

Board composition, non-executive directors and governance cultures in Irish ICT firms: a CFO perspective

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Abstract

Purpose – The emergence of the information and communications technology (ICT) sector in Ireland over the course of the past decade has paralleled a period of exceptional national economic growth. This has raised questions regarding wealth distribution, power and governance. This paper seeks to identify some of the characteristics of the governance culture in this sector in Ireland. It deals specifically with issues such as board composition, non-executive directors and the perceived role and usefulness of accounting information in the decision-making process.

Design/methodology/approach – Questionnaire feedback from chief financial officers (CFOs), focusing specifically on the board of directors of indigenous, private firms.

Findings – The research indicates that firms operating in this sector adopt structures and cultures similar to those in more traditional sectors. However, there is evidence that Irish ICT firms have responded positively to calls for the roles and responsibilities of non-executive directors to be recognised and accommodated. It also confirms the continuing centrality of accounting information to the decision-making process.

Originality/value – The research represents an initial survey of firms operating in this sector. As such it is concerned with identifying overall patterns and contours. It is unusual in seeking feedback from CFOs and, as such, offers some unique insights. The findings will be of interest to those operating in the ICT sector and those seeking to identify the governance features that characterise this emerging and dynamic area.

Keywords Boards of Directors, Corporate governance, Information, Communication technologies, Ireland, Non-executive directors

Paper type Research paper

Introduction

Governance shortcomings have been identified as a significant explanatory factor in the financial scandals and corporate collapses that have been a feature of the Anglo-American business world in the past decade (Becht *et al.*, 2002). The fact that these have coincided with one of the longest and severest bear markets of recent times has provided a context within which not only the operational, but also the structural, human and governance policies of companies are being more keenly examined. In addition, the critical value-creation role of companies ensures that issues of public policy, competitiveness, accountability and the claims of an increasing number of stakeholders are regularly summoned to inform the debate about governance (OECD, 1999; Monks and Minow, 2001; Higgs, 2003).

The fact that corporate activity involves risk, not all of which either can or should be eliminated, is also being recognised. Indeed, one significant and healthy consequence of reports such as the Turnbull Report has been to situate the debate about the role of governance within the broader context of risk management and internal control (Turnbull, 1999). Thus, the evolving understanding of governance is increasingly being informed by not only considerations of accountability and transparency, but also by issues relating to risk and related strategy (Stiles, 2001; Carpenter and Westphal, 2001).

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Informed by these various perspectives, healthy corporate governance is rarely viewed as an end in itself; it is, rather, one means by which the competing interests of various stakeholders can be accommodated in companies that are optimising performance. Thus, governance, and corporate governance in particular, may provide a context within which these competing perspectives and interests can be considered. This is especially the case as corporate governance provides an “architecture of accountability” (Higgs, 2003, p. 11), that is, a set of concepts, structures and processes that allow the nexus of interests that define a company to be identified, tested and refined.

Much of the research, analysis and subsequent recommendations in relation to corporate governance have focused upon modifying and strengthening existing paradigms and structures (Franks *et al.*, 2001; Becht *et al.*, 2002). Reflecting this, a succession of corporate governance reports in the UK and Ireland such as Cadbury (1992), (Ryan, 1992), Greenbury (1995), Hampel (1998), Turnbull (1999) and Higgs (2003) have sought to promote a modernisation of the existing model that incorporates the need for greater accountability, transparency and risk management (Stiles, 2001; Carpenter and Westphal, 2001). Further, eschewing calls for this to be subject to statutory control, these have favoured a comply or explain approach that couples voluntary compliance with the controls implicit in a market for information that accompanies an increasingly competitive international market (Monks and Minow, 2001).

The emergence of the information and communications technology (ICT) sector over the last decade has, therefore, paralleled considerable debate amongst governments, regulators and professionals as to the best and most efficient ways of governing and controlling firms. There has been much talk of corporate responsibility, good governance practices and the need to recognise the rights of a broader range of “stakeholders”. In particular, the realisation by many firms that employees are now their most critical creators of value has prompted a reconsideration of the “balance of power” between the providers of financial and intellectual capital. The human, financial and structural cultures of the “new economy” might be expected, therefore, to reflect this more transparent and democratic paradigm (Rajan and Zingales, 2000).

