board members is crucial to understanding what motivates board members in the range of settings identified above, and to understanding what characteristics are sought by firms and other organisations seeking to recruit. The body of research into the characteristics of independent directors is large, broad, multi-national, spans a broad range of contexts and offers a range of conclusions and inconclusive results. For all these reasons, what follows is an extended discussion of this research with specific foci on diversity (age, background and gender being three aspects of this but with most emphasis on gender as a context in which to explore some of the institutional and other underlying causes that might contribute to lack of diversity) and its rationale; possible challenges to independence; and aspects that might support or affect the effectiveness of independent directors in achieving the two roles expected of them: monitoring and firm performance.

4.7.2 Characteristics: Diversity

There is a substantial body of literature that supports the importance of having experienced and competent members on the board of directors (e.g. Carter and Lorsch, 2004, Coulson-Thomas, 1991, Garratt, 2003; Hillman, Canella and Harris, 2002; Kiel and Nicholson, 2003; van der Walt and Ingley, 2000). However, competence as a director is not simply a function of professional and industry-based managerial (namely CEO) expertise, which are the skill-sets most emphasised among shareholders and traditional selection criteria for board appointments. While executive experience brings many of the required commercial skills to a board position, the role of governing is distinct from managing in crucially important ways. Executives are required to implement or execute decisions agreed in conjunction with the board and will thus have primarily an operational perspective, while it is the board's role to guide the overall strategic direction of the organization. To have the level of competence necessary to provide leadership and engage actively with stakeholders, boards require directors with additional leadership skills and a solid understanding of the difference between managing and governing an organization (see Hillman et al., 2002 for a discussion of board capital).

As a starting point, a board is a complex organization that must rely on the collective strength provided by its members. Individual directors must accept a common responsibility to form an effective working group (Demb and Neubauer, 1992). Although certain individuals and groups are clearly more influential than others, board members usually see their boards as homogenous groups of colleagues who have similar socio-economic backgrounds, and who work together on a consensual basis (Hill, 1995; Westphal and Milton, 2000). Historically and persistently, board members are usually men, often with extensive experience in top management positions, with similar interests, and similar social and professional networks. Although some appointments from a pool of candidates

may be controversial, board members are traditionally selected from those already in the professional networks of the CEO and the other board members, and new members' qualifications may not be scrutinised (Huse, 2007). Independent or outside directors especially, are recruited primarily because of their expertise and reputation. Arguably, this communality has many advantages, such as common knowledge of the informal rules of the game, and a rapid grasp of issues to be discussed and decided (Huse, 2007).

Accordingly, current board recruitment practices appear to be more closely aligned to the needs and demands of key internal actors who are generally considered to be the top management team (Huse, 2005). Having the same business background, non-executive directors usually subscribe to the same dominant business ideology as the executives. This means that they may intervene reactively rather than proactively in executive decisions and therefore be less effective as a check on management hegemony, although they still serve to constrain managerial opportunism (Hill, 1995; Huse, 2005).

Given the above, Hill's (1995) study of boards as social organizations in major British companies is interesting because respondents (both executive and non-executive directors) identified certain personal attributes of non-executive directors ('breadth of vision', 'a broader perspective', 'a global view of the company and environment') that seemed more desirable than was expertise in a particular area. Because getting the right people in place is paramount, personality, reputation and influence all counted. What was needed were suitable people (Ruigrok, Peck, Tacheva, Greve and Hu, 2006), who could not only work with the existing members but also provide vital support for the firm in a changing environment (Ruigrok, et. al, 2006). Carefully identified and recruited members of a diverse group might offer the best chance of this, given their quite different experiences, and thus different attitudes on issues or problems.

Therefore, in recent years, firms have been under pressure from institutional investors and shareholder activists to appoint directors with different backgrounds

and expertise. Nevertheless, measurable progress toward more balanced and diversified boards has been slow, with by no means universal support. Debate continues over whether increased diversity leads to increased shareholder value, and whether it actually matters at all. The emphasis in the literature on achieving greater diversity implies that it is important but progress is slow (van der Walt and Ingley, 2003).

The issue of board diversity and its importance in determining the power (and hence effectiveness) of the board is therefore one that has been the subject of much study. Milliken and Martins (1996) usefully explore what is meant by the term, distinguishing between observable or readily detectable attributes (p. 403), such as race or ethnic background, age, or gender, and less visible or underlying attributes such as education, technical abilities, socioeconomic group, personality characteristics or values (They note that these are not mutually exclusive: for example, ethnic differences may be associated with socioeconomic status.). These qualities will manifest themselves in the choices directors make (Zahra and Pearce, 1989).

Board diversity can be seen as a means of conduit for representation of a range of interests held by a range of stakeholders and promoting those interests to the board through the medium of on-going relationships.

Indicative of this, Tyson (2003) argues that greater diversity (e.g. in knowledge, functional expertise and relational skills) can improve relationships with corporate stakeholders, such as customers, employees and shareholders and, if truly representative of a range of interests, achieves greater legitimacy among both shareholders and among the larger community of stakeholders (Ray, 2005).

Representation is thus an institutional process whereby the voice of the governed is heard and taken into account by those doing the governing (Bebchuk, 2007; Krohe, 2000, 2004; Ray, 2005). In addition, and according to resource dependence theory, the board is a provider or procurer of important resources rather than an

evaluator of management. In this service role, boards act as 'boundary spanners' and networkers with external sectors or organizations, such as financial institutions, or political bodies, finding ways to tap into these bases of power and influence (Parsons, 1960; Pfeffer, 1972, 1973; Pfeffer and Salancik, 1978). Pfeffer (1972; 1973) found that, by increasing in size, and including members of diverse occupational and professional groups, boards could link an organization to its external environment, thus helping to secure critical resources.

However, representation is not the only reason for diversity (Burton, 1991). It can be seen also as a means of drawing on a variety of experience that might effectively be used to address issues in a novel way (Ingley and van der Walt, 2003).

Minichilli, Zattoni and Zona (2009) report that board member diversity (functional or 'background' diversity rather than observable attributes) is positively associated with board performance. The promotion of diverse perspectives can encourage a wider range of solutions and ideas for strategic decisions (Eisenhardt and Bourgeois, 1988). Again drawing on resource dependence theory, researchers suggest that directors from a broad range of experiences and backgrounds may be actively involved in strategy making through counsel and advice to the CEO or by initiating their own analyses or proposing new business ideas (Zahra and Pearce, 1989). They argue that larger and more diverse boards reduce uncertainty surrounding strategy development (Pearce and Zahra, 1992) and can 'promote the airing of different perspectives and reduce the probability of complacency and narrow-mindedness in a board's evaluation of executive proposals' (Kosnik, 1990, p.138). Directors can contribute to creative strategy formulation, because they can offer a variety of experiences and quality of judgment (Rindova, 1999).

Similarly, in his study of the power and influence of boards of directors, Zald (1969) identified 'resources' possessed by board members (including detailed knowledge about organizational operations such as expertise about a technical process, access to and control of relevant external resources, and individual characteristics, such as social status, gender and personality) that influence how he

or she will relate to others. These different kinds of resources, Zald argued, are important in determining the ability of boards to challenge and/or formulate lines of action and thus contribute to decision-making. Boards of directors are sometimes impotent, he said, and sometimes all-powerful. What each will be is in part determined by context and other subjective characteristics. It is for both these reasons that it is argued that diversity on a board is important.

However, it should also be noted that researchers have identified disadvantages with diversity on boards in respect of its potential to disrupt cohesion among board members, and issues relating to board size and efficiency (see van der Walt and Ingley, 2003 and van der Walt et al., 2006 for a review of the literature on these effects). While Milliken and Martins (1996) and others champion diversity for its positive influence on decision-making and relationships, they warn that groups with diverse backgrounds and skills may have integration problems similar to those of other diverse groups, and membership turnover might be higher among those who are different from their peers. In this way the cognitive and symbolic benefits of diversity might be outweighed by affective costs that organizations cannot necessarily manage effectively. In addition, diverse boards may be less cohesive, and are more likely to experience coordination and communication difficulties than do more homogeneous boards (Forbes and Milliken, 1999). A striking research finding is that groups that are diverse have lower levels of member satisfaction and higher rates of turnover than more homogeneous groups (Milliken and Martins, 1996).

Others argue that, as boards increase in size and diversity to fulfill their roles, they may not be ideally suited to strategic decision-making, which involves complex and ambiguous tasks. Board members may bring their individual and constituency interests and commitments to the board. Differences among these interests, especially those based on occupational and professional affiliations, may lead to different views on proposed strategic changes that may be destructive rather than positive. Indeed the greater the diversity of board interests, the greater the potential for conflict and factions (Goodstein, Gautam and Boeker, 1994).

In terms of recent empirical evidence of the practice of diversity, some indication is given by McCabe and Nowak (2008 into the Australian situation, but some of the most comprehensive studies have been conducted by Pass (2004) into the situation in the UK, Cortese and Bowrey (2008) (also see Cortese, 2009) in Australia and by Spencer Stuart (2009) in the United States. Although the UK and Australian studies are based on data sets four years apart, the results are surprisingly consistent, perhaps a function of the common non-mandatory corporate governance regime and the similar legal and corporate framework in both countries. Pass (2004) conducted a study involving 51 large companies drawn from the FTSE index and selected as representative of the major industrial activities. Cortese and Bowrey (2008) looked at 42 of the largest 50 companies listed on the Australian Securities Exchange (the ASX). In both cases the researchers relied on the annual reports to provide the information they needed on the characteristics of non-executive directors (that while not necessarily equivalent in scope to independent, do include them). (Pass used 2001 and 2002 reports and Cortese and Bowrey 2006). The Stuart Spencer survey involved 500 Boards on the Standard and Poors index from 2008. Other surveys have also been conducted. The findings from these various surveys will, as identified in the introduction to this section, be discussed under the three headings of age, ethnicity and gender. It should also be noted that most time will be dedicated to gender, as this is the area where much of the research has been focused and also one where the issues that emerge in the diversity debate can usefully be explored.

4.7.3 Characteristics : Age Diversity

Pass (2004) found an age range of 51-66 with 59 as the average while for Australia (Cortese and Bowrey, 2008), although the range was wider - 32 to 64, the average age were 60. For Spencer Stuart (2009) the mean was even higher at 61.7 years of age, although they also found that the range of for newly appointed directors went from 28 to 74. These findings suggest that those nearing retirement are inclined to look to this role, perhaps for a variety of reasons including a wish to use their

experience and knowledge in business to give something back. Another possibility is that by then they have accumulated the networks, contacts, confidence and experience that will make them 'useful' individuals that can be relied upon to occupy such a position (Wallison 2006). A third possibility is that such individuals now have the time, wealth and knowledge to devote to active management of an investment portfolio and see the role of director as a useful means of safeguarding that investment. A final possibility is that a young CEO with a weak Board might perceive an older non-executive (or independent) director as more easily influenced, persuaded or pushed into supporting the CEO's proposals.

4.7.4 Characteristics: Background Diversity

In the Spencer Stuart (2009) survey, they identify 13% of new independent directors as being from diverse backgrounds (in terms of ethnicity – a factor not examined by either Pass (2004) or Cortese and Bowrey (2008)).

Peterson and Philpot (2009) report that in 2002, 50% of all Fortune 500 companies had at least one academic on the Board, with a total of 412 seats held by 282 individuals (which means a good proportion held more than one). Of those 412 seats, African-Americans held 62 or 15%. Both these cited proportions, and the failure by Pass (2004) and Cortese and Bowrey (2008) to include ethnicity in survey populations, are interesting given the rationale for diversity as a means of connecting with the environment – in an increasingly connected global economy, surely it makes sense to claim legitimacy from stakeholders and interest groups through diversity in board representation.

There is more reported research on career background (eg, Spencer Stuart 2009 and Pass 2004), a useful measure given that their range of experience is one of the arguments put forward for having them at the table. Spencer Stuart (2009) reports that 82% of new independent directors come from business backgrounds (65% CEOs and the like and 17% retired from such roles) and a relatively small 16% from diverse career backgrounds such as Government service, law or consulting. Out of the 317 in Pass' (2004) UK sample, 165 (52%) were former executives, 124

(39%) current executives and a mere 28 or 9% 'other' (Pass, 2004, p. 57). As the 'other' category includes politicians, academics and ex-civil servants, it is not unreasonable to conclude that there is an overwhelming tendency in various jurisdictions (also see McCabe and Nowak for some indication as to thinking in Australia and Jayne 2007) to appoint those with business expertise and/or experience rather than other types. In this context it is pertinent to note Wallison's (2006) dismissal of the value of advice from independent directors – with the major exception of a former government official who might add a useful perspective on likely government reaction to a proposal.

Peterson and Philpot (2009) confirm through a 'casual inspection' (Peterson and Philpot, 2009, p. 203) of company information that 'most' outside directors in 2002 in the United States were current or retired senior executives (so things appear to have remained largely unchanged for seven years). Of the 282 academics occupying positions as independent directors or Fortune 500 boards, most tended to be in the business discipline (27.2%), economics (8.0) or law (12.9), another factor supporting the assumption that business expertise or insight is the principal characteristic sought by companies when appointing independents.

4.7.5 Characteristics: Gender Diversity

The traditional board gender profile is overwhelmingly male. Claringbould and Knoppers' (2007) research provides evidence that men can control boards by affirming and negating affirmative action policies and by framing the process of recruitment and selection in such a way as to reproduce the male-dominated culture in the board. However, since the early 1980s, and in light of the growing realization that women control nearly all consumer spending, researchers have been paying more attention to the study of women directors, highlighting in particular the dearth of women in corporate governance roles (Toddi, 2001), a lack that has been directly related to the lack of female senior managers (Sheridan and Milgate, 2003) and arguing in favour of change.

One argument that can be used to support the appointment of more female independent directors is their ability to represent interests such as consumers. However, of relevance to this argument, Carver (2002) points out that, although the representation notion implies that a board represents the diversity within the ownership of the firm, he also reasons that a board cannot realistically be constituted so that it is fully representative of that diversity. There is the danger of tokenism (Carver, 2002) and perils in the idea that one member of a minority represents all members of that group. He warns that without actually gathering input from interest groups, even careful selection of those apparently represent-tative of such groups might seduce a board into complacency.

A better reason to appoint such directors is the value women can add (Daily and Dalton, 2003). They argue that more women are needed in boards of directors due to the fact that women and men have different strengths. Women are able to contribute in a unique way to the overall benefit of the organization. Moreover, they suggest that the presence of women in boards of directors signals that the entire organization promotes equal opportunities between men and women.

Overall, the main arguments for increasing the number of women in these leadership positions are based on the changing realities facing business, such as the globalization of activities, that has so dramatically changed world markets, and the challenges and social trends of the past two decades (Bilmoria and Piderit, 1994; van der Walt and Ingley, 2003).

Similarly, Burke (2000) argues that both men and women are appointed to corporate boards first and foremost because of their abilities. Consistent with the resource dependence view, the presence of women can also serve the organization's interest to build links to its environment, bringing both strategic input and social capital to the boards on which they serve (Bilmoria and Wheeler, 2000). A non-executive director in particular must be able to offer individual skills, broad knowledge, and expertise based on education, experience in management, and age (Burgess and Tharenou, 2000; van der Walt and Ingley, 2003).

Several studies based on data from companies with Anglo-Saxon corporate governance systems have examined the effect of recruiting female board members on a firm's performance. One of the most comprehensive of these was conducted by Campbell and Vera (2010) on Spanish companies where, helpfully for their data collection, the Unified Good Governance Code recommends affirmative action whereby female board appointments should be favoured in accordance with the *Gender Equality Act 2007*. Overall they found that the presence of female board members has a positive influence upon a firm's value. A firm's value on the stock market tends to increase upon the announcement of a female appointment to the board (Campbell and Vera, 2010). They therefore concluded that investors believe that recruiting female board members raises the value of a firm.

It is significant and ironic in this context that women tend to negotiate their entry by distancing themselves from their gender and proving their 'fit.' (as in acting, thinking and reasoning like their male colleagues). Indicatively, Claringbould and Knoppers (2007) interviewed a number of female board members about the recruitment and selection process that led to their presence on the board of directors. Their data showed that all of the interviewed women, prior to joining a board, were part of predominantly male networks.

Witz (1990) argues that exclusion (lack of fit) and inclusion (fit) are the result of processes between subordinate and dominant groups. Dominant meanings and images are associated with gender in accordance to the perceived roles of men and women by the dominant group. Such associations generate gender roles and associations between a person of a particular gender and certain activities. In their 2007 study, Claringbould and Knoppers established that their respondents had been asked to become a board member for specific reasons, the main one of which was their gender.

So it would appear that although there are necessary qualities needed for board membership (for example a strong track record, expertise in management and

governance, high visibility and social capital (Sheridan, 2001; Sheridan and Milgate, 2003)), the manner in which men and women are recruited onto a board highlights masculinity as a dominant group and femininity as the subordinate group. Recruiting women onto boards of directors seems to depend largely on how gender is perceived in specific contexts (Martin, 2003).

For example, if the dominant male group associates being female with domesticity, caring, low paid or part time work and so forth then a female has little 'fit' for a position as a CEO or board member (Acker, 1992; Witz, 1990). Managerial positions have come to be associated with white middle class men, a reason why there are fewer women than men in senior managerial positions (Collinson and Hearn, 1996). This situation persists where managers associate women with low paid, domestic work as they are then less likely to facilitate the inclusion of women into senior management positions.

How do these findings and theory translate to statistics on women and their representation on boards? Although 73.5% of the 200 largest companies in the world have at least one woman director, only 10.4% of all board members in the Fortune top 200 are women. The American companies that belong to the Fortune Global 200 have more women directors (17.5%) than European companies, who typically have less than one-half of that number. Women for example, comprise 6.3% of the corporate board members in The Netherlands (Claringbould and Knoppers, 2007).

The Spencer Stuart (2009) survey indicates a total of 16% of all directors are women, and 89% of Boards have at least one. In terms of new appointments, 17% are women. By comparison, 48% in the UK but only 17% of Australian Boards have one or more women occupying positions as non-executive directors. Pass' (2004) UK study revealed that only 11% of all non-executive directors are women while the Australian study by Cortese and Bowrey (2008) demonstrated that the average age of women in these positions was significantly lower than men at 53 (equivalent data is not available for the UK study). A possible explanation for these findings comes from the wider corporate context where the proportion of women

occupying senior roles, including on the Board, in companies in many jurisdictions still languishes well below that of men (McGregor and Vinnicombe, 2009; Oakley, 2000; Osler, 2008; Still, 1994). In addition, for the Australian study, and with the increasing attention being paid to this imbalance and moves to address it (Burke, 1997; Hornsby-Geluk, 2010; Janda, 2010), it is reasonable to conclude that the women's talent pool for directors is likely to be younger on average than the men's.

The recent growth in the percentage of women independent directors in the United States is of interest, particularly when viewed alongside findings from other research. Daily, Certo and Dalton (1999) investigated the position of women vis a vis Board membership in the United States but while they stated that some 37.6% of such women directors had a corporate background (Daily et al., 1999, p.96) they did not report either on total numbers nor on the number of boards with such outside directors. In addition, they reported that some 32% of outside women directors were 'affiliated' (or 'gray' (Felo, 2001, p.212) – connected to the company by business links (Daily et al.,1999) – and therefore clearly not independent under the current NYSE definition. A more recent one by Williams (2003) involved a sample of 185 companies in which he investigated the relationship between women members (albeit insiders as well as outsiders) and corporate philanthropy. In addition to finding a lowly average of 6% women on Boards (with a range of 0 to 26%), 41 companies or 22% of the sample had no women members at all (Williams, 2003, 5) Finally, Peterson and Philpot's (2009) study found that of the academics holding posts as independent directors in Fortune 500 companies, women (of all ethnicities) held 80 or 19%.

New Zealand, like the rest of the Western world has few female board members. In the most recent census of EEOU top 100 companies, McGregor and Fountaine (2006) found that only 7.13% of board members were female. New Zealand has an informal policy of affirmative action towards women in corporate governance but a strong anti-discrimination policy to prevent gender discrimination. However, when in 2008 there was a 10% growth in boards of State Owned Enterprises in New

Zealand (where the shareholding Ministers control the appointments of directors) with 12 new appointments, only one these was female (Vinnicombe, Singh and Burke, 2008). Thus even for a government that wishes to set a good example, gender parity has yet to be achieved.

With the observable trend in recent years towards corporate boards recruiting people based on experience rather than title, high level business women who are not CEOs are more likely to be considered not only in New Zealand but elsewhere. Moreover, the pool of likely candidates has become wider (Toddi, 2001).

By way of general conclusion to this discussion on diversity, recent research by Ingley and McCaffrey (2007) shows how established companies in New Zealand see new directors as bringing industry knowledge to the table as well as their reputation in business and industry. These established companies are concerned with the candidate's reputation in their industry, business community and financial sector. Most factors that influence established companies in their selection of non-executive directors are external to the organization, that is, "what the candidate *brings to* the company" (Ingley and McCaffrey, 2007, p.324). In contrast, the criteria used by New Zealand start-up companies can be summed up as "what the candidate *can do for* the start-up" (Ingley and McCaffrey, 2007, p.324). These findings demonstrate the importance for start-ups of a director's ability to bring contacts, networks and capital to the business. The importance of other criteria such as strategic capability, expertise in areas of interest to the business and understanding the business's risks also indicate the importance to the firm of a director as a resource.

Through all these director service activities, including providing information, directors can enhance a company's identity, reputation, commitment to mission, and standing in the community (Provan, 1980). In this way they can absorb environmental uncertainty, thus enhancing organizational performance. For example, members of hostile groups could be recruited on to governing boards, or

long-term contracts could be established with suppliers. The presence on University boards of government departments on which they rely for funding, is another.

Indicatively, boards are particularly interested in adding directors with expertise in technology or contacts in international markets. `When you take people who have different experiences and backgrounds, the group is more effective at problem solving' (Julie Daum, managing director of board services for Spencer Stuart, an executive-search firm (as quoted by Toddi, 2001, p. 3730).

4.7.6 Characteristics: True Independence

There is some belief that the longer a person serves, the less able they are to think objectively or to act independently. This could be a function of inculcation of the corporate culture (Pass, 2008; McCabe and Nowak, 2008) or friendships and other social connections formed with inside members of the Board (Kren and Kerr, 1997; Vafeas 2003). The dangers posed by this erosion of independence is implicitly acknowledged in the guidelines and codes issued by some rule and guidance bodies including the ASX (principle 6) and the FRC (principle B1.1), both of which state nine years as a suggested maximum, but not in the more prescriptive rules of the NYSE. Pass (2004) found that the average time served was 5.6 years with the range from 3-10.4 years while Cortese and Bowrey's (2008) finding was six years, a little more than in the UK but still well inside the maximum recommended in the principle. However, the maximum was well beyond that figure at 23 years. Spencer Stuart (2009) report that only 5% of respondents imposed any term limits on directors (most of whom will be independent). Of the 25 that do, 10 specify a 15 year limit, five, 12 and four, 10. Overall, the average tenure for independent directors was found to be 8.4 years.

The remuneration level for non-executive directors has also been raised as a potential threat to independence – if a director is in receipt of large sums from a

company, agency issues as outlined earlier may come into play. In the UK, fees ranged from £21000-69000 with £36800 as the average for non-chairs (or for comparative purposes approximately A$78,000 (Cortese, 2009) and in the United States US$75,893 (Spencer Stuart, 2009). Spencer and Stuart (2009) also report that 37% of respondents offer stock options to independent directors either as an alternative or in addition to their cash consideration. Cortese and Bowrey (2008) report an average of A$149,662 for Australian directors. However, it is in relation to the chairs that both Pass and Cortese express the most concern as to the potential impact on their independence and ability/incentive to monitor given an average in the UK of £222000 (or for comparative purposes approximately Aus$466,000 (Cortese 2009)) and $456,946 in Australia.

This whole question is a vexing one: Cortese (2009) suggests that the level can impact on perceptions on the part of fellow directors (particularly non-chairs when looking at the disparity between theirs and the chairs) as to independence. The same could easily hold for shareholders. McCabe and Nowak (2008) also hint at the unease director participants had of any situation where an independent director was reliant on just the company for income. There is some support, however, for the idea that the modern regulatory regime for directors raises such high expectations on the part of shareholders and has such significantly punitive aspects that directors need to be well recognised and rewarded for the work they do (Bush, 2005). From another but related perspective, it could also be argued that not only does paying a comparative pittance deter talented people from agreeing to serve but also encourages part-time involvement with potentially negative effects for shareholder value and monitoring (Pass, 2004; Wallison, 2006).

However, there is also some recent evidence (He, Wright, Evans and Crowe, 2009) suggesting that performance-based incentives play little part in motivating independent directors to do a thorough and effective job. This might suggest that such individuals see fixed remuneration as a recognition of their commitment of time and effort as directors but are willing to actually do the work for other

reasons – perhaps feelings of loyalty, worth or safeguarding their own investment (where they hold shares in the company) come into play.

Non-executive directors who hold a number of directorships are the final aspect Cortese and Bowrey (2008) considered as a threat to independence, although Pass (2004) and Spencer Stuart (2009) also look at the background of such directors (discussed below). This situation has been cited as a potential advantage (Pass, 2008), having no demonstrable impact on the ability of directors to carry out their duties (Ferris, Jagannathan and Pritchard 2003) but also as a potential problem (Pass, 2008; Matolcsy, Stokes and Wright, 2004; Steele, 2008). In his discussion of this issue, Steele cites the example (Steele, 2008, p.58-9) of an independent director who, in his rush to catch a train, grabbed the Board meeting papers for the wrong company. The confusion and embarrassment that followed his intensive, insightful and utterly misguided grilling of the Finance Director did nothing for the Board or his reputation as a good monitor.

This whole issue has been specifically addressed in the FRC code as something to be taken into account in determining whether a director is truly independent (FRC 2010). The findings of the immediate studies were to the effect that on average the UK non-executive directors held two other directorships (although 15 out of a total of 317 held more than five) and the Australian three with a maximum of nine, while in the United States, 66% of the respondent companies had recently imposed limits to the number of other directorships their directors could hold with 92% setting the figure at between 3-5.

