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# *A Handbook of Corporate Governance and Social Responsibility*

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# *Corporate Governance – Responsibilities of the Board*

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## Introduction

This chapter discusses the role and importance of the board in the corporate governance structure. More precisely, it analyses the duties and responsibilities of board referring to the dynamics of its process and to two existing models of control (unitary and dual board). The main aim of this chapter is to present the functions of the board in line with the current problems and challenges, caused first of all by the waive of corporate scandals and frauds that have resulted in reform actions, introducing increased transparency and accountability as well as the worldwide processes of globalization and internationalization of capital markets and corporate governance initiatives. The impact of regulatory reforms, codes of best practice, public pressure and investors' expectations addressed to the board results in significant change in the attitude of board members, board responsibilities and accountability. Under the conditions of severe competition, as well as crisis control, the board and its experienced, responsible and honest members play a crucial role in restoring confidence in capital markets, assuring sound governance and corporate efficiency.

The comparative analysis of corporate governance reveals significant changes in control structures applied in different countries, delivering a starting point for research in efficiency of the mechanisms used. Such analysis shows differences in ownership structure, compensation policy, corporate disclosure standards, investor protection, legal regime and the court system, and models of capital markets. Although national differences can also be depicted in the board model, its structure, composition and practice, the comparative analysis indicates the great importance of a board in each corporate governance system. According to all national approaches, the board should represent the interest of the company and look after the shareholder interests of corporate performance, generated profit and realized dividend. The board becomes a platform for balancing shareholders and stakeholders expectations, for discussing corporate strategy, for resolving shareholder conflicts and fights, for electing executives and formulating compensation policy. The board is also perceived as a liaison between shareholders and their general shareholder meeting and top management, having access to company data, detailed financial statements, corporate strategy plans and results, reports on performance

and company problems. Hence, the collectively responsible board has responsibility for monitoring, control as well as counsel, and advice on its meeting's agenda. Moreover, worldwide discussions provide evidence for the common understanding that board members should be highly skilled experienced professionals with high morale and that they are responsible and accountable, since the performance and even existence of the company lies in the board members' hands, more precisely in the work and advice they deliver and monitoring they exert.

This chapter analyzes the key role and importance of the board in the corporate governance structure depicted in national systems. It attempts to discuss the duties and responsibilities of the board referring to two existing models of control – the one-tier system (board of directors) and the two-tier system (supervisory and management boards). The aim is to present not only the immanent responsibilities and tasks of the board, but also to track the current challenges caused by corporate scandals, worldwide-adopted corporate governance reforms and globalization and internationalization processes, as well as to discuss future tendencies for the work of the board and tasks. The chapter is organized as follows – the first section presents the board within the corporate governance system, stressing its crucial role for protecting shareholder interests. It refers to a change in board position after 1960 and differences in the control approach in the case of a board of directors and supervisory board. The second section analyzes board duties which constitute the legal accountability of its members towards shareholders including fiduciary duty, duty of loyalty and duty of fair dealing, duty of care, duty not to entrench and duty of supervision. Responsibilities of the board, main tasks which need to be fulfilled and challenges that have to be addressed in the work of the board, are discussed in the third section. The conclusion section summarizes the discussion.

