The Blender Approach to Governance Leadership: Do Diverse Director Attributes Contribute to Board Capital?

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OVERVIEW

This paper examines the contributive significance of diverse director skills on organizations' boards. We review the impact of different educational and professional backgrounds and different attributes such as gender or ethnic background. We attempt to explore the meaning and value of such diverse attributes among boards of directors, their contribution to board capital and the strengthening effects on board effectiveness and accountability. We conclude from our research that board diversity is important in influencing the effectiveness of boards' service role, and that shareholders, executives and sitting directors express clear preferences for the need for diversity on boards.

THEORETICAL BACKGROUND

In his study of the power and influence of boards of directors, Zald (1969) argued that each board member possesses certain "resources", including detailed knowledge about organisational operations. These resources include qualities such as expertise about a technical process, access to and control of relevant external resources, and integrating characteristics such as social status, gender and personality. These factors influence how an individual will relate to others and how others will respond. These different kinds of resources, Zald contended, are important in determining the ability of boards to challenge and/or formulate lines of action and thus contribute to decision making. According to Zald, boards of directors are sometimes impotent and sometimes all-powerful. The question arises, therefore, as to within what kinds of organisations and under what conditions such outcomes arise. In this paper we reflect on the current discussion of governance quality which invariably includes calls for gender and other diversity, such as external versus internal directors, in order to better understand factors which relate to more- or to less-effective governance.

This paper examines the significance of appointing directors to boards whose attributes represent just such a diverse array of resources - that is, directors with certain backgrounds and education, certain technical and commercial expertise, certain industry and life experience, a particular gender or membership of an ethnic group. Our study takes up Hillman and Dalziel's (2003) idea of "board capital", defined as the human capital and the relational capital of the members of a board. The paper explores how diversity in the experience, skill and judgment of individual executive and non-executive directors can contribute to this resource and thus strengthen board development, operations and accountability. We also consider the expressed wishes of many shareholders, directors and executives in New Zealand organizations, when it comes to diversity on boards.

Boards of directors are complex organisations, which must rely on their collective strengths in order to fulfill their fiduciary role. Individual directors must accept a common responsibility to form an effective working group (Demb and Neubauer, 1992), which we note is is a broader responsibility than that of their legal status: acting as legal agents for shareholders. Although certain individuals and groups are clearly more influential than others within an organisation, 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). This can be positive factor in that it might enable rather than disable a harmonious, consensual discussion of board matters – but it might also inhibit the frank discussion of issues such as failures or other challenges facing the company, especially when the personal or professional interests of board members become part of the argument. Board members are predominantly men, and in New Zealand are on average 51 years old, often with extensive experience in top management positions, with similar interests and similar social and professional networks. This common ground has many advantages, such as knowledge of the informal rules of the game and a rapid grasp of issues to be discussed and decided on (Huse, 2007). Although some appointments from among 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 so new members' qualifications may not be scrutinised (Huse, 2007). According to Huse, independent or outside directors, especially, are recruited primarily because of their expertise and reputation. The appointment of outsiders, especially in large publicly listed firms, has increased since statutes in many countries mandate at least a minority of independent directors. The growing interest in independent directors, especially among the many small-/medium-sized firms in New Zealand is confirmed through our research results. However, we cannot determine conclusively whether the increasing demand for independent directors is based on a realization that the traditional means of director selection is inadequate, whether new directors on a board are expected to add value, whether more independent directors pacify outsiders, or whether their advice likely comes at lesser cost than if they were hired as paid consultants.

