CORPORATE BOARDS: THE NEW CORPORATE LEADERS

Jens Mueller, Waikato Management School, Hamilton, New Zealand
D. D. Warrick, University of Colorado at Colorado Springs, USA
Morina Rennie, University of Regina, Regina, Canada
Leo-Paul Dana, University of Canterbury, Christchurch   New Zealand

ABSTRACT

The historic view that corporate leaders serving on company boards are merely the legal stewards of shareholders is no longer the best explanation for the role of directors. This stakeholder theory is too simplistic to explain the many differing and sometimes competing interests of inside and outside directors of corporations. Based on large-scale research, we conclude that company directors' roles have become more complex and require a sophisticated skill level to perform well. We find in longitudinal research from 2006-2008 that investors are looking for boards with a diverse set of talents and we speculate that leadership talent is a key ingredient for board success. Stakeholder theory of audit and oversight appears to have been replaced by the "Commitment Theory" where directors affiliate with firms for some intangible greater good of "wishing to contribute". This might indicate a closer and more deeply rooted connection with the outcomes and ideals of firms, and we explore the foundations for this commitment. We also identify a set of leadership skills which are likely to be required from company board directors, in order to convert their enthusiastic commitment into practical relevance. We conclude that committed board directors are essential to establishing good leadership in companies.

1.   INTRODUCTION

The elected board of directors is a team which leads a corporation. The diversity of the team, along with its shared visions and goals, is essential to leading a successful corporation. As the evolution of the corporation is examined it becomes very "clear that every change the corporation form has undergone has been directed toward the corporation's own perpetuation and growth" (Monks & Minow, 2004). A corporation's probability of success is enhanced if it has the right moral leaders, satisfied stakeholders and communicates truthfully throughout all levels. Today, "several prevailing challenges facing directors remain unresolved; director accountability and personal liability, the separation of the chair and CEO roles, director stock ownership, board diversity, director interlocks, director performance stock card, and rotation of audit committee members."(Alpaslan, Green, Mitroff, 2009). Moreover, today's directors need to consider and balance the interests of numerous stakeholders. With so many unanswered questions it is no wonder "it takes a blend of leader, magician, and politician to find that special balance" (Charney, 2006) needed to be a successful corporate leader.

2.   STAKEHOLDER THEORY

"A chief executive is like the conductor of a large orchestra" (Adair, 2003). A chief executive must protect the interests and work towards the benefits of all stakeholders. Stakeholders are "people who have an interest, claim or stake in an organization" (Charney, 2006). This means that directors must take into account shareholders, customers, employees, suppliers, the government, and the local community when bringing decisions and deciding on strategies.

Shareholders are the owners of the organization and thus are the constituents to whom the corporate board is directly accountable. This view has meant that in the past the directors focused mainly on maximizing shareholder wealth. However, "a recent study at Harvard University found that 'stakeholder-balanced' companies showed four time the growth rate and eight times the employment goals when compared to companies that are 'shareholder-only focused' " (Zsolnai, 2004). This means that shareholder-only focused management is perhaps not the best approach. If all stakeholders need to be satisfied and if the organization shows better performance, and thus profit, as a result of balancing, the director's "goal will be to merge the interests of all parties so that everyone gets something out of it and the organization prospers. The ideal relationship is mutual trade to mutual benefit" (Ciulla, 2004).

It is essential that the board of directors be committed to the organization and its stakeholders. In order to be able to satisfy all stakeholders the director first needs to understand them. As stakeholders hold different positions they also have varying interests and agendas that need to be satisfied. Shareholders want to maximize return on their investment. Customers want "product reliability and product value." Employees want career prospects, good work environment and compensation. The local community's "well-being is strongly affected by the success or failure of local business"and they want the organization to be competitive with overseas companies, as well as act in a "socially responsible way." (Charney, 2006). The government wants an organization that abides by the Corporate Governance laws. Without an understanding of each individual stakeholder the board of directors cannot bring decisions which will ensure the satisfaction of all, and thus the success of the company will be compromised.

