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# A MULTI-THEORY APPROACH OF THE STRATEGIC ROLE OF BOARDS

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## **Abstract:**

*Boards' involvement in the decision process has been reported in different ways in accordance with corporate governance theories. Several scholars postulates that both resource dependence and stakeholder theory emphasize board involvement in decision management through boards' service roles; the legalistic perspective describes boards' involvement in decision control through the execution of control roles; whereas stewardship theory reflects boards' involvement in both decision management and decision control through boards' strategic roles. Other theoreticians split the way in which boards get involved in the decision process into two phases and make comments on the contractual approach associated with agency theory, managerial theory, legalistic theory, stakeholder theory within which boards are known for their limited involvement and on strategic approach linked to stewardship theory and resource dependency theory which recognize the strategic role of boards. Unlike board's control task which is grounded in the agency theory, the strategic task of boards is believed to have a multi-theoretic basis. The paper makes a comparative analysis of different corporate governance theories that are linked to the strategic role of boards.*

**Keywords:** boards, multi-theory, corporate governance, strategic role

## **1. Introduction**

Although there are numerous papers written on boards role during time, there is still little consensus about what these roles should really refer to. In fact, this question has been raised by many scholars in their attempt to depict the roles that boards play within corporate governance frameworks (Mintzberg, 1983; Zahra and Pearce, 1989; Hung, 1998; Boulton, 1978; Johnson *et al.*, 1996; Ong and Lee, 2000).

Some of the authors addressed the issue of boards' roles through the corporate governance theories by trying to link the roles of boards with the school of thoughts. Hung (1998), for example, splits the roles of boards into six different categories and argues that every each of them might be connected with one of the corporate governance theories. This way of defining boards' roles is also shared by Ong and Lee (2000), as they describe the four roles of the boards in accordance with the following theories: legalistic, strategic choice, agency and stewardship, whereas Korac-Kakabadze *et al.* (2001) based on previous research (Zahra and Pearce, 1989, Maassen, 1999) envision a simplified approach of the roles of boards by identifying the following three: service, control, and strategic.

This paper is developed around the strategic role of the boards and it represents an attempt to clarify the way in which boards engage in the strategy decision process on the one hand and to highlight new research directions in boards' engagement on the other hand. From an evolutionary point of view, boards have unfolded from a minor engagement within which they simple legitimize proposals of managers (Andrews, 1991; Shanklin and Ryans, 1981) to major involvement as they actively take part in the strategic decision process (Zahra and Pearce, 1990; McNulty and Petigrew; 1999).

The strategic role of boards is highly documented in both the literature of corporate governance and strategic management. Practitioners have stressed the importance of this function in regard to the overall success of the company admitting that board members should spend more time on strategic rather than on operational issues (Addleman, 1994; Tricker, 1999). Nadler (2004) argues there might be even some advantages for the managers that decide to engage the boards in strategy as this will result in a better understanding of the company, an increase in satisfaction and a stronger ownership and support.

There is no doubt about the clear convergence that exists among scholars that boards have a definite role to play in strategy; however, how boards fulfill this role is rather ambiguous (Hendry and Kiel, 2004; Pugliese *et al.*, 2009). Thus, in considering board attributes and the way in which boards engage to strategy decision process, this paper provides a review on the literature of boards' determinants for engagement in strategy. The paper starts with an overview of the reflection of boards' strategic function from corporate governance theories followed by the analysis of the way in which the strategic role is played in different contexts. The paper concludes by identifying further avenues of research and by describing how such research may be pursued.

## **2. Theories underpinning the strategic role of boards**

Boards' involvement in the decision process has been reported in different ways in accordance with corporate governance theories. Maassen (2002) postulates that both resource dependence and stakeholder theory emphasize board involvement in decision management through boards' service roles; the legalistic perspective

describes boards' involvement in decision control through the execution of control roles; whereas stewardship theory reflects boards' involvement in both decision management and decision control through boards' strategic roles. Charreaux (2000) and Ghaya (2011) split the way in which boards get involved in the decision process into two phases and make comments on the contractual approach associated with agency theory, managerial theory, legalistic theory, stakeholder theory within which boards are known for their limited involvement and on strategic approach linked to stewardship theory and resource dependency theory which recognize the strategic role of boards.

