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The Changing Nature and Functions of Boards of Directors

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Abstract

Recent corporate governance crises involving well-known firms such as General Electric, Wells Fargo, WeWork and Wirecard, among others, have called into question the functionality and efficiency of the current, dominant model of boards of directors. In most OECD countries, large and mid-size companies have adopted this model, which includes a majority of independent directors appointed by shareholders.

While the model offers advantages, it also presents critical weaknesses. In this paper, I will review the origins and main qualities of this model, then trace how changes in ownership and new disruptive challenges have raised concerns about its effectiveness. I will also describe the main contextual factors that companies should consider when choosing a board of directors model. Finally, I will present the steward model, in which the board as the firm's steward develops competencies that ensure effective governance of the firm.

Keywords: Board of Directors, Corporate Governance, CEO, Institutional Investors, Shareholders, Board-CEO Relationships.

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1. Corporate Crises and Boards in Crisis

On March 29, 2019, Tim Sloan, CEO of Wells Fargo, announced he was stepping down as the bank's chief executive immediately. Sloan had held this position since October 2016, when the bank's cross-selling and fake account scandal had become public. Wells Fargo senior managers in the retail bank unit had set ambitious sales objectives and introduced aggressive compensation incentives, pushing salespeople to increase cross-selling of financial products and open millions of unauthorized checking and credit card accounts. Customers were also overcharged for services they had never requested.

Earlier that month, Sloan had appeared before the U.S. House of Representatives Financial Services Committee and the Office of the Comptroller of the Currency to offer his views on the Wells Fargo scandal. His comments sparked sharp criticism among U.S. lawmakers. They took issue with his failure to acknowledge any personal responsibility and were unconvinced he was the best fit to continue as Wells Fargo's CEO. Two weeks later, under intense pressure and growing scrutiny from shareholders and media, Sloan announced his resignation.

A financial scandal devised by some of the bank's senior managers was overlooked by the board of directors, reflecting a poor managerial oversight system. The scandal evolved from aggressive sales objectives into a full-fledged corporate governance crisis. It eventually became the banking sector's largest reputational crisis since the Lehman Brothers bankruptcy of 2008. After a long search process, on September 27, 2019, the Wells Fargo board announced the appointment of Charles Scharf, former CEO of Bank of New York Mellon, as the new CEO.

The Wells Fargo crisis marked a turning point in the U.S. corporate world following the 2008 financial crisis. With a reputation as a well-managed, reliable bank that had escaped unscathed from the 2008 crisis, Wells Fargo was considered a model of what a good retail bank should look like. But the seeds of the scandal had been sown years earlier in the bank's retail business before they surfaced in 2016.

Several facts can help to understand the nature of this crisis. The first relates to regulatory changes in the U.S. These were designed to make banks more accountable and less prone to risk-taking, yet had not worked in the case of Wells Fargo. Second, this crisis would not put the bank's future in jeopardy–Wells Fargo had neither a problem of liquidity nor solvency–although regulators would limit its growth and strategic choices in the future. The third was the board of directors' failure to monitor top management and prevent the crisis (Srinivasan et al., 2017). Even if most individual board members were unaware of and opposed to these practices, one of the board's central functions in the bank's governance–taking care of the long-term development of the bank and monitoring top management–was not working properly. Regulators would eventually put tremendous pressure on the bank, reshape its board of directors and cap its growth.

This crisis raises several questions about the bank's corporate governance. How effective was the Wells Fargo board in developing strategy, corporate growth and executive compensation before the scandal emerged? How did the Wells Fargo board shape the values and goals of the bank? How did it monitor corporate culture? How was culture related with executive compensation? What mechanisms were in place to oversee risk management? Finally, why did the board take so long to recognize that it was ultimately responsible for this crisis?

The Wells Fargo governance failure may seem extreme, yet it reflects many challenges that boards of directors grapple with in the 21st century. The work of boards of directors has become extremely complex. Investors are putting more pressure on boards and CEOs. The business environment is more uncertain. Disruptive technologies are making business models obsolete and, in many cases, boards lack the necessary capabilities to deal with this disruption. Climate change is a growing challenge and an important risk for companies. Activist investors are circling companies in search of quick profits through spin-offs and restructuring. Meanwhile, there is an increasing number of regulatory issues on board agendas, as well as growing pressure from public opinion, social media and social activists.

There is some evidence that the quality of management has improved dramatically in many countries and industries over the past decades. Unfortunately, the same cannot be said of the quality of boards of directors. In fact, the number of recent corporate crises suggests that improving boards' effectiveness is still a work in progress.

The Wells Fargo, General Electric and other corporate governance crises reveal deficiencies in the dominant model of boards of directors and highlight the need for their deep renewal to make boards more effective institutions (Monks and Minnow, 2011; Lipton, 2017; Bainbridge, 2018; Gilson and Gordon, 2019). The current model of boards first emerged and became the paradigm in the 1990s, particularly among listed companies. It was put forward by investors and regulators as companies increasingly had to confront changes in ownership, the growing dispersion of shareholders and the rising role of institutional investors as shareholders. Investors wanted CEOs and top managers to be held more accountable to the board, and consequently introduced changes in the board structure, composition, functions and duties. Unfortunately, the success of these changes in improving governance has been limited.

To understand these events, it is important to review the recent evolution of boards of directors, the emergence of the current model of boards and its core characteristics. I also discuss why this model has been unsuccessful in helping firms deal with change. In the final section, I present the fundamental elements of a new model of boards of directors to improve its functionality, which will be developed in the rest of the book.

2. Recent Changes in Corporate Ownership

The evolution of boards of directors since the 1990s is not only the story behind the demise of managerial capitalism (Chandler, 1977; Cheffins, 2019) and the rising influence of boards of directors. It is also the story of a major shift in ownership around the world, in particular, the United States and Western Europe (Franks and Mayer, 2017) and subsequent changes in corporate governance and regulation. Shareholders have the legal capacity to appoint and remove board directors, and–within corporate law–give the board key governance functions. Shareholders' engagement and capital markets regulations have shaped the way boards work.

Between the 1950s and 1990s, households held the majority of shares in listed companies in most countries. Table 1 shows the evolution of ownership of listed companies in the US between 1950 and 2020. In 1950, the household sector held 92.8% of shares in U.S. listed companies. This figure was 45.6% in 2000 and 38.3% in 2020 (Dasgupta, Fos and Sautner, 2021). During those years, in the absence of large, relevant shareholders influencing boards of directors, these institutions essentially served as advisory boards to the CEO. The exceptions were companies with very large shareholders that shaped the firm's strategy such as family businesses and state-owned firms. This model of boards reflected the fragmentation of shareholders, with many individuals owning shares in listed companies, the separation of shareholders and boards, and the accumulation of power by CEOs at the expense of boards.

The U.S. company ownership started to change in the 1980s and 1990s, with the growing importance of institutional investors. The most relevant were mutual funds, exchange traded funds (ETF), insurance companies, public pension funds and private pension funds. By the end of 2020, these institutional investors owned directly over 40% of US shares in listed companies, while the household sector only held 38.3% (Dasgupta, Fos and Sautner, 2021). Many shareholders in U.S. and British family-owned firms accelerated their divestment from those firms by selling their shares to investment funds or going public. Today, family business still remains a relevant feature of the U.S. economy, but not in large, listed companies, where institutional investors and pension funds collectively control large shareholdings (Villalonga and Amit, 2009; OECD, 2021).

Table 1
Shareholders of US Listed Companies (%)

Shareholders	1950	1990	2000	2020
Household Sector	92.8	56.5	45.6	38.3
Mutual Funds	1.6	7.1	18.3	20.8
Closed-End Funds	0.9	0.5	0.2	0.2
Exchange-Traded Funds	0.0	0.0	0.4	6.6
Private Pension Funds	0.0	16.2	11.2	5.4
Federal, State and Government Pension Funds	0.0	8.1	7.7	5.3
Insurance Companies	2.6	4.1	6.2	1.9
Foreign Sector	1.6	6.9	9.3	16.4
Other	0.4	0.7	1.1	5.1

Source: Dasgupta, Fos and Seitner (2021). Federal Reserve Statistical Release Data: Flow of Funds Data United States. The Household Sector includes Bank Personal Trusts. In percentage of market value.

The rising power of institutional investors as shareholders (Bebchuk and Hirst, 2019; Fisch, Hamdani and Solomon, 2020; Rock, 2018) stems from the growth of mutual funds and index-based funds. Active investors who picked up stocks and sold others, charging clients expensive fees, were replaced by large passive investors like BlackRock, Vanguard, State Street and Fidelity, among others. These companies offer their clients a cheap way to invest in listed companies, and their success is one of the remarkable features of modern capital markets.

At the same time, the growing dominance of institutional investors has created a corporate governance conundrum. Institutional investors have swiftly become large block holders in listed companies. This has engendered potential anti-trust issues, highlighting the need for them to become involved in corporate governance as responsible owners (Azar, Schmalz and Tecu, 2018; Azar, 2020; Azar and Vives, 2021; Fisch, Hamdani and Solomon, 2020). Large institutional investors offer individual investors attractive financial opportunities, but their vast size and lack of regular engagement with the firm are problematic. While investing in thousands of companies, they seek to interact constructively with the boards of directors. Yet most do not have the capabilities to engage with boards on a regular basis (Bebchuk and Hirst, 2019) and, in many cases, they must follow the advice of proxy advisory firms for specific decisions to be voted in shareholders' meetings.

