INTERNATIONAL PERSPECTIVES ON THE PROPER ROLE OF THE INDEPENDENT DIRECTOR: IMPLICATIONS FOR SOUTH AFRICAN BOARDS OF DIRECTORS

by

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DECLARATION

I, Reginald Rispel, hereby declare that this study project is my own original work and that all sources have been accurately reported and acknowledged, and that this document has not previously in its entirety or in part been submitted at any university in order to obtain an academic qualification.

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ABSTRACT

Today, boards of directors are being examined as never before for their independence, integrity and effectiveness. The belief seems to be that independent directors will strengthen corporate boards by monitoring the actions of management and ensuring that management decisions are made in the best interest of the shareholders. Independent directors are now expected to make a more formal contribution to corporate governance than before. The importance of good governance is emphasized by both the USA and the UK governments' call for trustees and fund managers to intervene more proactively in the governance of companies, particularly in the light of dramatic examples of corporate failure such as Enron in the US and Parmalat in Italy where shareholder values have evaporated. Companies failed due to accounting scandals and the inability of the board to control a dominant and powerful chief executive officer. It is thus no secret that investors are looking increasingly to the independent directors on boards to be more effective in protecting their interests.

This literature study aims to identify international best practice concerning the role of the board and more particularly that of the independent director in ensuring good corporate governance. The study is based on sources which include a large contingent of up to date sources on the subject ranging from newspaper articles, journal articles, various corporate governance codes, company reports and reports on governance such as Cadbury and Higgs.

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ABBREVIATIONS

CEO	Chief Executive Officer
NEDs	Non-Executive Directors’
SEC	Securities and Exchange Committee
NYSE	New York Stock Exchange
NASD	National Association of Securities Dealers
OECD	Organization for Economic Co-operation and Development
PFMA	Public Finance Management Act
SA	South Africa
UK	United Kingdom
USA	United States of America
WWW	World Wide Web

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CHAPTER ONE

INTRODUCTION AND BACKGROUND TO THE STUDY

1.1 INTRODUCTION

Corporate governance has attracted a considerable amount of attention over the past decades, leading to recommended codes and best practices globally (Tricker, 1994). After spectacular high profile corporate collapses there are many debates concerning the effectiveness of corporate governance systems across continents, these include the controversy concerning the role of the board, the proposed role of the independent director, along with calls for a greater "stakeholder "approach to governance.

While most of the corporate governance debates and research have focused on the USA, there is a growing trend in international literature on corporate governance about the role of the independent director (Hoskisson, 1998; Davis and Kay, 1990; Shleifer and Vishny, 1997; Styles and Taylor, 2001; Weir and Laing, 2001). Internationally, many corporate governance codes and guidelines of best practices have been published by national agencies (the Cadbury Committee, 1992; the King Report I, 1994; the OECD Principles, 1999; the German Code, 2000; the UK Combined Code, 2000; the King Report II, 2002; and the Higgs Report, 2003). According to the aforementioned writers, many of these codes have been revised since the spectacular collapse of Enron and other high profile corporations. Tricker (1994) contends that because of evidence published, it reflects the great importance that governments, business and communities alike attached to this subject area. Tricker (1994) states that many of the codes developed perceived that good corporate governance is very important in assuring accountability and improving organizational performance.

According to King (2002) these codes and guidelines make recommendations on appropriate board structures and processes that protect the interests of the owners, and reconcile it with those of management and other stakeholders, including the communities in which they operate. King (2002) argues that good governance practices enable corporations to use their capital efficiently, maintain the confidence of investors and attract more, long-term capital. With the collapse of major companies in the United Kingdom, United States, and in South Africa, questions have been raised about the role of the board and the effectiveness of independent or non-executive directors to protect the interest of not only the shareholders, but all stakeholders.

For example, the Cadbury Report (1992) emphasized the contribution that independent non-executive directors could make, stating that: “The committee believes that the caliber of the non-executive members of the board is of special importance in setting and maintaining standards of corporate governance”. McKinsey and Company (2002) highlights that investors believe companies should create more independent boards and achieve greater boardroom effectiveness through better director selection, more disciplined board evaluation processes and greater commitment from directors.

According to Berle and Means (1932) the separation of ownership and management in public companies contributes to the agency problem. They also argued that less well informed owners could not monitor the decisions made by better-informed managers. They posit that the belief in the problem of separation of ownership and management goes back to Adam Smith’s argument that hired managers exert less “anxious vigilance” than owners. This reasoning of Berle and Means has led to the assumption that good corporate governance is dependent on the ability of owners to exercise control over corporate insiders and management. It is for these reasons that the agency theory perspective on corporate governance requires a high level of board independence in order to benefit shareholders and increase company profits.

However, not all researchers are in agreement with the agency perspective in that it results in conflict between owners and managers (Zahra and Pearce, 1989). According to Donaldson and Davies (1997) stewardship researchers, among others, have criticized the agency theory for overstating the case that managers merely seek to maximize personal wealth, even at the expense of owners. In contrast, stewardship theory claims that managers are essentially trustworthy individuals and therefore good stewards of the resources entrusted to them. Increasing board independence by adding more independent non-executives to the board is one of the strongest recommendations of public policy reports on corporate governance. In South Africa the King Report (2002) with specific reference to independent directors, suggests that a majority of non- executive directors should be independent of management. This view is also reflected in the listing requirements of major stock exchanges.

The next section deals with corporate governance related theories that have been developed to provide a greater understanding of corporate governance that will give context to the relevance and contribution of independent non-executive directors on the board of directors. In order to have a better understanding of corporate governance it is appropriate to define and clarify a number of corporate governance terminologies.

1.2 CORPORATE GOVERNANCE TERMINOLOGY

1.2.1 Corporate Governance

According to Naidoo (2002), corporate governance has become an issue of global importance, but exactly what constitutes corporate governance and precisely where its boundaries lie are still subjects to be debated. She argues that corporate governance is essentially the practice by which companies are managed and controlled. It encompasses;

- The creation and ongoing monitoring of a system of checks and balances to ensure a balance of power within a company;
- The implementation of a system to ensure compliance by the company with its legal and regulatory obligations;
- The implementation of processes whereby risks to the sustainability of the company's businesses are identified and managed and
- The development of practices which make and keep the company accountable to the broader society in which it operates.

Naidoo contends that corporate governance is essentially about the responsible leadership of companies. According to her, this is leadership that is transparent, answerable and accountable towards the company's identified stakeholders. Furthermore, she contends that corporate governance aims to achieve a balance between economic, social, individual and collective goal, seeking to align as closely as possible the interest of individuals, the company and society as a whole.

1.2.2 Board of Directors

A board of directors is a group of people from within the organization, and nominated and selected from outside the organization to represent the interest of shareholders. Directors from within the organization are referred to as executive directors and those from outside the organization as non-executive directors.

1.2.3 Executive Director

These are people such as the chief executive officer who are involved in the day to day management and/or in the full-time employ of the company, and/or any of its subsidiaries.

1.2.4 Non-Executive Director

These are people who are nominated and selected and approved at the shareholders meetings and are not involved in the day to day management of the company and are not full-time salaried employees of the company or any of its subsidiaries.

1.2.5 Non-Executive Independent Director

The Cadbury (1992), King (2002) and Higgs (2003) reports stress that the board should include independent non-executives of sufficient caliber and number for their views to carry significant weight in the board's deliberations. A non-executive director is considered independent when the board determines that he/she director is independent in character and judgement and there are no relationships or circumstances which could affect, or appear to affect, his/her judgement. Such relationships or circumstances would include where the director:

- Is a former employee of the company or group until five years of employment has ended;
- Has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- Has received or receives additional remuneration from the company apart from being a director's fee, participates in the company's share option or a performance related pay scheme, or is a member of the company's pension scheme;
- Has close family ties with the company's advisers, director's or senior employees;
- Holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- Represents a significant shareholder; or
- Has served on the board.

According to Cadbury (1998) and Higgs (2003), the board should identify in its annual report the non-executive directors it determines to be independent. The board they argue should also state its reasons if a director is considered to be independent notwithstanding the existence of relationships or circumstances which may appear to be relevant to its determination.

1.2.6 AGENCY THEORY

Agency theory argues that in the modern corporation, in which share ownership is widely held, managerial actions depart from those required to maximize shareholder returns (Berle and Means, 1932, Pratt and Zeckhauser 1985). According to the agency theory, the owners are the principals and the managers are the agents. The non-alignment of the objectives of the principles and agents could lead to agency loss which is the extent to which returns to the residual claimants, the owners, and fall below what they would be if the principals, the owners exercised direct control of the corporation (Jensen and Meckling, 1976).

According to Eisenhardt (1989) mechanisms which can reduce agency loss include incentive schemes for managers which reward them financially for maximizing shareholders' interest. Such schemes typically include plans whereby senior executives obtain shares at a reduced price, thus aligning the financial interest of executives with those of the shareholders.

Pivotal to the development of the agency theory is the argument that shareholders have lost effective control of large corporations as they have grown in size. Mizruchi (1983) is of the view that as early leaders died or retired, the subsequent dispersion of shareholdings left a void filled by the insiders running the day to day activities of the organization. According to Mizruchi (1983), professional managers were the only ones with the specialised knowledge necessary to operate the company, which meant they gradually gained effective control.

According to Fama and Jensen (1983), from an agency perspective, it is critical that organizations have boards of directors independent of management influence in order to achieve maximum performance. They are of the view that the only way for the board to achieve independent control is by separating the initiation and implementation of decisions. They argue that independent boards are more effective at enforcing such a separation and therefore independent boards have a positive effect on the company.

