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TABLE OF CONTENTS

THE ROLES OF THE BOARD OF DIRECTORS IN LISTED COMPANIES IN BRAZIL

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ABSTRACT

This paper provides an in-depth analysis of roles, activities and working style of the board of directors in a sample of 65 Brazilian listed firms. We use two survey questionnaires sent directly to directors, executives and firms to capture an insider perspective about the roles and activities played by Brazilian directors. We analyze the relationship between ownership type and structure, firm's characteristics and the composition of the board, showing evidence on how these factors interact and affect the firm's governance. Our findings show evidence that Brazilian boards are dominated by directors elected by the controlling shareholders and that independent directors are less present than recommended. The functions of CEO and chairman played by the same person is not a major concern; the power concentration is more important as boards are often chaired by relatives of controlling shareholders or themselves. Power concentration can be observed also in the relevant frequency with which shareholders relatives hold CEO positions. The absence of a family-related chairman is associated with a more active, deliberative and relevant board. This study contributes for market agents and the academic literature by drawing a realistic image of the board set in a prominent emerging market.

Keywords: roles of the board of directors; corporate governance; ownership structure and concentration of power.

1. INTRODUCTION

The activities and procedures of the board of directors are among the main elements that determine the quality of corporate governance practices of public companies. However, there is a significant discussion about the roles and functions played by the board on business and how this may affect the firm performance.

In the last years, most academic researchers were based on public external data about the boards (Hermalin; Weisbach, 1991; Yermack, 1996; Bhagat; Black, 1999). We believe it is necessary to develop more than a demography-outcome approach so that the implications of the board's characteristics in its performance can be understood.

For this reason, we propose in this study to analyze an insider, deeper and quantitative approach regarding the directors' activities and functions.

This research employs two survey questionnaires, containing questions about the board activities and work style, 122 executives and directors of 65 Brazilian listed firms present their insider perception of the board's roles and activities, which is confronted with firm's characteristics and governance structure.

Similar studies using survey questionnaires can be found in Hendry, Kiel and Nicholson (2010) and Jones, Marshall, Mitchell and Ramsay (2007).

This paper brings three contributions to the study of boards. Firstly, it analyzes the relationship between ownership type and structure, firm's characteristics and the composition of the board, showing evidence on how these factors interact and affect the firm's governance in listed companies in Brazil. Secondly, it identifies the roles performed by boards and how board's characteristics and firm's governance affect them.

Our results indicate that Brazilian boards are largely dominated by controlling shareholders and the participation of independent directors is still below the recommendation of the Brazilian code of best practices (IBGC, 2009) and by several authors, among them, Saito and Dutra (2006), Black, Carvalho and Gorga (2008).

In line with previous findings from studies in Brazil (Black; Carvalho; Gorga, 2008; Kpmg, Ceg, 2008), the accumulation of chairman and CEO positions is not a major problem in Brazilian companies. More critical is the concentration of power by the chairman, who in most cases are also the controlling shareholder himself or a relative to the controlling family. It is also relevant the frequency of CEOs being family members or relatives of the controlling shareholders.

Regarding the roles of the board, it was observed a predominance of activities related to the control role. The guidance role (strategy and policies) is also relevant, confirmed by the number of committees. The service role however is less relevant in the boards. The predominance of the control and guidance (strategy in his case) roles was also observed by Stiles and Taylor (2001) in the UK.

The presence of family members of the controlling shareholders in the positions of chairman of the board or CEO is related to greater relevance given to the service role.

The major gaps observed by respondents in relation to the activities of the board are: (i) not to direct matters of succession, (ii) not to monitor risks, (iii) not to actually decide on the company's strategy, (iv) not to monitor the performance of executives and the company, (v) not to establish contacts of interest to the company.

As main contributions, this paper is the first to our knowledge to analyze the roles of the Brazilian board of directors using primary data collected through questionnaires. Additionally, it provides an important insider view of the boards for a prominent emerging market. Policy strategies and corporate governance guidance can be derived by market regulators by this study. The results of this research may contribute to future theoretical models of corporate governance that aim to be more inclusive and customized.

This paper follows this sequence: the section 2 presents a literature review, section 3 details the sampling method and tests procedures, section 4 describes our results and section 5 concludes.

2. LITERATURE REVIEW

According to Hermalin and Weisbach (2001), empirical studies about the board of directors focus on understanding how their size and composition affect their own decisions and consequently the corporate value. This sort of research lacks a deeper comprehension of how boards work and interact with other corporate governance mechanisms.

