CHAPTER 2

Corporate Boards

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Abstract This chapter aims to set the ground, providing a brief definition of the corporate governance according to worldwide practices and focusing on the role and the functions of the board of directors. To reach this goal, a punctual review of the different theoretical frameworks coping with this topic is provided, putting in evidence the main differences as well as the principal points in common. Specifically, the agency theory, the stakeholder theory, the stewardship theory, the resource dependence theory, and the institutional theory are analysed. Moreover, the role of BoDs is analysed together with the features and the overview of "good" corporate governance practices according to existing literature and practice.

Keywords Corporate governance · Corporate board · Agency theory · Resource dependence theory · Stakeholder theory · Stewardship theory

2.1 Corporate Governance and Board of Directors

The expression "Corporate Governance" refers to all organisms, processes, and mechanisms designed and used to direct and control firms. Even though this expression is worldwide used since the beginnings of

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the 1980s, a general consensus on its significance and on what it effectively includes does not exist yet. The international literature, as well as numerous domestic and supranational authorities, provides different definitions mainly based on both the range and the variety of stakeholders considered and the range and variety of firm's bodies and mechanisms in charge of the governance of the firm (Kumar and Zattoni 2015). Despite the existence of a multitude of definitions, a common point of analysis is the recognition of the role of corporate governance in mitigating conflicts of interests between stakeholders in corporation. Leveraging on this need, a milestone in the conceptualization of the corporate governance is provided by the Cadbury Report (Cadbury 1992) titled "Financial Aspects of Corporate Governance", which describes corporate governance as "the system by which companies are directed and controlled". The Report was issued by "The Committee on the Financial Aspects of Corporate Governance", chaired by Adrian Cadbury, whose name it bears, to set out recommendations on the arrangement of company boards and accounting systems to mitigate corporate governance risks and failures. Specifically, the Cadbury Report states that "Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interest of individuals, corporations and society". The importance of this report relies on the fact that the recommendations proposed thereby have been used by several other subsequent corporate governance codes.

Over the following years, several other definitions were given, some of them more based on the idea that the company generates value specifically for shareholders, and others more focused on a wider idea of value creation for a broader number of stakeholders. For example, following the contribute developed by Denis and McConnell (2003), corporate governance is "the set of mechanisms – both institutional and market-based – that induce the self-interested controllers of a company to make decisions that maximize the value of the company to its owners". Similarly, Shleifer and Vishny (1997) suggest that "Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment". Moreover, remaining on the same path of contributes, Larcker and Tayan (2008) define corporate governance as "the set of mechanisms that influence the decisions made

by managers when there is a separation of ownership and control". It's therefore intuitive that these definitions embrace the idea that the main aim of a firm is to create value for the owners. This mainstream of studies is well known in the international literature under the label shareholders' approach (Rappaport 1986).

On the contrary, a wider perspective taking into account all the main stakeholders of the firm leads to a broader definition of corporate governance. In fact, according to this different branch of studies, known as the Stakeholders' approach (Freeman 1988), corporate governance can be defined as a "bundle" of internal and external mechanisms necessary to lower the interests' misalignments between the firm and the various stakeholders who have linkages with the firm itself (Hanson and Song 2006). Thus, the final aim of the corporate governance is the satisfaction of stakeholders' needs as the basis for ensuring the long-term success of the firm.

However, independently from the conceptual lens of analysis assumed, a common point between the two approaches occurs about the board of directors and its role. In fact, this body is universally recognized as the main mechanism of the corporate governance system adopted by the firms. For this reason, the following paragraphs aim to illustrate and explore the main characteristics and functions of the board of directors as a premise to understand its impact of the management of the firm and, in turn, as the ultimate goal of this work, on the performance of the company.

2.2 Board of Directors: What Are They and Why Do They Exist?

The board of directors (shortly, BoD or Board) is the body of the company appointed directly by its shareholders and entitled of monitoring and controlling the activities of the management as well as of the setting of the corporate strategies. Therefore, this group of people has a great direct responsibility towards the shareholders, but, at the same time, they are made to bear an indirect responsibility towards all the other stakeholders, since their decisions impact on a wide range of actors which revolve around the company.

The need to provide firms with a BoD comes from their evolution occurred during last decades. In fact, in former times, firms were small and directly managed by the ownership itself; over the course of time,

several companies have grown in their dimensions and in the range of activity transforming themselves in multinational companies and diversified corporations. These more complex organizations called for (and even today need) more structured mechanisms on the one hand useful to manage and monitor the strategies implemented by managers and on the other hand able to handle the regulations as well as the characteristics of the environment in which firms operate. In some countries (first of all the USA), this need is more acute since companies show a dispersed ownership picture, so they are not anymore controlled and managed by the ownership itself at all. As pointed out by Fama and Jensen (1983), in their famous work developing the agency theory, this situation led to a strong separation between those who own the company (the principal) and those who manage it (the agent). Within this kind of scenario, the BoD has a relevant role for shareholders, assuring them that the management behaves pursuing the shareholders' interests and not its personal ones. Therefore, acting as the intermediary between the shareholders and the management, the BoD has the primary purpose to solve and balance the various and differentiated interests, as suggested by the agency theory.