Kacperczyk (2009) argued that balancing the interests of all stakeholders – institutional (community, natural environment, and minorities) as well as technical (employees and customers) stakeholders is beneficial for the society on the whole. Examining how corporate governance affects firms' attention to non-shareholding stakeholders, the authors showed that attention to all stakeholders will increase if takeover threats are absent. Under such circumstances "incumbent CEOs expand their attention to institutional stakeholders, such as the community and the natural environment that are indirectly connected to the public corporation." Also they found that the firms which paid attention to all the stakeholders achieve higher growth and add to the value of shareholders. Alpaslan et al. (2009) suggested that adopting stakeholder approach and principles will assist the firms in managing crisis. They however, pointed out that more research is required on how stakeholders can manage crises efficiently and effectively.

3.   SEPARATION OF OWNERSHIP AND CONTROL

"Corporation law virtually carves the separation of ownership and control into stone (Monks & Minow, 2004). The organizations have grown too big and the number of shareholders has increased to such an extent that the ownership control is no longer possible. "Under all corporation statutes, the key players in the formal decision-making structure are the members of the board of directors who are empowered to make or delegate to employees most decisions affecting the business and affairs of the corporation. Shareholders have essentially no power to initiate corporate action, and indeed, are entitled to approve or disapprove only a very few board actions (Monks & Minow, 2004). The control of the organisation has thus been removed from its owners, the shareholders. This was done with the best intentions, but has proved to be a very controversial issue.

Fama and Jensen (1983) argued that separation of ownership and control leads to agency problems. Thus, in most complex organizations, residual claims are diffused among many agents. When there are many residual claimants, it is costly for all of them to be involved in decision control. As a consequence there is separation of residual risk bearing from decision control, and this creates agency problems between residual claimants and decision agents. Separation of decision management and decision control at all levels of the organization helps to control these agency problems by limiting the power of individual agents to expropriate the interests of residual claimants.   The board of directors has an important role to play. The board, according to Fama and Jensen (1983), ratifies and monitors important decisions and chooses, dismisses, and rewards important decision agents..

In the context of US firms, Bainbridge (2008b) argues that separation of ownership and control and distance of the shareholders from the board lead to efficient outcomes. Even the presence of strong institutional investors has mattered little to reduce the separation between ownership and control.

The board is seen to be comprised of professionals and experts who are better equipped than shareholders to lead an organization. Thus, it was seen that they would act in the welfare of the company and, therefore, in the interest of the shareholders who had neither the time, means, nor the expertise to lead the organization themselves. However, several times it has proved that directors did not act in the best interest of the shareholders and the organization. Instead they acted for their own personal financial gains, and this is where the problems between the separation of control and ownership arise. "There is a

risk that directors or managers will expand firm earnings on projects benefiting themselves, rather than shareholders" (Bainbridge, 2008a).

However, "vesting decision-making power in the corporation's board of directors and managers allows shareholders to remain passive, while also preventing the chaos that would result from shareholder involvement in day-to-day decision making" (Bainbridge, 2008a). The theories on corporate governance have moved to incorporate all stakeholders and to look at the diversity of inside/outside directors on a board to ensure that the interests of those who own and those who control the organization align.

4.   INSIDE/OUTSIDE DIRECTORS

Not only does the corporate leader need to balance among stakeholders, he or she also needs to find the right balance between the inside and outside directors sitting on the board. "No director qualifies as independent unless the board of directors affirmatively determines that the director has no material relationship with the listed company (directly or as a partner, shareholder, or office of an organization that has a relationship with the company.)" (Rezaee, 2009). The outside directors are perceived to not be biased, as they have no personal or financial relationship with the company, and are therefore more adept at bringing objective decisions concerning the welfare of the company. "Outsiders have neither the time nor the information necessary to be involved with the minutiae of day-to-day firm management. What outsiders can do, however, is to monitor senior management and replace those whose performance is sub par" (Bainbridge, 2008a).