Unlike board's control task which is grounded in the agency theory, the strategic task of boards is believed to have a multi-theoretic basis. The core element of agency theory is reflected in the fact that when a company is not completely owned by management, agency cost is raised between management and other parties. A rich body of literature exists in which the strategic role of boards is sustained through stewardship theory (Korac-Kakabadze *et al.*, 2001; Maassen, 2002; Hung, 1998). Proponents of stewardship theory recognize that directors play a crucial role in strategy (Donaldson and Davis, 1991; Boyd, 1995; Davis *et al.*, 1997).

Stewardship theory is believed to have its origins in the human relations school of management theories and it is perceived in contrast with agency theory. According to this school of thought, managers are not opportunistic and moreover they play a great role in empowering directors rather than monitoring and controlling them (Ong and Lee, 2000). Within the stewardship theory, boards' contribution is done by their knowledge, expertise and commitment that will facilitate the strategic role in the end (Muth and Donaldson, 1998).

However, the stewardship theory is not the only one used to portray the strategic role of boards. A summary of the main theories that underpin the strategic role directors is presented in Table 1 together with the central elements that highlight this role. The resource dependency theory is a strategic contingency theory developed by Pfeffer (1972). It assumes that corporations depend upon one another for access to valuable resources and therefore they try to establish links among them. According to this theory, two companies can benefit of the interlocking directorship if they are able to develop social relations between them within which one person is a member of the boards of both companies (Hung, 1998). From a resource-based view, it can be argued that the unique combination of the expertise and wider experience of the board (boards' human and relational capital) and the quality of top management will positively contribute to the strategic decision-making and ultimately to successful performance of the firm. Both stewardship and resource dependency theory have been criticized over time; the former is contested for its lack of details about board activities and for not describing how directors make decisions, whereas the latter is questioned for not focusing on the internal process of work and decision making (Charreaux, 2000; Stiles and Taylor, 2001).

Another corporate governance theory that examines the strategic role of boards is the strategic choice perspective. This theory is viewed as the theoretical

foundation for corporate research from 1980s to the mid 1990s (Ong and Lee, 2000). Within this framework of research, directors play a pro-active role in their struggle to help companies adapt to the changing environment by shifting from being merely legal advisors to being strategy advisors (Kreiken, 1985). Under this approach, boards actively participate in strategy formulation activities (Zahra, 1990). However, Zahra (1990) did not propose that board members replace CEO's in terms of their responsibilities. It is acknowledged that strategy formulation and implementation are an integral part of CEO's daily duties.

**Table 1: Boards' strategic role is grounded in a multi-theory approach**

<b>Corporate governance theories</b>	<b>The strategic dimensions of boards</b>	<b>Proponents</b>
<i>Stewardship theory</i>	Review of strategies formulated by managers;  Guidance for managers to achieve corporate mission and objectives.	Hung, 1998; Donaldson and Davis, 1991; Boyd, 1995
<i>Resource dependency theory</i>	Co-optation with external environment to secure critical resources.	Pfeffer, 1972
<i>Strategic choice perspective theory</i>	Scanning the environment;  Procuring assets;  Planning, implementing and evaluating strategic measures for divestments, acquisitions, R&D expenditures and capital expenditures.	Ong and Lee, 2000; Zahra, 1990; Kreiken, 1985
<i>Cognitive theory</i>	Taking strategic decisions;  Shaping strategic decisions;  Shaping the content, context and conduct of strategy;  Scanning, interpretation and choice.	Rindova, 1999; McNulty and Pettigrew, 1999; Forbes and Milliken, 1999

