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Measuring Board of Director Performance: An Overview and Future Research Opportunities[1]

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ABSTRACT

This article provides a brief overview of the literature on board of director performance, highlighting the difficulties in attempting to directly measure the performance of boards of directors and how various studies have tackled this challenge. As an illustration, I show that two current measures of board of director performance, board meeting activity and director attendance, suggest that the boards of Asian firms do not compare favorably to the boards of firms from developed markets. Suggestions for future research on the performance of corporate boards are provided, as well as implications for board of director practices in Asia.

1. Introduction

Boards of directors are tasked with monitoring and advising firm management and play an important role in representing and safeguarding the interests of shareholders. But, how do we know if boards of directors are performing their work to the best of their abilities? Numerous studies have related different aspects of boards of directors (e.g. independence, gender, expertise) to measures of firm outcomes (e.g. accounting quality) or firm performance. The focus of this work is not to review this large literature, but to highlight the different ways researchers have undertaken the task of measuring board performance.

Board of director performance is very hard to directly measure. For example, how much of the performance of a company is due to the efforts of the firm's CEO, the firm's other executives, the firm's employees and the firm's board of directors? The financial reporting quality of a firm is influenced by the firm's accounting staff, the firm's CFO, the firm's auditor and the firm's board of directors through the audit committee. So, how can we separately identify the influence the board of directors has on these firm outcomes? The simple answer is that we cannot. Not with the data that is currently available.

Therefore, how should we go about measuring board of director performance? This is a question I have been pondering for a while now and in seeking out different opinions on the issue, I was fortunate to interact with a group of company secretaries at a recent event in Hong Kong. Their take on board performance is that a board of directors has performed well if they have made the best possible decisions with the information they have available. Thus, they see their job, as company secretaries, as making sure the right quality and quantity of information is provided to the board of directors to enhance their decision making. I found this view interesting as it suggests that to truly measure board performance, we should compare the actual decisions of the board to the optimal decisions that the board should have made, if they had optimal information. Of course, this is an extremely difficult, if not impossible undertaking. So, we are left to consider how we can measure, at least some dimension, of board of director performance.

Prior studies have done this in a number of ways. Indirectly, studies have shown that directors that do a good job are more likely to be re-elected and more likely to obtain additional directorships (Fama and Jensen, 1983; Cai et al., 2009). Other studies have looked at board activity, such as the number of board and committee meetings that firms hold, and suggest that more meetings are associated with better board performance (Vafeas, 1999). Further studies have examined director attendance, proposing that it is hard for directors to be performing their duties if they are not actually present at meetings (Adams and Ferreira, 2008).

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The most interesting studies that I have seen have taken a further step in measuring board performance. Choi and Rabarison (2016) and Jiang et al. (2014) investigate the voting records of independent directors in a sample of Korean and Chinese firms. Schwartz-Ziv and Weisbach (2013) access the minutes of board meetings of a sample of Israeli firms and analyze the issues discussed and decisions made by directors. Pugliese et al. (2015) examine the interactions among board members from video recordings of board meetings and find director inclusiveness and evenness of participation are associated with higher perceptions of board effectiveness.

Ideally, researchers will bring together more of these dimensions of board of director performance in the future, so that we can get a broader view and better understanding of how we can and potentially should measure the performance of boards of directors. As always, we are reliant on the availability of data to perform our tests. Therefore, perhaps a good first step is to encourage firms to disclose more information about how they evaluate the performance of their boards of directors. Wouldn't it be interesting to know how many directors received a grade of "A" or "F" for their board performance during the year!

2. Literature on Board of Director Performance

This section provides an overview of studies that examine board of director performance from different dimensions. This is by no means an exhaustive literature review, with examples of research work simply selected to highlight the points being made.

A large number of studies around the world have related different aspects of boards of directors to measures of firm outcomes. These studies assume that certain types of boards (e.g. more independent boards) perform better, which will be reflected in better firm outcomes. An example, is Yermack (1996) which relates board size to firm value, finding that smaller boards are more effective as they are associated with higher firm valuations. From an accounting perspective, Klein (2002) examines whether board and audit committee characteristics are related to earnings management and concludes that boards structured to be more independent of the CEO are more effective in monitoring the corporate financial accounting process.