The inside directors can feel threatened by outside directors and have a fear of loosing control over 'their' company. However, as the inside directors have personal or financial ties to the company it is easy for them to be subjective. It can also be hard for them to fire people that they have worked with for a long time and developed a relationship with. Independent directors also bring diversity and a range of skills to the board, especially if some of them come from non-business backgrounds. The board of directors which encompasses people who come from varying sectors, such as the environment, human resources, health and safety and consumer relations, as well as of different gender, nationality, ethnicity and age group, will ensure that there is a diversity of opinions. A diversity of opinions will in turn ensure a more informed and thoughtful decision. "The quality of director's independence, influence, and ability to act independently as well as be an effective balance to executive directors is more important than the number of independent directors" (Rezaee, 2009).

Thus, it is the balance of directors, their skills, knowledge and personalities, and their ability to function collectively towards the same goal that is of the utmost importance. Rowe and Rankin (2002) argued while it is commonly suggested that insiders need to have more power than the outsiders for better strategic control, and outsiders to have more power than the insiders for more financial and strategic control, an alternative scenario is when both insiders and outsiders have equal powers and the manner in which this is achieved would depend on the firm and board.

Small and medium businesses which make up most of New Zealand business world, find it hard to attract prospective and good outside directors, but data shows that the benefit and the need for outside directors has been widely acknowledged. Taking five firm characteristics into account: inside share ownership, variance of aftermarket returns, operating history, leverage, and firm size, Mak (2006) on the basis of initial public offerings made by 110 New Zealand firms showed that while firms without any operating history used more outside directors, greater variance of aftermarket returns and lower inside share ownership are also related to higher share of outside directors. His study found that leverage and firm size are not related to the proportion of outside directors. Overall, Mak (2006) concluded that the use of outside directors leads to reduced agency problems. In the New Zealand context, Hossain et al. (2001) looked at whether impact of board composition on firm performance was influenced by Companies Act of 1993, the Financial Reporting Act of 1993, and related legislations. These legislations had significant implications for the outside directors. The results of the study, however, suggested that these legislations which had the objective of introducing accountability for outside directors and imposing liabilities for lapses in oversight had little impact on the relationship between outside board directors and firm performance. In any case, the authors reiterated the proportion of outside directors in New Zealand firms

has a positive impact on firm performance. They, however, found the impact of legislations on outside board directors and firm performance to be negligible.

Hossain et al. (2000) examined whether composition of boards differs between high and low growth firms and whether the use of outside directors is related to the firms investment size. Their results based on the cross sectional tests of 77 New Zealand firms suggested that high growth and the use of outside directors are related to each other. They showed that the proportion of outside directors is significantly and positively related to firms investment opportunity set (IOS), leverage, and number of board meetings, and is significantly and negatively related to low levels of inside ownership and firm size. In contrast, CEO tenure and high levels of inside ownership are not significantly related to the proportion of outside directors. They argued that uniform mandatory policies regarding the inclusion of outside directors in firms may not prove to be beneficial from the society's point of view. Orr et al. (2005) also using New Zealand firm level data in a randomly chosen sample found that board composition such as, characteristics of outside directors (tenure of outside directors, level of outside director equity ownership, number of other board positions held by outside directors, and total proportion of non-executive directors, including grey directors) of high growth firms is positively related to firm value.

The problem of choosing the right director arises and the "emerging trends…point to a future where technical skills will have less currency than those associated with 'human factor management" (McManus, 2006). This is not to negate the importance of technical skills and knowledge, but there is a recognition that there is a greater need for skill dealing with intrapersonal and interpersonal issues, particularly with stakeholders and senior levels of management" (McManus, 2006). To lead a company a director needs to have adequate skill and traits which will enable him/her to not only fit into the already existing environment of the firm, but also to improve it and, if need be, change it.

