The effectiveness of supervisory boards: an exploratory study of challenges in Dutch boardrooms

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Abstract: Triggered by highly publicised corporate scandals, changing societal expectations and the collapse of financial markets, the roles of boards of directors have changed significantly in safeguarding the interest of shareholders and other stakeholders. Yet, relatively little is known about contemporary challenges non-executive directors face and whether their boards are well-equipped for their new tasks. Based on self-assessment reports by supervisory boards, a survey and interviews with supervisory board members, this paper investigates the challenges non-executive directors face in the Netherlands, particularly after a decade of corporate governance reform. Non-executive directors’ inadequate role in scrutinising executive directors’ performance, information asymmetries and dysfunctional working relationships between executive and non-executive directors are among the greatest challenges indicated by non-executive directors on Dutch supervisory boards. The paper discusses several implications for scholars and practitioners and provides a unique insight in boardroom dynamics.

Keywords: supervisory board of directors; boardroom challenges; board roles and skills; corporate governance; boardroom; group dynamics; the Netherlands.
1 Introduction

Although the literature recognises that boards of directors are central to corporate governance systems (Daily et al., 2003; Zahra and Pearce, 1989), the perceived passivity and inability of boards to prevent corporate scandals and safeguard the interest of shareholders (and other stakeholders) have fuelled criticism dating back even to the early 1970s (Mace, 1971; Johnson, 2004; Peck, 1995; Sharpe, 2010). This is remarkable given the efforts of regulators and financial markets to improve the ‘checks and balances’ in the governance of corporations. Over the last decade, among others, the Sarbanes-Oxley Act in the USA, revised EU Company Law Directives and OECD corporate governance principles, and numerous national corporate governance codes, have been introduced in response to scandals and the financial crisis (Aguilera and Cuervo-Cazurra, 2004; Zattoni and Cuomo, 2010).

While these new regulatory initiatives, as codifications of expectations of key societal stakeholders, have been important to regain trust in corporate governance systems (Bezemer et al., 2007; Enrione et al., 2006), their impact on the effectiveness of boards has been topic of debate. First, the large majority of these corporate governance reform initiatives have focused on the more ‘visible’ or tangible aspects of board organisation, such as the structure and working procedures of boards and the qualifications of directors (Bezemer et al., 2012; Steger, 2011; Zattoni and Cuomo, 2010), emphasising the
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independence of the board (Daily et al., 2003; Finegold et al., 2007). While important, one could question the effectiveness of corporate governance reform when equally important social and group skills such as board members’ integrity, experience in working in teams and mitigating conflicts, and the ability to constructively contribute to complex decision making processes (Huse, 2007; Van Ees et al., 2009; Zattoni and Cuomo, 2010), are rarely addressed by reform initiatives.

Second, most corporate governance reform initiatives have focused on tick-the-box compliance and the formal corporate governance practices of boards, raising the question to which extent these reforms have modified the informal behaviour of boards. Carter and Lorsch (2004, p.15), for example, well-illustrate this criticism by quoting a board member who noted that “our Board satisfies all requirements of Cadbury, Greenbury and Hampel, but our board meetings are a complete waste of time”. This possible disconnection between formal and informal board practices is particularly significant as prior exploratory research has mainly pointed to problems in the informal spheres of the board, such as information asymmetries between management and directors, relational difficulties and tensions, and a lack of open boardroom discussions (e.g., Carter and Lorsch, 2004; Hooghiemstra and Van Manen, 2004; Johanson, 2008; Johnson, 2004; Sharpe, 2010; Thomas et al., 2009).

With a decade of corporate governance reform initiatives and associated difficulties as the context for this paper, we explore contemporary challenges boards face and examine whether boards are well-equipped to act as internal monitors of management. Thereby, this paper contributes to the literature in several ways. First, self-assessments reports of boards, the results of an exploratory survey and in-depth interviews of non-executive directors in the Netherlands suggest that non-executive directors face important challenges that, according to themselves, need urgent (regulatory) attention. Second, whereas regulatory reform efforts and prior research have often focused on the more tangible and structural aspects of board organisation (e.g., Daily et al., 2003; Finkelstein and Mooney, 2003; Pugliese et al., 2009), our results emphasise the importance of social and group skills and informal processes on the ability of boards to performing effectively. Third, whereas one-tier boards have been researched extensively, this paper provides a better understanding of the challenges non-executive directors may face on two-tier boards, i.e., Dutch supervisory boards, illustrating that the separation of decision management from decision control (Fama and Jensen, 1983; Maassen, 1999) adds an additional layer of complexity to non-executive directors’ role in governing corporations with a two-tier board.