Additionally, the most common theoretical models lack of detailing to capture the complexity contained in the board of directors' activities. Also, the vast majority of empirical studies were carried out in countries where the capital market is more mature and developed. So most of them use theories better suited to that reality. The concentration of ownership in Brazil creates a different environment from that prevailing in boards of directors of countries where there is widespread ownership. Bebchuk and Hamdani (2009) argue that the ownership structure is a fundamental piece to understand the corporate governance system. The authors show evidence that measures protecting outside investors in companies without controlling shareholders are often irrelevant or even harmful when it comes to investor protection in companies with a controlling shareholder, and vice versa. Consequently, analyzing corporate governance practices regardless of ownership structure can lead to serious mistakes and misinterpretations. Therefore, the quest for global governance standards should consider separate methodologies for assessing governance in companies with and without a controlling shareholder

In Brazil, the most frequent agency problem is found between minority shareholders and controlling shareholders. As Brazilian firms usually have their ownership concentrated in controlling blocks, such as those of the founding families, some minority shareholders' interests can be ignored in the benefit of the controlling block as in other emerging markets. This evidence is supported by the works of La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998) and Nenova (2000). In other countries, such as the United States or United Kingdom, the most common agency problem is found among firm's executives (specially the CEO) and the shareholders, since the pulverized ownership structure provides space for managerial discretion.

Due to this concentrated ownership structure, Brazilian boards are dominated by controlling shareholders' representatives. Previous researches (Black; Carvalho; Gorga, 2008) found evidence that boards are "comprised entirely or almost entirely of insiders or representatives of the controlling family or group. Many firms have zero independent directors." Additionally, board independence is an area of weakness, in Brazil, according to the authors. For Leal and Oliveira (2002) the effects of concentrated ownership is seen on the board's composition: most board members are not shareholders, but representatives of the controlling shareholders. Less than 21 percent of board members are independent and only 2 percent of them are elected by independent shareholder groups.

Leal and Oliveira (2002) also argues that Brazilian companies are commonly controlled by family groups or through shareholders agreements. The authors list a series of weaknesses found in Brazilian boards, such as: 1) invalidity of one-share-one-vote concept: controlling shareholders hold a very large portion of voting shares, much more than the minimum necessary to retain control; 2) widespread evidence of shareholder expropriation, since legal protection is weak; 3) stock issuance has been halted by low valuations and tax avoidance. Besides, they find that board procedures are rarely formalized and evaluation of CEOs is not a common practice.

For a better understanding of these particularities, this research proposes a multitheoretical approach about the roles of boards. Ruigrok, Peck, Tacheva, Greve and Hu (2006) support this view and affirm that a multitheorical approach may better capture the complexity of a corporate governance system. From the proposal that a multiple perspective can broaden the understanding of the problem situation, this research relied on the economic theories of organization - agency theory, transaction costs' theory, theory of the property rights, the prospects for theories of organization - stewardship (leadership, management) and resource dependence theory and the theory of stakeholders, derived from studies of politics, law and administration.

Zahra and Pearce (1989) join four major theoretical approaches together to produce an integrative model for the board of directors. The authors observe three roles for the board: service, strategy and control. Demb and Neubauer (1992) attest there is no theoretical framework for comparing different systems of corporate governance among different cultures and markets.

The needs of a multiple approach to understand the board is a result of its multiple functions. The control role is based on the agency theory, while the service role includes multitheoretical perspectives (Van Den Heuvel; Gils; Voor Deckers, 2006). The model of Fama and Jensen (1983) supports this view in regards to the strategic role of the board and suggests that the manager (agent), in general, is the one who should initiate the decision-making process, generating a proposal to be undertake by the company so that, in the next step, the board can approve the proposal or not. Implementing the proposal is, once again, a manager's responsibility. And it is a role of the board to monitor and evaluate how the manager implements the proposal. In this study, it was sought to determine whether the model applies to the environment with concentrated capital, such as Brazil, where controlling shareholders are part of the effective control of the organization.

Arguing that there is a trend in the literature to make board roles mutually exclusive and collectively exhaustive in the sake of categorizing, Jonsson (2005) argues that the roles are not always comparable in the studies, although the label used could be the same. The following table shows the labels used but the different researches and what they understand by the roles attributed to the board. This conceptual framework is related to this research's variables, described in the next section.