Nevertheless, in other countries, such as in most of the continental European ones, the ownership structure is quite different from the one previously described. In fact, in these contexts, the ownership of the firms is usually more concentrated, showing the presence of a dominant shareholder, able to control the majority (effective, when a single shareholder holds more than 50% or relative, when a shareholder owns the largest amount of ownership compared to the other owners) of the company (Faccio and Lang 2002; La Porta et al. 1999). Acting within this scheme, the role of the BoD is still relevant, but acts in a different way. In fact, in this case, the minority shareholders have a little power in the company and they can only rely on the BoD, trusting it for controlling that the majority shareholder behaves following the interests of all the shareholders and not only its personal ones. On top of that, when a shareholder majority exists, its presence in the management of the company is very common, arising the risk of opportunistic behaviours and increasing the importance of the BoD in covering the role of control mechanism. Coherently with these considerations, Fama and Jensen (1983) state that the importance of the BoD is determined by the operative influence to settle an effective information system that stakeholders could use to monitor the opportunism behaviour of the top management.

Notwithstanding, not all the academics and practitioners agree about the real possibility of the BoD to cope with these issues. In fact, some scholars think that the BoD cannot solve suitably the agency problems occurring within the firm. For example, Kumar and Sivaramakrishnan (2008) sustain that the delegation of governance to the board has a double effect: on one side, it is true that it improves the monitoring, and from the other side, it is equally true that it generates another agency problem because directors become dependent on the CEO and, in turn, their behaviours can be conditioned by the research of CEO's complacency. Thus, a reasonable question could arise: If the board of directors cannot really solve the agent-principal problem, as some scholars state, why do they exist?

A first answer can be found in the fact that companies must comply with the requirements and regulations of the stock exchange markets, and, at the same time, they have to be compliant with the rules of the corporate law codes enacted by home country legislator as well as by international authorities. Within this perspective, the board would be interpreted only as another product of regulation. However, it must also be said that if this was the reason behind the existence of the board, it would be only a deadweight cost for the organization. Instead, governing boards are prevalent all over the world, in both profit and non-profit organizations. In addition, the evidence shows how most of the BoDs are often much larger than what is required by the regulatory framework. All these features demonstrate that the presence of BoDs and their role goes far beyond the mere application of the law.

Deepening these last considerations, a second answer to the question about the reason at the base of the existence of boards comes from the idea, supported by several scholars, that corporate boards exist as a market solution to an organizational enterprise problem. In other words, they represent an endogenously determined body that helps to ameliorate the agency problems that affect companies. Nevertheless, Hermalin and Weisbach (2003), reviewing the contributes offered by the economic literature, put in evidence how the attention should be addressed to the board's inner workings (instead of analysing its relationships with the other bodies of the firm) in order to develop a more coherent model of the board and a better understanding of its role in corporate governance.

Finally, in contrast to the agency theory, some other theoretical frameworks have pointed out how an organization depends on the resources available in the environment in which it operates, showing a strong

relation between these resources and the firm's development. Adopting this perspective, it is possible to identify a third answer to the question about the existence of BoDs: the role of the board of directors is crucial in company events because directors can help the firm to acquire and manage critical resources, leveraging also on the social connections which can increase and strengthen the sources of knowledge.

Finally, another relevant issue in analysing BoDs and the reasons explaining their presence rely on the functions to be performed. In a nutshell, the board is elected by the owners of the company and it has to act protecting their investment. Indeed, following the insights provided by Mace (1971), boards can be seen as the body that advices and counsels the management of the firm, providing discipline to the company and acting in case of crisis or when a change in the management team is required. Precisely for these reasons, it's part of the board's prerogatives the choice of the management, which is the operating figure of the company. Moreover, considering that in a long-term perspective the goal of companies is to grow and flourish, increasing their value, the board becomes a central figure in assuring the achievement of these targets, governing, supervising, and directing the management team. As a consequence, it represents the ultimate decision-making authority in reaching these results. Thus, it has to set the company's policy, objectives, and the overall direction. Furthermore, among the relevant strategic and financial matters, the board is also called upon to oversee or give a substantial contribute in managing some critical aspects of the life of the company, such as: (i) the hiring (as well as the firing) of the top managers, (ii) the declaration of the stock dividends' policies and executives' remunerations together with the setting of the final economic objectives, (iii) the decision on stock issuance, (iv) the evaluation of M&A operations, and (v) the overseeing of the legal and regulatory compliance. In addition to these responsibilities, other duties pertain the board, such as the selection of the CEO, the approval of the budget, and the definition of compensation plans for top managers.