5.   THE ROLE OF THE BOARD

"The modern board of directors thus is properly understood as a production team whose product consists of a unique combination of advice giving, ongoing supervision, and crisis management" (Bainbridge, 2008a). A board's role is to lead the organization; to identify where it is and where it wants to go in the future, and find a way to bridge this gap. Nadler (2004) observed that, "the high-performance board, like the high-performance team, is competent, coordinated, collegial, and focused on an unambiguous goal" (p. 104). He noted that there are several possible levels of board involvement, such as, passive board, certifying board, engaged board, intervening board, and operating board. However, this is not a strict classification of boards and various roles may overlap each other. The directors and CEO may decide on the engagement level of the board in the firm. The passive board is obviously the least engaged board, while intervening and operating boards are the most engaged boards. To be effective the key requirements in board formation are the right mindset; right role; right work; right people; right agenda; right information; and right culture. It is also important that the board members get the job satisfaction, as Nadal (2004) noted "at its most effective, board building contributes not only to performance but also to member satisfaction."

A lead or presiding director is a figurehead who leads a board. His or her position is to "manage and facilitate the board's governance process; provide a measure of board independence from the CEO; develop the board's agenda for meetings; act as a liaison among the board, the CEO and shareholders; preside over executive sessions; oversee governance related activities and processes; and oversee significant issues between board meetings and inform the entire board about these risks" (Rezaee, 2009). Modern practices show that it is best that the board be chaired by an "independent, non-executive director, and only under limited and unique circumstances should the two distinct roles of the CEO and the chair be combined" (Rezaee, 2009). Many small and medium businesses find it hard to either attract a good independent lead director or to find substantial financial means to pay them. However, appointing an independent lead director "is essential to the proper and objective functioning of the board" (Rezaee, 2009) and the CEO. It is essential that the director appointed, whether an outsider or an insider, want the position and the responsibilities it brings for the right moral reasons, and not for financial gain or prestige, to ensure that they bring about rational decisions based on the welfare of all stakeholders.

6.   LEADERSHIP SKILLS

"The need of firms to survive and prosper in a world of increasing competition, of technological advances, of changing environmental regulations, of changing worker attitudes requires a higher level of leadership than before" (Vecchio, 2007). Thus, the CEO or the director does not necessarily need to be very skilled in the technical aspects of the firm, but rather be equipped with a set of skills and personal traits required to lead. There is a predominant view that leaders are born, not made, although "all leadership qualities can be developed-some more than others-by practice and experience" (Adair, 2003). First of all people need to want to be leaders for the right reasons; to do good for the company and themselves. Leaders need to exhibit integrity, enthusiasm, warmth, calmness, consistency, focus, humility, tenacity, strategic thinking, "an ability to articulate their vision to others" (Levinson, 2006), along with many other qualities. Harry Levison has "organized 20 personality dimensions into three groups according psychological themes" (Levinson, 2006), but stresses that "people are always more complicated than the rubrics we use to describe them. Behaviour is too elusive for fixed categories" (Levinson, 2006). The following are the dimensions of the leader' personality traits. Nobody will score highly in each category and therefore the specific needs of the company need to be taken into account when the right director is being chosen.

Dimension one: Thinking;
1. Capacity to abstract, to conceptualize, to organize, and to integrate different data into a coherent frame of reference.
2. Tolerance for ambiguity, can stand confusion until things become clear.
3. Intelligence, has the capacity not only to be abstract, but also to be practical.
4. Judgement, knows when to act.

Dimension two: Feelings and Interrelationships;
5. Authority, has the feeling that he or she belongs in a boss's role.
6. Activity, takes a vigorous orientation to problems and needs of the organization.
7. Achievement, orientated toward organization's success rather than personal aggrandizement.
8. Sensitivity, able to perceive subtleties of others' feelings.
9. Involvement, sees oneself as a participating member of an organization.
10. Maturity, has good relationships with authority figures.
11. Interdependence, accepts appropriate dependency needs of others as well as of him or herself.
12. Articulateness, makes a good impression.
13. Stamina, has physical as well as mental energy.
14. Adaptability, manages stress well.
15. Sense of humour, doesn't take self too seriously.

