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The business school that thinks and lives in the future

# The role of non-executive directors in Dutch firms

by Michiel Wolfswinkel

**According to recent research, the traditional belief that companies could suffer in performance terms if members of the supervisory board have too many commitments elsewhere needs to be revised.**

*The number of supervisory boards of Dutch listed companies of which an individual may be a member shall be limited to such an extent that the proper performance of his duties is assured; the maximum number is five, for which purpose the chairmanship of a supervisory board counts double. Dutch Corporate Governance Code (III.3.4).*

That it's time to revise the belief that over-busy supervisory board member can have a detrimental effect on companies is one of the conclusions to be drawn from my recent research into the nature and impact of corporate governance. This resulted in the award of my PhD in March this year following the publication of *Corporate Governance, Firm Risk and Shareholder Value of Dutch Firms*.

Although the research is concentrated on Dutch firms and continental European-style Supervisory Boards, the lessons learnt are just as relevant to, and applicable by, Anglo-Saxon corporate boards. What, after all, is a non-executive

director (NED) but a member of a de facto Supervisory Board?

Whether they are called Supervisory Board members or NEDs, the function remains the same: to supervise and provide advice and guidance to the management board, drawing on the skills and experience gained elsewhere. I have experienced this directly during my own career as a Chief Financial Officer.

## Gut feelings

In my work life, I became increasingly aware of the effects of human behaviour on corporate finance decision making. I observed that the CEOs with whom I worked were relying on their experience and gut feel more often than on a rational decision making process.

I noticed that in decision making many unwritten rules of thumb were being applied. I experienced the value of informal contacts and the power of being part of a network. I could feel the intrinsic boardroom tension between members of a Supervisory

Board and members of the Executive Board, at times vehemently arguing and challenging each other's views. With human behaviour playing such an important role in a firm's corporate governance and decision making, what would be the implications for that firm and its value?

One instance involved the need for the installation of a new IT system to improve the risk management function at the company where I was working. After I had outlined the problem and possible solution to the President of the Supervisory Board, he pointed out that another company, where he was also a Supervisory Board member, had faced up to the same challenge in a similar manner, but made a number of mistakes during the planned and implementation processes. He recognised the issues immediately, and initiated a dialogue with that company which enabled us to avoid making the same mistakes.

## Underlying fear

There is an underlying fear amongst regulators in the Netherlands, and in the Anglo-Saxon economies, that if Supervisory Board members are too busy they will not be able to keep their eye on the various balls they are responsible for following. A stream of literature contends that if they are too busy, the companies with which they



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are involved have inappropriately high-risk profiles.

The first step in my work was to compile a data set of Dutch companies. Once this was in place, I was able to begin analysing connections between different boards, people and financial institutions. I also built a number of

risk metrics, separating, for instance, company-specific risk from market risk (beta). I then examined risk aversion, wondering if it would be possible to identify boards shying away from making risky decisions, and began to come to what some might feel to be surprising conclusions.

As I have already noted, mainstream thinking has it that the busier Supervisory Board members are, the riskier their companies are. I have tested this accepted wisdom and have found that it is simply not true. There is no positive relationship. If anything, the relationship is a negative one. Double, triple, or quadruple functions on a Supervisory Board are a node through which risk is reduced. I believe that this fear is unjustified. Up to a certain level (as yet unidentified), the busier the individual Supervisory Board members are, the better it is for their companies. Their “busyness” brings new skills, knowledge, perspectives and relationships.

This has clear and important implications for boards seeking to hire new members to plug any gaps that might have arisen in their own profile. They should be looking to recruit from the ranks of well-connected existing Supervisory Board members. You want them because they are busy with relevant matters.

Coincidence of events and characteristics does not in itself, of course, prove the existence of a cause and effect relationship. The direction of any possible causality is a key concern in any serious analytical work. The introduction of a time lag is one of the features that make my own analysis viable in this respect. Except ▶

# The role of non-executive directors in Dutch firms (continued)

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in truly exceptional circumstances, a corporate Board will not be changed overnight. Examining a company's risk profile from year to year helps identify the relationship between individual appointments and subsequent corporate behaviour.

## Regulatory initiatives

Trends in corporate governance and in the expectations that people have of Supervisory Board members or NED have changed and gathered pace in recent years. At the beginning of the

At the 2005 CGA Accounting Research Centre conference, it was stated that internationally, trends in corporate governance can be viewed from the perspective of board stewardship, operations, independence, and disclosure. The rules and guidance relating to these board activities illustrate a number of interesting trends.

First of all, there continues to be a move from guidance to regulation. In the US, this trend is being reflected primarily in the areas of codes of

structure. However, in recent developments, greater attention is given to skills and ethics. This reflects back on the efforts of board members.

The overall effort required from board members continues to increase due to the increasing number of board meetings and the increasing number of subcommittee meetings they are supposed to attend. The enhancement of the roles and responsibilities of corporate boards has tended to heighten the natural tension between the dual roles required of these boards. They must be advisers to senior management, and carry a fiduciary responsibility to shareholders.

What is the next step? To me it is clear. If it is good to be connected, then what is the ideal number of such relationships? We do not know; that needs to be researched and tested. Perhaps a reader might think of taking this work to the next level.

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His dissertation *Corporate Governance, Firm Risk and Shareholder Value of Dutch Firms* can be found at: <http://repub.eur.nl/res/pub/39127/>

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millennium, a series of governance failures at US firms such as Enron and WorldCom, and European firms such as Ahold and Parmalat, caused a wave of regulatory initiatives aimed at improving corporate governance. The debate on corporate governance has continued to thrive since. Most recently, the OECD has stated outright that the financial crisis that began unfolding in mid-2007 can be attributed to an important extent to failures and weaknesses in corporate governance.

ethics, audit committee structure, and the separation of CEO and chairman of the board. The Netherlands still operates more from a principle based background and uses the “comply or explain” principle that allows firms to either comply with the Corporate Governance Code or explain why it deviates from the Code.

Developments in a firm's governance are also visible in the board's skills. Initial initiatives were aimed at improving a firm's governance