2.3 The Role of the Board of Directors: Theoretical Background

The search for an answer to the question on the reasons at the basis of the existence of BoD leads to the study of the roles attributed to this body of the firm. Different theories have been developed in the

attempt to clarify the role that the board has in directing and controlling a company. On actual facts, as previously mentioned, the board is in charge of setting the main firm's strategies, mediating among stakeholders' interests, monitoring the behaviours and the decisions adopted by managers, and providing them with the necessary resources. Naturally, the importance of these tasks varies over the time, depending on the circumstances the firm is coping with. This led academics and scholars to focus on specific aims to be achieved by the board instead of developing a comprehensive view of its role.

In order to provide a general overview of the main theoretical contributes aiming at studying the functions and the performance of the BoD, this paragraph and its subparagraphs are addressed to illustrate five different conceptual perspectives, respectively: the agency theory, the stakeholder theory, the stewardship theory, the resource dependence theory, and the institutional theory.

2.3.1 The Agency Theory

The agency theory framework can be applied to analyse the role of the BoD using the widely known "principle-agent" dilemma. Shareholders, as owners of the company, represent the principal, while the managers, who run the company from an operational point of view, are the agent.

First evidences of the development of this theory date back to 1932, when Berle and Means (1932), in their study on the governance structure of the 200 largest USA non-financial corporations, provided empirical evidence that ownership was divorced from control; in fact, fewer than half of the companies they examined were under what they categorized as managerial control. Specifically, the authors underline how the separation between ownership and control enhances when the firm is strongly financed with equity belonging to a large variety of subjects, no one of them having a significant amount of ownership on their own.[1] In such situation, all these owners will have a little knowledge of the company, which is actually run and managed by managers hired on the job market, not holding shares of the company. Thus, a separation between ownership and management occurs, and a misalignment of interests between shareholders (the principal) and the management (the agent) arises because the former's aim is to maximize the value of their shares and the latter's main aim is to strengthen their position and their power in the firm, enhancing

also their compensation and their personal benefits (Jensen and Meckling 1976). The risk that has to be avoided, in fact, is that these managers take advantage of their position to pursue personal interests instead of the shareholders' interest, which can be summarized in the profit maximization of the company. In fact, the position that managers occupy allows them to benefit from accurate and truthful information creating opportunities they could catch, at the expenses of the firms' wealth and resources. For example, they could take excessive risks on corporate assets or could prize themselves with groundless bonuses and remuneration. To cope with these risks, shareholders rely on the board, which has the duty to monitor managers and their behaviours, assuring the protection and the achievement of the shareholders' interests.

In firms where the ownership structure is not dispersed but instead is concentrated, as highlighted by Berle and Means (1932), the typical agency problem does not exist because actually there is no separation between the owners and the management or, eventually, the problem is strongly mitigated by the existence of a large block-holder, who has more incentives to control managers' behaviours (La Porta et al. 1999). Moreover, the largest shareholder usually also manages the firm and operates also in its governance, eliminating the aforementioned agency problem. Given this situation, a different agency problem arises: the misalignment of interests between the majority shareholder and the minority shareholders. The concentrated ownership, in fact, is characterized by the presence of a large blockholder that has a relevant influence on the firm's decisions, much more than the other owners, being actually the controlling shareholder (Shleifer and Vishny 1986). Thus, in this context, the risk that has to be avoided relies on the behaviour of the controlling shareholder, who could aim at gaining personal benefits at the expense of minority shareholders and the other stakeholders of the firm (Bebchuk and Fried 2003). Therefore, it is readily understandable that the relationship between majority shareholder and minority shareholders is characterized by conflict of interests and information asymmetry (Denis and McConnell 2003; Thomsen et al. 2006). Accordingly to these considerations, many corporate governance regulations are addressed to remove agency problems and to introduce or strengthen mechanisms to support shareholders in controlling managers. An example of the measures that have been taken in the past to increase BoD capacity-scrutiny is the establishment of the independent and the non-executive directors, which means the introduction of new members in

the BoD without any personal, material, or pecuniary relationship with the company or with other members of the BoD or of the management team.

The high importance given by the agency theory to the board in satisfying and protecting shareholders' interests finds its origin in the oldest economic idea that firms have to maximize shareholders' wealth. However, the general acceptance and the fame of this theoretical framework have diminished over the recent decades due to major corporate failures and scandals. Some scholars, in fact, have started to address the causes of these situations to the prevalence of the maximization of short-term share price rather than long-term firm's value. In other words, through the approval of operations oriented to the maximization of short-term profit and price, the board loses the focus on the long-term effects of these decisions and actions on the firm (Klettner 2017). As a consequence, placing shareholders' interests (that mainly focus on profit maximization) first might lead to an underperforming of the outcomes and in turn to a deterioration of the firm's wealth together with the welfare of employees, communities, and investors (Stout 2012). Because of these reasons, over the past years a greater emphasis has started to be given to more stakeholder-oriented theories.

2.3.2 The Stakeholder Theory

While the agency theory focuses the attention towards the specific relationship between the shareholders and the BoD, the stakeholder theory enriches the stream of actors to be considered. In fact, this theory suggests that a firm has responsibilities towards a broader group of stakeholders and not only towards shareholders. Each person or group that can influence or can be influenced by the actions of the company is defined as a stakeholder. This includes workers, clients, suppliers, competitors, creditors and, more in general, the society in which the firm is run. Thus, this theory suggests that the firm has to generate value for all its stakeholders and not only for the shareholders (Freeman 1984).