## The Board within the Corporate Governance System

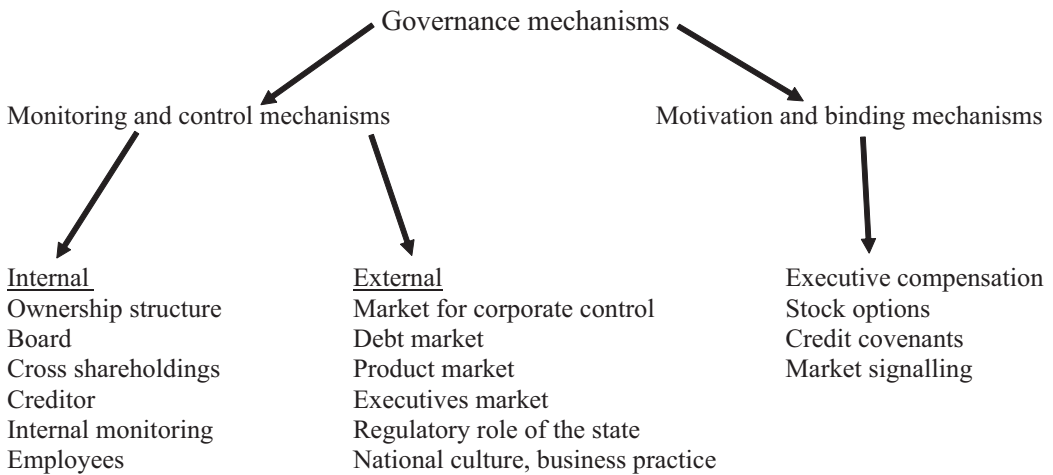
### THE ROLE OF THE BOARD

The board is a crucial element of the corporate governance structure and its efficiency and performance determines the success of monitoring and the operation of the company. As noticed by Monks and Minow (2004) boards 'are the link between the people who provide capital (the shareholders) and the people who use that capital to create value (the managers)'. In other words, boards become the liaison between concentrated or dispersed shareholders of different identities (individuals, funds, companies, banks and so on) who exert the residual rights and executives who, as a matter of fact, constitute the powerful group that runs and controls the company (Roe, 1994). The organization form of a joint stock company, characterized by separation of ownership and control or, using other words, of finance and management, (Jensen and Meckling, 1976) was questioned already by Adam Smith due to the huge discretionary power left in the hands of executives and marginal control capabilities of the capital owners. According to Smith investors 'seldom pretend to understand anything of the business of the company' whereas 'being the managers of others people's money rather than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private co-partnery frequently watch over their own (Smith, 1937 as quoted in Monks and Minow, 1996). These severe problems rooted in moral hazard were identified

as principal-agent conflict leading to substantial agency costs in companies characterized by separation of ownership and control and dispersed ownership structure (Shleifer and Vishny, 1997). Shareholders face the information asymmetry of hidden action and hidden information that results from the opportunistic behaviour of managers who are acting within the framework of incomplete contracts, primarily in their own interests (Fama and Jensen, 1983a; Fama and Jensen, 1983b). Research and analyses delivered evidence that interests of executives are opposed to those of shareholders due to the issues of choice, effort, differential risk exposure or differential horizon of activity (Jensen and Smith, 1985). Business practice and numerous examples of frauds or corporate scandals provide vast evidence for the real risk of expropriation of shareholders and hence their need to form a control and monitoring body within the company. As stated by Fama and Jensen (1983a) the residual risk, meaning the risk of the difference between stochastic inflows of resources and promised payments to agents, is borne by those who contract for the rights to net cash flows, that is, the shareholders. Thus, shareholders must have incentives to monitor contracts with agents. The central hypothesis provides that the separation of residual risk bearing from decision management leads to decision systems that separate decision management from decision control. Residual claims are distributed amongst many agents that provide for unrestricted risk-sharing. This situation reflects perfectly the conditions and organization form of large, open, common stock corporations, mostly referring to public listed companies (Fama and Jensen, 1983a). These companies are characterized by the specific knowledge and diffusion of decision functions and diffuse residual claims and delegation of decision control. Therefore, in order to provide efficiency and mitigate the principal-agent problem, so severe under the condition of separation of decision management (initiation and ratification) and decision control (implementation and monitoring), strong decision hierarchies such as boards are necessary. In other words, the board ensuring effective monitoring is described as one of many efforts that are meant to reduce agency costs and to align the interests of non-owner management to the interests of shareholders in modern public corporations (Fisch, 2004).

Corporate governance of joint stock companies, and particularly public listed companies, encompasses different governance mechanisms that form sets of characteristics for respective national systems. As shown in Figure 10.1, governance mechanisms include mechanisms of monitoring and control as well as motivation and binding mechanisms. The other perspective delivers the typology of the internal mechanism known as hierarchies, such as ownership structure, board, creditor or internal monitoring and external mechanisms such as markets of debt, products, executives and corporate control (Weston et al., 2001).

It is important to stress that the board functions within a corporation and within its structure, by-laws and constraints. Since the corporation involves different parties that contribute capital, expertise and labour (Monks and Minow, 1996) in order to achieve the corporate goal and maximize shareholder value, the board becomes a platform where all these parties debate and compromise for the direction of company activity. Most recently, the efforts of worldwide reforms and initiatives introducing improvement of monitoring standards as well as the globalization process based on increased capital mobility, flexibility and market transparency, drew a lot attention to corporate governance practices. Moreover, control problems revealed in corporate scandals place boards in the centre of governance structure indicating the need for its work improvement,



**Figure 10.1 Governance mechanisms**

Source: Wolf (1999), p. 17.

strengthening monitoring function and increasing the moral and ethical standards of its members (Fisch, 2004; MacAvoy and Millstein, 2003).

## MAIN TASK OF THE BOARD

The board and its function within the company should address the problematic issues mentioned in the section above. Therefore, the board should respond to challenges of separation of ownership and control and act towards mitigating agency problems, aligning the goals of managers with the interest of shareholders. Hence, the main board task is to represent, formulate and realize the interests and expectations of shareholders as the owners of the companies (see also, Hambrick and Jackson, 2000; John and Senbet, 1998). It is the board which holds the ultimate accountability and bears the final responsibility for corporate success or failure (Ibrahim and Angelidis, 1994). As formulated in the OECD Corporate Governance Principles (2004) 'board members should act on a fully informed basis, in good faith, with due diligence and care and in the best interest of the company and the shareholders'. The board should provide for balancing 'two distinct powers: the power of those who own the corporation and the power of those who run it' (Monks and Minow, 1996). The board functions as the result of empowering shareholders, providing for the representation of their interest that is rooted in the shares they possess, as the title of invested capital and right for exerting influence of the corporation (Monks and Minow, 2004; Fisch, 2004). The construction of joint stock companies is based on the assumption that shareholders delegate substantial powers to management and therefore there is a need to assure that these powers will not be abused at their cost. Hence, the board plays the control function over the vast discretionary power which was given to executives as the fundament for the joint stock company and separation of ownership and control. However, representing the interests of shareholders, the board has to keep in mind that limiting the activity of top managers and incurring substantial constraints on them to prevent them from expropriating shareholder value may have the reverse effect. Researchers and business practice reveal that managers need to hold significant power,