This paper is structured as follows: Section 2 summarises previous research on the challenges boards face as well as the regulatory efforts to improve their effectiveness. Section 3 briefly describes the corporate governance context, two-tier board model and regulatory initiatives in the Netherlands. Section 4 describes the research method, a combination of self-assessments of 11 supervisory boards, a survey and several in-depth interviews with Dutch supervisory directors. Section 5 describes the main challenges directors experience in the Netherlands and assesses whether boards are adequately equipped to manage these. Section 6 concludes with a discussion of the main results and emphasises the implications of the research findings for scholars and practitioners.
2 The effectiveness of boards of directors

As traditionally defined by corporate law, the main responsibility of boards of directors is to supervise management ensuring they act in the best interests of shareholders. Rooted in agency theory, supervision is deemed necessary for counteracting managerial opportunism that may arise as a result of the separation of corporate ownership from management (Fama and Jensen, 1983; Davis et al., 1997; Zahra and Pearce, 1989). In addition, scholars have argued that boards of directors create value by providing advice to managers and enabling access to critical resources (Geletkanycz and Boyd, 2011; Huse, 2005; Pfieffer and Salancik, 1978). Accordingly, an increasing number of studies have examined the antecedents and consequences of boards of directors’ involvement in traditional monitoring roles and emerging non-traditional service roles of boards of directors (Huse, 2007; Machold et al., 2011; Mezghanni, 2011; Petrovic, 2008; Pugliese et al., 2009).

Despite these research efforts, it is still not fully understood how boards effectively function and contribute to corporate decision making (Dalton and Dalton, 2011; Filatotchev and Boyd, 2009; Pye and Pettigrew, 2005). However, the ineffectiveness of boards of directors has been well documented. By the 1970s, boards were already criticised for their perceived passivity in the wake of US corporate failures (e.g., Mace, 1971; Clendenin, 1972; Heller and Milton, 1972) and criticism on the effectiveness of boards of directors has increased since (Johnson, 2004; Peck, 1995; Sharpe, 2010), often labelling them as rubber stamps (cf., McNulty and Pettigrew, 1999; Zahra and Peace, 1989). Particularly, managerial dominance over the board, information asymmetries between management and directors and the inability of board members to act independently of managers have contributed to the perceived ineffectiveness of boards (Carter and Lorsch, 2004; Hooghiemstra and Van Manen, 2004; Johanson, 2008; Johnson, 2004; Sharpe, 2010; Thomas et al., 2009).

2.1 Challenges in the boardroom

The literature suggests that several contingencies can have an effect on boards of directors’ effectiveness to alleviate agency problems that may arise from the separation of corporate ownership from management. Conger et al. (1998, p.140) note that boards, like every group of decision-makers, need ‘knowledge, information, power, motivation and time’ to adequately fulfil their role in the governance of corporations. Accordingly, scholars have noted that although boards are composed of capable and skilled directors, they often lack information about the day-to-day operations of the corporation in order to effectively monitor management and provide advice (Goldschmid, 1998; Leblanc and Gillies, 2005). Moreover, being reliant on information solely provided by management, it is often problematic for directors to challenge management and overcome information asymmetries between management and the board (Eisenhardt, 1989; Hooghiemstra and Van Manen, 2004; Linck et al., 2008; Zhang, 2010). An example of the reliance of directors on management is documented by Peck (1995, p.149) who describes a studied board as “primarily passive, receiving information from executive directors (and other trust staff)".

Besides information asymmetries, boards of directors are challenged with the management of interpersonal relationships in the boardroom. A powerful chair and/or CEO may dominate the board and have it ‘rubber-stamp’ decisions. Pettigrew and
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McNulty (1995, p.857), for instance, cite a director who describes: “we were decorations to be admitted and entertained once a month and told how good it was ... a chairman has a lot of influence in making it that way”. Samra-Fredericks (2000) and Brundin and Nordqvist (2008) emphasised the importance of language and non-verbal communication in the boardroom in reference to the effectiveness of the board, highlighting how both might (dis)functionally affect decision making processes. Additionally, Westphal and Khanna (2003) and Westphal and Stern (2007) illustrate how directors adhere to boardroom norms and values, socially distancing themselves from non-compliant board members. Westphal (1998, 1999) also describes how friendships between a CEO and board members affect the effectiveness of boards, potentially offsetting disadvantages associated with measures to improve board independence.