Dimension three: Outward Behaviour Characteristics;
16. Vision, is clear about progression of his or her own life and career, as well as where the organization should go.
17. Perseverance, able to stick to a task and see it through regardless of the difficulties encountered.
18. Personal organization, has good sense of time.
19. Integrity, has a well-established value system, which has been tested in various ways in the past.
20. Social responsibility, appreciates the need to assume leadership with respect to that responsibility (Levinson, 2006).

Newcomb (2006) pointed out that broadly board members have two types of responsibilities- governance and support. To perform these two responsibilities effectively, the strategy is to be inquisitive and ask insistent questions. Some other qualities which Joyal (2006) pointed out for effective board membership are: active listening skills, good arbitration skills, flexible attitude and open to change, and a visionary perspective. He observed, "Listening actually is more important for a leader than speaking, Active listening helps you understand how others feel about topics. It also encourages constructive dialogues among directors and management, particularly when it pertains to time-sensitive matters." Also another skill required is, "to know when to open up necessary dialogues that help prepare the board for challenges and rewards of the future (Joyal, 2006)."

On leadership skills, Collins (2005) argued that the key requirement for a company to reach great heights is to have a Level 5 leader, that is, a leader who has contradictory qualities of both personal humility and

very strong professional will[1]. He pointed out that although leaders at other levels can reach high levels of success, yet it is the Level 5 leader alone who can make an organisation excel and reach great heights of success. The other key drivers along with level 5 leader are getting committed staff with the right skills set, strong culture of discipline and strong consistent efforts.

7.   INTEGRITY, TRANSPARENCY AND TRUST

"The rational leader will not take the job unless it is personally important to him or her" (Ciulla, 2004). People want to lead and make motivated leaders when they perceive that what they are doing is good for themselves, their family, their organisation, and their local community. Thus a good lead director will be in the job for the greater common good. "The common good goes beyond the individual level and belongs to all members of the firm, enabling them to achieve their personal goals" (Zsolnai, 2004). A good leader needs to be able to balance the organization and give it a clear vision of where to go.

Hardy (2007) argued that leader should not only lead but should also be oriented to creating a knowledge driven organisation - a key ingredient of which is transparency and trust. According to him "trust should be accepted as a key ingredient for organizations to evolve beyond the *industrial* type of organization by enabling the *knowledge-driven* organization. Furthermore transparency is needed to create trust." Trust creation is also dependent on integrity, consistency, coherence, and behaviour and is built on the process of knowledge exchange, sharing and understanding. Besides trust, innovation is another key requisite for leader in knowledge driven economy. Thus "creating an environment supportive of imaginative thinking and reflection on problems, causes and future solutions is a small requirement for innovation to flourish." Also the leaders need to remain open to new ideas for innovation to take place. Also the leaders also need to be collaborative for enhancing firm productivity and knowledge management.

He or she also needs to exemplify the virtues required from all levels of employees. Acting in a way which does not personify the goals, ideals and values expressed by the director themselves will make the director appear hypocritical and untruthful. If other employees perceive the employer to be untruthful they "are less likely to volunteer ideas or information the leader needs to know. They are more likely to question the leader's motives. They are less likely to give the leader 100-percent effort" (Charney, 2006). Without trust leadership is impossible. Communication plays a vital part in gaining and developing trust. "Communication is to some degree a science and is also an art form, and can only be derived from a real understanding of people" (Vecchio, 2007). Therefore in order to be able to communicate with the managers, the directors need to get to know them.

The most dangerous thing within an organization is untruthful communication of lower to upper levels. Managers always know more about the company than the directors as they are involved in the day-to-day, minutiae dealings and they also have first-hand knowledge of how the employees within the varying sectors are operating. A director who supports and respects open communication is more likely to hear the negative aspects of the organization, and therefore be able to deal with them before they escalate.