technical capabilities and shareholders' trust for efficient work towards maximizing shareholder wealth and realizing shareholder goals. Too restrictive control exerted over executives limits their abilities, power and creativity, which leads to poorer corporate performance and lower shareholder value. Hence, the board needs to provide balance between mechanisms of monitoring and control versus motivation and binding as shown in Figure 10.1.

It is also important to mention that, looking at fulfilling the interests and expectations of shareholders, the board has to take into account the interests of the company as a whole. Hence, the orientation of the board should be based on the long-term perspective, not pushing exclusively for short-term goals. This requirement places a high responsibility on the board, demanding from the board members a balanced approach, objectivity and wise policy of assets accumulation, investment and consumption. Thus, as stated in the mentioned above OECD Corporate Governance Principles (2004), the board has to be very careful when making decisions that affect shareholder groups and should always provide for equal and fair treatment of shareholders.

## UNITARY VERSUS DUAL BOARD

Discussing the role and responsibilities of the board requires the mention of two board models – the one-tier system and the board of directors and the two-tier system and supervisory board and their specificity (Mallin, 2004). The characteristics, work organization, advantages and constraints of both types of boards are crucial for the analysis since it has a significant impact on the main task, responsibilities and structure supporting realization of the board goals.

The board of directors (Kojima, 1997) known also as the unitary board, is dominant in corporate governance systems and can be found in Anglo-Saxon countries (United States, UK, Ireland, Australia, Canada) as well as in others (Japan, Russia). The board of directors consists of executives (managers of the company) and non-executives who can be appointed out of affiliated or gray members and independent directors with no ties related to the company. The biggest advantages of the board of directors include the possibility of dialogue and better communication between executives and non-executives (monitoring, counsel, advice, reprimand) and the access to corporate data and information by non-executive directors. The board of directors proves to be flexible and relatively inexpensive, representing the interests of shareholders as well as allowing for a quick decision-making process and efficient information flow. The negative aspects of the unitary board refers to the very powerful position of the CEO who, in 90 per cent of American public listed companies, holds the Chairman function at the same time (it is important to mention that both functions are separated in 85 per cent of boards of UK companies) fully controlling the work, agenda and directions of the board. The presence of executive directors and the directors' appointment process dependence on the CEO impacts the board's work and responsibilities and more precisely affects 1) building coalition between executives and independent directors and outside directors' support for CEO policy; 2) evaluation of board work; 3) resisting hostile takeover; and 4) formulating compensation policy for top management. As a matter of fact, the risks of these negative aspects are mitigated by the formulation of different committees (compensation, audit and nominating) which should be dominated by independent directors. Moreover, latest recommendations suggest the separation of the CEO and Chairman roles, introducing

the function of 'leading' or 'presiding' directors to conduct board meetings or to call meetings exclusively of independent directors.

As shown in Table 10.1, the dual board system (Mallin, 2004) is based on two main bodies, that is, the supervisory board and the management board (executives), and is provided by Corporate Law in Germany, Austria and Poland. The supervisory board includes exclusively non-executive directors who should provide for their objectivity, or at least independence from, the executives representing different shareholders (families, banks, individual investors) or stakeholder groups (employees) or have the status of independent directors. The mandates of supervisory and management boards have to be kept separately (Kojima, 1997). The supervisory board plays monitoring functions, appoints the CEO and structures executive compensation, selects the auditor and follows corporate strategy issues. The strong independence of board directors provides for a better balancing of the roles of Chairman and CEO, as well as a high objectivity for accessing corporate policy, top management evaluation and setting executive compensation. The major weakness of the dual model lies in its limited access to corporate data and information which has to be delivered by the management board. The relative separation of board members and executives is mitigated by joint meetings and specialized committees (compensation, audit and nominating). The threat of the dominance of the board work by representatives of controlling shareholders, particularly in the area of dividend policy, is attempted to be reduced by the presence of independent directors. The dual board is also often criticized for its higher costs of functioning and the lack of direct contact between executives and outside directors. Table 10.1 summarizes the pros and cons of unitary and dual boards.