Coherently to this conceptual framework, the role of the corporate governance is the balancing of the interests of all different parties (Abrams 1951), since, in turn, this leads to better financial outcomes, as proven by numerous empirical analyses (Donaldson and Preston 1995; Jones 1995; Laplume et al. 2008). This assumption is based on the overpassing of the traditional vision of the maximization of firm's value for shareholders in

favour of a new paradigm founded on the maximization of the overall firm's performance. In fact, Freeman (1984), seen as the father of the Stakeholder Theory, in his milestone book "Strategic Management: a Stakeholders Approach", offers a pragmatic approach to strategy, underlining how some companies are now justifying broader social policies and actions not for normative reasons, but for strategic purposes.

Overall, this theory offers a descriptive approach, since it describes the firms as a constellation of cooperative and competitive interests, expressed by different stakeholders, which are a source of intrinsic value. In fact, stakeholders are identified by their interests in the firm, whether the corporation has any corresponding functional interest in them (Donaldson and Preston 1995). Within this framework, connections between the activities of stakeholders and the achievement of various corporate performance aims can be examined. Nonetheless, the theory is not confined to the description of the existing situation nor to the prediction of the cause-effect relations; it also provides some structures or practices that can lead to the design of the stakeholder management. Specifically, stakeholder management needs to pay simultaneous attention to the legitimate interests of all appropriate stakeholders when defining the organizational structure of the firm and setting general policies. The main issue concerning the application of this theory in the management practice is represented by the identification of the stakeholders and their legitimate "interest" in the firm. Accordingly, this theory implies that not all stakeholders, even if identified, will equally participate in the decisions and the processes of the firm.

Conversely, even though it recognizes the importance of the relationships between shareholders and management, the theory does not take it into consideration as the only bond in a firm. In fact, all actions implemented by the firm have to provide benefits for all stakeholders, aligned with a socially responsible vision of the organization. As a consequence, the main aim of an effective corporate governance structure should be the value creation maximization of the firm, considered in its totality (Blair 1995).

2.3.3 The Stewardship Theory

During the 1990s, thanks to the progressive studies focused on social psychology and behaviour of managers, a new theoretical perspective, called Stewardship Theory, emerged. In open opposition to the agency

theory previously described, this new paradigm starts from the assumption that the management of a firm works in the interest of the company and not against it (Donaldson and Davis 1991). In fact, the stewardship theory underlines how shareholders nominate directors to serve in the board. Thus, they have a specific and sole assignment: serving according to the shareholders' interests in every aspect, and this is the legal foundation of the shareholders' protection which led to assume the member of the board (the stewards) to be collectivists, pro-organizational, and trustworthy (Davis et al. 1997).

In other words, grounded in psychology and sociology theories, stewardship theory argues for the possible alignment between the principals and agents as a consequence of a psychological contract or a close relationship with agent behaving in a community-focused manner, directing trustworthy moral behaviour towards the firms and its shareholders (Davis et al. 2007). Thus, stewardship theory holds that there would be no inherent, general problem of executive motivation (Donaldson and Davis 1991), leveraging on what affects human beings and their behaviour within a system. Specifically, there are two main psychological factors that affect individuals, namely socio-emotional wealth and economic well-being (Gomez-Mejia et al. 2011), and a relationship can be viewed from a stewardship perspective when pro-organizational and collectivistic behaviours have greater utility than selfish interests (Davis et al. 2010). As a consequence of this, company motivations prevail on individual motivations. In fact, managers, acting as stewards, behave in a collective manner because they are trying to accomplish the goals of the organization as a whole, for example innovation, profitability, sales growth, and survival/continuity (Vallejo 2009). A steward watches over shareholders' wealth and seeks to maximize it through favourable firm performance (an aim shared by most stakeholder groups) because this will maximize his or her utility functions as well (Davis et al. 1997). Nonetheless, the risk of opportunistic behaviours cannot be ignored, since they are entailed in the human nature. Thus, the key to an efficient stewardship can be traced only in the organizational design of the firm, which should be built upon fundamental values as trust and integrity. In this sense, the selection of the managers, as well as of the members of the BoD, should be driven with the aim of finding people motivated in behaving in the interest of the company thanks to their commitment in respecting the organizational cultural rules and sharing these values. In fact, as suggested by Smallman (2004), since stewards' individualistic self-serving behaviours have a lower

utility than collectivistic organizations ones, organization comes first and cooperation is the key to the stewards' rationale.

Finally, the stewardship theory recognizes the existence of other stakeholders as well as the need to consider the effects of firm's strategy on them, but the primary loyalty should be towards the shareholders, since other stakeholders (e.g. suppliers and employees) have their interests protected by law (Tricker 2009).

