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SUPERVISORY BOARD'S CONTRIBUTION TO CORPORATE STRATEGY: EVIDENCE FROM CROATIAN COMPANIES

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Abstract:

The main objective of this paper is to expand understanding of how supervisory boards contribute to corporate strategy. Using a sample of supervisory boards of Croatian listed companies, in this paper we investigate: (1) the overall level of supervisory boards involvement in corporate strategy, and (2) how are supervisory board's structural attributes related to the intensity of strategic involvement. Our results indicate that supervisory boards indeed have an active role in shaping and supporting the corporate strategy. Strategic activities that supervisory boards most often execute are authorizing strategic decisions proposed by the management board and crisis management activities.

Key words: *corporate governance, supervisory board, strategy*

1. Introduction

The phenomenon of corporate governance deals with the relationships between entities that have the potential to determine the company's success (Monks & Minow, 2001). In addition to specifying the distribution of rights and responsibilities among the managers, shareholders, and other stakeholders, it also provides a framework for strategic decision-making procedures in the company (OECD, 2004).

Systems of corporate governance differ among national and institutional contexts and it is possible to distinguish between (1) Anglo-Saxon system which is present in the USA and UK and (2) Continental system which is applied in the continental Europe and Japan (Thomsen, 2003). Unlike in the Anglo-Saxon system, the ownership structure of companies in the continental system is most commonly highly concentrated (Shabir & Rosmini, 2016), the capital market has no significant role as a capital provider nor as a supervisory mechanism, and there is a possibility of establishing a dual (two-tier) corporate governance model (Thomsen, 2003). The two-tier model of corporate governance is characterized by the separation of management and control functions, that is, the establishment of types of corporate boards: (1) a management board responsible for managing the corporation and (2) a supervisory board holding responsible for management oversight (Maasen, 2002).

The supervisory board is an important internal corporate governance mechanism with the primary purpose of advancing the management control process (Gad, 2015). Given its unique position between the owners and the managers, the supervisory board performs three core tasks: (1) control, (2) resource provision, and (3) strategic. The changed context of corporate governance in Western countries, resulting from corporate scandals in large US corporations and increased regulatory and social demands, has led to changes in expectations regarding how boards should participate in strategic decision-making (Bezemer et al., 2012).

Furthermore, the financial crisis caused by the period of slow economic activity has forced supervisory board members to reflect on their conventional attitudes and take a more active role in the company's corporate strategy (Eurlich & Stiglauer, 2012).

The main objective of this paper is to expand our understanding of how supervisory boards perform their strategic task. Specific objectives of the paper are: (1) to investigate the extent to which the supervisory board is involved in the company's strategic activities, and (2) examine how the extent to which the supervisory board is involved in strategic activities relates to its size and independence.

The paper is structured in four sections. In the first section, the theoretical background of the identified research problem is presented along with the research hypotheses. The central part of the paper contains a section where the methodological aspects of the study are described and a section where the main findings are presented and discussed. The final section summarizes our main findings, practical implications, and contributions made.

2. Theoretical background and research hypotheses

The supervisory board is an important internal corporate governance mechanism with the primary purpose of advancing company welfare (Gad, 2015). The purpose of the supervisory board is to ensure, on behalf of the stakeholders, that the company achieves targeted results. Given its unique position between the owners and the managers, the supervisory board performs three fundamental tasks: (1) control, (2) resource provision, and (3) strategic.

The control task of the supervisory board is rooted in the agency theory proposing that modern corporations face conflicting interest problems between the owners and the managers. Agency theory proposes that managers are opportunistic agents guided by their interests and not by the goal of maximizing shareholders' wealth (Jensen & Meckling, 1976). The supervisory board thus appears to be an instrument of internal control reducing opportunistic behavior and ensuring that managers act in the shareholders best interest (Johnson et al., 1996). Zahra and Pearce (1989) recognize this role as crucial in achieving company effectiveness. The supervisory board and management board are not in hierarchical relation, rather they have collaborative relationships and function on the same organizational level. The supervisory board's resource provision task implies helping the company to build a firm relationship with its environment. Following resource dependence theory (Pfeffer, 1972), boards facilitate access to the necessary external resources, enable the company to collaborate with its

environment and represent company in the media. Furthermore, it is up to the supervisory board to build and strengthen the company's networks with entities in its environment and to contribute to corporate reputation (Muth & Donaldson, 1998).