4.7.7 Characteristics: Effectiveness

As an indication of what firms seek in independent directors, nearly 50% responding to the Spencer Stuart (2009) survey put business expertise at the top of their wish list, in particular in respect of financial and risk. (Interestingly, given the heightened awareness and exposure to legal rules, the desire to have

independent directors who could advise of legal risk came a lowly bottom at 2% of all mentions).

Also in the case of North America, other indications of the overall effectiveness of independent directors come via the literature around effectiveness of such directors. In early studies (pre NYSE and NASDAQ requirements for independence) Fama and Jensen (1983) state that independent directors tend to be major decision-makers at other organisations while Borokhovich, Parrino and Trapani (1996) offer the holding of interlocking directorships and executive positions as reasons for an independent director failing to challenge the CEO. Both these indicators point to business people as the most likely independent presence on the Board. *Post* the requirements things do not seem that different. Kolasinski (2009), for example, argues that poor acquisition decisions by the CEO can be avoided if independent directors use their good business judgment to prevent it – thereby implying that they will in most likelihood be experienced in business. Wallison (2006) also assumes that independent directors are likely to be professional - probably holding directorships elsewhere.

4.7.7.1 Do Independent Directors Improve Shareholder Value?

Pass (2004) found a higher proportion of business related academics as outside directors by comparison to those from other areas, a finding that suggests that the forward looking or visionary approach of such individuals help a company strategize for the future – or maintain or increase shareholder value on the longer term – rather than merely focus on the past and the financial results.In Hills (2005) study, respondents who fell into the 'non-executive' director category cited board-conflict resolution, dismissal or support of CEO and the shaping of company morality as important aspects of their role.

However, others look beyond the direct independent director-shareholder value link to hypothesise that some companies might have different objectives in mind

when selecting such directors. Agrawal and Knoeber (2001) posit that those with political or legal backgrounds are recruited onto Boards in order to assist companies in managing their environments. Therefore, as external political (as in the case of those in the electric utility sector (Agrawal and Knoeber, 2001)) or regulatory/governmental pressures increase so too will the proportion of those with relevant backgrounds. Theoretically, this strategy will permit the Board to mine the expertise of these outside or independent directors in order that they might better understand their responsibilities and, perhaps more importantly, utilise those directors' networks and contacts to minimise business risk. This in turn will have a positive effect on shareholder value as the market responds positively to the perceived stability and low risk associated with the investment (Gordon, 2007).

Peterson and Philpot (2009), in their study of academics as Board members, identify two potential direct benefits for the company of having such directors (and not just from business or related disciplines), these being advanced discipline-level expertise and for them more importantly, experience in research and/or creative activity (benefits that seem somewhat contradictory to their findings that the vast majority are from the business or related disciplines).

However, they also posit a broader role, this being in line with that of Agrawal and Knoeber (2001), Cunningham (2010), Ray (2005) and Tyson (2003) more generally,that academics may assist the company in managing its environment by liaising with important stakeholder groups. They suggest, for example, that a community-based company might have the President of the local university on its Board (who then provides assistance in recruiting talent) or as a means of increasing the profile of the company in the academic community). A company in an environmentally sensitive industry could demonstrate its concern for pollution or threats to biodiversity by having a biologist in such a position.

Finally, and more directly relevant to shareholder value, they suggest that because such expertise is valued by the company, such outside directors will be elected or

appointed to committees that contribute to fulfilment of the duty of care owned by the Board to shareholders. Peterson and Philpot (2009) suggest the most likely such bodies would be those concerned with public affairs or community relations rather than financial. This suggestion is interesting given that Williams (2003) sees this type of body as "soft" with compensation, executive or finance committees having a greater impact on corporate governance (Williams, 2003, p.2) and therefore more important and prestigious.

Arguably, in an environment of triple bottom line or balanced score card reporting and pressure for companies to be socially responsible, wider environment and therefore for the broader experience non-business people might bring is of increasing importance to the company and is likely to improve shareholder value, at least in the longer term. Perhaps also of relevance in this regard is the fact that recent amendments to the Companies legislation in the UK (*Companies Act 2006*) s172 codify those very aspects of governance in which an independent non-business director might shine – for the first time it specifically charges a director to promote the success of a company (s172). In so doing, he or she must consider a variety of factors, including fairness of treatment for various member groups, employees, suppliers, customers, the environment, the community and the need to maintain high business standards.

However, and despite the above, results of relevant empirical research on the link between the membership on the Board of independent directors and shareholder value (or company performance more generally) are mixed (Petra, 2005; McCabe and Nowak, 2008). Amongst the plethora of studies since 1980 are those that suggest a positive link either generally or in specific contexts between the proportion of independent directors (or similar data sets such as non-executive or outside directors) and company performance (Fama and Jensen 1983; Baysinger and Butler 1985; Coles and Hesterley, 2000; Beasley 1996). Others have achieved results that are not so clearly positive. Bhagat and Black (1998) found no such positive correlation, neither did Hermalin and Weisbach (1991), Bhagat and Black (2002), Wan (2005) or Prasanna (2006).

Without dismissing these studies, it is difficult to draw any clear conclusion as to whether the presence of independent directors reduces or improves shareholder value or is neutral in effect. Basically, and as stressed by Bhagat and Black (1998) and by Gordon (2007), they are not consistent in their approach, research method or context. In addition it could be argued that some of the studies finding a positive correlation are early – prior to the financial scandals that pushed the issues of corporate governance to the front of investors' minds, and prior to moves to make it strongly recommended if not mandatory to have independent directors. In the case of the later ones, Beasely (1996) looked only at the issue of financial statement fraud while Prasanna (2006) utters the caution that the results should be treated carefully given the nature of the data and the fact that the concept of independent directors had only lately arrived to the Indian business world.

Another explanation may come from the experience such individuals have from their tenure on the Board. It is hoped that individuals are selected or recommended to the shareholders in General Meeting for election on the basis of their credentials and what they can bring to the company, not necessarily in terms of business experience but also a wider world view (Agrawal and Knoeber, 2001, Peterson and Philpot, 2009). However, indications are that this is not always the case.

McCabe and Nowak (2008) as discussed above, highlight the tendency for a board to support the election of potential director candidates who are most like them. Pass (2008) also refers to the "cynics" (Pass, 2008, p.294) who note that recruitment and selection for non-executives is partly determined by their "acceptability" to other directors. This can result in capture of independent directors and reduce their willingness or courage to speak against the crowd.

Theoretically at least, having a majority of independent directors should minimise this danger, however the longer the tenure enjoyed by independent directors the more likely it is that a new director will be trapped into "groupthink" (Van den

Berghe and Baelden, 2005, p. 64), be affected by a general cozy atmosphere (Demb and Freidrich Neubauer, 1992) or even fall prey to "bullies" in the Boardroom (Maharaj, 2007). This is further exacerbated where a director does not have understanding or experience in the corporate culture and relies on the "old hands" for guidance (Ritchie, 2007). For this reason amongst others, various jurisdictions encourage companies to establish Board training and evaluation programs (OECD 2004) to ensure new Directors (and seasoned ones) are fully aware of their role, rights and responsibilities and to have mentoring structures in place for the "old hands" (such as the Chair in cases where that person is also independent) to provide guidance (Spencer Stuart, 2006).

It has also been suggested that independent directors are less willing to take risks (Wallison, 2006; Ritchie, 2007), therefore potentially closing down opportunities for the company to grow. Cohen, Dey and Lys (2005) look at risk taking (using capital investment as a proxy) and conclude that the preparedness to take risk has slowed in the United States after the passage of Sarbanes-Oxley but, as Wallison (2006) points out, more research has to be done on this aspect.

In making a similar point but focusing on legal liability, Wallison (2006, p.3) stresses the potential for such directors to be personally liable for losses caused through failure to fulfil their directors' duties, citing in particular the "substantial settlements" (Wallison, 2006: 3) directors of Enron and WorldCom were forced to pay for failing to catch and address fraud. He considers that these cases were unusual but the fact remains: the legal frameworks in place in many jurisdictions (such as New Zealand under the Companies Act 1993 (ss 131-138), the Australian Corporations Act 2001 (Cth) (ss 180-190), the Companies Act 2006 (UK) ss 171-176 and the Delaware General Corporations Law (exemplar regime in the United States) s141(a) via case law on this subsection) make no specific distinction between executive or non, inside or outside, dependent or independent directors in terms of their liability for breach of duty. Normally there is an implied distinction based on concepts of business judgment and/or reliance on another for advice (New Zealand Companies Act 1993, ss131,136,137 and 138; Australia,

Corporations Act 2001, ss180 and 189; UK Companies Act 2006 ss171 and 174 (implied); Delaware s141 (a) via case law on this section (Gordon 2007)), but these judge the performance of the director either on whether it was reasonable for that person to think the way they did or to rely to the extent they did (subjective) or what a reasonable person in his or her position would have thought (objective). Either way, they do not excuse a director, even an independent one ill-informed on the business or the company, for failure to be vigilant, informed or to ask appropriate questions. The huge increase in potential liability and the massive increase in the burden of expectation from shareholders are identified as factors deterring otherwise qualified individuals making themselves available for Boards or making them less enthusiastic about the ones they are on (Reuters, 2009)

By way of general conclusion to this discussion and given the uncertainty as to the link between independent directors and shareholder value, Bhagat and Black's (2002) reflection on the results of their 1998 study and the negative or non-correlation it revealed is potentially valuable in scoping research that might help clarify the issue. In this paper they suggest various rationales for their results. These include: while some independent directors may improve performance this same outcome may not hold for a Board with a super-majority of independent directors (all but one or two), that the test they designed and conducted is limited in its ability to produce useful results in a noisy experimental context and that, as every company is different in its needs, values and growth trajectory, any uniform approach to membership mix on the Board is suboptimal (Bhagat and Black, 2002). In other words, it is not the presence per se of independent directors on the Board that improves shareholder value: it is the type, talent, background, experience and performance of such directors that are important – and these are in turn a function of the available talent pool (Jayne, 2007; Bush, 2005), recruitment practices and policies of the companies involved (Jayne, 2007; Peterson and Philpot, 2009); and the characteristics of the corporate structure and power distribution between executive and board (Borokhovich, Parrino and Trapani, 1996; Sharma, 2004; Le Blanc and Gillies, 2005; Pass, 2008). .

The second main aspect of the independent director's role, as identified above, is that of monitoring of the CEO and other members of the executive by way of challenging proposals and decisions and setting remuneration.

4.7.7.2 Do Independent Directors do a Good Job of Monitoring?

There seem to be two premises, albeit related, underlying the argument that independent directors have an unequalled power to conduct this monitoring task. The first premise relates to CEO and executive behaviour and performance. Agency theory stresses the critical monitoring or control role of the board, because of its primary duty as the agent of shareholders, protecting their interests and maximizing their wealth (Jensen and Meckling, 1976). An objective board is best placed to conduct this task (Baysinger and Hoskisson, 1990; Coles and Hesterley, 2000), which is why critics say that poor director selection and thus ineffective decision-making are handicaps (Zahra and Pearce, 1989).

Lacking a strong remuneration or other income-based incentive to support the CEO, the independent director is the best choice to apply such objectivity. Borokhovich, Parrino and Trapani (1996) looked to studies of stock market prices to support a suggestion that the market trusts outsider-dominated Boards to those with a majority of insiders as did Gunasekarage and Reed (2008) who found a positive correlation but only where the market considered there to be a significant agency problem. However, other studies that look at other aspects of the monitoring function cast a somewhat more cautious light.

Coles and Hesterley (2002) for example, identify a second crucial criterion that must be satisfied in order for an independent director, or any director for that matter, to monitor executive behaviour effectively, this being receipt, digestion and comprehension of material and relevant information. For Coles and Hesterley (2002), inside directors would find it easier to satisfy this criterion than would outsiders or independents due to their position in the company and to their experience of its operations. Long, Dulewicz and Gay (2005) identify similar

barriers to independent directors on UK boards achieving this role, noting in particular the torrent of information delivered to members of the Board as a result of formalisation of strategic and financial planning processes. Struggling in vain to absorb and comprehend such torrents, independent directors (here classified with non-executive directors) are often left heavily reliant on executive interpretation (Long et al. 2005, p.671), a situation that leads to what Hooghiemstra and van Manen (2004, p.317) label the 'independence paradox'. McCabe and Nowak (2008) make a similar point in relation to Australian companies, a point also pertinent to the Centro case where the Directors placed huge reliance on the CFO for advice on the validity and accuracy of the financial statements (advice that turned out to be wrong to the tune of some AU$2 billion).

Finally, there is the danger that where boards target those with business skills (see the discussion on diversity and desired skills) independent directors will be 'people like us' (McCabe and Nowak, 2008, p.559) who 'perpetuate' (Higgs, 2003, p. 42) past practices and ways of thinking. This implicit 'cronyism' (Pass, 2004, p. 60) may blunt the ability or urge of such appointees to act independently of other members or the CEO.

More particularly, if directors come onto the Board due to their expertise but in an area not directly related to the company business, he or she may feel the need to rely heavily on the CEO for advice and guidance about the company and its business and feel uncomfortable with the idea of challenging proposals and decisions or giving business advice (Borokhovich, Parrino and Trapani, 1996; Wallison, 2006). By analogy too, in the case of a Board with a mix of inside and independent directors, independents may be dismissed by fellow directors and the executive as ignorant ciphers, there to make up the numbers, thereby further diminishing their effectiveness and generating tensions in the Board. Le Blanc and Gillies (2005) offer a direct quote from a Director on this point: 'The CEO perceives the Board as an impediment – a group of individuals that must be tolerated and that add little value. Many are particularly dismissive of the input from the outside directors simply because they do not believe that they have

sufficient experience or knowledge to give much valuable input to the decision-making process' (Le Blanc and Gillies, 2005, p. 49).

The second and related premise is that independent directors have the power, mandate and motivation (by virtue of their election by and accountability to shareholders) to exercise their authority to monitor CEOs and other members of the executive, including in the course of setting remuneration. "Empirical evidence" (Petra, 2005, p. 58) supports the idea that the level of CEO compensation is inversely related to the level of control exercised by the Remuneration committee (a committee responsible for setting CEO remuneration and other incentives) (see Jiraporn, Young and Davidson, 2005 for a similar conclusion). Petra (2005) also argues that the presence of independent directors on such committees serves to increase their negotiating power vis a vis the CEO.

However, a yawning abyss sometimes appears between "can" and "does" in this particular context. That loading up the Remuneration committee with independent directors is not necessarily the solution was a lesson learned from the collapses of Enron (2001), Global Crossing Ltd (2002) and WorldCom (2002). Each had high percentages of independent directors on their remuneration boards with Enron and Global at 100% and WorldCom at 75% (Petra, 2005, p.58). If shareholders are not "diligent" in doing their homework prior to electing director candidates and directors not "genuinely" independent, this problem will remain (The Economist, 2003).

Borokhovich, Parrino and Trapani (1996, p.339) cite three possible reasons why the incentives of so-called independent (they use the term "outside") directors may not be well aligned with those of the shareholders in the monitoring function. First, in cases where the CEO dominates the selection process they may nominate outsiders (including independent directors) who would be more inclined to support their decisions. Secondly, interlocking directorships (a term used to describe the situation where members of a small group of directors sit on a range of Boards, effectively allowing that group to influence decisions on all those Boards

(Burt, 1983; Tuengler, 2000) may discourage an independent director from controlling CEO remuneration - such as where the question arises at company A and where that CEO is on the Board of a company (company B) where the independent director is an executive –a tit-for-tat effect.

Finally and more generally, there are some concerns emerging from the literature as to how Boards work and issues as to how directors, particularly independent directors, perceive their role and their relationships with other directors and with the executive. Cunningham (2010) for example, sees three fundamental dilemmas for such outsiders (specifically non-executive directors or NEDs) arising from their role on the Board. These are engagement v non-executive (knowing what is going on versus staying objective), challenging v supporting (questioning the CEO to ensure a valid decision is made versus supporting, offering advice and expert insight), and independence v involvement (standing back from the group versus cooperative board decisions). Le Blanc and Gillies (2005) highlight possibly greater concerns: from their survey of 200 directors they refer to a "large number" who were "deeply disturbed" (Le Blanc and Gillies, 2005, p. 67) by a lack of trust between the Board and management, lack of commitment on the part of their fellow directors, strong personality conflicts and problems with the way Board meetings were managed.

4.8 Independent Directors as "Board Capital"

Directors and the skills they have may be seen as vital strategic resources, the crucial "board capital". This useful concept was coined by Hillman and Dalziel (2003), who defined it as the human capital and the relational capital of the board members. Directors' expertise, experience, knowledge, reputation, skills and education can be seen as human capital. Human capital theory proposes that investments in such human capital result in economic advantages of advancement and higher salaries (van der Walt and Ingley, 2003). Burgess and Tharenou (2000) argue that such investments increase women's skills and knowledge for senior

positions, in the same way as men, helping them to gain the visibility to be freely chosen for boards. Relational capital, sometimes called social capital, is "the sum of actual and potential resources embedded within, available through, and derived from the network of relationships possessed by an individual or social unit". Relational capital also results of social ties (Hillman and Dalziel, 2003, p.386).

Both kinds of capital can contribute to the general resources provided by inside and non-executive directors to their organization, which in turn strengthens firm performance. These resources include timely information, advice and counsel, building external relations, provision of firm legitimacy and reputation, maintaining channels of communication between the firm and external organizations, helping to acquire resources from important outside parties such as financial capital (Hillman and Dalziel, 2003). For example, directors with specialist expertise, such as legal and financial, or management expertise built up from experience in other firms, or official skills gained during government employment can provide advice and counsel.

This provision of resources to an organization, by its board, can be seen as a function of board capital. This view was advanced by Pfeffer and Salancik (1978, p.170), who identified the provision of expert advice and counsel, and the exercise of oversight control as two primary components of a board's internal administrative function (Westphal, 1999).

Carpenter and Westphal (2001) showed the kind of advice and counsel provided by directors who had ties to strategically related organizations (relational capital). Certo, Daily and Dalton (2001) showed how the prestige of directors (board capital) could enhance the credibility and performance of the organization. Board capital enables the exchange of valuable information by providing channels of communication between the firm and external organizations, reducing some sources of uncertainty (Hillman and Dalziel, 2003). Board capital (e.g. financial experts) can also aid in acquiring resources, such as finance, from important elements outside the firm (Zald, 1969).

Conclusion to this section

A board is a group of people, selected for their expertise, who work together to add value to the organization they lead. Although diversity in boards of directors far from being a requirement per se, it is crucial in the service role, but not in the strategic role. There is much more to board composition than director selection and achieving the right skill mix, important as these elements are in assembling balanced boards. Boards need to be aware of the potential to add value through the pool of board capital contributed collectively by their directors as a strategic resource for their organization. This board capital is a measure of the value added by the board in its governance. Researchers have linked board capital directly to the provision of resources and firm performance, according to resource dependence theory.

Thus boards may need to focus first on merit criteria for director selection, seeking qualified individuals and reflecting in the mix, gender and a range of expertise, experience and personal attributes. Shareholders may be unmoved by the gender debate, for example, and prefer to hire exclusively for performance.

Despite independent directors being identified as the crux of good corporate governance and despite moves in a range of small and large, developed and developing countries to make them a requirement or at least a very strong recommendation for public companies, the empirical evidence of their effectiveness achieving their touted purposes – of increasing shareholder value and monitoring the executive of the company - is by no means clear. Numerous studies show positive, negative and no effect on corporate governance practices or policy of their membership on the Board while others utilise a range of data sets to map the characteristics and nature of independent directors. Also some recent empirical studies seem to indicate a deep malaise on some Boards, which, if carried through to governance practices and decisions suggest that the presence of independent directors is just not achieving good outcomes.

A common message that seems to come out of the literature is that independent directors per se are only one aspect of corporate governance and, as such, cannot be considered the one shot panacea to corporate ills. It is necessary to go further and both look at how they fit into the raft of policies and practices adopted by the company and at the qualities they bring. Although in this regard there is a distinct preference for those with business experience (preferably in the same area of business if not in the company itself) there is also some sentiment favouring those with a wider world view, sentiment consistent with the social support for the display of social and other responsibility by the company.

What is missing from this literature is an analysis of this vital link between presence of independent directors, activities and outcomes on a broad range of criteria. With the ever-increasing emphasis on their membership and the ever-increasing demands placed upon them, this is the one major area that would clearly afford some detailed and comprehensive exploration.

4.9 THE RECRUITMENT OF DIRECTORS

If the skill sets of existing directors are less-than-stellar, or where shareholders see those directors as not up to the task of addressing changes in the external environment, those shareholders might see a reason to bring in other directors to strengthen the competence of their boards. Hence three further hypotheses should be tested:

H6 = Shareholders and directors consider a new director's experience to be more important as a contribution than age or diversity.

H7 = Work experience is preferred over formal qualifications, for new independent directors.

H8 = The majority of firms surveyed intend to hire at least one new independent director in the next 5 years.

Rationale: In the context of recruitment of board members, codes of good governance and researchers both emphasise the benefits of increasing the number of independent directors (De Andres-Alonso, Azofa-Palenzuela and Romero-Merino, 2009). It is thought that utilising a number of independent directors helps to assure the board's objectivity when monitoring the managerial team, thus reducing the managers' opportunistic behaviour and increasing the organization's efficiency (Baysinger and Hoskisson, 1990; O'Regan and Oster, 2005) although there is no conclusive empirical evidence on the influence of board independence on the firm's efficiency (De Andres-Alonso, Azofa-Palenzuela and Romero-Merino, 2009).

If independence is a desirable trait, what are the characteristics of a 'desirable' or 'ideal' independent director? On the assumptions that for some shareholders at least, the inclusion of an independent director is desirable, and that indeed there is a significant interest in independent directors in New Zealand, the question arises what skills and/or attributes shareholders and fellow directors desire in any external directors, and how they see those new appointees as contributing to the talent of the board.

The issue of recruiting new board members has been explored in the context of both for-profit boards and non-profit boards (Brown, 2007).In 2007, he examined whether using recommended recruitment, board member orientation and evaluation practices resulted in more competent board members and if the presence of these board members led to higher board performance. His results supported the hypothesis that using board development practices did lead to more capable board members and the presence of these board members led to stronger board performance. Ansari (2010) recommends recruiting board members who have a variety of backgrounds to enable them to engage with a diverse range of stakeholders.

To provide guidance into how a wish list of such potential directors should be compiled, McNamara (2010a) developed a director recruitment grid (see appendix). This grid provides structure for research into an individual's suitability for a position on the board. McNamara (2010a) further suggests that the most important consideration when recruiting new board members is the range of skills needed at the time. He also recommends that board development committees maintain an up to date list of potential board members which identifies the skills that individual could contribute.

Finally, McNamara (2010) recommends that the board chair and CEO meet potential board members in order to impart gain a clear understanding of the firm and to receive a board member job description. Any potential conflicts of interest with the candidate must be identified. The prospective board member should be invited along to a board meeting and introduced at the beginning. Shortly after the meeting, the prospective board member should be contacted and asked whether they would like to join.

Insofar as process of recruitment is concerned, often a new board member will be recruited by word of mouth, which raises the question of how objective the search might be. Current board members may recommend an individual or an open position may be made known by word of mouth (Ansari, 2010), supporting the concerns that director appointments are decided by insiders, and possibly not based on criteria that would ever allow outsiders to be considered. Zablocki (2007) also confirms the above suggestion. Good networking facilitates recruiting new board members and most often a prospective board member will be someone a current board member already knows (Zablocki, 2007).

However there are executive search consulting companies that specialise in 'board services'. Spencer Stuart is a multinational executive search consultancy firm and offers a firm access to a database containing information on potential independent directors for a company. Spencer Stuart claims that there is a greater need for

independent directors given recent changes to corporate legislation and governance codes (Spencer Stuart, 2010). It offers to assist firms in finding and researching potential independent directors and conducts more than 400 searches for independent directors every year for companies around the world.

In addition, some board members are recruited though the use of public advertisements. Den Hartog, Caley and Dewe (2007) examined the use of advertisements for this purpose. They compared all job advertisements that appeared in a prominent public domain (The Times Newspaper, UK) and found that out of the total number of advertisements (4217) that appeared over the course of 15 months, 1390 were for leadership positions such as chairperson, CEO or director. Hartog et al.'s analysis highlighted the terminology of the adverts most successful in attracting ideal candidates for leadership roles. They found that the terminology such as 'people oriented' and 'transformational' were used far more than terms describing traits such as 'task oriented' or 'transactional'.

In the particular instance of non-profit organisations, boards are generally composed of founders and substantial donors who serve as volunteers. Hence their willingness to maintain their personal donations of wealth or time and, presumably, some ideological affinity to the purposes of the organization, is commonly an implicit condition for membership (De Andres-Alonso, Azofa-Palenzuela and Romero-Merino, 2009). Recruitment of board members in non-profit organisations can therefore be self perpetuating.

Traditionally, companies seek board members by having someone suggest a prospect, which they then pursue (Gottlieb, 2005). Most board will recruit new members by having existing board members put forward names. The nominee will generally fill out an application form and attend a meeting or two, after which they may be asked to join the board (Gottlieb, 2005).

It is advisable to put in place a process for recruiting board members, writes Gottlieb (2005), whether it is to replace existing board members or to begin an

organised programme to recruit new members with skills complimenting those currently represented around the board table. Particular attention should be paid to ensuring diversity on the board although Zablocki (2007) claims that recruiting for diversity is hard. Often the perfect candidates are identified, researched and approached, but the answer is no.

Standard advice is for the board to develop a wish list of potential candidates (Massey, 2010) whose backgrounds and circumstances are then checked for details such as wealth, giving capacity, giving history, volunteer involvement, educational background and business relationships. It is also important that the right person in the organization be identified to approach recruits (Massey, 2010).The final list should then be reviewed by the board development committee to ensure that the right potential recruits will be approached. He further suggests the full board should agree before this is done. Finally, should the recruitment be successful, the new board member ought to be encouraged to immediately get involved in meetings and events.

An important preliminary step in determining how to recruit qualified board members with such a commitment is understanding the motivations of board members in non-profit organizations (discussed above).

Cleave and Inglis (2006) suggest that future research with a focus on individuals serving as board members will help determine and understand the necessary human resource strategies needed to increase the skills and effectiveness of board members. This affects the recruitment and retention of board members by allowing organizations to better understand what they are looking for in a candidate and allowing a candidate to assess if they are able and willing to fill that position. By understanding key motivations of potential board members, organizations and their nominating committees will be able to strategize effectively on their specific recruitment strategies (Ansari, 2010).

