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Boards' involvement in strategic human resource decisions: towards an integrative model

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ABSTRACT

The resent studies of corporate governance has been focused mostly on investigating the association and correlation between board's characteristics and organizational performance. However, boards effectiveness, as crucial internal mechanism of corporate governance, is indirectly, but not completely determined by its structural characteristics. Board's involvement in strategic decision making has significant impact on the assessment of board's effectiveness and board's power is a critical factor in deterring board's ability to perform their strategic role. Therefore, the aim of this paper is to analyses the character of board's involvement in strategic human resource decisions. In order to achieve this objective, we have analyzed the corporate government's theories and their implication for board's involvement in SHRM. In addition we offer a comprehensive model of board's involvement in SHRM.

KEY WORDS

corporate governance, board's involvement, SHRM

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1 INTRODUCTION

The number of studies that aim to determine the factors that have influence on board effectiveness has risen. However, most of them are trying to find certain association and correlation between board's characteristics and organizational performance. The actualization and popularity of this research approach in corporate governance has been increasing especially in the last two decades. Nevertheless, the understanding and measuring board effectiveness is a complex issue. Boards effectiveness, as crucial internal mechanism of corporate governance, is indirectly, but not completely determined by its structural characteristics (Van den Berghe and Baelden, 2005; Levrau and Van den Berghe, 2007). Board's power is a critical factor in deterring board's ability to perform their strategic role (Gavin, 2012). Therefore, the structural approach that is widely used in corporate governance research need to be enhanced with more qualitative studies that are going to give deeper understanding of board's involvement in strategic decision making.

The aim of this paper is to analyses the character of board's involvement in strategic human resource decisions. In order to achieve this objective, we have analyzed the corporate government's theories and their implication for board's involvement in SHRM. In addition we offer a comprehensive model of board's involvement in SHRM.

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2 THEORIES OF CORPORATE GOVERNANCE

The key theories in corporate governance are briefly described in the following pages. According to Jensen (2001), the firm must have sing goal and social welfare is maximized when all firms in an economy attempt to maximize their own firm value. In this terms, the "firms value is simply the long-term market value…" (Jensen, 2001, p. 11). Therefore, "the manager is the agent of the individuals who own the corporation or establish the eleemosynary institution, and his primary responsibility is to them" (Friedman, 1970). This are the main ideas of the shareholder theory.

However, the main premise in the stakeholder theory is that there a number of groups within and outside an organization that have influence or are inflicted by the decisions made by the management of an organization. The stakeholder theory has redefined perspective of the organizational objectives and suggests that the main organizational goal is to adequately coordinate the interests of the different groups of stakeholders (Evan and Freeman, 1993).

According to Jansen and Fama (1983), the separation of ownership and management leads to agency problem. The agents (managers) give prorate to their personal interests instead of the shareholder interests. Jensen and Fama (1983) argue that the solution for this problem is in separation and diffusion of decision management and decision control (p. 309). In this terms, managers should be responsible for the decision management (that includes decision initiation and implementation), and directors should be responsible for decision control (that includes ratification and monitoring). As a result to this, in relation to board composition, agency theory has two normative suggestions: 1. the majority of board members should be outside or independent directors, and 2. it is necessary to avoid CEO duality (Kiel и Nicholson, 2003). Jensen (1993) argues that boards with more than 7 or 8 members are less effective and are more easily controlled by the CEO. Agency theorists suggest that boards should be more independent from top management teams, smaller and accountable and with an independent board chair (Dubbin и Jung, 2007, p. 30/31). Board independence is expected to have positive impact on organizational performance (Wang, 2009).

The main assumption of the stewardship theory is that managers are collectivists, pro-organizational and trustworthy (Davis et al, 1997). This theory is based on the assumptions in organizational psychology and organizational sociology. The stewardship theorists claim that critical factor for increasing shareholder returns is a correctly design organization structure which allow the CEO to take effective action (Davis et al, 1997). According to Donaldson (1990) the most effective boards are those in which the majority of the members are insiders and in which the CEO has dual role. In fact, the authors of stewardship theory do not support the concept of board independence, that has gained a significant popularity in the last few decades in the USA.

