SAGE ASQ

Director Reputation, CEO-Board Power, and the Dynamics of Board Interlocks
Author(s): Edward J. Zajac and James D. Westphal
Source: *Administrative Science Quarterly*, Vol. 41, No. 3 (Sep., 1996), pp. 507-529
Published by: Sage Publications, Inc. on behalf of the Johnson Graduate School of Management, Cornell University
Stable URL: http://www.jstor.org/stable/2393940
Accessed: 26-02-2015 20:57 UTC

Your use of the JSTOR archive indicates your acceptance of the Terms & Conditions of Use, available at http://www.jstor.org/page/info/about/policies/terms.jsp

JSTOR is a not-for-profit service that helps scholars, researchers, and students discover, use, and build upon a wide range of content in a trusted digital archive. We use information technology and tools to increase productivity and facilitate new forms of scholarship. For more information about JSTOR, please contact support@jstor.org.

Sage Publications, Inc. and *Johnson Graduate School of Management, Cornell University* are collaborating with JSTOR to digitize, preserve and extend access to *Administrative Science Quarterly*.

http://www.jstor.org

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

Director Reputation, CEO-Board Power, and the Dynamics of Board Interlocks

Edward J. Zajac
Northwestern University
James D. Westphal
The University of Texas at Austin

This study advances research on CEO-board relationships, interlocking directorates, and director reputation by examining how contests for intraorganizational power can affect interorganizational ties. We propose that powerful top managers seek to maintain their control by selecting and retaining board members with experience on other, passive boards and excluding individuals with experience on more active boards. We also propose that powerful boards similarly seek to maintain their control by favoring directors with a reputation for more actively monitoring management and avoiding directors with experience on passive boards. Hypotheses are tested longitudinally using CEO-board data taken from 491 of the largest U.S. corporations over a recent seven-year period. The findings suggest that variation in CEO-board power relationships across organizations has contributed to a segmentation of the corporate director network. We discuss how our perspective can reconcile contrary views and debates on whether increased board control has diffused across large U.S. corporations.•

Have boards of directors of large U.S. corporations recently moved toward greater control of top managers? Recent discussions of corporate governance practices in the U.S. seem to vary widely in their answer to this question. For every research study or business press editorial pointing toward increasingly active boards, there appears to be a corresponding study or editorial arguing the opposite (Lorsch and MacIver, 1989; Davis, 1991; *Fortune,* 1993; *Wall Street Journal,* 1995a). The theoretical explanations used to support one or the other perspective range from a belief that public discourse and investor pressures have led to the diffusion of greater board independence across U.S. corporations (Useem, 1992; *Wall Street Journal,* 1995b) to the managerialist belief that managerial entrenchment and the cooptation of boards by powerful chief executive officers (CEOs) remain as strong as ever (Pfeffer, 1992; *Wall Street Journal,* 1995c).

Rather than debate the relative merits of such sweeping and rather one-sided perspectives on corporate governance, we suggest instead that a theory is needed that can simultaneously explain the coexistence and persistence of both board-controlled and CEO-controlled firms. We develop and test a theory that can explain such variation, based on an analysis of director appointments, whereby powerful actors in the CEO-board relationship affect the diffusion of board independence through the selection and retention of directors whose prior directorship experiences suggest differential sympathy for their interests. For instance, we propose that more powerful CEOs will avoid director candidates who have participated as directors in increasing the level of board monitoring and control over CEOs on other boards, while favoring new director candidates with prior directorship experience in protecting or bolstering CEO control.

With few exceptions (e.g., Mizruchi and Stearns, 1988; Davis, 1993), much of the corporate governance literature

© 1996 by Cornell University.
0001-8392/96/4103-0507/$1.00.

•

Both authors contributed equally to the paper. We are grateful to Jerry Davis, Ranjay Gulati, Paul Hirsch, Willie Ocasio, Toby Stuart, Brian Uzzi, and seminar participants at Carnegie Mellon University, the Harvard Business School, and UCLA for comments and suggestions on earlier versions of this paper. The paper has also benefited from the helpful comments of Mark Mizruchi and the anonymous reviewers for *ASQ,* as well as the editorial assistance of Linda Johanson.