In small family businesses, boards of directors tend to be recruited 'in house'. The results of a pilot survey conducted by Johannisson and Huse (2000) suggest that entrepreneurial firms avoid recruiting outside directors. Contrastingly, managerial firms actively welcome outside directors. Family-run businesses were ambivalent on the issue.

However, overall, in the New Zealand context there is high and growing demand for independent directors. According to a 2007 survey (Jayne, 2007), over 700 New Zealand firms were looking to recruit directors. This demand is not confined to large corporate but, as indicated earlier, includes SMEs. The question is, which ones and why?

The next chapter describes empirical research conducted into some of the aspects explored in this chapter: specifically perceptions of the benefits to be obtained from their recruitment, the demand for, the role and motivation of independent directors. It could be subject to criticism due to its focus on directors and experience in large corporate, and therefore it has limited significance in relation to the use and role of such directors in New Zealand SMEs, the focus of much of the discussion so far, and the rationale for the project as identified in chapter one. However, the following points should be
Made:

- The variety of corporations in New Zealand means that the experience of many of those organisations included in the sample can be extrapolated to SMEs
- Many of the respondents had served on NPOs, SMEs and other corporations. Therefore, their views and expertise are of relevance also to SMEs
- The legal rules and requirments are similar for SMEs and other corporates. It is what they do and whether they are listed or not that deptermines the requirements. Therefore, it was not considered necessary to distinguish them further.

Chapter 5: THE EMPIRICAL RESEARCH

5.1 Introduction

This chapter describes methodology in conducting the research. Also, and by way of reminder, it lists the research questions and hypotheses, the methods used in the statistical analysis, the data collection process and the methods applied in data interpretation. It is important to note that the survey instrument (included in the appendices to this document) incorporates a broader range of questions than are subject to analysis and discussion in this and the subsequent chapter. The reason for this lies in the fact that it was designed to support several research projects, not because some parts proved too difficult to analyse or because the results were problematic or contradictory.

5.2 Research Design: Methodology

The research around corporate governance, and the role and importance of independent directors in this process, is, as indicated by what has already been discussed, large, complex and diffused. Consequently the canon of knowledge is also arguably large and complex. The intention in this case is to enrich our understanding of corporate governance and independent directors in New Zealand and to contribute to the creation of a comprehensive picture of New Zealand governance.

The means of creating such a picture can include historical research and case studies and often includes direct observation as a further means of enquiry (Eisenhardt, 1989a; Merriam, 1998; Yin, 1994). In this instance, perceptions, attitudes and beliefs of stakeholders in governance were explored by way of a nation-wide survey of three such groups: directors, management and shareholders.

I also wanted to enrich our understanding of the influence on governance of the characteristics, strengths and weaknesses of particular organizations (Cooperrider, Whitney, and Stavros, 2003) through the exploration of individual cases. The practice of analysing individual cases and extrapolating the findings to a larger population is well described (Stake, 1995). For this research, a deeper understanding of the context in which independent directors' function was obtained by way of in-depth interviews held with selected individuals (see Appendix One for a list of organizations involved in this aspect of the research).

More particular to this instance, these individual cases include those firms or other relevant organizations whose directors completed both individual surveys and participated in follow-up/validation investigations (Cohen, 2001; Yin, 2003) The benefits of reviewing the governance performance and attitudes with all or most directors of an enterprise lies in improving our understanding of the board as a collective unit of decision-making and attitudes. In addition, this information can be used as a validation tool for the anonymous large-scale nation-wide survey.

To focus the data collection, directors interviewed were selected on the basis of their firms being representative by size and industry.There are two explanations for selection of the survey population.

First, and as explained above, I intended to contribute to a comprehensive picture of governance in the New Zealand context. Although, as emphasised previously, most private firms in New Zealand are SMEs, it is also correct to say that most attention both in terms of rules and regulations and in attention has been directed to large corporate (Devlin, 2004) and/or governance issues facing public bodies. Hence, empirical research focusing solely or largely on governance in SMEs would offer a very pallid and limited picture.

Secondly, a major emphasis in the work and in the research is in identifying the motivations and characteristics of independent directors and demand for their services. Again, much attention has been directed to independence on the boards

of large corporates. For this reason, much of the experience is also embedded in this context and should be tapped for the benefit of SMEs.

5.3 Research Questions and Hypotheses

By way of reminder, the survey instrument (as described in 5.4 below) is directed at answering the following research questions, as defined and justified in chapter one. They are:

a. Do independent directors contribute positively to company boards in New Zealand?
b. Are independent directors sufficiently qualified to discharge their duties as company directors?
c. What is the motivation of independent directors to serve on a company board in New Zealand?
d. What are the characteristics and qualities of a 'desirable' independent director?
e. Are New Zealand companies looking for additional independent directors?

The questions reflect the specific data sought to answer the hypotheses, with several questions asked with a somewhat wider framefor background information but not included in the statistics. The survey populations of business operators/executives, shareholders and company directors were selected for their direct connection to the topic of company directorships in SMEs. Executives, as in small firms they often participate in the selection of directors or are decision-makers on the question whether new directors are needed at all; shareholders because they are legally and practically the ones appointing new directors; and company directors because they often participate in the generation of a 'short list' from which shareholders select appointable directors.

To enable these questions to be answered, a series of eight hypotheses were devised for testing by the research. Also by way of reminder (as they are described and justified in Chapter 4), these hypotheses are as follows:

H1 = Directors are motivated by the chance of doing good rather than by other benefits of a directorship

This hypothesis challenges the theoretical assumptions that directors perform purely based on some legal construct following, among others, agency theory. Given the high level of activity and engagement produced by the non-profit sector in New Zealand, it is presumed that there are other 'do good' factors at work to engage people into contribution of effort and energy. Such engagement would prima facie run against the presumption that a somewhat emotionally distanced arrangement crafted by legal constructs is the basis on which company directors feel triggered to produce their contribution. I note that the question asks about 'doing good' in an unspecified manner and thus is of limited value to pinpoint specifically which parts of 'goodness' the respondents focus on when selecting this choice ans their answer. This work is intended to identify areas where follow-up research can be placed, and thus, if this hypothesis process true, would certainly be one of these areas.

H2 = Independent directors are considered to contribute positively to the board.

The literature, described above, is rife with arguments for and against the inclusion of independent directors on company boards. At the same time, in the SME markets independent directors are the exception and not the norm. This hypothesis, when prove true, would lay the groundwork to craft arguments for the inclusion of independent external directors even on the boards of privately-held, family-owned, small-/mid-size businesses on the basis of their contribution to the board. The presumption would be, quite reasonably, that if independent directors are reported to make a positive contribution, then such a contribution is not

limited to specific firms but by implication reproducible in many other entities as well. This question was asked of executives (who would likely interact with independent directors in SMEs), shareholders (who would likely form an opinion as to the contributions independent directors make) and company directors (who would have seen independent directors in operation).

H3 = Independent director contributions are not seen to be equally important by directors and shareholders

On the platform of independent director being hailed in the literature as being producers of value at a board, the question arises who would support the inclusion of external directors on NZ SME boards and who would not. Seeing that the two groups of actors involved in board member appointments are the existing board (through the most commonly practiced system of 'recommending' new board candidates for election) and shareholders (who vote on new board member appointments or re-appointments of existing ones and sometimes have nominations of their own…), it is important to determine how each of these two groups perceive the possible contribution of value by externals directors.

H4 = Directors consider themselves more than 'average' competent in all aspects of contributing to a board.

Inherent in the call for more independent directors is the knowledge and competence on which they would ride into the board room. If they are not insider executives with the inherent specific knowledge about the firm's operation, then their claim to a board seat would be based on specific abilities that allow them to be proper agents for the shareholders. It is then an important consideration to identify whether and in which categories of the usual array of stewardship qualifications, newly appointed directors excel with their skills. If there was an outcome indicating a lack of transferable skills into a directorship role, the

presumption of more independent directors must fail unless there are additional training and education features added into the mix.

H5 = Directors report that their level of 'commitment' exceeds their level of competence in other areas.

Connected to H4, this adds a non-skill area into the set of competencies a prospective director could offer, that of commitment to be a good director. Following on from the theoretical framework of being a competent steward of a firm in the interests of its shareholders, this hypothesis tests for alternate competencies other than specific skills. "Other areas" were specific skills-based areas given in the survey and generated from the most commonly used training categories in directorship and givernance training, i.e. the ability to think strategically, the understanding of legal frameworks of governance, the ability to communicate effectively, etc.

H6 = Shareholders and directors consider a new director's experience to be more important as a contribution than age or diversity.

Given the low number of independent directors on New Zealand SME company boards, the question arises how well newly appointed directors would fit in, to discharge their duties effectively. Looking at age ('old boys network') and diversity (mainly gender, evidenced as a flash point by fewer than 12% of women being in corporate leadership roles in New Zealand), as areas where new directors could provide freshness around the board table, this question tests whether a selection of new directors would mainly focus on specific expertise, or on age or diversity. Following from this outcome, specific recommendations can be advanced how to search for the directors that seem to be most wanted.

H7 = Work experience is preferred over formal qualifications, for new independent directors.

On the basis of directors needing to perform within the framework of the legal and constitutional requirements, whether agents, stewards or other placeholders for the interests of shareholders, a relevant question is based on which specific ability new and independent directors might be considered for vacant board seats. Historically, lawyers and accountants, professional degree holders, were preferred, as were MBA graduates and other holders of advanced degrees. As it is not clear how such specific academic qualifications aid the discharge of directorship duties, this question tests whether this somewhat anecdotal and historic condition still exists or whether other, less formal, qualifications, such as work experience, would constitute sufficient attractiveness to be voted onto a board. This question set communicates a more general understanding by the respondents whether informal (work experience) qualifications are preferred over formal (degree) qualifications.

H8 = The majority of firms surveyed intend to hire at least one new independent director in the next 5 years.

This hypothesis tests for the real-life relevance or the argument that additional directors, independent ones preferably, would be needed to advance the level of governance in New Zealand. If, by way or argument, there was no interest by SMEs to hire new directors in the future, then the preceding argument of skills diversification, gender and age diversity and the benefits of independent directors would be rendered academic only and of no practical consequence for the upgrade of governance quality in New Zealand.

5.4. The Survey instrument

5.4.1 Development

The survey was developed by reviewing prior research on governance in New Zealand and overseas to identify factors that are considered relevant. Interviews were conducted with several organization leaders in New Zealand to further identify elements of interest in the theme of governance, independent directors and board/director competence.

The resulting survey instrument was then tested for functionality and ease of application with 15 directors/shareholders, all of whom were graduates of the Waikato Management School MBA programme. Further refinements were made to make questions and answer choices easier to understand and operate.

Ethical approval was obtained from the Ethics Committee of the University of Waikato. Aside from the obvious issues of representation and conflict-free wording, the information provided to all recipients specifically assured their anonymity. Respondents were given the opportunity to provide contact details if they wished to be contacted for a follow-up interview, and to re-establish anonymity, that contact information was then permanently removed from the answers. Nearly 62% of the respondents indicated they would be willing to discuss this matter further, demonstrating the high level of interest in this topic. In the case of directors of ten organizations (see Appendix One for details) those respondents were contacted for follow-up in-depth interviews.

No inducements were promised or given with the exception of arranging a free www.finddirectors.com 2-year listing membership for those respondents who wished to have one. Completion of the survey was not required to obtain this free listing (that has a value of NZ$95 but no cash value).

The following section describes the format of the survey instrument and the questions included. In addition, it offers justification for each question by relating it to one or more of the hypotheses tested by that question.

5.4.2 Format and Questions

The survey consists of 3 parts, each formatted specifically for either shareholders, senior managers or directors, with a joint preamble set of demographic questions. Depending on whether a recipient self-classified as either one or more of these 3 classes of respondents, the applicable sections of the survey would open up. Below is an overview of the questions in the survey by reference to the eight hypotheses being tested. It should be noted that as there was some (relatively minor) modification to the instrument between 2009 and 2010, the table also identifies where such modification occurred. This proviso guards against misinterpretation of results where changes affect those results.

The content, purpose and approach to analysis of each question or group of questions is described below by reference to each of the eight hypotheses.

5.4.2.1 Director Motivation

To gain insight into the reasons why directors might take up positions on a board, the survey included questions relating to what factors a participant may consider as important, were a position to be offered. Participants were asked to rate the importance of the factors on a 4-point scale: “Very important”; “Somewhat important”; “Somewhat unimportant”; and “Very unimportant”. To measure the principal motivation(s) of directors, I use responses to these questions pooled over all available survey years.

The question and answer choice options are:

Question: If you were offered a Board position now, how important would each of the following factors be for you?

Answer Choices (indicating the abbreviations used in the tables below):

"ImpFee" = Fees and Benefits to the Directors

"ImpPrestige" = Status/Prestige of the Organization

"ImpPublic" = Whether the Company's Shares are Publicly Traded

"ImpKnown" = Becoming Known/Networking

The Importance questions allowed 4 responses:

1. Very important
2. Somewhat important
3. Somewhat unimportant
4. Very unimportant'

I may consider both the "important" responses (1,2) to support H1, whereas the "unimportant" responses (3,4) do not. Therefore, I code the answers to true/false relative to the hypothesis:

- Very important, Somewhat important => True
- Somewhat unimportant, Very unimportant => False

and compare the relative proportions for the ImpGood question against the relevant "benefit" related questions: ImpFee; ImpPrestige; ImpPublic; ImpKnown, using the MH statistic. The set of sub-hypotheses for H1, then are

Hypothesis	**Test**		
H1S1:	ImpGood	>	ImpFee
H1S2:	ImpGood	>	ImpPrestige
H1S3:	ImpGood	>	ImpPublic
H1S4:	ImpGood	>	ImpKnown

Hypothesis H1 will be considered supported where all sub-hypotheses hold for the various cases.

5.4.2.2 The Contribution of Independent Directors

One of the persuasive reasons for including independent directors on boards would likely be the manifest contributions made by those presently on the board. Both presently serving directors and shareholders are likely to be faced with making such a judgment. Therefore, it is important to establish not only whether independent directors are seen as contributing positively to the board but also whether the attributes sought by directors and shareholders are the same. Questions on this topic were added to the survey set in 2009 (Table 5.2.2 T1).

However, and as stated above, shareholders could not be expected to have detailed awareness of the specific contributions made by independent directors to the workings of the Board. For this reason, only directors were asked to provide feedback on this question and only their answers were used to examine the validity of H2.

The question and answer choice options are:
Question: Based on your experience, how would you rate the NON-EXECUTIVE/INDEPENDENT Directors' contribution?
Answer Choices (indicating the abbreviations used in the tables below):
"IndPerform" = Their contribution to the performance of the organization
"IndMtg" = The quality of their contribution during board meetings
"IndNetw" = Their ability to assist with networking
"IndStrategy" = Their ability to provide strategic vision
"IndSyst" = Creating a sustainable enterprise
"IndGov" = Their understanding of governance issues
"IndBus" = Their understanding of the organization's business

In relation to relevant questions asked of directors on such contribution, five possible answers could be given:

1. Poor
2. Not so good
3. Acceptable
4. Very good
5. Outstanding

I may consider answers 3,4,5 to support the H2, whereas answers 1,2 do not. Therefore, I code these answers

- Not so Good; Acceptable => False
- Very good; Outstanding => True

and the proportion of true/false outcomes are compared against the null (equal) proportions for the relevant questions. The contributing sub-hypotheses for H2 are:

Hypothesis	Test		
H2S1:	IndPerform	>	null
H2S2:	IndMtg	>	null
H2S3:	IndNetw	>	null
H2S4:	IndStrategy	>	null
H2S5:	IndSust	>	null
H2S6:	IndGov	>	null
H2S7:	IndBus	>	null

Hypothesis H2 will be deemed supported where the hypothesis holds for each sub-hypothesis in the pooled case.

By way of explanation and justification for the coding of "acceptable" as false rather than true: it was considered that the judgment by respondents of contribution as merely acceptable was damming with faint praise. Positive contribution seems to be more than mere acceptability.

In this specific case (and others in the reported statistics), the question was deliberately neutrally worded and a balanced (between potentially "negative" and "positive") range of responses allowed, to ensure respondents were not presented

with a biased answer set. The responses are then forced into two groups, where clearly the positive responses group well, as do the negative. The question then is how best to incorporate the middle response. In some surveys this is accomplished using even-number of choices, however this approach actually only achieves the outcome of those who would have chosen “average” randomly assign themselves to “positive” or “negative”. Subsequent analysis based on those data are questionable as the two middle-responses (typically the largest population) are compromised. In the survey here, the “average” response is allowed, forming a true picture of perceived value.

The question remains, how best to address the “average” response. The test desired was (in the reviewer’s example) if independent directors contribute positively. A positive contribution is assumed to mean more positive than the relevant “average” contribution. Hence a view of “average” contribution is NOT a positive contribution. The question was not probing NEGATIVE vs POSTIVE, but POSITIVE vs NON-POSITIVE contributions. So, the appropriate test is

<all positive> against **<all non-positive>**

The “Acceptable” then properly ought to be included in the “non-positive” group. Contrast, for example, the previous question on importance of director’s specific motivations. There a 4-point scale was deemed appropriate as it was felt a motivation was either important or not, and there was no “average” to consider.

5.4.2.3 Contribution of Directors as Perceived by Directors and Shareholders

Hypothesis two was tested using the responses of directors only as it was considered unlikely that most shareholders would fully understand the difference between independent and inside directors. However, it was also considered imnportant to analyse responses of both groups in respect of their perceptions as to the contributions of directors more generally, as they interact with directors in

different ways. A number of such questions were included in the survey, however in this analysis, I only consider only two sets of these: the contribution as a result of international experience (as perceived by directors and shareholders (ContGbl and ShrGbl (Questions 37 and 44 respectively)) and the benefit to the firm of successful business experience (as perceived by directors and shareholders (ContRecord and ShrRecord (Questions 39 and 49, respectively)).

The two pairs of questions asked of directors and shareholders were considered sufficiently similar that I could compare responses and assess if directors and shareholders had the same requirements of directors.

The question and answer choice options are:
Question: As a shareholder, how important are these attributes in a director?
Answer Choices (indicating the abbreviations used in the tables below):
"ContGbl" = Having global business experience
"ContRecord" = Having a track record of business successes

The ContGbl and ContRecord questions have only two answers (Yes or No), whereas the shareholder questions, ShrGbl and ShrRecord) have three outcomes:

1. Very important;
2. Somewhat Important;
3. Not Very Important.

A "Yes" response (1) was considered to be a positive statement while 2 and 3 were considered negative, 2 because such a response was considered to be neutral at best. Answers were therefore coded as:

- Very important => YES
- Somewhat important, Not very important => NO

This coding allows a comparison of responses from both groups. In this case I am interested in whether the two groups (directors and shareholders) have the same

view, but not whether it be more or less important in any case. The test then is just to assess if the null hypothesis (Q1=Q2) holds.

Sub-hypotheses for Q1 and Q2:

Hypothesis	Test		
H3S1	ContGbl	≠	ShrGbl
H3S2	ContRecord	≠	ShrRecord

Hypothesis H3 will be considered supported where all the sub-hypotheses are shown to hold for the pooled case

5.4.2.4 Competence as a Director

A direct rationale for the inclusion of independent directors in firms is their competence in matters relating to governance. Using the approach for directors to self-evaluate the performance of themselves and that of their fellow directors, with all replies being anonymous and thus more reliable, this research wishes to identify whether directors consider themselves above-average competent in areas which relate directly to the discharge of their governance duties.

The question and answer choice options are:
Question: How would you describe the overall competence of the Board (not just your own individual competence) in these areas?
"CmpCommit" = Commitment, to the business and to stakeholders
"CmpStrategy" = Corporate strategy and the principles of risk/strategic change
"CmpLegal" = Legal, regulatory and corporate governance and the responsibilities of directors
"CmpLead" = Leadership qualities, commanding respect of others, displaying judgment and courage
"CmpTeam" = Team player abilities, listening and influencing skills and awareness of own strengths and weaknesses

The competence questions allow 5 responses:

1. Excellent competence
2. Good competence
3. Sufficient competence
4. Poor competence
5. Very poor competence

Since I wish to establish whether directors consider themselves at least better than average, I may consider answers 1,2 to support H4, whereas answers 3,4,5 do not, 3, because it was deemed an inadequate indication of confidence. Therefore, I coded the answers

- Excellent; Good => True
- Sufficient competence, Poor, Very Poor competence => False

and tested the proportion of true/false outcomes compared against the null (equal proportions) for each competence question. Where the null hypothesis does not hold, inspection of the proportion of true outcomes will determine for that case whether directors consider themselves more competent than average. The contributing sub-hypotheses for H4 are:

Sub-hypotheses:

Hypothesis	**Test**		
H4S1:	CmpCommit	>	Null
H4S2:	CmpStrategy	>	Null
H4S3:	CmpLegal	>	Null
H4S4:	CmpLead	>	Null
H4S5:	CmpTeam	>	Null

Hypothesis H4 will be considered supported where all sub-hypotheses hold for the various cases.

5.4.2.5 Commitment by Directors

These questions explore the intangible quality of 'commitment' as a contribution as compared to the more tangible/measurable qualities of technical skills, such as 'risk management', 'auditing', 'strategic planning', etc.

It should be noted that one of the competency questions, (question 29, coded as CmpCommit) asked participants to rate their and their fellow directors' level of commitment to the board (Question 29). Where directors classify themselves as above average for commitment compared to the other competency questions, it suggests they consider the levels of commitment exceed competency in the specific skills areas tested.

The question and answer choice options are:
Question: How would you describe the overall competence of the Board (not just your own individual competence) in these areas?
"CmpStrategy" = Corporate strategy and the principles of risk/strategic change
"CmpLegal" = Legal, regulatory and corporate governance and the responsibilities of directors
"CmpLead" = Leadership qualities, commanding respect of others, displaying judgment and courage
"CmpTeam" = Team player abilities, listening and influencing skills and awareness of own strengths and weaknesses

Competency questions allow 5 responses:
1. Excellent competence
2. Good competence
3. Sufficient competence
4. Poor competence
5. Very poor competence

I consider answers 1,2 to be an assessment of above average, whereas 3,4,5 to be at or below average. I code to the answers to:

- Excellent; Good, Sufficient competence => True
- Poor, Very Poor competence => False

and compare the proportion of true/false outcomes between CmpCommit and the other competency questions to test the null hypothesis (that there is no difference). If the null does not hold, I establish which question has the higher proportion of true outcomes. The contributing sub-hypotheses to H5 are:

Sub-hypotheses:

Hypothesis	Test		
H5S1:	CmpCommit	>	CmpStrategyl
H5S2:	CmpCommit	>	CmpLegal
H5S3:	CmpCommit	>	CmpLead
H5S4:	CmpCommit	>	CmpTeam

Hypothesis H5 will be considered supported where the all the sub-hypotheses are all shown to hold for the pooled case.

5.4.2.6 Directors and Diversity

One of the issues that has been the subject of research particularly with reference to independence is the extent to which those serving in that role are representative of diverse interests and groups. Therefore, respondents were asked (ContDiv; Question 34) to indicate whether they saw themselves as contributing to the diversity of the board in terms of either gender or age. This question was intended to test whether diversity is considered as important in selection as was as a new director's previous work experience. It should be noted that research in the area indicates that diversity is far wider than just gender or age: however, these two served to provide focus in this instance.

The question and answer choice options are:

Question: In your observation of organizations in this country, boards need Directors that contribute:

"ContWithin" = Work experience within the industry

"ContOut" = Work experience outside the industry

"ContGbl" = International experience

These questions are two-outcome (Yes/No), and as such tested against each other, with analysis of the relative proportion where the null hypothesis is shown not to hold.

I compare CmpDiv against CmpWithin; CmpOut; and CmpGbl. The subhypotheses for H6 are:

Hypothesis	Test (rank)		
H6S1	ContDiv	<	ContWithin
H6S2	ContDiv	<	ContOut
H6S3	ContDiv	<	ContGbl

5.4.2.7 Directors and Desirable Characteristics

To further develop the picture of a desirable independent director in the eyes of both shareholders and directors, respondents were given a list of characteristics to rank in terms of preference.

In all the survey years directors were asked to evaluate and rank desirable characteristics. I wished to test if directors value experience over formal qualifications.

The specific matter of professional qualifications is addressed in question 38 – whether directors should be lawyers, business consultants, accountants or other professionals (coded as ContLaw), and experience in questions 35-37 (including industry, other and international experience respectively).

The question and answer choice options are:

Question: In your observation of organizations in this country, boards need Directors that contribute:

"ContWithin" = Work experience within the industry

"ContOut" = Work experience outside the industry

"ContGbl" = International experience

The contribution questions are two-outcome (Yes/No), and were tested against each other. Where the null hypothesis failed (ie the outcomes are NOT the same), inspection of the proportion identified which value exceeded the other. The sub-hypotheses contributing to H7 are:

Hypothesis	Test		
H7S1	ContLaw	<	ContWithin
H7S2	ContLaw	<	ContOut
H7S3	ContLaw	<	ContGbl

This whole work would be largely moot if firms were unwilling to take advantage of independent director contributions in the future. It was important to establish whether firms had any plans or desire to have or increase the numbers of independent directors on their boards.

Therefore, in the 2009 survey year an extra question was included: "How many new external/independent Directors will your organization likely look for in the next 5 years" (Question 58, DirExt).

5.4.2.8 Independent Director Recruitment

There were a number of possible outcomes, Do Not Know, None, 1, 2, 3, 4, 5 or more. Since this question is designed to test the hypothesis that a majority of firms are considering a future appointment of at least one independent director, I

omitted any response where the participant failed to enter a value, or did not know. I coded

- 1, 2, 3, 4, 5 or more => True
- None => False

I could then calculate the proportion of true outcomes tested against the null (proportions of true and false are equal) to determine if a significant majority of firms are considering appointing independent directors in the future.