The resource dependence theory points that the control of the environment is crucial for organizational survival and for creating competitive advantage. This can be done with cooptation. Cooptation, in terms of board structure and composition, indicate hiring directors that are able to connect the organization with the important elements in the environment. According to the resource dependence theory the board is an instrument for managing the organizational environment and, therefore, board size is directly connected with organizational size. In addition, this theorists reason that "…firms with greater needs for access the capital markets would be expected to have a smaller percentage of inside directors…" (Pfeffer, 1972, p. 222). Authors that extent this theory, at the beginning of the XXI, "…suggests that different types of directors will provide different beneficial resources to the firm. As a result, more diverse board will provide more valuable resources, which should produce better firm performance" (Carter et al, 2010, стр. 398).

"The contingency approach may be seen as covering two areas of analysis: first, leadership theory and the 'micro' problems of motivation and productivity in the work group; and secondly, organization theory with its more 'macro' problems of designing organization structures and systems" (Redding, 1976, p. 199). In the past decade, this approach was used in studies focused on researching which contingencies have an impact on the effectiveness of corporate governance practices. According to the contingency theory the role of corporate governance is likely to differ in accordance with the changes in the crucial contingencies in the organizational environments (Aguilera et al, 2008). In other words, "the effectiveness of corporate governance would depend on a firm's size, age, phase, and the character of industries and innovation" (Ghofar and Islam, 2015, p.19).

In summary, the theories used in corporate governance that are trying to provide better understanding of the boards' roles and effectiveness can been divided in four main approaches: the shareholder theory approach, the stewardship theory approach , the stakeholder theory approach and the context- dependent organizational theories approach (Martin et al., 2012). In the following table are presented the main corporate governance theories and their links to strategic human resource management.

Table 1. Theories of corporate governance and their implications for SHRM

Theories	Implications for SHRM and organizational governance	Implications for role of HR
Traditional shareholder value model Aim: to explain how shareholder maximize returns on their investments	Unitary view of firm Focus on returns on human capital and 'hard' HRM, including cost to income rations and flexibility 'Exclusive' talent management policy Leader-centric view of organization	HR as guardians of talent management and advisers of value-adding core employees Limited role in board selection, development and remuneration HR focus on cost control, with limited strategic role
Stewardship theory Aim: concern to rescue shareholder value	Essentially unitary theory of firm Leaders as guardian of shareholder value, but with duties to act as steward Soft HRM privileging employee engagement Balance between 'exclusive' and 'inclusive' talent management policies Reputation of firm as employer seen as key issue Relaxed business case for corporate social responsibility (CSR)	HR as guardians of more sophisticated approach to HRM HR as guardians of corporate culture HR as guardians of leadership development and potential role in board development
Stakeholder theory Aim: Boarder understanding of effectiveness by recognizing wide range of legitimate interests in firm over economic and non-economic goals and values	Essentially pluralist theory of the firm Focus on employee as key stakeholders with rights and as 'subjects-within-themselves' Soft and hard power and HRM can both be justified in different circumstances Fairness and tolerance as key principles Distributed leadership model Reputation of firm for social legitimacy as a core concern	HR as promoters of pluralism, including economic and non-economic goals HR as promoters of corporate citizenship and ethical policies HR as promoters of distributed leadership
Context-dependent organizational theories Aim: To show that different corporate governance practices and goals may be more or less effective/acceptable in different contexts No universal governance practices	No one best way of organizing corporate governance and HRM	HR needs to be sensitive to context and contributors to cost effectiveness, contingent and complementary HR policies and practices

Source: Martin and Gollan, 2012

3 TOWARDS A MODEL OF BOARD INVOLVEMENT IN STRATEGIC HUMAN RESOURCE MANAGEMENT

In order to develop better understanding of the boards' involvement in strategic human resource management, in Figure 1 is presented an elaborated model. The model has four elements, which include: antecedents of boards' involvement, key areas of involvement, effects of board involvement in SHRM and mechanisms for increasing boards' involvement in strategic human resource decisions. All the elements of the model are going to be separately described and discussed.