A much more recent theory is the cognitive approach according to which directors have an essential role within the organizations due to their knowledge, professional experience and expertise in strategic problem solving. The cognitive theory was developed around the work of the following scholars: Rindova (1999), McNulty and Pettigrew (1999) and Forbes and Milliken (1999). In the cognitive framework, directors are presented as experts with both specific knowledge (about the

firm and its activities), and general knowledge (in strategy, finance, law, etc.). When referring to McNulty and Pettigrew's study (1999), we have to highlight the three levels of boards' involvement in strategy: "taking decision", "shaping decisions" and "shaping the content, context and conduct of strategy". Forbes and Milliken (1999) developed a framework about board process and dynamics to explain the link between board demographics and corporate performance. They proposed a model of strategic making effectiveness.

### **3. The strategic role of boards – towards a conceptual model**

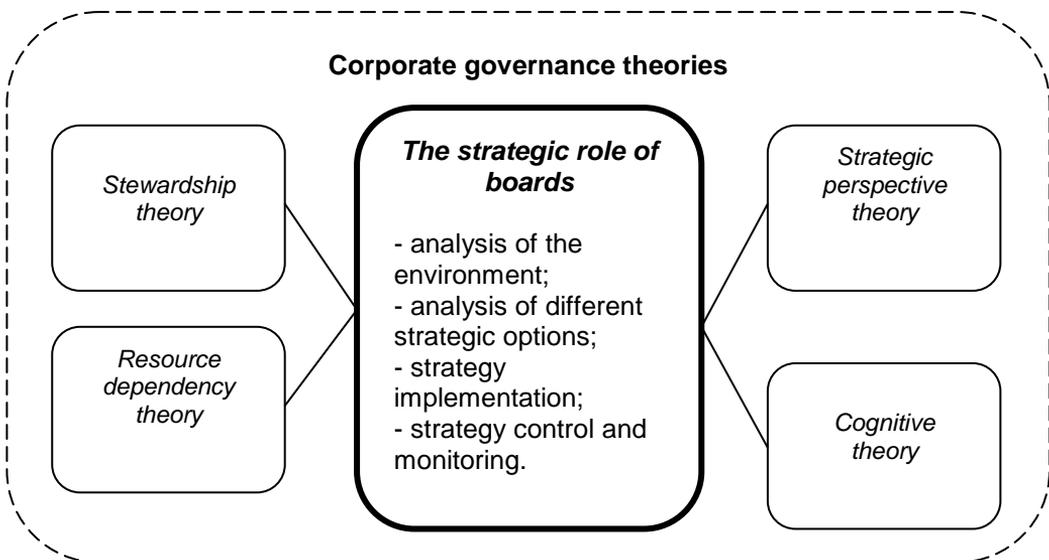
As Judge and Zeithaml (1992) pointed out, the term "strategy" may have different meanings to different people. Things tend to get even more complicated when trying to find a definition for "boards' engagement in strategy". There is few consensus in terms of the way in which board engagement in strategy is defined in the literature. A possible explanation of that might be the fact that this is an emergent concept and for that reason it cannot have a single universal definition (Pugliese *et al.*, 2009; Ravasi and Zattoni, 2006). Ghaya (2011) considers that possible reasons for the lack of general agreement is due to scholars' believe that the reader understands the concepts and there is no need for further clarification. In a study of 150 journal articles that draw on board of directors' contribution to strategy, Pugliese *et al.* (2009) found that almost thirty percent of the papers revisited do not state or define the nature of boards' strategic involvement. Other forms of strategic involvement of boards referred to the following (Pugliese *et al.*, 2009): (1) the degree to which directors may have an impact on the general strategy of the companies, e.g. by developing the mission, establishing long-term targets, and allocating resources; (2) the degree to which boards can contribute to different strategic outcomes, e.g., such as innovation, change, diversification and mergers and acquisitions; and (3) the level of boards' participation in various stages of strategic decision making through interacting with top managers.