TABLE 1: NOMENCLATURE OF BOARD'S ROLE ACCORDING TO THE LITERATURE

Author	Nomenclature and understanding of board's role according to the researcher			Number of roles
Mace (1971)	**Advisory** - The role of the board is mainly advisory and not decision-maker. - The management conducts day-to-day decisions and directors act as a source of advisory and suggestions to the management.	**Discipline** - The board disciplines the executives. Even without investigative questions, the mere existence of directors meeting induces the management to be careful with firm's numbers and reports. - The board does not take the decisions indicated by the CEO. The board's approval is superficial. - The board acts as a 'collective consciousness' (p. 97). The board is seen as a gatekeeper of the external world and it assures that the executives will not misbehave.	**Decision-maker in times of crisis** - Select the next CEO in case of death of incapacity. - When the CEO leadership and performance are so poor that a replacement is necessary. Directors do not effectively evaluate the CEO, as they are elected by him/her, but they sustain a loyalty relationship. It takes a lot of evidence to fire the CEO.	03
Fama e Jansen (1983)	**Decision Control and Monitoring** Ratify the resources usage proposal and main guidelines. Monitoring the performance of decision-making agents and the implementation rewards. Higher level of the firm's control system. Hiring, firing and defining the high level executives.			01
Zahra e Pearce (1989)	**Monitoring and Control** Select the management Monitoring and evaluating executives' performance.	**Strategy** - Defining the business model - Developing the firm's mission - Selecting the strategy to be followed	**Advisory and Service** - Represent the interests of the firm in the community. - Act as a link for the external environment - Perform ceremonial functions during the firm's lifetime.	03
Johnson, Daily e Ellstrand (1996)	**Monitoring and Control** – Monitoring the fiduciary duty of the management to the shareholders. – Hiring and firing the CEO – Defining the executives' compensation – Monitoring the executives	**Resource dependence** Ease the resource acquisition Legitimate the CEO decisions	**Advisory and Service** Advisory the CEO and main executives Initiate and formulate the firm's strategy	03
Stiles e Taylor (2001)	**Strategy** Boards are not involved in the strategy definition process, but only in certain parameters within the ongoing strategy. Business model gatekeeper: deciding in which business operate; providing criteria for acquisitions and divesting decisions. Select proposed strategies Guardian of the firm's values	**Control** Delimitate the firm's frontier according to the firm's purpose. Act as a judge in the firm's beliefs, maintaining the firm's values. Monitoring the firm's operation, the external environment and the CEO performance.	**Institutional** Linkages to external groups. The knowledge feeds the strategic discussion and can improve the firm's learning. Keep a healthy relationship with the firm's owners. Develop a solid reputation on the firm's management and accountability.	03
Hillman e Dalziel	**Monitoring and Control** Monitoring the CEO	**Resource Dependency** Provide legitimacy / widening the firm's public		02

Author	Nomenclature and understanding of board's role according to the researcher				Number of roles
(2003)	Monitoring and implementing firm's strategy Planning the CEO succession Evaluating and rewarding the executives	image Providing *expertise*. Linking the firm to third-parties Facilitate the access to external resources Build external relationships Help on strategy definition			
Carter e Lorsch (2004)	***Watchdogs*** Monitoring the company and management's performance Supervising the financial results. - Evaluate the CEO. Analyze the annual audit with external auditing. Risks monitoring: reassure that major risks are identified and under control.	***Pilots*** Taking major decisions Deciding on acquisitions and divesting, capital structure and dividends. Deciding on CEO hiring and firing. Approving changes on corporate organization. Approving the risk limits.	**Advisory** Advisory to the management, specially the CEO. Management can use the expertise and experience from the directors.		03
Jonsson (2005)	***Rubber Stamper*** –Nothing but agrees with management's decision. Authorize the day-to-day actions. –Following legal procedures. –The author cites Peter Drucker in his reference to the board as the impressive legal and ceremonial fiction. (1974, p.628)	***Watchdog*** More diligent monitoring. Complaining about irregularities and lack of information.	***Pilot*** Directing the company. Take decisions and act over them.	**Advisor** Dialogues with the management. Supporting the management bringing connections to external resources and relationships.	04
Clarke (2007)	**Control** **-** Monitoring the management and assuring the accountability in the firm.	**Strategy** Approving and monitoring the firm's strategy	**Advisory** Advisory and orientate the executives in critical matters.	**Institutional** Building institutional relations with investors, third-parties and community.	04
Fama and Jensen use the expression *ratify* to refer not only to the act of accepting passively the executives suggestions, but exactly the opposite, that is, exercising maximum control over the internal agents responsible for the initiation and implementation of decisions in the company, which can be called ad a *decision management*. By acting on behalf of the shareholders, the board holds the role of *decision controller*, which includes approving and monitoring management's choices and results.					

3. METHODOLOGY

The study is quantitative, based on statistical procedures and is fundamentally descriptive and correlational. Descriptive studies intend to describe measure and evaluate various aspects of the phenomenon, while the correlational studies seek the degree of relationship between two or more concepts or variables.

Based on the literature review about boards of directors and their roles on firm's strategy, control and guidance, we constructed a 17-questions survey questionnaire about the activities that the Board of directors performs.

The questions are part of a questionnaire applied to the directors. The variable seeks to measure, based on the understanding of the activities that the board carries out, the roles that it plays in the company's corporate governance.

The table below presents the questions sent to firm's executives and directors, regarding the board's roles of control, guidance and service.