1.2.7 STEWARDSHIP THEORY

The stewardship model is one based on the premise that a manager is a “steward” rather than the self-interested rationale economic man of agency theory (Perrow, 1986:234). According to Perrow, stewardship theory recognizes a range of non-financial motives for managerial behaviour. These include:

- The need for achievement and recognition;
- The satisfaction of successful performance;
- Respect for authority; and
- The work ethic.

According to Donaldson and Davis (1991), managers are viewed as interested in achieving high performance and capable of using a high level of discretion to act for the benefit of shareholders. Stewardship theory they posits that a manager, when confronted with a course of action seen as personally unrewarding, may comply based on a sense of duty and identification (Etzioni, 1975).

Stewardship theory argues that the reallocation of corporate control from owners to professional managers may be a positive development toward managing the complexity of the modern corporation. However, the model completely disregards the additional value that non-executive directors add.

According to research done by Pfeffer, the value of non-executive directors is not as much how they influence managers, but how they influence constituencies of the firm. Turnbull (1997), is of the opinion that the more regulated an industry is the more outsiders were present on the board to reassure the regulators, bankers, and other interest groups. Stewardship theory, Pfeffer argues, emphasizes the firm’s ability to build strong common interests between the various stakeholders (owners, the board and top management).

1.2.8 STAKEHOLDER THEORY

According to Freeman (1984) and Blair (1995) the major challenge to the principal-agent or stewardship model stems from the stakeholder model, which claims that the firm should serve a wider interest of stakeholders rather than shareholders only. Stakeholders such as employees, creditors, suppliers, customers and local communities have long-term relationships with the firm and affect its long-term success.

Freeman, (1984) and Blair (1895) argue that it is their welfare that must be taken into account especially when it comes to corporate decision making. They also believe that the current corporate governance system in the Anglo-American environment fails to encourage stakeholder involvement with the firm, including inter-firm cooperation and employee participation.

1.2.9 MANAGERIAL HEGEMONY

According to Huse (2007), the theory of managerial hegemony describes the board as a legal fiction, viewing it as formerly but not genuinely the principal governance body of the corporation. He argues that despite the board’s formal governing power over management, it is in reality dominated by corporate management. The author posits that boards are creatures of the chief executive officer (CEO) and in practice he says, the task of boards are really to enhance the welfare of the CEO. The writer contends there is a lack of independence associated with the board members, the selection of outside board members being controlled by management.

According to Huse (2007) managerial hegemony is a descriptive theory, and it describes the consequences that have evolved from property rights theory and the legal perspectives. Huse posits that research done shows that the time constraints that part-time board members labour under in performing their work, with the result that they tend to be passive until a crisis occur. Based on the above introduction and background the objectives of the study are outlined below.

1.3 PRIMARY AND SECONDARY OBJECTIVES OF THE RESEARCH STUDY

1.3.1 The Primary Research Objective

To conduct a literature review with regard to the role of the independent non-executive director on the board of directors.

1.3.2 Secondary Research Objectives

To review current international and national corporate governance literature to ascertain:

- The role and functions/responsibilities of a board of directors;
- The role of individual directors; and
- The role and responsibilities of an independent non-executive director.

1.4 RESEARCH METHOD

This paper will explore previous research studies and findings about corporate governance and the role of the non-executive independent director to obtain a more contemporary academic understanding of what the role of an independent director should be. The study is of a exploratory and descriptive nature and will include a large contingent of up-to-date sources on the subject ranging from newspaper articles, journals, various corporate governance codes and electronic sources.

1.5 STRUCTURE OF THE RESEARCH STUDY PROJECT

This research study project commences with an introduction and background to the major issues in corporate governance internationally.

Chapter two provides a review of literature relevant to the research project and discusses the theoretical framework which is used to organize the research.

Chapter three provides a critical assessment of the proper role of the independent non-executive internationally as defined in the literature as well as views on the role of the board.

Chapter four provides a detailed analytical discussion on the proposed role of the independent director.

Chapter five provides a summary of the results of the research project, conclusions and recommendations.

1.6 SUMMARY

This chapter has presented concepts and issues relating to the stakeholder and various corporate governance theories and definitions. It was seen that corporate governance is concerned with the nature and interactions and relationships between the company and its various stakeholders in the process of decision making and in terms of control over the company's available resources. Corporate governance, thus, has to be understood as the interactions between internal stakeholders and the board members who are running the company for the benefit of all stakeholders.

However, to understand corporate governance in a specific company it is necessary to identify and understand the behavior of the main actors, including the board members, external actors and internal actors, and the context in which governance take place.

Extensive efforts have been made in recent years to develop codes of best practice for corporate governance and to regulate the rules in order to achieve some kind of accountability and reliability.

Agency theory, stewardship and stakeholder theories have undoubtedly assisted us to understand the role that directors may play in contributing to the performance of the organizations they govern. According to Jensen and Meckling (1983) agency theorists, for example, concentrate on the link(s) between board independence and leadership structure and various operationalisations of firm performance. This meant that managers now possessed superior knowledge and expertise to the firm's owners and were therefore in a position to pursue self-interested action at the expense of shareholders. On the contrary, Donaldson and Davis (1991) contend that stewardship theory focuses on the proportion of insiders on the board to investigate links with corporate performance.

In contrast to agency theory, stewardship theory posits that managers are essentially trustworthy individuals and this makes them good stewards of the resources entrusted to them. Corporate governance codes and how they relate to the independent director are covered in chapter two.

CHAPTER TWO

CORPORATE GOVERNANCE: AN INTERNATIONAL PERSPECTIVE

2.1 INTRODUCTION

In this chapter a review of the literature with regard to international corporate governance codes and guidelines is presented. The literature review provides insight as to why these codes and guidelines are important and their relation to the independent director. It will also be determined how the various codes and guidelines contribute to seeing the important role of the independent director from different perspectives and with differing emphasis.

Over the past decades corporate governance has attracted considerable attention, leading to recommended codes of practice, conceptual models and guidelines. Based on a review of the literature, corporate governance is defined for this study as the practice by which companies are managed and controlled. Internationally, many corporate governance guidelines and codes of best practices have been published by various committees. However, since the latest corporate scandals including Enron, World.com and the like, many of these codes have been revised in the last few years.

According to the OECD and the Worldbank (1999) corporate codes and guidelines commonly perceived as good corporate governance is very important in assuring accountability and improving performance. Typically, the guidelines make recommendations on appropriate board structures and processes that protect the interests of the owners, and reconcile them with those of management and other stakeholders, including the communities within which they operate. Good governance practices, they argue, enable companies to use their capital efficiently, maintain the confidence of the investors and attract more patient, long-term capital. Moreover, it enhances strategic focus, builds market confidence and community support, and is an important source of corporate competitive advantage (OECD, 1999; and World Bank, 1999).

In view of international developments, it is not surprising that South Africa has also placed the importance of good corporate governance on its agenda. As was the case with several other developing economies, the importance for reform is based on the need for foreign capital.

One of the major players in the reform of corporate control has been the Institute of Directors of South Africa and the Johannesburg Stock Exchange (JSE).
This chapter will provide more insight into international corporate governance codes as it relates to the independent director and the contributions from USA, Germany, France and a South African perspective.

2.2 CORPORATE GOVERNANCE CODES: AN INTERNATIONAL PERSPECTIVE

2.2.1 The USA Perspective

Recent high-profile corporate failures such as Enron in the US have underlined the continuing need to improve corporate governance globally. These failures have also prompted a re-examination of how the US principles of corporate governance might be updated to take account of the latest meltdowns of corporate giants.

According to Garratt (1996), the United States desired the same ends as the United Kingdom. that is boards, directors, presidents and chief executive officers should be more open and rigorously accountable to their shareholders and stakeholders. As a direct result of the Enron collapse major changes were proposed by the regulatory environment. Among the steps that have already been taken are:

- The Securities and Exchange Commission (SEC) has announced plans to create a new organization outside the structure of the American Institute of Certified Public Accountants (AICPA) to oversee auditors of publicly held companies;
- The creation of a disciplinary committee to provide more transparency; and
- The expansion of the authority of the new disciplinary committee to monitor compliance with SEC practice Standards, and to refer practices of non-compliance to the disciplinary board.

In June of 2002, the SEC proposed to require chief executives to vouch personally for financial statements. The New York Stock Exchange (NYSE), acting at the SEC's request, published new proposals to strengthen corporate governance for listed companies. The NYSE is however proposing new standards for director independence, along with a requirement that all boards contain a majority of these independent directors. Almost all American boards already have a large majority of independent directors. Part of the NYSE's answer to the explosion of accounting scandals among listed companies, for instance, has been to set clearer and more detailed qualifications for independent board directors who serve on audit committees (Weir and Laing, 2001).

On 30 July, 2002 President Bush signed into law the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley). Sarbanes-Oxley incorporates many reforms intended to protect investors by improving the accuracy and reliability of corporate disclosures. One of the reforms requires companies listed on the major stock exchanges to maintain audit committees composed entirely of outside independent directors.

Furthermore, on 4 November 2003 the Securities and Exchange Commission (SEC) approved changes to the corporate governance requirements of the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD). Similar changes were approved on 1 December 2003 by the SEC for the American Stock Exchange (AMEX). However, these changes go beyond Sarbanes-Oxley and require companies to maintain boards of directors that are composed of a majority of outside independent directors as well as requiring companies to maintain fully independent audit committees. Additionally, the changes would require companies to either maintain fully independent compensation and nominating committees or make provisions whereby executive compensation as well as director nominees is determined by a majority of independent directors.