**Table 10.1 Comparative analysis of board of directors and supervisory board**

	<b>Board of directors (unitary board)</b>	<b>Supervisory board (dual board)</b>
Advantages	<ul style="list-style-type: none"> <li>Capability to represent shareholders interests</li> <li>Flexible and relatively inexpensive form</li> <li>Direct contact between executives and non-executives that enables sound monitoring and counselling</li> <li>Efficient information flow and non-executives' access to corporate data</li> </ul>	<ul style="list-style-type: none"> <li>Capability to represent shareholders interests</li> <li>All members are non-executives</li> <li>Balancing the power of CEO and board Chairman</li> <li>Higher objectivity and independence, particularly in the process of management evaluation, compensation policy</li> <li>No personal connections enable sound monitoring and counselling</li> </ul>
Disadvantages	<ul style="list-style-type: none"> <li>Powerful position of CEO who holds Chairman function</li> <li>Dependence on CEO policy, lack of objectivity</li> <li>Risk of building a coalition between CEO and outside directors (evaluation of board work, resisting to takeovers)</li> </ul>	<ul style="list-style-type: none"> <li>Higher costs of board functioning</li> <li>Poorer information flow and non-executives' access to corporate data</li> <li>Lack of direct contact between executives and non-executives</li> <li>Risk of dominating the board by majority shareholder</li> </ul>

Source: Own analysis.

The ongoing debate on efficiency of board types often delivers more positive arguments for a board of directors, indicating higher flexibility, better information flow and lower costs. Moreover, proponents of the unitary board point at countries such as France and Italy where corporate law allows for both board models leaving the choice to corporations. Moreover, the company decision can be reversed. The analysis shows that approximately 85 per cent of French companies and approximately 90 per cent of Italian companies adopted the board of directors as the main control and monitoring corporate body. However, recent reforms and initiatives introduced in both board systems indicate common directions of increasing the number of independent directors and creating respective committees for detailed tasks. The emergence of a unified board still remains in purely theoretical debate, but the recent reforms deliver the harmonization of board best practice.

Referring to the main task, the board of directors provides an undoubtedly stronger representation of shareholder versus stakeholder interests, focusing primarily on creating value. Although the composition of the unitary board reveals strong representation of independent directors, ranging from 30 per cent to even 75 per cent, it does not show real participation of stakeholder representatives. The supervisory board reveals in this matter higher participation of contingency directors representing not only shareholders, but also employees or communities (for example, the codetermination rule in German boards). Therefore the dual board is often perceived as the corporate body which becomes a wider platform for balancing interests of different stakeholder groups and presenting a long-term orientation.

## INCREASING BOARD RESPONSIBILITIES

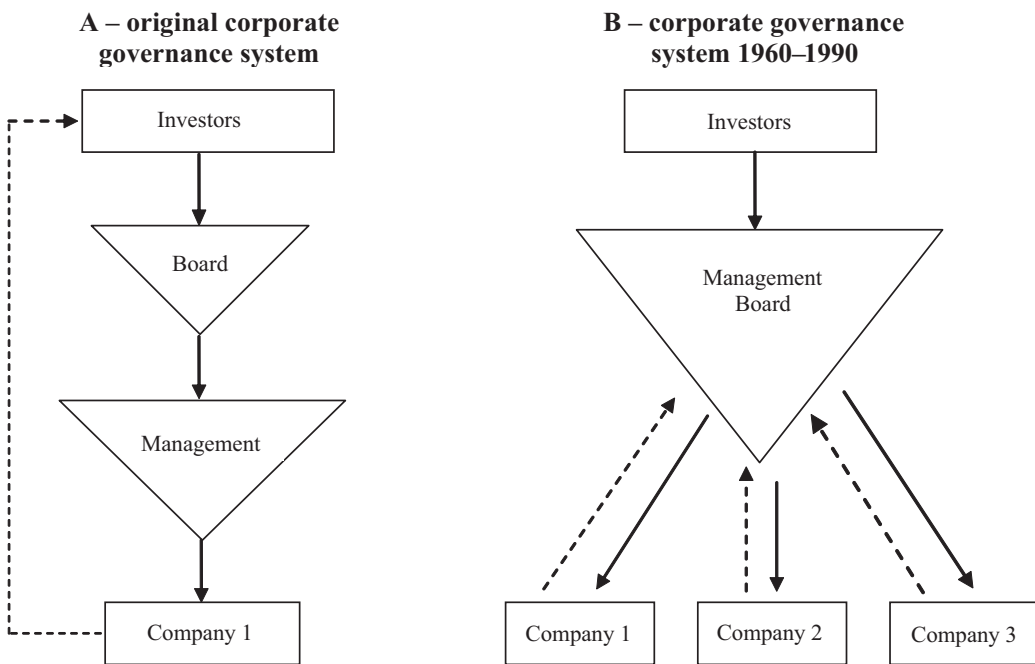
As corporate governance is currently an extensively researched topic, many analyses concerning its work procedures, composition and efficiency of functioning provide understanding for board role and responsibilities. However, despite the impressive number and quality of articles, papers and reports on board functioning, the topic is far from being fully analyzed. Moreover, in line with recent corporate scandals (WorldCom, Enron), identified governance shortcomings (inefficient independent directors, limited information for board members) as well as responding to emerging business challenges and major changes in the corporate environment (growing importance of IT, e-commerce, e-business, deep changes in economic systems), the analysis of the board still remains at the centre of management research. Recommendations for board work constitute a significant part of the best practice code formulated either on the regional (OECD, EU), national (United States, UK, Germany, France) or corporate levels (Allianz, ING, GM). More interestingly, newly formulated guidelines are heavily rooted in the former hints and suggestions, although, as seen from the today's perspective, provide a deeper meaning and understanding for board role and functioning referring to its fundamentals. The research and analysis on board efficiency that used to address the form now seems to focus on the substance.