Hill's (1995) study of how boards of directors work as social organisations in major British companies showed the importance of certain personal attributes ("breadth of vision", "a broader perspective", "a global view of the company and environment"), which seemed to be more significant than expertise in a particular area. The study showed how the non-executive directors themselves stressed the importance of balance, of recruiting outsiders with a variety of experience who were members of networks across the business community, or able, for example, to aid access to major financial institutions when capital needed to be raised. Because having the right people in place is paramount, personality, reputation and influence all counted. What was needed were the "right people", whose "faces would fit" with those of existing members (van der Walt and Ingley, 2003). We note from our previous and ongoing research that there is less demand for directors that hold many board directorships or are holders of professional practicing certificates, i.e. accountants or solicitors. From this research, thousands of shareholders, directors and managers in New Zealand have indicated to us that their ideal director candidate is a successful executive with current work experience that preferably includes a global focus. This means that the ‘right people’ might be new people, those who are not yet part of the small group of current New Zealand directors, thus raising issues of recruitment, governance training, induction and integration.

While still having faces that “would fit”, the members of a diverse group might have quite different experiences and thus different attitudes toward and perspectives on significant issues or problems. Milliken and Martins (1996, p. 403) usefully distinguished between observable or readily detectable attributes such as race or ethnic background, age, or gender, and diversity with respect to less visible or underlying attributes such as education, technical abilities, socioeconomic group, personality characteristics or values. (Milliken and Martins noted that these are not mutually exclusive: ethnic differences may be associated with socioeconomic status, for example.) These qualities will manifest themselves in the choices and decisions that directors make (Zahra and Pearce, 1989).

Contextual variables can affect board attributes and, ultimately, the board’s contribution to organisational performance. Norburn (1986) showed 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. We have found from our ongoing research that prospective directors in New Zealand rank highest being able to ‘do good’ as a motivator to accept a new directorship, which bestows duties on both the firm and the new directors to each meet the expectations of the other.

These studies have highlighted the relevance of individual characteristics of directors in selection and appointment to board positions and the affective contributions of directors exhibiting some combination of these characteristics, to board functioning. These characteristics include demographic, personality, behavioural, experiential and professional variables that are found to influence individual director and overall board effectiveness.

RESEARCH METHODOLOGY

We repeated our 2006 survey in New Zealand with a 2007 edition of an on-line survey, distributed to shareholders, corporate executives and current directors. Distribution of the survey was facilitated with support from several large organizations in New Zealand through their databases (PricewaterhouseCoopers, ANZ Bank, Business New Zealand, Crown Company Monitoring Advisory Unit, Ministry of Women Affairs, NZ Shareholder Association, NZ Venture Capital Association, several universities, etc.). With a good regional distribution throughout New Zealand and representation of all industry groups, these organizations distributed invitations members of their networks and databases to complete an on-line survey. Depending on whether the respondents were owners, or shareholders or directors, they were directed to different segments of the survey instrument, thus allowing for data capture specific to the expertise and role of the respondent. Bias applies with regard to organizations not represented in the address lists of the distributing firms, or without access to the internet.

With 1,800 responses received in 2007, comparable to the 2,100 responses from the previous year (2006), this is one of the largest non-government surveys on corporate governance in New Zealand. The results from both surveys are cumulative, being derived from consistency in the survey instrument, questionnaire design, distribution, respondent characteristics and industry representativeness, as well as in responses. This means that the results from both surveys can be combined for discussion, with the 2007 results confirming those of 2006 and thus providing a comprehensive picture of corporate governance in New Zealand.

Respondents were filtered in the questionnaire so that some completed only one section of the survey, many completed two sections and few completed all three sections. More than 63 percent of all respondents requested a copy of the results report, indicating more than a passing interest in this topic. On that basis we conclude that corporate governance is an engaging topic among SME leaders as well as those of large businesses and investors in New Zealand. With public battles over whose director candidates should sit on the Telecom board or where to seek accountability for failed finance firms, the topic of good corporate governance is high in media interest in New Zealand.