According to Petra (2005), it is clear that lawmakers in Congress and regulatory agencies such as the SEC believe that independent directors will strengthen corporate boards of directors. According to the NYSE, the changes are designed to ‘‘further the ability of honest and well-intentioned directors, officers, and employees of listed issuers to perform their functions effectively’’. According to NASD, the changes ‘‘will enhance investor confidence in companies that list on NASDAQ’’ The belief seems to be that independent directors will monitor the actions of management and ensure that management decisions are made in the best interests of the shareholders.

2.2.1.1 The Sarbanes-Oxley Act

The Sarbanes-Oxley Act was introduced in the United States in 2002. According to Huse (2007), it was, essentially, a result of political expedience and uneasy compromise following the scandals such as Enron and Tyco and contained few of the ingredients of considered public policy.

Nonetheless, its introduction was to be the largest incursion ever of state control into matters of corporate governance. Previously, public policy on corporate governance in the United States had mainly been referred to in state laws. Its main practical content concerns auditors, disclosure and the protection of whistleblowers.

2.2.2 The United Kingdom (UK) Perspective

According to Weir and Laing (2001), the governance of companies has been the subject of increasing interest in recent years given the concerns expressed about the standards of accountability and financial reporting of UK listed companies.

This resulted in a number of investigations and reports which have subsequently been published, by amongst others, Cadbury (1992), Greenbury (1995) and Hampel (1998). All three investigators called for greater transparency and accountability in areas such as board structure and operation, directors' contracts and also the establishing of board monitoring committees. They also stressed the importance of the non-executive independent directors' monitoring role.

2.2.2.1 Cadbury Report (1992)

The Cadbury Report (1992) included all the major elements and sub-committees familiar in today's public company board. In addition, Cadbury explicitly stated that the role of the non-executive director was two-fold:

- Reviewing the performance of the board and executives and
- Taking the lead where potential conflicts of interest arise.

Some of the main recommendations made, are as follows:

- That the majority of non-executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment" (Parkinson, 1998).
- Non-executives should be appointed for specified terms;
- Executive remuneration should be subject to the recommendations of a remuneration committee made up entirely or mainly of non-executive directors, and an audit committee, comprising of at least three non-executive directors should be established.

2.2.2.2 Greenbury Report (1995)

The Greenbury report (1995) was published three years after the Cadbury Report and addressed the role of the non-executive directors and expanded on their roles and responsibilities and directors' remunerations.

Specifically, four main issues were dealt with, which are as follows:

- The role of a remuneration committee in setting the remuneration packages for the CEO and other directors;
- The required level of disclosure needed by shareholders regarding details of directors' remuneration and whether there is the need to obtain shareholder approval;
- Specific guidelines for determining a remuneration policy for directors; and
- Service contracts and provisions binding the company to pay compensation to a director, especially in the event of dismissal for unsatisfactory performance.

2.2.2.3 Hampel Report (1998)

The Hampel Committee was established in 1996 to review and revise the earlier recommendations of the Cadbury and Greenbury Committees. The report emphasized the value of principles rather than legislation and focused on the measures considered necessary to improve the effectiveness of the board. Hampel added further expectations and responsibilities to the role of the non-executive director, making it clear that they have a strategic as well as monitoring role.

2.2.2.4 The Combined Code (1998)

The Combined Code consolidated the principles and recommendations of the Cadbury, Greenbury and Hampel committees. It was formulated in 1998 and revised in 2003 following the publication of the Higgs report. Stock Exchange listed companies were required to make a two part disclosure statement on their adherence to the Combined Code:

- The first part of the disclosure statement required a company to report on how it applies the principles of corporate governance;
- The second part required a company to confirm that it complies with the individual provisions or to provide explanations where the provisions were not adhered to;

Essentially, the approach of the Combined Code was to insist on the disclosure of all important aspects of corporate governance structures and practices, and to stress that shareholders needed to recognize that there will be instances where departures from the code provisions are justifiable and that at least one third of the board must be non-executive directors.

2.2.2.5 The Higgs Report (2003)

The corporate failures in the United Kingdom and the numerous failures in the United States of America, prompted the government to appoint Sir Derek Higgs, a banker at UBS, and non-executive of EGG, to review corporate governance in the UK and in particular the role and responsibilities of independent directors.

The report recommended a number of changes to the combined code and a revision of the code in July 2003 incorporated into most of Higgs recommendations. The main purpose of the report was to examine the role, independence and recruitment of non executive directors. According to the author, the Combined Code recommended that boards should comprise of at least one-third non-executive directors, a majority of whom should be independent.

Higgs (2003) believes the boards of UK listed companies should exercise greater accountability, and will result in non-executive directors having a more demanding and influential role. Higgs suggested that at least half of the directors to be independent of the executives.

The report further establishes independence requirements and proposes due diligence before appointment of non-executive directors in relation to knowledge, skills and experience. Non-executive directors will also on appointment have to ensure that they have sufficient time to meet their obligations.

Other important recommendations of the Higgs report include:

- The board should review its performance, the performance of its committees and individual directors at least once a year;
- The company secretary should be accountable to the board through the chairperson on all governance matters; and
- The terms of reference of the remuneration committee should be published.

2.2.3 The French Perspective

According to Wirtz (2001), the French attitude towards business distinguishes itself from a monistic representation of the firm, that is to say, one that would be exclusively focused on shareholder interests. In 1995, Marc Viénot, a former CEO of one of France's most important banks, published a report on corporate governance which benefited from widespread attention in the French business community. It stipulates the "obligation" of the board of directors "to act in all circumstances in the *social interest* of the firm". The report then goes on to explicitly distinguish this perspective from an approach purely guided by the maximization of shareholder value.

Mallin (2005) contends that most French companies are incorporated as a *société à responsabilité limitée* (SARL) and are managed by a general manager, answerable to shareholders. Larger and quoted companies are incorporated as a *société anonyme* (SA), led by a *président* director general (chairperson/chief-executive) who has virtually absolute power. The AFG-ASFFI code recommends that the roles of chairman and CEO should be separated; the code also recommends that one third of directors should be 'independent', that is, with no conflict of interest. According to Mallin (2006), the code also endorses the Viénot recommendation for standing committees of the board, on consisting primarily of independent directors.

2.2.4 The German Perspective

According to Du Plessis (2001), in Germany the introduction of a code of good corporate governance practices was always seen in the context of the broader definition of corporate governance. Du Plessis posits that the approach to such a definition was a realistic one, with two aspects being highlighted. Firstly, corporate governance could not ignore the stakeholder debate and, secondly, the concept of corporate governance encompassed more than just the creation of legal structures for decision making and supervising the corporation.

It was furthermore realised that because of the peculiarities of the German corporation's law, in particular the prescriptive nature of the *Aktiengesetz* (*AktG*) regarding a two-tier board, no international code would fit the German situation perfectly.

Du Plessis (2001), states that the vast differences between the OECD principles of good corporate governance and the UK Combined Code, served as a clear illustration that no international code could really serve as example for Germany.

Soon after the release of the Baums report it was made known that a group of experts would be appointed to draft a code of best practices for Germany applying to all listed German corporations and it was indicated that the code should follow the "comply or explain" principle adopted in the UK.

This task was given to a Corporate Governance Commission under the chairmanship of Dr Gerhard Cromme (the Cromme Commission), who was appointed in September 2001. One of the main aims of the Code was to improve corporate governance practices relating to managing, directing and overseeing listed corporations. The code adopted the two basic principles that referred to the above, namely, that it would basically only apply to listed corporations and that it would not be mandatory, but that listed corporations should explain if they do not follow certain specific recommendations of the Code.

What is different from most other systems where voluntary corporate governance codes were adopted, is that in Germany the obligation to comply with the German code or to explain non-compliance was introduced into the German law through a statutory provision, section 161 of the *Aktiengesetz* (*AktG*).

Section 161 basically puts a statutory duty on supervisory boards and management boards of all listed German corporations to state that they ‘comply’ with the German Code as published electronically by the Standing Corporate Governance Commission or to ‘explain’ if they do not comply with the Code.

The comply-or-explain statement according to Du Plessis (2001) had to be done on an annual basis and also be made available to the shareholders at all times. Du Plessis argued that such a voluntary corporate governance model provided the advantage of responding quickly and effectively to constantly changing needs of businesses, something that cannot be achieved if corporate governance practices are formalized through legislation, especially because of the tediousness involved in amending legislation.

2.2.5 The South African Perspective

The King Committee on corporate governance published the King Report on corporate governance for South Africa-2002 (King II Report) at an Institute of Directors (IoD) Conference on 26 March 2002 (The draft’s second report on corporate governance was released by Judge Mervyn King’s committee in July 2001). The report finally provided corporate South Africa with a world class code of conduct.

According to Judin (in Directors Monthly, June 2003) it is to South Africa’s great credit that the country has enshrined one of the most liberal and certainly most community orientated constitutions anywhere in the world, resulting in almost half of South Africa’s statute books to be re-written. This inevitably made it necessary for the committee to revise the King 1 report published in (1994) and the second report was published in March, 2002. The purpose of the King report1994 and the King report on corporate governance 2002 is to promote high standards of corporate governance in South Africa.