5.5 Survey Population, Samples and Responses

5.5.1 Nationwide Surveys

This research project was designed to capture a broad cross-section of responses from shareholders, managers and directors throughout New Zealand, across a broad spectrum of activity and over a period of several years. The survey instrument emphasised that the responses were to be treated as anonymous, with individual respondents unidentifiable in any analysis. This anonymity served two purposes: (a) It greatly assisted with obtaining ethics approval for this research, and (b) it created an environment where participants felt they could answer the research questions more openly/honestly. The latter feature was highlighted during the test of the survey instrument where participants indicated that if they were identifiable, they might not always answer truthfully in areas where a "politically correct" answer might be expected. However, and helpfully, some respondents indicated their interest in further exploring issues around the survey and its questions: these respondents were contacted directly for follow-up interviews.

In order to maximise the reach, the survey was distributed as an email attachment to those on the client lists of national organizations and firms (see Appendix 1 for a list of these organizations), whose cooperation in this process allowed the creation of one of the largest data sets on governance in the country. These 'distributors' sent a generic introductory email to their clients (pre-selected as owners,

executives or directors of incorporated enterprises), recommending the completion of the survey, for which a hot-click link was included in the email. The distributors' emails were signed by a partner, CEO or Chair of the distributor organization and thus carried assurance that they were sent to appropriaterecipients.

Several points should be made about this decision to administer the survey in this way. First, although the web-based distribution inherently limits the sample pool to those shareholders, managers or directors with access to the internet and willingness to complete such a survey on the web, this was not deemed to taint the sample pool given the high level of access to the internet in New Zealand.

Secondly, a downside to this method of distribution was the inability to capture data on the exact number of surveys distributed, or response rates from this distribution, as organizations generally did not wish to share this data. Judging from those data sets where distribution details were available, the responses rates varied from 1.6% of banking clients to 19% of members of the NZ Shareholders Association.

Thirdly, this method of distribution was intended to reduce sample bias.However, because of the differing efforts on the part of the various distributors, uneven sample sizes occurred throughout the four years of data collection, sometimes also skewing the industry and geographic distributions from year to year. For instance, in the year the Employers and Manufacturers Association (EMA) of New Zealand distributed the survey to their members, a large group of manufacturing firms responded, with a commensurate impact on the overall response distribution. To address these inherent differences in response rates and preventing year-specific/sector specific response rates distorting the overall results, no year-by-year comparisons have been performed. Instead, the data has been analyzed as a whole.

Fourthly, it was likely that the addressees may not only be shareholders but might also/or be senior managers or directors. To manage this multiplicity of roles, and to fight survey fatigue that might result from multiple sub-sets of questions to the same addressees, the survey contained three distinct question sets (but with a preamble of demographic variables that applied to all respondents). Recipients were asked to select the appropriate category. This "do it once only" distribution was also greatly preferred by the distributing organizations that were largely unable or unwilling to break down their address lists into the three categories.

As a consequence, greatly varying response rates were recorded for questions in the three different subsections. Not all questions received a sufficient number of responses to permit analysis by all dependent variables, i.e. age, gender, location and industry.

In addition, the total numbers of responses varied considerably between survey years. The rather low responses for 2008 and 2009 resulted in tests upon questions for these individual years often falling below significant response levels. Where possible, the total (pooled years) response has been used in the analysis. A separate analysis of data from years with low numbers of responses and a large difference in industry represenattions would not have allowed for a meaningful statistical review and analysis of the data.

There was a risk of duplicate replies which was mitigated on the following assumptions: (a) Different distributors were active in different years including different clients on the data base. (b) In the event that clients might have overlapped and that clients who received the same survey twice (and might have felt compelled to reply to the same survey more than once…), a note was included in the email solicitation to disregard any duplicate survey transmission.

5.5.2 In-depth Board Reviews

Given the large variation in response numbers, industry representations and distribution methodology year-on-year, in early 2010, directors of a group of 10+ firms in different industries, size ranges and locations were asked to complete a modified shorter version of the large-scale survey instrument by way of validation phone calls (this group of respondents had also indicated their willingness in the returned survey to be contacted for this purpose). This was intended to accomplish two purposes:

(a) Validate the results of the large-scale, national, longitudinal sample, and

(b) Interview directors individually to collect qualitative data.

These in-depth Board Reviews included the same survey as sent through the large-scale distribution with follow-up individual verbal interviews to confirm that all questions were understood. The comparison of results showed that there was no statistically meaningful difference in the results between this small population and the larger population.

Those ten are listed below (and described) with the following table (table 4.5.2 T1) indicating the actual numbers of participants from each of those organizations.

- A large nationwide non-profit organization (NZ Red Cross)
- A large national education institution (NZ College of Chiropractic)
- A large regional construction firm (HEB Construction)
- A large national retail franchise (FootMechanics)
- A regional professional service organization (Franklin Vets)
- Two organizations with local membership (Rotorua Golf Club and Spring Hill Golf Club)
- A national web-based health business (WebHealth)
- A local non-profit Maori trust (Turanga Health)
- A national investment firm (GZ2 Holdings)
- A regional for-profit community agency (Kawerau Enterprise Agency)

Table 5.5.2.T1: Participating firms, 2010 survey.

Company	Industry	Respondents
Franklin Vets	Professional service	7
Foot Mechanics	Retail	3
GZ2 Holdings	Finance	2
HEB Construction	Construction	6
KEA	Public sector	14
Red Cross	Public Services	10
ChiroCollege	Health	10
Rotorua Golf	Sport	11
Springfield Golf	Sport	6
Tauranga Health	Non-profits	1
WebHealth	Health	7

By way of further information, the following table indicates how the hypotheses were reflected in both the nationwide survey and the modified one.

Table 5.5.2.T2: Hypotheses and the relevant survey questions.

	Hypothesis	Questions	Survey	
			Previous	2010
1	Directors are motivated by doing good rather than personal benefit.	ImpGood; ImpFee; ImpPrestige; ImpPublic;	Present	Present
2	Independent Directors are considered to contribute positively to the board	IndPerform; IndMtg; IndNetw; IndStrategy; IndSust; IndGov; IndBus	Present	Present
4	Directors consider themselves more than average competent in all aspects of contribution to a board.	CmpCommit; CmpStrategy; CmpLegal; CmpLead ; CmpTeam	Present	Present
5	Directors consider their level of commitment exceeds their level of competence	CmpCommit; CmpStrategy; CmpLegal; CmpLead ; CmpTeam	Present	Present
7	Directors value work experience above formal qualifications for new directors	ContLaw; ContWithin; ContOut; ContGbl	Present	Present

6	Directors and shareholders consider a new director's experience to be more important as a contribution than age or diversity	ContDiv; ContWithin; ContOut; ContGbl	Present	Present
3	Director contributions are not seen to be equally important by directors and shareholders.	ContGbl; ShrGbl; ContRecord; ShrRecord	Present	**Not present**
8	The majority of firms surveyed intend to hire at least one new independent directors in the future.	DirExt	Present	**Not present**

5.5.3. Candidate Interviews

Further qualitative/narrative input was collected from 62 candidates for Ministerial appointment to 15 District Health Boards in New Zealand (Northland, Waitemata, Counties Manukau, Hamilton, Bay of Plenty, Wanganui, Lakes/Rotorua, MidCentral, Hutt Valley, Wellington/Capital and Coast, Nelson, Dunedin, Invercargill, Canterbury, Couth Canterbury). District Health Boards in New Zealand are large enterprises with an average of $700 Million annual turnover, funded by the Government, and under pressure to be commercially responsible.

Access to these candidates was made available during their Ministry of Health interview, on direction of the Minister of Health of New Zealand, the Hon. Tony Ryall. Interviewees for these appointments therefore are mainly experienced corporate leaders or directors, with significant governance experience. Questions to these individuals were limited to the reasons why they would want to serve on a board, to whom they were accountable and what they wanted to achieve.

The purpose for these interviews was to validate that all questions were well understood and to compare results to the respondents in the non-profit/health categories from the widely distributed survey set. It was confirmed that the

questions were well understood, and there was no statistically meaningful difference in the replied between this control group and the larger population.

5.6 Survey Analysis, Processes and Methods

Statistical Methods

Descriptive statistics for individual and organization demographic characteristics were summarised by survey year using counts of respondents in the various categories, and converted where appropriate to proportion, expressed as percentage. Chi-square tests were used to assess whether the categories of these characteristics differed by survey year. The results for individual years were compared against each other and the pooled outcome by Pearson's product-moment correlation, which allows a measure of how similar each year is to the others. Where response proportions over years were shown to be significantly different, these questions may only be analysed as pooled outcomes, rather than by year. In general, all questions showed significant differences year to year, related to the different sample sizes that were due to different distributing organizations being involved each year. Years 2006 and 2007 each have more than 1700 participants, whereas 2008 had 59 (due to a large portion of the responses for that year being destroyed through a server malfunction at the survey operator) and 2009 had 310 responses. Due to 2008 having few participants, there were no individual outcomes analyzed separately. This research therefore does not offer longitudinal year-to-year comparisons.

The survey conducted in the final year of this set (2009) was somewhat different than that administered in previous years. While it included all of the previous year's questions, it extended the question set somewhat both with extra questions and answer options to provide the foundation for additional research projects. The relevant extended answer set for this analysis is that for the industry group. The reduced participant level of the 2009 survey also meant there were

correspondingly fewer participants within the interaction groups, and most fell below the threshold or 40 participants to be considered significant for analysis.

For almost all comparisons, the question results were pooled over all the survey years, before being segregated, as required, for any interactions. The exception to this is the questions that were only asked in the 2009 survey year, which necessarily were analysed as a separate, single-year, result group.

Spearman correlations were used to assess the strength of correlation and the variance explained between items within specific survey questions. These questions assessed the following: factors considered important by individuals when offered a board position; assessments of individuals' own and fellow directors' competence in specific areas; assessments by shareholders of the importance of specific attributes in directors; assessments of contributions of non-executive/independent directors; and directors' assessments of their own involvement in specific areas. The two latter topic areas were addressed only in the 2009 survey. Analysis results were summarised using Spearman partial correlation coefficients (r) where data was available for multiple years, or using Spearman correlation coefficients (r) where data was available only for the 2009 survey.

While adjusting for survey year, Mantel-Haenszel analysis was used to test for all associations between demographics (age, gender, region location, market share, and market competition) and for each item within the questions addressing factors considered important by individuals when offered a board position; assessments of individuals' own and fellow directors' competence in specific areas; and qualities needed in directors for boards of NZ organizations. However, for items within questions addressing directors' assessments of their own involvement in specific areas and the contributions of non-executive/independent directors, survey year was not adjusted for in the analysis, as these questions were only available in the 2009 survey.

Statistical analyses were performed using SAS version 9.2 (SAS Institute Inc., Cary, NC, USA).

<u>Pearson's Product-Moment Correlation</u>

The Pearson product-moment correlation coefficient (typically denoted by *r*) is a measure of the correlation (linear dependence) between two variables, *X* and *Y*, giving a value between +1 and −1 inclusive. It is widely used as a measure of the strength of linear dependence between two variables. It was developed by Karl Pearson from a similar but slightly different idea introduced by Francis Galton in the 1880's[1,2,3]. Since the data I have are a subset of the population (being a survey of a relatively small number of participants from a much larger populations), I calculate the sample correlation coefficient,

$$r = \frac{\sum_{i=1}^{n}(X_i - \bar{X})(Y_i - \bar{Y})}{\sqrt{\sum_{i=1}^{n}(X_i - \bar{X})^2}\ \sqrt{\sum_{i=1}^{n}(Y_i - \bar{Y})^2}}$$

and $r = +1$ or $r = -1$ correspond to a perfect correlation (all the data points would lie on a straight line), both ascending or one ascending while the descends respectively. A correlation $r = 0$ shows the two data sets have no relationship between themselves.

I can test the significance of the correlation, which is an estimate of the probability this sample correlation could have arisen by chance, having been drawn from a larger population which did not (in the overall population) have a correlation between the two variatbles (*X* and *Y*).

The commonly applied test, which I use here, is the Student-t test, typically denoted by *t*. It is known that

$$t = \frac{r\sqrt{N-2}}{\sqrt{1-r^2}}$$

is distributed normally about zero, with deviation 1, and so I can compare the specific result for our case to this distribution and estimate how likely this may arise by random selection. I express this likelihood of random outcome by its significance, p = the Student cumulative density function with N-2 degrees of freedom. The significance, p, expresses the probability the observed outcome (of the t-test) could arise randomly.

Mantel-Haenszel Comparison

In several outcomes discussed below, I contrast participant responses between different questions. These question outcomes vary in the allowed answers, and I code these answers to binomial either in support of the hypothesis under consideration, or otherwise.

This provides a very powerful comparison between the questions, and our analysis makes extensive use of the Mantel-Haenszel statistic (MH), sometimes called Odds-Ratio[4]. MH compares two binary-valued data sets (True/False is usually assumed, but any binary value dataset is valid), and tests if the observed difference in True/False proportion is significantly different between them.

In its simplest formulation, consider p_1 = the probability of a true outcome in the first dataset, and p_2 = the probability for the second data set. The probabilities of a false outcome are $q_1 = 1 - p_1$ and $q_2 = 1 - p_2$ respectively, and

$$MH = \frac{p_1 q_2}{p_2 q_1}$$

which I test for significance using the chi-square density function, with one degree of freedom. The MH statistic is a measure of how different the proportions are, so

a smaller MH value denotes better agreement between the two datasets. Correspondingly, the significance test is for the two distributions to be consistent, and so the outcome is significant when $p > 0.05$.

Note that in contrast to the Pearson correlation, the *p*-value for MH increases as the agreement between datasets improves.

It is also worth noting that MH measures against the null hypothesis, and as such does not provide, of itself, information as to which dataset may have increased True outcomes in the case where the null hypothesis is shown NOT to hold. Inspection of the actual proportions, once the null hypothesis has been shown not to hold, is required to assess which of the datasets shows the enhanced true outcome.

Significance and Confidence Limit

Significance, where unqualified, is taken to mean significant at the 95% level, as ascertained by the appropriate test. If any other meaning is intended, the specific significance level will be stated.

As is common practice, I consider an outcome to be significant where the probability of being random is less than 5%. For various reasons this is commonly referred to as the 95% confidence limit, and for the comparisons considered here, this corresponds to

Test	*p*-value for 95% confidence
Mantel-Haerszel	0.05 or LARGER
Pearson correlation	0.05 or SMALLER

Integrations and Segregations

For each of the hypotheses I tested, as well as the overall or pooled proof (or otherwise) of the hypothesis, I was interested in identifying the contributing

factors. The hypotheses were also tested for the response dataset of the appropriate question(s) segregated by age, gender, region location and industry. In several cases, particularly for the 1999 survey year-only data, the amount of response for a given segregated question fell below the established cutoff for significance (40), and generally was omitted from the reported analysis.

The survey presented a number of related questions, in very similar format and with identical, or at least congruent, allowable answers. This research also includes probing the interaction between several questions. These interactions were analysed using pooled responses all years the questions were asked, where the number of responses were sufficient.

5.7 Conclusion to Chapter 5

This chapter has described and justified the empirical research conducted on the role and importance of independent directors in corporate governance in New Zealand. In addition, it has explained in some detail how the questions in the survey and follow-up interviews link back to the hypotheses that emerged from the research questions identified in chapter one and that were validated by reference to the literature in chapter three, It also identifies and describes the statistical tests carried out on the findings and identifies the assumptions on which those findings are evaluated. The following chapter reports on those findings and relates them to the literature on governance in Chapters 2 and 3 and boards and independent directors in Chapter 4.

Chapter 6: ANALYSIS AND INTERPRETATION

This chapter reports on the findings from the empirical research. In the interests of consistency, logic and rigour, it discusses the findings by reference to each hypothesis and in light of relevant theory. This process involves explaining the decisions made in analysis of each relevant question or set of questions in the survey, a discussion of further relevant detail extracted in the course of the in-depth studies and a review of how the findings do or do not reflect relevant theoretical constructs as described in chapters two and three. Prior to this detailed analysis, it is useful to offer some preliminary remarks on the patterns and characteristics of the responses to the survey as these can affect the nature and pattern of findings on the substantive questions and consequently the analysis carried out.

6.1 Survey Responses

The data collected from both the large-scale public survey over the four-year period 2006-2009 and from the in-depth validation sample of 10+ firms throughout New Zealand, give a general overview of the characteristics of this population. The survey introductory text and the survey questions are shown in Appendix A, and it must be noted that the 'real' survey, as an online survey, displayed the questions in a slightly varied form to accommodate the formatting requirements of the respective displays used by respondees. Radio-style button were used to display answer choices in matrix formats (example below):

As a shareholder, how important are these attributes in a director?

	Very Important	Somewhat Important	Not very Important
Having a good reputation in the market	○	○	○
Having company-specific market/product knowledge	○	○	○
Holding many other directorships	○	○	○
Being an employee of the firm	○	○	○
Having global business experience	○	○	○
Holding a Certificate from an entity that trains directors	○	○	○
Communicating directly with shareholders	○	○	○
Forming his/her own opinions and arguing strenuously if there are disagreements among directors	○	○	○
Having a track record of business successes	○	○	○

For several industry groups (Agriculture, Education, and Tourism) this survey did not attract sufficient responses to permit meaningful statements to be made. The limitations for this work will reflect this lack of applicability. For the remaining industry sectors, year-to-year variations are a function of the different distribution mechanisms used. In total, even when considering possible shifts in replies year-to-year, most industry groups are sufficiently represented sufficiently to permit specific indications of governance behaviour in those industries

Table 6.1 T1: Industry type answer options tests by survey year

Industry type	**Survey Year**				**[a]Common**
	2006	**2007**	**2008**	**2009**	
	n	**n**	**n**	**n**	
AGRICULTURE				1	
EDUCATION				3	
ENERGY/ UTILITY/ INFRASTRUCTURE	42	59	2	15	Yes
FINANCE/ BANKING/ INSURANCE	66	94	3	10	Yes
HEALTH	35	57	0	31	Yes
MANUFACTURING/ PROCESSING	64	183	3	16	Yes
NON-PROFITS	47	84	5	18	Yes
PRIMARY SECTOR (AGRIBUSINESS, FARMING ETC.)	85	59	4	2	Yes
PROFESSIONAL SERVICES	41	139	8	25	Yes
PUBLIC SECTOR/ LOCAL GOVERNMENT	24	56	1	9	Yes
RESEARCH/ SCIENCE	44	18	1	3	Yes
RETAIL/WHOLESALE	59	106	3	9	Yes
TELECOMMUNICATIONS/ TECHNOLOGY/ MEDIA	19	90	1	6	Yes
TOURISM (INCL. HOSPITALITY, EVENTS, SPORT, ETC.)				3	
TRANSPORT	65	34	0	0	Yes
Pooled	**591**	**979**	**31**	**167**	

[a]Industry choices common to all years are shown as “YES”
Options offered only for the 2009 survey are shown as empty.

The question connected to this table is: “In which industry does your organization operate (mark all that apply)”

The response rate peaked in 2006 and 2007, largely because of the interest this survey created in New Zealand among distributors, some of whom used the data of the first two years to create firm-specific advisory material as part of their corporate positioning. This effort had declined after 2 years, and those distributors

were replaced with new ones whose efforts were not as effective, especially in 2008. However, the overall participation of more than 4,000 directors, shareholders and executives is sufficient to create a large-scale model for the application to New Zealand firms in general.

Table 6.1 T2: Total participants by survey year

Survey Year	Total participants
2006	1723
2007	1988
2008	59
2009	310
All years	**4082**

This number of responses equals the total number of returned surveys. The analyses included only those responses where the relevant section was completed.. By way of example, in 2009 310 surveys were received but only 167 of those 310 surveys included answers as to the industry origin of the respondent. Therefore, only 167 responses would have been included in the industry analysisfor this year.

6.1.1 Gender

This is often an issue discussed in the context of governance, especially given the low number of women involved in New Zealand governance. In light of the most often cited statistic of 8-9% of women representation in such roles (including senior managers and directors of listed firms in New Zealand), the respondents to this research include a significantly greater share of women (at 23%) and includes a significant number of women not currently involved in governance, but interested in governance either as shareholders or senior managers (Table 6.1.1T1). This indicates that women are indeed interested in governance issues to a much greater level than historically indicated. This research therefore appears applicable for women participants in governance as much as or more than for men. The gender distribution does not significantly differ between survey years, except for the 2009 dataset, which shows significantly more female participants (likely because of the more active participation of the Ministry for Women's Affairs). I may use the

pooled relationships for probing effects of gender upon other questions, but it would not be appropriate to include effects that were year-specific as testing indicates little or no significance of such variation (Table 6.1.1 T2).

Table 6.1.1T1: Responses for Gender by survey year

Gender	Survey Year			
	2006 [1]n=1723 n (%)	2007 [1]n=1988 n (%)	2008 [1]n=59 n (%)	2009 [1]n=310 n (%)
Female	373 (24.1)	399 (22.6)	10 (17.5)	94 (31.9)
Male	1173 (75.9)	1365 (77.4)	47 (82.5)	201 (68.1)

[1]Numbers may not add to totals due to missing data

Table 6.1.1T2: Significance tests for Gender by survey year

	Survey year			
	2007 MH (p) [a]	2008 MH (p)	2009 MH (p)	Pooled MH (p)
2006	1 (0.295) [c]	1.3 (0.19) [c]	7.8 (0) [b]	0 (0.98) [c]
2007		0.8 (0.414) [c]	11.9 (0) [b]	1.1 (0.261) [c]
2008			4.7 (0) [b]	1.3 (0.209) [c]
2009				9.3 (0) [b]

[a] Mantel-Haenszel statistic
[b] Significantly different
[c] Not significantly different

The question connected to these tables is: "You are Male/Female"

6.1.2 Age

Consistently for all survey years, the distribution of age groups shows a healthy representation of all ages, with the majority of replies coming from respondents in the 46-65 age range. With the New Zealand director age being 52 years on average, this response appears to provide sufficient replies from all age groups to make age a well-covered variable.

However, survey results show a significant difference between survey years in terms of average participant ages. Although 2006 and 2007 are not significantly

different (r=1.0, p<0.001); and 2008 and 2009 are not significantly different (r=0.9, p=0.030), there is a clear shift as between 2006/7 and 2008/9. This shift correlates well with the different distribution pathways used. With the manufacturing industry well represented, there was a larger proportion of participants in 56–65 age bracket for 2008 (51%) and 2009 (36%) against 2006 (25%) and 2007(25%) (table 5.1.2 T1). Hence a slight aging in overall participant age became apparent.

As was the case in relation to gender, I may use the pooled relationships for probing effects of age-grouping upon other questions, but it would not be appropriate to include effects that were year-specific as testing indicates that the differences are not significant (table 6.1.2 t2).

Table 6.1.2 T1: Responses for Age groups by survey year

Age Group	Survey Year			
	2006 [1]n=1723 n (%)	2007 [1]n=1988 n (%)	2008 [1]n=59 n (%)	2009 [1]n=310 n (%)
≤35 Years	156 (10.1)	153 (8.6)	2 (3.5)	14 (4.6)
36 to 45 Years	374 (24.2)	429 (24.2)	6 (10.5)	48 (15.7)
46 to 55 Years	525 (34.0)	608 (34.3)	14 (24.6)	96 (31.4
56 to 65 Years	384 (24.8)	439 (24.7)	29 (50.9)	110 (36.0)
>65 Years	107 (6.9)	146 (8.2)	6 (10.5)	38 (12.4)

[1]Numbers may not add up to totals due to missing data

Table 6.1.2T2: Significance tests for Age by survey year

	Survey year			
	2007 r (p)[a]	2008 r (p)	2009 r (p)	Pooled r (p)
2006	1 (0) [c]	0.5 (0.344) [b]	0.8 (0.111) [b]	1 (0.001) [c]
2007		0.6 (0.335) [b]	0.8 (0.096) [b]	1 (0) [c]
2008			0.9 (0.03) [c]	0.6 (0.274) [b]
2009				0.8 (0.07) [b]

[a] Pearson correlation moment
[b] Significantly different
[c] Not significantly different

The question connected to these tables is: “Your age is:”

6.1.3 Industry

For the survey year of 2009, respondents were provided with a wider range of options when selecting their industry type than was the case for 2006 or 2007. This broadening coincided with a substantial drop in numbers of responses. However, as the new category responses account for only 14% of the 2009 responses, I may compare year profiles by omitting these responses. Comparison of the 12 commonest responses shows no significant differences in industry make-up over the survey years. I may use the pooled or yearly relationships for probing effects of industry group upon the responses to other questions.

6.1.4 Company location

Respondents were given the option to self-classify the headquarters location of the firm with which they have the most significant contact, either as investor/shareholder, senior executive or director. With the distribution of the survey being centered on New Zealand, the 99%+ representation of New Zealand firms was expected (the non-New Zealand responses apparently came from managers working for New Zealand firms but being located overseas).

I may, with no loss of generality, omit these few non-New Zealand locations, forming a binomial response (North and South Islands), and test this between years using the MH statistic. On this basis the company location shows significant differences between survey years, with 2009 being very strongly dominated by North Island responses, 2007 and 2008 less so (and not significantly different from each other), whereas 2006 was a more evenly balanced split between the two islands.

The 71%/29% split of responses from the North Island/South Island respectively for 2009 is an appropriate representation of corporate populations in new Zealand

(Table 5.1.4 T1), with the majority of firms located in the North Island, specifically in Auckland and Wellington and the provinces in between (Table 5.1.4 T2).This alternating focus on different locations corresponds with the different distributors used, i.e. the Chamber of Commerce distributors that generally draw from a specific regional pool of respondents as well as the Business New Zealand subsidiaries (i.e. EMA Northern, EMA Central and Otago).

I may use the pooled relationships for probing effects of these questions, but this research does not explore or identify any year-specific effect.

Table 6.1.4 T1: Responses for Company Location by survey year

Company Location	**Survey year**				
	2006 n (%)	**2007** n (%)	**2008** n (%)	**2009** n (%)	**Pooled** n (%)
Australia	0 (0)	0 (0)	0 (0)	2 (1.2)	2 (0.1)
North America	0 (0)	0 (0)	0 (0)	2 (1.2)	2 (0.1)
NZ North Island	318 (56.4)	754 (75.7)	31 (77.5)	148 (89.2)	1251 (70.8)
NZ South Island	246 (43.6)	242 (24.3)	9 (22.5)	13 (7.8)	510 (28.9)
Western Europe	0 (0)	0 (0)	0 (0)	1 (0.6)	1 (0.1)

Table 6.1.4 T2: Significance testing for Company Location, North and South Island locations only.