1 ANTECEDENTS OF BOARD INVOLVEMENT IN SHRM

The antecedents of board involvement in SHRM can be divided in two groups: External factors and internal organizational factors. The external factors include the legal framework and the environmental uncertainty.

The legal framework is important in the analysis of boards' involvement in SHR decisions. Namely, in a two-tier board system, the management board is responsible for decision, management, and the supervisory board is responsible for decision control. In one-tier board system, both, decision management and decision control are responsibility of the boards' of directors. According to the Maassen, G.F. (2002) board composition and board leadership structures may account for problems associated with the independence of one-tier boards, while the description of two tier board models may suggest a positive association between the composition and the leadership structure and the separation of decision management from decision control in two-tier boards. In this way, the characteristics of the two-tier board model suggest that the formal division of board roles between executive and non-executive directors may reduce agency costs and may simplify directors' duties and liabilities. Therefore, a two-tier board system may be more efficient in addressing the strategic issues, including the decisions in the area of SHRM.

According to Hendry and Kiel (2004) the boards' involvement in strategic roles is determined by the level of uncertainty in the environment. They suggest that when environmental uncertainty rises than the boards are more focused on behavior and on their strategic role.

The internal organizational factors include: ownership structure, board structure and composition, individual factors (such as: directors experience and personal characteristics).

Ownership structure, defines as ownership concentration has been analyzed as an determinant of boards involvement in strategic decision making in various studies (e.g., Baysinger et al., 1991; Beatty and Zajac, 1994). However, the suggestion of Ravasi and Zattoni for considering ownership as a multi-dimensional construct, might be more productive in the attempt to develop a more sophisticated model of boards' involvement in strategic human resource decisions. Namely, the ownership structure has different aspects (degree of concentration, heterogeneity of interests, etc.) that influence the board's functions in different ways.

Board composition commonly refers to the proportion of inside and outside directors in the board, whereas board structure refers to the leadership structure (CEO duality) and does the board has committees and subcommittees. In regard to the board composition, various studies have shown that the presence of outside directors has been positively associated with boards' involvement (Johnson et al.,1993 and Dahya and McConnell, 2005). The board's leadership structure has been analyzed in different ways and the results are inconclusive. Ruigrok et al. (2006) suggest that CEO duality is negatively associated with board involvement, while Ogbechie et al. (2009) do not detected relation between CEO duality and board involvement. On the other hand, some studies indicate that the chairs' leadership style has influence of the boards' involvement in strategic decision making Bailey and Peck (2013).

The personal characteristics of the boards' members and their experience include the individual cognitive capabilities of the directors, their ethical views and background. Balta et al. (2010) have found that educational level affect both the financial reporting and the hierarchical decentralisation in the strategic decision-making process. However, this study shows that the educational specialty did not appear to have any significant influence on the strategic decision-making process

2 KEY AREAS OF BOARDS' INVOLVEMENT IN SHRM

Bain and Barker (2010) have defined several responsibilities to the boards that are directly connected with the human resource management in the organization. This responsibilities include approval of (p. 7-8):

a) The appointment and the removal of the managing director, other executive directors of the company secretary;
b) The appointment or removal of other directors recommended by the nomination committee;
c) The rules and duties of the chairman and managing director and their discretionary powers;
d) The arrangement of directors' and officers' liability insurance;
e) And other matters that are indirectly influencing the human resource management policies such as: the approval of the approval of the health and safety policy and the value statements and systems to monitor how the organization's values apply in practice.

