Boards Will Never Be Any Good at Policing Executives

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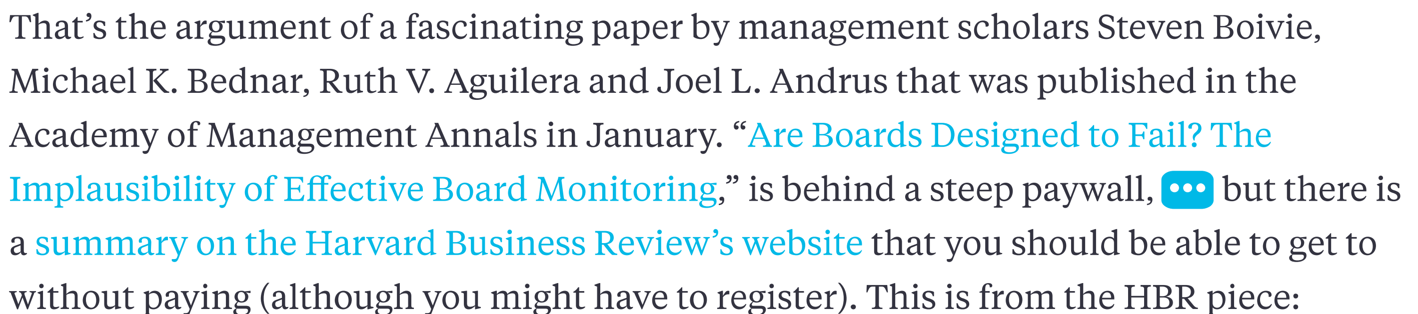
By Justin Fox

The job of the corporate board of directors is to oversee company management on behalf of shareholders. This is, I think it's fair to say, the most widely accepted understanding of what boards were put on earth to do.

Yes, there are those who think the board should be looking out for other stakeholders -- employees, customers, society -- beyond just the owners of shares. There's also a lot of evidence that boards aren't all that great at management oversight.

Yet the belief that the board's most important role is to oversee the corporation's top executives -- "monitor" them, as the academic jargon has it -- remains entrenched. It informs most journalistic accounts of corporate debacles, and most research into the attributes that make boards effective. It is also behind the big push over the past quarter century to get more outside directors onto boards, and to separate the jobs of chairman and chief executive officer.

So here's a subversive suggestion. Maybe boards are *never* going to be any good at keeping executives from betraying shareholders, messing up corporations and breaking laws. We should just accept that, stop beating boards up for it and move on.



That's the argument of a fascinating paper by management scholars Steven Boivie, Michael K. Bednar, Ruth V. Aguilera and Joel L. Andrus that was published in the Academy of Management Annals in January. "Are Boards Designed to Fail? The Implausibility of Effective Board Monitoring," is behind a steep paywall, ••• but there is a summary on the Harvard Business Review's website that you should be able to get to without paying (although you might have to register). This is from the HBR piece:

> Analyzing nearly 300 research articles that examined the effectiveness of board

> monitoring, we came to the conclusion that it is unreasonable to expect boards to be able to do an effective job at ongoing monitoring. We show that for most boards there are significant barriers at the director, board and firm level that prevent them from being effective monitors.

The biggest issues have to do with information. From the original paper:

> In many cases even the most motivated directors will be unable to effectively monitor executives because of the many barriers that limit the acquisition, processing and sharing of adequate information.

Outside directors tend to be people with limited time and attention, as well as limited access to information about the corporation. They also face disincentives for rocking the boat at board meetings and challenging the CEO.

What *are* board members good for? Well, according to Boivie et al., they provide “access to resources like advice, counsel, knowledge of external events and/or influence with external stakeholders.” They also play a crucial decision-making role during “punctuated events” -- crises, basically -- such as management transitions, accounting scandals and “other internal and external shocks that increase the uncertainty in which a firm operates.”

As for who is supposed to play the monitoring role if boards can’t, the paper doesn’t offer a simple answer. Neither did Boivie, an associate professor at Texas A&M University’s Mays School of Business, when I talked to him this week. Boards do become hands-on monitors during a crisis -- “they will still fire the CEO if things are bad enough,” he said -- and outside investors play that role sometimes too. Other outside checks on executives’ behavior that I can think of include competitive forces and government regulators. But it may also be that monitoring is overrated.

The board-as-monitor view is part of an intellectual framework descended from a 1976 paper by economists Michael Jensen and William Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure.” The gist is that executives are agents acting on behalf of a corporation’s owners, and the central challenge of the corporation is getting those agents to do their duty.

It’s hard to overstate how much influence this “agency theory” has had on how we think

about corporations and diagnosis their ills. It's where the idea that the job of corporate management is to maximize shareholder value came from, for example.

It's become apparent through the years, though, that agency-theory-inspired corporate governance may actually worsen some of the ills it aims to cure. ••• Here's Boivie's (condensed) take from our conversation:

> Agency theory is potentially a self-fulfilling prophecy. If you treat an executive as if you're really worried about them cheating, then pretty soon they're going to view themselves as contract labor. There's tons of evidence from the lower levels that people hate to be monitored all the time. It removes trust. So when we treat CEOs like agents, they tend to act like agents.

I think that's a pretty good description of the path that CEO attitudes and behavior actually followed during the 1980s and 1990s. As agency theory rose to dominance, executive tenures shortened and pay skyrocketed. There's been a bit of backtracking and rethinking since then, but the notion that boards are supposed to be looking over CEOs' shoulders and making sure they're not being naughty remains dominant. Maybe it's time to let it go.

1. *And strangely, unlike their business-school colleagues in accounting and finance, management professors aren't in the habit of posting early versions of their work online for all to see. Which might be a good topic for a future column.*

2. *This has been a favorite theme of former business school dean and frequent Harvard Business Review contributor Roger Martin.*

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