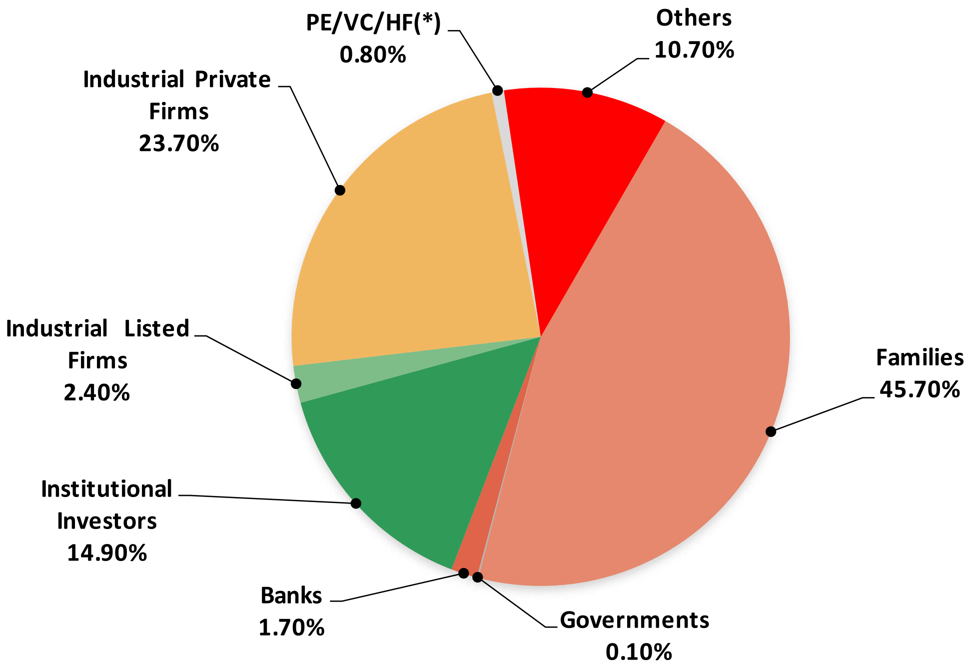
Corporate ownership has evolved differently in continental Europe, Asia and Latin America. By the end of 2017, families and individuals still owned 45.7% of shares in more than 28,000 companies in 85 countries (OECD, 2021). Families were by far the largest type of owners of companies around the world (see Figure 1). Countries such as Germany, Switzerland, France, Italy and Spain still reflect a very significant presence of families as shareholders in large, listed companies today. International firms like Henkel and BMW in Germany; Schindler and Roche in Switzerland; Prada and Fiat in Italy; Danone and Bouygues in France; and Acciona, Inditex, Ferrovial and Gestamp in Spain, are all listed companies whose founding family still controls a substantial percentage of shares. This provides these firms with a shareholder of reference that signals a clear commitment to long-term development. In Asia and Latin America, family businesses are also very relevant, although governments remain important shareholders of reference.

This model of ownership, with families as shareholders, has several implications for corporate governance. First, the families are shareholders with a significant stake in the firm's equity and who dedicate time to governance functions. In most cases, the family has representatives on the board of directors and an influence on the firm's values and long-term orientation. In well-governed companies, families with a controlling stake know they should exercise self-control and not abuse their position.

Second, families as shareholders often have long-term horizons and think in terms of generations. This gives companies shareholder stability and longer timeframes when considering strategic decisions. Companies with long-term shareholders may be slightly slower in terms of adaptation and change, but offer stability. Both attributes–adaptability and stability–may be positive capabilities for companies at different stages of their development.

Industrial foundations have recently emerged as important shareholders in some large companies in continental Europe (Thomsen et al., 2018). Foundations have received the company's shares from the founders and become their owners, often with a large, controlling stake. This is the case of companies like Ikea, Bertelsmann or CaixaBank, in which significant shareholdings are in the hands of a foundation. Although they also have governance challenges, foundations provide a long-term horizon and are adept at aligning the interests of the firm's different parties.

Figure 1
Corporate Ownership in 85 Countries



Source: OECD Capital Market Series Dataset (2017, 28.643 Companies)
(*) PE: Private Equity. VC: Venture Capital. HF: Hedge Funds

Private equity and venture capital firms have emerged as a new generation of investors that provide equity and an exit option to the previous shareholders. They have grown fast over the past 30 years, first in the U.S. and later in Europe and Asia. When they invest, they tend to become shareholders of reference in these companies. Private equity firms follow a model of corporate governance that, in general, aligns shareholders, boards and senior managers better, although their time horizons are shorter.

As a result of these ownership shifts, shareholders have become more heterogeneous over the past three decades. The discussion on how to improve the quality of governance through better boards of directors also needs to take into consideration the identity of shareholders and their commitment to the firm. Shareholder expectations of boards of directors evolve as the nature and preferences of shareholders become more diverse. Diverse shareholders have, among other attributes, different earnings expectations, appetites for risk and time horizons. Each shareholder has its own motivations for getting involved in corporate governance and having an active presence on the board of directors. In particular, large institutional investors are learning how to actively engage with companies without having a seat on their boards. Boards of directors should take these factors into account. Considering shareholder heterogeneity is relevant because an important duty of boards is to ensure the company has the ownership structure and the type of shareholders that its purpose and activity require. In good companies with competent boards, shareholders' views should be discussed in the boardroom. And boards should also make sure that the firm's shareholders support the company's development.

The increasing diversity of shareholders, each with unique expectations and time horizons, has emerged almost at the same time as globalization and technology–forces that have reshaped industries and companies over the past decades. Disruptive technologies and new ways to organize production and distribution of goods and services have eroded traditional companies' competitive advantages. At the same time, new entrants have challenged incumbents, corporate performance has decreased, and the complexity of boards of directors' strategic challenges has grown dramatically.

Changes in ownership over the past few decades, with weaker shareholder engagement, has made the independence of board directors and other dimensions of the board structure dominant features of boards since the 1990s. Boards of directors moved from managerial capitalism and being CEO-centered to assuming a critical role in the firm's governance. Unfortunately, board director independence is not enough to ensure that boards can play this vital role in governance in times of disruptive changes.

3. The Emerging Generation of Boards of Directors in the 1990s

Throughout the 1990s, most boards of directors–particularly in listed companies–were essentially advisory boards that confirmed the decisions made by top management. Despite a growing scholar and regulatory consensus that the main functions of the board were monitoring top management and governing the company, the fact is that few boards played this function effectively. Only in certain corporate crises that required restructuring and turnaround processes did the board of directors play a leading role. However, this advisory model fell into disfavor since this approach did not adequately fulfill its goal of monitoring management and, more importantly, did not govern the long-term development of the firm. The CEO was in charge of the company and controlled the board. There was no clear role for the board and the monitoring of top management was ineffective.[1]

Growing shareholders' diversity, the emergence of large institutional investors, and the increasing role of capital markets forced a reconsideration of the role of boards of directors in the early 1990s. Investors were concerned about protecting their investments and governments started to regulate corporate governance to defend shareholders' rights.

The legal tradition of boards in the U.S. and the EU share some common notions regarding the functions of the board of directors, yet with relevant differences which have influenced how boards evolved. In the U.S., the dominant legal tradition is shaped by the jurisdiction of Delaware, the state where most U.S. listed companies are incorporated. According to the General Corporation Law of the State of Delaware, "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors" (n. 141 a). The board of directors is the center of this corporate governance model. Court decisions over the years have confirmed the preeminence of the board of directors in the firm's governance.

Delaware and other national jurisdictions establish that board directors have two basic duties, which highlight its centrality. The duty of care defines that a board director must exercise diligence in acting as a board member, which includes the study of the affairs the director should

[1] Notorious corporate crisis like the Penn Central collapse in 1970, with illicit payments, highly leveraged transactions, and a board of directors that neither anticipated nor functionally manage the crisis, marked a turning point in corporate governance and drove the need for more effective boards of directors (Cheffins, 2019; Securities and Exchange Commission Task Force, 1972). In Germany, the Siemens governance crisis in the late 1990s was also an inflection point in governance.

know about and the decisions to be made[2]. The duty of loyalty requires that a director shows undivided loyalty to the company that it serves, putting the firm's interests above personal interests in business issues.

In the U.S., the renewal of boards of directors also gained momentum from the private sector, which highlighted the centrality of boards in the firm's governance. In 1978, the Business Roundtable published "The Role and Composition of the Board of Directors of the Large Publicly Owned Companies," underscoring that the board is the ultimate corporate authority. It endorsed the principle of the board-centric approach to governance. In 1988, the American Law Association published its own set of principles of governance based on the Delaware legal tradition that expanded the 1978 Business Roundtable report.

In the EU, the trigger for the renewal of corporate governance and the board's role was the "Report of the Committee on the Financial Aspects of Corporate Governance" (Cadbury et al., 1992), published in the United Kingdom. It was prepared by a committee chaired by Sir Adrian Cadbury, with the support of the UK Financial Reporting Council, the London Stock Exchange and the accounting profession in the aftermath of UK's 1986 financial "big bang." This report advocated the central role of the board of directors in the firm's governance and adopted various Delaware principles, but also pointed out its own identity. It stated that public companies "should be headed by an effective board which can both lead and control the business. Within the context of the UK unitary board system, this means a board made up of a combination of executive directors, with their intimate knowledge of the business, and of outside, non-executive directors, who can bring a broader view to the company's activities, under a chairman who accepts the duties and responsibilities which the post entails." (n.41).

This report paved the way for many of the corporate governance codes approved over the past two decades in most countries, including the influential OECD "Principles of Corporate Governance" (1999). Many of these codes are based upon the Cadbury report and assume that boards made up of independent board members offer the best system for improving the quality of governance and eventually, the firm's long-term performance. This pathway for boards looked very reasonable, but was insufficient to guarantee companies' long-term success since it did not take into account some of the board of directors' holistic responsibilities.

3.1. The New Model of Boards of Directors: Core Attributes

The first attribute of the new board of directors model is a majority of external, independent board directors without professional connections with the company and its top management. In the previous model, many boards comprised the firm's senior executives. Independent directors are supposed to guarantee that the board is not constrained by managers' conflicts of interest or preferences.

The second attribute is the division of work within boards through the creation of specialized board committees. The most significant are the audit committee, the executive compensation committee and the nomination committee, each with a president and a majority of external directors. By emphasizing these committees, regulation clarifies some of the board's main duties. All board members share the same legal responsibility yet hold different roles within the board to make it more effective.

[2] Board directors are supposed to use their best business judgment to make decisions. Courts will defer to board directors and their business judgment. In the case of shareholders challenging a decision, any judicial review will be examined from the perspective of the process followed by the board.