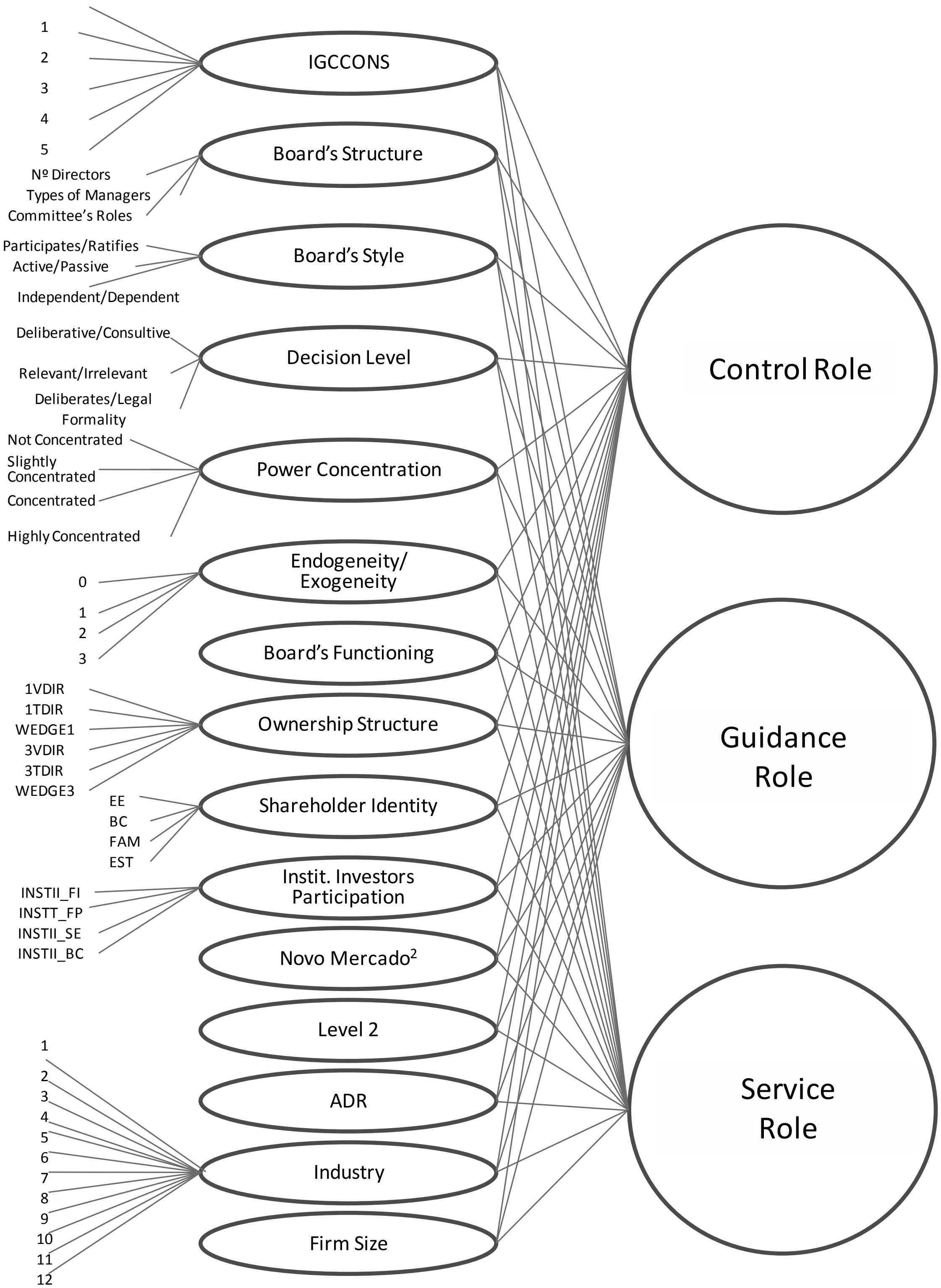
TABLE 2: ACTIVITIES OF THE BOARD ASSOCIATED WITH BOARD ROLES AS PART OF THE QUESTIONNAIRE

Role	#	Activity
Control	1	Hire and dismiss the chief executive officer (CEO)
	2	Approve the hiring (or dismissing) of the other executives on the proposal of the CEO
	3	Approve the remuneration and incentive packages for executives that will be sent to the Shareholders' Meeting
	4	Evaluate and monitor the performance of executives and company
	5	Discuss and conduct matters of succession of key positions in the company
	6	Define the responsibility of the chief executive and his/her subordinates
	7	Oversee the relationship of the executives with related parties
	8	Monitor the company's risks
	9	Appoint and replace the independent auditors
Guidance	10	Make *de facto* decisions concerning the strategy of the company
	11	Make decisions (or propose them to the Shareholders' Meeting) on the main facts of the company such as acquisitions, divestitures, capital structure, and dividends.
	12	Deal with and lead the matters relating to corporate governance
	13	Approve the code of conduct and Internal Regulation of the board of directors
Service	14	Establish contacts with the external network of interest to the company and use it for the benefit of the company.
	15	Facilitate the company's access to external resources, such as funding, for example.
	16	Provide advice and guidance to the chief executive and his subordinates.
	17	Play the role of institutional representation of the company

Independent variables

The figure below presents the conceptual scheme for all the 28 independent variables used in this research and partially reported here.