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

has taken board composition as a given, seeking to examine its implications rather than its determinants, but three distinct streams of research on boards could be invoked to examine the selection or retention of individual directors. One stream of research in organization behavior has typically examined the extent to which boards are a passive tool of management interests (Vance, 1968; Mace, 1971; Herman, 1981). Typical for this line of inquiry is examining how specific dimensions of board structure (e.g., the proportion of outside directors or the separation of CEO and board chair roles) can affect relative power and decision-making tendencies in the CEO-board relationship and thus affect the allegiance of board members to management's or shareholders' interests (Kosnik, 1987; Finkelstein and Hambrick, 1989; Wade, O'Reilly, and Chandratat, 1990; Mallette and Fowler, 1992). This line of research would suggest that the composition of boards will be determined largely by the attempts of powerful individual CEOs to coopt existing directors and influence the selection and retention of directors who are more likely to be sympathetic to that particular CEO's interests (Westphal and Zajac, 1995).

A second stream of research draws largely from organizational sociology and is concerned with determining the macro-structure of boards, i.e., the network of interlocking directorates (Ornstein, 1980), and its implications, such as the diffusion of particular organizational practices. From this perspective, internal power and influence dynamics between CEOs and boards are less relevant than how interlocking directorates may reflect interorganizational dependencies (Pfeffer and Salancik, 1978; Pennings, 1980; Zajac, 1988) or unity among members of the elite class (Koenig and Gogel, 1981; Mizruchi, 1982; Useem, 1982). Thus the best predictor of the specific composition of boards of directors is likely to reflect either interorganizational dependencies or social ties among members of the elite class. Empirical studies examining whether "broken" interlocks between resource-interdependent firms are reconstituted reflect an attempt to address such issues (Ornstein, 1980; Palmer, 1983; Palmer, Friedland, and Singh, 1986; Stearns and Mizruchi, 1986).

A third perspective on corporate governance that can address the question of director appointments is grounded in the agency conception of corporate boards as a generally effective, if imperfect control mechanism serving to protect shareholder interests (Fama, 1980). From this financial economics perspective, an efficient labor market for corporate directors acts as a motivating and disciplining device (Fama and Jensen, 1983). Directors seek to develop and maintain a favorable reputation as active representatives of shareholder welfare, thus enhancing their human capital on the boards on which they sit and increasing their attractiveness as candidates for board appointments at other firms.

While each of these largely nonoverlapping streams of research contributes to some understanding of changing board appointments, considering both the intraorganizational and interorganizational dimensions of board membership together would provide additional insights. We develop such

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

a theoretical framework in this study, linking both intra- and interorganizational dynamics involving CEOs and boards of directors. This study contributes to the literature on CEO-board relationships by showing how director experience on other boards can affect decision making (i.e., director selection and retention) on a given focal board. It contributes to the literature on interlocking directorates by proposing and testing a new perspective on the formation and dissolution of board interlock ties that differs from the interorganizational resource dependence and intraclass unity approaches described above. While we share the view of intraclass theorists that interlocks can serve to "guide managerial behavior, socialize new directors into [the capitalist class] culture, and socially control deviant behavior" (Palmer, 1983: 42), we suggest that interlocks serve these functions for distinct and competing subcultures within the larger class of business elites. Finally, it contributes to the literature on director reputation by suggesting that while a director's prior experience can affect subsequent board appointments, such appointments may reflect a political rather than an economic rationality, in which both active *and* passive board members can thrive in a labor market for directors that is segmented by orientation toward management.

We test our perspective using longitudinal data taken from hundreds of large U.S. corporations over a recent seven-year period. Some research has suggested that this period coincides with the spread of increased board activism and shareholder orientation (Useem, 1992; Davis and Thompson, 1994; Zajac and Westphal, 1995) and an attendant increase in conflict between management and shareholder interests. In this context, a director's reputation for activism or passivity, along with the relative power of CEOs and boards, should be particularly relevant in influencing director selection and retention and thus the dynamics of board interlock formation and dissolution during this period.

