

BOOK REVIEW: “BOARD OF DIRECTORS: A REVIEW OF PRACTICES AND EMPIRICAL RESEARCH”

by

Stefano Dell’Atti, Montserrat Manzaneque, and Shab Hundal
(Virtus Interpress, 2020)

Udo C. Braendle *

* School of Business Administration, American University in Dubai, Dubai, UAE



How to cite this paper: Braendle, U. C. (2021). Book review: “Board of directors: A review of practices and empirical research”. *Corporate Governance and Sustainability Review*, 5(2), 102–105. <https://doi.org/10.22495/cgsrv5i2p9>

Copyright © 2021 The Author

This work is licensed under a Creative Commons Attribution 4.0 International License (CC BY 4.0). <https://creativecommons.org/licenses/by/4.0/>

ISSN Print: 2519-8971
ISSN Online: 2519-898X

Received: 08.03.2021
Accepted: 25.06.2021

JEL Classification: G34, M12, M14
DOI: 10.22495/cgsrv5i2p9

Efficient management control is at the center of the corporate governance debate since its beginning. Particularly boards of directors are in the spotlight as they are links between managers and investors, therefore being an effective instrument of good governance. Boards are seen as an economic institution that can help to solve the agency problems inherent in managing an organization.

As much as the literature on boards is growing, a systematic review like the one presented in the book of Dell’Atti, Manzaneque, and Hundal (2020) has been missing so far. The focus on practices is noteworthy and necessary. This is especially relevant as boards of directors are facing recent challenges that need to be addressed. The focus of this review is particularly on board diversity and sustainability issues that will keep boards busy in the 21st century.

Dell’Atti et al. (2020) present the extensive empirical literature on boards, that has filled the vacuum in formal literature. But answering the questions of how board characteristics such as composition or size affect the company’s performance, or how they affect the actions of the board, is not always easy (Alanazi, 2019). Almost all variables of interests are endogenous both a result of the actions of previous directors and influences of subsequent directors. Moreover, many empirical results can be interpreted either as equilibrium or out-of-equilibrium phenomena (Hermalin & Weisbach, 2003). It is very difficult to distinguish between the two interpretations in a given study but they often have quite different implications for policy.

From a very abstract viewpoint, the question of why boards exist at all, is still not finally answered. Think of the press and academics who regularly criticize boards for being insufficient guardians of other people’s money and being too much in management’s hands (Baldacchino, Camilleri, Schembri, Grima, & Thalassinis, 2020). On the other hand, board systems exist for a long time and if they were really so inefficient we could have expected the market to improve or even replace them.

In other words, pointing out that an institution is not first-best efficient does not mean that we need another regulation. A reasonable alternative is that boards are second-

best solutions to the agency problems confronting a company with a large divergence in interests among its members (Hermalin & Katz, 1991).

Therefore, the potential answer that boards just exist as a product of regulation is not far-reaching enough because if they existed just for that reason they would represent deadweight costs to firms which subsequent lobbying would have eliminated, at least somewhere in the world. So, if boards resembled deadweight costs to the companies we should expect them all to be a minimum size. But on the contrary, boards are much larger in practice than required by law (Almutairi & Quttainah, 2019). Hence, the literature defines boards of directors as part of the market solution to the contracting problems inside most organizations as the shareholders are too diffuse, rationally plugged by free-riding, and often too uninformed to control managers and tie their compensation packages.

As mentioned above, formal analysis of the role of boards of directors and how they should be regulated are rare. Hermalin and Weisbach (2003) consider a model where the firm's performance together with monitoring by the board reveals information over time about the ability of the CEO. In this model, the extent of monitoring by the board is a function of the board's independence as measured by the directors' financial incentives as well as their distaste for confronting management, and therefore an endogenous variable. As a result, CEOs tend to be less closely monitored the longer they have been on the job. This is an important insight, namely the gradual erosion of the effectiveness of boards over time. It suggests that regulatory responses should be targeted more directly at the selection process of directors and their financial incentives to monitor management.

Xiao, Li Sun, and Weng (2021) allow for the dismissal of minority directors who oppose management but newly selected members are assumed to act in the interest of shareholders. The model predicts that directors, who are assumed to prefer staying on the board, will be reluctant to vote against management unless the evidence of mismanagement is so strong that they can be confident enough that a majority against management will form. This implies that boards are mainly active in crises situation.

As presented in the book, the bulk of empirical literature deals with board composition and independence and their effect on corporate performance. Summed up, the evidence from the US (dela Rama & Kostyuk, 2019) suggests that board composition and corporate performance are "not related", the relationship is "uncertain" or is "at best ambiguous" (Al-Saidi, 2021; Hermalin & Weisbach, 2003). These are all results from the US, and it is very refreshing that Dell'Atti et al.'s (2020) book sheds light on as the international evidence on the role of boards in corporate governance and their impact on corporate performance, as the international literature has been sketchy or not easily accessible.

Looking ahead, diversity and sustainability are the two challenges that will keep boards of directors busy in the years to come. From a corporate governance perspective, of course, the topic of diversity is especially interesting with regard to the board of directors. Following Pfeffer (1983), a large empirical body of literature has emerged trying to investigate that link, while spanning various types of diversity such as age, gender, and broader organizational outcomes (Carter, D'Souza, Simkins, & Simpson, 2010). Results have shown largely inconsistent findings, with some studies reporting a positive relationship, a negative relationship, or no relationship at all (Abdel-Azim & Soliman, 2020).