FIGURE 1: CONCEPTUAL RESEARCH MODEL



Novo Mercado and Level 2 are special listing segments for companies committed to better governance practices that those demanded by law

Sample

The research universe comprises financial and non-financial companies listed on the Stock Exchange of Sao Paulo (BM&FBovespa), in traditional segments, Level 1, Level 2 and Novo Mercado (special listing segments requiring corporate governance practices beyond corporate law provision), which totalizes 449 companies in December 2007.

This study uses a non-probability convenience sample formed by the companies listed on BM&FBovespa representing different industries and ownership structures.

After sending the two questionnaires (the first, containing questions addressed to the companies and the second to firm's executives and directors) to all companies in analysis scope, responses were received from 65 companies from questionnaire 1 ,and from 122 director and executives from questionnaire 2. A common intersection of respondents between the two questionnaires yielded a total of 102 observations.

Thus, in the descriptive analysis on matters related to businesses, it is used the sample of 65 companies, while for topics involving only issues related to the executive management and board, the sample of 122 respondents was considered. For the analysis of statistical models involving issues relating to the two questionnaires, the final sample was of 88 observations.

In order to include information regarding the ownership structure, secondary information for the period 1998 to 2007 from these respondent companies were gathered. 2007 data is adopted as a measure of the current shareholding structure, and the past values were used for the calculation of indicators of the degree of variability of this structure over time.

Additionally, in order to verify a possible different behavior of the companies listed in the special segments, two subsets of firms were observed separately, which will be called reference groups:

a) Companies listed on the BM&FBovespa that also issue *ADR*'s in the New York Stock Exchange, comprising a total of 32 companies in September 2008;

b) The companies listed in the special listing segments with superior corporate governance practices to those required by Law that is, BM&FBovespa's Level 2 and Novo Mercado, a total of 120 companies in July 2008.

4. RESULTS

The majority of firms in our sample is controlled by blocks of shareholders, especially by family ones. Brazil has a highly concentrated ownership environment: on average, the top three shareholders have 62% of total shares in the firms we analyzed. Institutional investors, on the other side, have on average 22.5% of shares. The table below presents the ownership classification of our sample

TABLE 3: DISTRIBUTION OF FIRMS ACCORDING TO THE OWNERSHIP STRUCTURE

Ownership Structure		Respondent Firms	%
		65	100,0
Shareholder Identity	Foreigner	7	10,7
	Controlling Block	23	35,3
	Family	22	33,8
	Government	6	9,2
	None of above	7	10,7
Ownership Concentration	% of stocks of the major shareholder (average)	44,4	
	% of stocks from the top 3 shareholders (average)	62,2	
Institutional Investors	% of stocks of institutional investors (average)	22,5	

Regarding the listing segment of these companies, more than half of them belongs to the BM&FBovespa's Novo Mercado and Level 2, special listing segments for companies committed to better governance practices that those demanded by law or issues ADR (American Depositary Receipts) in the New York Stock Exchange, representing also higher standards of governance requirements. The other part of companies in our sample belongs to the traditional listing segment, BOVESPA.

As for the relationship and origin of directors, we observe they are frequently associated to the controlling shareholders. Approximately 52% of directors in our sample are the controlling shareholders themselves or they are associated to them by familiar linkages. Less than 30% of board members are classified as independents. On the other hand, only 10% of directors represent the interests of minority shareholders. Saito e Dutra (2006), studying Brazilian boards and ownership structure, have also identified that minority shareholders do not usually use voting mechanisms at their disposal to elect board directors. They argue that "legal mechanisms that allow the election of minority shareholders' representatives do not necessarily means changes in the board composition". The table below presents the relationships between the origins of directors and the shareholders.

TABLE 4: DISTRIBUTION OF FIRMS ACCORDING TO DIRECTORS ORIGIN AND RELATIONSHIP

Director's origin	Firms	%	Directors	%
Total	65	100,00	512	100,00
Controlling shareholder	58	89,23	266	51,95
Minority shareholders	33	50,77	52	10,16
Independent director	54	83,08	142	27,73
Executive	25	38,46	33	6,45
Workers' representantive	5	7,69	5	0,98
Executive with relevant shareholding	2	3,08	5	1,56
Former executives	4	6,15	9	1,17

This evidence alerts us to the elevated power concentration existent in Brazilian companies and lead us to examine the level of this concentration. Since the power of controlling shareholders is a main issue on Brazilian firms, we created a power concentration indicator based on three questions to understand the relationship between controlling shareholders and the board and CEO. Since the independency of the board is associated to better corporate governance practices, the influence imposed by controlling shareholders may compromise the governance system.

The three questions to assess this fact are:

1. Is the chairman family-related to the controlling shareholders or other controlling block?
2. Is the CEO family-related to the controlling shareholders or other controlling block?
3. Are the chairman and CEO the same persons?

We attributed 1 point for each positive answer to these questions. For this reason, the concentration of power index may vary from zero to 3 points, where 3 points would indicate the maximum level of power concentration in the firm.