The third attribute is the recommendation to separate the role of the chairperson from the role of the CEO. This feature is dominant in the EU but still highly debated in the U.S. The chairperson's main function is to take care of the firm's governance and board leadership. The CEO's mission is to manage the company. The empirical evidence around the advantages and disadvantages of this separation is not very clear (Finkelstein, Hambrick and Cannella, 2009), although there is a widespread assumption, based upon individual cases and situations, that this division of functions is a prudent governance decision in most companies.

The fourth attribute is that shareholder primacy has been the firm's dominant goal in different governance codes, with some exceptions, such as the German Code of Corporate Governance (2005), chaired by Gerhard Cromme, and the 2003 Spanish Code, chaired by Enrique Almada. Both codes highlighted the role of the board in developing the company for the long term and creating value sustainably. The past three decades have witnessed the peak of the doctrine of profit maximization as the goal of good governance and shareholders' primacy. The recent UK Unified Code (2018) emphasized the value of corporate purpose and the need to pay attention to other stakeholders in governing the company. This may be a turning point for the definition of the firm's goals from a legal perspective.

The fifth attribute is the evolution of executive compensation, which is proposed by the board compensation committee, approved by the board and eventually voted by shareholders. Over the past two decades, the standard executive contract has defined an executive compensation system dependent upon the company's financial goals. It is based on the assumption that economic incentives genuinely connect top managers' motivations with shareholder gains (Edmans and Gabaix, 2016). In many cases–particularly in the U.S.–these incentives are huge and tend to be linked to the share price rather than to cash generated. The fact is that executive compensation levels have been rising dramatically, both in good and bad years, and at times based on schemes that are neither easy to understand nor related to the firm's performance. They are under attack by proxy advisory firms and some investors, and have provoked public outcry. There is widespread agreement that the current system does not work and the recent inclusion of ESG goals will make this system even more complex.

The sixth feature of this model is compliance. The complexity of leading companies in competitive industries on a global scale make the role of the board very important and its task herculean. Board members may have limited time to deeply understand the company's strategy. They might not know senior managers well. There are also constraints in board meeting agendas and compliance issues require a lot of attention. The information provided is selected by the chair of the board and the CEO. The chairperson defines the board meeting's agenda and time allocation of each issue with the CEO.

Codes of good governance and other regulatory frameworks state that the board should know about certain issues–financial performance, strategy and executive compensation, among others–and that it should discuss these issues often. Top management reports to the board on these matters and how the company meets legal compliance. All in all, these duties are related to what organizational scholars would define as the formal organization. However, corporate performance also depends on how the informal organization functions: how board directors work together as a team, the depth of their strategic discussions, the quality information they receive from CEOs and their interaction with them.

The final feature is that investors still rely on market forces for good governance. In the 1980s and 1990s, hostile takeovers with massive amounts of debt contributed to discipline management follies, such as diversified conglomerates which were not creating value. Activist investors play a similar role today. Their strategies are controversial and may create other problems for companies in which they invest, as the cases of iconic companies such as Xerox and Yahoo! attest.

3.2. Board Structure: Is it Enough to Create an Effective Board?

In the 1990s and 2000s, most listed companies in the U.S. and Western Europe gradually adopted many of the attributes of the new board of directors' model. This became the reference and also extended its influence on family firms and other privately-owned companies. While this model had some potential advantages, the GE crisis briefly described earlier highlights some problems.

GE had successfully weathered the effects of the 2008 financial crisis thanks to very prudent financial management and the support of key investors. In 2015, GE completed the $22 billion acquisition of Alstom power business to form an industrial behemoth in energy. Soon afterwards, some investors noted that the company was using more cash than it was generating (Colvin, 2019;). In May 2017, GE reported that its power unit had a negative outlook and that orders were down. CEO Jeff Immelt stepped down in June 2017 and John Flannery replaced him. In the following months, the board declared all GE divisions were under review and announced very large write-off in its long-term insurance business and its power business. The exorbitant costs of the write-off moved the company on the verge of collapse. Eventually, on October 1, 2018, the board of directors fired Flannery after 15 months on the job and named Larry Culp, a recently appointed GE board member, as the new CEO.

The dramatic GE crisis is relevant for corporate governance. GE was considered a paradigm of success among large U.S. companies. Its managerial and leadership styles were studied in universities and companies around the world. Its board was made up of external, independent members, most of them successful business leaders. It was structured following recent corporate governance criteria. It was weak in terms of diversity, but had most of the qualities used as indicators of a good board.

The GE board context make the GE crisis even more difficult to understand. Why did the board fail to see GE's quickly deteriorating performance? Why did the board approve in 2015 the highly expensive acquisition of Alstom at a time when most observers considered energy prices to be at their peak? What did the board think about GE's financial situation and the fact that the company was unable to generate the cash necessary to face future liabilities? Is it reasonable for a good board of directors of a company renowned for its ability to generate great leaders to appoint three different CEOs in less than a year and a half?

Even for former GE board directors, it is difficult to get the full picture of what happened at the company. GE's board structure was fine, but the scale of the GE governance crisis was monumental. GE is still a unique company with leading technologies and will probably survive, but the nature of its recent governance crisis sheds light on why boards of directors today might not be working effectively.

3.3. The Declining Effectiveness of the Current Model of Boards of Directors

Unfortunately, the notion of boards of directors made up of independent directors did not live up to its promise. Many boards of directors failed to fulfill their job: to help develop the company for the long term and protect investors. It is also important to note that the crisis of boards of directors I describe is essentially a crisis of boards in listed companies with dispersed ownership and external board directors. In this paper, I also discuss the experiences of family businesses or listed companies with large shareholders. These cases reveal a deeper shareholder commitment and better alignment between shareholders and boards of directors.

The reasons for the failure of the current model of boards of directors are diverse. This model does not consider the role of the board in strategy, nor board directors' insufficient knowledge of the business, broader political and social trends, and the firm's strategy. Some recent corporate crises (Deutsche Bank, Yahoo! and WeWork, among others) stemmed from mediocre business strategies. Boards also need to better understand the global political and social context in which they operate. The recent crises of large tech platforms like Facebook and Uber are rooted in a lack of understanding of the wider political, economic and social context in which these companies operate. In some cases, board directors may not be prepared for a deep discussion on strategic issues with the founders or the top management team.

The second reason is that this model does not address the delicate issue of CEO development and succession. John Flannery at GE, Travis Kalenick at Uber or the three CEOs in five years at Deustche Bank, among others, are cases of corporate governance crises related to how boards manage the CEO appointment process. Some of these CEOs had positive qualities yet were not fit to lead as the chief executive of a complex organization. The hiring, development and firing of the CEO and the top management team is a central duty of the boards. Unfortunately, boards spend little time on this task.

The third reason is the assumption of the lack of collaboration between the board of directors and the CEO and top management team. Agency theory introduced the hypothesis of the diverging interests of top managers and shareholders, and the need to align managerial goals with financial incentives (Jensen and Meckling, 1976). But agency theory has transformed a hypothesis into an undisputed assumption in corporate governance. This hypothesis downplays a condition of good governance: a company needs both a good board of directors and a good senior management team. They should work in tandem to develop the firm for the long term and guide it with a clear sense of purpose.

The fourth reason is the lack of proper shareholder engagement and stewardship, in particular, in companies with dispersed shareholders. Boards need committed shareholders, especially in companies that depend on long-term investment. Shareholders should behave as responsible owners of shares and make sure that boards of directors fulfill their duties with professionalism and integrity.

The evidence of the past two decades shows that regulatory enforcement and capital market discipline are not enough to improve the quality of boards. There is also a clear need to rethink the role of boards in a new era defined by heightening competitive forces, technology disruption and new geopolitical risks. The interaction between companies and regulators will become more demanding, as the recent experiences of Facebook, Google and Uber among others in both Europe and the U.S. have shown. Companies cannot solely act as efficient optimizers. In times of trade wars or global health crises, companies need a certain degree of flexibility and resilience and the ability to change quickly. Boards should work with senior managers to achieve this. There is certain evidence stemming from recent international surveys on boards for directors that this pressure to change is also noticeable on current boards of directors, as the recent IESE 2021 Survey on Boards of Directors highlights. Current board members expressed that their boards should focus more on strategy, disruptions, and CEO and leadership development, while caring about the firm's purpose, the board as a team and the firm's culture. Renewing boards of directors and designing a clear reform pathway have become urgent and essential.

4. Rethinking the Model of Boards of Directors

The perception is growing that current model of boards based on external, independent board members, board committees and stronger compliance have significant governance limitations. This, in turn, has opened up discussions about proposals for improving the model.

The first proposal for boards of directors' reform is a natural evolution of the current model. It puts forward designing better stock-based incentives for executives and giving shareholders more voting powers. Some scholars (Bebchuk, 2007) and institutional investors support this view. Improvement will arise from more effectively enforcing contracts with top managers, expanding shareholders' powers, and giving boards new responsibilities through regulation. These reforms include better aligning boards of directors and CEO compensation to long-term performance plans, opening up new avenues for activist investors to have stronger influence, giving shareholders a bigger say on strategic decisions including climate change policies, and shareholder democracy to allow them to vote on certain strategic issues.

Expanding shareholder democracy entails giving shareholders the right to vote on more decisions in annual shareholders' meeting or in extraordinary meetings. However, this may not always be a winning proposition for many companies that need to make strategic decisions for the long term. Few shareholders take the necessary time to get to know the company and its challenges well. Wider shareholder democracy may be a useful concept for some decisions, but the analogy between a company and a democratic political system is limited. A company is a business, but not only a business. It is also an organization, a human endeavor, whose people help create economic value in a specific industry context through coordination of activities. Without a good understanding of these realities, higher direct shareholder democracy may be inefficient for governing a company to create long-term value, as the effects of some cases (Hewlett Packard, Xerox and Yahoo, among others) of shareholders' activism show.