While these studies are informative, I would like to highlight two issues. First, these types of studies do not directly measure board of director performance. Certain types of boards are assumed to perform better because they have certain characteristics. Second, there is quite a large distance between the characteristics of the board and the firm outcomes being measured. By this I mean that there could be countless other factors also related to the documented firm outcomes. Thus, I like to think of these studies as providing high-level links between board characteristics and firm outcomes, but we really don't know much about what is going on inside the firm.

Another group of studies measure the performance of individual directors in rather indirect ways. Fama and Jensen (1983) propose that multiple directorships are a signal of director quality, as directors that perform better are more likely to be invited to serve on additional boards. Cai et al. (2009) argue that the likelihood of directors being re-elected is lower if they have not performed well in their directorship. Other studies examine the market reaction at the appointment or departure of directors (Rosenstein and Wyatt, 1994; DeFond et al., 2005; Fich and Shivdasani, 2006), suggesting that the market can anticipate the expected performance of directors (for appointments) or will react positively if a poor performing director leaves the board.

To better understand the actual practices of boards of directors, studies have also examined the frequency of board and committee meetings. The argument here is that meetings are a sign of board activity. While more meetings may not necessarily mean the board is performing better, it does provide an indication of board effort. Vafeas (1999) shows that boards tend to hold additional meetings after periods of poor firm performance and this increased board effort is linked to subsequent improvements in firm performance. Other research has focused on the attendance of directors at board and committee meetings. Adams and Ferreira (2008) highlight director attendance as a measure of director performance and find that higher pay entices directors to attend more meetings.

The most direct and interesting studies of board of director performance that I have come across in recent years are the following. These studies delve into the actual workings of boards and give us a much richer understanding of what board do and how we can better measure board performance. Choi and Rabarison (2016) and Jiang et al. (2014) examine the voting records of individual directors in Korea and China, respectively. The first paper shows how strongly outside directors express their opinions against items proposed by managers, with greater director activism linked to better firm outcomes. The second paper shows that younger and more reputed directors are more likely to dissent and confront management, with this dissent providing valuable information to outside stakeholders.

Schwartz-Ziv and Weisbach (2013) use the minutes of board and committee meetings of Israeli companies to analyze what boards actually do. Their data allows them to investigate the issues discussed at meetings, whether alternative views are presented, if further information is requested, the decisions made and if any directors have dissenting views. Pugliese et al. (2015) use video recordings of board meetings of Australian companies to examine how directors interact with each other across different agenda items. They note that discussions and group interactions generally follow a similar format, but the contributing directors change across different agenda items. Their results indicate that director inclusiveness and evenness of participation are associated with higher perceptions of board effectiveness. They highlight the main contribution of their study as moving beyond the individual-level analysis of directors and offering a detailed view of the dynamics of the board as a group.

3. An Illustration and Implications for Asia

The prior section provides examples of how previous studies have endeavored to measure board of director performance, with the focus shifting to more specific measures of what boards are doing and how they operate. This section provides an illustration of how the boards of Asian companies are performing, based on the measures of meeting activity and director attendance. These measures are selected due to the availability of data. This analysis is not comprehensive and is simply presented to provoke the interest of readers.

The data is sourced from the 2013 annual reports of listed companies in selected Asian markets – Bangladesh, China, Hong Kong, India, Malaysia, Singapore, Sri Lanka and Thailand. The top-20 largest non-financial firms in each market were selected and their annual reports were located online and searched for board and committee meeting activity and director attendance data. Not all companies disclosed this data so the number of firms in each country reflects the availability of data in annual reports. As a comparison, the same process was followed for firms in Australia and the United Kingdom.

Table 1
Board Meeting Activity and Director Attendance

Country	Average no. meetings	Average attendance rate	% directors attendance < 75%	No. directors	No. firms
Selected Asian markets:					
Bangladesh	12.38	90.57	7.14	140	15
China	10.03	95.44	3.43	175	20
Hong Kong	8.71	91.35	10.84	249	19
India	12.94	85.53	18.18	66	5
Malaysia	15.49	91.95	9.09	55	5
Singapore	15.98	94.33	2.17	46	4
Sri Lanka	12.12	93.02	11.76	34	4
Thailand	16.07	88.49	14.55	55	4
For comparison:					
Australia	17.73	96.20	1.60	187	20
UK	14.45	96.38	2.20	227	20

Table 1 shows that the average number of meetings (including board and committee meetings) that directors are required to attend ranges from lows of 8.71 in Hong Kong and 10.03 in China to highs of 15.98 in Singapore and 16.07 in Thailand. As a comparison, the average number of meetings are 14.45 in the United Kingdom and 17.73 in Australia. Thus, the analysis suggests that boards in most Asian markets, perhaps with the exception of Thailand, Singapore and Malaysia, are not holding as many meetings as the boards of firms in developed markets.