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[1] Collins suggested that there are 5 levels of leaders, and level 5 is the highest in the hierarchy. Level 1 (lowest in hierarchy) is a highly capable individual who has talent, knowledge skills, and good work habits; Level 2 is contributing team member who contributes to the team objectives and works effectively with others in a group setting. Level 3 is competent manager who can organise people and resources for achievement of pre determined objectives. Level 4 is a committed leader who is committed to strong pursuit of a clear vision and inspires the group to reach high standards. Collins further suggested that the 'yin and yang' of twin pillars of level 5 leadership-*personal humility* are: i) a compelling modesty, shunning public adulation; ii) quiet, calm steely determination; relies principally on inspired standards, not charisma, to motivate; iii) places company's growth over personal growth; sets up successors for even more greatness in the next generation; iv) for poor results, does not other people, external factors, or bad luck. Level 5 leader with the qualities of *professional will* i) leads to superb results, ii) has strong will power and determination despite insurmountable difficulties; iii) sets high standards and iv) acknowledges and attributes success to 'other people, external factors, and good luck'.

After all, "directors are beholden to management for nomination, compensation, and information" (Monks& Minow, 2004).

8.   METHODOLOGY

Since 2006, we have distributed an annual web-based governance survey in New Zealand, and in 2008 also in Canada, through a number of corporate staleholders in the governance debate in both countries (chambers of commerce, government departments, large banks, law firms, executive recruiters, shareholder associations, venture capital associations, chartered secretaries assocation, universities and industry groups). Although we have no control over the distribution methodology of each of those distributors, we believe that the 5,000+ responses are statistically respresenattive of the types of business, in location, size and industry, operating in New Zealand. In Canada, the sample comprised about 150 responses.