The change in perceiving board role and functions becomes a response to reforms in corporate governance system and a substantial shift in powers, which today lies in the hands of aware and strong investors. MacAvoy and Millstein (2003) refer to the 'broken engine' of companies that failed to create value for shareholders and focus on the misinterpreted or misused role of the board saying that 'between 1960 and 1990



this system was, in general, disoriented, with the board serving as a source of support in the pursuit of management's goals. The CEO dominated both management and the board, serving as the board chairman, and appointing the board of directors to assist. It was the CEO, not the board, who determined corporate strategy as well as how earnings were to be distributed among employees, customers, community groups and investors'. Thus in that system, the board was not functioning as an agent for investors and was not pursuing the main goal of protecting shareholder interest. Figure 10.2 presents the original structure of governance as well as the twisted system of 1960–1990.

As shown in the figure, the original system provides the structure that enables the board to fulfil its role and responsibilities, and the board becomes a control, monitoring and motivating mechanism over management. The board acts in the interest of shareholders and through this system profits generated by company are returns on investment for investors. However, the system after 1960 substantially reduced the control and monitoring power of the board that led to the 'strong managers, weak owners' problems. The executives dominated the decision-making process, referring to the distribution of generated earning which, according to the figure, were not paid out as dividends for shareholders but became tools for aggressive mergers and acquisition policy. In result, the system led to 'expansive diversification, increased executive compensation and, last, discretionary dividends' (MacAvoy and Millstein, 2003:9). The abovementioned corporate governance shortcomings, as well as devastating corporate scandals and loss of the confidence to companies and capital markets, imposed the necessity to return to the original construction of a board of directors and its role and place within the corporate governance system, particularly versus management.



**Figure 10.2 Board role in two systems**

Source: MacAvoy and Millstein (2003), p. 8.

It must be mentioned that the previously discussed problems of the 1960–1990 corporate governance system refer predominantly to the United States, and to some extent, to the UK. However, a different picture can be depicted from companies operating in continental Europe and south-east Asia, particularly in Japan. The major problems of boards functioning in continental Europe refer to the dominance by the controlling shareholder as the result of the concentrated ownership structure. Therefore, instead of – as presented in Figure 10.2 – the influence and the power exerted by management, the controlling shareholder was able to dominate the board and literally take over the decision process. Problems such as these are now solved by (or attempted to be solved by) the recommendation of independent directors sitting on the board. The Japanese version of these issues referred to the necessity of operating within a group of companies (keiretsu). This led to high interest rates imposed by keiretsu banks on that group companies. As a result, companies tended to lower the proportion of external capital (bank loans) which led to a reduction of the monitoring executed by banks (and the Japanese corporate governance is known as the bank-based), created a control vacuum and provided high discretionary power for managers who engaged themselves in expansive diversification and investment policy.

## Board Duties

The work of a board includes not only certain responsibilities that will be outlined in the next section, but also becomes a legal construct based on contract between directors and shareholders. The directors are to fulfill given set of tasks which assume ‘the obligation to represent the interest of owners who cannot represent themselves, undertaking a serious fiduciary responsibility’ (Colley at al., 2003). Therefore the board directors, before engaging in tasks of monitoring, control and counseling, have to be aware of the set of duties that are imposed on them. These duties place board directors in a special professional group referring to high ethical and moral standards and include:

- **The fiduciary duty** that means that ‘a director must demonstrate unyielding loyalty to the company’s shareholders’ (Monks and Minow, 2004) which translates into being trustworthy in acting in the best interests of those whom the director represents (Colley at al., 2003; Wallace and Zinkin, 2005). The main function here is enhancing the stockholder gain and simultaneously pursuing creation of firm value in the long term. However, directors have to keep in mind their obligation to act in the interest of the company as a whole at the same time. Moreover, while being appointed to the board, the director has to represent all shareholders, not only the group that elected them, as the board is a collective body based on team work and collective responsibility.
- **The duty of loyalty and duty of fair dealing** – duty of loyalty refers to the supremacy of shareholders’ interests and means that the interests of shareholders must prevail over any individual director’s interests or benefits. As a result, directors cannot use their position, power resulting from this position or information in order to make personal profits or gain private advantages. The duty of fair dealing constitutes a component of the duty of loyalty requiring all transactions with the corporations to be handled forthrightly and in an open manner fair to the interests of

the corporations. Moreover, the duty of fair dealing refers to disclosure of any existing conflict of interest and rejection of taking advantage of opportunities for receiving personal gains.