Gilson and Gordon (2019) introduced a different proposal inspired by the private equity industry. Many private equity firms have a phenomenal track record in increasing the firm's value in relatively short periods of time. A key element in their strategy is the use of a special type of boards of directors, which stands out in terms of its structure, composition, commitment and functions. In this case, the private equity company names directors with extensive experience in a specific industry, who spend a considerable amount of time with the CEO to understand what needs to be done to execute a successful turnaround and improve the company's long-term growth prospects. Board directors' compensation is linked to the financial performance of the company and, eventually, to the equity value at the time of the private equity firm's exit. Gilson and Gordon propose a slightly different approach, in which independent board members work with directors appointed by the private equity firm. They also suggest linking board members' compensation to long-term value creation, as occurs in companies owned by private equity firms.

The private equity version of boards is an interesting approach for improving quality. Its main attribute is that it requires board members to substantially increase their time commitment to the firm and board issues. While the private equity model may be a suitable solution in some cases, shareholders' time horizons create a problem for some companies. By their very nature, private equity firms and their investors have limited time horizons, with their ultimate intention being to sell the company to other investors or launch an IPO. This may not be the best timeframe and not even the best solution for many firms. This proposal also depends too much on financial compensation and incentives, and does not address deeper issues such as the necessary role of boards in the firm's long-term development. Moreover, an emphasis on the executive compensation incentives paid to board members may create new agency problems, with directors focused on their own financial compensation.

Similar to this proposal is that of the professional board directors (Pozen, 2010). This approach stipulates that the current model of boards of directors, whose members work only part-time and frequently also serve on the boards of other companies, be replaced by a board with professional, external board members with a higher time commitment to each company. In this model, a board member would only sit on one or two boards, with a high dedication to each company–at least 10 days a month–and a long-term contract and executive compensation more closely tied to financial performance. This proposal is interesting but has some drawbacks, such as diminished engagement of shareholders in boards of directors. This model does not solve the agency problem and still relies on executive compensation as a motivational force. This model also reinforces the potential negative effects of a strong CEO with another layer of powerful board directors.

Bainbridge (2018) makes a more radical proposal for avoiding the failures brought about by the current model of boards: outsourcing major governance functions to specialized external companies. Instead of individuals elected by shareholders to serve on boards, companies will choose a board service provider (BSP). This is a company with the explicit purpose of offering other companies the corporate governance services that they need, including its board of directors. The BSP will be the final decision-maker in any company. The proposal is very radical and difficult to implement, even in listed companies, in particular, when firms have large shareholders–families, family offices or pensions funds. These shareholders usually want to have some seats on the board of directors. Some national corporate law systems protect their rights to do so.

A final proposal comes from certain institutional investors and regulators. In recent years, investors have been asking companies for additional disclosure of non-financial information. Initially, these investor demands were focused on the firm's model of governance, particularly regarding executive compensation, board composition, or board committees. Carbon footprint and social issues recently joined the list of elements (Environmental, Social and Governance factors) that companies should disclose. Institutional investors started to request this type of information as they realized that non-financial issues can have an economic impact on the firm's performance. They wanted to know more about it and eventually ask companies to reduce risks stemming from these. Regulators also joined them in setting new standards for firms in some of those areas. These initiatives are necessary in some cases. Unfortunately, they are not enough to improve governance quality, because do not address some of the corporate challenges discussed in this chapter and that boards should tackle. There is a need to rethink the role and functions of boards of directors in a more holistic way.

5. In Search of a New Model of Boards of Directors

The current model of boards, based on independent directors with limited dedication to the firm, is not functional to help firms confront strategic challenges. Moreover, this model is based on a key agency theory hypothesis: the design of mechanisms and incentives to monitor CEOs so that they maximize shareholders' returns (Friedman, 1970; Jensen and Meckling, 1976; Fama and Jensen, 1983). This assumption does not accurately reflect the reality of heterogeneous shareholders and the corporate world itself, and the need to develop the board's competencies. But it has been partially translated into many corporate law systems that define the functions of the board in this way.

Other alternative views of boards, such as the board as an institution that provides resources (access to capital markets and other investors) to the company (Pfeffer, 1972) or the board as a strategic decision-making institution (McNulty and Pettigrew, 1999) never became mainstream in corporate governance studies.

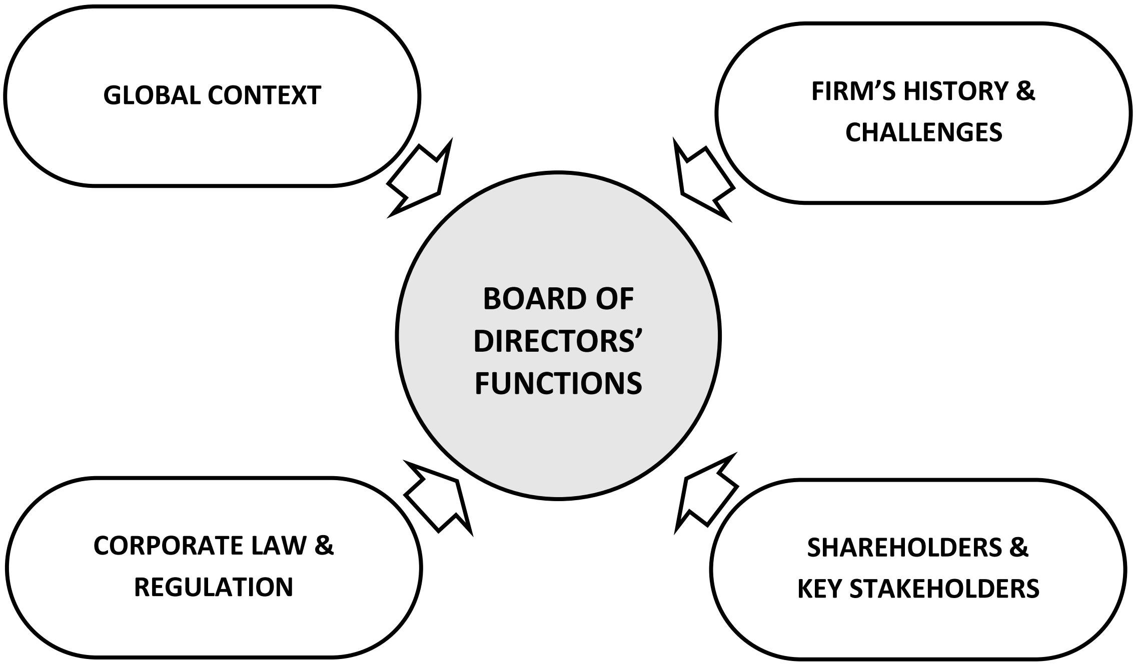
In this section, I will briefly review the major forces that shape the changing model of boards of directors: the firm's global context and competitive challenges, the firm's history and specific context, the nature of shareholders and key stakeholders, and the role and interaction of scholarly ideas and regulation (see **Figure 2**). Some of these forces (the interaction between ideas and regulation) have been discussed in the previous sections. In particular, in this section I will describe first some of the competitive challenges that define the firm's global context. I will also introduce a more holistic notion of the firm, which is important for the firm's governance and goes beyond the hypothesis of maximizing shareholder value. Finally, I will discuss the role of shareholders and key stakeholders, particularly the CEO and senior management team, and their interaction with the board.

These concepts and factors are important for the holistic model that I will present in Section 6, because they reflect major forces that shape the way boards are designed and behave. In particular, these notions take into account new board capabilities, the notion of the firm as a relevant social institution, the firm's basic relationships with shareholders and other parties, including the relationship of the board of directors with the CEO and top management team. They consider what regulators and investors expect from boards of directors, but go beyond them.

5.1. Firm's Global Context: Complex Challenges and New Competencies

The increasing complexity of the business world makes the role of the board of directors ever more demanding. Understanding the nature of the challenges corporate governance will face in the coming years is a critical step for rethinking the functions and capabilities that boards need to develop (Klarner, Yoshikawa and Hitt, 2021).

Figure 2
Board of Directors' Functions: Driving Forces



The companies mentioned in this paper offer a glimpse of some of the most pressing challenges that boards are facing and the need to develop the required competencies to effectively tackle them. The first is the strategic complexity that companies need to navigate in order to remain competitive in a changing world driven by technology, protectionism, climate change, or changing consumer behavior.

The second challenge is the new dynamics of competition and technology disruption in many industries. The current software revolution and the emergence and dominance of platform-based companies have intensified industry rivalry and given rise to new sources of competitive advantage. Board directors should have adequate knowledge and experience on these issues to make good decisions. Moreover, in firms dominated by software and other intangible resources and capabilities, people and leadership development have also become top priorities for boards.

Investing in people and leadership development are relevant areas, and boards of directors need to work on them in cooperation with the CEO. This is the third challenge that boards need to tackle. This goes beyond the boards of directors' duty regarding CEO succession plans. In today's economy, intangible assets like software, customer intimacy, brand and reputation are more important than ever (Haskel and Westlake, 2018). They are created and driven by people. In the past, people development was defined and implemented by the CEO and the senior management team. As people become more important in the value creation process, boards need to understand them and support their development in cooperation with the CEO.

The fourth challenge is that shareholders expect good financial performance and predictable growth in the companies where they invest. Unfortunately, growth has become an elusive goal amid stagnated productivity, flat or decreasing populations in advanced economies, and increasing political risk in emerging markets. The likely outcome of lower global integration and relocation of activities in global value chains–the result of the U.S.-China trade war–will probably lead to lower volumes of foreign direct investment and financial flows. This may slow down GDP growth and increase volatility in the coming years.

The fifth challenge is the fight against climate change and pressing social issues like race and gender discrimination. Boards are compelled to take environmental, social, diversity and other non-financial issues into consideration. Some of these themes are or will be mandatory; others may be optional. Boards should make sure that there is a coherent integration of these issues into the firm's strategy and business model, the development of a multi-stakeholder strategy, and the definition of new metrics and indicators to track relevant quantitative and non-quantitative factors. This new reality makes the work of boards of directors more complex.

While tackling these external challenges, boards also face an important internal challenge: the need to reconsider the collaborative nature of their work and the development of a professional, constructive and collaborative relationship with the top management team. A board of directors is a collegial team of professionals with a collective decision-making process. All the problems that teams face–coordination, free-riding, trust, leadership, etc.–are compounded by the fact that boards of directors are made up of people whose dedication to the company is limited. Boards will not be effective in corporate governance unless they recognize the need to operate as a team. They also need to understand that they do not manage the company: this is the responsibility of the CEO and the senior managers.