9.   DATA ANALYSIS

We note that in both countries shareholders seem to support the notion that boards must include diverse skills. Shareholder preferences cluster around a track record of business success, communication skills (specifically with shareholders), company-specific market and product knowledge and a good reputation. This result reveals the importance to shareholders of functional contributions of directors in specific talent areas. Any suggestion that boards, in representing the interests of owners, are expected by these owners to exhibit only the bare minimum oversight required by law, is not supported by our data.
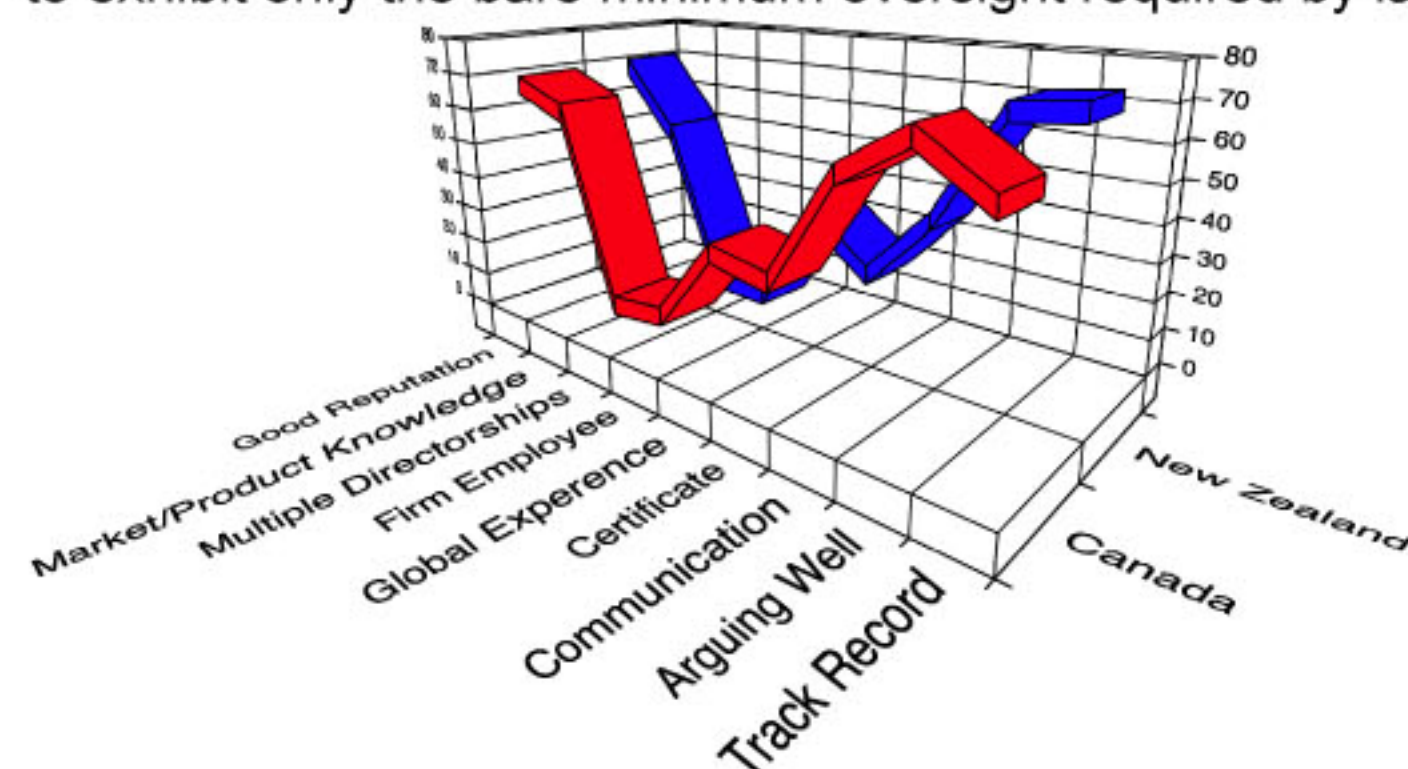
Graph 1: As a shareholder, how important are these attributes in a Director?
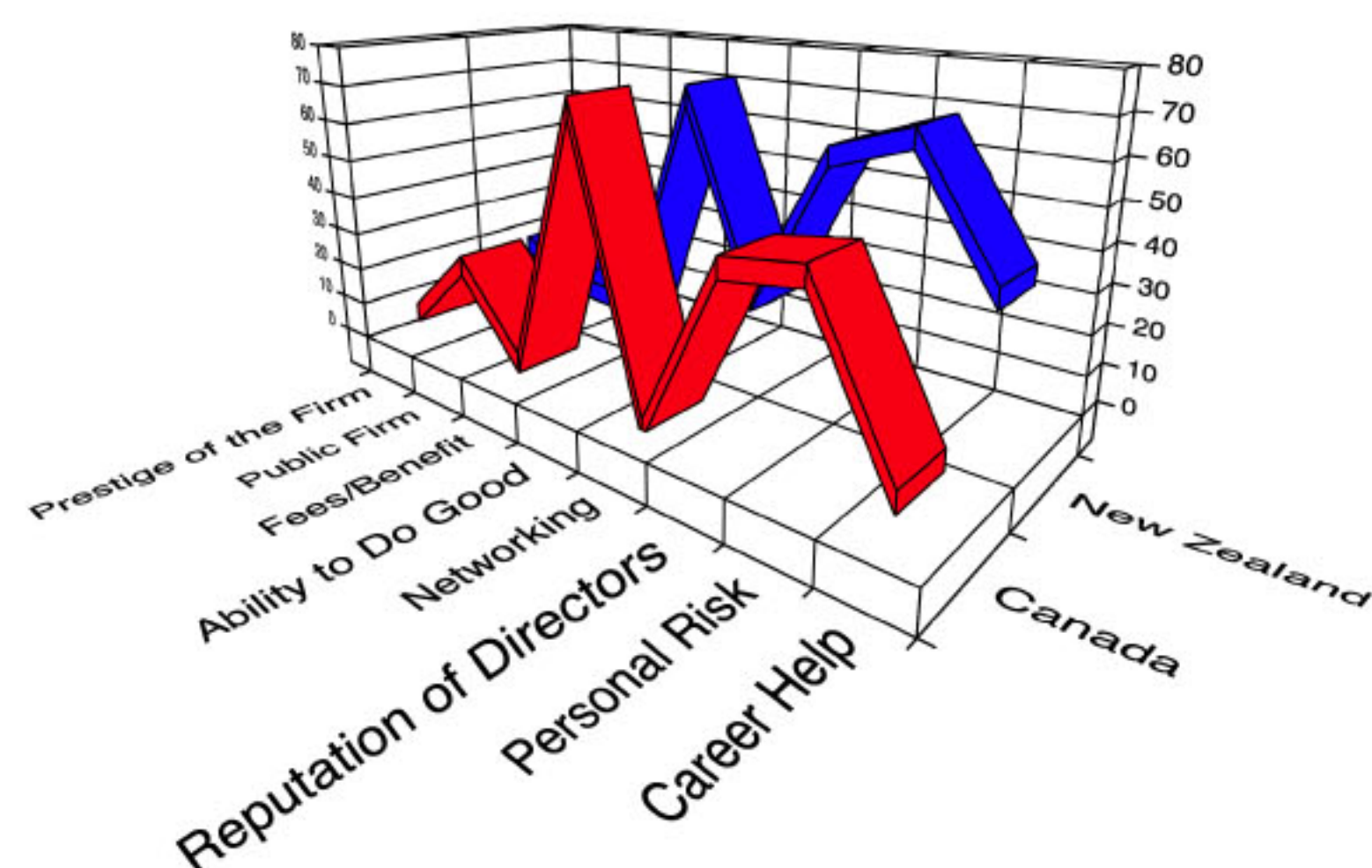
Graph 2: If you were offered a Board position now, how important would each of the following factors be for you? Note: New Zealand has laws under which unlimited personal liability can be apportioned to directors when their firm trades while insolvently, and thus the concern over 'personal risk' is markedly greater higher here than in other countries we have reviewed.