Corporate governance scholars agree that boards should contribute to corporate strategy (Zahra & Pearce, 1990; Stilles & Taylor, 1996; Rindova, 1999), but there seems to be a lack a consensus on how exactly boards should perform their strategic task. Board involvement in strategy is associated with board members' involvement in scanning the corporate environment, and strategy formulation (Rindova, 1999). Therefore the board's strategic task represents the overall level of board members' involvement in making non-routine decisions that affect the long-term company performance (Judge & Zeithaml, 1992).

The management board is responsible for the implementation of the corporate strategy, but the question remains to what extent should the supervisory board, together with the management board, contribute to the strategic planning process (Gad, 2015). The OECD Principles of Corporate Governance (2004) state that, among others, the key function of the supervisory board is to analyze and guide the corporate plans, strategy, and annual budgets. Besides, the task of the supervisory board is to set performance targets, monitor strategic implementation, and oversee capital expenditures while overseeing investments and disinvestments, with particular emphasis on the board's role in risk management. The strategic role of the supervisory board is also to reduce the asymmetry of information and to enable the creation of strategic business goals and corporate policies aimed at creating more value for the company (Eurlich & Stiglauer, 2012). The supervisory board should contribute to the creation of strategic proposals, endorsing and overseeing their implementation (Eurlich & Stiglauer, 2012), evaluating previous strategic decisions made by management, and providing support and advice to the management board in achieving a shared vision of the company (Tipuric, 2006). Research conducted on a sample of German public corporations conducted by Eulerich & Stiglbauer (2012) showed that supervisory boards have indeed taken a more active role in the strategic management process and are now acting as "strategic coaches" with a proactive role in the corporate strategy.

Larger boards are considered to be beneficial as more members imply greater accumulation of knowledge and experience (Judge & Zeithmal, 1992), which can be particularly useful when making decisions in an uncertain environment (Pfefer, 1972). On the other hand, communication among members in larger boards may be difficult which can slow down the decision-making process (Mueller & Barker, 1997) and make it more challenging for members to operate in a harmonized manner (Velte, 2010). This paper starts with the assumption that it is more difficult for a larger board to be effective in using members' knowledge and experience (Ruigrok et al., 2006; Ogbechie et al., 2009). Accordingly, we propose that larger boards, due to the coordination difficulties will be less efficient in performing their strategic task. Therefore, our first hypothesis is:

H1: Supervisory board size is negatively related to strategic task performance.

Corporate governance scholars and practitioners are particularly interested in the concept of board independence. Board independence, as an attribute of board

structure, traditionally is measured as the proportion of independent board directors to all board members (Ogbechie et al., 2009). The Croatian Code of best practice (2020) recommends that supervisory boards should be composed mostly of independent directors. Thereby, the independent director is defined as the one who is not in business, family, and other relations with the company, the majority shareholder of the company, or management/supervisory board members.

Independent members enrich the supervisory board's overall expertise with their valuable industry knowledge and experience. Besides, independent members have a more objective approach to decision-making (Zahra & Pearce, 1990). However, independent members are usually less familiar with day-to-day activities within the company (Baysinger & Hoskisson, 1990). Therefore, we propose that independent members' lack of insider information limits their ability to contribute to strategic task performance. With that, our second hypothesis is:

H2: Supervisory board independence is negatively related to strategic task performance.

3. Sample and methods

The sample frame for our study consisted of supervisory boards of Croatian companies listed on the Zagreb stock exchange. The total number of supervisory boards in the sample frame was 144 with a total of 651 members.

The online questionnaire was sent to e-mail addresses of 315 board members, and our response rate was 10,79%. The final sample consisted of 34 supervisory boards, which made 23,6% of the total number of supervisory boards on the Zagreb stock exchange. The majority of our respondents were males (73,5%), aged from 50 to 65 years (35,3%). The most common academic degree and the field of study were master of science (50,0%), and economics (55,9%).