A THEORETICAL FRAMEWORK FOR BOARD CONTRIBUTIONS

Two main theoretical perspectives in the management and corporate governance literature underlie the rationale for board diversity. Agency theory stresses the critical monitoring or control role of the board, because of its primary legal duty as the agent of shareholders, protecting their interests and maximising their wealth (Jensen and Meckling, 1976). Agency theory stresses a board's strategic contribution, especially its contribution to the organisation's mission, and the development of strategy – which is why critics claim that poor director selection and thus ineffective decision-making are a handicap to this task (Zahra and Pearce, 1989). This theory suggests that owners as principals should select board members who are able to monitor management effectively because of their primary duty as agents of shareholders. This raises issues as to shareholders' abilities to identify effective board members for their respective firms and their power to then orchestrate their admission to the board, as well as the organized departure of ineffective directors. Practice demonstrates that in reality, shareholders have relatively little power in these situations to influence significantly the composition of a board.

According to resource dependence theory, the board is a provider or procurer of important resources rather than merely a controller and evaluator of management. In this service role, boards act as "boundary spanners" and networkers with external sectors or organisations such as financial institutions, or political bodies, finding ways to tap into these bases of power and influence, for the benefit of the organisation (Parsons 1960; Pfeffer, 1972, 1973; Pfeffer and Salancik, 1978). Pfeffer (1972, 1973) found that, by increasing in size and being composed of members of diverse occupational and professional groups, boards could link an organisation to its external environment, thus helping to secure critical resources. Our research confirms an interest in directors with successful practical work experience, "success stories", and global work history, rather than interest in specific topical areas of contribution. Our work thus supports the theories that directors bring transferable skills and act as resources rather than auditors.

Pearce and Zahra (1992) also confirmed this finding and have shown how, by increasing in size and diversity, boards helped to provide such linkages and access to the key resources required by their organisations. Given what should be the diversity and breadth of their expertise and their connections, outside or independent directors are then in a good position to provide counsel to management. On this basis we suggest that the integration of independent directors to boards requires not only recruitment pathways different from those used to recruit from the current small pool of existing directors, but also preparation of the organization to allow an effective contribution by these outside directors, as well as specific training and education for novice directors.

Recent research by Ingley and McCaffrey (2007) showed how established companies in New Zealand see new directors as bringing industry knowledge as well as their reputation in business and industry to a company. This is confirmed by our ongoing research, where one of the most-frequently demanded qualifications of new directors is their current work experience. These established companies are concerned with criteria that evaluate 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 organisation, that is, "what the [directoral] candidate *brings to* the company" (p.324) in relation to reputation and experience in the industry, for example. In contrast, the criteria used by New Zealand start-up companies can be summed up as "what the [directoral] candidate *can do for* the start-up" (p.324). The data from Ingley and McCaffrey's research showed 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 desire to use the director as a resource for the firm.

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 organisational performance. For example, members of hostile groups could be recruited onto governing boards, or long-term relationships could be established through cross board services between customers and suppliers. The relationship between University boards and the government departments on which they rely for funding, is another example of how boards can utilise the social capital of its external directors when appointed from their key agencies on whom they depend for certain resources.

CAN DIVERSITY ADVERSELY AFFECT BOARD EFFECTIVENESS?

Although Milliken and Martins (1996) and others have argued for the positive effects of diversity - for example providing a broader perspective in decision making and encouraging creative and innovative solutions to problems - they have warned that groups with diverse backgrounds and skills may have integration problems similar to those of other diverse groups, because 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 and organisations should not necessarily make this trade-off. According to this thinking, diverse boards may be less cohesive and more likely to experience coordination and communication difficulties than 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). We argue that our finding indicating that many more independent directors that are expected to join New Zealand boards in the future supports the need to plan for this reported dissatisfaction, both on the part of organisations that need to prepare an appropriate nesting strategy for new director to bed in effectively, as well as for the new directors, who need to develop the appropriate expectations of their future board experiences.

GROWING DEMAND FOR INDEPENDENT DIRECTORS

This demand for new independent directors appears to be significant in both impact and numbers. From our research we note that less than 50 percent of all surveyed organisations indicate they would NOT recruit any independent directors within the next five years. This denotes a potentially exploding demand for external directors on New Zealand boards, with the corresponding pressures to develop alternative recruitment pathways and director education. The willingness for these mainly small-/mid-size firms to admit outside directors to their boards is remarkable for its de-crusting of the walls around SME boards.