The board of directors should establish a collaborative, professional and transparent relationship with the CEO and the senior management team, offering them support and also ensuring the management team is fully aligned with the long-term goals and governance criteria defined by the board. This perspective on the work of boards of directors essentially diverges from the current model of boards. In the following chapters, I present evidence of successful companies that have effectively developed this positive relationship. It can impact how employees work in teams, the degree of collaboration in corporate initiatives, and the company's ability to innovate and come up with better and profitable ideas for its customers. In the end, the culture of work of the board of directors permeates and affects the culture of the organization.

5.2. A Holistic Perspective of the Nature of the Firm

Creating a new mission for the board of directors requires some explicit assumptions regarding the notion of the company, its purpose and the role shareholders and other stakeholders play in its future (Hart and Zingales, 2017; Mayer, 2013; Henderson, 2020). Since the 1970s, shareholder primacy has been a key principle in governance and maximizing shareholder value became the undisputable goal of the firm. Both the new challenges confronting firms and the limitations of the shareholder primacy paradigm require a deeper reflection on what a firm is and which goals it should have for an effective governance.

In this section, I present some assumptions and notions on companies I observed in the organizations examined in writing this paper. Some of these have also been highlighted in the academic literature (Simon, 1976; Holsmtrom and Milgrom, 1991; Freeman, 1984; Milgrom and Roberts, 1992; Roberts, 2004; Porter and Kramer, 2011; Mayer 2013; Edmonson, 2016; Hart and Zingales, 2017). Many of these notions differ from the hypothesis of maximizing shareholder value, and can help reflect deeper on the role of boards in governance.

The first assumption is that companies are relevant social institutions that create wealth and jobs, generate investment and innovation, promote community prosperity and foster social dynamism. They need to be competitive in order to survive. Companies are complex institutions with different parties contributing to it (Freeman, 1984; Milgrom and Roberts, 1992; Roberts, 2004; Barney, 2018). Shareholder value is only one indicator of their successful development. Corporate governance needs to take into consideration these diverse parties and their contributions to the firm's long-term value creation.

The second assumption is that companies require the collaboration of various parties, who bring distinct assets, resources and capabilities to a common project (Holmstrom and Milgrom, 1991; Milgrom and Roberts, 1992; Barney, 2018). Today's economy has been defined as "capitalism without capital" (Haskel and Westlake, 2018), in which talent, ideas and intangible assets are more important than physical assets. In this context, collaboration and trust are indispensable.

Cooperation among individuals in companies is usually organized around teams. In agile organizations, teams are the central block. The theory of the firm based on team production is more relevant in this context (Alchian and Demsetz, 1972; Blair and Stout, 1999). These teams require people who have the necessary capabilities to develop the different tasks, as well as the attitudes to work cooperatively. Teams are effective under certain conditions, such as when there is clarity in the mission and goals, and coordination (Edmonson 2012; Katzenbach and Smith, 2015), among others.

The third assumption is that companies will benefit from defining and working with a corporate purpose that expresses their reason for being and describes their distinct personality, values and uniqueness. As Mayer (2018) points out, a corporate purpose defines why a firm exists, helps coordinate the different goals and expectations of stakeholders, and integrates them at a superior level.

The fourth assumption is that most companies need capital to invest for the long term (Barton and Wiseman, 2014). The investment needed for decarbonization, energy transition or communication infrastructures, among others, is colossal and requires long time-horizons. Companies with long-term investments also require investors with long-term horizons. Boards should make sure the company has the investors with the time perspective it needs.

The fifth assumption is that good management matters (Bloom and Van Reenen, 2007). Good governance requires effective managers who will coordinate the efforts of the different parties, help develop and implement strategy, engage people and direct them towards the common purpose. Managers are not only agents of investors who aspire to maximize shareholder value. Rather, they should aim to develop the company for the long term, create value for all, and assure that the different parties that contribute to the company–and not only shareholders–are considered. Effective boards of directors should make sure that a company has a very competent senior management team.

The sixth assumption is that a company also needs a board of directors that represents and balances diverse shareholder and stakeholder interests, but also that offers an independent view that helps protect the firm (Carter and Lorsch, 2003). The board should make sure the company is well governed, with a focus on its long-term development and an understanding of how competitive advantages are generated, particularly those related to talent development, innovation and corporate culture.

The final assumption is that companies contribute to society by designing a competitive value proposition for their customers. In this process, they innovate, provide goods and services, create jobs, pay taxes, offer educational opportunities to employees, and respect the environment, among other contributions. Companies leave behind many impressions in their interactions with stakeholders. Society offers companies the right to operate and a stable social context, including a rule of law, education and healthcare services. Companies cannot survive in decrepit societies and should contribute to them beyond their direct economic impact. Competitive companies need dynamic societies and should contribute to creating them. It is the proper role of the board of directors to reflect on the company's interactions with different stakeholders and their lasting effects, and the overall impact of its actions on the wider society.

In the context defined by these assumptions, the role of boards of directors is truly relevant. More specifically, the evidence presented in this paper suggests that boards should become stewards of the company's long-term development. If this is the board's mission, the indicators of performance need to change. Financial performance is indispensable, but there are other goals that companies should consider. These include, among others, customer service and satisfaction; employee engagement and development; environmental sustainability; innovation and new products and services; talent development and diversity; and a corporate culture that is healthy, fair and inclusive. If the company has good management, all of these elements will help create economic value, while respecting stakeholders and also benefitting shareholders.

This board of directors model enables governance that thinks and acts for the firm's long-term success. Boards are accountable to shareholders and other stakeholders. They make decisions to enhance the firm's purpose and its long-term development. They work with top managers collaboratively, promote an inclusive and humane culture, and help make companies respected institutions in society. Boards should work effectively with top managers, since together they reflect the two engines driving the firm (Canals, 2010a).

5.3. Central Relationships with Shareholders and Stakeholders that Define the Board's Role and Functions

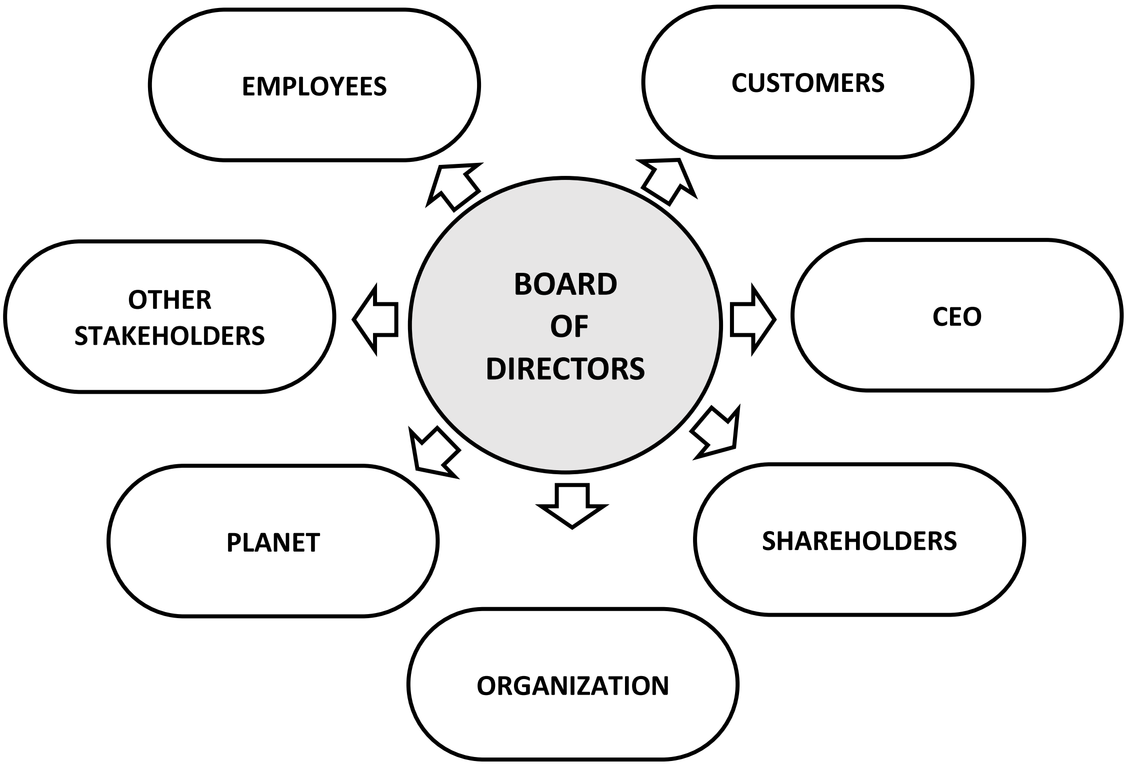
Corporate law describes boards of directors' duties in the company they serve, shareholders and other stakeholders. In general, national jurisdictions have defined board duties as those relevant to protect the company and its shareholders.

The board should comply with the law, however, good governance goes beyond compliance. A more holistic view of the board of directors should consider shareholders' interests, but also take into account other stakeholders. The notion of shareholder primacy in corporate governance comes from the identification of ownership of a company's shares with ownership of the company and the right to residual claims (Jensen and Meckling, 1976; Grossman and Hart, 1986). This notion is clear, but rather simple for reflecting a company's complexity and the function of coordinating and sustaining different stakeholders.

In governing the firm, the board should manage stakeholder relationships effectively and with fairness, since they are essential for the firm's long-term development. In **Figure 3**, I present the essential relationships of the board with certain stakeholders. Some of these relationships derive from the firm's nature and activities, and the board's specific duties (for instance, with shareholders or employees) as defined in different jurisdictions. Other relationships emerge from the firm's activities and exchanges with other stakeholders. Effective boards should understand and nurture these, in particular, relationships with customers and suppliers, as well as the firm's effect on planet and local communities. These relationships have a direct impact on the firm, not only in terms of costs, but also revenues. They also influence interactions with customers, reputation and building competitive advantage.