We also find that directors do not see themselves in a narrow oversight role. Directors in both countries declare that their overwhelming motivation for joing a new board is the ability "to do good" which suggests an impressive level of motivational engagement. Although this broad declaration will require more follow-up to identify specific drivers, we suggest that this motivation to become engaged requires firms to provide opportunities for directors to go such good, and for directors to clearly articulate what those requirements might be.

Taken together our findings and other findings in the literature point to the board's value as the firm's premier leadership entity. While it is true that corporate boards have certain minimum legal responsibilities which must be met, they are positioned to be much more than that. With a focus on the important leadership attributes discussed earlier in this paper, boards can move toward achieving this potential.

10.   CONCLUSION

"The board of directors has evolved over time as the corporate form has evolved in response to changing economic conditions" (Rezaee, 2009). A committed director who is in 'it' for the right moral reasons is essential in leading the corporation in the right direction, and we propose that this motivation of directors has begun to shift away from the legal duties of a shareholders' agent to that of an independently motivated board member. The prestige and money that the directors enjoy is no longer the motivating factor of today's directors, especially in New Zealand where independent salary reviews have shown a significant compensation lag compared to its nearest neighbour, Australia. Studies have shown that directors want to improve the community within which they live, the organization they work for as well as feel proud of the work that they are doing. "The future challenges for boards of directors are in the areas of executive compensation, CEO succession, strategic planning, risk management and assessment, and corporate sustainable performance on economic, social, governance, ethical and environmental matters" (Rezaee, 2009). The appointment of the right committed leader as opposed to the right business person will ensure that the corporation is led successfully but also requires the firm to recognize that directors join with a complex set of commitment ideology to which the entity must cater to create a long-term engagement.

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