INTERORGANIZATIONAL TIES AND INTRAORGANIZATIONAL POWER

Although researchers have drawn on a variety of theoretical perspectives to explain the diffusion of organizational phenomena through interlock network ties, recent discussions have tended to emphasize the role of such ties in spreading knowledge and awareness about specific organizational changes. As articulated by Galaskiewicz and Wasserman (1989: 456), network ties between boundary-spanning personnel, including board members, "act as a conduit to disseminate ideas and innovations." Empirical support for this argument has been found in studies investigating the likelihood of adopting poison pills (Davis, 1991), making specific kinds of corporate acquisitions (Haunschild, 1993), adopting the multidivisional form (Palmer, Jennings, and Zhou, 1993), or making campaign contributions to particular political candidates (Mizruchi, 1992).

On a deeper level, interlock ties may help spread more fundamental belief systems about corporate strategy, organizational structure, or the board's role in the

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

organization, providing the foundation for a variety of organizational changes. Empirical research investigating the development of group norms has shown how the prior experiences of individual group members in similar contexts can provide the foundation for norms of the focal group (Bettenhausen and Murnighan, 1985). Thus board members who have participated in various strategic or structural changes on other boards bring those beliefs and the various, more specific scripts associated with them to the focal board, ultimately "negotiating" or advocating changes in board norms consistent with their beliefs (Bettenhausen and Murnighan, 1985). While governance scholars have noted the potential role of socialization experiences in affecting board decision making (Alderfer, 1986), such processes are frequently assumed to operate only within the focal board. Given that a large portion of corporate directors hold multiple board seats, however, and have held other directorships in the past (Useem, 1984; Mizruchi, 1992), the collective influence of directors' experiences on other boards may frequently outweigh the effect of socialization experiences on the focal board. Thus directors who have participated in structural changes that increase board control over management may help spread increased board control to the other boards on which they sit, either by raising awareness about specific changes or by moving board norms toward a behavioral model that favors active monitoring and oversight on behalf of shareholders. In effect, by virtue of their prior experiences, such directors "come to a normative understanding" that the role of corporate director requires monitoring and controlling management decision making, prompting them to initiate and encourage changes consistent with such behavior where they serve as outside director (Burt, 1987: 1289; Ocasio, 1996). Conversely, directors who have participated in structural changes that protect or enhance the CEO's control over the board may come to believe that outside directors should defer to the CEO's judgment on strategic issues, leading them to help maintain board norms that favor director passivity and loyalty to the CEO.

Director Experience and Change in Board Interlocks

Given that directors' relative experience with increased board control at other companies can affect their willingness to abide CEO control at the focal firm, powerful CEOs may seek to sustain CEO control by (1) avoiding director candidates who have participated in greater board control over management and (2) selecting, instead, directors whose experience on other boards reflects board passivity toward management. Conversely, powerful boards can perpetuate or increase their control over management by (1) avoiding directors who have been socialized into a passive board role, as indicated by their participation in allowing greater CEO control on other boards and (2) appointing individuals with prior experience in asserting board control. Moreover, individual board members should prefer activist new directors because, as Alderfer (1986) suggested, boards require unanimity and a sense of common purpose to control management decision making effectively, just as all groups require unanimity and cohesion to manage actors in

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

their environment (Gladstein, 1984). Through selection and retention, then, powerful actors in the CEO-board relationship can "manage" board interlocks so as to reinforce or increase their control.

This argument is consistent more generally with the theoretical and empirical literature on power in organizations, which cites control over employee selection as an efficient means of building political coalitions (Pfeffer, 1981: 163; 1992). Managers can often build or protect their power bases more easily and cheaply by hiring or promoting individuals likely to support their personal, political interests than by trading favors with existing colleagues (Pfeffer, 1981). Drawing on this literature, several governance scholars have suggested that CEO control over the director selection process represents an important source of managerial entrenchment (Mace, 1971; Kosnik, 1987; Fredrickson, Hambrick, and Baumrin, 1988; Wade, O'Reilly, and Chandratat, 1990). For instance, Lorsch and MacIver (1989) and Finkelstein and Hambrick (1989: 124) noted that CEOs can "coopt" the board by favoring the appointment of "sympathetic" new directors. Although this process has typically been associated with CEO behavior, Westphal and Zajac (1995: 78) suggested that this process also applies to boards seeking to increase their monitoring and control by appointing new directors who are sympathetic to the orientation of existing directors. In effect, we propose that directors' experiences on other boards may furnish a relatively direct indicator of their relative "sympathy" toward either management or shareholder interests, thus providing a basis for director selection and retention.