This paper attempts an initial investigation of the extent to which these values are reflected in the governance regimes of small and medium sized enterprises (SMEs) operating in the indigenous Irish ICT sector, with particular emphasis on the extent to which they have impacted on corporate boardrooms. It is structured as follows: the next section traces the emergence of the ICT sector in Ireland and identifies the unique characteristics that make the Irish experience and context such a suitable research focus; this is followed by a summary of the methodology adopted; the empirical findings are then presented and discussed; the paper concludes with a brief summary and suggestions for further research.

Research context: Ireland and the ICT sector

Ireland has experienced phenomenal economic growth in recent years. In the period 1995 to 2002 real GDP grew by an average of almost 8 per cent per annum. Much of this dynamism is attributable to the emergence of a vital high-technology ICT sector. Firms in this sector are engaged in software design and development, web design, network security implementation, hardware assembly and other related functions. The total employed is estimated to be almost 100,000 (Enterprise Ireland, 2003; CSO, 2003).

The ICT sector in Ireland can be divided into two sub-categories: multinational firms and indigenous firms. The multinational sector comprises over 130 international firms, including five of the top ten software development companies in the world. This sub-category employs over half of those working in the overall ICT sector. Much of the activity currently carried out in Ireland by foreign multinationals centres on the physical manufacture and distribution of products, with over 40 per cent of all PC packaged software and 60 per cent of business application software sold in Europe being produced in Ireland (Enterprise Ireland, 2003; CSO, 2003).

The indigenous sector is smaller in terms of both revenues and networks. Nevertheless, a focus on overseas markets is one of its key characteristics, with more than 80 per cent of firms active internationally. Indigenous firms employ almost as many people as the large multinationals. However, the seven indigenous Irish ICT firms that are listed on the major international stock exchanges employ over 3,000 of these. These latter indigenous public firms are not represented in the research presented in this paper. Consequently, the results presented here relate only to the private indigenous ICT sector. The firms surveyed have employment levels ranging from ten to 251 people and include, therefore, mainly small and medium-sized enterprises (SMEs).

Methodology

Utilising a variety of publicly available information sources, over 600 firms were identified by the research team as operating within the Irish ICT sector. Such sources included the Irish Software Association, the National Software Directorate, Forfás, Enterprise Ireland, Industrial Development Authority and trade periodicals. Each of these firms was contacted by telephone to confirm the name of the chief financial officer (CFO), the current number of permanent employees and the postal address. This task was undertaken primarily to ensure that the appropriate senior financial executive within each firm was identified. Apart from the fact that they could provide a perspective not often sought, CFOs were targeted because they could comment on specific aspects of a firm's financial management and governance policies.

Only those private indigenous companies having at least ten full-time, permanent employees were targeted, a criterion met by 382 firms. Subsequently the CFO of each firm was posted a copy of a 12-page questionnaire together with supporting documentation, which included a covering letter setting forth the aims of the research project, along with a prepaid business reply envelope for completed questionnaires. Data collection commenced in mid-June 2001 and the process involved a number of follow-up telephone calls and e-mails. Data collection concluded in May 2002.

The 382 questionnaires posted in mid-June 2001 generated 140 responses. Analysis of these responses indicated that 52 firms either did not satisfy the parameters of the study or were unwilling to participate. This left a total of 88 usable responses from private, indigenous Irish firms and an effective response rate of 23 per cent. This paper is based upon the information supplied by these 88 private, indigenous firms.

Empirical results and discussion

Under the Anglo-American governance regime the unitary board is an essential feature (Maclean, 1999; Monks and Minow, 2001; Pearson, 2002). Not surprisingly, in the wake of the various scandals and incidences of underperformance, the role, function and suitability of a forum that derives its essential features from a dramatically different commercial period and context is being questioned. Thus, German and Japanese models of governance, for instance, have been explored as alternatives to the existing unitary board (Fohlin, 1999; Franks and Mayer, 2001; Hoshi and Kashyap, 2001). However, the relative failure of these two countries to negotiate the increasing governance and financing challenges posed by globalisation have meant that, if only by default, the robustness of the Anglo-American model has had to be acknowledged (John and Senbet, 1998; Monks and Minow, 2001).

Much of the focus of recent corporate governance research and best practice codes has been concerned, therefore, with improving the efficiency, effectiveness and competency of boards. To some extent this has seen a questioning of the structural and operational aspects of corporate boards. By far the greater amount of energy has been expended, however, upon matters relating to the board members themselves and their relationships and behaviours (Hermalin and Weisbach, 1998; John and Senbet, 1998; Franks *et al*, 2001). On the one hand, driven by issues of public concern and policy, these have been informed by traditional concerns such as remuneration levels and multiple directorships (Greenbury, 1995; Short and Keasey, 1999). However, significant developments have also taken place in relation to matters such as the role and relative powers of executive and non-executive

directors, roles that have become the focus of greater attention as both business complexity and executive remuneration levels have increased (Cotter *et al.*, 1997; Hermalin and Weisbach, 1998; Franks *et al.*, 2001).