In synthesis, the stewardship theory calls for a balanced governance in which stewards (directors) solve conflicts arising within groups, generating concrete results that fulfil the interests of all the subjects involved in the firm.

2.3.4 The Resource Dependence Theory

Although agency theory is still the predominant framework used in the investigation about the board of directors, empirical studies on resource dependence theory suggest that this conceptual framework is a more successful lens for understanding boards (Dalton et al. 2007; Johnson et al. 1996; Zahra and Pearce 1989).

The application of the resource dependence theory in explaining the role of BoD has its roots in the pioneering contribute developed by Pfeffer (1972) founded on the idea that boards enable firms to minimize dependence on current resources and gain the access to new sources of resources. Specifically, this theoretical framework was originally developed to provide an alternative to the economic theories for merger operations and board interlocks in order to investigate on the interorganizational relationships that affect organizational failures (Pfeffer and Salancik 1978). Starting from the consideration that organizational survival depends on the ability of the firm to acquire and maintain resources available in the environment in which it acts, the theory affirms that companies have to plan strategies and tactics to restructure their dependencies and reduce them (Davis and Cobb 2010; Casciaro and Piskorski 2005). In achieving this goal, early studies using the resource dependence theory to examine boards focused on their size and composition as a proxy of the firm's ability to cope with resource dependence, opening the company to new sources of critical resources. Pfeffer (1972), for example, finds that board size relates to the firm's environmental needs and those with greater interdependence require a higher ratio of outsider directors. In other words, the author states that "board size

and composition are not random or independent factors, but are, rather, rational organizational responses to the conditions of the external environment" (Pfeffer 1972: 226), confirming this assertion in a replication study (Pfeffer 1973). On the same path of analysis, Sanders and Carpenter (1998) find a relation between board size and environmental dependence, measured by the level of internationalization of the firm, and Dalton et al. (1999) conduct a meta-analysis to show a positive relationship between board size and firm financial performance.

It is relevant to underline that the board composition and its size are contingent not only to the external environment, but also to the firm's current strategy and prior financial performance (Pearce and Zahra 1992); in other words, adopting a more general view, the resources provided by the members of the board should match with the needs of the firm (Pfeffer 1972). This is equivalent to saying that it's not just the number, but the type of directors (viewed in terms of resources they can bring to the firm) that matter. Coherently, Pfeffer and Salancik (1978) identify four benefits that directors can provide to organization:

(1) Advices and counsels or, more in general, information that derives from their previous expertise, experience, and skills (Baysinger and Hoskisson 1990; Gales and Kesner 1994) and that can be exploited to perform higher results (Westphal 1999);
(2) Access to channels of information between the firm and other organizations, useful to reduce transaction costs and to cope with the uncertainty of the external environment. In fact, executive director's external ties play a critical role in the strategy formulation process and in subsequent firm performance (Eisenhardt and Schoonhoven 1996; Geletkanycz and Hambrick 1997), thanks to the facilitate access they provide, for example, in identifying strategic information and opportunities (Pfeffer 1991) and in revealing information about the agendas and operations of other firms (Burt 1983);
(3) Preferential access to commitments or support form important elements outside the firm, such as financial capital institutions, political bodies or other important stakeholders' groups (like customers, suppliers or local communities). To reach this aim, firms can even invite representatives of these stakeholders as effective members of the BoD in order to create more commitment and involvement;

(4) Legitimacy, viewed in terms of reputation and credibility of the firm, suggesting that the prestige of the directors that compose its board can enhance the value and the worth of the organization.

All these benefits minimize external dependence of the firm as the international literature demonstrates through empirical analyses addressed to test and measure the assumptions of the theory. For example, Provan (1980) identifies a positive relationship between the ability of firms in attracting and co-opting powerful members of the community in their boards and the capacity to acquire critical resources from the environment. More specifically, Mizruchi and Stearns (1988, 1994), focusing on a specific type of resource, the financial one, demonstrate how the ability of a firm to access to new sources of financing depends on the representation of financial institutions in its board.

Moreover, various streams of the resource dependence theory address the attention towards the analysis of specific situations or conditions in which firms can benefit most from the resources provided by the board. For example, Lynall et al. (2003) develop the initial idea proposed by Zahra and Pearce (1989) about the linkage between the firm life cycle and the importance of the role of the board in terms of resource dependence to underline how this link is more significant during the early stages of the life cycle. Furthermore, other authors investigate board or firm characteristics to measure the effect of the theory. On this path of studies, Daily and Dalton (1992) empirically demonstrate a significant relationship between some board characteristics, such as the size and the composition, and the performance obtained by small corporations.

2.3.5 The Institutional Theory

The institutional theory refers to organizational behaviours, with a completely different perspective compared to the previously mentioned theories (Meyer and Rowan 1977). According to Argote and Greve (2007), the main aim of this theory is to explain how firms adapt to a symbolic environment of cognition and expectations and regulatory environment of rules and functions. In fact, since organizations are embedded in institutional environments, organizational dynamics tend to be replies to or replications of the regulations and structures of the larger environment (Hall and Soskice 2001; North 1990).