An implication of this line of reasoning is that changes in relative control by the CEO or board may spread through the network of interlocking directorates in ways that have not been specified in prior research. We propose here that the diffusion of specific governance changes will depend on whether powerful actors in CEO-board relationships seek to deflect or encourage such diffusion. For example, the diffusion of a governance change that diminishes CEO control may be deflected by powerful CEOs by avoiding or eliminating interlock ties with prior "adopters." Similarly, powerful CEOs may also steer the diffusion of changes that protect or increase their control over the board by adding ties to prior adopters of such changes. As one director cited in Lorsch and MacIver (1989: 77) suggested, "The CEO shapes the board very much the way he wants, not only bringing people in, but also getting people he doesn't like off the board." Similarly, directors who sit on powerful boards are likely to prefer new director candidates who share their belief in active boards. As another director cited in Lorsch and MacIver (1989: 5) noted, "Directors today don't want colleagues like the old ones who rubber-stamped management's decisions."

In this way, contests for intraorganizational power can affect interorganizational ties: The actions of powerful corporate leaders seeking to influence the selection and retention of board members generate a "segmented" interlock network (Kaufman, 1986), with relatively few ties between active and passive boards and relatively dense ties between boards

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

with similar power structures. Here, we examine the dynamic process by which this segmentation is maintained. We propose that a director's prior experiences on boards that have made changes that increase or decrease board control over management provide a strong indication of that director's likely subsequent behavior on other boards, affecting the relative attractiveness of that director in the following ways:

Proposition 1a: Directors who sit on boards that have recently moved to *increase* board control over management will have (1) fewer subsequent appointments to boards having low control and (2) more subsequent appointments to boards having high control.

Proposition 1b: Directors who sit on boards that have recently moved to *decrease* board control over management will have (1) more subsequent appointments to boards having low control and (2) fewer subsequent appointments to boards having high control.

In the remainder of this section, we develop specific testable hypotheses corresponding to the propositions offered above. While it is difficult to observe and measure directly the level of board control over management in large corporations, a number of indicators have been used in prior governance research to capture such differences across organizations. We consider five different indicators in this study: changes in the ratio of outside to inside directors, in board leadership structure, in diversification, in total compensation, and in compensation contingency. The first two are measures of board structure that assess board control over management, and the latter three are measures of strategy or policy that reflect attention to shareholder interests or managerial interests. Given that all five variables are visible to top managers and directors at other companies, they can provide a more salient basis for new director selection than less visible measures of actual board decision-making processes.

Change in the outsider ratio. Perhaps the most commonly used indicator of board independence from management is the ratio of outside to total directors. Governance researchers and champions of board reform have long contended that nonemployee or "outside" directors are better positioned to control management decision making than insiders (Fama and Jensen, 1983). As subordinates to the CEO, inside directors may be reluctant to challenge or question the CEO's position on an issue in board meetings, even when shareholder interests appear to be threatened (Fredrickson, Hambrick, and Baumrin, 1988; Hoskisson, Johnson, and Moesel, 1994). Outsiders should also be better able than insiders to judge managerial performance impartially, raising the likelihood that a poorly performing CEO will be dismissed (Boeker, 1992). Thus, increases in the ratio of outside to inside directors can be considered indicative of increased board control over management, while decreases in this measure should indicate greater board passivity in monitoring management decision making:[1]

Hypothesis 1a: Directors who sit on boards that have recently increased the ratio of outside to inside directors will have fewer subsequent appointments to boards having low control and more subsequent appointments to boards having high control.

[1] For each of the hypotheses developed below, the two components of the hypothesis are related but distinct, such that a director can experience a change in appointments at low-control boards but not experience any change in appointments at high-control boards.

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

Hypothesis 1b: Directors who sit on boards that have recently decreased the ratio of outside to inside directors will have more subsequent appointments to boards having low control and fewer subsequent appointments to boards having high control.