The firm's core relationships are with employees and customers. Employees work in a company to make a living, but with the purpose of serving customers. The board should avoid managing specific relationships with customers or employees; this is the responsibility of the top management team. But the board should make sure that the goals, policies, dominant values and culture, as well as decisions regarding the basic relationships with employees and customers, are coherent with the firm's purpose and governance. This is because the company exists to serve customers. An effective board should use indicators of performance that shed light on the quality of this engagement. This notion has clear implications in terms of the amount of time the board dedicates to reviewing people policies, talent development, and customer service and satisfaction.

Figure 3
The Board of Directors: Its Key Relationships



The second relationship is with the CEO and top management team. Appointing a CEO is one of the most salient decisions that a board has to make. In addition to hiring and firing the CEO (Monks and Minnow, 2011), boards should also be implicated in the development, assessment and mentoring of the CEO and the top management team, including the board's succession plans. Monitoring the CEO and the top management team is the legal duty of an effective board of directors, thus their responsibilities should also include CEO development. Moreover, it is fair to say that the boards of directors of the companies cited in this paper assume their chief duty is to help develop the company in collaboration with the CEO and the senior management team. I will discuss this relationship deeper in the next section.

The third relationship is with shareholders, which has been the dominant perspective in corporate governance. However, boards need to move beyond maximizing shareholder returns in the short term to help create value sustainably for the long term. This requires that a board knows well the firm and its business, fully understands how the firm creates and sustains its competitive advantages, and works with the CEO to reinforce these.

The board should also make sure the company attracts the type of shareholders needed for future development. Since shareholders are diverse, boards of directors have the responsibility to identify and engage the right shareholders. Shareholders should become stewards of the firm's purpose by providing stable capital in return for the confidence in the firm's effective management. While this may be particularly challenging in listed companies, even in these cases, the board should reflect upon this goal, through engagement and constructive dialogue with shareholders.

The fourth relationship of the board of directors is with the company as an organization. The board should understand the company and its business, formal and informal organization and culture. Board members should get to know key people in the organization in order to assess their competencies, as well as their customers. The board should also understand the firm's external context, industry, competitors, strategy and corporate culture, and what makes a company unique for its employees. In addition, the board needs to consider its impact on the organization and the firm's long-term ability to compete and succeed.

The fifth relationship is with the planet and natural environment. Companies and governments are coming to terms with a deteriorating environment caused by human actions. The levels of atmospheric pollution, the depletion of species and natural resources, and the promotion of unnecessary consumption are important obstacles for achieving a sustainable society. This is an important reason why governments should regulate the firm's environmental impact and define a level playing field for all, through coordinated international efforts. At the same time, companies should disclose their real environmental impacts and associated costs, and strive to minimize them. By doing so, they will gain the respect of investors, customers and employees.

The sixth relationship is with society, in particular, the local communities where the company operates. The company impacts society through a variety of channels: wealth generation, job creation, new investment, R&D, employee education and development, and tax payments, among others. Companies make a contribution through these actions. It is also true that companies benefit from social goods that society provides such as education, health care, public infrastructures and a stable social environment. One can argue that companies pay taxes to support these public goods. This is not always the case. It is not a matter of adding new responsibilities to companies. Rather, it is a question of understanding that companies need healthy societies in order to operate successfully in the long term. Firms are key players in these societies, and as such, they are part of the solution for improving them. Companies should be respected institutions because they are efficient and promote the common good.

5.4. A Central Relationship: The Dynamics Between Boards of Directors and CEOs

The interaction between the board of directors and the CEO and senior managers is a key relationship and an indispensable feature of good governance. Boards of directors focus on the governance of the corporation for its long-term development and work with the CEO on purpose, strategy and major corporate policies. The CEO takes the governance goals and guidelines, and manages the company to reach them. Just as a bird needs two wings to fly, good governance requires the cooperation of both. The quality of the interaction between the board and the CEO is a defining feature of good governance and shapes the effectiveness of boards.

In Table 2, I present a simple model to explain the nature of some interactions between the board of directors and the CEO, and their potential outcomes depending on their respective level of professional commitment and capacity for mutual engagement. The different scenarios highlight the potential threats, as well as the opportunities for good governance. The first–and worst–scenario is defined by a mediocre top management team and a weak board of directors; they are neither professionally competent nor engaged with one another in a collaborative way. Under these circumstances, the company is adrift, even if the business is doing fine for a while from an economic viewpoint. Neither the board of directors nor the CEO are up to the challenge of developing the firm for the long term. Shareholders should shake up the board and the board needs to renew the top management team. This is the worst scenario for the firm's potential development.

The second scenario is a board of directors that demonstrates professionalism, yet the top management team lacks competence. In the end, this situation mainly reflects a board problem since it was unable to diagnose the firm's managerial competencies earlier and the CEO is unable to effectively manage the company. The board is responsible for this situation; its structure and composition may be good, but is not functional enough. Making sure that the company has a competent CEO and top management team is the top responsibility of the board of directors. Corporate crises, such as the GE case described earlier, may be an outcome of this combination of factors.

Table 2
Interactions Between the Board of Directors and Senior Management

		Senior Management	
		Mediocre	**Competent**
Board of Directors	Weak	Governance Failure Corporate Decline	Managerial Capitalism Corporate Diversification
	Strong	Weak Management Leadership Development Gap	Long-Term Horizon Trust

The third scenario reflects a case in which the management team is strong and engaged, but the board of directors is professionally weak and not deeply committed to the company and its duties. This was the case of managerial capitalism seen in many boards before the reforms of the 1990s. The company may perform well in the short term, but a weak board could lead to future crises that may emerge from divisions among board members in facing complex challenges or the rise of activist shareholders. A good management team is not enough to offset a mediocre board of directors in the long term.

The fourth scenario emerges when both the board of directors and the top management are fully engaged with the company and are professionally competent to do their respective jobs. In this case, the firm's governance and management foundations are solid. The board should develop some policy guidelines that help establish and sustain constructive relationships between the board and the CEO. Even in this case, the company needs clear governance principles to enable both board directors and top managers to understand their respective roles and collaborate well for the long-term success of the firm.

A board of directors in a company with a solid management team also has some challenges. In this case, some of its top priorities are how to develop and lead the management team, how to think about top management succession, how to challenge the team to tackle new initiatives, and how to develop functional ways to work together. Leading a good management team is also a challenge for a board.

The interaction between the board and the top management team is critical for good governance. The board should be active, but not act alone, and board members need to be engaged while working as a team and in collaboration with the top management. Boards should take the lead in setting up some principles for board-CEO relationships: ask the CEO to work with the board along a determined pathway, encourage the CEO and the top management team to come up with new ideas, and integrate different perspectives regarding the firm's future.

6. The Board of Directors as the Steward of the Firm's Development

In this paper, I present a holistic model of boards of directors in which the board serves as the steward of the firm's long-term development[3], a function that assumes that the firm should create economic value sustainably for shareholders and key stakeholders[4]. This model confirms that the board has the central governance function, should tackle the firm's strategic challenges and should play a mediating role among different stakeholders (Blair and Stout, 1999). It involves a renewal of the functions of the board so that it acts as a credible trustee for shareholders and other stakeholders. The notion of the board as steward also highlights the need to protect not only investors, but also the company itself and its future development. In this context, shareholders play an important role. A better corporate governance system also means that shareholders–in particular, relevant shareholders–should understand what engaging with the firm entails and spend time learning about the company if they want to have an effective voice in its affairs.

The main attributes of the steward model in relation to current model of boards of directors can be organized in four blocks, as summarized in Table 3. The blocks are: the changing business landscape, shareholders, company goals and boards of director functions. This table succinctly contrasts features of the steward model with the traditional model.

[3] The notion of stewardship in management (Davis, Schoomarn and Donaldson, 1997), and in family business and the investment management community (Cossin and Boon Hwee, 2016) has a long tradition. Unfortunately, it has not been widely used in studying boards.

[4] This model is developed based upon some relevant scholarly foundations: the role of boards in strategy (McNulty and Pettigrew, 1999); the company as a multi-stakeholder institution (Freeman, 1984; Bower and Paine, 2017; Henderson, 2020); the diversity of shareholders (Hart and Zingales, 2017; Franks and Mayer, 2017); the company based on purpose (Bartlett and Ghoshal, 1994; Stout, 2012; Henderson and Van den Steen, 2015; Mayer 2018; Quinn and Thakor, 2019; Edmans, 2020); board collaboration with the CEO and the board as team (Hambrick, 1987; Holmstrom and Milgrom, 1991; Blair and Stout, 1999; Hackman, 2002; Finckelstein, Hambrick and Canella, 2009; Edmonson, 2012); or the role of executive incentives in governance (Edmans and Gabaix, 2016)

Table 3
Boards of Directors: The Current Model and the Steward Model

	The Current Model	The Steward Model
Business Landscape	Stability Occasional change Externalities not considered Passive stakeholders	Complexity Continuous disruption Volatility Climate change Activist consumers and employees
Firm Shareholders	Dispersed and homogeneous Low commitment	Heterogeneous Good stewards
Company Goals	Profit maximization Shareholder primacy	Long-term value creation Shareholders and stakeholders
Board of Directors Functions	Agent of shareholders Oversight Focus on profits Compliance Board structure Monitor CEO Complex reporting	Steward of purpose Strategy, long-term value Profits and overall impact Corporate culture and diversity Board as a team Collaborate with the CEO Accountability

The majority of empirical studies on boards of directors put forward hypotheses on the relationships between structural factors of boards of directors and companies' performance. These also select large sets of data and try to verify whether there is a causal relationship of among factors. Some of these studies have been very useful in pointing out relevant factors that can help improve governance quality. Unfortunately, many of them are not able to provide a holistic perspective of what makes boards of directors work. This paper takes a different pathway. I worked on detailed, longitudinal clinical studies of international companies, with dozens of structured interviews with their CEOs, board members and senior managers. The use of clinical studies–or longitudinal case studies–presents both advantages and challenges (Eisenhardt, 1989; Pettigrew, 1990; Eisenhardt and Graebner, 2007).