The results indicate that 27% of our sample can be included into the Concentrated or Highly Concentrated power groups. This evidence may indicate that in a relevant proportion of companies the controlling shareholders are the ones who actually run the companies, with a reduced power of minority shareholders if any.

TABLE 5: DISTRIBUTION OF THE LEVEL OF POWER CONCENTRATION ON THE FIRM

	Frequency	%
Not concentrated	39	60,94
Slightly concentrated	8	12,50
Concentrated	10	15,62
Highly concentrated	7	10,94
Did not answer	1	
Total	65	100,00

The results of the descriptive statistics make up a clear picture of the boards in Brazilian companies: they are largely dominated by controlling shareholders and the participation of independent directors is still well below the recommendation of a majority of independents by the Brazilian code of best practices (IBGC, 2009) and by several authors, among them, Saito e Dutra (2006), Black, Carvalho and Gorga (2008). This situation identified in previous research (KPMG, CEG, 2008) indicates that much improvement can still be made in the composition of the boards of listed companies.

Roles and activities of the board

Regarding the focus of this research, the roles of the board of directors, it was observed that there is a predominance of activities related to the control role in the same way that the committees related to this role are almost double those that relate to guidance activities (strategy and policies) of the company. The guidance role is also relevant, confirmed by the number of committees. The role of service however is less relevant in the boards.

The table below presents the percentage of answers by directors that agree with the statement.

TABLE 6. DISTRIBUTION OF CONSOLIDATED OPINION ON ACTIVITIES THAT THE BOARD PERFORMS

Activities	Opinion	Answers	%
Play the role of institutional representation of the company	Agree	73	60,33
	Disagree	48	39,67
	No Answer	1	
Hire and dismiss the chief executive officer (CEO)	Agree	110	90,16
	Disagree	12	9,84
The board approves the hiring (or dismissing) of the other executives on the proposal of the CEO	Agree	106	87,60
	Disagree	15	12,40
	No Answer	1	
Approve the remuneration and incentive packages for executives that will be sent to the Shareholders' Meeting	Agree	100	81,97
	Disagree	22	18,03
Evaluate and monitor the performance of executives and company	Agree	89	73,55
	Disagree	32	26,45
	No Answer	1	
Make de facto decisions concerning the strategy of the company	Agree	99	81,82
	Disagree	22	18,18

	No Answer	1	
Discuss and conduct matters of succession of key positions in the company	Agree	79	64,75
	Disagree	43	35,25
Facilitate the company's access to external resources, such as funding, for example	Agree	58	47,54
	Disagree	64	52,46
Provide advice and guidance to the chief executive and his subordinates.	Agree	102	83,61
	Disagree	20	16,39
Define the responsibility of the chief executive and his/her subordinates	Agree	87	71,31
	Disagree	35	28,69
Establish contacts with the external network of interest to the company and use it for the benefit of the company.	Agree	80	65,57
	Disagree	42	34,43
Deal with and lead the matters relating to corporate governance	Agree	92	75,41
	Disagree	30	24,59
Address the main operational matters of the company	Agree	32	26,23
	Disagree	90	73,77
Approve the code of conduct and internal regulation of the Board of directors	Agree	91	75,21
	Disagree	30	24,79
	No Answer	1	
Make decisions (or propose them to the Shareholders' Meeting) on the main facts of the company such as acquisitions, divestitures, capital structure, and dividends.	Agree	114	93,44
	Disagree	8	6,56
Oversee the relationship of the executives with related parties	Agree	93	76,23
	Disagree	29	23,77
Monitoring the firm's risk	Agree	104	85,25
	Disagree	18	14,75
Appoint and replace the independent auditors	Agree	107	88,43
	Disagree	14	11,57
	No Answer	1	

The predominance of the control and guidance (strategy in his case) roles was also observed by Stiles and Taylor (2001) when investigating 51 board members, 121 secretaries of board of directors and developing four case studies in the UK. Here, despite the most mentioned is an activity related to strategy, is the set of control activities that, together, grow in importance. The finding confirms the view of the agency theory that sees control as the most important task of the board. An activity which ranked as the fifth largest in the list of agreement - monitoring risks - can be linked to the period of this research field, from September to December 2008, coinciding with the outbreak of the international financial crisis.

The presence of family members of the controlling shareholders in the positions of chairman of the board or CEO is related to greater relevance given the role of service.

The decision degree of the board of directors is associated with better set of governance practices. This was observed when there was a situation experienced by boards which replaced their CEOs, in a process that, before making the decision, they discussed the matter thoroughly, unlike the group that only approved the ready-made proposal submitted to the board.

Regarding the development of the strategy, the boards are more involved in the approval stage than in the monitoring phase. The result is consistent with the recent finding of Muritiba (2009), but other than that expected by the model of Fama and Jensen (1983) who see involvement in monitoring the board at the same degree of approval. Unlike this model, many of the boards studied are still involved in the initiation step that would be delegated to managers, according to Fama and Jensen (1983).