Change in board leadership structure. It is also commonly suggested by organizational scholars and members of the business press that separating the CEO and board chair positions (i.e., allocating each position to separate individuals) should greatly increase the board's capacity to control management decision making (Vance, 1983; Harrison, Torres, and Kukalis, 1988; Crystal, 1991; Beatty and Zajac, 1994; Finkelstein and D'Aveni, 1994). Given that the board chair is nominally responsible for evaluating CEO decisions, allocating both roles to the same individual presents a conflict of interest (Kesner and Johnson, 1990; Zajac and Westphal, 1996). Moreover, board meetings represent the primary forum for directors to challenge CEOs' proposals (Lorsch and MacIver, 1989). By dictating an agenda that offers a limited opportunity for open debate, a CEO serving as board chair can easily minimize the level of board monitoring behavior (Demb and Neubauer, 1992). Conversely, an independent chairperson is better able to control management on behalf of shareholders. Thus, we hypothesize:

Hypothesis 2a: Directors who sit on boards that have recently separated the CEO and board chair positions will have fewer subsequent appointments to boards having low control and more subsequent appointments to boards having high control.

Hypothesis 2b: Directors who sit on boards that have recently combined the CEO and board chair positions will have more subsequent appointments to boards having low control and fewer subsequent appointments to boards having high control.

Change in corporate diversification. According to managerialist and agency researchers, top managers have personal incentives to pursue diversification beyond the level at which shareholder wealth is maximized (Hill and Snell, 1988; Jensen, 1988; Baysinger and Hoskisson, 1990). From the managerialist perspective, top managers may diversify into largely unrelated businesses to increase their personal power, compensation, and status (Marris, 1964). Agency theorists emphasize the link between diversification and reducing managerial risk (Amihud and Lev, 1981). By diversifying into unrelated businesses, managers can stabilize their investment portfolios while also reducing their employment risk. Shareholders should favor lower levels of diversification, because they can diversify their investment portfolios more easily than CEOs can diversify their employment. Thus, as nominal representatives of shareholder interests, relatively powerful boards of directors should resist managerial preferences for excessive corporate diversification (Hoskisson, Johnson, and Moesel, 1994). Conversely, as Jensen (1988) has suggested, board passivity may be partly responsible for inefficient diversification levels. Therefore, reduced corporate diversification provides an indication of greater shareholder representation and lower managerial control over board monitoring activity. Participation on boards that have overseen reduced corporate diversification would send a negative signal in the

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

market for directors at CEO-dominated boards and a positive signal at companies with more active boards:

Hypothesis 3a: Directors who sit on boards that have recently decreased corporate diversification will have fewer subsequent appointments to boards having low control and more subsequent appointments to boards having high control.

Hypothesis 3b: Directors who sit on boards that have recently increased corporate diversification will have more subsequent appointments to boards having low control and fewer subsequent appointments to boards having high control.

Change in total compensation. The managerial and academic literatures on corporate governance have long attributed high levels of CEO compensation to board passivity and CEO entrenchment. Several studies have reported evidence that board independence from the top management is associated with smaller increases in CEO compensation (Finkelstein and Hambrick, 1989; Main, O'Reilly, and Wade, 1995; Westphal and Zajac, 1995). Changes in CEO compensation at large companies are well publicized and highly visible to managers and directors at other boards and thus may provide a salient indicator of the relative independence of the board from management. Participation on boards that have reduced the level of CEO compensation would therefore send a negative signal in the market for directors at CEO-dominated boards and a positive signal among companies with more active boards:

Hypothesis 4a: Directors who sit on boards that have recently decreased total compensation will have fewer subsequent appointments to boards having low control and more subsequent appointments to boards having high control.

Hypothesis 4b: Directors who sit on boards that have recently increased total compensation will have more subsequent appointments to boards having low control and fewer subsequent appointments to boards having high control.