As with any group organised to work together interdependently and cooperatively, it is often a challenge to make a board operate as an effective team (Conger and Lawler, 2009; Morner et al., 2010). Handicapped by a limited number of board meetings and opportunities for directors to interact (Pettigrew and McNulty, 1995), things easily can go wrong in the boardroom. For example, Mina (2009) describes 101 challenges directors face during meetings, including argumentative board members who do not listen to other views, the absence of feedback on directors’ individual contributions, electronic distractions and side conversations. Others portray board meetings as routinised activities, which arrangements are not often evaluated and adapted to changing circumstances (Leblanc and Gillies, 2005; Lorsch and McIver, 1989; Nicholson et al., 2011). Johnson (2004, p.43), while observing a board, describes these issues by noting that there “appeared to be little shared thinking” and “the board was locked into a routine way of behaving”.

2.2 Improving the effectiveness of boards: regulatory reform initiatives

Triggered by highly publicised corporate scandals and the collapse of financial markets worldwide, challenges in the boardroom have attracted societal attention over the last decade. To restore the public’s trust in publicly traded corporations and to ensure that appropriate ‘checks and balances’ are in place, regulators and financial markets have introduced new board standards through, for example, the Sarbanes-Oxley Act, revised EU Company Law Directives, OECD corporate governance principles and national corporate governance codes (Daily et al., 2003; Zattoni and Cuomo, 2010).

In line with the principles of the agency theory, these initiatives mainly aim to improve a board’s monitoring potential by increasing its independence from management (Daily et al., 2003; Finegold et al., 2007; Ramli et al., 2010). Typical measures to improve a board of directors’ independence include increasing the number of outside non-executive directors, separating the roles of the CEO and the chair, limiting the number of board interlocks and establishing oversight board committees. As a result, board systems appear to evolve and converge around the globe (Bezemer et al., 2007; Chhaocchharia and Grinstein, 2007; Long, 2006; Valenti, 2008).

However, while corporate governance meta-analyses suggest that board independence in some cases may have a small, positive impact on company performance (e.g., Dalton et al., 1999; Rhoades et al., 2000, 2001), research findings are rather mixed and inconclusive (Bhagat and Black, 2002). Moreover, the unintended consequences of boardroom reform with a focus on independence are not fully understood. In fact, regulatory initiatives introducing independent board structures may have complicated the
operations of boards of directors and negatively impacted their effectiveness as independent monitors of management (Bezemer et al., 2007; Davis et al., 1997). First, by maintaining a distance from management, problems related to information asymmetry between managers and board members might be intensified. Second, a strong emphasis on control might fuel distrust, further complicating the working relationship of directors and managers. Third, by focussing on the prevention of failures, boards might miss out on opportunities to add value by providing advice to management or enabling access to critical resources.

In addition, while the emphasis on independent board structures might be important, one could also question the effectiveness of corporate governance reform as equally important aspects, such as board members’ integrity, experience in working in teams and mitigating conflicts, and the ability to constructively contribute to complex decision making processes are rarely addressed (Lichtenstein et al., 2008; Steger, 2011; Zattoni and Cuomo, 2010). Moreover, the focus on formal structures and procedures may potentially have little impact on the informal behaviour of boards as directors might decouple their espoused board procedures and practices from their enacted ones. It is with these regulatory reform developments in mind that we briefly describe the Dutch corporate governance system and regulatory context in the next paragraph.

3 Corporate governance in the Netherlands

The Netherlands have a coordinated market economy with a long standing tradition of balancing the interests of the private sector with societal groups. Dutch company law, for example, explicitly defines corporations as legal entities that must take into account the rights of all stakeholders affected by the firm, not only the shareholders. As a result, the government, financial institutions, work councils representing the employees in large firms and directors operating in two-tier boards, play important roles in the governance of listed corporations.

This institutionalised stakeholder approach is supported by a two-tier board model consisting of an executive board and a non-executive supervisory board. The supervisory board consists solely of non-executive directors to assure its independence from management and has the duty to supervise and advice the executive board while acting in the best interests of the company and its stakeholders. Although formally independent of management, supervisory boards may have some of the disadvantages associated with board structures that separate decision management from decision control. The two-tier board model adds an organisational layer that may decrease the speed of decision-making (Moerland, 1995). Furthermore, a board composed solely of outsiders may lack the necessary day-to-day knowledge about the business and may not have access to information as a result of information asymmetries between the supervisory board and the executive board (Hooghiemstra and Van Manen, 2004; Maassen, 1999). An often heard complaint in the Netherlands is that the centralisation of power in the hands of a small group of supervisory directors creates a socially insular system in which directors are loyal to each other only, protecting mutual self-interests and preventing the inflow of new directors through the cooptation system (Bezemer, 2010; Heemskerk, 2007).