According to a recent EY survey the four key areas of human resource management that should be priority for the boards and the corporate government system of the company include: executive compensation, succession planning, diversity and inclusion and talent strategy (Ernst & Young, 2014).

Executive compensations

The boards 'role in the decisions of the executive compensations in the previous studies has been analyzed from two different approaches. Bebchuk and Fried (2003) have synthetizes these approaches as:

a) optimal contracting approach, used by the financial economists that views managers' pay arrangements as a (partial) remedy to the agency problem. Under this approach "boards are assumed to design compensation schemes to provide managers with efficient incentives to maximize shareholder value" (p. 72) and
b) managerial power approach, that views executive compensation as part of the agency problem itself.

They argue that "…managerial power and rent extraction are likely to have an important influence on the design of compensation arrangements. Indeed, the managerial power approach can shed light on many significant features of the executive compensation landscape that have long been seen as puzzling by researchers working within the optimal contracting model. ...managers' influence over their own pay might impose substantial costs on shareholders—beyond the excess pay executives receive— by diluting and distorting managers' incentives and thereby hurting corporate performance." (p.72)

In regard to the research of governance influence of the exsecutive compensation, number of scholars have given their contribution. Namely, Deuthch (2005) concluded that there is negative relationship between the percentage of outside directors and CEOs'incentive pay expressed as a ratio of total compensation. (p.433). On the other hand, the findings of Guthrie et al (2012), have indicated that the impact of the independent directors on the CEO pay may not be significant. The study of Ntim et al (2017), has indicated that in a context of concentrated ownership and weak board structures, the second-tier agency conflict (director monitoring power and opportunism) is stronger than the first-tier agency problem (CEO power and self-interest). It can be concluded that the findings of the studies on the correlation between governance structures and executive compensation are not consistent.

Succession planning

Executive and top management succession planning is crucial organization process since it affects organizational dynamics and growth. Designing formal process of succession planning and establishing long term and emergency succession plan for the key management positions is one of the fundamental boards' responsibilities.

The key elements of the succession management process are the identification of the future requirement of the organization, the identification and development of leadership talent and the ability to identify results (Lynn, 2001). According to Lynn (2001), succession management is a cyclical process designed to ensure organizational continuity through timely, adaptive, and ongoing change in the development and deployment of leadership talent.

Hansen and Wexler (1988) have identified four strategies that are used in succession planning:

a) Crown Prince-Identifying and nurturing a single heir for each position
b) Slate-Having a limited number of qualified candidates (two to four) available to fill a vacancy.
c) Pool-Developing a reservoir of qualified employees capable of filling any number of positions.
d) Wave-Choosing a single heir from a small reservoir of individuals who have been carefully selected by the organization, and/or have been developed over a period of time, perhaps ten or more years in advance. Generally, no individual in this reservoir is slated for any particular position until it must be filled.

However, all of the mention strategies have strengths and weaknesses. Which strategy is going to be implemented mainly depends on the succession contingencies (such as, industry and organizational characteristics and board power and the organizations previous experience in succession planning.

Despite the importance of the succession planning for the organizational continuity, surveys from the past decade have indicated that there is lack of preparedness of the board in regard to this issue and that board members have insufficient knowledge about the internal candidates (Heidrick and Struggles, 2010).