The report highlights the difficulties for companies to account for profitability alone and underlines the move from the single to the triple bottom line which embraces the economic, environmental, and social aspects of a company’s activities.

The report also illustrates what can be regarded as constituting the seven characteristics of good corporate governance, namely: discipline, transparency, independence, accountability, corporate responsibility, fairness and social responsibility.

Today the majority share owner is the person in the street, collectively represented by the financial institutions. Institutions are becoming more active in keeping a close check on their investments, and in this regard have a greater duty towards their ultimate beneficiaries than towards company directors.

There are proposals in the UK, that if institutions do not check the quality of governance in the corporations in which they invest, the authorities will consider passing regulations to ensure investor vigilance. South Africa is already seeing a similar movement towards shareowner activism (www.thecorporatelibrary.com).

Over and above the financial and regulatory aspects of corporate governance, the King Report advocated an integrated approach to good governance in the interests of a wide range of stakeholders. According to Judin (2003), the King II report acknowledges that there is a move away from the single bottom line (that is, profit for shareholders) to a triple bottom line, which embraces the economic, environmental and social aspects of a company's activities.

Table 2.1 presents a summary of some of the major reports or guidelines that have made recommendations concerning board composition. While remaining silent on issues of board size, these reports do recommend that the roles of chairman and CEO be separated and that outside and/or independent directors represent at least a majority on the board. All of these reports mentioned have aimed at improving the standard of accountability and maximizing shareholder value. Also they were driven by the objective of improving performance standards thereby helping in access to capital.

2.3 SUMMARY

International guidelines perceive that good corporate governance assures accountability, improves performance and is a source of competitive advantage. This chapter have presented concepts relating to the stakeholders and various corporate governance codes theories and definitions. It was seen that corporate governance is concerned with the nature and interactions and relationships between the company and its various stakeholders in the process of decision-making and in terms of control over the company’s available resources.

Corporate governance, thus, have to be understood as the interactions between internal stakeholders, external stakeholders and the board members who are running the company for the benefit of all stakeholders.

However, to understand corporate governance in a specific company it is necessary to identify and understand the behavior of the main actors, including the board members, external stakeholders and internal stakeholders, and the context in which governance take place. Extensive efforts have been made in recent years to develop codes of best practice for corporate governance, to regulate the rules in order to achieve some kind of accountability and responsibility. Compliance with all of these guidelines should improve company performance and significantly reduce the risk of business failure for reasons other than commercial viability.

Table 2.1: Summary of International Corporate Governance Codes and Guidelines.

Country	Report	Recommendations			
		Size of board	CEO duality	Outside directors	Independent directors
USA	NYSE, 2002	Board to determine	The two roles should be separate	N / A	Majority
UK	Cadbury Report (Committee on the Financial Aspects of Corporate Governance, 1992)	N / A	The two roles should be separate	minimum of 3	Majority
UK	Higgs Report (Review of the role and effectiveness of Non-Executive Directors, 2003)	Board should include a balance of executive and non-executive directors	The two roles should be separate	N / A	Substantial majority
France	Vienot Code (1995)	10-16, board to determine	The board should determine	N / A	One third of the board.
Germany	Baums Report (2000)	Two tier board 20 members	Supervisory board	N / A	Majority on audit committee
South Africa	KingII (Report on Corporate Governance for South Africa, (2002)	Board should include a balance of executive and non executive directors	The two roles should be separate	N / A	Majority

CHAPTER THREE

LITERATURE REVIEW: THE BOARD AND THE INDEPENDENT DIRECTOR

3.1 INTRODUCTION

This chapter will focus on the types of boards and the key relationships within the board; between a chairperson and chief executive director; between executive and non-executive directors, and in particular the role of the independent non-executive director in influencing these relationships and promoting teamwork within the board of directors.

High-profile business failures such as Enron Corp., WorldCom, Inc., and Global Crossing, Ltd. have focused the public's attention on how management manipulates earnings in an attempt to deceive the unwary public. Public confidence in corporate governance structures and the ability of corporate boards to monitor and control management's behavior has eroded to very low levels (Petra, 2005).

Boards are being forced to deal with tough questions: such as how much is enough when it comes to paying the executive? What is the best way to account for option grants? What kind of ties should be banned between directors and the companies they oversee? On how many boards that directors serve can they add value? How should the audit committee be compiled? And how much additional consulting, if any, is acceptable for the outside accounting firm? The recent scandals have made it clear that the decisions boards have to make on the above issues can have disastrous consequences for their companies (Lavelle, 2002).

According to the Cadbury report (1992), corporate governance is about implementing and improving the governance structures and processes of companies to improve their performance and make them more accountable to shareholders and other stakeholders. It covers issues such as the structure and operation of the board of directors, financial reporting, transparency and audit, separation of powers and minority shareholders' rights. In the same vein, South Africa has seen the King II report dominating the corporate governance debate in South Africa.

It is clear that recent upheavals in the corporate world have sparked a discussion on the role of the boards in general and independent non-executive directors in particular.

3.2 TYPES OF BOARDS

Garratt (1996) identified four board structures that are typically used, these are:

- The Non-Executive Board -According to the author this type of board comprises notionally independent non-executive directors who decide policy and strategy that is then delegated to the chief executive for implementation.

- The chief executive wields enormous power in controlling the information flowing to and from the board. This Garratt argues could have a huge potential for corruption. Such board structures are common in the USA, New Zealand and among public and semi-public service boards;

- The Executive Board -According to Garratt (1996) this is the most common type of board, found in family companies, owner directed businesses and the subsidiaries of multi and transnational companies around the world. The structure of this board allows for the dominance of the chief executive who also adopts the role of the chairperson. This type of structure is characterised by a lack of diversity and a cloning of membership is. Garratt strongly suggests that influence of the external independent director is lacking;

- Two-Tier Boards-This board structure comprises an upper 'board' which deals with the policy and strategic issues and a lower 'board' which represents the different interest in the company. Garratt argues that the separateness of the boards can prove to be problematic as it allows political issues to dominate board discussions. He further argues that both boards can lose sight of working towards a common goal. This structure is common to Germany, France and The Netherlands and has been proposed as a model for boards in the European Union; and

- The Unitary Board-This structure represents the traditional Anglo-Saxon model. According to Garratt it assumes that all directors are equal and must accept the same responsibilities and liabilities for the performance of the organization. This type of board is led by the chief executive or managing director who is responsible for the operations of the business. Independent non-executive directors formulate policy, ensure accountability and provide debate and constructive criticism of the chief executive's performance. Garratt states that such independent directors are crucial to both the "Performance" and Conformance" of the unitary board so that the interests of shareholders and other stakeholders are heard and protected.

3.3 THE ROLE AND FUNCTION OF THE BOARD

According to the Higgs Report (2003), the board is collectively responsible for promoting the success of the company by directing and supervising the company's affairs. The board's role is to provide entrepreneurial leadership to the company within a framework of prudent and effective controls which enable risk to be assessed and managed. According to Payne (2002), the board is the focal point of the corporate governance system. It is ultimately accountable and responsible for the performance and affairs of the company. The author argues that delegating authority to board committees or management does not in any way mitigate or dissipate the discharge by the board and its directors of their duties and responsibilities.

Higgs (2003) argues that the board should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives, and review management performance. Higgs states that the board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met.

Furthermore, Higgs is of the view that for a board to be effective it should not be so large as to become unwieldy. It should be of sufficient size that the balance of skills and experience is appropriate for the requirement of the business and that changes in the board's composition can be managed without undue disruption. The board should ensure that the company complies with all relevant laws, regulations and codes of business practice, and that it communicates with its shareowners and relevant stakeholders (internal and external) openly and promptly and with substance prevailing over form.

3.4 BOARD COMPOSITION

According to Payne (2002), companies should be headed by an effective board that can both lead and control the company. The board should comprise a balance of executive and non-executive directors, preferably with a majority of non-executive directors, of whom sufficient should be independent of management so that minority interests can be protected. An obvious consideration of South African companies would be to consider the demographics in relation to the composition of the board.

Payne (2002) argues that procedures for appointments to the board should be formal and transparent, and a matter for the board as a whole, assisted where appropriate by a nomination committee. This committee should constitute only non-executive directors, of whom the majority should be independent, and should be chaired by the board chairperson. He contends that board continuity, subject to performance and eligibility for re-election, are imperative and a programme ensuring staggered rotation of directors should be put in place by the board to the extent that this is not already regulated.

3.5 DUTIES OF THE BOARD OF DIRECTORS

According to King (2002), all states define the roles of directors in terms of duties. The major duties of directors are:

- The fiduciary duty-According to the writer central to the role of being director is the fiduciary duty- being trustworthy in acting in the best interest of those whom the director represents. This duty the writer posits has, the elements of both integrity and competence

- The duty of loyalty and the duty of fair dealing-The writer contend that by assuming his or her office, the corporate director commits allegiance to the company and acknowledges that the best interest of the company and the shareholders must prevail over any individual director's self interest. The basic principle of this duty of loyalty is that the director should not use his or her corporate position to make a personal profit or gain other personal advantages.

The duty of fair dealing requires that all transactions with the company be handled in a forthright and open manner that is fair to the interest of the company.

- The duty of care - The duty of care according to King, in general, requires a director to act in the best interests of the company and with the care reasonably expected of "an ordinary prudent person." The director also has the duty to be informed and to make the necessary inquiries to arrive at this state. According to the writer this duty, allows the board to delegate functions to and rely on others, including other directors, officers, employees, experts and board committees.