	Survey Year			
	2007 MH (p) [a]	**2008** MH (p)	**2009** MH (p)	**Pooled** MH (p)
2006	62.5 (0) [b]	6.8 (0) [b]	68.8 (0) [b]	41.8 (0) [b]
2007		0.1 (0.946) [c]	21.2 (0) [b]	7 (0) [b]
2008			6.8 (0) [b]	0.8 (0.426) [c]
2009				32.5 (0) [b]

[a] Mantel-Haenzsel statistic

[b] Significantly different

[c] Not significantly different

The question connected to these tables is: "In what region is your organization's headquarters located?"

Given the characteristics of the respondents to the survey and the decisions that have been made on the analysis of the responses, it is now timely to examine and analyse the findings by reference to the hypotheses as identified and to the relevant research as explored in chapters three and four. This analysis will be conducted by reference to each hypothesis in turn.

6.2 Analysis of Results

6.2.1 H1: Directors are motivated by the chance of doing good rather than by other benefits of a directorship

In the nationwide surveys, directors were given several choices to indicate what would motivate them most in considering whether to serve as a director. In the same category of intangible/tangible benefits were the options "Gaining Prestige", "Receiving Fee Income", "Becoming Known", "Doing Good", and "Furthering their Career". There were also choices related to the downside of such service for directors in New Zealand, including "Reputation of other Directors" and "Personal Risk".

It is useful to note that the concept of "doing good" was not defined in the survey because it was considered important that directors should be able to interpret it in the way most appropriate to their circumstances. However, it became clear during the pilot that almost all respondents defined "doing good" as being of value to the company.

From the comments made in the returned surveys, as well as from the follow-up interviews with directors, it is clear that the legal rules in New Zealand (and elsewhere) that hold directors personally for damages incurred while trading insolvent, created a concern about the personal risk associated with directorships

and that the (presumably 'high') reputation of the other directors would help mitigate this fear. Directors believe that if their fellow directors have a reputation to lose they will manage the firm in a way that reduces the likelihood of personal liability for themselves, thus protecting the other members of the board by proxy.

This raises concerns over the perceived ability of new independent directors to make a difference on their own rather than being tied to the behaviour of other directors. It is relevant to remember that one of the major reasons for the push to independent directors on the board is that such directors are less likely to be in the Executive's "pocket" (Ryan and Wiggins, 2004, p479) and that independent directors have the power and strength to conduct an independent appraisal of performance (Fama and Jensen, 1983). However, this assumes that there is either a sufficiently high proportion of such directors on the board to enable them to work together or that all the independents are willing to act that way. Future research might attempt to determine to what extent independent directors are truly acting as independents when they make decisions on New Zealand boards or whether their decision-making is based on their perception of how the other directors behave and vote.

Of greater significance in this context is that director respondents, when given the choice of several benefits, were more likely to select "Doing Good" as the most important motivator connecting them to the firm (Table 6.2.1T1).

Table 6.2.1 T1: Pooled outcomes for the importance of director motivations

Question	Possible answer			
	Very Important n (%)	Somewhat Important n (%)	Somewhat Unimportant n (%)	Very Unimportant n (%)
ImpPrestige	353 (26.7)	541 (41)	314 (23.8)	113 (8.6)
ImpPublic	202 (15.1)	424 (31.7)	478 (35.7)	234 (17.5)
ImpFee	211 (21.2)	402 (40.5)	276 (27.8)	104 (10.5)
ImpGood	418 (46.6)	234 (26.1)	160 (17.8)	85 (9.5)
ImpKnown	214 (19)	235 (20.9)	298 (26.5)	379 (33.7)
ImpRep	564 (53.8)	324 (30.9)	50 (4.8)	110 (10.5)
ImpRisk	577 (50.3)	422 (36.8)	96 (8.4)	53 (4.6)

ImpCareer	542 (44.3)	408 (33.3)	192 (15.7)	82 (6.7)

The question and answer choice options are:

Question: If you were offered a Board position now, how important would each of the following factors be for you?

Answer Choices (indicating the abbreviations used in the tables below):

"ImpPrestige" = Status/Prestige of the Organization

"ImpPublic" = Whether the Company's Shares are Publicly Traded

"ImpFee" = Fees and Benefits to the Directors

"ImpKnown" = Becoming Known/Networking

"ImpRep" = Reputation of other Directors"

"ImpRisk" = Level of Personal Risk"

"ImpCareer" = Opportunity for Personal Career Advancement"

Table 6.2.1 T2 (below) offers further detail as it shows the individual sub-hypothesis outcomes for the pooled case, where the results suggest that directors rank "doing good" as motivation for serving above any fees they might receive, prestige or status, the fact the company is publically listed or becoming known in the corporate world.

Table 6.2.1 T2: H1 Outcome: Pooled

	Q1	Q2	N	YES (%)		MH	p	Q1>Q2
				Q1	Q2			
POOLED	ImpGood	ImpFee	897	46.6	21.2	136.3	0	YES
	ImpGood	ImpPrestige	897	46.6	26.7	93	0	YES
	ImpGood	ImpPublic	897	46.6	15.1	265.7	0	YES
	ImpGood	ImpKnown	897	46.6	19.0	176.9	0	YES

There was no difference in the wording of the questions for pooled answer sets.

It is possible then to conclude that hypothesis one, that directors are motivated by doing good rather than by other personal benefits offered as choices, is supported. This survey finding is supported by recent findings (He, Wright, Evans and Crowe, 2009) that independent directors may choose to serve for a variety of less than

selfish or financial reasons, and the many narrative comments by respondents who indicated that they believe there is more to directorships than earning money or having a title.

When the influence of such specific characteristics of respondents as gender (see app 1, table 2), location (table 3) and age (table 4) are taken into account, it was discovered that this hypothesis remained supported. However, and as indicated in table 5, the industry grouping had some influence on the findings. For example, it appears that in finance/banking/insurance, prestige may be more important than is doing good while in health, the fact the firm is publically listed may be a higher priority. For those in the manufacturing/processing industry, becoming known was considered of greater importance and in the case of non-profits, prestige outweighed doing good. These results are not completely unexpected. It could well be assumed that doing good on a non-profit board was an inherent expectation and therefore not necessary to mention (while prestige could be desired) while in the finance industry expertise is highly likely to be valued. Hence it is likely that directors would see service as a path to more directorships and greater renown.

However, the questions and the findings raise several important issues:

First, what does 'doing good' mean? The phrase itself is ambiguous in the extreme and could well include purposeful activities to a standard unique for each person. However, in the in-depth discussions with directors, a general theme emerged that narrows the definition down two central arguments:

A. Directors wish to be helpful and want to see that their contribution advances the goals of the entity. This means the participation is less about duty, compliance, audit and legal representation of shareholders, and more about the meaningful input of advice into an organization and achieving a tangible and better outcome (firm performance - Lockhart, 2007).
B. Directors believe that organizations should be connected to their community surroundings through more than generating profits for shareholders.

> Interviewees frequently stated that boards should not merely advance the position and goals of a narrow group of stakeholders, i.e. the shareholders, but reflect on the role the entity has in the eyes of all major stakeholders (Freeman, 1984; Millar and Abraham 2006).

Secondly, this infusion of a generalised 'doing good' halo that seems to hover over directors when they act on boards put them on a straight collision course with their duties as historically defined. While the interviewed directors all acknowledge that they work for shareholders in the strictest legal sense, they appear to be unwilling to see themselves as unidirectional megaphones of the shareholders. They wish to act in the interests of what they see as the general good of the firm and its position among its stakeholders.

Finally and more generally, the finding seems counter-intuitive to the mainstream agency theory assumption of self interest as the main driver of decisionmaking. Although this theory as applied to governance commonly refers to control by the board of the executive (Berle and Means, 1932; Jensen, 1983; Spence and Zeckhauser, 1971; Ross, 1973), as mentioned in chapter 2, the underlying premise of self interest can also be applied to anyone having power to make decisions involving another person's property or resources, including boards. Consequently, the indication that directors are concerned with doing good is more reminiscent of the premises underpinning the alternative theories of corporate governance, most particularly stewardship theory (that a director (or manager) should look after or marshal and manage the resources of the firm for the long-term benefit of all interested parties (Davis, Schoorman and Donaldson, 1997; Mason et.al, 2007; Muth and Donaldson, 1998)) and stakeholder theory (that the director (or manager) must consider the needs and worth of a range of stakeholders, not just shareholders in the interests of sustaining long-term value (George, 2010; Bhimani, 2008). Also, arguably, if it was assumed by those accepting directorships that doing good was the most important and fundamental controlling principle for their decisions and acts (Alces, 2008; Mason et. Al. 2007; Wallis, 1997), new institutional

theory would serve as a clear theoretical framework in which to evaluate and assess this aspect of governance.

Indicatively, the interviewees for District Health Board appointments (refer to 5.5.3) to a large extent ignored their legal and clearly stated duty to be accountable only to the Minister of Health of New Zealand and during their interviews declared that they believed their duty lies in working towards the best community outcomes (76%), rather than to work as per the wishes of the Minister/sole shareholder (24%). Although it is clearly a desirable outcome for District Health Boards to achieve positive health outcomes for their respective communities, these organizations must stay within their budgets and prioritise care based on the economic reality of their capped funding, rising costs, longer life expectancy and greater health care demands. In this environment it would be excusable to see director candidates confuse their accountabilities, but even when advised that their duty is only to the shareholder, many were clearly surprised and uncomfortable with that notion.

Similar sentiments were expressed by more than 60% of the survey respondents completing narrative comments or when interviewed after they submitted their survey. By way of indication, the following table (6.2.1 T3) shows little difference between the relevant 2006-9 results and the verification survey carried out in 2010. While the proportion of respondents differs in level between the 2006-2009 population and the verification population, this difference is not significant in terms of our hypothesis. It appears clear that aspiring directors are either (a) ignorant of their exclusive legal duties of agents of shareholders, or (b) have created their own world of accountability in which shareholders feature, but not to the exclusion of all other considerations.

Table 6.2.1. T3: H1 sub-hypotheses, pooled. Contrasted for the two datasets

Q1	Q2	2006-2009 Population						Verification Population, 2010					
		N	YES (%)		MH	p	Q1>Q2	N	YES (%)		MH	p	Q1>(
			Q1	Q2					Q1	Q2			
ImpGood	ImpFee	897	46.6	21.2	136.3	0	YES	51	79.8	7.0	54.3	0	YE:
ImpGood	ImpPrestige	897	46.6	26.7	93	0	YES	51	79.8	11.0	48.1	0	YE:
ImpGood	ImpPublic	897	46.6	15.1	265.7	0	YES	51	79.8	9.0	51.1	0	YE:
ImpGood	ImpKnown	897	46.6	19.0	176.9	0	YES	51	79.8	20.6	35.8	0	YE:

The question connected to this table is: "If you were offered a Board position now, how important would each of the following factors be for you?", with the answer choices being:

"ImpFee" = Fees and Benefits to the Directors

"ImpPrestige" = Status/Prestige of the Organization

"ImpPublic" = Whether the Company's Shares are Publicly Traded

"ImpKnown" = Becoming Known/Networking

6.2.2 H2 = Independent directors are considered to contribute positively to the board.

Questions exploring this issue were introduced to the survey in 2009 (specifically as indicated in table 6.2.2 T1). Therefore, it is not possible to pool results across years. It should also be noted that respondents were asked to answer these questions only where they had had some experience of independent directors. It should also be noted that directors only were asked for responses on this aspect of the survey.

Table 6.2.2 T1: Relevant questions from 2009 survey

Question		Short
Based on your experience, how would you rate the NON-EXECUTIVE/INDEPENDENT Directors' contribution:		
51	Their contribution to the performance of the organization	IndPerform
52	The quality of their contribution during board meetings	IndMtg
53	Their ability to assist with networking	IndNetw
54	Their ability to provide strategic vision	IndStrategy
55	Creating a sustainable enterprise	IndSust
56	Their understanding of governance issues	IndGov
57	Their understanding of the organization's business	IndBus

As indicated in table 6.2.2 T2, a large majority of the 55 or so respondents answering the questions considered that independent directors contribute positively over a range of attributes, including networking, strategic vision and sustainability.

Table 6.2.2 T2: H2 Outcome: Pooled

	Q1	N	YES (%)	MH	p	Q1>50
Pooled	IndPerform	57	95.7	30.2	0	YES
	IndMtg	55	93.8	26.1	0	YES
	InpNetw	55	84.8	15.2	0	YES
	IndStrategy	55	86.6	17.1	0	YES
	IndSust	55	95.5	28.9	0	YES
	IndGov	54	97.3	31.4	0	YES
	IndBus	55	93.8	26.1	0	YES

There was no difference in wording for pooled answer sets.

The answer choices were:
"IndPerform": Their contribution to the performance of the organization
"IndMtg": The quality of their contribution during board meetings
"Ind(p)Netw": Their ability to assist with networking
"IndStrategy": Their ability to provide strategic vision
"IndSust": Creating a sustainable enterprise
"IndGov": Their understanding of governance issues
"IndBus": Their understanding of the organization's business

There therefore appears little doubt among directors that independent directors contribute positively to the board, a finding supported by the verification survey conducted in 2010 (see table 6.2.2 T3)

Table 6.2.2 T3: H2 Oucome: Pooled for contrasting datasets.

Q1	2006-2009 Population					Verification Population, 2010				
	N	YES (%)	MH	p	Q1>50	N	YES (%)	MH	p	Q1>50
IndPerform	57	95.7	30.2	0	YES	44	94.4	21.9	0	YES
IndMtg	55	93.8	26.1	0	YES	44	94.4	21.9	0	YES
InpNetw	55	84.8	15.2	0	YES	44	90.0	17	0	YES
IndStrategy	55	86.6	17.1	0	YES	44	92.2	19.3	0	YES
IndSust	55	95.5	28.9	0	YES	44	92.2	19.3	0	YES
IndGov	54	97.3	31.4	0	YES	44	94.4	21.9	0	YES
IndBus	55	93.8	26.1	0	YES	44	98.9	28	0	YES

The question connected to this table is: "Based on your experience, how would you rate the NON-EXECUTIVE/INDEPENDENT Directors' contribution? (Skip this if you have not experienced independent directors in action)". See the full question text on the preceding page.

Such an overall appreciation for the contribution of independent directors should be good news for shareholders, owner/operators or senior managers of fims in New Zealand, including SMEs, who have not yet found a compelling reason to add independent directors into the governance structure of their firms. As I know from the questions pertinent to H1 (above) that independent directors are not majorly focused on directorship fees, there is thus likely to be an opportunity to recruit independent directors even where the offered fees are low.

Overall, I consider that hypothesis two is supported : Independent directors are considered by their fellow directors to contribute positively to the board.

When location is taken into account (determined by mapping the source of the returned questionnaires) it appears that the hypothesis remains supported for companies in the North Island of New Zealand
Interactions with Gender (Table 6 in the appendix to this chapter), fall below our significance response cutoff of 40, but are included for reference as the outcomes have some level of response and support the pooled outcome. However, interactions for Age and Industry show quite low individual response levels and are omitted.

All these positive results seem to support the message that the presence of independent directors on the board is desired by existing members for a wide variety of reasons, not only because statutes (such as *Sarbanes-Oxley*) and codes/listing rules increasingly demand it but because they provide benefits to the organization in and of themselves due to their delinking from insiders (Fama and Jensen, 1983; OECD, 1999 and 2004; Ryan and Wiggins, 2004), a breadth of expertise and experience (Fama and Jensen, 1983; Hill, 1995; Peterson and Philpot, 2007; Ruigrok, Peck, Tacheva, Greve and Hu, 2006) and their ability and preparedness to look beyond a close profit horizon (Epstein and Roy, 2005) ,

However, these findings do not tell the whole story. Since shareholders and directors interact differently with independent directors, it is also important to establish whether their presence is valued differently by these two groups. It is doubly important to identify such differences in light of the agency theory assumption that directors represent the interests of shareholders and independent directors do better than insiders in such a role (Bhagat and Black, 2002; Donaldson and Davis, 1991; Jensen and Meckling, 1976; Fama and Jensen, 1983; Borokhovich, Parrino and Trapani, 1996). The potential for such differences was explored through hypothesis 3.

6.2.3 H3: Director contributions are not seen to be equally important by directors and shareholders

Table 6.2.3 T1 portrays the results of two of the relevant questions, where the analysis indicates that it is supported – director contributions are not seen to be equally important by directors and shareholders. It should be noted that the shareholder respondents considered it more desirable than did director respondents that an director have a record of business management. This is understandable: one of the primary roles for the board is to safeguard the shareholder's investment and to increase the value of the firm (see, for example, Bhimani, 2008 and George, 2010 as well as the advocates for the application of stewardship and institutional theories in this context).

Table 6.2.3 T1: H3 Outcome: Pooled

	Q1	Q2	N	YES (%)		MH	p	Q1≠Q2
				Q1	Q2			
POOLED	ContGbl	ShrGbl	856	57.9	32.2	99.5	0	NO
	ContRecord	ShrRecord	1177	48.4	77.6	151.2	0	NO

The question connected to this table is: "In your observation of organizations in this country, boards need Directors that contribute:"

For pooled data sets no difference in wording existed between data sets.

The question text was:
"ContGbl": International Experience
"ContRecord": Track record of having run a successful business

These results further indicate that shareholders value the global experience of directors to a slightly lesser extent than directors do, likely because they do not have first-hand experience of the contribution of individual directors with such expertise to board meetings.

Additional insight on such diversity of perceived value can be obtained when industry type, location and gender are taken into account (see Table 6.2.3 T2)

(below). Although most cross-tabulations supported the "supported" finding, in four instances – health, non-profits, professional services and telecommunications, it did not. This result may well be explicable given the predominance of SMEs or the equivalent largely volunteer-run non-profit organisations in these areas (Carree, van Stel, Thurick and Wennekers, 2002; Clark et. al, 2010; OECD, 2000; Steane and Christie, 2001).

Table 6.2.3 T2: H3 Outcome: Pooled and interaction summary

Test stratum	**Premise**
Pooled	**Supported**
Female	Supported
Male	Supported
North Island	Supported
South Island	Supported
<=35 yr	Supported
36-45 yr	Supported
46-55 yr	Supported
56-65 yr	Supported
>65 yr	Supported
FINANCE/BANKING/INSURANCE	Supported
HEALTH	Not Supported
MANUFACTURING/PROCESSING	Supported
NON-PROFITS	Not Supported
PRIMARY SECTOR (AGRIBUSINESS, FARMING ETC.)	Supported
PROFESSIONAL SERVICES	Note Supported
RESEARCH/SCIENCE	Supported
RETAIL/WHOLESALE	Supported
TELECOMMUNICATIONS/TECHNOLOGY/MEDIA	Not Supported

The issues of accountability stemming from such a lack of understanding is recognised: in the follow-up interviews to the survey, the particular issue of independent directors was explored. A high 84.9% of shareholders, senior managers and directors indicated that a new idirector should have the ability to effectively communicate with shareholders. For SMEs in particular, this requirement appears at odds with the simple and short communication pathways

that should exist in a smaller firm. Shareholders, however, reported that they do not believe they are receiving timely and clearly understandable information.

From the comments supplied by shareholder respondents, they do not seem to have major concerns that the directors are incompetent or do not work in the best interests of the firm, but there is an uncertainty whether shareholders receive information of all of the discussions that occur during board meetings or just a carefully edited, sanitised version of the events. In addition, shareholders consider that the information they receive is late, several weeks after a board meeting (presumably after the minutes have been drafted, edited and produced), and devoid of the detail information they apparently wish to better understand why the boards are making the decisions they do.Not in all cases is even this information presented in a format easily understood by shareholders.

Of relevance to this point, it was noted by several directors during the interview sessions that, mainly for legal reasons, board minutes tend to be quite short and cryptic, mainly recording decisions made, but largely devoid of any indication of discussion and reflection.

Given the push in an ever-increasing range of jurisdictions for independent directors, largely to further the interests and rights of shareholders, it would seem appropriate that shareholders be better linked to governance activities. After all, directors are ultimately responsible to shareholders for the firm's welfare and for the accuracy and completeness of investment-relevant information – that is what they are there for (Bartholemeusz, 2002; Colley, Stettinius, Doyle and Logan, 2005; OECD, 2004). Perhaps one way of achieving this would be via a more transparent and inclusive feedback and communication process between board and shareholders.

6.2.4 H4 - Directors consider themselves more than 'average' competent in all aspects of contributing to a board.

When directors were asked how they would rank themselves and other directors on boards of New Zealand firms in terms of competence, they tended to award 'above average' ratings in overall competence in several categories offered as choices. Even in an anonymous submission process this would be expected and therefore offers little in the way of new or revealing details.

Thus the more important information from this question set is in which sub-categories of governance skills do directors believe they excel and in which ones do they not. The pooled outcome (Table 6.2.4 T1) shows that overall directors consider themselves as better than average competence for all aspects identifed, and so this research concludes that H4 is supported for the pooled case although in interpreting these results it should be noted that the proportion of respondents differs significantly in level between the 2006-2009 population for several sub-hypotheses.

Table 6.2.4 T1: H4 Outcome: Pooled

	Q1	N	YES (%)	MH	p	Q1 > null
POOLED	CmpStrategy	708	58.6	10.6	0	YES
	CmpLegal	705	56.6	6.2	0	YES
	CmpLead	772	70.9	70.2	0	YES
	CmpCommit	709	83.5	179	0	YES
	CmpTeam	769	65.9	40	0	YES

The question connected to this table is: "How would you describe the overall competence of the Board (not just your own individual competence) in these areas?"

The question text was: "How would you describe the overall competence of the Board (not just your own individual competence) in these areas?"

"CmpStrategy": Corporate strategy and the principles of risk/strategic change
"CmpLegal": Legal, regulatory and corporate governance and the responsibilities of directors
"CmpLead": Leadership qualities, commanding respect of others, displaying judgment and courage

"CmpCommit": Commitment, to the business and to shareholders
"CmpTeam": Team player abilities, listening and influencing skills and awareness of own strengths and weaknesses

The surprising result is that the only skills category in which directors rank themselves and their peers as 'excellent' more frequently than for any other category is, by a wide margin, "Commitment" (49.9%). In cases such as leadership (24.1%), strategic planning (14.7%), legal/auditing (17.4%), and team performance abilities (19.1%), the directors rank themselves significantly lower. Of all of the categories offered, 'commitment' would be the softest one in terms of not representing a skill that needs training and learning but is more attitudinal and thus 'easier' to achieve.

Regardless of whether the respondents have indicated that their absolute competence levels are low, or that there is a need to raise the competence levels from the current levels, the important function here is the relative differential between "Commitment" and specific skills commonly associated with governance and leadership. The consensus here is clearly that there is a differential in skills, and if there were indeed this giant sucking sound of new incoming independent directors in New Zealand SMEs, skills building will need to be part of the process to embed those directors into their new board rooms with a reasonable chance to perform their governance jobs satisfactorily.

Cross-tabulation of these results with Gender, Location, Age and Industry reveal a less than overwhelmingly positive picture of self and fellow-assessment of competence. These details are summarised in Table 6.2.4 T2.(Mantel-Haerszel static outcomes are only shown for those interactions with sufficient response levels to meet our cutoff criterion). H4 is shown to be supported for Males; North Island; Age 56-65; and some industry groups but, more significantly, not supported for female director respondents, directors of companies located in the South Island, those directors younger than 55 and in industry groups traditionally prominent in the New Zealand economic landscape.

Table 6.2.4 T4: H4 Outcome: Pooled and interaction summary

Test stratum	Premise
Pooled	**Supported**
Female	Not Supported
Male	Supported
North Island	Supported
South Island	Not Supported
<=35 yr	Not Supported
36-45 yr	Not Supported
46-55 yr	Not Supported
56-65 yr	Supported
>65 yr	Not Supported
ENERGY/UTILITY/INFRASTRUCTURE	Not Supported
FINANCE, BANKING, INS	Not Supported
HEALTH	Not Supported
MANUF, PROC	Supported
NON-PROFITS	Not Supported
NZ LOTTERIES COMMISSION	Supported
PRIMARY SECTOR (AGRIBUS, FARMING ETC.)	Not Supported
PROF SERVICES	Supported
RESEARCH, SCIENCE	Not Supported
RETAIL, WHOLESALE	Not Supported
TELECOMM, TECH, MEDIA	Supported

6.2.5 H5 - Directors report that their level of 'commitment' exceeds their level of competence in other areas.

The prominent ranking granted "commitment" as identified above in relation to H4 is further borne out by when hypothesis 5 was tested using the same data. The pooled results from the two data sets (as presented in table 6.2.5 T1, below) indicate that for both, directors ranked themselves higher on commitment (CmpCommit) than on any of the other aspects of contribution (these being leadership, strategy, professional support, or team-building). This finding is further supported by analysis of the verification dataset.

Table 6.2.5.T1: H5 sub-hypotheses, pooled. Contrasted for the two datasets

Q1	Q2	2006-2009 Population						Verification Population, 2010					
		N	YES (%)		MH	p	Q1 > Q2	N	YES (%)		MH	p	Q1 > Q2
			Q1	Q2					Q1	Q2			
Cmp Commit	Cmp Strategy	709	83.5	58.6	106.6	0	YES	51	87.5	42.2	23.1	0	YES
Cmp Commit	Cmp Legal	709	83.5	56.6	121.9	0	YES	51	87.5	55.9	12.6	0	YES
Cmp Commit	Cmp Lead	709	83.5	70.9	33.2	0	YES	51	87.5	71.6	4	0	YES
Cmp Commit	Cmp Team	709	83.5	65.9	59.7	0	YES	51	87.5	63.7	7.8	0	YES

The question connected to this table is: "How would you describe the overall competence of the Board (not just your own individual competence) in these areas?"

"CmpStrategy": Corporate strategy and the principles of risk/strategic change
"CmpLead": Leadership qualities, commanding respect of others, displaying judgment and courage
"CmpCommit": Commitment, to the business and to shareholders
"CmpTeam": Team player abilities, listening and influencing skills and awareness of own strengths and weaknesses

Such ranking of personal commitment, a 'soft' skill not requiring training and learning but more attitudinal and thus 'easier' to achieve higher than the 'hard core' skills raises questions as to the value New Zealand directors can add to the board and to the company. In this, the concept of 'board capital' coined by Hillman and Dalziel (2003) is important as it implies that a wide range of skills, including business competence and expertise, along with strategic planning and vision all go to assist the board in improving company performance.