At the base of this assumption, there is the idea that companies tend to adapt likewise when they find themselves in similar circumstances, as suggested by Campbell (2007) who supports this idea through the detection of "best practices" for corporate governance. This concept is well known in the international literature under the name of isomorphism, whereby firms (and more in general organizations) conform to the accepted norms of their population. According to the milestone work developed by DiMaggio and Powell (1983), there are three types of mechanisms to explain the isomorphic institutional change: (i) the coercive mechanisms which occur when cultural expectations in the society or external constituents on which an organization is dependent force organizations to change in a certain way; (ii) the normative mechanisms, which arise primarily with pressures from professionalization, introducing standards of appropriate behaviours; and (iii) finally, the mimetic mechanisms, which refer to the situation in which an organization copies successful role models developed by another organization because its actions are believed to be rational or because of a desire to avoid appearing deviant or backward.

Regardless of the mechanisms useful to explain the isomorphic institutional change, as a result of this process, the organizational action largely mirrors a pattern of doing things that progress over time and become legitimated within an organization and its environment (Pfeffer 1972).

The adoption of organizational practices and norms co-evolving with institutions might become institutionalized. In other words, institutionalization can be defined as the process by which a specified set of components and a number of activities come to be normatively and cognitively held in place and considered as a rule. Likewise, when existing practices get developed into an enforceable norm, the goal is that that normative practice gets institutionalized by coercive or isomorphic means (Terjesen et al. 2015).

Nonetheless, the theory admits that organizations may vary in the degree to which they conform to the changes occurred in their external environment (DiMaggio and Powell 1983). In fact, the pressure for isomorphism can be amplified or reduced by the regulatory policies as well as by the strategic positioning of the firm (Judge and Zeithaml 1992).

In this context, corporate boards respond to external pressure, such as social rules and conventions, with the final aim to legitimize the corporation. In doing this, they have to conduct a careful analysis of the external environment to be promptly prepared to changes in expectations (Hung 1998).

2.4 Board Features

The review of the different theoretical perspectives demonstrates that there is a need to take an integrated approach rather than a single reading key to understand the effect of good corporate governance. In fact, over the years, different lenses of analysis have addressed the attention towards specific aspects of the same big picture. For example, while the agency theory places primary emphasis on shareholders' interests, the stakeholder theory takes care of the interests of all stakeholders (and not just the shareholders). Similarly, while the agency theory stresses the problem of the conflict of interests between ownership and management, the stewardship theory gets over this aspect leveraging on the legal agreement between these two parties. Moreover, always with the aim of overcoming the principal-agent problem, the resource dependence theory underscores the importance of board as a source of new resource for the firm. All these aspects are only different focuses on which each theory mainly concentrates the attention. Nevertheless, they can often be analysed as a whole, opening the study to a new stream of research.

Regardless of the specific features of each theory, it is clear that corporate governance is concerned with the social, political, and legal environment in which the corporation operates. Similarly, the outcome of a good corporate governance practice is an accountable board of directors who ensure the safeguard of the interests of different stakeholders of the firm. Thus, the review conducted in the previous subparagraphs has allowed the construction of a conceptual framework within which to embed the board processes and dynamics. These considerations let us to shift the focus of the attention towards the board of directors and its main features.

A corporate board is composed by a group of individuals—the directors—nominated by the shareholders, who decide on the most significant issues in terms of firm's strategies, firm's growth and, ultimately, firm's value.

Even though different rules and regulations for boards are applied by each country, reflecting specific characteristics of local context, they all have in common the obligation for corporations to create a board of directors which is nominated by the shareholders. Among the others, the board has the duty to meet at least once per year for the annual report approval, preserving minutes of the meetings that document the debated issues and decisions taken. Only proprietorships and LLCs are

not required to elect the board of directors, but they can still form one if they want.

As far as public companies are concerned, they are required to have a certain number of the so-called independent directors (also called "outside directors"), as initially declared in the Sarbanes-Oxley Act (SOA)[2] of 2002 and later required by other domestic and international regulations. Independent directors are identified as individuals who are not affiliated with the company or, in other words, that do not have any relationship with the company. On the contrary, private companies are not obliged, but just advised to have independent directors as a precondition for a better governance structure. The benefits of having outside directors rely on different aspects. First, they should bring a more objective view since they are more likely to deliver unbiased judgements and ideas. Second, they should provide the company with new knowledge and additional competencies, since they often represent an access to external resources otherwise unavailable to the firm. Finally, they should be the balancing element among the different shareholders' interests and visions. Different studies confirm the evidence of these benefits. For example, Daily (1995), acting within the resource dependence theory framework, finds that firms with a higher proportion of independent directors are more likely to successfully recover from bankruptcy through the Chapter 11 reorganization procedures.[3] Similarly, Zahra and Pearce (1989) show how outside members act as a channel to guarantee a preferential access to external resources and competences. Moreover, external directors may also play an important monitoring role in small, unquoted companies. Specifically, according to Deakins et al. (2000), in performing their function of advisor, counsellor, and expert consultant, external directors may also be able to overcome potential moral hazard problems for venture capitalists.