- The duty of skill - With regards to the duty of skill the King states, it is expected of each director that whatever his practiced ability is, he will apply that ability in the interest of the company he represents. In making a judgment call, therefore, a director will use his skills to ad to the debate around the table.

- The duty of diligence - According to King (2006), diligence simply means that a director must do his homework. The director of a company, or indeed the leader of any entity, who comes to the decision- making table without being fully informed about the issues to be decided there, and who has not studied the information furnished to him or her in the document pack, is not fulfilling their duties. Diligence according to the writer also requires that a director understands the issues and information given to him.

3.6 BOARD OF DIRECTOR RELATIONSHIPS

3.6.1 The Chairperson and Chief Executive Officer (CEO)

According to Stiles and Taylor (2001) the relationship between the chairperson and chief executive is of crucial importance since it lies at the heart of a network of other associations. They are of the view that its quality has knock-on consequences, affecting relationships with other board members and the executive team.

However, the authors believe that many organizations have split the roles of the chairperson and chief executive officer in response to the Cadbury recommendations, which stressed the benefits of such a division in terms of balancing power and authority at the head of the organization.

The authors are of the view that difficulty arises in achieving balance, since the roles are ambiguous and tend to overlap. In some cases, they say that the two individuals attempt to formalize the relationship through written schedules of roles and responsibilities. Several boards constructed formulas such as the chairman being responsible for the board with the chief executive responsible for the day-to-day operations of the firm and for managing the performance of the executives.

Stiles and Taylor (2001) argue there is a constant process of negotiation between the two individuals over time. If this negotiation is not handled well, if there is defensiveness or mutual suspicion, then there is strong potential for the two individuals to slip into a struggle for power. According to them a regular meeting, where everything is up for discussion, is the key. If trust is achieved, the chief executive officer gains valuable sources of advice and counsel from the chairperson.

3.6.2 The Relationship between Executive Directors and Independent Non-Executive Directors

According to Stiles and Taylor (2001), the unitary board's mix of executive directors and independent non-executives has the potential for both creativity and conflict. They are of the view that the executives' attitude towards independent non-executives ranged from suspicion that they were simply policeman on the board who served to provide little in the way of added value, to the perception that they provide a valuable service in terms of advice and counsel, as well as contracts and sources of external influence.

However, as members of the board, their role is similar to any other director; Independent directors primarily provide inputs to all key-decisions, such as strategies, performance evaluation and risk evaluation affecting the company. Significant contribution is expected when matters relating to the committee on which they are members are being discussed. They should ensure that the board addresses areas of concern in managing the company and that it should be recorded in the minutes if not resolved (Stiles and Taylor, 2001).

While their legal duties and objectives are the same as executive directors, the time devoted by independent non-executive directors to the company's affairs is significantly less and therefore the degree of care, skill and diligence is lower then expected from executive directors.

Perhaps the single most important role that independent directors play directly in relation to the board is the objective view that they bring in while evaluating the board and the management decisions, creating a balance in the interest of the shareholders (Styles and Taylor, 2001).

3.6.3 Managing the Relationships: The Role of the Chairperson

According to Higgs (2003), the role of the chairperson is pivotal in creating the conditions for overall board and individual non-executive director effectiveness, both inside and outside the boardroom. The particular nature of the chairperson's role will inevitably be shaped by the challenges facing the company, its scale and complexity and the nature of its business. The role differs significantly from that of other non-executive and executive directors.

The chairman has the responsibility of leading the board in setting the values and standards of the company and of maintaining a relationship of trust with and between the executive and non-executive members. The chairman needs to foster relationships of trust with both the executive and non-executive directors on the board, whilst at the same time maintaining support for, and partnership with the CEO.

The board agenda must take full account of the issues and concerns of all board members for the board to be effective. This is the chairperson's responsibility. The chairperson should also make efficient use of board time by ensuring that board agendas are forward looking and concentrate on strategy, rather than approving proposals which should be decided by management.

The chairperson is responsible for managing the business of the board to ensure that sufficient time is allowed for discussion of complex or contentious issues and, where appropriate, arranging for informal meetings beforehand to enable thorough preparation for board discussion. It is particularly important that non-executive directors have sufficient time to consider critical issues and are not faced with unrealistic deadlines for decision-making.

3.7 THE BOARD AND THE INDEPENDENT DIRECTOR

According to Lin Pope and Young (2001), the composition of the board and the separation of roles of CEO and chairman are some of the key topical issues in the current governance debates. One of the major roles of the board of directors is to ensure that the composition of the board is representative and enables objectivity, and this implies appointing proportionately more non-executive directors.

The non-executive director, who is an independent director, does not serve for the protection of management. Independent directors are pivotal to making boards the first line of defense against short-term thinking and self dealing schemes by management (Pope and Young, 2000).

They concluded that it is perhaps no coincidence that such appointments consisted almost exclusively of “figurehead” non-executive directors- high profile individuals who lacked detailed knowledge of the company’s products and operations and whose availability is severely limited as a result of their many other commitments.

Investor bodies such as the UK National Association of Pension Funds have suggested a limit of perhaps four non-executive posts. But Cowe (2002) believes it would be wrong to set a specific limit because the demands vary enormously from one board to another.

One of the major problems with directors of public companies is that they sometimes do not own much of the company’s shares. There is a high probability that executive directors would have increased their effort if they held more shares. Colvin (2002) ascertained that 64% of (963 of 1500) of all directors in the USA do not own shares. Another problem which they faced was that there were too many inside directors, and therefore has the ability to over-power the independent director with regards to important decisions.

3.8 THE ROLE OF THE INDEPENDENT DIRECTOR

What is the role of the Independent director? Essentially the (independent) non-executive directors' role is to provide a creative contribution to the board by providing objective criticism. The Cadbury (1992) report initiated a debate about the main functions and responsibilities of non-executive directors. Today, it is widely accepted that non-executive directors have an important contribution to make to the proper running of companies and, therefore, more widely to the economy at large. According to Cadbury, non-executive directors should bring an independent judgment to bear on issues of strategy, performance and resources including key appointments and standards of conduct.

Cadbury (1992) states that there is no legal distinction between executive and non-executive directors. As a consequence, in the UK unitary board structure, non-executive directors have the same legal duties, responsibilities and potential liabilities as their executive counterparts.

Clearly, it is impossible that non-executive directors cannot give extensive attention to the business of the company. However, it is important that they show the same commitment to its success as their executive colleagues. All directors should be capable of seeing company and business issues in a broad perspective.

Nonetheless, non-executive directors are usually chosen because they have a wealth of experience, are of an appropriate caliber and have particular personal qualities. Additionally, they may have some specialist knowledge that will help provide the board with valuable insights or perhaps, key contacts in related industries or the City (Financial Times November, 2003).

The Stock Exchange's Combined Code, that effectively codifies the main features of the Cadbury (1992), Hampel (1998) and Higgs (2003) reports for listed companies, advises that the balance of executive and non-executive directors should be such that no individual or small group of individuals can dominate the board's decision-taking. Non-executive directors should comprise not less than half the board. While much of the comment and discussion on non-executive directors tends to focus on listed companies, it is important to note that they can also make a valuable, albeit somewhat different, contribution to private companies.

3.8.1 The Role of the Independent Director towards Shareholders and Stakeholders

Weir and Lang (2001) is of the view that the shareholders look to independent directors to provide transparency in respect of the disclosures in the working of the company as well as providing a balance towards resolving conflict areas. In evaluating the board's or management's decisions in respect of employees, creditors and other suppliers of major services, independent directors have a significant role in protecting the stakeholder's interests. In this regard the audit committee is an important committee.

According to Weir and Lang (2001), it is one of the mandatory requirements of the audit committee to look into the defaults in payments to deposit holders, non-payment of declared dividends and creditor's. Further more they are required to review the function of the "whistle blower mechanism" and related party transactions, as it will, safeguard the interests of the stakeholders.

3.8.2 The Role of the Independent Director towards Senior Management

Weir and Lang (2001) are of the view that independent directors have a direct role in reviewing the performance of senior management. According to them many corporate governance requirements stress this by providing for their nomination on the remuneration committee, which involves review of their performance in relation to remuneration.

They are of the view that, independent directors add other expertise that is providing guidance to the company in developing and implementing its strategic policies. The role of such independent directors they argue, takes significant importance in evaluating decisions of the management of the company.

3.8.3 The Role of the Independent Director towards the Board

According to Weir and Lang (2001), as members of the board, their role is similar to any other director, independent directors primarily provide inputs to all key decisions such as strategies, performance evaluation and risk evaluation, affecting the organization. Significant contribution is expected from them whenever matters relating to the committee are being discussed.

They should ensure that the board addresses areas of concern in running the organization and that these are recorded in the minutes if not resolved. They argue that while the legal duties and objectives are the same as executive directors, the time devoted by independent non-executive directors to the organization's affairs is significantly less and therefore the degree of care, skill and diligence is lower than expected from executive directors.

Perhaps the single most important role that independent directors play directly in relation to the board is the objective view that they bring while evaluating the board and the management decisions, creating a balance in the interest of the shareholders.

These areas they say are executive remuneration, succession planning, and changes in corporate control during after take-over and acquisition as well as the audit functions. Weir and Lang (2001) are of the view that as members of the board, independent directors should, not only comply with the code of conduct but also establish, implement, monitor its adherence by other senior management and set an example for others.