The fact directors rank themselves mainly 'good' and 'sufficient' on those skills should therefore be disappointing for shareholders who entrust the long-range visionary leadership to their directors and rely upon them to maximize performance. By implication, either these directors were of a superior skill set when they started and have now gone stale, or they never had the prerequisite skills to perform to the standard of 'excellent' to start with. If governance is a performance area that has begun to move into the position of center stage when firms are evaluated and responsibility is attributed for failures, then it would be expected that directors have a broad skill set that matches up well with the increasingly challenging governance environment.

6.2.6 H6 - Shareholders and directors consider a new director's experience to be more important as a contribution than age or diversity

Much is said in the media of the apparent lack of diversity in New Zealand board rooms (for example, McGregor and Fountaine, 2006), and while diversity goes further than gender, it is the lack of women in governance positions that attracts the most attention. Without doubt, an 8% participation of women in governance roles in publicly listed firms is appalling for a country that prides itself of having been the first in the world to grant women the right to vote, and where not too long ago all key roles in government were held by women (Prime Minister Helen Clark with a previous Prime Minister being Jenny Shipley, Speaker of the House Margaret Wilson, Governor General Sylvia Cartright, Chief Justice Sian Elias).

However, board diversity more generally has been raised and explored for a range of national contexts (for example, Burton,1991; Cortese and Bowrey, 2008; Minichilli, Zattoni and Zona, 2009; Pass, 2004; Pearce and Zahra, 1992; Spencer Stuart, 2009; Tyson 2003; van der Walt and Ingley, 2003); research focusing on factors of age, race and background in addition to gender. This research explores whether shareholders and directors believe diversity is of greater importance than work experience.

Consequently, shareholders, directors and senior managers were offered the opportunity to select what attributes of an incoming director would be most valuable in terms of contributing to the boardroom. These attributes included age/gender as aspects of diversity (see question 37 in app C). However, given that diversity means different things to different people, and diversity is certainly not seen as important to all (see the discussion in chapter 5 in particular) the decision was made in this research not to be too specific on defining all aspects of diversity. This does offer avenues for further research.

These results were then analysed in light of the value given to other attributes such as experience in the industry (ContWithin), experience more generally (ContOut) and international experience (ContGbl).The results of analysis of the answers to the relevant questions are provided in table 6.2.6 T1 (below).

Table 6.2.6 T1: H6 Outcome: Pooled

	Q1	Q2	N	YES (%)		MH	p	Q1<Q2
				Q1	Q2			
	ContDiv	ContWithin	758	51.8	73.3	84.6	0	YES
POOLED	ContDiv	ContOut	758	51.8	66.1	35.8	0	YES
	ContDiv	ContGbl	758	51.8	57.9	6	0	YES

The question connected to this table is: "In your observation of organizations in this country, boards need Directors that contribute:"

For pooled data sets no difference in wording existed between the data sets.

The question text was:

"ContDiv" = Diversity
"ContWithin" = Work experience within the industry
"ContOut" = Work experience outside the industry
"ContGbl" = International Experience

The pooled outcome shows H6 holds for each sub-hypothesis, and so this research concludes that hypothesis 6 is supported – that directors consider a new director's

experience to be more important than the contribution to gender or age diversity. More specifically, the pooled result indicates that diversity in the boardroom is not considered as important as experience-based contribution. This result is not necessarily a pleasing one for those who had hoped that there is a growing demand and expectation for age and gender diversity among New Zealand boards. However, a closer analysis indicates that the picture is not consistent (see table 6.2.6 T2).

Table 6.2.6 T2: H6 Outcome: Pooled and interaction summary

Test stratum	N	Premise
Pooled	**758**	**Supported**
Female	121	Not Supported
Male	631	Supported
North Island	396	Supported
South Island	162	Not Supported
<=35 yr	42	Not Supported
36-45 yr	158	Not Supported
46-55 yr	281	Supported
56-65 yr	221	Supported
>65 yr	52	Not Supported
FINANCE/BANKING/INSURANCE	79	Supported
MANUFACTURING/PROCESSING	95	Supported
NON-PROFITS	48	Not Supported
PRIMARY SECTOR (AGRIBUSINESS, FARMING ETC.)	48	Not Supported
PROFESSIONAL SERVICES	73	Not Supported
RETAIL/WHOLESALE	55	Not Supported
TELECOMMUNICATIONS/TECHNOLOGY/MEDIA	46	Not Supported

I can dispose of the matter of age and gender quite easily: Overall, gender diversity was more likely to be selected as important than was age. However, it is interesting to note that although women tended to rank diversity as more important than did males, they did not focus on gender diversity. Gender is discussed elsewhere (see,for example, 6.1.1).

There is some indication that the average age of 52 for New Zealand directors might be high for some, but no strong preference was expressed for any specific age band. During the interview sessions with younger (<40) senior managers and owner/operators it became quickly evident that these individuals not infrequently preferred director candidates who were at least 15 years older than themselves, to balance a board of much younger people. There generally was no expression of desire that directors be younger than the ones currently seen in boardrooms in New Zealand.

On one hand, this deals a blow to those who believe company directors in New Zealand are an ageing group of individuals (predominantly males), but on the other hand, it does also suggest that there is no particular preference for any specific age group, thus allowing access to the board roles to people irrespective of age.

When industry sector is taken into account, it appears that only in two of these (finance and banking and manufacturing and processing) are contributions other than diversity ranked more highly. This is interesting in that it tends to suggest that in a range of situations and industrial contexts, diversity is becoming more valued, either because of the representative/stakeholder connectivity flavour it provides (Bebchuk, 2007; Krohe, 2000, 2004; Peterson and Philpot, 2009 Ray, 2005) or because those from a range of backgrounds are increasingly seen to contribute value to those boards as argued by Bilmoria and Piderit, 1994; Burgess and Tharenou, 2000; Burke, 2000; Campbell and Vera, 2010; Carver, 2002; Daily and Dalton, 2003 and van der Walt and Ingley, 2003 amongst others.

When the results of the 2006-9 surveys are pooled and compared to those obtained in the 2010 survey (see table 6.2.6,T3 below) , it was found that for various of the subhypotheses that not all results from the 2010 survey supported the hypothesis. Indicatively, perhaps, is the finding from the 2010 survey that while 55% considered diversity important (as compared to 52% from the national surveys), a much greater 74% indicated that external experience was important.

This indicates, possibly as a sobering thought for those who believe that a change/upgrade in our governance diversity is absolutely required, that a diversity change will likely only occur when the proposed new directors have experiences and skills commensurate with what the market wants. The relative indifference to diversity changes for the sake of diversity changes, and the focus on transferable skills and experiences, would leave our lamentable lack of diversity unchanged, unless we could offer fresh director candidates meeting not one but bothcriteria. This points, similar to the discussion in H4, to the need for an upskilling and training regime without which it is unlikely that changes in board compositions will occur any time soon.

Overall, it was concluded that this hypothesis is not supported by this population. Without further research establishing a reason for this variation is speculative only: however, one explanation may be the increasing attention over time to the importance of diversity in the boardroom along with the increased importance in listing rules (NZX, 2007), recommendations (NZSC, 2004) and the media on independent directors.

Table 6.2.6.T3: H6 sub-hypotheses, pooled. Contrasted for the two datasets

Q1	Q2	2006-2009 Population						Verification Population, 2010					
		N	YES (%)		MH	p	Q1 < Q2	N	YES (%)		MH	p	Q1 < Q2
			Q1	Q2					Q1	Q2			
ContDiv	ContWithin	758	51.8	73.3	84.6	0	YES	51	54.8	56.7	0	0.969	NO
ContDiv	ContOut	758	51.8	66.1	35.8	0	YES	51	54.8	74.0	4.2	0	YES
ContDiv	ContGbl	758	51.8	57.9	6	0	YES	51	54.8	20.2	13.2	0	NO

The question connected to this table is: “In your observation of organizations in this country, boards need Directors that contribute:”

For pooled data sets no difference in wording existed between the data sets.

The question text was:

“ContDiv” = Diversity
“ContWithin” = Work experience within the industry
“ContOut” = Work experience outside the industry
“ContGbl” = International Experience

6.2.7 H7: Work experience is preferred over formal qualifications, for new independent directors.

As indicated by the results reported in table 6.2.7 T1, the majority of respondents considered it important that directors have experience in and out of the particular industry (ContWithin and ContOut respectively) and internationally (contGbl) and such experience outranks formal qualifications such as legal, accounting and others Because all the subhypotheses hold for the pooled results I conclude that H7 is supported – directors value work experience above formal qualifications for new directors. Although these questions did not directly address independent directors, it is fair to argue that independent directors may well have a diversity of experience that contributes positively to the board.

The question is, what is and indeed should be that experience? Research by Fama and Jensen, 1983; Kolasinski, 2009 and, Wallison 2006, assume or find that independent directors will be experienced in business (in line with the findings in this instance) although there are others such as Agrawal and Knoeber (2001), Cunningham (2010), Spencer Stuart (2009) and Women on Boards (2006) who argue that companies may have quite different purposes in mind when identifying potential independent directors (including increasing diversity although not necessarily).

Table 6.2.7 T1: H7 Outcome: Pooled

	Q1	Q2	N	YES (%)		MH	p	Q1<Q2
				Q1	Q2			
	ContLaw	ContWithin	931	50.5	73.3	104.7	0	YES
POOLED	ContLaw	ContOut	931	50.5	66.1	47.4	0	YES
	ContLaw	ContGbl	931	50.5	57.9	10	0	YES

The question connected to this table is: "In your observation of organizations in this country, boards need Directors that contribute:"

The question text was:

"ContLaw" = Professional Skills (Lawyers, Business Consultants, Accountants, etc.)
"ContWithin" = Work experience within the industry
"ContOut" = Work experience outside the industry
"ContGbl" = International Experience

When these results are considered in light of gender, age, location and industry group, variations emerge (see table 6.2.7 T2 (below).

Table 6.2.7 T2: H7 Outcome: Pooled and interaction summary

Test stratum	N	Premise
Pooled	**931**	**Supported**
Female	143	Not Supported
Male	776	Supported
North Island	492	Supported
South Island	191	Not Supported
<=35 yr	43	Not Supported
36-45 yr	185	Not Supported
46-55 yr	358	Supported
56-65 yr	267	Supported
>65 yr	73	Not Supported
ENERGY/UTILITY/INFRASTRUCTURE	39	Not Supported
FINANCE/BANKING/INSURANCE	79	Supported
HEALTH	42	Not Supported
MANUFACTURING/PROCESSING	112	Supported
NON-PROFITS	58	Not Supported
PRIMARY SECTOR (AGRIBUSINESS, FARMING ETC.)	57	Not Supported
PROFESSIONAL SERVICES	94	Supported
RETAIL/WHOLESALE	73	Not Supported
TELECOMMUNICATIONS/TECH/MEDIA	55	Supported

Predictably perhaps, the hypothesis is not supported for females but is for males – perhaps this is indicative of the fact that women are only just now entering the higher echelons of management, and are often there because of university qualifications and a functional qualification rather than because of long experience. Indicatively, research findings point to boards preferring those with immediately and directly useful attributes (Peterson and Philpot, 2009, Spencer Stuart 2009) while others point to women directors as being much younger than the average (Cortese and Bowrey, 2008). Men, on the other hand may have traditionally been selected due to their connections (Nwabueze and Mileski, 2008) and to fit the profile and team fit expected by existing members (Claringbould and Knoppers, 2007; Higgs, 2003; Huse, 2007; McCabe and Nowak, 2008).

In addition, for companies in the South Island and respondents in every age group bar the two middle ones (46-65) the hypothesis was unsupported. Without further research it is speculative to reflect on reasons for these results: it would appear that one of the possible explanations - that companies whose head office is located in the South tend to be in industries that are dominated by smaller firms where education and qualifications could be considered important (such as technology and professional services) - is unlikely given that for both of those sectors the hypothesis is supported. Finally, those two business sectors with significant levels of unskilled or semi-skilled workers (retail and agriculture) reflect results against the overall trend. Only in the case of non-profits would it appear that formal qualifications are ranked above experience – a result that may reflect the nature of people who seek election onto such boards and the nature of the NPO board as a resource (in accordance with resource dependency theory (see, for example, Pfeffer,1972; Pfeffer and Salancik,1978 and Christopher, 2010 but also the issues associated with failure to utilise properly outlined by Taylor, et. al, 1996) and stewardship, (Davis, Schoorman and Donaldson,1997)).

The proportion of respondents differs significantly in level between the 2006-2009 and the verification populations for each sub-hypothesis. Indeed, for two sub-

hypotheses the outcome in the 2010 survey (see table 6.2.7 T3 for details and comparison) is against the trend in the 2006-9 and cannot be taken to support the hypothesis. Formal qualifications (ContLaw) are preferred over experience within the industry (ContWithin, MH=4.3, p<0.001) or globally (ContGbl, MH=32.1, p<0.001), while there is no significant difference in preference for experience outside the industry compared to formal qualifications (ContOut, MH=0.1, p=0.959). Again, without further research it is difficult to arrive at a clear conclusion for this variance: it could be a function of the population questioned or accelerating change in attitudes towards what constitutes the desirable director. However, some information of value was obtained.

Table 6.2.7 T3: H7 sub-hypotheses, pooled. Contrasted for the two datasets

Q1	Q2	2006-2009 Population						Verification Population, 2010					
		N	YES (%)		MH	p	Q1< Q2	N	YES (%)		MH	p	Q1< Q2
			Q1	Q2					Q1	Q2			
Cont Law	Cont Within	931	50.5	73.3	104.7	0	YES	51	76.0	56.7	4.3	0	NO
Cont Law	Cont Out	931	50.5	66.1	47.4	0	YES	51	76.0	74.0	0.1	0.959	NO
Cont Law	Cont Gbl	931	50.5	57.9	10	0	YES	51	76.0	20.2	32.1	0	NO

The question connected to this table is: “In your observation of organizations in this country, boards need Directors that contribute:”

The question text was:

“ContLaw” = Professional Skills (Lawyers, Business Consultants, Accountants, etc.)
“ContWithin” = Work experience within the industry
“ContOut” = Work experience outside the industry
“ContGbl” = International Experience

Immediately apparent in this 2010 survey are what are not considered desirable attributes for new independent directors. These include holding multiple

directorships, being an employee of the firm, and holding a directorship-training certificate.

Multiple Directorships

Being a director can be a part-time or full-time profession for individuals, who then seek multiple directorship mandates and thus practice governance simultaneously for several firms. On the positive side, holding multiple directorships might indicate that the person has developed better-than-average skills in the area of governance and is appreciated for the contribution to boards by several other firms (Ferris, Jagannathan and Pritchard 2003; Pass, 2004 and 2008; Spencer Stuart 2009). This might lessen the risk for a firm to recruit an under-qualified director. A 'professional director' might also gain current knowledge about governance issues in some firms that might be applied to the governance at other firms, thus possibly contributing to an effective transfer of knowledge. And, lastly, a professional director might have directorship mandates in firms in similar/related fields and thus might be able to contribute specific knowledge of value, subject to conflict situations.

However, all this does not seem to constitute valid arguments for shareholders, senior managers and directors in their search for new directors. Only 2.5% believe it is important that a new director holds multiple directorships, while 67% believe it is not important.

Following on from individual discussions with directors and owner/operators it seems clear that professional directors are not perceived to have current practical management/leadership experience and thus are suspected of not to be able to contribute in those areas. There also appears to be some sense of mistrust as to the commitment a director has to each board if he/she sits on many boards at the same time. This is of particular importance in the context of independent directors

as such directors are more likely to have a number of appointments than is an insider who has more day to day involvement in the company.

A Director as an Employee of the Firm

No doubt much to the relief of those pushing for more independent directors on boards, 74.1% of shareholders, senior managers and directors do not wish a new director to be an employee of the firm (which would make that director non-independent). Whether there is the awareness that the status of being an independent director precludes employment at the firm, or whether there are other motivations at work, clearly employees are not seen as adding much value to the board.

In the follow-on discussions with directors and owner/operators they clearly expressed an appreciation of the 'independent' status of directors and also opined that employees would not meet this requirement. This allows the cautious conclusion that there is a value perceived as associated with independence, a finding in line with that found in other research (such as McCabe and Nowak, 2008) and that appears to contradict the argument that outsiders could not contribute as directors due to lack of specific firm knowledge (Brody, 1996; De Andres-Alonso, et. al, 2009, Pati, 2007).

Having a Director Training Certificate

Slightly more than half of the respondents (52.3%) believed holding a Qualified Director certificate was important (offered in New Zealand by Directions – Understanding Governance Ltd, private provider with a roster of corporate leaders as presenters), while only 48.4% thought the same for a certificate from the Institute of Directors. For neither institution is this a sign of endorsement by the market, and it appears that no great value is placed on the completion of a

directorship-training course. As such, this finding appears to be inconsistent with the recommendations of the OECD (2004) and the findings of Spencer Stuart (2006) that such training programs are appropriate.

In conjunction with the above findings of less-than-excellent skills of directors, this situation should sound alarms among educators, regulators and corporate leaders. If the current training regimes are not appreciated as being important, then either there is a lack of knowledge of the director skills gaps (not knowing what one doesn't know…), or there is a lack of appreciation for the learning a participant can take away from these training events.

What do shareholders, senior managers and directors look for in new directors? Respondents to the 2010 survey are strongly in agreement with their desire to select a director with a good reputation, one who can form and defend their own opinions, have a track record of success in business, and have company-specific market knowledge and experience. To a lesser degree, such directors should have global business experience and be able to communicate effectively with shareholders. These desirable characteristics and talents are discussed in more detail below.

Good Reputation

Nearly 70% of respondents consider the reputation of directors to be very important, and more than 27% consider it somewhat important, making this the single most important attribute for directors, a finding in line with D'Aveni's (1990) research in relation to executives. It is not clear what exactly 'reputation' means, but the in-depth discussions with directors identified several areas included in this definition: (a) Absence of public failures such as bankruptcies, criminal/civil prosecutions and other scandals; (b) 'being known' in the industry specific to each firm, and (c) being held in high regard by the current directors (Ruigrok, et. al, 2006).

Strong Opinions

67.7% of respondent consider it 'Very Important' (and a further 28.2% find it 'Somewhat Important') that a director can form opinions and then defend them vigorously during a board debate. This outcome seems to indicate the true value given to directors, and suggests a belief by the respondents that such a vigorous debate does not currently exist on boards (see Le Blanc and Gillies, 2005 for support of this view in another context).

In the follow-up interviews, several directors made clear that they believed the current boards were 'closed systems' where sitting directors were mutually dependent on each other's goodwill for re-elections and an 'easy life', a finding that seems to reflect the view of . Van den Berghe and Baelden (2005) and that of Zablocki, (2007) in relation to selection processes. If the purpose of an director (particularly one deemed independent) is to bring an impartial/independent view of corporate affairs to the board, then the ability to make and defend controversial viewpoints flows naturally from this.

Industry Knowledge

95.4% of respondents want directors with industry-specific knowledge presumably so that they can overcome the lack of insider knowledge at the firm with transferable relevant skills and knowledge from the outside (Fama and Jensen, 1983; Ingley and McCaffrey, 2007; Peterson and Philpot, 2007).

Global Experience

85.4% of respondents consider it somewhat or very important for a new director to have global business experience. With New Zealand being dependent on foreign direct investment and exports, to create a trade balance surplus, the connection to

a business world beyond New Zealand is important for competitiveness, growth and sustainability. In the in-depth interviews, many business owner/operators of SMEs expressed concern over their lack of knowledge to take their business onto the global scene. There are concerns over the cost and risk of an expansion, uncertainty over the appropriate methods of market entry overseas, fears to not understand the cultural needs of those markets and the beliefs that expansion beyond New Zealand is "too hard".

Arguably, such a concern also embraces the whole gamut of environmental factors with which business must increasingly contend, and which appears to reflect the view of the New Zealand Securities Commission (2004) as portrayed in its guide to corporate governance. Of additional relevance are the arguments put up by Toddi (2001) and Gelb and Strawser (2001) and advocates of the resource dependency theory that in the interests of long-term performance and sustainability, firms looking to appoint independent directors should look to those with that broader experience.

Interestingly, when interviewees were asked whether it would be attractive to them were they offered the opportunity to have a director on the board with such broader knowledge, considerable interest was expressed.

When asked why they would not just hire a business consultant for the same kind of expert advice, the owner/operators expressed concern over the reliability and commitment of a consultant to their firm (but those concerns were not voiced in the context of bringing a new director on board).

6.2.8 H8: The majority of firms surveyed intend to hire at least one new independent director in the future.

As indicated in table 6.2.8 T1 (below) the majority of firms (more than 51%) intend to hire at least one new independent director within the next 2 years. Hence it is

possible to conclude that H8 is supported. It should be noted that this question was only introduced into the survey in 2009, making any comparison with earlier years impossible.

Table 6.2.8 T1: H8 Outcome: Pooled

	Q1	N	YES (%)	MH	p	Q1>50
Pooled	DirExt	145	65.4	7.1	0	YES

The question connected to this table is: "How many new external/independent Directors will your organization likely look for in the next 5 years?"

Only limited further analysis of the responses was considered necessary (see table 6.2.8 T2) – neither gender nor age was considered relevant given that the question focused on intentions of the company. Reponses by industry group fell well below minimum levels for analysis and are omitted.

Table 6.2.8 T2: H8 Outcome: Pooled and interaction summary

Test stratum	**Premise**
Pooled	**Supported**
Location	
North Island	Supported
South Island	Not Supported
Gender: Not relevant	
Age: Not relevant	Supported
Industry: Insufficient response levels	Supported

Finally, as indicated in table 6.2.8 T3, only North Island respondents provided answers to this question.

Table 6.2.8 T3: H8 Outcome: Location

	Q1	N	YES (%)	MH	p	Q1>50
NZ NORTH ISLAND	DirExt	128	64.7	5.7	0	YES
NZ SOUTH ISLAND	DirExt					

The question connected to this table is: "How many new external/independent Directors will your organization likely look for in the next 5 years?"

Even when accounting for the fact the some senior managers or directors would consider an independent director initially for an advisory board rather than a full board position, this is important information in that these numbers, when extrapolated across the country, are astonishingly high. However, they also arguably reflect a general drive to independent directors populating boards across countries and industries as demanded by legislation (see discussion in chapter 3 more generally).

It is also apparent that there is a greater willingness among SME directors to consider independent directors as additions to their board, possibly because their contribution might be cheaper as directors than as consultants. However, the implications of this trend is refreshing: the previously quite isolated governance environment of privately-owned SMEs in New Zealand will open up to let fresh new faces into the board room. This research needs follow-up work to determine whether these SMEs have indeed extended invitations to independent directors, and how successful those engagements have been.

This result indicates the need of possibly thousands of independent directors over the next decade in New Zealand and thus raises questions as to the search mechanisms to match candidates to firms, the upskilling and skills maintenance programs for directors, and the development of mechanisms to measure the value contribution of independent directors in the assumption that some of the newly hired independent directors may be suited to their new high office.

6.3 Conclusion to Chapter 6

The table below (table 5.3 T1), summarises the findings relevant to the 8 hypotheses, in particular comparing the results obtained in 2010 with those obtained from previous surveys carried out in the period 2006-9. It indicates that although most of the hypotheses are and remain supported, some are not, including, rather surprisingly, H4, 6 and 7. Although these hypotheses were deemed supported in prevous years they are no longer so. These changes seem to

suggest the range of expectations placed on directors are considered by both them and shareholders harder to achive and maintain. In addition, the level and nature of training offered to directors is not considered sufficient or suitable.

Hypothesis		Survey data			
		2006-2009 Population		Verification Population 2010	
		N	Outcome	N	Outcome
H1	Directors are motivated by doing good rather than personal benefit.	897	Supported	51	Supported
H2	Independent Directors are considered to contribute positively to the board	54	Supported	44	Supported
H4	Directors consider themselves more than average competent in all aspects of contribution to a board.	705	Supported	50	Not supported
H5	Directors consider their level of commitment exceeds their level of competence	709	Supported	51	Supported
H7	Directors value work experience above formal qualifications for new directors	931	Supported	51	Not supported
H6	Directors and shareholders consider a new director's experience to be more important as a contribution than age or diversity	958	Supported	51	Not Supported

The final chapter (chapter 7) offers an overall summary and conclusion to this work and identifies the scope for further research.

Appendix to Chapter 6: additional tables referred to in relation to hypotheses one and two but not included in the script.