Even though worldwide corporate governance reformers claim for a growing percentage of outside directors within the board, this request is viewed with scepticism by some academics and practitioners. In fact, the value of independent directors is still an important unsettled question in the literature (Adams et al. 2010; Bhagat and Black 1999; Gordon 2007). While some studies find a positive relation between board independence and corporate outcomes (e.g. Aggarwal et al. 2009; Byrd and Hickman 1992; Cotter et al. 1997; Dahya et al. 2008), a significant part of the literature has demonstrated that the effectiveness of independent board members is reduced by the lower amount of information and knowledge they have about the company compared to the non-independent ones,

not being able in practice to effectively oversee and control agency problems (Berle and Means 1932; Jensen 1993). Moreover, several empirical studies did not find any consistent evidence that independent directors make a difference in terms of firm performance, showing minimal or not statistically significant correlations (Bhagat and Bolton 2008; Duchin et al. 2010; Fields and Keys 2003; Hermalin and Weisbach 2003).

The debate on the effectiveness of the directors has to be enriched by the consideration of the role of each member of the board within the firm, putting in evidence the distinction between the executive and the non-executive directors: the first ones are those board members which hold decision-making power as well as managerial responsibilities, while the latter are board members without decision-making power and managerial responsibilities. In other words, non-executive directors are not official members of the executive management team and do not have an official employment agreement (nor is compensated for) any services rendered outside the official duties pertaining of the board. Here too, the international literature has investigated the contribution of non-executive directors in terms of organizational performance. At the same time, they have received significant attention from regulators as a mechanism for strengthening firm governance, with corporate governance guidelines focusing on their roles on BoDs (Cadbury 1992; Greenbury 1995; Hampel Report 1998; Higgs 2003; Financial Reporting Council 2018).

The key aspect in analysing their impact on board effectiveness is their helping to seize opportunities with respect to sensemaking and enhanced organizational transformation (Hom et al. 2019). In fact, non-executive directors serve a number of important functions on the board of directors, such as: (i) monitoring senior managers and increasing firm's efficiency in its contracting with these senior managers (Goh and Gupta 2016); (ii) contributing, through their experience and expertise, to strategic decision-making on issues of strategy, resource allocation, risk management, succession planning, remuneration, and standards of conduct (Higgs 2003); and (iii) enhancing the board's set of resources, providing news sources of knowledge and networking to other organizations and firms (Hillman and Dalziel 2003).

The decisions about the board composition (in terms of balancing between, on the one hand, independent and non-independent directors and, on the other hand, executive and non-executive directors) are reflected into the board dimension. The number of individuals and the

manner through which board members are appointed is regulated by the company's statutes, which also define the duration of the board term, usually ranging from 3 to 6 years. However, the board, as well as the shareholders, still has the power to revoke the members before the end of the term if serious matters take place, such as financial damages to the firm, illegal behaviours, or disclosure of confidential or internal information. Focusing specifically on the number of members, there are no required standards to comply with. Worldwide the practice shows that firms usually have boards composed by up to 20 people even though some studies, based on empirical evidence, underline how that ideal size is lower (Lipton and Lorsch 1992; Magnanelli 2012; Magnanelli et al. 2017), since the number of board members is negatively related to the firm's financial performance, measured through the ROE index (Paniagua et al. 2018).

In each BoD, a president (chairman) and a vice president are nominated. These figures are appointed by the board among its members. The chairman is entitled to run and manage the board meetings, and she/he has the task to support reaching the consensus in board decisions. The chairman position can be held by either a non-executive or executive member. Moreover, the board also appoints the Chief Executive Officer (CEO), the highest figure from a managerial point of view. While in the past the role of CEO and the chairman was usually played by the same manager, nowadays corporate governance codes of best practices suggest of having a CEO who is not also the chairman of the board, keeping the two roles separate.

In addition to the aforementioned features of the board, the corporate governance varies according to the model adopted by the firm. The most common governance models are the monistic (or one-tier) model, mainly used in common law countries, first and foremost UK and USA, and the dualistic (or two-tier) model, largely adopted in civil law countries, such as Germany, Italy, France, Spain, and Greece.

The monistic model is also known as market-based system of corporate governance and it is typical of those economies in which share is widely distributed among individuals and institutions (Nestor and Thompson 2001). The model has been developed considering shareholders' interests as the primary focus of the company law. Moreover, it guarantees an emphasis on effective minority shareholder protection in securities law and regulations. Finally, the model is suitable when there is a stringent requirement for continuous disclosure to inform the market. From

a practical point of view, the model gives management and administrative powers respectively to a Board of Directors elected by the shareholders and to an Auditing Committee, whose members are chosen within the Board of Directors. The Auditing Committee members must be independent and professional. Thus, the BoD is the main governance body, composed by executive and non-executive directors, with the aim to direct the company's business.