Graph 1: *In here*

COMPETENCE OF BOARD MEMBERS

When we asked sitting directors of New Zealand organizations how they rank their own boards in effectiveness in key skills categories, they reported the highest level of competence as being in the category “commitment”, while effectiveness in all technical areas of contribution was ranked far lower. This raises the issue of existing skills deficiencies, which based on these responses, would be amplified as more independent directors join boards. Given the intensifying regulatory and audit functions expected by boards, and New Zealand’s easy attribution of unlimited personal liability to directors for creditor losses while trading insolvent, it is of concern that key skills expected from directors appear to be less developed than their sense of commitment and service. Boards with a high commitment to perform to a lesser-than-required standard would not advance best practice in governance in New Zealand.

Graph 2: *In here*

WHICH DIVERSITY MATTERS MOST?

On the other hand, the promotion of diverse perspectives can encourage a wider range of solutions and ideas for strategic decisions (Eisenhardt and Bourgeois, 1988). Indeed resource dependence researchers suggest that directors 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). Zahra and Pearce (1992) argued that larger and more diverse boards of directors reduce uncertainty surrounding strategy development. Corporate governance researchers have argued that diversity among board members' backgrounds 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 with diverse perspectives can contribute to creative strategy formulation, because they can offer a variety of experiences and better quality of judgement (Rindova, 1999) and are more likely to engage in constructive dissent or challenge assumptions associated with strategic proposals.

Others have argued 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 varying and differing views on proposed strategic changes. Indeed the greater the diversity of board interests, the greater the potential for conflict and factions (Goodstein, Gautam, and Boeker, 1994).

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 acceptance of arguments in favour of this perspective. Questions have arisen as to whether evidence supports the idea that increased diversity leads to increased shareholder value and whether in fact increased diversity in the boardroom matters at all. The emphasis in the literature on achieving greater diversity in corporate boards implies its importance, yet slow progress toward achievement seems to be a contradiction of its value (van der Walt and Ingley, 2003). Others have argued that shareholders have developed a clear preference for the diversity they like to see in their boards, and that the traditional emphasis on gender diversity is replaced by a preference for specific abilities and experiences (Mueller, Dana and McDonald, 2008).

The idea of boardroom diversity does not simply mean active representation, however, as Burton (1991) has argued. Diversity in the boardroom can instead be seen as a broadening of merit, with the aim not of representing certain identified interests, but representing those with certain characteristics gained from a variety of experience, which might be used effectively to address issues in a novel way (Ingley and van der Walt, 2003). In this way, boards need to focus foremost on merit criteria when selecting directors.

GENDER DIVERSITY

Researchers have been paying more attention since the early 1980s to the study of women directors. This growing literature shows only tentative results. A prominent theme in the debate is the dearth of women on corporate boards. Diversity, and the value women can add as directors, is the main business argument for increasing the number of women on boards of directors (Daily and Dalton, 2003). The main arguments to increasing the number of women in these leadership positions are based on such changing realities facing firms as the globalisation of all business activities which has dramatically changed world markets, and the challenges accompanying key social trends of the past two decades, such as the proportion of women engaged in the workforce (Bilmoria and Piderit 1994; van der Walt and Ingley, 2003). Nevertheless, as reported in the New Zealand Census of Women's Participation, the reality is that the path of aspirant female directors into corporate governance is difficult.

While Carver (2002) argued that representing ownership requires that a board represent the diversity within that ownership, he also reasons that it is impossible for a board to be constituted so that it represents all diversity present in the ownership. Carver highlighted a tendency toward tokenism in affirmative action initiatives, implying that one member of a minority represents all members of that group. He warned that selection of directors from widely representative groups might seduce a board into complacency over embracing diversity without actually gathering input from such groups.