Table 1: H1 Outcome: Gender Profile

	Q1	Q2	N	YES (%)		MH	p	Q1>Q2
				Q1	Q2			
FEMALE	ImpGood	ImpFee	136	54.4	18.4	38.7	0	YES
	ImpGood	ImpPrestige	136	54.4	22.8	35.7	0	YES
	ImpGood	ImpPublic	136	54.4	14.3	61.8	0	YES
	ImpGood	ImpKnown	136	54.4	17.6	46.4	0	YES
MALE	ImpGood	ImpFee	742	45.6	21.9	99.8	0	YES
	ImpGood	ImpPrestige	742	45.6	27.8	61.5	0	YES
	ImpGood	ImpPublic	742	45.6	15.2	206.1	0	YES
	ImpGood	ImpKnown	742	45.6	19.3	133	0	YES

Table 2: H1 Outcome: Location (North or South Island)

	Q1	Q2	N	YES (%)		MH	p	Q1>Q2
				Q1	Q2			
NZ NORTH ISLAND	ImpGood	ImpFee	501	51.5	14.6	157.5	0	YES
	ImpGood	ImpPrestige	501	51.5	21.4	112.7	0	YES
	ImpGood	ImpPublic	501	51.5	11.6	217	0	YES
	ImpGood	ImpKnown	501	51.5	14.0	173.5	0	YES
NZ SOUTH ISLAND	ImpGood	ImpFee	190	45.8	24.1	21.1	0	YES
	ImpGood	ImpPrestige	190	45.8	31.3	10.2	0	YES
	ImpGood	ImpPublic	190	45.8	17.1	46.7	0	YES
	ImpGood	ImpKnown	190	45.8	19.7	33.9	0	YES

Table 3: H1 Outcome: Age profile

	Q1	Q2	N	YES (%)		MH	p	Q1>Q2
				Q1	Q2			
A. <=35 YEARS	ImpGood	ImpFee	29	55.2	15.8	11.4	0	YES
	ImpGood	ImpPrestige	29	55.2	26.5	6.3	0	YES
	ImpGood	ImpPublic	29	55.2	18.0	11.6	0	YES
	ImpGood	ImpKnown	29	55.2	13.3	14.6	0	YES
B. 36-45 YEARS	ImpGood	ImpFee	164	43.3	18.4	25	0	YES
	ImpGood	ImpPrestige	164	43.3	26.7	12	0	YES
	ImpGood	ImpPublic	164	43.3	12.1	50.8	0	YES
	ImpGood	ImpKnown	164	43.3	17.5	28.4	0	YES
C. 46-55 YEARS	ImpGood	ImpFee	323	51.1	21.4	65.7	0	YES
	ImpGood	ImpPrestige	323	51.1	25.7	53.5	0	YES
	ImpGood	ImpPublic	323	51.1	15.5	116.2	0	YES
	ImpGood	ImpKnown	323	51.1	19.9	76.7	0	YES
D. 56-65 YEARS	ImpGood	ImpFee	288	43.8	22.8	29.9	0	YES
	ImpGood	ImpPrestige	288	43.8	26.6	22.6	0	YES
	ImpGood	ImpPublic	288	43.8	16.3	65.7	0	YES
	ImpGood	ImpKnown	288	43.8	20.1	43.5	0	YES
E. >65 YEARS	ImpGood	ImpFee	81	45.7	23.9	9	0	YES
	ImpGood	ImpPrestige	81	45.7	32.5	3.5	0	YES
	ImpGood	ImpPublic	81	45.7	13.7	25.7	0	YES
	ImpGood	ImpKnown	81	45.7	15.8	19.3	0	YES

Table 4: H1 Outcome: Industry
Industry designations with less than 40 total responses are omitted.

	Q1	Q2	N	YES (%)		MH	p	Q1>Q2
				Q1	Q2			
FINANCE/ BANKING/ INSURANCE	ImpGood	ImpFee	79	39.2	21.7	5.9	0	YES
	ImpGood	ImpPrestige	79	39.2	21.5	0.4	0.661	NO
	ImpGood	ImpPublic	79	39.2	12.8	6.3	0	YES
	ImpGood	ImpKnown	79	39.2	17.7	16.9	0	YES
HEALTH	ImpGood	ImpFee	39	51.3	22.7	7.2	0	YES
	ImpGood	ImpPrestige	39	51.3	27.8	13.6	0	YES
	ImpGood	ImpPublic	39	51.3	14.8	0.1	0.917	NO
	ImpGood	ImpKnown	39	51.3	15.4	23.8	0	YES
MANUFACTURING/ PROCESSING	ImpGood	ImpFee	119	54.6	21.6	29.2	0	YES
	ImpGood	ImpPrestige	119	54.6	21.9	26	0	YES
	ImpGood	ImpPublic	119	54.6	17.3	8.5	0	YES
	ImpGood	ImpKnown	119	54.6	8.0	0	0.983	NO
NON-PROFITS	ImpGood	ImpFee	55	61.8	13.3	28.8	0	YES
	ImpGood	ImpPrestige	55	61.8	20.5	0.4	0.69	NO
	ImpGood	ImpPublic	55	61.8	6.6	7	0	YES
	ImpGood	ImpKnown	55	61.8	12.5	0	0	YES
PRIMARY SECTOR (AGRIBUSINESS, FARMING ETC.)	ImpGood	ImpFee	40	55.0	28.6	7.1	0	YES
	ImpGood	ImpPrestige	40	55.0	30.9	0	0	YES
	ImpGood	ImpPublic	40	55.0	18.1	0	0	YES
	ImpGood	ImpKnown	40	55.0	12.5	0	0	YES
PROFESSIONAL SERVICES	ImpGood	ImpFee	89	58.4	8.2	53.2	0	YES
	ImpGood	ImpPrestige	89	58.4	21.2	0	0	YES
	ImpGood	ImpPublic	89	58.4	11.1	0	0	YES
	ImpGood	ImpKnown	89	58.4	15.0	0	0	YES
RETAIL/ WHOLESALE	ImpGood	ImpFee	80	43.8	13.5	16.9	0	YES
	ImpGood	ImpPrestige	80	43.8	24.2	0	0	YES
	ImpGood	ImpPublic	80	43.8	14.9	0	0	YES
	ImpGood	ImpKnown	80	43.8	17.1	0	0	YES
TELECOMMUNICATIONS/ TECHNOLOGY/ MEDIA	ImpGood	ImpFee	61	55.7	12.5	23.8	0	YES
	ImpGood	ImpPrestige	61	55.7	7.7	0	0	YES
	ImpGood	ImpPublic	61	55.7	7.8	0	0	YES
	ImpGood	ImpKnown	61	55.7	11.7	0	0	YES

The question connected to these tables is: “If you were offered a Board position now, how important would each of the following factors be for you? “

Answer Choices:
“ImpFee” = Fees and Benefits to the Directors
“ImpPrestige” = Status/Prestige of the Organization
“ImpPublic” = Whether the Company’s Shares are Publicly Traded
“ImpKnown” = Becoming Known/Networking

Table 5: H1 Outcome: Pooled and interaction summary

Stratum	N	Premise
Pooled	**897**	**Supported**
Female	136	Supported
Male	742	Supported
North Island	501	Supported
South Island	190	Supported
<=35 yr	29	Supported
36-45 yr	164	Supported
46-55 yr	323	Supported
56-65 yr	288	Supported
>65 yr	81	Supported
FINANCE, BANKING, INSURANCE	79	Not Supported
HEALTH	39	Not Supported
MANUF, PROCESSING	119	Supported
NON-PROFITS	55	Not Supported
PRIMARY SECTOR (AGRIBUSINESS, FARMING ETC.)	40	Supported
PROFESSIONAL SERVICES	89	Supported
RETAIL, WHOLESALE	80	Supported
TELECOMM., TECH, MEDIA	61	Supported

Table 6: H2 Outcome: Gender Profile
Note the low response levels for both but especially for female.

	Q1	N	YES (%)	MH	p	Q1>50
FEMALE	IndPerform	15	96.9	8.6	0	YES
	IndMtg	15	90.6	6	0	YES
	InpNetw	15	84.4	4.1	0	YES
	IndStrategy	15	90.6	6	0	YES
	IndSust	15	96.9	8.6	0	YES
	IndGov	15	90.6	6	0	YES
	IndBus	15	90.6	6	0	YES
MALE	IndPerform	39	93.8	18.6	0	YES
	IndMtg	37	93.4	17.3	0	YES
	InpNetw	37	85.5	10.7	0	YES
	IndStrategy	37	85.5	10.7	0	YES
	IndSust	37	96.1	20.1	0	YES
	IndGov	36	98.6	22.6	0	YES
	IndBus	37	96.1	20.1	0	YES

The question connected to this table is: Based on your experience, how would you rate the NON-EXECUTIVE/INDEPENDENT Directors' contribution?"

Answer Choices:

"IndPerform" = Their contribution to the performance of the organization

"IndMtg" = The quality of their contribution during board meetings

"IndNetw" = Their ability to assist with networking

"IndStrategy" = Their ability to provide strategic vision

"IndSyst" = Creating a sustainable enterprise

"IndGov" = Their understanding of governance issues

"IndBus" = Their understanding of the organization's business

Chapter 7: CONCLUSIONS AND SCOPE FOR FURTHER RESEARCH

7.1 Summary and Overview

The primary purpose of this work is to offer a foundation for further research into governance requirements, needs and prospects in relation to corporate governance arrangements and processes. Consequently, it focuses on the current state of play on corporate governance in New Zealand and the theoretical standpoints of relevance to this issue. Chapter one provides an overview and justification for the work and identifies the questions that are explored in the course of the research.

Chapter two, intended as a means of providing background for the study on one particular aspect of governance – independent directors - begins with a definition of governance (and when it can be considered to be "good"), a section that is followed by an overview and appraisal of principles designed to further governance, an overview that includes information as to how those principles have been incorporated into law, rules and guidelines in various relevant jurisdictions and the limitations of those principles in the New Zealand context.

The third chapter follows on from chapter two as it investigates the primary theoretical framework for the examination and assessment of governance – agency theory- and posits a range of alternative frameworks that have been posed as critiques to agency theory and as means of addressing its perceived shortcomings in particular contexts and more generally.

Chapter four refers to a large body of research in discussing and analysing the roles and functions of the board of directors and the particular place of independent directors (as an increasingly valued aspect of good corporate governance). Its second main purpose is to provide the theoretical justification for the eight hypotheses explored through the empirical research conducted and

reported in this work. It begins with an explanation as to the purposes of a board of directors and the characteristics of a 'good" as opposed to a poor. One principle point that emerges again and again from the literature is that, generally speaking, a board must have independence from the executive: what independence means in this context remains subject to debate. Institutional Theory is used to illustrate the way in which independence of boards becomes accepted as the norm (important given the rapid growth in this as the norm, as reflected in the research described in both this chapter and chapter three). The second part of the chapter reflects on independent directors in the New Zealand context – important given the focus of the empirical research and the purpose of the work – while the third offers an exploration as to motivations of directors to serve under various models of ownership and in light of the historical and legal context – important given the drive to independence in a myriad of contexts and structures. The final part of the chapter examines characteristics of independent directors both in terms of where they come from and what they can offer to the firm or other organisation.

Chapter five provides detail of the empirical research. It describes the instrument in detail along with information on the populations whose views were sought for the purposes of analysis and insight. It should be noted that there were three steps to the process: one involved four nationwide web-based surveys distributed to shareholders, directors and executives of New Zealand companies over 2006-9, the second involved phone interviews on particular aspects of the survey asked of individual directors in 10 different organizations and finally, the exploring of views held by those appointed to District Health Boards. The purpose of such in-depth interviews in steps two and three were verification of findings from step one and to permit further study and exploration of ideas not possible in the web survey.

Chapter six reports on the results of these surveys and the extent to which the hypotheses put up in chapter four are either supported or not supported. As part of that reporting, results are subject to some analysis and comparison with the findings from previous research as identified and discussed in chapters three and four.

Keeping in mind that the major purpose of this work was to provide a foundation for the examination of independent directors in New Zealand, most particularly for SMEs, the following section is devoted to major implications that arise from those findings that are of particular relevance in this context and to an identification of further research.

7.2 Implications of Findings

7.2.1 Communication and Workload

One of the issues that emerged from the findings, and one of particular importance to shareholders of SMEs who are not also on the board (assuming that they have boards at all), is communication – what the directors are doing, what is happening that could potentially threaten the well-being of the firm and what is the impact of decisions. This raises an issue of transparency when directors report back to shareholders, to make sure shareholders understand the substance of board deliberations, the benefits of vigorous debates and the strong unified leadership when the board instructs senior management. When shareholders do not understand how directors contribute to the creation and maintenance of an effective and resilient governance system in the firm, they likely will be less appreciative and understanding of the decisions directors make.

It also seems from the research that the issue of timely and transparent communication with shareholders could easily be handled better by directors once they know there are issues.

For most firms, the board would meet no more than monthly or bi-monthly, minutes of the meeting could be completed within a few days of the meeting, and the final minutes could then be distributed immediately by e-mail, or be available for download, or on-line viewing with password access, if the minutes are deemed confidential or commercially sensitive. Communication about what the board does

and how it makes its decisions should be part of the most basic routine of connecting to its more important stakeholders, the shareholders.

More specific to boards, one of the concerns that has been raised is the increasing workload expected of directors, a function of an over-emphais on the control function of the board. An implication of the research is that boards of New Zealand's SMEs could be effective with fewer face-to-face meetings, particularly when the firm tracks closely to its business plan and budget. Strategic developments that involve major changes for the whole firm or the allocation/reallocation of resources do not tend to arise as frequently as every month. Thus, it has been proposed that boards of New Zealand SMEs should meet quarterly only, a view also supported by this research.

7.2.2. The Qualification of Directors

If governance is a performance area that has begun to move into the position of center stage when firms are evaluated and responsibility is attributed for failures, then it would be expected that directors have a broad skill set that matches up well with the more challenging environment of governance in New Zealand.

Not intended as an excuse but as a realistic assessment, it must be said that directorship training is not easy to come by in New Zealand. Some membership organizations, such as the Institute of Directors, offer directorship training but rarely with a focus on needs of SMEs where smaller boards likely mean that directors must be multi-skilled in more than one specific category to make up sufficient governance abilities in the board room. Some universities offer governance papers as part of their public education offering, but largely taught by academics rather than practitioners and thus likely perceived as not being sufficiently relevant. Other organizations have offered directorship training to their members and the public, such as the Employers and Manufacturers Association (EMA Northern) in Auckland, a sub-set of the nationwide Business New Zealand

group of company members, but these efforts appear isolated, unfocused and not in line with the growing demands placed on directors. Only the EMA-operated Qualified Director course has a skills assessment at the end that must be passed to earn the qualification, and thus it appears that the training for directors in New Zealand does not match its stated importance.

This research identifies a significant skills gap of directors that will likely prevent boards in New Zealand from being effective governance participants. Whatever the reason for poor levels of skill, a campaign to raise awareness might be required to drive more directors to upgrade/update skills through some vehicle of formal governance education. While the Ministry of Health has developed a 2-day formal training session to be offered regionally to all sitting and new board members of District Health Boards, only few firms will be able to muster sufficient resources to offer such in-house training events for their directors. Therefore, there is a need in New Zealand for more directorship training events that are perceived to deliver value, and this research shows that it is not only novice directors who would likely benefit from training, but that there is a serious skills gap among sitting and presumably more experienced directors.

For a small country with a high degree of connectivity and easy access for most to the nearest larger city, operating continuous director training, for new directors as well as in the form of skills boosters to existing directors, should be logistically easy and affordable. This research expresses no opinion which type of provider, public or private or a combination, might be the most suitable to address this education gap, but if it is not addressed the poor ability of directors to perform to the high and increasing expectations of good governance will not improve.

7.2.3. Governance: Diversity and Other Characteristics of Independent Directors

Diversity: The research shows that skills and other 'professional' characteristics are considered more desirable than is the ability of a person to contribute to

board diversity. This finding has implications for groups presently poorly represented (making it that much harder to gain a foothold in this world). Looking at this finding another way has implications also for SMEs. Given that such are frequently family businesses controlled by family members who may be from such minority groups, these findings may well indicate that such firms continue to lack the expertise needed to prosper as a business.

Reputation: Although 'having a good reputation' appears to be easily defined, it is important that future research better identify the characteristics associated with 'good' and 'bad' reputation. For instance, would a director who regularly does not go along with a majority of other directors suffer a reputational damage for being troublesome? Events such as being a director of an insolvent firm or being convicted of criminal acts would justifiably affect the reputation of a director, but what about the director of a firm that voluntarily liquidates because it has come to the end of its useful corporate life? 'Reputation' as a term invites the application of a value system that will be subjective rather than objective, and thus care must be taken to not adversely affect the eligibility of directors who can effectively contributes but might be tainted by irrelevant activities.

Ability to Mount and Support a Good Argument: In general, this sentiment seems to indicate a fear of directors banding together for the wrong reasons and thus manifests a level of distrust against directors that is disturbing. If it needs a director with the stamina to maintain a vigorous defense for his/her argument to succeed, does that mean that less strong directors will not be heard? Is there a fear that directors' valid opinions might not be debated if the fervour and fighting spirit are missing? It appears that a lack of understanding exists over the operation of board meetings. There seems to be a prevailing belief that directors decide based on established alliances in the boardroom, and that newcomers would have no chance to present alternative viewpoints unless they are able to fight for them. This seems to be a naïve interpretation of board routines and often likely to be wrong. A remedy for this widespread misconception might be to invite shareholders and senior managers to attend board meetings, at least those sessions that discuss

matters not commercially sensitive or otherwise not suitable for immediate public consumption, so that they get a first-hand impression of the dynamics of a board meeting. Re-iterating points made above, in this context it seems appropriate to refresh the suggestion that board minutes appropriately reflect any debate and intense discussion of issues, so that there can be no doubt that directors have a forum in which to debate matters fully and effectively.

Industry Skills and Knowledge: This would intuitively be the fastest way to get independent directors up to speed in understanding the business, but does this provide for the largest possible pool of director candidates to choose from?

It is encouraging that 'work experience', especially within the industry and globally, is a key ingredient of the wish list for new directors. Thjis brings in a new pool of candidates for independent director roles: Executives currently working in positions within the same industry either in New Zealand and with global work experience, or overseas. Aside from the advantage in giving these executives a new and challenging role, this desire specifics a skill set that is relatively easily available, albeit not necessarily in the local town or valley. Replacing the historic preference for accountants and lawyers with that of practical work experience and a track record should also produce independent directors that can relate to the management team of the firm where they join the board, including a greater acceptance through their related work roles in their own firms.

If many of the skills required by directors are transferable skills (such as understanding the legal obligations of directors, being able to interpret financial statements and performing audit function, creating long-range visionary strategic plans, communicating strategies to the CEO and management, and communicating with shareholders and other stakeholders), why does a new director have to understand the minute details of how the operation works? Would this not be a skill that can be learned quickly, and be complemented by insiders such as senior managers, who can provide specific operational details?

There is possibly another reason for this requirement. It appears as if most insiders consider their business as 'special' and outsiders would be incompetent to discharge governance obligations unless they are thoroughly familiar with the specific industry. This is a limiting view of the governance world and likely will result in an exclusion of competent directors simply because they have not grown up in the milking machine industry or do not know how to rebuild engines or lack the ability to sell real estate. If the purpose of independent directors is to complement the skill sets of the incumbent, likely internal, directors, then tindependents would only need to understand the inner workings of the firm. More probable than not, the existing board members, the CEO or the management team will have a superior grasp on the deep reaches of the firm's operation and can communicate those on demand.

Professional Qualifications: While solicitors and accountants have historically been asked to come onto the boards of SMEs, likely as arbitrators of the various owner factions and to provide 'free' professional advice, shareholders, senior managers and directors now are far less likely to be asked to serve. The majority of respondents believed that professional degree holders had too narrow a scope of expertise to be able to contribute to general management issues. Although accountants and solicitors might very well have amassed a lot of knowledge while dealing with clients in a wide range of industries and situations, it appears that this 'knowledge by proxy' is deemed insufficient for the current challenges of independent directors. This means conversely that it is no advantage for an aspiring independent director to hold such qualifications.

Finally, and most importantly, the research suggests that an alternative governance framework may suit New Zealand better than one based on agency principles. Such a one is described below.

7.2.4 Alternative Framework for Board Responsibility

Let us take an imaginary but representative small firm with a commercial board, and three octogenerian shareholders, the survivors of the founding family, all in poor health. If that firm currently drains its working capital to support the three owner shareholders in their lifestyle and health needs and thus defers necessary investments in plant, equipment, upskilling, etc., clearly the firm suffers and eventually, presumably after the death of the owners, becomes unsustainable. The independent directors are now in a quandary of what decision to make. If they were to adhere strictly to the mandate to represent shareholder interests, they would continue to deplete assets to provide for the three shareholders, knowing that the firm will no longer be able to invest in the future – unable to maintain its market position and technical competence and to attract and retain good staff. Legally, their duties are well-described and unambiguous: Look out for your shareholders. These directors will know that their decisions in favour of the shareholders will ruin the business, destroy its brand and create unemployment when it finally and inevitably ceases trading. They would likely decide to not deal with that decision and try to sell the business as a going concern, using the proceeds to provide for the shareholders.

It is their belief that a director looks out for more than the shareholders' unitary well-being that potentially conflicts with their legal duties as directors.

The research conducted here indicates that this feeling of a more holistic approach to board leadership is widespread among New Zealand directors and aspiring directors. Unless the shareholders consent to directors taking on a more global view of their corporate universe, undoubtedly with the good motivation to improve the entity's position in relation to the many essential stakeholders a firm acquires and maintains constantly, this belief of directors may create conflict with the shareholders. It requires considerable communication between shareholders and directors, to identify the reasons directors apply to their decision-making, to mitigate any friction that will eventually arise from these diverging courses.

What are the consequences for shareholders/firms?

If there is a growing demand for independent directors in New Zealand, and if those independent directors enter a board room with a commitment to perform to a 'standard of doing good' that does not center exclusively on the needs of the shareholders, firms need to take this into account when they discuss with new directors what both firms and directors expect. Directors who join for the purpose of contributing to a firm and then are largely unable to do so, will leave after a short time. Equally costly, directors who look at a firm to be accountable to more than its shareholders and then develop a fractious relationship with those shareholders, will eventually be dismissed at the cost of disruption and reputational damage. Neither of these outcomes is desirable.

I conclude that shareholders, senior managers and directors consider an independent director as an advisor of a special kind. There is a desire to connect the consultant tighter into the firm's fabric, hoping to receive advice less tainted by self-interest but more focused on the entity's needs. Given the low pay for directors in New Zealand and the low pay expectation of independent directors in New Zealand, it seems that a modified agency theory model might operate better for directors in New Zealand, centered along the theme of 'commitment'. It would recognise that additional forces pull directors away from a solitary focus on shareholder needs, and that this commitment can energise directors to contribute with enthusiasm. Such a governance framework could provide firms with committed consultants at a fraction of the cost when they are directors, rather than when they remain arms-length advisors. This does not imply that every consultant should be invited to become a director, but in areas where the knowledge of the director overlaps well with the strategic interest of the firm to plug a competence gap at board level, having a director fill this void appears to be more palatable to owners and directors, than relying on a consultant for the same information.

I note that for only 21.2% of all survey respondents 'fees' are very important, while 46.6% report that 'doing good' is most important. This would indicate that directors in New Zealand might well drop any demand for higher director fees if there is a mechanism by which they can contribute along the lines of their desire to 'do good'.

This would impose a duty on a firm to create a board/governance environment in which such a positive director contribution is encouraged and rewarded, rather than directors being used to rubberstamp management proposals or to accede to dominant shareholder wishes. This points to a more complex process of embedding a new director into the independent directorship role, including better selection criteria, more transparency during the mutual due diligence process by firm and director, more involved induction/education and a greater envelope of tolerance for the breadth of director contributions.

Linking these conclusions and recommendations back to the various theories, it appears clear that for each of the prevailing theories, Agency Theory and Stakeholder Theory, the current model does not make room for the inclusion of the intangible motivation of 'doing good' as part of the connection. This new ingredient needs to find a home in the discussion of governance structures and their theoretical underpinnings. The existence of such a driver for interest in governance would create demands on the part of companies, directors and the regulatory framework, to review reward systems, look at upskilling and corporate structures in a dynamic context. This area is clearly evolving and likely will continue to do so, once more independent directors join boards and begin to participate.

A final word: This research highlights the necessity to better inform shareholders, senior managers and directors about the purpose and benefits of independent directors. If the approach by firms is to seek directors with knowledge as close as possible to that of the current inside directors, then this will likely reduce the pool

of available candidate to those being the mirror image of the existing directors and thus be less-than-useful as truly independent contributors to governance.

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Earnings manipulation and stock-based incentive misalignment. *Academy of Management Review, 51*(2), 241-258.

Appendix I

Organizations that distributed this survey to their data bases were:

- 3 Media Group
- NZIM
- NZ Shareholders Association
- NZ Institute of Rural Health
- Waikato Management School
- Sheffield Recruiting
- Moyle Remuneration Company
- ANZ
- BNZ
- Simpson Grierson
- NZ Venture Capital Association
-

1)

This research tries to obtain information that leads to a better understanding of good governance here and globally. Many corporations, associations, government organisations and universities are participating in this work. If you have any questions at all about this research, do not hesitate to contact Associate Professor Jens Mueller at m@usainfo.net . This survey is in several short parts and will take 8-10 minutes to complete. Your responses will be combined with those of all other participants to provide total anonymity for you. You can end the survey at any time by leaving the screen. We thank New Zealand Management Magazine and NZIM for their kind support with our work.

You are likely a present or past company officer/executive, company director or investor, and have been carefully selected for the value of your contribution to this work. If you are involved with more than one organisation, please reply with regard to the organisation where you are regularly most engaged.

Thank you for your time and interest. You will have an opportunity to indicate that you wish to receive a free copy of the summary report of this work or several other benefits. This governance work is widely supported by corporates throughout New Zealand, and your contribution is essential.

This survey automatically branches into 3 sections depending on your responses; you may not see all 3 sections.

You are:

Male Female

Your age is:

under 18 years
18 - 24 years
25 - 34 years
35 - 44 years
45 - 54 years
55 - 64 years
above 64 years

As a token of our appreciation for your time, we have arranged for any of the following benefits available to you. Please tick which ones you would like and please enter your e-mail address here. The researchers will remove your e-mail address from the answers, to guarantee the anonymity of your replies.

FREE copy of the results report of this survey
FREE confidential benchmark performance report for the board on which you sit
FREE 2-year www.finddirectors.com INDIVIDUAL membership
FREE 1-year www.finddirectors.com CORPORATE membership
$200 discount coupon for any "Qualified Director" seminar
Enyer your e-mail address here:

Are you currently, or have you been in the past five years, an executive of a New Zealand organization? After answering this question, please click "Next" below.

Yes No

2)

This section asks questions about your organization and how it handles its governance issues. If you are/were a Director or Executive in more than one organization, please reply with details about the organization where you regularly are/were most engaged.

In what region is your organization's headquarter located?

Auckland
Wellington
Christchurch
Hamilton
Dunedin
Other North Island
Other South island
Australia
Western Europe
Eastern Europe
North America
South America
Africa

In its market, your organization's market share is:

Large (above 30% market share)
Medium (10-30% market share)
Small (under 10% market share)
Does not apply (self-employed, retired etc.)

How old is this business?