Questionnaire was divided into three parts and contained 30 question in total. The first part contained questions on board members' demography and general data on the company. The second part of the questionnaire followed up with questions on board structure and composition. The final part of the questionnaire contained questions on board strategic activities. In this section the respondents rated the intensity of board strategic involvement into the following activities: (1) Authorizing strategic decisions, (2) Evaluating the performance of past strategies, (3) Setting long-term objectives, (4) Actively advising management board regarding its strategic performance, (5) Supervising strategy execution, (6) Formulating strategic options, (7) Activities oriented towards prevention of crises, (8) Crisis management activities, (9) Establishing guidelines for achieving long-term goals, (10) Participating in the formulation of the company's vision, (11) Participating in the formulation of the company's mission, (12) Participating in the formulation of implementation plans for achieving long-term goals, and (13) Defining the key performance indicators.

The dependent variable Strategic task was calculated as the average score of all strategic activities. Independent variables in the study were (1) Board size (total number of board members), and Board independence (percentage of independent

board members). Data were analyzed using MS Excel and Statistical Package for the Social Sciences (SPSS).

4. Results and discussion

First, the structural attributes of the supervisory boards from the sample were analyzed. The majority of supervisory boards from the sample were from companies with more than 1.0000 employees (53,6%). The smallest board from the sample had 2, and the largest 9 members (mean=6,15). The average representation of independent directors was 32,49%.

Further, board meeting practices were analyzed. The results showed that most of the boards represented in the sample had 4 to 6 meetings annually and that the average meeting duration is within 1 and 2 hours (61,7%). The respondents were also asked to share the schedule of their meeting schedules during crises. In more than half of the boards from the sample (61,8%) meetings were always held when there is a threat of potential crisis, while 8,8% of the boards had meetings where the crisis is already escalating.

Further, we examined the important aspects of board involvement in corporate strategy. Although only 8,8% of our respondents come from boards that had a strategy committee, nearly 41,7% of them reported that their supervisory board holds specialized meetings for discussing strategy-level questions (i.e. strategic workshops). Croatian supervisory boards have the right to refuse to authorize management's board strategic decisions, and 32,4% boards from our sample put that right into practice. The activity of Authorizing strategic decisions was given the highest score (4,13), followed by Crisis management activities (3,79), and Evaluating the performance of past strategies (3,68). The activities that were given with the lowest scores were Participating in the formulation of implementation plans for achieving long-term goals (3,09) and Defining the key performance indicators (3,09). The remaining activities' scores are presented in Table 1.

Table 1: Supervisory board strategic activities

Activity	<i>Not involved</i>	<i>Slightly involved</i>	<i>Moderately involved</i>	<i>Strongly involved</i>	<i>Extremely involved</i>	<i>Not able to estimate</i>	Mean
(1) Authorizing strategic decisions	0 (0)	2 (5,9)	7 (20,6)	8 (23,5)	15 (44,1)	2 (5,9)	4,13
(2) Crisis management activities	1 (2,9)	3 (8,8)	9 (26,5)	10 (29,4)	11 (32,4)	0 (0)	3,79
(3) Evaluating the performance of past strategies	1 (2,9)	3 (8,8)	12 (35,3)	8 (23,5)	10 (29,4)	0 (0)	3,68
(4) Setting long-term objectives	1 (2,9)	6 (17,7)	7 (20,6)	11 (32,4)	9 (26,5)	0 (0)	3,62
(5) Actively advising management board regarding its strategic performance	1 (2,9)	4 (11,8)	10 (29,4)	9 (26,5)	8 (23,5)	2 (5,9)	3,59
(6) Supervising strategy execution	1 (2,9)	8 (23,5)	6 (17,7)	13 (38,2)	6 (17,7)	0 (0)	3,44
(7) Formulating strategic	1 (2,9)	7 (20,6)	9 (26,5)	10 (29,4)	6 (17,7)	1 (2,9)	3,39