3.9 THE INDEPENDENCE OF NON-EXECUTIVE DIRECTORS

Both the Cadbury (1992) and Hempel (1998) Committee reports recommended that non-executive directors should be "independent" of the board to ensure objectivity. A non-executive director who is, for example, a retired director of his or her serving company, or who works for a firm that provides services to the company, may be perceived as less than wholly independent. In addition, they argue that, non-executive directors with many years of experience on the same board may become less effective monitors as they build close relationships with the executive directors.

According to Moses Mo-Chi Cheng (2005), president of the Hong Kong Institute of Directors "independence" does not have superficial meaning it exhibits the attitude toward the job, especially under great pressure. This is the primary requirement of an independent non-executive director. An independent non-executive director does not have any direct interests in a company, but such a person should have independent thinking and independent views, and must take care of the interests of all stakeholders rather than the interests of a particular group. In addition, he/she has a special task, that is, to protect small shareholders.

Cheng (2005) further argues that like any other director, an independent non-executive director must be honest, straightforward and impartial toward the company that appointed him/her and uses his/her caution, skills and hard work through out the process to influence the operations of the company. He/she should basically have the same responsibilities as executive directors, including bearing the legal responsibilities.

It is very important for independent non-executive directors to air their affirmative and objective views and take independent decisions. As an independent non-executive director the law demands impartiality in taking decisions by taking into account all available information, instead of casting votes according to the views of shareholders who were instrumental in the appointment of a specific independent non-executive director.

Cheng contends that first of all, an independent non-executive director must study and get to know all the information provided by the company; secondly, the voting and decision taking are not influenced, directly or indirectly, by individual interests; thirdly, he must honestly ask himself whether any private interests have influenced his judgment and lastly non-executive directors must constantly seek to establish and maintain their own confidence in the conduct of the company, in the performance of the management team, the development of strategy, the adequacy of financial controls and risk management, the appropriateness of remuneration and the appointment and replacement of key personnel and plans for management development and succession. The role of the non-executive director is therefore both to support executives in their leadership of the business and to monitor and supervise their conduct.

The King II Report (2002) defines an independent director as a non-executive director who:

- Is not a representative of a shareowner who has the ability to control or significantly influence management;
- Has not been employed by the company or the group of which it currently forms part, in any executive capacity for the preceding three financial years;
- Is not a member of the immediate family of an individual who is, or has been in any of the past three financial years, employed by the company or the group, other than in a director capacity;

- Is not a significant supplier to, or customer of the company or the group;
- Has no significant contractual relationship with the company or the group; and
- Is free from any business or other relationship, which could be seen to materially interfere with the individual's capacity to act in an independent manner.

3.10 SUMMARY

This chapter has described the nature of relationships within and around the board. It has sought to build on the views of independent directors in an attempt to make sense of their roles in large organizations. Highlighted, are some of the key contextual and structural features of boards that can affect the involvement of the board in the running of the company. These included the roles of the independent director, the relationships between the chief executive officer and the chairperson, and the relationship between the independent director and various other stakeholders.

According to Westphal (2002), much of the recent and continuing work on corporate governance has been concerned with changes in board structure and composition that have sought to increase the board's ability to exercise control. These changes include introducing a sufficient number of independent non-executive directors to the boards of organizations, separating the roles of chairperson and chief executive officer, and establishing committees of the board.

The author is of the view that boards that are structurally independent from management are able to rein back managerial interest and align them with the interest of shareholders and reduces the agency problem. With organizations becoming more complex and the business environment unpredictable, the role of the board will come under greater scrutiny. According to Stiles and Taylor (2001), structure and composition of the board count for much in terms of how boards are run, but at the heart of board's effectiveness is the caliber of its members, their willingness to participate, and the quality of the relationships between them.

CHAPTER FOUR

THE PROPOSED ROLE AND RESPONSIBILITIES OF THE INDEPENDENT DIRECTOR

4.1 INTRODUCTION

According to the Higgs report (2003), the role of the non-executive director is complex, demanding and requires skills, expertise and integrity as well as particular behaviours and personal attributes. The author posits that non-executive directors need to be sound in judgment and need to have an inquiring mind. Higgs argues that they should question intelligently, debate constructively, challenge rigorously, decides dispassionately and that they should listen sensitively to the views of others, inside and outside the board.

In order to fulfill their role he argues that non- executive directors must acquire the necessary expertise and knowledge to discharge their responsibilities. They must be well informed about the business and the environment in which the business operates he says. This he says requires knowledge of the markets in which the company operates as well as a full understanding of the company itself.

According to Higgs (2003), non-executive directors must create the right balance between the interest of senior employees, the company and in particular, the shareholders. This sometimes means taking an unpopular line and in times of crisis, which most boards have at some stage, the non-executive director can play a significant role. He states that non-executive directors can be a powerful force in challenging executive directors.

In view of what has been discussed in the preceding chapter, the role and responsibilities of the board and the independent non-executive director has gained special attention. Hence, a review of some of the critical outcomes of this attention, having an impact on the proposed role of the independent director in corporate governance, is necessary.

4.2 THE BEHAVIOR AND PERSONAL ATTRIBUTES OF THE INDEPENDENT DIRECTOR

Higgs (2003), states that understanding the company well is essential to gain credibility and reduces the inevitable disparity in knowledge between executive and non-executive directors. Developing such knowledge cannot be done within the confines of the boardroom alone.

According to Higgs a number of consultation responses identified the personal attributes required of the effective non-executive director. They are founded on:

- integrity and high ethical standards;
- sound judgment;
- the ability and willingness to challenge and probe; and
- Strong interpersonal skills.

First and foremost, integrity, probity and high ethical standards are a prerequisite for all directors. Second, sound judgment is central to the non-executive director's role. This is essential for each of the elements of the non-executive director's role set out above. Third, all non-executive directors must be able and willing to inquire and probe.

They should have sufficient strength of character to seek and obtain full and satisfactory answers within the collegiate environment of the board. The objectivity and fresh perspective acquired through their relative distance from day-to-day matters, combined with experience acquired elsewhere, is the basis for questioning and challenging the accepted thinking of the executive. Questioning does not only serve to raise specific concerns, it can also prompt stronger executive performance.

Higgs contends that executive directors especially value informed and constructive debate with non-executive directors. Fourth, the ability to work with other people is an essential characteristic of the effective non-executive director. Much of their effectiveness depends on exercising influence rather than giving orders and requires the establishment of high levels of trust. Inevitably, the effectiveness of a non-executive director's contribution will change over time.

Non-executive directors should be willing and able to acknowledge when their individual contribution is no longer fresh, and should make way for newcomers in an orderly and managed way.

4.3 WHY HAVE INDEPENDENT DIRECTORS ON BOARD?

According to Gopalakrishnan (2005), there are several distinct benefits that an independent board of directors can bring to a company, ranging from long-term survival to improved internal controls. The author believes that independent directors on the board can:

- Counter balance management weaknesses in a company;
- Ensure legal and ethical behaviour at the company, while strengthening financial accounting controls;
- Extend the "reach" of a company through contacts (social capital), expertise, and access to debt (financial capital) and equity capital;
- Be a source of well conceived, binding, long term decisions for the company; and
- Help the company survives grow and prosper over time through improved succession planning through membership in the nomination committee.

4.4 THE ROLE OF THE INDEPENDENT DIRECTOR

According to Clarke (1998), academic research that is consistent with corporate governance codes and in particular research on the role of non-executive directors focuses on three main roles. These are considered separately below.

4.4.1 Monitoring the Board

According to Weir and Lang (2001), it is important that there is a mechanism to monitor the actions of the chief executive and other executive directors to ensure that they pursue shareholder interests. Dare (1998) contends that non-executive directors are effective as monitors when they ask awkward question and that they can provide independent judgment in the areas that personally affect the executive directors' remuneration, appointments and also dismissals. Davis and Kay (1990) argue that if there is to be a corporate monitor, then the non-executive director appears to be the ideal candidate for such a purpose.

4.4.2 Strategy Development

Tricker (1984) contends that it is generally accepted that boards of directors are involved in the formulation of strategy, setting policies and the acquisition and allocation of much needed resources. According to Hill (1995), directors see their main purpose as strategic direction and non-executive directors sees a wider role for themselves in this area by bringing a breadth of vision, experience, environmental scanning and being available as a sounding board for the chief executive officer.

Stiles (2001) posit that the board is responsible for setting the broad strategic parameters within which detailed strategic activity takes place. The author also considers the board as the final arbiter on key questions such as ‘what business are we in?’, ‘which areas should we go into?’ as well as challenging existing strategies and organizational habits that needed to change. As far as the extent of the non-executives director involvement in strategy is concerned, Pettigrew and McNulty (1995) argued that the role of the independent director was dependent upon the skills and motivation of the non-executive directors and other factors such as crisis conditions or changing boardroom dynamics.

4.4.3 Conflict Resolution

According to Davis and Kay (1990), non-executive directors should be active in matters of conflict resolution especially in areas concerning executive remuneration, responses to takeovers and the appointment of and removal of executive directors. In a study conducted by McNulty and Pettigrew (1996) they found that non-executive directors believed that they were able to make significant contributions in the areas of board remuneration, hiring and firing of chairman and board members as well as board processes and conduct.

4.5 THE RESPONSIBILITIES OF THE INDEPENDENT DIRECTOR

To execute their role, independent directors, have similar responsibilities to those of other directors (Gopalakrishnan, 2005). According to the author the fiduciary duties of care, diligence and acting in good faith apply equally to independent detectors’ as to other directors. He posits that in view of faith imposed on them by various agencies they are more bound to execute their functions with impartiality.