Although corporate governance scandals are uncommon, the Netherlands have a long tradition of corporate governance reforms. Already by 1997 the Peters Corporate Governance Committee had published its 40 recommendations and initiated a societal
debate to improve board practices on the basis of self-regulation. In 2003 and 2008, the Tabaksblat Code and Frijns Committee followed. In contrast to the earlier Peters Committee, the latter two codes have introduced very detailed board standards and corporations are legally required to explain deviations from the codes’ corporate governance provisions in their annual report (Bezemer et al., 2012). In line with other European corporate governance codes (Zattoni and Cuomo, 2010), the latest Dutch corporate governance code devotes quite a lot of attention to the independence of the board and its members (see Bezemer, 2010; De Jong et al., 2005, 2010; Maassen, 1999; Van Ees et al., 2003 for more detailed descriptions of the Dutch corporate governance system).

However, despite all these regulatory efforts to improve the functioning of supervisory boards in the Dutch setting, surprisingly little is known about contemporary challenges non-executive directors face and whether their boards are well-equipped for their changing tasks. In the remainder of this paper, we therefore explore the inner dynamics of Dutch boardrooms and survey what aspects of a supervisory board’s functioning deserve further (regulatory) attention in the near future.

4 Research methodology

This study applies various research methods to assess the main challenges supervisory board members currently experience in the Netherlands. During the first stage of the study, self-assessments were conducted by 11 supervisory boards to explore which areas related to board supervision and operation were perceived as challenging. The self-assessments involved two for-profit and nine large non-profit organisations and were conducted by a training institute for (non-)executive directors between October 2007 and December 2009 in the Netherlands. Each self-assessment was based on semi-structured interviews with the CEO and chair of the board and an evaluation of the strengths and weaknesses of the board by each director on the board. A group discussion was organised for each entire board to discuss the results of the self-assessment based on a report outlining the strengths and weaknesses of the board and an action plan to improve the board’s functioning. The 11 self-assessment reports resulted into a total of 120 boardroom challenges, on average 11 per board, ranging from 5 to 23 identified challenges per board. Given the overlap between the 120 identified board challenges, two researchers recoded the list of challenges into 17 distinct categories (see Table 1 for a brief description of the 17 identified boardroom challenges).

During the second stage of the study, the outcomes of the self-assessment reports were used to design a questionnaire. The questionnaire started with an open-ended question asking respondents to list the challenges they experienced in the boardroom (i.e., “what challenge(s) do you remember in your functioning as supervisory board member?”). Next, respondents were asked to assess whether they had experienced challenges in the 17 identified areas and whether the directors could provide illustrative examples for each. The supervisory directors were also asked to rate the importance of the 17 challenges, enabling us to assess the significance of experienced issues. Finally, respondents were asked to list additional issues boards of directors may face that were not included in the classification of 17 boardroom challenges. A few respondents were able to identify additional issues, suggesting the classification already included most board challenges identified through self-assessments.
Table 1 The 17 challenges resulting from the self-assessments by boards