Table 1 also shows that average director attendance rates range from lows of 85.53% in India and 88.49% in Thailand to highs of 94.33% in Singapore and 95.44% in China. As a comparison, average attendance rates are 96.20% in Australia and 96.38% in the United Kingdom. An alternative measure of director attendance, which is popular in the United States and is intended to highlight poor attendance practices, is the percentage of directors who attend less than 75 percent of meetings. Table 1 indicates that these numbers are 18.18% in India, 14.55% in Thailand, 11.76% in Sri Lanka, 10.88 in Hong Kong, 9.09% in Malaysia and 7.14% in Bangladesh. All of these are substantially higher than the 2.20% in the United Kingdom and the 1.60% in Australia.

While I acknowledge that this analysis is not sophisticated and that meeting activity and director attendance are not perfect measures of board of director performance, the results confirm many beliefs about the current state of boards of directors in Asia. Relative to the developed markets of Australia and the United Kingdom, the statistics for many Asian markets do not compare very favorably. Some researchers have suggested that boards of directors operate differently in Asia, because of the prevalence of inside ownership and family business groups. This may be the case. It is possible that boards play a different role in firms with different ownership structures. However, all of the firms in our analysis are large listed companies with shares available on stock exchanges for small investors to invest in. Shouldn't small investors be worried about how well directors are performing their jobs and looking after the interests of shareholders?

Each of the selected countries has issued at least one edition of a corporate governance code (http://www.ecgi.org/codes/all_codes.php), promoting improvements in board governance practices. While there have been documented improvements in corporate governance practices across the Asian region, it seems that there is still work to be done to further advance board of director performance. While it is difficult to formulate specific policies to improve board of director performance, I think it is quite obvious that holding enough meetings to adequately address the issues facing the firm and having all directors actually show up to these meetings would be quite good starting points!

4. Conclusions and Future Research Opportunities

How can shareholders ensure that boards of directors are performing their monitoring and advising functions to the best of their ability? This article provides a brief overview of the literature, highlighting the difficulties in attempting to directly measure the performance of boards of directors. Studies have utilized a number of different measures – likelihood of director re-election, number of board and committee meetings, director attendance rates, agenda items, length of discussions, dissenting views and director voting. Each of these items measures some aspect of the performance of boards of directors.

Ideally, in the future we can expand these dimensions of board of director performance and even put together a more comprehensive measure of overall performance. Some suggestions for future research are:

1. Surveys and interviews. At the moment we know little about how we should measure board of director performance. Surveys and interviews of directors will help us to better understand how we can measure and understand board performance. Should we be focusing on operational measures of board performance or measures of board outcomes? What do directors think are the best measures of their performance? Surveys and interviews could also be used to ask directors about their own performance and to rate the performance of their board colleagues. This type of peer review would provide interesting data for us to analyze.
2. Observations. Sitting in on board meetings or video recordings of meetings provide us with an unbiased view of what boards are doing and how we can measure their performance. Do boards perform better when all directors share their views on each agenda item or when only those with relevant expertise contribute the most? Is it beneficial to have a strong leader as chairman of the board or should the chairman be a facilitator rather than the leader? Is the time spent discussing issues related to the quality of board decisions and outcomes?
3. Actual performance evaluations. In recent years, firms are being encouraged to assess the performance of their boards of directors each year, so usable data on the performance of individual directors and/or the performance of the entire board cannot be too far away. For example, the UK Corporate Governance Code states that boards should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors each year. These performance ratings may be provided by companies or by external consultants. We have many types of ratings for firms already, e.g. debt ratings and corporate governance ratings, so board performance ratings would be a welcome addition.

I look forward to future research that allows us to gain a better understanding of how directors contribute individually and the overall performance of the board of directors as a group. The ultimate aim is to identify improvements so that more boards of directors can perform closer to their optimal potential in safeguarding the interests of shareholders.

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