Younger than 3 months
3 months - 2 years
3 years - 5 years
6 - 10 years
Older than 10 years

Competition in New Zealand in your organization's market is:

Strong
Not strong

Competition outside of New Zealand in your organization's market is:

Strong
Not strong
Not Applicable (we have no activities outside New Zealand)

In which industry does your organization operate (mark all that apply):

Manufacturing/Processing
Finance/Banking/Insurance/Venture Capital/Private Equity
Energy/Utility/Infrastructure/Construction
Health
Transportation/Logistics
Retail/Wholesale
Public Sector/Local government
Research/Science
Primary Sector (agribusiness, farming etc.)
Professional services
Non-Profits
Telecommunications/technology/media
Tourism (incl. hospitality, events, sport, etc.)
Other, please specify:

The gross annual revenue of your organization is:

Below $200,000
$200,000 - $749,000
$750,000 - $1 1/2 Million
$1 1/2 - $4 Million
$5 - $10 Million
$11 - $20 Million
$21 - $50 Million
$51 - $100 Million
$101 - $500 Million
Above $500 Million
Don't know

The number of full-time equivalent employees at the organisation is:

No staff
1 staff
2 - 4 staff
5 - 9 staff
10 - 20 staff
21 - 200 staff
201 - 500 staff
More than 500 staff

What type of ownership does your organization have?

Government Organization/Public Services Firm/Crown Corp
Non-Profit Organization
Family-Owned Firm (under 25% family-owned)
Family-Owned Firm (26-49% family-owned)
Family-Owned Firm (50%+ family-owned)
Privately-Owned Corporation (not family owned)
Publicly-Traded Corporation (i.e. stock exchange listed)
Other:

How many Directors are on the Board of your organization?

1
2
3
4
5
6
7
8
9
10 or more
There is no formal Board

How many of those directors have NO dealings/relationships with the organization other than being a director and are neither founders nor employees or significant shareholders (10%+)?

None
1
2
3
4
5
6
7
8
9
10 or more
Do not know

Your Chief Executive is also

A Director
The Chair of the Board
Neither

If your firm appointed new directors in the past five years, how did the organization find them? (Please mark all that apply)

Referral from Management
Referral from Law Firm/Accountant/Auditor
Referral from Bank/Investment Partner/Venture Capital Firm
Appointed by Government
Referral from existing Directors
Recruitment/Search Firm
Referral from Institute of Directors
Referral from www.FindDirectors.com
Do not know
Other

Which of the following training/education does the organization provide for directors? (Please mark all that apply)

Outside education at university, etc.
Formal internal director induction/training program
Outside non-university director training program (i.e. IOD, Qualified Diretor, etc.)
Informal advice
None
Do not know
Other, describe here:

How many new external/independent Directors will your organization likely look for in the next 5 years?

None
1
2
3
4
5 or more
Do not know

On average, how long have the current Directors of your organization been in their Director positions?

Less than a year
1 - 2 years
3 - 4 years
5 - 6 years
7 or more years
Do not know

Check if your organization (mark all that apply):

Has a formal risk-management system beyond normal insurance cover
Regularly profiles its risk exposure beyond financial risk
Fully understands its 'risk appetite'
Regularly reports formally on its risk management
Involves the board in risk management decisions
Involves only the CEO or staff in risk management decisions
Considers risk management a part of its strategy planning
Other, describe here:

Please share with us, in a sentence or more, how well (or not) governance works in your organization:

Are you, or have you been in the past five years, a member of the Board of Directors of a New Zealand organization? (After answering this question, please click "Next" below.)

Yes
No

3)

This section asks questions about your organization and how it handles its governance issues. If you are/were a Director in more than one organization, please reply with details about the organization where you regularly are/were most engaged.

What is the largest number of corporate boards you served on at any one time?

None
1
2
3
4
5
6
7 or more

If you were offered a Board position now, how important would each of the following factors be for you?

	Very Important	Somewhat Important	Somewhat Unimportant	Very Unimportant
Status/Prestige of Organization				
Whether the Company's Shares are Publicly Traded				
Fees/Benefits to the Directors				
The Ability to "Do some Good"				
Becoming Known/Networking				
Reputation of other Directors				
Level of Personal Risk				
Opportunity for Personal Career Advancement				

How would you describe the overall competence of the Board (not just your own individual competence) in these areas?

	Excellent Competence	Good Competence	Sufficient Competence	Poor Competence	Very Poor Competence
Corporate strategy and the principles of risk/strategic change					
Legal, regulatory and corporate governance and the responsibilities of directors					
Leadership qualities, commanding respect of others, displaying judgment and courage					
Commitment, to the business and to shareholders					
Creating a sustainable enterprise					
Team player abilities, listening and influencing skills and awareness of own strengths and weaknesses					
Ability to manage dissent among Board members					

Based on your experience, how would you rate the NON-EXECUTIVE/INDEPENDENT Directors' contribution? (Skip this if you have not experienced independent directors in action)

	Outstanding	Very Good	Acceptable	Not so Good	Poor
Their contribution to the performance of the organization					
The quality of their contribution during board meetings					
Their ability to assist with networking					
Their ability to provide strategic vision					
Creating a sustainable enterprise					
Their understanding of governance issues					
Their understanding of the organization's business					

Speaking as a director, where should your board spend more or less time in the future?

	Should spend MORE time	No Change Needed	Should spend LESS time
Compliance & Regulatory Issues/Auditing			
Risk Management			
Succession Planning for Board and Top Managers			
Industry/Competitive Analysis			
Corporate Social Responsibility, Environmental and Sustainability Issues (i.e. Triple Bottom Line)			
Helping CEO and Managers operate the organization			

How would you describe your own involvement as a director?

	Strongly Agree	Somewhat Agree	Somewhat Disagree	Strongly Disagree
I can influence the outcome of board decisions				
I am concerned about my reliance on management for information				
I am adequately rewarded for my director contribution				
I am concerned about my personal risk as a director				
I find being a director personally rewarding				
I do not experience internal politics on the board				

How did you hear about openings for your directorships?
(Please mark all that apply)

From Company Management/Directors
From Company staff
From Law firm/Accountant/Auditor
From Bank/Investment Bank/Venture Capital Partner
Through the Government, i.e. CCMAU
From a Recruiter/Search Firm
You are a Founder of the organization
You are or represent a large Shareholder
Through Institute of Directors or FindDirectors.com
Other, describe here:

If your organization has a formal/informal process/policy to handle conflicts of interest for directors or Ethics issues, what proportion of the directors would know this process/policy?

	Fewer than 25%	25% - 50%	51% - 75%	More than 75%	We do not have a formal process/policy
Conflict of Interest					
Ethics					

In your observation of organizations in this country, boards need Directors that contribute:

	Yes	Maybe	No
Gender Diversity			
Age Diversity			
Work experience within the industry			
Work experience outside the industry			
International Experience			
Professional Skills (Lawyers, Business Consultants, Accountants, etc.)			
Track record of having run a successful business			

How would you rate the importance of each of the following tasks for the Board?

Very Important

Somewhat Important

Not Sure

Somewhat Unimportant

Very Unimportant

Compliance & Regulatory Issues

Mentoring the CEO
Monitoring the strategic health of the firm
Industry/Competitive Analysis
Ensuring corporate sustainablity
Challenging Management thinking/beliefs
Managing the Reputation of the Organization

Please share with us, in a sentence or more, your thoughts about governance and directorships in this country:

Do you own now, or have you owned in the previous 5 years, any shares in a New Zealand corporation?

Yes No

4)

Do you own now, or have you owned in the past five years, shares of a New Zealand corporation? (After answering this question, please click "Next" below.

Yes No

5)

Are you, or have been in the past five years, a member of the Board of Directors of a New Zealand organization? (After answering this question, please click "Next" below.

Yes No

6)

How well are you informed about the corporate governance policies in the companies you invest in?

Very Well Informed
Well Informed
Informed
Not so Well Informed
Not at all Well Informed

As a shareholder, how satisfied are you with the performance of directors in your organization?

Highly Satisfied
Satisfied
Not Satisfied
Highly Unsatisfied

As a shareholder, how important are these attributes in a director?

	Very Important	Somewhat Important	Not very Important
Having a good reputation in the market			
Having company-specific market/product knowledge			
Holding many other directorships			
Being an employee of the firm			
Having global business experience			
Holding a Certificate from an entity that trains directors			
Communicating directly with shareholders			
Forming his/her own opinions and arguing strenuously if there are disagreements among directors			
Having a track record of business successes			

Speaking as a shareholder, where should your directors spend more or less time?

	More Time Needed	No Change Needed	Less Time Needed
Compliance & Regulatory Issues/Auditing			
Risk Management			
Succession Planning for Board and Top Managers			
Industry/Competitive Analysis			
Corporate Social Responsibility and Sustainability Issues			
Helping CEO and Managers operate the organization			

As an investor, please share with us what changes in Corporate Governance you would wish to see in the future?

Thank you for your participation. Please click below to finish.

Finish

7)

This section asks questions about your organization and how it handles its governance issues. If you are/were a Director in more than one organization, please reply with details about the organization where you regularly are/were most engaged.

In what region is your organization's headquarter located?

Auckland
Wellington
Christchurch
Hamilton
Dunedin
Other North Island
Other South Island
Australia
Asia
Western Europe
Eastern Europe
North America
South America
Africa

In its market, your organization's market share is:

Large (above 30% market share)
Medium (10-30% market share)
Small (under 10% market share)
Does not apply (self-employed, retired etc.)

How old is this business?

Younger than 3 months
3 months - 2 years
3 years - 5 years
6 - 10 years
Older than 10 years

Competition in New Zealand in your organization's market is:

Strong Not strong

Competition outside of New Zealand in your organization's market is:

Strong Not strong
Not Applicable (we have no activities outside New Zealand)

In which industry does your organization operate:

Manufacturing/Processing
Finance/Banking/Insurance/Venture Capital/Private Equity
Energy/Utility/Infrastructure/Construction
Health
Transportation/Logistics
Retail/Wholesale
Public Sector/Local government
Research/Science
Primary Sector (agribusiness, farming etc.)
Professional services
Non-Profits
Telecommunications/technology/media
Tourism (incl. hospitality, events, sport, etc.)
Other, please specify:

Below $125,000
$125,000 - $500,000
$501,000 - $1 Million
$1.1 - $2.5 Million
$2.51 - $7.5 Million
$7.6 - $12.5 Million
$12.6 - $35 Million
$36 - $75 Million
$76 - $500 Million
Above $500 Million

The number of full-time equivalent employees at the organisation is:

No staff
1 staff
2 - 4 staff
5 - 9 staff
10 - 20 staff
21 - 200 staff
201 - 500 staff
More than 500 staff

What type of ownership does your organization have?

Government Organization/Public Services Firm/Crown Corp
Non-Profit Organization
Family-Owned Firm (under 25% family-owned)
Family-Owned Firm (26-49% family-owned)
Family-Owned Firm (50%+ family-owned)
Privately-Owned Firm (not family owned)
Publicly-Owned Firm (i.e. stock exchange listed)
Does not apply, i.e. self-employed/retired

How many Directors are on the Board of your organization?

1
2
3
4
5
6
7
8
9
10 or more
There is no formal Board

How many of those directors have NO dealings/relationships with the organization other than being a director and are neither founders nor employees or significant shareholders (10%+)?

None
1
2
3
4
5
6
7
8
9
10 or more
Do not know

Your Chief Executive is also

A Director
The Chair of the Board
Neither

If your firm appointed new directors in the past five years, how did the organization find them? (Please mark all that apply)

Referral from Management
Referral from Law Firm/Accountant/Auditor
Referral from Bank/Investment Partner/Venture Capital Firm
Appointed by Government, i.e. CCMAU
Referral from existing Directors
Recruitment/Search Firm
Institute of Directors or www.FindDirectors.com
Do not know

Which of the following training/education does the organization provide for directors? (Please mark all that apply)

Outside education at university, etc.
Formal internal director induction/training program
Outside non-university director training program
Informal advice
None
Do not know
Other, describe here:

How many new external/independent Directors will your organization likely look for in the next 5 years?

None
1
2
3
4
5 or more
Do not know

On average, how long have the current Directors of your organization been in their Director positions?

Less than a year
1 - 2 years
3 - 4 years
5 - 6 years
7 or more years
Do not know

Check if your organization (mark all that apply):

Has a formal risk-management system beyond normal insurance cover
Regularly profiles its risk exposure beyond financial risk
Fully understands its 'risk appetite'
Regularly reports formally on its risk management
Involves the board in risk management decisions
Involves only the CEO or staff in risk management decisions
Considers risk management a part of its strategy planning
Other, describe here:

What is the largest number of corporate boards you served on at any one time?

None
1
2
3
4
5
6
7 or more

If you were offered a Board position now, how important would each of the following factors be for you?

	Very Important	Somewhat Important	Somewhat Unimportant	Very Unimportant
Status/Prestige of Organization				
Whether the Company's Shares are Publicly Traded				
Fees/Benefits to the Directors				
The Ability to "Do some Good"				
Becoming Known/Networking				
Reputation of other Directors				
Level of Personal Risk				
Opportunity for Personal Career Advancement				

How would you describe the overall competence of the Board (not just your own individual competence) in these areas?

	Excellent Competence	Good Competence	Sufficient Competence	Poor Competence	Very Poor Competence
Corporate strategy and the principles of risk/strategic change					
Legal, regulatory and corporate governance and the responsibilities of directors					
Leadership qualities, commanding respect of others, displaying judgment and courage					
Commitment, to the business and to shareholders					
Creating a sustainable enterprise					
Team player abilities, listening and influencing skills and awareness of own strengths and weaknesses					
Ability to manage dissent among Board members					

Based on your experience, how would you rate the NON-EXECUTIVE/INDEPENDENT Directors' contribution? (Skip this if you have not experienced independent directors in action)

	Outstanding	Very Good	Acceptable	Not so Good	Poor
Their contribution to the performance of the organization					
The quality of their contribution during board meetings					
Their ability to assist with networking					
Their ability to provide strategic vision					
Creating a sustainable enterprise					
Their understanding of governance issues					
Their understanding of the organization's business					

Speaking as a director, where should your board spend more or less time in the future?

	Should spend MORE time	No Change Needed	Should spend LESS time
Compliance & Regulatory Issues/Auditing			
Risk Management			
Succession Planning for Board and Top Managers			
Industry/Competitive Analysis			
Corporate Social Responsibility, Environmental and Sustainability Issues (i.e. Triple Bottom Line)			
Helping CEO and Managers operate the organization			

How would you describe your own involvement as a director?

	Strongly Agree	Somewhat Agree	Somewhat Disagree	Strongly Disagree
I can influence the outcome of board decisions				
I am concerned about my reliance on management for information				
I am adequately rewarded for my director contribution				
I am concerned about my personal risk as a director				
I find being a director personally rewarding				
I do not experience internal politics on the board				

How did you hear about openings for your directorships? (Please mark all that apply)

From Company Management/Directors
From Company staff
From Law firm/Accountant/Auditor
From Bank/Investment Bank/Venture Capital Partner
Through the Government, i.e. CCMAU
From a Recruiter/Search Firm
You are a Founder of the organization
You are or represent a large Shareholder
Through Institute of Directors or www.FindDirectors.com
Other, describe here:

If your organization has a formal/informal process/policy to handle conflicts of interest for directors or Ethics issues, what proportion of the directors would know this process/policy?

	Fewer than 25%	25% - 50%	51% - 75%	More than 75%	We do not have a formal process/policy
Conflict of Interest					
Ethics					

In your observation of organizations in this country, boards need Directors that contribute:

	Yes	Maybe	No
Gender Diversity			
Age Diversity			
Work experience within the industry			
Work experience outside the industry			
International Experience			
Professional Skills (Lawyers, Business Consultants, Accountants, etc.)			
Track record of having run a successful business			

How would you rate the importance of each of the following tasks for the Board?

	Very Important	Somewhat Important	Not Sure	Somewhat Unimportant	Very Unimportant
Compliance & Regulatory Issues					
Mentoring the CEO					
Monitoring the strategic health of the firm					
Industry/Competitive Analysis					
Ensuring corporate sustainablity					
Challenging Management thinking/beliefs					
Managing the Reputation of the Organization					

Please share with us, in a sentence or more, your thoughts about governance and directorships in this country:

Do you own now, or have you owned in the previous 5 years, any shares in a New Zealand corporation?

Yes No

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APPENDIX B: On-line web-based survey instrument used for the in-depth 2010 survey.

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1)

We are assisting your organisation's board with better understanding its quality of governance. This research is confidential and no individual's reply will be shared with anyone outside the research team. Only a summary report will be presented to the organisation's board, to allow the directors to assess their effectiveness, when benchmarked against many other NZ entities. If you have any questions at all about this research, please contact Professor Jens Mueller at 021 516 326, or m@usainfo.net . This survey will take 6-8 minutes to complete. Your responses will be combined with those of other participants to provide total anonymity for you. You can end the survey at any time by leaving the screen.

Thank you for your time and interest. Your opinions are very important to us, and we know time is precious. We have made this survey easy to navigate for you. Your contribution is essential to obtain a comprehensive understanding of governance at your organisation.

You are (we need this data to compare your demographics to several thousand other directors in New Zealand):

Male Female

Your age is (we need this data to compare your demographics to several thousand other directors in New Zealand):

under 18 years
18 - 24 years
25 - 34 years
35 - 44 years
45 - 54 years
55 - 64 years
above 64 years

Before you became a director in this entity, your professional background included experience in (check all that applies):

Small-/Mid-Size Business
Large Business
Not for Profit Organisation
Government/Teaching
Professional (i.e. law, accounting)
Other, please tell us:

Please enter your telephone number and e-mail, in the event you are selected for a follow-up and verification of the survey information. Your identity will not be disclosed in any of the results. Without this information, your responses must be discarded to maintain the integrity of the data base.

2)

This section asks questions about your organisation and how it handles its governance issues. If you are/were a Director in other organisations as well, please reply with details about your engagement at this entity only.

On how many boards and advisory boards do you currently serve?

None
1
2
3
4
5
6
7 or more

If you were offered a Board position now, how important would each of the following factors be for you?

	Very Important	Somewhat Important	Somewhat Unimportant	Very Unimportant
Status/Prestige of Organization				
Whether the Company’s Shares are Publicly Traded				
Fees/Benefits to the Directors				
The Ability to "Do some Good"				
Becoming Known/Networking				
Reputation of other Directors				
Level of Personal Risk				
Opportunity for Personal Career Advancement				

How would you describe the overall competence of the Board (not just your own individual competence) in these areas?

	Excellent Competence	Good Competence	Sufficient Competence	Poor Competence	Very Poor Competence
Corporate strategy and the principles of risk/strategic change					
Legal, regulatory and corporate governance and the responsibilities of directors					
Leadership qualities, commanding respect of others, displaying judgment and courage					
Commitment, to the business and to shareholders					
Creating a sustainable enterprise					
Team player abilities, listening and influencing skills and awareness of own strengths and weaknesses					
Ability to manage dissent among Board members					

Based on your experience, how would you rate the INTERNAL Directors' contribution? (These are directors who also have a management role or other interests in the entity, other than being a director)

	Outstanding	Very Good	Acceptable	Not so Good	Poor
Their contribution to the performance of the organization					
The quality of their contribution during board meetings					
Their ability to assist with networking					
Their ability to provide strategic vision					
Creating a sustainable enterprise					
Their understanding of governance issues					
Their understanding of the organization's business					

Based on your experience, how would you rate the EXTERNAL Directors' contribution? (These are directors who do not have a management role or other interests in the entity, other than being a director)

	Outstanding	Very Good	Acceptable	Not so Good	Poor
Their contribution to the performance of the organization					
The quality of their contribution during board meetings					
Their ability to assist with networking					
Their ability to provide strategic vision					
Creating a sustainable enterprise					
Their understanding of governance issues					
Their understanding of the organization's business					

Speaking as a director, where should your board spend more or less time in the future?

	Should spend LESS time	Should spend MORE time	Should spend ABOUT THE SAME time
Compliance & Regulatory Issues/Auditing			
Risk Management			
Succession Planning for Board and Top Managers			
Industry/Competitive Analysis			
Corporate Social Responsibility, Environmental and Sustainability Issues (i.e. Triple Bottom Line)			
Helping CEO and Managers operate the organization			

How would you describe your own involvement as a director?

	Strongly Agree	Somewhat Agree	Somewhat Disagree	Strongly Disagree
I can influence the outcome of board decisions				
I am concerned about my reliance on management for information				
I am adequately rewarded for my director contribution				
I am concerned about my personal risk as a director				
I find being a director personally rewarding				
I do not experience internal politics on the board				

How did you hear about openings for your directorships? (Please mark all that apply)

From friends in the community who are not involved in the entity
From someone at the organisation's management
From the Government/CCMAU
From someone at the organisation's board
From an advertisement
I work at the entity
From a recruiting firm
Other, describe here:

If your organization has a formal/informal process/policy to handle conflicts of interest for directors or Ethics issues, what proportion of the directors would know this process/policy?

	Fewer than 25%	25% - 50%	51% - 75%	More than 75%	We do not have a formal process/policy
Conflict of Interest					
Ethics					

In your observation, boards in general need Directors that contribute:

	Yes	Maybe	No
Gender Diversity			
Age Diversity			
Work experience within the organisation's industry			
Work experience outside the organisation's industry			
International Experience			
Professional Skills (Lawyers, Business Consultants, Accountants, etc.)			
Track record of having run a successful business			

How would you rate the importance of each of the following tasks for the Board?

Very Important

Somewhat Important

Not Sure

Somewhat Unimportant

Compliance & Regulatory Issues
Mentoring the CEO
Monitoring the strategic health of the firm
Industry/Competitive Analysis
Ensuring corporate sustainablity
Challenging Management thinking/beliefs
Managing the Reputation of the Organization

Which of the following training/education does the organization provide for directors? (Please mark all that apply)

Outside education at university, etc.
Formal internal director induction/training program
Outside non-university director training program
Informal advice
None
Do not know
Other, describe here:

How are the senior managers of the entity involved in board activities?

CEO only
ALWAYS

CEO only
SOMETIMES

Senior Managers
ALWAYS

Senior Managers
SOMETIMES

Other staff

Attend ALL board meetings
Attend SOME board meetings
Attend SOME PORTIONS of board meetings
Meet with Board Members during special sessions/retreats
Meet with Board Members informally outside of board meetings

Your CEO is a member of the Board

Yes No

Your Chair is a manager of the organisation

Yes No

Your Chair is also the CEO

Yes No

Please share with us, in a sentence or more, your thoughts about governance at your organisation:

Please share with us, in a sentence or more, your description of the THREE most significant threats the organisation faces in the upcoming years:

APPENDIX C: Questions asked in the survey, and short labels used to refer to them

Combined dataset: 2006, 2007, 2008, 2009

	Question	Short
Personal details:		
1	Survey Year	Year
2	Gender	Gender
3	Age	Age
Company details:		
4	Regional Location	Location
5	Market Share	Share
6	Market Competition	Comp
7	Industry	Industry
8	Gross Annual Revenue	Revenue
9	Number of full-time equivalent employees	FTE
10	Ownership	Owner
11	Number of directors on the Board	DirNum
12	Number of directors who have no dealings with the organisation	DirDeal
13	If your firm appointed new directors in the past five years, how did the organisation find them	DirHow
14	Which of the following training/education does the organisation provide for directors	DirTrain
15	How many new external/independent directors will your organisation likely look for in the next 5 years	DirExt
16	On average, how long have the current Directors of your organisation been in their Director positions	DirTime
17	What is the largest number of corporate boards you served on at any one time	NumBrd
Importance of the Organisation's attributes if offered a board position now:		
18	Importance of Status/Prestige of Organisation if offered a Board position now	ImpPrestige
19	Importance that the Company is Publicly Listed if offered a Board position now	ImpPublic
20	Importance of Fees/Benefits to the Directors if offered a Board position now	ImpFee
21	Importance of the Ability to Do Some Good if offered a Board position now	ImpGood
22	Importance of Becoming Known if offered a Board position now	ImpKnown
23	Importance of Reputation of other Directors if offered a Board position now	ImpRep
24	Importance of Level of Personal Risk if offered a Board position now	ImpRisk
25	Importance of Opportunity for Personal Career Advancement if offered a Board position now	ImpCareer
Director competence:		
26	Your own and your fellow directors' competence in: Corporate	CmpStrategy

	strategy and the principles of risk/strategic change	
27	Your own and your fellow directors' competence in: Legal, regulatory and corporate governance and the responsibilities of directors	CmpLegal
28	Your own and your fellow directors' competence in: Leadership qualities, commanding respect of others, displaying judgment and courage	CmpLead
29	Your own and your fellow directors' competence in: Commitment, to the business and to shareholders	CmpCommit
30	Your own and your fellow directors' competence in: Team player abilities, listening and influencing skills and awareness of own strengths and weaknesses	CmpTeam
Miscellaneous:		
31	How did you hear about openings for directorships	Hear
32	Does your organisation have a formal process to handle conflicts of interest for Directors	DirConflict
33	What proportion of the people on the board would know the code of conduct	CmpCode
Director contribution to board:		
34	Boards need Directors that contribute: Gender/Age Diversity	ContDiv
35	Boards need Directors that contribute: Work experience WITHIN the industry	ContWithin
36	Boards need Directors that contribute: Work experience OUTSIDE the industry	ContOut
37	Boards need Directors that contribute: International Experience	ContGbl
38	Boards need Directors that contribute: Lawyers, Business Consultants, Accountants or other professionals	ContLaw
39	Boards need Directors that contribute: Track record of having run a successful business	ContRecord
Shareholder needs of a director:		
40	As a shareholder, how important are these attributes in a director: Having a good reputation in the market	ShrRep
41	As a shareholder, how important are these attributes in a director: Having company-specific market/product knowledge	ShrSpec
42	As a shareholder, how important are these attributes in a director: Holding many other directorships	ShrDir
43	As a shareholder, how important are these attributes in a director: Being an employee of the firm	ShrEmploy
44	As a shareholder, how important are these attributes in a director: Having global business experience	ShrGbl
45	As a shareholder, how important are these attributes in a director: Holding a Certificate from the Institute of Directors	ShrCertID
46	As a shareholder, how important are these attributes in a director: Holding a Certificate from Directors Understanding Governance	ShrCertDUG
47	As a shareholder, how important are these attributes in a director: Communicating directly with shareholders	ShrComm
48	As a shareholder, how important are these attributes in a director: Forming his/her own opinions and arguing strenuously if there are disagreements among directors	ShrInteg
49	As a shareholder, how important are these attributes in a director: Having a track record of business successes	ShrRecord
Personal Details:		
50	Are you currently employed as an executive, or are (or have been) a Director in an organisation	Employ