These earlier debates on the topic have brought forth two interrelated propositions for the future. First, and irrespective of diversity's economic implications, there are viewpoints holding that diversity among boards should be enhanced solely to promote equal opportunities and social justice (Syed & Kramar, 2009), a mindset and movement which has been labeled affirmative action. More recently, such propositions have also been reflected in various legal frameworks and corporate governance guidelines. For example, the German Corporate Governance Code (GCGC) advises the supervisory board "to respect diversity" when appointing the board of directors. The second viewpoint is that creating equal opportunities is "the right thing to do" (Carter et al., 2010). Those authors advocate the opinion that any actions taken concerning diversity management should have an impact on the bottom line in organizations. Accordingly, good compliance with diversity issues not only serves equality demands but is theoretically assumed to impact a firm's position in the capital market, as it leads to a lower cost of capital and thus to higher firm performance.

Sustainability is another big topic for boards, as company stakeholders, including the government, employees, the media, and the public, are increasingly concerned with organizations' commitment to governance standards, environmental issues, social investment, and community involvement. Having initially been understood as environmental sustainability (Amankwah-Amoah, 2020) the concept was developed further and now embraces environmental, social, and economic sustainability. This stance is also inherent in the notion of the triple bottom line, which entails the thinking that people, planet, and profit are inextricably linked with each other and that organizations can create long-term value by striving to expand the life span of societies, ecosystems, and economies (Elkington, 2010). The concepts of sustainability and corporate social responsibility (CSR) have gained a significant position in the general management literature (Toussaint, Cabanelas, & Blanco-González, 2021), there will affect how boards can address all of these dimensions in their work. As Dell'Atti et al. (2020) highlight, the progress reflected in this book reinforces the dynamism and relevance of this field going forward.

REFERENCES

1. Abdel-Azim, M. H., & Soliman, S. (2020). Board of directors' characteristics and bank performance: Evidence from the Egyptian banking sector. *Journal of Governance and Regulation*, 9(1), 116-125. <https://doi.org/10.22495/jgrv9i4art10>
2. Alanazi, A. S. (2019). Corporate governance and the characteristics of the board of directors: Evidence from an emerging market. *Corporate Board: Role, Duties and Composition*, 15(1), 17-24. <https://doi.org/10.22495/cbv15i1art2>
3. Almutairi, A. R., & Quttainah, M. A. (2019). Internal and external corporate governance mechanisms in the context of the emerging market. *Corporate Governance and Organizational Behavior Review*, 3(2), 52-57. https://doi.org/10.22495/cgobr_v3_i2_p5
4. Al-Saidi, M. (2021). Board independence and firm performance: Evidence from Kuwait. *International Journal of Law and Management*, 63(2), 251-262. <https://doi.org/10.1108/IJLMA-06-2019-0145>
5. Amankwah-Amoah, J. (2020). Stepping up and stepping out of COVID-19: New challenges for environmental sustainability policies in the global airline industry. *Journal of Cleaner Production*, 271, 12300. <https://doi.org/10.1016/j.jclepro.2020.123000>
6. Baldacchino, P. J., Camilleri, A., Schembri, B., Grima, S., & Thalassinou, Y. E. (2020). Performance evaluation of the board of directors in listed companies: A small state perspective. *International Journal of Finance*, 10(1), 99-119. Retrieved from https://www.researchgate.net/publication/340682340_Performance_Evaluation_of_the_Board_of_Directors_in_Listed_Companies_A_Small_State_Perspective
7. Carter, D. A., D'Souza, F., Simkins, B. J., & Simpson, W. G. (2010). The gender and ethnic diversity of U.S. boards and board committees and firm financial performance. *Corporate Governance: An International Review*, 18(5), 396-414. <https://doi.org/10.1111/j.1467-8683.2010.00809.x>
8. dela Rama, M., & Kostyuk, A. (2019). Editorial: Adapting Anglo-American corporate governance concepts in non-Anglo-American environments. *Corporate Governance and Sustainability Review*, 3(1), 4-6. https://doi.org/10.22495/cgsrv3i1_editorial

9. Elkington, J. (2010). Corporate sustainability. In W. Visser, D. Matten, M. Pohl, & N. Tolhurst (Eds.), *The A to Z of corporate social responsibility* (1st ed.) (pp. 114–119). Chichester, UK: A John Wiley & Sons, Ltd., Publication.
10. Hermalin, B. E., & Katz, M. L. (1991). Moral hazard and verifiability: The effects of renegotiation in agency. *Econometrica*, 59(6), 1735–1753. <https://doi.org/10.2307/2938287>
11. Hermalin, B. E., & Weisbach, M. S. (2003). Boards of directors as an endogenously determined institution: A survey of the economic literature. *Economic Policy Review*, 9(1), 7–26. Retrieved from <https://www.newyorkfed.org/research/epr/03v09n1/0304herm.html>
12. Pfeffer, J. (1983). Organizational demography. In L. L. Cummings, & B. M. Staw (Eds.), *Research in organizational behavior: An annual series of analytical essays and critical reviews*. (pp. 299–357). London, UK: Jai Press.
13. Syed, J., & Kramar, R. (2009). Socially responsible diversity management. *Journal of Management and Organization*, 15(5), 639–651. <https://doi.org/10.5172/jmo.15.5.639>
14. Toussaint, M., Cabanelas, P., & Blanco-González, A. (2021). Social sustainability in the food value chain: An integrative approach beyond corporate social responsibility. *Corporate Social Responsibility and Environmental Management*, 28(1), 103–115. <https://doi.org/10.1002/csr.2035>
15. Xiao, J., Li Sun, S., & Weng, D. H. (2021). The unfriendly board: Antecedents and consequences of board dissent. *European Management Journal*, 39(1), 135–146. <https://doi.org/10.1016/j.emj.2020.10.002>