According to Gopalakrishnan (2005), it is necessary for the independent directors to:

- Prepare themselves thoroughly for meetings;
- Be objective in forming decisions relating to the company and its business;
- Be open minded, free and frank in expressing their opinions and at the same time be willing to engage in meaningful debates;
- Be committed to decisions made as a board;
- Continuously seek information both from within and if required outside professional knowledge to keep abreast with the latest developments in the areas of the company's operations;
- Be informed on the laws and regulations influencing their functioning as directors; and
- Utilize the expertise that they possess to the advantage of the company.

4.6 THE INDEPENDENT DIRECTORS CODE OF CONDUCT

The following code is a professional conduct guideline for independent directors. According to the charter of the independent directors association adherence to these standards by independent directors and fulfillment of their responsibilities in a professional and faithful manner promotes confidence in the Institution of Independent Directors on behalf of the investment community and companies. Implementation of best corporate governance practices by Independent Directors in Boards of Directors (Supervisory Boards) of public companies enhances the company management efficiency, improves its image and contributes to the overall growth of the company's shareholder value.

This code is drafted in development of the Code of Corporate Conduct introduced by the Charter of the Independent Directors Association. It also takes into account the OECD's Principles of Corporate Governance and other best international corporate governance practices. The code takes into account the specific legal and business environment of the activity of members of Boards of Directors of National and International Corporations.

It is recommended to all independent directors working in South African as well as international companies. Compliance with this code is compulsory for all association members carrying out the functions of an independent director in boards of directors of national and international companies.

4.6.1 Guidelines for professional conduct of an independent director

- An independent director shall respect the truth and act objectively and constructively in exercising his/her duties;
- An independent director shall exercise his/her responsibilities in a bona fide manner in accordance with applicable legislation;
- In decision-making situations, an independent director shall ensure that the decision would benefit the company, its shareholders and other stakeholders, providing a reasonable balance of interests;
- An independent director shall not abuse his/her position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any other associated person, except for the remuneration for board membership;
- Observance of the independence requirement is the most important aspect of the activity of an independent director; and
- Transparency and openness to dialog are the distinguishing characteristics of an independent director.

4.6.2 Professional activities of an independent director: relationship with the company.

- An independent director shall strive to acquire as soon as possible a sufficiently broad knowledge of the company's business in order to work effectively in its board of directors;
- An independent director shall endeavor to make his/her own contribution to the company's successful development, image enhancement and growth of the shareholder value;

- An independent director shall make decisions for the benefit of the company and all of its shareholders;
- In relations with the company, an independent director shall adhere to the principle of openness with respect to himself/herself as well as his/her affiliated parties; and
- An independent director shall be fully aware of all liabilities arising from performance of his/her duties as member of the Board of Directors (Supervisory Board) of the company.

4.6.3 Professional activities of an independent director: relationship with shareholders

- An independent director acts as an agent of all the company shareholders and therefore shall, within the limits of his/her authority, protect the rights and legitimate interests of all of the company's shareholders and help establish constructive dialog between the company's shareholders and management;
- An independent director shall endeavor to ensure that shareholders are given access to corporation information; and
- An independent director shall strive to be accessible and open to shareholders.

4.6.4 Professional activities of an independent director: relationship with third parties.

- When dealing with third parties, an independent director shall be loyal to the company and its shareholders and protect their interests;
- When dealing with the investment community and stock market analysts, an independent director shall make every possible effort to enable all the parties concerned to have simultaneous access to the information disclosed; and
- An independent director shall disclose only accurate information that may be disclosed according under applicable laws and does not damage the company's business.

4.7 REMUNERATION OF INDEPENDENT NON-EXECUTIVE DIRECTORS

According to Higgs (2003), a remuneration committee should look at the overall compensation structure of the corporation to determine if it established appropriate incentives for management and employees at all levels. The Higgs Report (2003) suggests that the remuneration committee should consist exclusively of independent non-executive directors. The author posits that the committee should determine and agree with the board a framework or policy for the remuneration of the CEO, the board chairperson and other members of the executive management that is authorized to consider. Higgs strongly suggests that the remuneration of the non-executive director should be determined by the chairperson and the executive members of the board.

4.8 THE ROLE OF THE NOMINATION COMMITTEE

According to Huse (2007), nomination committees are recommended in most codes of best practice, which should lead the process for board appointments and make recommendations to the board. Higgs (2003) suggests a nomination committee should have majority of non-executives, but that the board chairperson should lead the nomination committee. Huse (2007) contends there must be a formal, rigorous and transparent procedure for the appointment of new board members.

According to Higgs (2003), it is the task of the nomination committee to evaluate the balance of skills, knowledge and experience on the board and, in light of this evaluation, prepare a description of the role and capabilities required for a particular appointment. For the nomination of a chairperson, the nomination committee should prepare a job specification.

4.9 SELECTION OF INDEPENDENT NON-EXECUTIVE DIRECTORS

According to Berry and Perrin (2001), to select a suitably balanced team of directors can prove more difficult than it appears. They argue that the selection and appointment of a non-executive director is a very important task and that the recruitment of such a person is expensive and needs to be taken seriously. They also believe that the board must be clear about the particular skills that they want a non-executive director to bring. They are of the view that chemistry is important, as a non-executive director must be able to establish credibility with the board and be able to present views perhaps not held by the majority.

According to Berry and Perrin (2001), the key to any successful appointment is for the Board to be clear about the qualities that they are looking for in a potential applicant. They posit that many attributes may be desired- integrity, diplomacy, tact experience of business, good judgment and financial and commercial acumen. They say the non-executive director must not depend on the appointment alone to supplement his income. He or she should not owe any particular allegiance to any member of the board, and should be in every way independent. According to the writers when selecting a non-executive director, a specification should be drawn up detailing the personal and commercial qualities of the individual sought, as well as the particular skills that the board would wish the individual to bring.

4.10 SUMMARY

Corporate governance has been a controversial issue in recent years. To ensure that the board functions as it should, governments around the world increasingly require publicly listed companies to appoint and/or increase the number of independent directors on the board. According to Cadbury (1992), the non-executive director has a critical role in resolving potential conflicts of interest between the company and executives, and in ensuring that there are adequate systems to safeguard the interests of the company where such interests may conflict with the personal interests of the directors.

Fundamentally, non-executive directors should contribute independent views to the board's deliberations and decisions, while identifying strongly with the company's business. Therefore, non-executive directors must have the strength of character and be able to stand back from the issues being considered, and the ability to exercise impartial judgment on conflicts or potential conflicts of interest between the company and its executives. This calls for demanding personal qualities of integrity, courage, common sense and excellent interpersonal, as well as, listening and communication skills

However, it is acknowledged that non-executive directors who are able to provide independent and objective contributions to a board's deliberations, judgment and decisions would contribute enormously to good corporate governance which would benefit all stakeholders, in particular investors who are not involved in the management of the company.

CHAPTER FIVE

OVERVIEW, RECOMMENDATIONS, FINDINGS AND CONCLUDING REMARKS

5.1 INTRODUCTION

The purpose of this study was to examine the international perspectives on the proper role of the independent director in corporate governance. This research is especially timely given that board diversity and independence are significant corporate governance issues facing the modern corporation. According to McKinsey and Company (2002) investors believe companies should create more independent boards and achieve greater boardroom effectiveness through better director selection, more disciplined boardroom evaluation processes and greater commitment from directors.

They argue that improvement in the independence of corporate boards ought to yield improvements in corporate performance. They contend that independent directors are expected to be more effective in monitoring managers, thereby reducing agency costs arising from the separation of ownership (shareholders) and control (managers) in the day-to-day company management.

5.2 OVERVIEW OF THE STUDY

According to Stiles and Taylor (2001), the field of corporate governance has been inundated with policy recommendations, as governments and institutional bodies seek ways to make companies more accountable and, ultimately, more effective in an increasingly competitive environment. The writers posit that many policy theories have had an implicit reliance on agency theory assumptions. These assumptions they contend centered on the nature of managerial motivation, which, it is claimed, rests on opportunism and self seeking behavior. Much attention has been paid to the issue of board composition, by increasing the international awareness of boards to appoint independent non-executive directors.

Empirical evidence on the association between independent non-executive director’s and firm performance is mixed. Some studies have found that having more independent non-executive directors on the board improve firm performance Barnhart et al (1994); Daily and Dalton, (1992); Schellenger *et al*., (1989).

However, other empirical evidence does suggest that independent non-executive director’s do play an important role of shareholder advocate. For example, studies have shown that shareholders benefit more when outside independent directors have control of the board in tender offers for bidders (Byrd and Hickman 1992) and in hostile takeover threats (Gibbs, 1993).

Furthermore, an investigation by Beasley (1996) commissioned by the Treadway Commission into the governance structures of failed firms indicates that the boards of directors were dominated by management and outsiders with special ties to the company or management. Beasley (1996) found that independent directors reduce the likelihood of financial statement fraud. It would therefore appear; from these studies that independent non-executive director’s do monitor and control management in specific contexts such as takeovers and financial statement reporting.

However, it is interesting to note that the Enron board of directors composed of a majority of independent directors while the boards’ of WorldCom, and Global Crossing, were composed of a majority of management and other non-independent directors (Beasley, 1996). It appears therefore that the presence or lack of independent directors did not influence the management of these firms.