Burke (2000, 1997) agreed that both men and women be appointed to corporate boards primarily because of their abilities. Consistent with the resource dependence view, the presence of women can also serve the organisation's interest in building links to its environment, thereby bringing both strategic input and social capital to the boards on which they serve (Bilimoria and Wheeler, 2000). A non-executive director, especially, needs individual skill, broad knowledge and expertise based on the combined contributions of education, advancement in management and maturity of judgement rather than age (Burgess and Tharenou, 2000; van der Walt and Ingley, 2003).

Graph 3: *In here.*

We report that there is largely indifference among our respondents regarding gender representation on boards in New Zealand. Shareholders, executives and existing directors in our survey believe that a successful track record in business, coupled with work experience and global experiences is of greater importance than age, gender or holding professional credentials. This indicates that future board positions for independent directors will likely be filled from the ranks of executives in other organisations, many of which will have had no prior board experience. As gender appears to be a factor where approximately half of the respondents attributed importance while the other half did not, we suspect that there is no immanent change in the low representation of women on New Zealand boards. This suggestion is supported by the fact that the selection of executives with global work experience would likely favour men over women, given that traditionally more men fill those positions.

We note, however, that there appears to be no shortage of women with an interest in becoming corporate directors in New Zealand. On the www.finddirectors.com web site, a 'Trade Me' for directors where candidates list themselves with their qualifications, more than 30 percent of the 300+ listings are from women, some with superb qualifications that would perfectly match the above wish list for new directors.

BOARD CAPITAL

Merit of this kind can be seen as a vital strategic resource contributed by directors to their organisations and forming part of crucial "board capital". The concept of board capital was introduced by Hillman and Dalziel (2003) who defined it as combining the human capital and the relational capital of the board members. According to this concept, 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 for the individuals in whom these investments are made (van der Walt and Ingley, 2003). Burgess and Tharenou (2000) argued 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 board positions. 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 from social ties (Hillman and Dalziel, 2003, p.386).

Both kinds of capital can contribute to the general resources provided by executive and non-executive directors to their organisation, 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 organisations, helping the firm to acquire resources from important outside parties (Hillman and Dalziel, 2003). For example, directors with specialist expertise such as legal and financial skills asn experience, management expertise built up from experience in other firms, or official skills gained during government employment, can provide advice and counsel to management for decision making.

This provision of resources to an organisation 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 and control as two primary components of a board's internal administrative function (Westphal, 1999).

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

CONCLUSION

A board is a group of people selected for their expertise, who work together to add value to the organisation they lead. Although diversity in boards of directors is far from being a requirement *per se*, it is crucial in the service role, but the benefits are less documented in the strategic role. Board composition that achieves diversity involves alternative director selection processes from those traditionally employed in director searches. Our research indicates that current boards in New Zealand report skill levels that could benefit from additional director education. Corporate governance education needs to be offered for sitting directors as well as to the numerous prospective directors who will be brought onto boards on the basis of improving governance competence through a more diverse and independent board. To assemble balanced boards, as advocated by the agency perspective of the role of boards, behavioural traits of directors and other interpersonal and political dynamics play a key role. Boards thus 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 organisation. Director recruitment must change from favoring known ‘friends’ to specifically matching talents and ability with corporate needs. The pool of 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.

Bringing together the two perspectives of agency theory and resource dependency, boards must seek to evaluate their own performance to improve their governance competence, utilizing in the mix, gender and a range of expertise, experience and personal attributes to craft an effective board. While shareholders may be unmoved by the gender debate, for example, and prefer firms to hire directors exclusively for specific abilities, a key consideration in the selection of directors and in board composition is the organisation’s long-term strategic requirements. Given that strategic circumstances change over the firm’s life cycle and reflect its response to its operating environment, boards must renew themselves regularly, either through regular and ongoing skills enhancement of existing directors and/or through director rotation. The strategic and life cycle context needs also to be taken into account in building board capital and in valuing the board's contribution as a strategic resource for the firm. The question becomes not simply whether or not to diversify the board but, importantly, what particular skill requirements, capabilities and other attributes will be required by the board to lead the firm effectively through the challenges posed by the next phase in its strategic advancement. From our research, there is no indication that a call for an enhancement of board competence and diversity applies only to large firms. Shareholders and senior managers of SMEs in New Zealand are equally interested in recruiting independent directors, improving board competence and making use of board contributions to enhance the long-term strategic planning of the firm.