- **The duty of care** – which means that ‘a director must exercise due diligence in making decisions’ (Monks and Minow, 2004) and assumes that directors act carefully in carrying out their responsibilities referring to the possible best performance of directors in dealing with board functions (Colley at al., 2003). Hence, the board directors have to act in the interests of the company using their skills, experience and knowledge to provide for best monitoring, control and counselling. This may include, particularly these days, the director’s personal responsibilities of accepting the workload and, for instance, limiting themselves from serving on too many boards which could lower their performance. From the perspective of the whole board, duty of care would include delegating some functions or using the expertise of respective specialists (lawyers, accountants) when organizing the work of the board. Additionally, it is crucial to mention that the practical interpretation of the duty of care imposes high standards of independence in terms of business relations to the company, strong requirements towards directors’ skills and experience, as well as the appropriate and efficient organization of board work.
- **The duty not to entrench** – which refers to the needs of the objective assessment of the company situation, openness to possible solution and the board readiness to undertake crucial decisions, particularly in the cases of poor economic performance. The business practice reveals that poor corporate performance quite often results in creating certain coalition between the board and management. The entrenched board blocks the decisive movements and shareholders initiatives (for example, replacing executives), does not address the main problems and as a result does not fulfill its responsibilities.
- **The duty of supervision** – is an element of duty of fair dealing with effectiveness with which directors exercise their oversight responsibilities (Colley at al., 2003). This translates into the best performance of the primary board function of supervision over management and assumes the care of collecting all necessary data, information and documents required for effective oversight. The predominant rules of duty of supervision are based on the highest standards of ethics and disclosure referring both to board directors as well as to executives.

The set of directors’ duties presented in Table 10.2 concludes this section.

**Table 10.2 Duties of directors**

Categories	Detailed duties
<b>Primary duties</b>	
Looking after the company’s best interests as a whole	acting in good faith in the best interest of the company as a whole exercising the level of care, skill and diligence that can be reasonably expected exercising the powers granted by the company’s constitution for a ‘proper purpose’ refraining from or prevent any act that would adversely affect decision making concerning the company activities

**Table 10.2 Concluded**

<b>Categories</b>	<b>Detailed duties</b>
<b>Primary duties</b>	
Avoiding conflict of interest	<p>declaring fully to the board all dealings in company shares</p> <p>recording material-relevant interests in any transaction for the register</p> <p>avoiding improper use of his or her position or the use of any information obtained through that position for personal gain or to harm the company</p> <p>ensuring that his or her remuneration is fair to the company</p>
Dealing with shareholders	<p>determining and certifying what is fair and reasonable consideration for the issue of shares or the repurchase of shares on issue</p> <p>responding appropriately to written shareholder requests for information</p> <p>ensuring that the company does not carry out businesses in a manner that is harmful to creditors and shareholders</p>
Others	<p>maintaining the company's solvency and reputation</p> <p>fulfilling specific duties in the event of takeovers (see also Colley at al., 2003)</p>
<b>Secondary duties</b>	
Ensuring the quality of company information	<p>taking all reasonable steps to prevent falsification of accounting records</p> <p>providing proper explanations to external auditors to help them to interpret the information correctly</p> <p>making sure that any overseas documentation is properly recorded</p> <p>checking the accuracy and completeness of any statements that are made by the company</p> <p>ensuring that the financial statements comply with the appropriate financial reporting standards</p> <p>ensuring that these financial statements are audited whenever audits are required</p>
Providing documentation	<p>ensuring that shareholders receive a copy of the annual report or the financial statements at least a set number of working days before the AGM</p> <p>ensuring that the annual return is filed with the Registrar within the time required</p> <p>ensuring that the following documents are available for inspection by the public: certificate of incorporation, constitution of the company, share register, register of directors and address for servicing documents</p>
Ensuring that shareholders can inspect shareholders' minutes, written communications to shareholders, and directors' certificates and the interest register (see also Fisch, 2004)	<p>dealing with Registrar to ensure: the board notifies the Registrar of any changes of the constitution, issue of shares, acquisition of own shares or changes in the directors; and the board delivers a copy of share certificate to the Registrar, having certified that the consideration for a share, option or convertible securities or financial assistance to buy company's shares</p> <p>recording for register any relevant interest in shares issued by the company or any interest in any transaction or proposed transaction involving the company having previously notified the board</p>

Source: Wallace and Zinkin (2005), p. 263-264.

## Responsibilities of the Board

### OUTLINE OF BOARD RESPONSIBILITIES

The work of the board is placed within a strong and stable framework of legal standards as well as ethical and moral requirements. Having in mind these requirements, positive postulates (the board should) and negative warnings (the board should not) and being aware of examples of corporate scandals and frauds, the board has to be very careful in fulfilling its responsibilities. The sets of board responsibilities may differ slightly in the importance placed on given issues, but all of them include: (Monks and Minow, 2004; Carter and Lorsch, 2004) 1) the aspects of review of strategic, financial and investment decisions; 2) providing accountability, monitoring and counsel to top managers; 3) selection, evaluation, replacement of CEO and review of succession planning; 4) providing highest moral and performance standards of board; and 5) review the adequacy of the company's systems with all applicable laws/ requirements. One of the examples of the comprehensive and complete set of board responsibilities is formulated in the OECD Corporate Governance Principles (2004). According to OECD board functions include the following (see also Alexander et al., 1993; Sherdian, 2001):

- Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance and overseeing major capital expenditures, acquisitions and divestitures.
- Monitoring the effectiveness of the company's governance practices and making changes as needed.
- Selecting, compensating, monitoring and when necessary replacing key executives and overseeing succession planning.
- Aligning key executive and board remuneration with the longer-term interests of the company and its shareholders.
- Ensuring a formal and transparent board nomination and election process.
- Monitoring and managing potential conflict of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
- Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit and that appropriate systems of controls are in place, in particular, systems for risk management, financial and operational control and compliance with the law relevant standards.
- Overseeing the process of disclosure and communication.