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Questioning executive directors</td>
<td>Issue relating to the ability of non-executive directors to challenge executive directors during and after meetings; issues relating to the question when (not) to continue probing, particularly in cases where answers of the executive directors are incomplete or not satisfactory.</td>
</tr>
<tr>
<td>2 Information supply from executive directors</td>
<td>Issues relating to the quality and/or quantity of information provided by the executive board.</td>
</tr>
<tr>
<td>3 Social intercourse and working with the executive board</td>
<td>Issues relating to the behaviour and (non-)verbal communication between the supervisory board and the executive board; interpersonal conflicts and clashes between both boards.</td>
</tr>
<tr>
<td>4 Unclear role division between both boards</td>
<td>Issues relating to confusion about the roles, tasks, and responsibilities of the supervisory board and executive board (particularly when non-executive directors become more actively involved in daily affairs of the firm).</td>
</tr>
<tr>
<td>5 Relation distance/involvement</td>
<td>Issues relating to the professional distance non-executive directors should maintain from executive directors.</td>
</tr>
<tr>
<td>6 Supervisory board composition</td>
<td>Issues relating to the members of the board, e.g., gender diversity, distribution of the portfolio, level of expertise and being ‘fit for the job’.</td>
</tr>
<tr>
<td>7 Attention to specific issues related to the firm</td>
<td>Issues relating to the degree of attention paid to specific content areas, such as HRM, ICT and risk management.</td>
</tr>
<tr>
<td>8 Effectiveness/efficiency board meetings</td>
<td>Issues relating to the effectiveness and efficiency by which meetings are run, e.g., meeting length, agenda items, time to speak, room for an in-depth discussion regarding key issues.</td>
</tr>
<tr>
<td>9 Employers’ task towards executive directors</td>
<td>Issues relating to the nomination, selection, remuneration, firing and evaluation of executive directors.</td>
</tr>
<tr>
<td>10 Integrity</td>
<td>Issues relating to which the board and its members act according to societal and personal norms and values.</td>
</tr>
<tr>
<td>11 Willingness to justify</td>
<td>Issues relating to the willingness of the board and its members to be accountable for its own functioning and decision making.</td>
</tr>
<tr>
<td>12 Chair’s role</td>
<td>Issues relating to the functioning of the chair, e.g., his/her actions in between meetings, the actual chairing of the meeting and his/her overall leadership competences.</td>
</tr>
<tr>
<td>13 Integral responsibility</td>
<td>Issues relating to the whole board being involved and responsible for the choices that are being made (despite the allocation of certain tasks to sub-committees and expert board members).</td>
</tr>
<tr>
<td>14 Advisory task towards executive directors</td>
<td>Issues relating to the counselling of executives by non-executive directors.</td>
</tr>
<tr>
<td>15 Board dynamics</td>
<td>Issues relating to the interpersonal communication patterns between non-executive directors, e.g., the degree of (in)formal interaction, the provision of honest feedback, the presence of interpersonal trust and the room of reflection.</td>
</tr>
<tr>
<td>16 Stakeholder orientation</td>
<td>Issues relating to the way in which the board communicates with stakeholders and manages their expectations.</td>
</tr>
<tr>
<td>17 Statutes and by-laws</td>
<td>Issues relating to compliance with regulatory initiatives.</td>
</tr>
</tbody>
</table>
In June 2010, the web-based questionnaire was sent to 143 former and current supervisory board members (all alumni of the aforementioned training institute) yielding a response rate of 24%. The background of the participants varied widely in terms of sector (ranging from NGO boards and public sector bodies to listed firms). Over 68% of the respondents participating in the study had one or two supervisory board positions. Almost half of these respondents had one to four years of experience at supervisory board level.

Finally, in the third stage of our study, five semi-structured interviews were held in autumn 2010 with highly-experienced supervisory board chairmen and former CEOs of listed corporations on the NYSE Euronext in the Netherlands (see Table 2). To select participants, convenience sampling was used (all interviewees were contacts of the training institute in the Netherlands), given well-known difficulties for researchers to obtain access to individuals at this level within companies (Daily et al., 2003). Interviews were conducted to verify results of the study and obtain expert opinion on how the effectiveness of supervisory boards in the Netherlands can be further enhanced. Excerpts of these interviews have been included in the empirical section of this study to describe the challenges of supervisory board members identified in the survey. The outcomes of the study were also presented at several director events in the Netherlands to obtain further feedback and to empirically validate the results of the study.

Table 2  Overview interviewed supervisory directors (n = 5)

<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rob Pieterse</td>
<td>Former CEO of WoltersKluwer NV, Non-executive Board Member</td>
</tr>
<tr>
<td></td>
<td>SAB Miller, Supervisory Board Chair Royal Grolsch NV, member</td>
</tr>
<tr>
<td></td>
<td>Tabaksblat Committee</td>
</tr>
<tr>
<td>Kees Storm</td>
<td>Former CEO of AEGON NV, Supervisory Board Chair AEGON NV,</td>
</tr>
<tr>
<td></td>
<td>Pon Holdings, Royal KLM, Non-executive Board Member Unilever,</td>
</tr>
<tr>
<td></td>
<td>InBev S.A., Baxter International</td>
</tr>
<tr>
<td>Tineke Bahlmann</td>
<td>Non-executive Board Member ING Group NV, Nedap NV</td>
</tr>
<tr>
<td>Rob van den Bergh</td>
<td>Former CEO of VNU/The Nielsen Company, Non-executive Board Member</td>
</tr>
<tr>
<td></td>
<td>TomTom, Pon Holdings, VNU Media</td>
</tr>
<tr>
<td>Peter Elverding</td>
<td>Former CEO of DSM NV, Supervisory Board Chair Océ, ING Group NV,</td>
</tr>
<tr>
<td></td>
<td>Supervisory Board Member SHV, Friesland Campina,</td>
</tr>
<tr>
<td></td>
<td>Supervisory Board Vice Chair Q-Park</td>
</tr>
</tbody>
</table>

5  Empirical results

The 11 self-assessment reports reveal significant challenges of supervisory boards in the Netherlands. One of the boards, as an illustrative example, identified the following boardroom issues:

1 too little communication occurred among supervisory board directors outside formal board meetings

2 no meetings were held without members of the executive board and/or other executives being present

3 the audit committee was not functioning satisfactorily

4 the information provided to the supervisory board was too quantitative
the supervisory board did not sufficiently debate items on the agenda
board attendance was limited
the supervisory board was too much focused on control of management
the supervisory board was not involved early enough in the corporate decision making processes
‘decision-making moments’ for the supervisory board should have been defined more explicitly.