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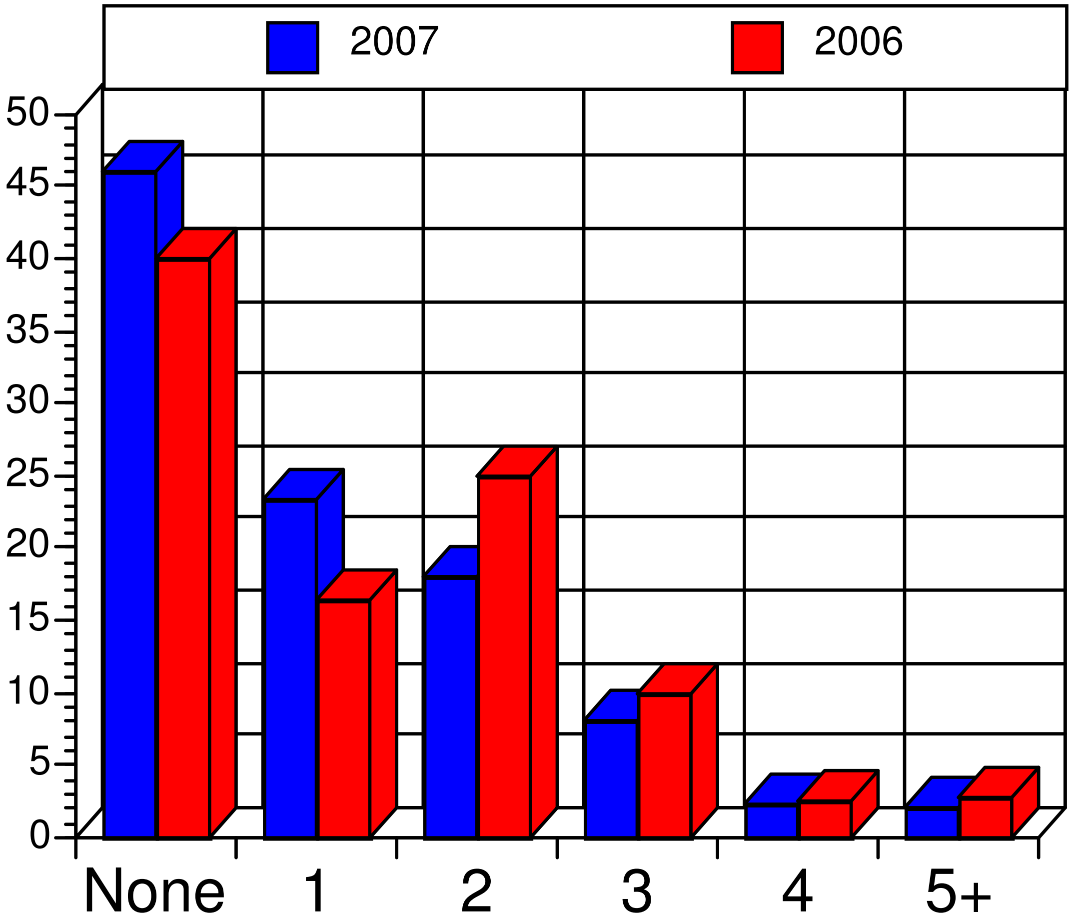
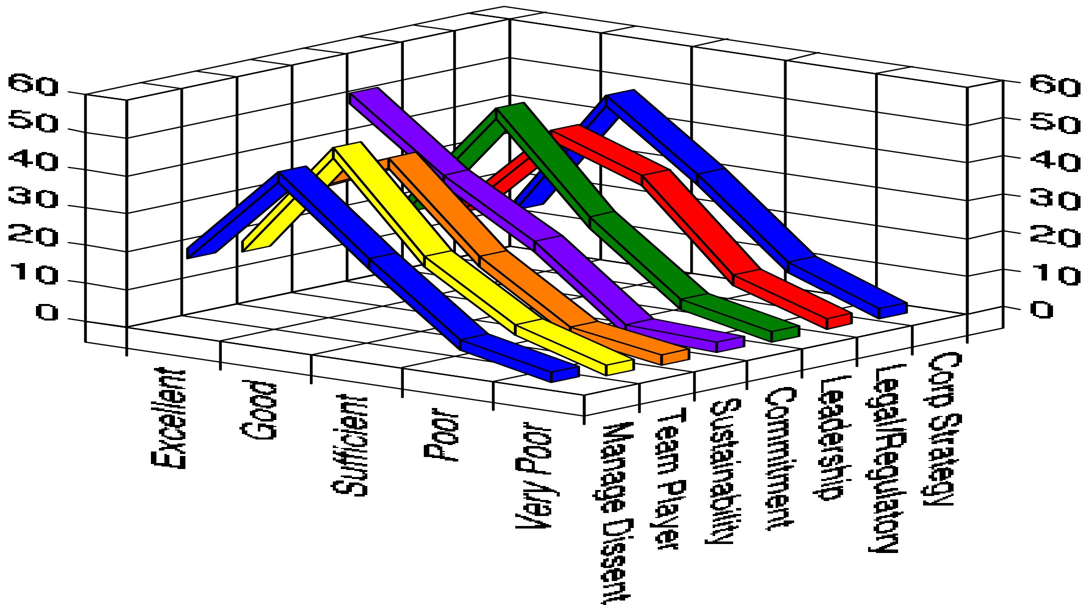
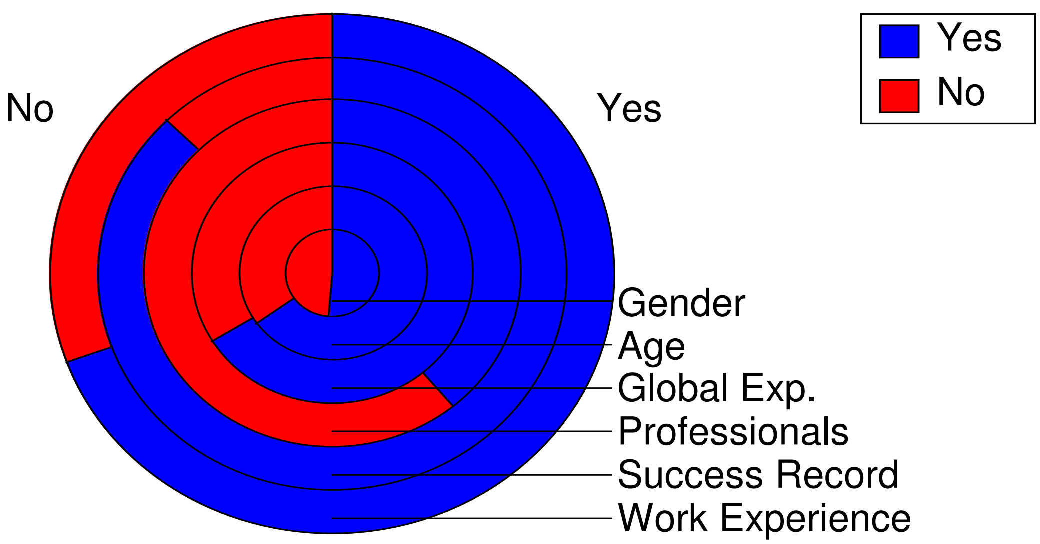


Nearly 60% of all firms are looking for at least one independent director over the next five years, with nearly 40% of firms looking for 2 or more independent directors.

Graph 1: *How many independent directors will your organization recruit over the next five years?*



Graph 2: *How do you rank the effectiveness of your board in these seven categories?*



Graph 3: *List the qualities that are/are not important to you when recruiting an independent director.*