Companies' clinical studies may offer a better understanding of the internal dynamics and evolution of an organization, with a longer time horizon. They allow the observation of a more holistic perspective of a company, by including the different views of the firm's senior managers and board directors. They may offer some clues on which policies and practices work and which ones do not work in a specific company. A call for prudence is indispensable here: conclusions from clinical studies should be taken with special care, avoiding the tendency to extrapolate and generalize.

The longitudinal clinical studies were based upon personal structured interviews with chairpersons, CEOs, board members and senior managers[5]. The questions selected for interviews were grouped into major categories: companies' strategic challenges as perceived by the board; how the board works on those challenges; how the board cooperates with the CEO in tackling those challenges and defining the firm's strategy; how the board works as a team; the role of CEO and people's development; the culture of the board and the culture of the firm; how the board engages shareholders and key stakeholders; and how the board assesses the firm's overall impact beyond financial performance.

I organized and structured the interview data in a model that highlights the main functions that boards should assume to help firms deal with disruptive challenges effectively. I tried to connect these with previous academic contributions on this theme.

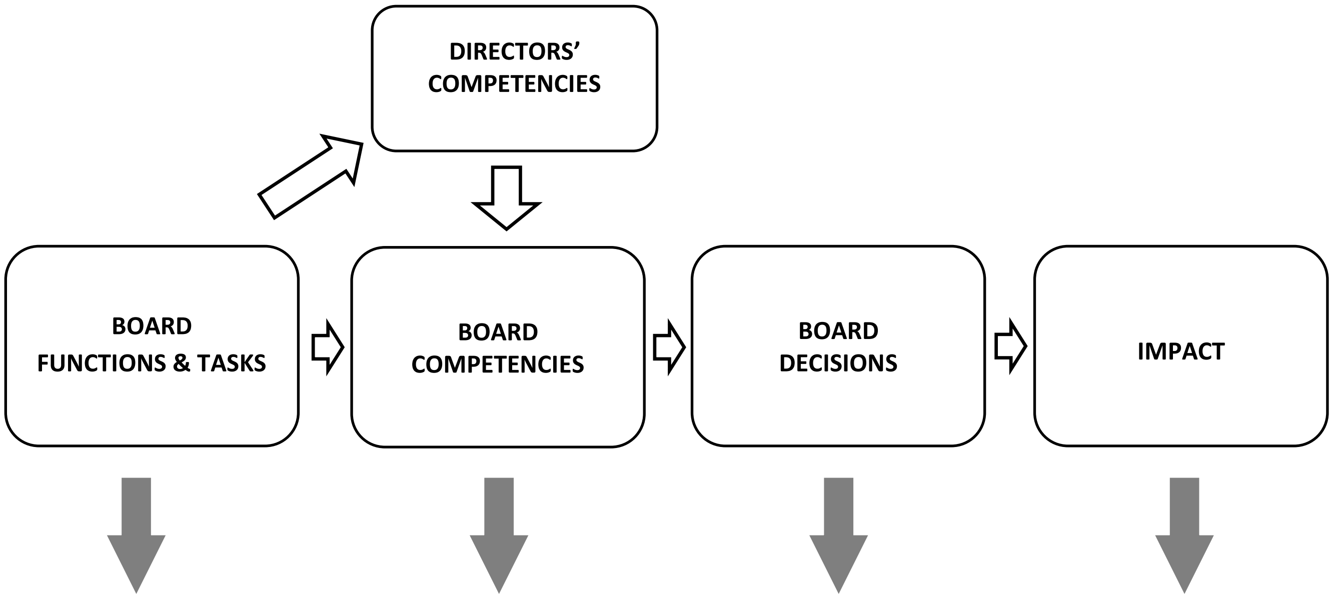
This model is limited in that it is based on the features of the companies cited in this paper, but it provides some insights to reflect on the areas where boards of directors can actually improve their effectiveness. It is consistent with the notion of boards as defined by corporate law in most OECD countries. It is a model that is also shaped by the firm's global context, the firm's current challenges, its major shareholders and key stakeholders, and by ideas and regulation, as highlighted in **Figure 1**.

Effective boards should think and act beyond monitoring and compliance. Boards should shift their attention from improving short-term results toward long-term value creation, with good strategic thinking and execution. To achieve this goal, boards should move from control to purpose and corporate culture, which are major drivers of organizational performance. Boards also should evolve and move from oversight of the management team to leadership development policies and practices.

These broad areas encompass a number of critical tasks and functions that boards should undertake, beyond monitoring CEOs. Boards should develop the competencies needed to undertake these tasks and functions. The current emphasis on diversity in boards is relevant, as it reflects the need that boards have of board members with different backgrounds and professional experiences. Diverse board members are needed to fulfill the required competencies to serve on a board. But the board itself should develop practices and have as a team the competencies to govern the firm and help it tackle its main challenges. The quality of boards' competencies will help improve the quality of the boards decision-making or CEOs advisory function, and eventually have a positive impact on the firm's overall performance. **Figure 4** presents the logic behind the notion of boards of directors' functions and tasks cited in this paper and their connection with directors' competencies, board of directors' competencies, board decisions and performance.

[5] The clinical studies consist of eleven international companies from seven countries: Almirall, Amadeus, Bertelsmann, Cellnex, Fluidra, Henkel, Ingka, Puig, Schneider Electric, Unilever and Werfen. They include 78 structured interviews with the companies CEOs, board members and senior executives, conducted between 2014 and 2020. They also use available public information. All clinical studies except one were summarized and are available as shorter case studies, nine of them at IESE Publishing and one at Harvard Business School Publishing.

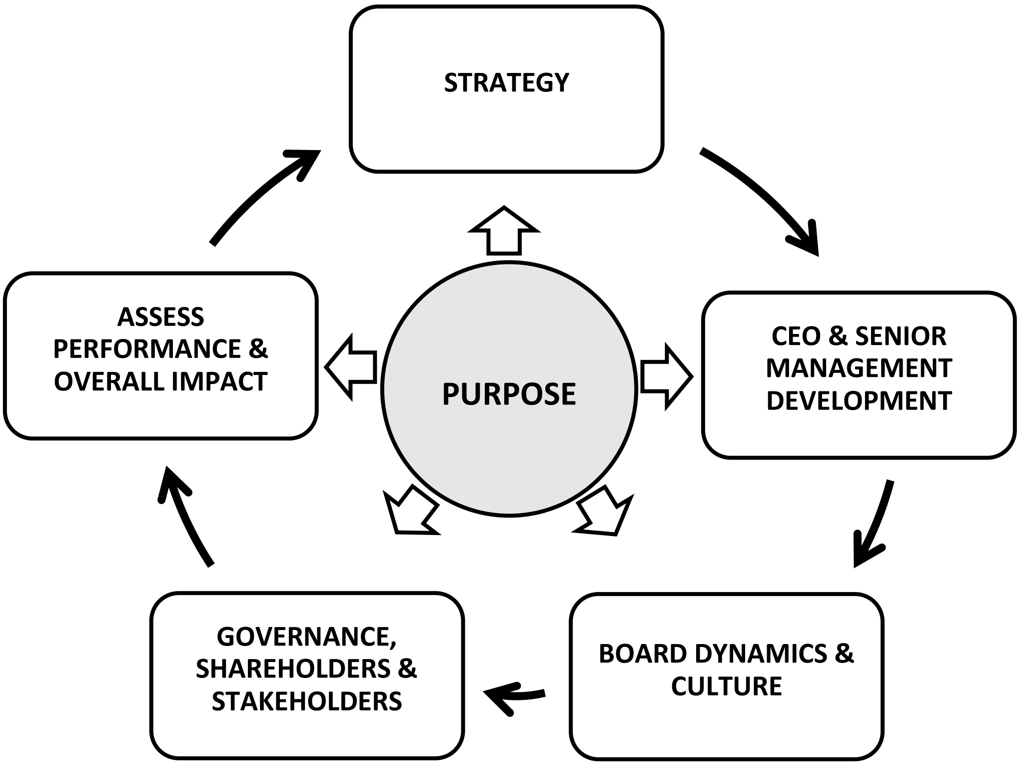
Figure 4
Board Functions, Competencies and Decision



• PURPURPOSE • STRATEGY • TRANSFORMATION • CEO & MANAGEMENT • CULTURE & TEAM • SHAREHOLDERS & STAKEHOLDERS • ASSESS IMPACT • STAKEHOLDERS	• STRATEGY • ORGANIZATIONAL • LEADERSHIP • ENGAGEMENT • MONITORING	• BOARD DECISIONS • BOARD DECISIONS WITH THE CEO • CEO DECISIONS WITH BOARD'S ADVICE	• CUSTOMERS • PEOPLE • FINANCIAL • PLANET • SHAREHOLDERS • STAKEHOLDERS • COMMUNITY

The model of the board of directors presented in this paper is based upon six major board functions (see Figure 5): define and approve a corporate purpose; establish a long-term orientation for the firm through strategy and corporate transformation; select, develop the CEO and the senior management team, and prepare credible succession plans; define the agenda of the board, and the culture and guidelines of the board as a team; engage shareholders and critical stakeholders; monitor performance and assess the firm's overall impact.

Figure 5
The Board of Directors as the Firm's Steward: A Holistic Model



A board of directors will be able to undertake these tasks and functions if the members have the right capabilities and personal attributes. However, while individual capabilities are relevant, they are not enough. The board is a team and, as such, must be able to work collegially while developing competencies that will enable it to undertake its functions successfully. The main competencies of the board stem from five major functions, as reflected in **Figure 4**. These competencies are strategic, organizational, leadership, engagement and monitoring. The experiences of the boards reviewed for this paper indicate that a board's competencies are shaped by its main functions and tasks. This is the fulcrum of this paper, although in discussing the board's tasks and functions, some implications for boards' competencies will ensue.

The first function is the firm's purpose. The board should understand and discuss why the firm exists and establish in cooperation with the CEO the specific customer needs the firm wants to serve in a profitable and sustainable way. Profits are a condition of success and survival but are not the specific purpose of a company (Drucker, 1973; Ghoshal, 2005; Stout, 2012; Mayer, 2018). A clear purpose can facilitate a better clarification and integration of the motivations that different parties bring to a company. It can also motivate employees and attract the talent the firm needs. It will help firms communicate better with their customers, while also clarifying for investors the type of company they are investing in. Defining purpose may be easy but implementing this in a firm is highly complex. Purpose has emerged as a new, central function of a board of directors.

