Boards of Directors and Firm Performance: A Combination of Agency and Dependence Theory Perspectives.

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BBS Doctoral Symposium 23rd & 24th March 2009
Abstract

The study will examine the two more discussed functions of boards of directors (monitoring and provision of resources) and their association with firm performance. According to agency theorists, the main responsibility of the boards is to monitor the management of a company and antecedents to monitoring are the board incentives like board dependence and equity compensation. On the other hand, resource dependency theorists follow a different path, where they examine the provision of resources as the main function of boards, and board capital is, according to them, the primary antecedent of this function. The study will be based in the effort to combine the two perspectives and it will be argued that board capital affects both monitoring and the provision of resources and that board incentives influence these relationships.

Introduction

Agency theory literature focuses on the monitoring function of the boards of directors and argues that, by reducing the agency costs, firm performance can be improved. The main activities of the monitoring function, as stated by (Hillman and Dalziel, 2003), are monitoring the CEO, monitoring strategy implementation, planning CEO succession and evaluating and rewarding the CEO/top managers of the firm. Moreover, it is argued that by providing a framework for analysing how firms can address differences between the interests of principals (e.g., shareholders/board of directors) and agents (top managers), valuable contribution results, in assessing the efficient structure of executive compensation contracts and corporate governance (Beatty and Zajac, 1994). By stating structure of corporate governance we mean leadership structure (duality) and board dependence (internal/external members). Previous studies have shown that there is a preference for a dominance of external
independent directors in a board, as boards consisting mainly of internal members or even of externals that are not independent of the current management of the firm, have less incentive to monitor management.

In contrast, resource dependency theorists examine the provision of resources as the main function of the boards of directors and they explore the relationship of the board capital, as the antecedent of this function, with firm performance. Provision of resources refer to the ability of board members to bring resources to the firm. The activities of the board related to the provision of resources are: providing legitimacy/bolstering the public image of the firm, providing expertise, administering advice and counsel, linking the firm to important stakeholders or other important entities, facilitating access to resources such as capital, building external relations, diffusing innovation, and aiding in the formulation of strategy or other important firm decisions. Board capital consists of human capital (experience, expertise, reputation) and relational capital (networking to other firms, and external contingencies) (Hillman and Dalziel, 2003). Board capital has been positively associated with the provision of advice and counsel, the provision of firm legitimacy and reputation, the provision of channels of communication and the acquirement of resources elements outside the firm (financial capital influence and influence with political bodies or other important stakeholder groups).

Hillman and Dalziel (2003) have proposed a theoretical model, where both perspectives have been combined and they argue that board capital positively influences both functions of the board, which are monitoring management and providing resources. Additionally, regarding board incentives, they suggest that board dependence negatively affects the relationship between board capital and monitoring but positively affects the relationship between board capital and provision of
resources. In addition they argue that board equity compensation positively affects the relationship between board capital and monitoring and the relationship between board capital and provision of resources (Figure 1). It is believed that integration of monitoring and the provision of resources will not only more accurately reflect the real world but also may overcome theoretical weaknesses in choosing one approach over another. On one hand, agency theorists state that incentives will directly improve a board's monitoring without taking into account the heterogeneous board abilities to monitor. Likewise, resource dependence theorists focus on board capital and how it relates to the provision of resources and firm performance, without considering how incentives to provide advice and counsel or to utilize their links to other organizations, for example, may affect this relationship. Both ability and incentives are likely to affect behaviour within organizations, suggesting that examining one without the other is insufficient (Hillman and Dalziel, 2003).

Developing on that model and by further studying the literature, there will be an effort to expand on these constructs, and to explore possible additional relationships to other constructs that are not included in the existing model. Also, further examination of the variables will be considered to identify possible interdependence among them. The empirical part of this study will probably be conducted in Greek listed firms, and the questions related to the constructs will be sent through questionnaires. The reason for choosing the listed companies, is that corporate governance practices are more likely to appear in these companies, since the Greek market mainly consists of small-medium firms and it is expected that the more appropriate sample would be the management of such firms, where boards of directors exist and greater reliance on rules is expected to be present.
Figure 1: Theoretical Model

Board Capital
- Human Capital
- Relational Capital

Board Incentives
- Board Dependence
- Executive Compensation

Monitoring
- Monitoring CEO
- Monitoring strategy implementation
- Planning Succession
- Evaluating and rewarding the CEO/top managers

Provision of Resources
- providing legitimacy/bolstering the public image of the firm
- providing expertise
- administering advice and counsel
- linking the firm to important stakeholders or other important entities
- facilitating access to resources such as capital
- building external relations
- diffusing innovation
- aiding in the formulation of strategy or other important firm decisions

Firm Performance
References