What boards should but are not doing

The survey questionnaire allow us to examine which board's activities are not being performed adequately. The major gaps observed by respondents in relation to the activities of board are: (i) not to direct matters of succession, (ii) not to monitor risks, (iii) not to actually decide on the company's strategy, (iv) not to monitor the performance of executives and the company, (v) not to establish contacts of interest to the company.

Likewise, the questionnaire investigates which are the activities that the boards are doing but should not. The two activities top ranked were: (i) address the main operational matters of the company; (ii) ratify the management decisions with few discussions according to suggestions by the CEO.

These results deserve consideration by market agents, considering that this was answered mostly by companies with superior governance practices in relation to the market average. Also in this section of the questionnaire, respondents were more critical than when responding to initial questions about the activities of the board, showing here a much less positive reality than initially.

All results obtained in this study should be considered in light of three characteristics of the sample concentration: (i) the majority of companies is listed on the Novo Mercado, Level 2 or issues *ADR*'s in New York Stock Exchange. In such cases, the rules of governance are more stringent, which can lead to the assumption that the results obtained here do not reflect the entire market, but are related to companies which generally adopt superior practices in relation to their peers in the market, (ii) the vast majority of companies are family-controlled or part of a controlling block, which in this case is consistent with the prevailing market environment, (iii) there is a predominance of directors and managers connected to the controlling shareholders of the respondents, which can lead to a less critical view of governance practices given the relationship with those who actually decide the model.

Econometric tests

Given the small number of observations and high number of variables, initially we used principal factor analysis for each group of variables in order to build targeted factors that measure the three main roles of the board of directors (control, guidance and service). In terms of the role of control, the factor analysis showed two factors explaining 80.2% of the total variability (49.4% by the first factor and 30.8% for the second). The first factor obtained from the analysis of guidance indicators showed a explained variance of 87.6%, while regarding the role of service, the variability explained was only 66.9%.

Subsequently, in order to select the more variables relating to each of the three papers board of directors, an adjustment in a multiple regression model for each factor separately constructed, using a critical level of 10%, in order to ensure a greater number of variables to be incorporated into the model during the selection of variables. In view of the failure on the assumption of normality of the dependent variables considered (indicators from factor analysis), the standard errors of the estimators were calculated from the bootstrapping method, minimizing problems arising from this assumption.

Finally, in order to eliminate the endogeneity bias, we adjusted a model of simultaneous equations from the individual models of each of the roles of the Board of Directors. Again, in order to reduce the effects of the failure on the assumption of normality, the bootstrap procedure was used for calculation of the standard errors of the coefficients.

The model allows us to conclude that boards involved in the initiation step and monitoring of the strategy is positively associated with the role of control. This result points to a reflection: where the control really resides? Considering the predominance of respondents from firms with family ownership and controlling blocks in the sample, is the Board of directors that would be associated with the role of control or the presence of directors related to the controlling shareholders and family members also in other management organs that would give this connotation of control to the board?

An additional result is that: the larger the role of control exercised by the board of directors, the greater will be the role of direction and the greater will be the service role provided by the board. These relationships suggest a hierarchy of the roles of the board. Interestingly, however, the role of control is negatively associated with the role of service. This finding may lead to speculation that boards dealing with control activities cannot or may not want to engage in service activities, which could be considered less important.

When this result is contrasted with those obtained in the descriptive statistics in which it was identified that the role of service grows in relevance when CEO or chairman are family members of controlling shareholders, one can speculate that the role of control is less present in companies run by relatives of controllers. By being more present in the management and the board, the controlling shareholders can understand that there is no need for the board to play the role of control as a stated in the agency theory, because they are actually playing this role. But the question is: who will play this role on behalf of minority shareholders and other stakeholders considering that the expropriation in companies with concentrated ownership can be made by controlling shareholders in expenses of the minority shareholders? Furthermore, the results of descriptive statistics suggest another reason for concluding that the role of control is weakened by the controlled companies: when the CEO is a family member of the controlling group, respondents agreed less with the activity of the board when deciding on the hiring or dismissal of that CEO. It is worth noting that this is one of the primary tasks of a board of directors.

Referring back to the Simultaneous Equations Model, the only independent variable that recorded a significant relationship with the roles of the board of directors was the listing on the Novo Mercado, indicating that the boards of listed companies in this segment are positively associated with the guidance role.

6. CONCLUSIONS

The board of directors performs a fundamental role in corporate governance systems. A deeper understanding of its functioning can contribute for improving and adjusting corporate governance practices. This paper aimed to go beyond the usual demography-outcome framework used in board's research, which employs external public data to analyze boards and present for the first time primary data on the role of the board in listed companies in Brazil.

We used two survey questionnaires sent directly to directors and firms to capture an insider view about the roles and activities played by Brazilian directors. Our goal was to investigate the relationships between the role of board in Brazilian companies and the firm's characteristics and ownership structure. The study is quantitative, descriptive and correlational.