5.3 RECOMMENDATIONS

- As with executive appointments, all board members should be involved in the decision to appoint independent non-executive directors.
- The board should approve standards for determining a director’s independence, taking into account the laws that are governing a country, as well as the view of investors and other stakeholder groups
- When considering whether a director is independent the board should also consider whether the director has any other relationships, either directly or indirectly, with the company’s senior management or other board members that could affect the director’s actual or perceived independence.
- Create and publish corporate governance principles so that everyone from employees to potential investors understand the rules under which the company is operating

- The primary role of the non-executives should be involvement in board decisions rather than to perform roles which would undermine the unitary board concept that is working well in the UK. A role that needs to be developed further is acting as promoters of good ethical behaviour to ensure that the company is run on behalf of the shareholders as a whole.
- The King report should be kept under regular review so that it is updated for changing circumstances, and be in line with international corporate governance standards.

5.4 FINDINGS

Studies by Weisbach (1998), Baysinger and Hoskisson (1990), McNulty and Pettigrew (1999), Carpenter and Westhpal (2001), Weir and Lang (2001), styles and Taylor (2001) and Pearce II and Zahara reported that boards with a healthy representation of independent non-executive directors on the board are associated with better financial performance compared to those with no or a smaller percentage of independent non-executive directors. However, there is some evidence that having an independent director on the board is correlated with less cases of fraudulent financial reporting (Beasley *et al* ., 2000; Dunn, 2004). Table 5.1 highlights selected empirical studies findings that independent directors do strengthen corporate boards.

According to recent evidence in the UK and elsewhere it would seem that internationally companies have made a choice in favour of appointing independent directors rather than following some of the other guidelines of corporate governance codes that refer specifically to good board practices.

The study revealed that:

- Many countries across the continent have adopted a code of Corporate Governance Best Practice based on international standards like the South African King report, the UK Cadbury report; the Higgs report; the OECD Code and the Commonwealth Secretariat Code.
- A significant number of recent studies find that independent non-executive directors have a positive effect on accountability and firm performance.

- Non-executive independent directors do appear to strengthen corporate boards; however, more needs to be done to re-establish the market's confidence in corporate South Africa's ability to effectively govern itself.
- There is convergence to International Accounting Standards: Listed companies in South Africa and all over Africa for example Kenya, Tanzania, Botswana, and Mauritius are required to use International Accounting Standards.

5.5 IMPLICATIONS FOR SOUTH AFRICAN BOARDS OF DIRECTORS

The development of corporate governance in South Africa and across the world has manifested itself in a number of interesting ways. Foremost among these has been the changes that the JSE has undertaken,

- By revising its listing rules, which makes a number of the recommendations under the second King report mandatory and applies the 'comply or explain' principle with respect to conformity with the remaining guidelines.

- The recommendations of South Africa's second King report on corporate governance have been incorporated into legislation and regulations relating to financial markets on the grounds that these support prudential conduct.

- The banking regulator on corporate governance went further, in calling for an inquiry into the corporate governance of South Africa's major banks. This investigation resulted in a number of recommendations, which have given rise to significant changes to the Banks Act.

At the same time, the regulations accompanying the PFMA were significantly altered to conform to various recommendations contained in the second King Report. This was followed by a completely revised protocol on corporate governance for all state-owned enterprises, which replaced the earlier policy protocol. The new protocol introduced more comprehensive and rigorous guidelines for public sector institutions. Shortly after this government has introduced the municipal finance management Act, which imposes significant governance obligations on officials and executives associated with municipal financial administration.

Since then a serious of statutory interventions and regulations have also been introduced to combat money laundering as well as support for stricter anti-corruption measures. This was a clear signal from government that corporate governance has been identified as a matter of national significance.

5.6 RECOMMENDATIONS FOR FURTHER RESEARCH

According to Pettigrew (1992), the central problem with research on corporate governance and the Board of Directors has been that the majority of studies have been conducted at one remove from board activity. He argues that much energy has been expended in testing theoretical models using secondary data, while few descriptive studies have actually been carried out with directors themselves, but I would suggest the use of more qualitative data methodologies to investigate board processes (Pettigrew, 1992). I believe that such a study methodology can provide us with richer forms of data and new tools for analysis to shed light on the complex processes involved in the selection of non –executive directors, their roles and functions on corporate boards.

5.7 CONCLUDING REMARKS

Corporate governance is about the way in which boards oversee the running of a company by its managers, and how board members are in turn accountable to shareholders and the company. This has implications for company behaviour towards employees, shareholders, customers and banks. Good corporate governance plays a vital role in underpinning the integrity and efficiency of financial markets. Poor corporate governance weakens a company's potential and at worst can pave the way for financial difficulties and even fraud.

If companies are well governed, they will usually outperform other companies and will be able to attract investors whose support can help to finance further growth (Petra, 2005).

As discussed previously, director independence is perhaps the most debated corporate governance issue faced by today's organizations. In the current study, we considered international perspectives on the proper role of the independent director and the extent to which they could make any difference whilst serving on a company's board of directors.

Some studies have shown that firm performance is unaffected by the presence of outside independent directors. This would indicate that management is controlling firm performance and the decision management function of the board is controlled by management (Petra, 2005).

According to Petra (2005), the above discussion would seem to indicate that outside independent directors do play an important role in controlling management (i.e. decision control) in the context of specific settings such as takeover threats, CEO compensation, and individual nominations to the firm's board. Only time will tell if the spotlight now shining brightly on corporate board rooms will lead to changes that increase investor confidence in corporate governance. The research shows overwhelming support for the inclusion of independent directors on corporate boards and provide clear guidelines regarding their roles and responsibilities as well as what could be expected of them. The researcher is of the view that boards with a healthy representation of independent non-executive directors on the board does appear to strengthen corporate boards.

Table: 5.1 Selected empirical studies finding that independent directors do strengthen corporate boards

Authors	**Description of study**	**Major empirical findings**
Schellenger *et al*. (1989)	Advocates of board of director reform suggest that outsider dominated boards take a more active role in promoting the financial performance of the firm.	The study finds that there is a positive correlation between ratio of outside directors and dividend payout ratios. The findings provide evidence that the composition of the board of directors affects dividend policy.
Byrd and Hickman (1991)	The study examines the association between the presence of outside directors and the returns to shareholders of bidding firms in tender offers.	The study finds that bidding firms on which independent directors hold at least 50% of the seats Have significantly higher returns than other bidders.
Barnhart *et al.* (1989)	In this paper the researchers attempts to Determine whether, after controlling for managerial ownership or shares, the proportion of independent outside directors is related to overall performance.	There is statistically significant curvilinear relationship between board composition and performance, and conclude that board composition and overall performance is related.
Beasley (1996)	This study empirically tests the prediction that the inclusion of larger proportions of independent outside directors on the board of directors significantly reduces the likelihood of financial statement fraud.	Results from logit regression analysis of 75 fraud and 75 no-fraud firms indicate that no-fraud firms have board with significantly Higher percentages of independent directors than fraud firms.
Dechow *et al*. (1996)	This study investigates firms subject to accounting enforcement actions by the SEC for alleged violations of generally accepted accounting principles.	It was found that an important motivation for earnings manipulation is the desire to attract External financing at lower cost. According to the researchers firms manipulating earnings are more likely to : 1. Have boards of directors dominated by management, and 2. Have a chief executive officer who simultaneously serves chairman of the board.

Table: 5.1 Selected empirical studies finding that independent directors do strengthen corporate boards

Authors	**Description of study**	**Major emperical Findings**
Shivdasani and Yermack (1998)	The researchers study whether CEO involvement in the selection of new directors Influences the quality of appointments to the board of directors**.**	It was found that companies are more likely to appoint grey outside directors who have conflicts of interests and less likely to appoint independent outsiders under these conditions, and are less likely to make pivotal appointments that give the board a majority of independent outsiders.
Carcello and Neal (2000)	This study examines the relation between the composition of financially distressed firms, audit committees and the likelihood of receiving going concern reports.	The researchers found an inverse relation between the likelihood of receiving a going concern report and the percentage of affiliated directors on the audit committee. Their findings are consistent with the BRC's (1999) recent recommendations for completely independent audit committees.
Dehaene and Ooghe (2001)	In this paper, the researchers analyzed the composition of directors in a sample of 122 Belgian companies and verified whether this composition has an impact on the performance of the firm, as measured by returns on equity and assets.	Through statistical calculations, the authors found that board size and percentage of outside directors are positively related to company size and differ significantly across Industries. They also found a significantly positive relationship between the number of external directors and return on equity, and where the functions of chairman and chief executive are combined, the return on assets is significantly higher.
Yoshikawa and Phan (2003)	This paper explores the performance impact of recent changes in foreign shareholdings and boardroom reforms in Japan.	They found that participation of independent outside directors in Strategic decision making was associated with positive stock returns.

Table: 5.1 Selected empirical studies finding that independent directors do strengthen corporate boards

Authors	Description of study	Major empirical findings
Belden *et al*. (2005)	The researcher hypostasized that firms with a larger share of Independent outside directors on their Boards pay higher dividends, an action They say that reduces agency cost.	Using sophisticated statistical analysis and a database of over 500 firms, she finds that companies with more independent outside Directors pay higher dividends.
Helland and Sykuta (2005)	The researchers examine the relative likelihood of a firm being a defendant in securities litigation based on such traditional measures of board effectiveness as the insider outsider composition of the board controlling for firm value, previous unfavourable financial audit, year and industry.	They found that companies that are the target of shareholder litigation have systematically higher percentages of inside directors. The results suggests that boards with Higher proportions of outside directors do a better job of monitoring management.

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