Composition of board of directors

Given the critical role played by the board in the governance and organisation of firms, respondents were asked to answer a number of questions relating to their structure, composition and role. The results indicate that boards of directors in the Irish ICT sector show little variation in either gender or age profile from boards operating in firms in more traditional sectors (IAIM, 2002; Grant Thornton, 2003; Brennan and McDermott, 2003). The principal findings are presented in Table I.

As indicated in Table I, average board size is 4.95 (median 5), with males dominating (4.55). There is no evidence of the sector encouraging greater incorporation of women on their boards, with women continuing to provide only a token presence (0.40). In only five cases did the number of female board members exceed one, and in no case did women comprise a majority of the board. This is consistent with the gender profile of Ireland's leading companies where women hold only 7.3 per cent of directorships in publicly quoted companies (EIRIS, 2003).

The majority of board members are executive directors (3.09). However, in line with best practice, these are supplemented by non-executive directors (2.05). The majority of board members are over 35, with non-executive directors being older, on average, than executive directors. This suggests an awareness of the importance in terms of both strategy and financing of the presence of experienced board members and of the broader governance issues surrounding the presence of non-executive directors. Founders are in a minority on the board (2.22). In addition, financiers, such as venture capitalists are well represented, with over one-third of respondents indicating that such a representative sits on the company's board.

Role of financial information in the decision-making process

The importance of financial information in the context of facilitating board decisions was also investigated. CFOs were asked for their responses (1 = strongly disagree, 7 = strongly agree) to the following statements:

- Board members depend heavily on financial information to make decisions.
- Board members can understand financial statements and budgets.
- It is important that directors are able to understand financial information.

The results are shown in Table II.

The deficiencies of accounting information, particularly in relation to its failure to recognise and measure much of the intangible asset base of the ICT sector, have been widely highlighted (Brennan and Connell, 2000). Nevertheless, accounting information is still viewed as central to the decision-making process (4.90). Not only is it perceived as important that board members should be able to understand financial information (6.39), but

Table I Composition of board of directors

| | | No. on board | No. on board of directors who are: | | | | | | | |
|----------|----------|--------------|------------------------------------|--------|-----------|---------------|----------|--------------|----------|---------|
| | | | Male | Female | Executive | Non-executive | Founders | Non-founders | Under 35 | Over 35 |
| <i>n</i> | Valid | 85 | 85 | 85 | 81 | 76 | 85 | 73 | 79 | 80 |
| | Missing | 3 | 3 | 3 | 7 | 12 | 3 | 15 | 9 | 8 |
| | Mean | 4.95 | 4.55 | 0.40 | 3.09 | 2.05 | 2.22 | 2.73 | 1.22 | 3.88 |
| | Median | 5.00 | 5.00 | 0.00 | 3.00 | 2.00 | 2.00 | 2.00 | 1.00 | 4.00 |
| | Std dev. | 2.064 | 1.979 | 0.640 | 1.591 | 1.773 | 1.238 | 2.250 | 1.499 | 2.324 |
| | Min. | 1 | 1 | 0 | 1 | 0 | 0 | 0 | 0 | 0 |
| | Max. | 13 | 10 | 3 | 9 | 9 | 7 | 11 | 6 | 10 |

Table II Importance of financial information to board decision making

| | | <i>Board members depend heavily on financial information to make decisions</i> | <i>Board members can understand financial statements and budgets</i> | <i>It is important that directors are able to understand financial information</i> |
|----------|---------|--|--|--|
| <i>n</i> | Valid | 84 | 83 | 83 |
| | Missing | 4 | 5 | 5 |
| Mean | | 4.90 | 5.75 | 6.39 |
| Median | | 5.00 | 6.00 | 7.00 |
| Std dev. | | 1.510 | 1.277 | 0.881 |
| Min. | | 1 | 2 | 3 |
| Max. | | 7 | 7 | 7 |

CFOs are confident (5.75) that board members can actually do so. This would seem to confirm, albeit from the not-disinterested perspective of CFOs, the continuing centrality of financial accounting information to the decision-making process in ICT firms, in spite of its deficiencies (O'Regan *et al.*, 2001).