One supervisory board member even remarked that he often felt like “being a guest of the executive board”.

**Table 3** Perceived importance and occurrence of challenges (n = 34)

<table>
<thead>
<tr>
<th>Occurrence (experienced by % of board members)</th>
<th>Importance (scale 1 to 5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Integrity</td>
<td>21%</td>
</tr>
<tr>
<td>Questioning executive directors</td>
<td>82%</td>
</tr>
<tr>
<td>Information supply from executive directors</td>
<td>47%</td>
</tr>
<tr>
<td>Social intercourse and working with executives</td>
<td>68%</td>
</tr>
<tr>
<td>Willingness to justify</td>
<td>21%</td>
</tr>
<tr>
<td>Unclear role division between both boards</td>
<td>47%</td>
</tr>
<tr>
<td>Chair’s role</td>
<td>29%</td>
</tr>
<tr>
<td>Integral responsibility</td>
<td>15%</td>
</tr>
<tr>
<td>Relation distance/involvement</td>
<td>41%</td>
</tr>
<tr>
<td>Supervisory board composition</td>
<td>47%</td>
</tr>
<tr>
<td>Advisory task towards executive directors</td>
<td>24%</td>
</tr>
<tr>
<td>Attention to specific issues related to the firm</td>
<td>44%</td>
</tr>
<tr>
<td>Board dynamics</td>
<td>27%</td>
</tr>
<tr>
<td>Effectiveness/efficiency of board meetings</td>
<td>50%</td>
</tr>
<tr>
<td>Employer’s task towards executive directors</td>
<td>44%</td>
</tr>
<tr>
<td>Stakeholder orientation</td>
<td>32%</td>
</tr>
<tr>
<td>Statutes and by-laws</td>
<td>18%</td>
</tr>
</tbody>
</table>

The outcomes of the survey confirm as well that most of the respondents face a large number of challenges: 30 respondents (88%) indicate that they have experienced a challenge in four or more of the 17 areas. More than 40% of the respondents report more than seven challenge areas their boards face. The average number of challenges per respondent is 5.9. A closer examination of the survey results suggests that most supervisory directors are critical about their own functioning (see Table 3, second column): the majority of the study participants observe important issues regarding:
1. questioning executive directors about their performance (82%)
2. the working relationship of the supervisory board with the executive board (68%)
3. the effectiveness/efficiency of board meetings (50%).

Challenges regarding information provided by executive directors were regularly mentioned as well (47%). Table 3 (third column) summarises respondents’ answers to the following question: ‘How important are problems in the following aspects to the functioning of a supervisory board?’ In response to this question, integrity is considered to be the most important aspect (4.8), followed by supervisory directors’ ability to inquire about executive directors’ performance (4.6) and the sharing of information by the executive board with the supervisory board (4.4).

Using the urgency/importance framework of Covey et al. (1994), juxtaposing the most frequent and most important challenges tells us which areas related to the functioning of supervisory boards have the highest priority according to the respondents. Table 4 displays the outcome of this analysis, using means as cut-off points to classify challenges as important or not important and whether respondents frequently or not frequently mention them. As shown in the upper left corner of Table 4, four challenges areas appear to be most prominent.

Table 4 Challenges – importance versus occurrence

<table>
<thead>
<tr>
<th>Important</th>
<th>Less important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relatively often experienced</td>
<td></td>
</tr>
<tr>
<td>• Questioning executive directors</td>
<td>• Relation distance/involvement</td>
</tr>
<tr>
<td>• Information supply from executive directors</td>
<td>• Supervisory board composition</td>
</tr>
<tr>
<td>• Social intercourse and working with the executive board</td>
<td>• Attention to specific issues related to the firm</td>
</tr>
<tr>
<td>• Unclear role division between both boards</td>
<td>• Effectiveness/efficiency board meetings</td>
</tr>
<tr>
<td></td>
<td>• Employer’s task towards executive directors</td>
</tr>
<tr>
<td>(High priority; immediate action)</td>
<td>(Take action if time)</td>
</tr>
<tr>
<td>Relatively not often experienced</td>
<td></td>
</tr>
<tr>
<td>• Integrity</td>
<td>• Integral responsibility</td>
</tr>
<tr>
<td>• Willingness to justify</td>
<td>• Advisory role towards executive directors</td>
</tr>
<tr>
<td>• Chair’s role</td>
<td>• Board dynamics</td>
</tr>
<tr>
<td></td>
<td>• Stakeholder orientation</td>
</tr>
<tr>
<td></td>
<td>• Statutes and by-laws</td>
</tr>
<tr>
<td>(Take preventive measures)</td>
<td>(Low priority; no action)</td>
</tr>
</tbody>
</table>