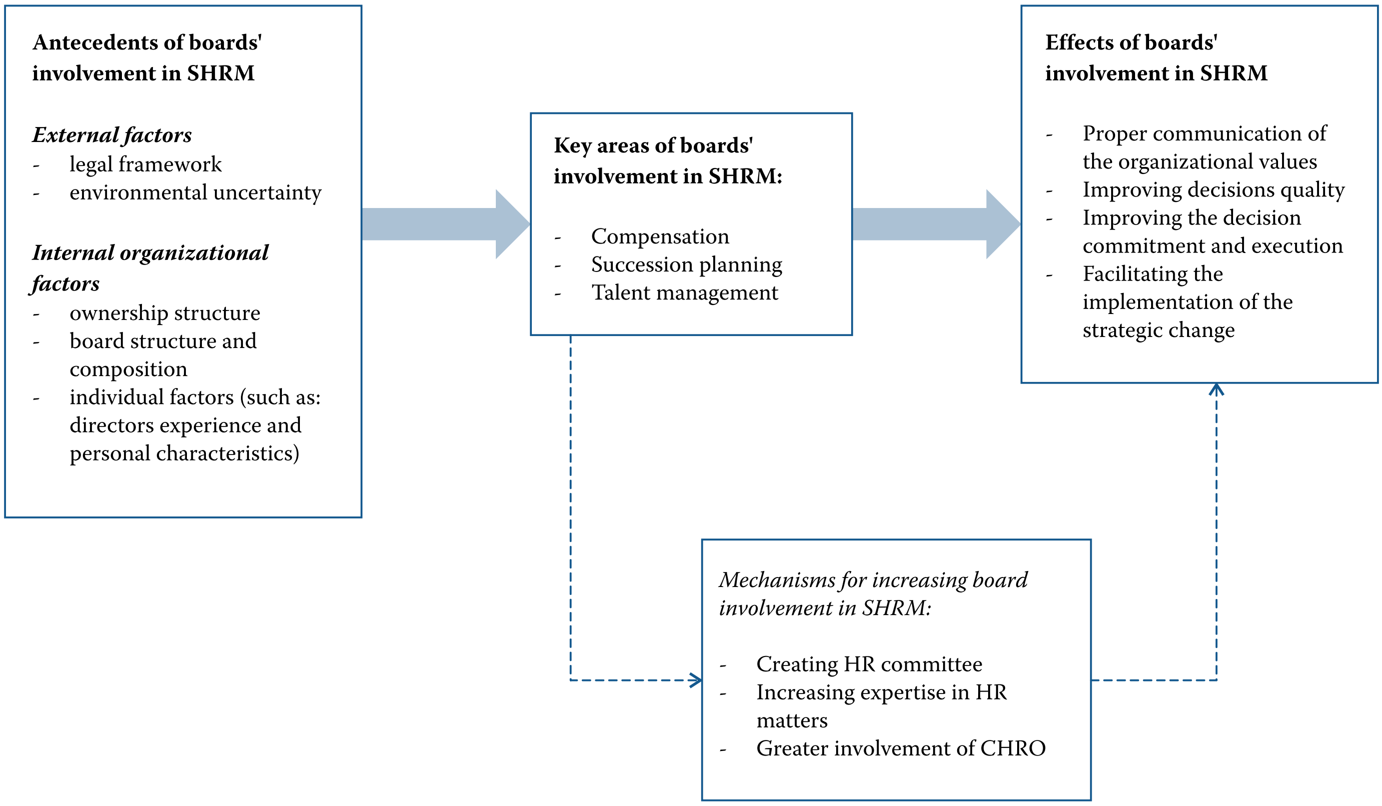
Talent management

In order to build capacities for organizational success in the future, the company needs to develop a talent strategy. "A talent strategy makes explicit the types of investments an organization makes today in the people whom it believes will best help it achieve competitive excellence in the future" (Berger and Berger, 2011, p. 4). This strategy is crucial for building the competitive advantages on the long-run and therefore the boards members need to be involved in its formulation.

Strategic talent management is defined as "activities and processes that involve the systematic identification of key positions which differentially contribute to the organization's sustainable competitive advantage, the development of a talent pool of high potential and high performing incumbents to fill these roles, and the development of a differentiated human resource architecture to facilitate filling these positions with competent incumbents and to ensure their continued commitment to the organization"(Collins and Mellahi, 2009).

Board members needs to have asses to the relevant and accurate date regarding the human resources of the company. In today's highly competitive environment the board members needs to develop better understanding on the potential of the human resources that are available to the company, in order to plan and support its future growth.