Additionally, the board should also take care of its structure, composition, procedures, cooperation and communication that respect all appropriate laws and requirements as well as provide the highest efficiency and performance in the best interests of shareholders. Therefore, the board should have access to accurate, relevant and timely information which becomes the basis for its discussion and decision. The most crucial board functions are discussed in detail below.

## REVIEW OF STRATEGIC, FINANCIAL AND INVESTMENT DECISIONS

The review of strategic, financial and investment decisions can be generally understood as the review of a company's strategic direction which is the primary responsibility of the board that allows to protect shareholders' and companies' interests and provide for long-term growth and development. The board controls and influences the dividend payout process. According to the agency theory, board members representing the companies' and shareholders' interest should have a longer time horizon for the investment and strategy as compared to executives who always calculate the threat or the possibility of changing their job and leaving for another company. Therefore the time perspective becomes crucial. The review of strategic direction requires the board members to have knowledge, experience and awareness of the business characteristics, structure, complexity and 'rules of the game'. Discussing the state-of-the-art of the board position in the strategic process, it is important to refer to the two models of corporate governance described above where, following the framework of MacAvoy and Millstein, the change of the board role is noticeable. From the 'twisted' corporate governance model of 1960–1990, characterized by weak board position and its coalition with top management, the board currently gains 'original' importance and role and is powerful enough to exert real control over management and review the strategic direction. This change, along with the requirements towards board knowledge, gains importance under current market turbulence, dramatic economic and social challenges and the growing role of Internet technology and globalization. This requirement is heavily rooted in the developing internal management technologies, business to business transactions and dealing with customers that are themselves creating new market choices and opportunities worldwide (Carter and Lorsch, 2004). Additionally, the growing importance of intellectual capital and intangible assets, as well as the development of a knowledge-based economy, produces new challenges for companies and their boards. Yesterday, solutions and business strategy that turned out to be outdated may lead to market share loss and even to corporate failures. Therefore the review of a company's strategic direction, particularly corporate strategy, investments and divestures, are on the one hand an extremely difficult task and, on the other hand, constitute the essentials of board responsibilities which are to be evaluated by markets and shareholders with no sentiments whatsoever.

## PROVIDING ACCOUNTABILITY, MONITORING AND COUNSEL TO TOP MANAGERS

Providing accountability and monitoring to executives remains the core of board responsibilities as it is rooted in the primary goal of board functioning, that is, protecting shareholder interest. The control exerted over the work of top managers remains the most crucial source for the evaluation of company performance, also related to competitors and market trends. It is suggested that the board prepares some points of reference, using the benchmarks of other companies as well as widely recognized measures that provide effective evaluation. The fulfilling of this responsibility requires a complex set of corporate materials and reports, presenting to top managers the goals achieved, corporate performance and financial results. Therefore, the content of this responsibility includes providing a formal procedure to determine the quality of the materials received from top managers and to ensure a complete approach to monitoring corporate performance. Some

elements of the recommended procedure and content of reports are suggested by the Best Practice Code or stipulated by hard law. It is important to mention that several crucial changes in this area were introduced by the Sarbanes-Oxley Act. Although requirements stipulated by SOX refer only to companies listed on United States markets, its analysis from the perspective of increased accountability proves to deliver interesting insights. For instance SOX requires 'board members to know not only cash flow versus earnings, but also how and from which information system these estimates were derived, as well as the roles played by internal and external auditors in valuation of the information from which the estimates were derived' (MacAvoy and Millstein, 2003:101). Moreover, SOX stipulates that top executives sign financial statements, guaranteeing that the provided information is reliable. The monitoring of executives by the board assumes that its members should react to warning signals, poor performance results or negative symptoms, referring to either corporate efficiency or corporate governance practices. This should then prevent the question frequently asked after the Enron and WorldCom scandals: 'Where was the board?' (Carter and Lorsch, 2004; Wearing, 2005).

The second component of this responsibility requires the board members to be able and willing to provide counsel and advice for executives, reply to their questions and respond to their needs and expectations with reference to company operating, business rules or corporate governance practices. Apparently, board members can neither delegate their responsibilities to executives nor make decisions about the company management. However, the board counsel is often perceived as of huge importance and high value by top managers (Carter and Lorsch, 2004; Demb and Neubauer, 1992).