First, questioning executive directors about their performance is perceived as a challenge in the supervisory boardroom. Interviews and survey outcomes highlighted that it is often difficult for supervisory directors to strike a balance between trusting executive directors (‘trust me’) and requiring executive directors to fully inform the supervisory board (‘prove to me’). One of the interviewees remarked: “an executive director who wants
maximum freedom tends to dwindle into vagueness and promises”. Another respondent described a situation in which the CEO persuasively requested supervisory directors to refrain from asking detailed questions about the day-to-day management of the corporation. The solution seems to be, as one respondent remarked, “questioning, questioning and again questioning of executive directors”. Some respondents are very adamant about this: “It is a clear case that executive directors have to answer all supervisory board questions completely, whether they perceive the questions relevant or not. Executive directors are obliged to answer”. When executive directors did not provide clarity to the supervisory board, some respondents, however, admitted that they gave up too easily. The survey results indicate that four out of five supervisory directors find this a very challenging area for the supervisory board.

Second, inadequate information provided to the supervisory board by executive directors was a high priority area for supervisory directors with 47% and 4.4 scores on incidence and importance respectively. Respondents criticised the quality of information they received from executive directors, stating, among others, that “in some cases, the information supply is not based on the needs of supervisory directors whatsoever”, “a tsunami of data was produced” and “there was an overreliance on short-term financial data in the information packages we received before meetings”. Supervisory board members sometimes also had the impression that executive directors were unwilling to provide the required information: “the executive board does not play an active role in providing information to the supervisory board at all”. A number of respondents mentioned that the quality of information was sufficient, but arrived too late or after a decision had been made by the supervisory board. “Continuously asking challenging questions and talking with other people in the firm” was proposed by one of the interviewees as a solution to resolve this particular issue.

Third, the study shows that the interaction with the executive board is another issue with a high priority for supervisory directors. Supervisory directors who participated in the survey often emphasise the political side of the boardroom, hidden agendas and the strategic use of information asymmetries between the executive board and the supervisory board. Many respondents refer to situations where there is little agreement among management and board members, resulting in power struggles that sometimes became personal, leading to the departure of executive directors or supervisory directors. One respondent vividly recalled that “there was some miscommunication between management and some supervisory directors, eventually leading to the dismissal of the CEO and a significant change in the governance model of the firm.” Another supervisory director mentioned that it “took some time before management saw us as a value-adding instrument and no longer as a nuisance”. Other supervisory directors struggled with a tendency of executive directors to execute supervisory board decisions marginally and to continuously question past decisions made by the supervisory board. In sum, many participants in the survey emphasised the challenge of supervisory directors to develop a healthy and cooperative working relationship with executive directors.

Fourth, 47% of the respondents have experienced issues related to the confusion of roles among executive directors and supervisory directors (a score of 4.2). One respondent mentioned that he felt really uncomfortable on one supervisory board, because supervisory directors were regularly involved in executive tasks, which by law are reserved to be executed by executive directors. Another respondent provided an example in which an executive “thought he was in charge” and attempted to dominate supervisory board meetings. Supervisory board members often struggle with the question
6 Discussion and conclusions

This paper explores challenges faced by supervisory directors in the Netherlands, particularly after years of corporate governance reform to improve the effectiveness of supervisory boards. An analysis of 11 self-assessment reports, a survey and semi-structured interviews with leading supervisory directors, revealed that supervisory boards face important challenges that, according to supervisory directors themselves, need urgent attention. In particular, challenging the executive board on its actions when necessary, working together with executive directors and obtaining sufficient quality information from the executive board are key areas of improvement. Interestingly, all these issues refer to less visible:

1 social and group skills
2 informal board processes, aspects that have received rarely attention in (self-)regulatory corporate governance reform initiatives.

These findings have three important implications for scholars and practitioners. First, the study highlights the need to pay more attention to board dynamics and social interactions between supervisory board members and executive directors to understand and improve the effectiveness of boards of directors. Instead of solely focussing on board composition, independence and the selection of individually capable supervisory directors, this suggests that important gains can be achieved by:

1 approaching the board as a team whose total sum should be more than its parts
2 improving informal boardroom processes.