Figure 1 Integrative model of boards' involvement in SHRM



3 EFFECTS OF BOARDS' INVOLVEMENT IN SHRM

The effects of boards involvement in strategic decision making in the contemporary literature has been analyzed mainly by their implications on the financial results. The recent studies in corporate governance in the past few decades are focused on determine the association between boards structural characteristics and firms financial performance. However, the board's involvement in strategic decision making is a complexed issue and has various effects on the behavior on the members of the organization and through that of the overall organizational performance.

According to Judge and Talaulicar, (2017), the effects of board involvement in the overall strategic decision making can be systematized in four groups that that include, (p.134):

1. environmental–level effects which include: environmental sustainability and community well-being;
2. organizational-level effects which refer to: accounting and market performance, fraud and illegal activities and strategic change;
3. board-level effects that include: decision quality, decision speed and decision commitment and board turnover;
4. director-level effects mainly referring to: director turnover and director reputation.

Therefore, all of the proposed effects of board's involvement in the strategic decision making can be analyzed as multi-dimensional constructs, including the effects of board's involvement in SHRM. In this paper we focus only on the boards' contribution in the SHRM, and the effects of board's involvement in SHRM should include:

a) Proper communication of the organizational values;
b) Improving decisions quality;
c) Improving the decision commitment and execution;
d) Facilitating the implementation of the strategic change.

4 MECHANISMS FOR INCREASING BOARD INVOLVEMENT IN SHRM

The most important mechanisms for increasing board's involvement in SHRM, described by Ernst & Young survey (2014, p.17-22) include:

a) Creating HR committee – the task of the committee „is to review, report on and, if required, make recommendations to the Board of directors or management board on matters relating to human resource, and corporate diversity" (p.22). In order to be able to make a contribution in addressing the SHRM issues in an appropriate manner, the HR committee composition is an significant aspect. Namely, when the process of determining the composition of the HR committee, means making an effort to include individuals that possess the necessary skills and experiences to exercise his/her role, but in the same time an individual that is willing to present and argument its opinion.

b) Increasing expertise in HR matters - The lack of skill and expertise in HR matters is often seen as an issue. Therefore, often boards invite non-board members with adequate HR experience on the meetings, in order to acquire the necessary HR insights (p.18). As for the independent directors, it is important to have proper experience in compensation matters and talent strategy, and must have embedded the company's values in order to be able to give the contribution in the issues related to SHRM.

c) Greater involvement of CHRO - CHRO must spent more time on their advisory role to the board members for matters that are crucial for human resource development. They should be present on the meetings with the data for the metrics of the organization's human capital. In this way the CHRO can articulate the key information regarding the organization's capabilities and capacity and guide the crucial business decisions (p.19).

4 CONCLUSION

According to the analysis of the theories of corporate governance it can be concluded that there are four main streams that give different understanding of board's involvement in strategic human resource decisions (Martin and Gollan, 2012). The traditional shareholder theory is focused on the return of human capital and prefers 'excusive' talent management strategies. The stewardship theory, in a way, is an extensions of the shareholder that that suggest implementation of more soft mechanisms for increasing employee engagement and increased focus on corporate reputation. In the stakeholder theory proposed that fairness and tolerance should be the main principal in HRM. Context-dependent organizational theories suggest that different practices should be applied in different situations.

According to the comprehensive model of boards involvement in SHRM, the key areas that should be addressed by the boards are compensation, succession planning and talent management. The antecedents of board's involvement in SHRM are systematized in two groups: external and internal. The most important external factors are the legal framework and environmental uncertainty. The internal organizational factors include: ownership structure, board structure and composition and individual factors (such as: director's experience and personal characteristics).

Finally, the effects of board's involvement in strategic human resources decisions include: proper communication of the organizational values, improving decisions quality, improving the decision commitment and execution, facilitating the implementation of the strategic change. The effect of boards' involvement in strategic human resource management should be analyses separately as independent research constructs in order to be achieved better understanding of the impact of boards' involvement on the overall boards' effectiveness.

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