Non-executive directors

Corporate governance regulations for the SME sector in Ireland remain largely un-codified. In 1998, Enterprise Ireland, the government organisation responsible for the development of indigenous firms, commissioned a document entitled *Corporate Governance – Leadership not Management: Practical Guidelines for Ambitious Private Companies* from Prospectus Group, a private consulting body. This encouraged private indigenous Irish firms to follow international best practice, tailored to the needs of the private sector. One area in which Irish companies appear to have embraced emerging best practice is in the appointment of non-executive directors (Prospectus Group, 1998).

The role of the non-executive director has traditionally been informed by a variety of considerations and theoretical perspectives. Thus, the separation of ownership and control that characterises the Anglo-Saxon model has highlighted the stewardship and monitoring aspects of non-executive directors' functions (Maclean, 1999). Agency and managerial perspectives focus on the role of the board, and independent non-executive directors in particular, as a key mediating influence in protecting shareholder wealth from self-serving managers (Fama and Jensen, 1983). In recent years one of the principal developments in the evolution of the governance regime has been the extent to which it has come to be accepted that non-executive directors "have a crucial part to play [as] custodians of the governance process" (Higgs, 2003, p. 11). Indeed, such has been the focus on the role of the non-executive director as monitor of corporate governance that many have now felt it necessary to re-emphasise the strategic and value-creation aspects of their function (Stiles, 2001; Carpenter and Westphal, 2001; Higgs, 2003).

As indicated in Table I, the number of non-executive directors on these boards is two (median). This is greater than the single non-executive director to be found on the boards of equivalent UK companies (Barrow, 2001). It is also consistent with research identifying Ireland as one of the more progressive EU countries in appointing non-executive directors to their boards (IAIM, 2002; Grant Thornton, 2003; Brennan and McDermott, 2003).

In an attempt to better situate the perceived importance of non-executive directors to good corporate governance practice, respondents were asked for their responses (1 = strongly disagree, 7 = strongly agree) to the following statements:

- Our organisation conforms to best practice in relation to corporate governance.
- Non-executive directors are critical to good governance.
- Board members have been briefed on corporate governance best practice (e.g. Cadbury, Greenbury, Hampel and Turnbull Reports).

The results are shown in Table III.

Table III Non-executive directors and best practice

| | | <i>Our organisation conforms with best practice in relation to corporate governance</i> | <i>Non-executive directors are critical to good governance</i> | <i>Board members have been briefed on current corporate governance best practice</i> |
|----------|---------|---|--|--|
| <i>n</i> | Valid | 84 | 79 | 81 |
| | Missing | 4 | 9 | 7 |
| Mean | | 5.05 | 5.15 | 2.90 |
| Median | | 5.00 | 6.00 | 3.00 |
| Std dev. | | 1.361 | 1.769 | 1.729 |
| Min. | | 1 | 1 | 1 |
| Max. | | 7 | 7 | 7 |

The responses revealed a mixture of high aspiration and limited achievement. For instance, non-executives are perceived by CFOs as critical to good governance (5.15). Furthermore, when asked to assess the extent to which their firm conforms to best practice in relation to corporate governance, the average response (5.05) suggested a high level of self-satisfaction. When this was compared with the extent to which firms briefed board members on current best practice, they did not score well (2.90).

Overall, the responses suggest that the role of the non-executive director is appreciated by the CFO. Notwithstanding the deficiencies in the manner in which they are educated as to current best practice, the perception is that non-executive directors bring various strengths to the board. This is consistent with ongoing regulatory endeavours aimed at securing the functions of the non-executive director as both custodian of the governance process and an independent strategic voice (Grant Thornton, 2003; Brennan and McDermott, 2003; Higgs, 2003).

Conclusion

This paper has investigated the board structure and governance culture of SMEs operating in the private indigenous ICT sector in Ireland. In general, it would appear that this sector has a governance culture quite similar to that prevalent in traditional firms and sectors. Thus, boards continue to be heavily populated by financial capital, either in the form of founders or venture capitalists. The critical role of non-executive directors is increasingly being recognised. CFOs, perhaps because of the extent to which they perceive that the information they provide is privileged in the decision-making process by directors, are positive in their perceptions of the contribution that boards make.

Future research under this ongoing project will focus more specifically on the workings of boards of directors and their various sub-committees. In particular, the extent to which the interests of a broader range of stakeholders, such as knowledge employees, are being accommodated will be tracked. Now that much of the pioneering phase associated with companies operating in this ICT sector has been traversed, this will form part of an investigation intended to identify the manner in which the wealth, knowledge and governance dividends generated are being distributed.

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Further reading

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