In line with a behavioural theory of boards (see Forbes and Milliken, 1999; Van Ees et al., 2009), this calls for future research efforts that more explicitly model informal dynamics, such as the role of information asymmetries, the level of trust between managers and supervisory board members, and presence of boardroom values and norms that might undermine the performance of boards. Methodologically, multi-level techniques and observation-based approaches seem particularly useful in capturing the complex relations that might be involved in such research endeavours. In this study, self-assessment reports also turned out to be a rich and unique source of information to obtain an overview of challenges in the boardroom.

Second, the study highlights the presence of significant boardroom challenges that need to be addressed in the Dutch context. In terms of possible interventions, the empirical results tentatively suggest that (self-)regulatory initiatives might not be the best way to successfully address the identified boardroom challenges. Although we did not directly assess the impact of the Dutch regulatory initiatives, the persistence of some well-known boardroom challenges pose the question whether a further codification of informal board processes might generate the desired improvements in boards’ effectiveness. As identified by the survey and structured interview participants,
alternative interventions may be necessary to solve challenges relating to the non-executive’s inadequate role in scrutinising executive directors’ performance, information asymmetries and dysfunctional working relationships between executive and non-executive directors. For instance, as illustrated by the self-assessments, the regular evaluation of a board (by third-party experts) may be helpful in:
1 critically reflecting on areas that need improvement
2 supporting the dialogue between executive and non-executive directors.

Specifically, executive search firms, institutes of directors and other training institutes are well-positioned to educate, evaluate and improve the performance of the board of directors as a team of highly-skilled individuals. Moreover, and in line with the current developments in the Netherlands, it may be helpful to further strengthen the formal position of the board secretary, particularly in the light of addressing possible information asymmetries. Given their central and relatively neutral position in firms, board secretaries may be well-positioned to act as a linking pin between non-executive directors and the rest of the organisation.

Third, while most of the identified challenges are attributed to both one-tier and two-tier boards in the literature, their presence may be particularly significant in a two-tier context for two reasons. First, the formal separation of the management board and supervisory board may intensify some of the challenges. For example, information asymmetries may manifest themselves earlier as none of the executive directors is formally involved in the supervision of the management board. Second, the organisational distance between executive and non-executive directors may also make it more difficult to address some of the challenges. The fact alone that members from both boards formally meet separately, for example, makes it already more difficult to build trust in their working relationships. An interesting development in that regard is the Dutch Bill on Management and Supervision, allowing companies to choose between the one-tier and two-tier models. The Bill is expected to be effective as of July 1, 2012. While heavily debated and contested, it might be very interesting to observe and assess in due time how this will affect the extent to which non-executive directors perceive (various) boardroom challenges.

This exploratory study has several limitations, but also provides avenues for future research. First, although the study controlled for the number of board positions and experience of directors, this study has treated all supervisory board positions equally in order to establish a general trend. As the perceived challenges of supervisory directors may be contingent on the specifics of the boards they operate on, follow-up research is necessary. For example, future studies could investigate whether supervisory boards from well-known companies experience different challenges compared to lesser known companies, whether non-profit supervisory board members have challenges that differ from supervisory boards of for-profit organisations, and whether supervisory boards composed of a large number of directors face challenges that are different from smaller supervisory boards. Second, given the exploratory nature of the study and limited number of study participants, the findings should be treated with care. Particularly, the convenience sampling approach might have affected the outcomes. Future studies, with larger random samples, are recommended to further assess the generalisability of the findings. Third, the findings of this study may be contingent on the Dutch corporate governance context and the specifics of the two-tier board model. Future research studies
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could examine to which extent similar developments are observable in other countries with a two-tier board model (Austria and Germany) and in countries with one-tier and two-tier board models (e.g., Denmark, France and Macedonia). Fourth, while the survey and semi-structured interviews provided additional insight in the contemporary challenges supervisory boards face, we still know little about the reasons why certain challenges exist and how they affect a company’s performance. Further studies could examine the antecedents and consequences of boardroom challenges in much more detail.

To conclude, this exploratory study has shown that supervisory boards and non-executive supervisory board members are confronted with important challenges. This is remarkably given a decade of (self-)regulatory corporate governance reform initiatives in the Netherlands. In particular, the interaction between the supervisory board members and executive directors remains an area of concern for non-executive directors. Interestingly, the respondents referred frequently to issues that go far beyond the ‘usual suspects’ and more visible features of boards, highlighting the need to investigate board behaviour, dynamics and processes in greater detail. Accordingly, these findings encourage corporate governance scholars to further contribute to research on the ‘black box’ of boardroom processes to gain a better understanding of the key challenges of non-executive directors and the opportunities to improve the effectiveness of boards of directors in supervising executive directors.

References


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