It should be noted right from the beginning that there is a distinction between "how boards engage in strategy" and "boards' strategic roles". We have seen so far that boards' involvement in the strategic process may vary from little to major involvement when board members are asked to state their opinion about a certain merger or acquisition. Next, we will examine some of the most frequently cited strategic roles in the literature and we will propose a conceptual model (Figure 1) that could serve as a general framework in future researches on the strategic role of boards.

Initially, boards were recognized for their passive actions that serve their strategic roles. Board members were seen as actors that could oversee or ratify the general strategy of the company. Andrews (1980, p.30) states that "a responsible and effective board should require of its management a unique and corporate strategy, review it periodically for its validity and use it as the reference point for all other board decisions". Demb and Neubauer (1990) argue that the involvement of directors in the formulation of strategy may have unique benefits for the companies: it helps non-

executive directors to move along the learning curve regarding the industry; it prepares the board for implementation actions; it helps developing a commitment and a sense of corporate strategy among board members.

With time, the strategic role of boards has evolved. Several studies that have been published in the last years have identified another component of the strategic role as board members tend to be much more actively involved in developing the general strategy of the company and not just monitoring or controlling the strategy. Zahra (1990) had made comments long before on the reasons for which boards should become more strategic-orientated. First, directors serve the role of linking the company to the environment which will enrich the level of knowledge about competitiveness and industry changes. Second, as directors may serve in other boards pertaining to other companies they may provide valuable information in strategic decision-making process. Third, as the result of the complex competitive environment, boards can offer CEOs guidance in strategic actions.



#### **4. Discussions and conclusions**

The way in which boards involve in the strategy decision process has been highly debated in the last years by different researchers (Bammens *et al.*, 2011; Pugliese *et al.* 2009). It was our intension as well to embrace a similar research. This work enables us to draw on some insights on previous research contributions by illustrating the avenues for future research. Our study has several scholarly and practical implications which will be highlighted next.

The strategic role of boards is multi-theory grounded as there are several corporate governance frameworks which describe this role. Among these, the stewardship theory is cited frequently by researchers together with resource

dependence theory, strategic choice theory and more recently, the cognitive theory for being the foundation pillars of boards' strategic involvement.

Even though the strategic role of boards is documented in several theories, how this role is fulfilled remains one of the major question marks in corporate governance and strategic management literature. Pugliese *et al.* (2009), in an extensive literature review on corporate governance articles focusing on boards' contribution to strategy argue that there are at least four types of implication depending on the researchers' preference.

One avenue for future research on boards' engagement in strategy should be the way in which directors behave. Indeed, we need to know more about the behavior of those who sit on boards, so we could better understand its implications. This will not be an easy task to do as behavior is not a transparent board attribute like structure is for example. This calls for qualitative studies which will be able to penetrate beyond directors' minds. Probably the most fruitful behavior attribute in the next year will be related to the ethical behavior of boards. This is a challenging assignment as it is difficult to perform analysis on such an issue. Researchers will have to struggle with a certain barrier from directors that would not want to answer questions about their ethical behavior.

Another possible avenue for theoretical researches is the one that links all boards' attributes to contextual attributes. In some cases, context no matter is about industry or company environment can count a lot for boards' to engage. Because of that, we consider that is being necessary to understand the role of the context in relationship between boards and strategy.

Our study has also implications for practitioners resulting from boards' involvement in the strategy decision process. First, by having more strategic-orientated boards, one could easily expect to see directors acting with more care, being conscious about their actions. If this is the case, directors will consider more reasonable alternatives before setting the limits of their strategies and jumping to decisions. Second, directors that involve more on strategic tasks are more likely to collaborate with senior management. This cooperation will lead in the end to better corporate performance (Judge and Zeithaml, 1992; Ruigrok *et al.*, 2006).

The main purpose of this paper was to review some of the most relevant theoretical and empirical studies on how board determinants affect the involvement in the strategy decision process. By doing so, we were able not only to perform an up-to-date literature review which includes studies up to present day, but also to portray a new classification of board attributes that better suites the actual needs of worldwide researchers.

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