Activity	Not involved	Slightly involved	Moderately involved	Strongly involved	Extremely involved	Not able to estimate	Mean
options							
(8) Activities oriented towards prevention of crises	1 (2,9)	7 (20,6)	9 (26,5)	10 (29,4)	6 (17,7)	1 (2,9)	3,39
(9) Establishing guidelines for achieving long-term goals	1 (2,9)	7 (20,6)	9 (26,5)	12 (35,3)	5 (14,7)	0 (0)	3,38
(10) Participating in the formulation of the company's vision	1 (2,9)	7 (20,6)	6 (17,7)	17 (50,0)	2 (5,9)	1 (2,9)	3,36
(11) Participating in the formulation of the company's mission	1 (2,9)	6 (17,7)	9 (26,5)	15 (44,1)	1 (2,9)	2 (5,9)	3,28
(12) Participating in the formulation of implementation plans for achieving long-term goals	1 (2,9)	12 (35,3)	7 (20,6)	11 (32,4)	3 (8,8)	0 (0)	3,09
(13) Defining the key performance indicators	1 (2,9)	11 (32,4)	9 (26,5)	10 (29,4)	3 (8,8)	0 (0)	3,09

Remark: The numbers in the table represent the number of respondents who assigned a certain value to a specific activity, whereas the numbers in the brackets represent the percentage.

The overall score for the supervisory board strategic task was 3,47 which can be evaluated as a moderate level of strategic involvement.

We continued our analysis by looking at how the identified antecedents (board size and independence) relate to strategic task performance.

Table 2: Correlations

		Strategic task	Size	Independence
Strategic task	Pearson Correlation	1	,054	-,022
	Sig. (2-tailed)		,763	,901
	N	34	34	34
Size	Pearson Correlation	,054	1	,007
	Sig. (2-tailed)	,763		,968
	N	34	34	34
Independence	Pearson Correlation	-,022	,007	1
	Sig. (2-tailed)	,901	,968	
	N	34	34	34

Based on the Pearson correlation coefficient, the correlation between the observed antecedents and strategic task performance was not statistically significant. We further show the observed differences in strategic task performance considering supervisory board size and independence.

Table 3: Board independence and strategic task performance

	Board independence	N	Mean	Std. Deviation	Std. Error Mean
Strategic task	Low	20	3,54	,91	,20
	High	14	3,38	,89	,24

Table 4: Board size and strategic task performance

	Board size	N	Mean	Std. Deviation	Std. Error Mean
Strategic task	> 5 members	16	3,30	,97	,24
	5 or more members	18	3,63	,80	,19

Although we were not able to show that the observed antecedents to strategic task performance were statistically significant, our results outlined avenues for further research on this topic as described in our concluding section.

5. Conclusion

This section summarizes our key findings. With this research, we succeed to gain insight into how supervisory boards perform their strategic task. First of all, our results show that the absence of a strategic committee doesn't imply that strategic issues in supervisory boards are being ignored. Further, we were able to demonstrate that supervisory boards execute their strategic task, as well as to illustrate disparities in the intensity of their involvement in specific strategic activities. Further, our results indicate that authorization or approval of important strategic decisions is among boards most important activities. This is also supported by our finding that a significant number of supervisory boards have used their right to disapprove management decisions they find inappropriate. Furthermore, as it appears, supervisory boards are also more strongly involved in activities of addressing emergencies and evaluating the existing strategy compared to activities of strategy formulation, implementation, and defining key performance indicators.

Several limitations of this study should be acknowledged. Interpretation of the results is limited by our research design since the study is cross-sectional and based on self-reported data. We would like to urge researchers to consider the broader range of methods when focused on board member behavior. Second, the study was carried over supervisory boards of publicly traded companies that account for less than 15% of all joint-stock companies in Croatia. Generalization of our results is thus to some extent limited. Finally, the major limitation of the present study is a small sample size. Response rates in board studies tend to be relatively low, as reaching to upper echelons of the company stays one of the biggest challenges in this field of study.

Despite the above-mentioned limitations, this paper contributes to the literature on board strategic task in several segments. In this paper, based on relevant literature, a comprehensive list of supervisory boards' strategic activities is identified. Further, the scores of the identified activities were used to compute the overall level of board strategic task performance. The presented tool can be of great value to both corporate governance scholars and practitioners.

Our analysis enabled us to outline fruitful avenues for further research on this important topic. Since board structural attributes didn't prove as significant antecedents, we call for future research to observe a broader spectrum of strategic task predictors. Such predictors should mainly reflect important aspects of board member behaviors and include relevant board process.

6. References

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