Under the label "dualistic model", a plethora of corporate governance models, adopted by European countries reflecting their differences in history, culture, financial traditions, ownership patterns, and legal systems can be included. Nevertheless, a common element is traceable in the emphasis on cooperative relationships and reaching consensus. Moreover, the model is highly dependent upon banks, since companies show high debt/equity ratios (Clarke 2007). Operationally, the model is based on the presence of two separate boards, the management board, which is responsible for the day-to-day business, and the supervisory board, which monitors the management board's activities. Moreover, while the management board is elected by the supervisory board, the latter is elected by the shareholders.

2.5 What Are the Features of Good Board Performance?

Due to the recent global financial crisis, the several corporate failures and scandals occurred in the last decades; legislators, institutions, and practitioners have started claiming for new corporate governance codes stressing the necessity for board's performance valuation.

The main purpose of codes of corporate governance is to define and suggest the best features for a governance system. The principal subject called in question by these codes is always the BoD, analysed on the base of all its characteristics and functions. In fact, as mentioned in the report on the OECD Principles of Corporate Governance (OEDC 2004), "Good corporate governance should provide proper incentives for the board and the management to pursue objectives that are in the interest of the company and its shareholders and should facilitate effective monitoring". Thus, over the years, literature has focused the attention on what can actually be defined as "good" corporate governance.

Specifically, considering the board of directors, researchers suggest as good governance features the following ones:

- Small size: boards seem to be more efficient when their size is small. Some scholars (Jensen 1993; Lipton and Lorsch 1992; Yermack 1996), as well as the empirical evidence, suggest to maintain a low number of members sitting in the board to assure a better performance for the firm. In fact, in case of large boards, efficiency will decrease and, as a consequence, it will be easier for the CEO to take control over the board;
- Young and not busy members: it seems that young and not busy directors are more efficient in the monitoring processes (Ferris et al. 2003);
- Separation between CEO position and chairman position: in case of CEO duality, the independence of the board is threatened (Yermack 1996). Nevertheless, some authors sustain that the CEO duality actually facilitates the communication between the board and the management team, creating a stronger leadership (Brickley et al. 1997);
- Short-term CEO and chairman tenure: in case of a lengthy stay, these key figures could start acting and behaving as they would be the only owners of the firm; Hermalin and Weisbach (1988) underline that an established CEO has a lot of influence on the board, and, moreover, her/his power becomes even stronger when the CEO duality takes place (Johnson et al. 2009; Loebbecke et al. 1989);
- High number of meetings: the high number of meetings assures that directors do have a real knowledge of the company and its issues, providing the possibility to better decide on the firm's strategies and actions (Lipton and Lorsch 1992);
- Independence of the members: it is assured when there is a large portion of independent members. When the board members are independent directors, they are considered more efficient at monitoring managers and CEO (Byrd and Hickman 1992; Fama and Jensen 1983). Independent directors are perceived as those who can better and fair judge on the management, ensuring the protection of shareholders' interest and the maximization of the firm's value (Beasley 1996).

As far as the idea of evaluation that the board's operations and processes are concerned, supporters state that it would highlight any criticality, leading to eventual corrective actions that would better the board's performance and thus reducing the likelihood of corporate

failures (Nicholson et al. 2012). The crucial point of such analysis is undeniably the way to assess the actual board's functioning. In fact, despite the increasing recommendations, governance codes do not provide any specific method or guidance about the criteria that should be used to assess the board's performance. Thus, as a matter of fact, firms have a great level of flexibility to evaluate their boards. Consequently, each firm will set up its own valuation system depending on the circumstances and the scenario in which it operates (Minichilli et al. 2007).

Another point on which everyone agrees is that an effective board implements an effective decision-making process, a necessary condition to guarantee the firm's wealth. Specifically, the board's decision-making process has to include: the identification of the board's roles and responsibilities, the effective information collection and disclosure, the acquisition of the needed skills, experiences, and competences necessary for the analysis of the corporate situation, and, finally, it has to be able to provide an independent judgement on the managers' way of operating (Klettner 2017).

All the above-mentioned factors affect the performance of the board and, as a consequence, the evaluation system applied in the company to check the board's effectiveness should take them into account.

Notes

1. In greater detail, Berle and Means (1932), studying the 200 largest US non-financial corporations in 1929, found that 44% of them had no individual ownership interest with as much as 20% of the stock, a share that they viewed as an approximate minimum necessary for control. The authors classified these 88 firms, which accounted for 58% of the total, as management controlled. Moreover, they found that in only 11% of the firms did the largest owner hold a majority of the firm's shares (Mizruchi 2004).
2. The Sarbanes-Oxley Act applies to all companies that are listed on the New York Stock Exchange and it provides several indications and rules about the board composition, responsibilities, and disclosure. Specifically on independent director, it refers to person who does not accept any fee from issuer (other than as director) and is not an affiliated person of the issuer or any subsidiary.
3. Chapter 11 is the chapter of the Bankruptcy Code of the US Court which permits the reorganization under the bankruptcy laws of the USA.

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