## SELECTION, COMPENSATING, EVALUATION, REPLACEMENT OF THE CEO. REVIEW OF SUCCESSION PLANNING

The responsibilities discussed above remain in strong interdependence with the selection of the CEO out of the most appropriate candidates, evaluating the CEO's job as well as structuring the compensation package for them. The selection of the CEO, which may seem an easy task, proves to be one of the most difficult and complicated responsibilities to fulfil as this decision always has far reaching and long-term results determining *de facto* the company's fate. More and more management research indicates the key role of the CEO in corporate success and failure, stressing additionally the impact of the compensation package (structure, particularly the proportion of variable component referred the fixed pay) for the CEO's working attitude and motivation towards increasing shareholder value. Board tasks of selection and compensating the CEO are gaining more attention both from board members and powerful investors, who expect improved performance and increase of shareholder value. The fact that we now have the highest turnover rate of CEOs in corporate history remains an indication of today's turbulent times and investors' pressure. Additionally, in response to CEO turnover, as well as retirement, the succession planning and the process of preparation of the new CEO to take over the top function gains more importance from the perspective of assuring managerial continuity. What is more, the believed to be optimal compensation scheme, based mostly on stock options, turned out to be not only inefficient but also a path to fraud and substantial shareholder loss in the case of corporate scandals. Hence, current efforts aim at identifying the balance between fixed pay and performance-based components in order to provide both high motivation and long-term managerial perspective.

## PROVIDING HIGHEST MORAL AND PERFORMANCE STANDARDS OF BOARD

Providing highest moral and performance standards of the board refers mostly to two aspects. First, the board should take care of its composition of the highly qualified members whose education, experience, objectivity, morale as well as availability (time for reading corporate reports and for participating in meetings) meet the company's needs and requirements, and ensure the high performance of the collective body. It must be emphasized that these requirements strongly demand that directors truly know the business of the company they monitor relating to the main competitors, customers, suppliers, market rules, threats and regulatory framework (Monks and Minow, 1997, 2004; MacAvoy and Millstein, 2003). These requirements often also refer to the suggested proportion or number of independent directors. As the examples of companies engaged in corporate scandals show, the quality of board members, particularly their knowledge about the business and the morale and ethical standards, become crucial aspects, not only for the board performance, but also for the success or failure of the company (problems of conflict of interest, dependence on CEO, low skills and low morale). Apparently the composition of the board remains the decision of the general shareholder meeting but board members also have some influence and, more importantly, they are able to assess the quality of the given member. The issue of high moral standards includes avoiding conflict of interests, providing the best possible monitoring, careful reading of corporate materials, efficient communication with other members, active participation in board meetings, readiness and ability to objective evaluation of management as well as fulfilling all board duties (fiduciary duty, the duty of loyalty and duty of fair dealing, duty of care, the duty not to entrench and duty of supervision). High morale refers also to refraining from leaving the board if this should be costly or negative for the company. However, some examples indicate that members leaving the board because of its poor performance can serve as the signal for conflicts or inefficiencies of the board (for example, Robert Monks in Tyco). The second group of responsibilities in this point includes all aspects related to the board procedures, structure and work organization, either perceived as a formal requirement or best practice code recommendation or known as a tool for efficient performance (Colley et al., 2003). The board should select a chairman (or leading or presiding director), vice-chairman and secretary, and form board committees (audit, nominating and governance, remuneration, executive and committee of outside directors). The board itself should formulate or fulfil the existing role of the board function, organization of board meetings (time, place, frequency, information about the meeting) and discussing the agenda, approving procedures for voting, communicating with executives, disclosure policy and meetings with shareholders, as well as the formal procedure for evaluating its functions. Concluding this point it must be emphasized that the work of the board and its efficiency relies to a large extent on board resources and capabilities, therefore board responsibilities should include ensuring the best inputs.

## Conclusions

This chapter presents in depth analysis of the board responsibilities and duties referring to aspects of the board role within the corporate governance system, board model and future challenges of emerging new business sectors and economic phenomena. However,



despite expansive analysis that undoubtedly ensures impressive numbers and quality articles and papers, the aspects of the work of the board, its responsibilities and decision process still remains a challenging area of further research and study. The dynamics of board process, confronted with the emerging new business characteristics rooted in Internet technology, market turbulence, structural changes and finally globalization, provide a complex set of challenges for companies and their boards. Moreover, the dynamic market situation, as well as impatient shareholders that become a crucial source of external financing for companies, push boards for higher efficiency, stricter evaluation procedures, tougher accountability and threat of shareholder litigation, as well as more disclosure. The board, protecting the interests of shareholders and the company, becomes the ultimate stage of review of strategic planning, monitoring of executives, evaluation and compensation, succession policy, addressing of all legal requirements, ensuring integrity for corporate communication and disclosure. In summary, the board facing these challenges, and addressing all the demands and needs directed at it, has to carefully manage its infrastructure, including skilled, experienced and objective members, resources and capabilities to ensure it functions at its best. The complexity of the work of the board, its position within the company, its accountability and responsibilities under the pressure of investors and market situation create a fascinating research area for both academics and business practitioners and will surely remain the centre of corporate governance analysis.

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