The second function of the board of directors is to offer the firm and its shareholders and other stakeholders–for instance, customers or suppliers–a long-term orientation. The board is the responsible party for the firm's development, which requires that it spend time reflecting on strategy with the CEO. The board should not overstep and replace the senior management team in this key function, but work with the CEO and the team. In this respect, the board should not only approve the strategic plan prepared by the senior management team, it should work with the team to discuss it, check assumptions by asking the right questions, help think about scenarios, debate goals and policies, and help the CEO gain a more holistic perspective of the firm's future. By thinking about the firm's challenges and strategic options in an integrated way, and defining mechanisms to track execution, the board will be better equipped to help the CEO face the firm's challenges.

Strategy is not static, but dynamic. If market conditions change, the board should challenge the senior management team on whether the firm should change course. Corporate change and transformation used to be processes that companies undertook once in a while. Amid the current disruptive climate in the business world and society, companies need to change more often and boards need to ensure the CEO is helping steer the course needed for the firm's survival.

The third board function is the process of CEO and senior managers' appointment, development, compensation and eventual succession. The choice of a new CEO is one of the most influential and complex decisions a board makes. Choosing the wrong CEO is also a prime reason why companies get into trouble. As with strategy, individual board members may have experience in choosing CEOs but it is not the most common type of expertise in boards of directors. Moreover, success in CEO nominations is also related to a process of leadership development in the company, including senior managers and those who report to them, which becomes a key area the board should pay attention to. In the end, senior leadership development is closely connected with the firm's people development policies. Successful strategy and transformation processes depend very much on their interaction with an effective leadership development practice.

The fourth board function is related to board dynamics, the human and interpersonal dimensions of companies. A central aspect of the human perspective of boards of directors is the human reality of the board itself. The board is a group of directors who meet only occasionally, with a part-time dedication to the company and ambiguously defined goals beyond the generic duties of care and loyalty. The question of whether the board can work as an effective team is a core issue in corporate governance that has received little attention in the academic literature. Research carried out for this paper suggests this factor is highly relevant for board effectiveness.

A company is made up of people with concrete tasks and responsibilities, and who should be respected, engaged and developed with the board's support. Corporate culture is a key dimension in talent attraction and development. Moreover, corporate culture can have an impact on setting goals, defining corporate strategy and designing compensation schemes for managers and employees, as the Wells Fargo experience illustrates. Investors and regulators are increasingly concerned about how the board of directors monitors and shapes the firm's culture.

The fifth function of the board as the firm's steward is to guarantee that the company has the functional and clear governance system to develop it for the future and attract the right shareholders who understand with the firm's purpose and strategy. The board–through the chairman, CEO or CFO–should define clear guidelines to engage with shareholders. These should go beyond financial commitments regarding dividends policies or other financial dimensions. Loyal shareholders should make the effort to know the company well, and boards of directors should make sure that their concerns are taken into account, even if the decisions that some shareholders may advocate aren't considered by the board. The board, rather than shareholders, should govern the company. However, shareholders and other significant stakeholders, have a say on the company's development. The board should also provide clear guidelines on how senior managers should engage key stakeholders.

The sixth function of the board of directors is to assess the firm's overall impact, including financial performance. Companies should disclose information following the guidelines defined by regulators for each jurisdiction. Nevertheless, a board has the duty to explain which goals the firm pursues, how they meet shareholders' and different stakeholders' expectations, the firm's strategy and strategic decisions and how they support the firm's purpose. The board should use an integrated–and simple–framework to report the firm's performance, including relevant financial and non-financial dimensions. This is a demanding function for boards of directors, but a consequence of a more holistic view in defining a purpose for a company, crafting strategy, developing people, and supporting the firm's culture. The board should regularly assess its effectiveness in advancing the firm's purpose and diverse goals.

This model of boards of directors defines key goals for boards that meet their legal duties of monitoring top management and the firm's performance, but it also transcends them. Moreover, it defines key areas and drivers which are indispensable to achieve these goals. This model also helps consider boards from the perspective of the professional competencies that members, and the board as a team, require in order to be effective. In some cases, boards' nominating committees use a list of needed board competencies–such as finance, digital transformation and cross-cultural skills–and how capable different board members should be in each one of them. This is useful but may not suffice. The board should make sure that it can successfully manage major business and social challenges. This model can help the board reflect on them.

In Table 5, I present a simple framework that relates each main board function and the board's professional competencies. These areas are organized in four categories: knowledge and experience, capabilities, soft skills, and personal attitudes (Canals, 2012). The board can use this framework to assess regularly the level of competency of the board and individual board members in these basic functions.

In this paper, I put forward the steward model for discussing the key functions of the board. This framework includes, yet transcends, compliance. The model is based on theoretical and empirical evidence from researched companies, and includes a number of relevant principles for boards of directors.

The first is that firms are relevant social institutions that have–or possibly have–a purpose, as well as explicit goals to achieve. Defining and nurturing a corporate purpose is a pathway for companies to foster strategic thinking, customer loyalty and employee development, as well as manage diverse shareholder and stakeholder expectations, establish boundaries on what to do and what not to do, and structure key strategic decisions. Boards of directors should play a role in all of these realms and protect the firm's purpose.

The second is that the board should help develop the company as an organization for long-term value creation. Board members should encourage long-term thinking and foresee where the company will be in a few years' time, understand the industry in which the company operates, its customers and competitors, discuss the company's strategy and business model with the top management team and setting an aspiration for the type of company that it wants to be.

The third principle is that boards should look after the survival and successful transformation of companies, which are currently under tremendous pressure to change. The role of the board in transformation is unique, although very different from the roles of the CEO and top management team. Defining the board's responsibilities and functions in corporate transformation is a critical feature of a good board of directors.

The fourth is getting the right CEO and senior management team for the firm. Boards that aspire to develop companies for the long term should move beyond financial goals and metrics, and support the development of the CEO, management team and talent pool, as well as succession plans. People make a difference and boards should help companies in moving from financial performance to investing in people to boost innovation and performance. People development is indispensable for a competitive and dynamic company. Thus, boards of directors should also get involved and oversee this process.

Table 5
The Board of Directors: Key Functions and Competencies

	Knowledge	Capabilities	Soft Skills	Personal Attitudes
1. Purpose • Notion of Purpose • Integration into Strategy • Purpose and Values				
2. Corporate Strategy • Strategic Challenges • Strategy • Transformation				
3. CEO and Senior Managers • CEO • Senior Management • Leadership Development				
4. Human Side of Boards • Corporate Culture • The Culture of the Board • The Board as a Team				
5. Governance • Engaging Shareholders • Managing Stakeholders • Quality of Governance				
6. The Firm's Overall Impact • Financial Performance • People and Leadership • Customers • Planet • Suppliers and Other Stakeholders • Local Communities				

The fifth issue is that corporate culture and values are important attributes of good companies. Culture is considered the responsibility of the CEO and the senior management team. Nevertheless, the sheer importance of culture in fostering a positive work context means the board needs to understand, assess and shape it. Boards that think long term need to move beyond compliance to promoting a healthy corporate culture that encourages positive individual and corporate behavior. Collaboration is a key ingredient of a healthy culture. Boards should shift from monitoring the CEO to collaboration. CEOs and senior managers are accountable to the board of directors and the entire team, and boards are accountable to shareholders, regulators and the entire organization. Boards need to go beyond monitoring management to become a team capable of working with the top management to develop the firm for the long-term.

The sixth is that effective boards should engage actively with shareholders, listen to them, learn from their suggestions, and make sure the company has the shareholder structure that best supports the company's purpose. It should also engage relevant stakeholders in a constructive dialogue and gain their views and commitment to the long-term development of the firm.

The seventh is to ensure that ESG dimensions are coherently integrated in the corporate purpose, strategy and people development strategy. The example set by successful companies, which have taken ESG dimensions seriously over years, shows that integrating these dimensions into the firm's strategy is a key success factor.

Finally, financial performance is indispensable, but boards should also help assess the firm's overall impact. Economic performance needs to be complemented by other performance indicators related to the firm's talent pool, customers, pattern of learning and innovation, and contributions to addressing externalities, such as carbon emissions. Boards need to consider both financial and non-financial goals.

Boards of directors that develop their functions following these guidelines will have a deeper and more positive impact on companies and society. I define these boards as the firm's stewards, institutions that think and act long term, with entrepreneurial initiative and collegiality, and are accountable to shareholders and stakeholders. They are boards that truly support the firm's long-term development.

7. Final Reflections

In this paper, I have examined the evolution of boards of directors over the past few decades and presented some arguments for the renewal of the role of the board of directors. The combination of new corporate challenges, technology disruption, dispersed ownership, investor activism, and environmental and social issues drive the need for change in boards of directors. The CEO and top management team play a critical role in leading the company. Collaboration between the board and the CEO requires a new perspective: how the board and top management team–led by the CEO–can work together in a more cooperative and productive way for the company's long-term development.

The current model of boards of directors should evolve toward a more holistic perspective of the board's role and functions, focused on the firm's long-term development. The board as the firm's steward model offers a holistic framework to assess and design the functions, agenda and work of boards of directors. It focuses on central functions and responsibilities of boards of directors overlooked in the current model, such as their role in forging corporate purpose, strategy, corporate culture and leadership development.

This model of boards includes six major functions that define the core areas the board should support: corporate purpose; strategy and transformation; appointing and developing the CEO and key people; developing the firm's culture and the board as a team; and assessing the firm's impact.

In particular, I highlight the human, interpersonal relationships of the board, both among board members and between the board and the senior management team. It is vital to consider the board as a team, a group with its own decision-making processes which need to be effective in order to fulfill its mission. In any company, the CEO and senior managers are not only agents to be monitored; they serve as key actors in developing successful companies. The interaction and collaboration between the board of directors and the top management team based on professionalism and integrity is essential for good governance.

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