Our survey captures the answers of 122 executives and directors from 65 firms in 2008. The analysis is performed using multivariate techniques, such as statistical methods that simultaneously analyze multiple measurements on each subject or object of research, drawing specifically on factor analysis of the simultaneous equations model to check the relationships between the different variables and the role of board of directors.

This research contributed to the study of boards of directors, as well as to practice in companies. The main contribution was to provide for the first time a picture of the activities of the board of directors in listed Brazilian companies - particularly those that belong to more stringent practices of governance - and the resulting roles prevalent in the board.

Noting the many areas for improvement aspects that still exist in the activities of the boards in this group of companies that adopt higher best governance standards, one can speculate how poor will the practices be in other listed companies in Brazil. Not to mention private companies. Progress in the improvement of corporate governance practices in the country have just started and the results of this survey indicate points for improving the activity of the board: to increase its activities in monitoring the implementation of the strategy, to take care of matters of succession in the company, to monitor the performance of the company and their executives, to monitor risks, to effectively decide the strategic direction of the company.

The results indicate some other practical implications for specific ways of improvements in governance practices. One relevant one is the need to observe the proportion of outside and independent directors when the CEO and chairman are family members or relatives of the controlling shareholders. As evidenced in the results when this occurs, the role of control can be diminished or the performance of the board of directors may be limited. When the chairman is a family member or relative of the controllers, the board was less active, deliberative and relevant regarding their decision-making degree. Thus, in addition to observing whether the two positions are exercised by the same person, the market should move towards a more refined level of scrutiny, with attention to proportion of external and independents, particularly in cases of great concentration of power with controllers or their representatives acting as executives or board directors as well.

With the finding that the minority shareholders continue having a small participation in the boards and, as other studies (Saito; Dutra, 2006) have shown, they do not use all mechanisms at their disposal to be represented in the board of directors, another recommendation is that the minority shareholders seek to organize themselves better, paying particular attention to the cases where they may join others for electing members of the board.

To the regulator it is recommended improvements in the public information on listed companies, particularly through the IAN, Annual Report Information of public companies (At the time of this research was done, the IAN was being studied for future public consultation and later CVM released its substitute “Reference Formulary” that provides the framework to companies to offer much more transparency to market agents.). By including elements such as those leading to the observation of the indicator of concentration of power and uncovering the relationships between managers and controlling shareholders, to name one example, the regulator would provide tools to monitor the market itself and encourage improvements in the practices of companies. More information about the meetings of the board, such as frequency and type (face or via other media), may provide information to stakeholders to better assess the performance of the board.

Finally, other positions held by directors in other companies - listed or not - can be extremely valuable to the market players to assess whether the directors are able to devote the time necessary for the fulfillment of their fiduciary duties.

In the context of academic research, this work contributed to a more refined view on the composition of the board and placed this issue as compared to other governance elements. This occurred when creating an index of concentration of power, which takes into account not only the positions of chairman and CEO occupied by the same person, but if these positions are occupied by family members or relatives of controlling shareholders. Distinct degrees of power concentration may be useful to assess how it is reflected in other practices of the board, even broader, in the whole corporate governance.

As for future research, the universe of the boards is just beginning to be explored and other possibilities are opening to the use of indicators of power concentration most widely associated with other board practices and corporate governance. The combination of the roles of the board of directors elements regarding the vision of the board, based on social networks and the phenomenon of board interlocking, also appears to be an opportunity.

Future studies, as advocated by Guerra, Fischmann and Machado Filho (2009), should consider theoretical frameworks that reveal the dynamics of the board and analyze its different aspects, addressing its most core aspect, the functioning of the board of directors.

Motivational aspects (and non-pecuniary), power relations, culture, leadership style, personality traits of members, types of independent directors according to professional expertise and business background can be observed to assess their relationship or influence the work of a group of individuals that make up the board as a collective body (Guerra; Fischmann; Machado Filho, 2009). In this case, the indicators of concentration of power could be inserted in the joint analysis. By integrating the dimensions of individual and group, new perspectives arise from analyzing the board of directors' functioning, which can be seen as a potential team formed by individual stars.

Additionally, this study proposes, as argued Guerra, Fischmann and Machado Filho (2009), the discussion on the capability of the researchers to engage in building a theoretical, multidisciplinary and integrated framework that models the complexity and different aspects of the board, such as group decision-making process, in which elements such as trust, social networks and board interlocking (to name a few) can add dimensions not captured by economic models. To economic theories of organization and the prospects for theories of stakeholders and stewardship theory it can be added lessons from psychology and sociology. Trust, cognitive aspects, cohesion, commitment, consensus are among the elements to be observed. This regards adding the dimensions of behavioral and social character of boards to the economic and the organizational dimensions.

The roles of the board, its function and dynamics remain to be explored and represent proficuous research opportunities with benefits for academia and the market agents. The understanding of the central board of directors of the governance system has just begun.

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Level 1, Level 2 and Novo Mercado refer to special listing segments at BM&FBovespa that requires corporate governance practices beyond the corporate law requirements.

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