Change in compensation contingency. Contingent compensation contracts include a variety of different incentive plans that link management pay to firm performance, thus aligning the interests of CEOs with the preferences of shareholders (Jensen and Meckling, 1976). According to agency theorists, long-term incentives such as stock options, performance shares, or restricted stock are a primary mechanism by which corporate boards protect shareholder interests against management excesses (Kerr and Kren, 1992; Gibbs, 1993; Beatty and Zajac, 1994), and both economic and behavioral literatures on executive compensation suggest that, in general, CEOs should prefer less long-term incentive compensation in their pay packages. From a normative agency theory perspective, CEOs (as risk-averse agents) prefer less risk in their compensation contracts (Harris and Raviv, 1979). By making compensation contingent on future firm performance, long-term incentives add uncertainty to a CEO's compensation. Some empirical evidence suggests that passive boards make only limited use of long-term incentive compensation in designing CEO compensation contracts (Tosi and Gomez-Mejia, 1989), while increased board independence from management is typically followed by higher levels of contingent compensation (Westphal and Zajac, 1995). Membership on boards that

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

have increased CEO compensation contingency should therefore decrease an individual's marketability among CEO-dominated boards, while increasing his or her attractiveness to relatively active boards:

Hypothesis 5a: Directors who sit on boards that have recently increased CEO compensation contingency will have fewer subsequent appointments to boards having low control and more subsequent appointments to boards having high control.

Hypothesis 5b: Directors who sit on boards that have recently decreased CEO compensation contingency will have more subsequent appointments to boards having low control and fewer subsequent appointments to boards having high control.

METHOD

Sample and Data Collection

The population for this study included top managers of the largest U.S. industrial and service firms, as listed in the 1986 *Forbes* and *Fortune* 500 indexes. We restricted our attention in this study to directors who were also CEOs, because recent evidence shows that CEO-directors play a pivotal role (relative to other directors) in determining the extent to which a board develops a passive or active orientation (Lorsch and MacIver, 1989: 18; Westphal and Zajac, 1997). The *Forbes* 500 uses multiple lists whose overlap depends on the specific size measure used; we included top managers of those firms that qualified according to two or more size measures. Directors were excluded from the final sample if complete diversification and compensation data were unavailable. This procedure yielded a final sample of 491 directors. *T*-tests revealed no significant differences between this sample and the larger population across any of the director, board, or firm attributes for which data were available on the larger population (i.e., director age, compensation level, board composition or leadership structure at the director's home company, or profitability or size—measured as log of sales—of the director's home company).

Data were collected for the years 1985 to 1992, inclusive. We obtained data on interlock ties, board structure, and CEO and outside director characteristics from the *Dun and Bradstreet Reference Book of Corporate Management, Standard & Poor's Register of Corporations, Directors, and Executives,* and *Who's Who in Finance and Industry;* compensation data came from proxy statements. Finally, we obtained diversification data from Standard & Poor's COMPUSTAT *Business Segment Tapes* and *Compact Disclosure;* size and performance data were provided by COMPUSTAT and the Center for Research in Security Prices (CRSP).

Independent Variables

We measured participation in increased board control across five different indicators. For each indicator, we first calculated the measure for each board in the sample in each year and then created measures of participation in increased board control for each year by comparing—for all boards on which the focal individual sits—the value of the given measure in year t with the value in year $t - 1$. Thus, for

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

example, we first measured the outsider ratio in each year as the number of nonemployee directors divided by the total number of board members. We then calculated *participation in increased outsider ratio* as the number of boards on which the focal individual sits that increased the ratio of outside to inside directors from year $t - 1$ to year t. Board leadership structure was measured dichotomously, coded as 1 if the CEO and board chair positions are separate in a given year, and 0 otherwise. To measure *participation in CEO/board chair separation,* we calculated the number of boards on which the focal individual sits with combined CEO-board chair position in year $t - 1$ and separated CEO-board chair positions in year t.

In some cases, as in the outsider ratio, it was also possible to measure participation in increased board control as the *average* change across all boards on which the individual serves as director. We chose to treat each change as a dichotomous event for theoretical and empirical reasons. Theoretically, for most of the five measures, any change should represent a distinctive and visible event to managers and directors on other boards (exceptions are discussed further below). Empirically, the size of change is very restricted for several of our independent variables, e.g., boards rarely increase the outsider ratio by adding more than two individuals to the board, so that the magnitude of such increases is very similar across cases (Mizruchi and Stearns, 1988). Thus the count variables based on dichotomous change measures would be highly correlated with variables indicating the average, continuous change. Nevertheless, to ensure that our results did not hinge on one particular specification, we also conducted a separate analysis measuring participation as the average change in the relevant measure across all boards on which the individual serves as director (i.e., for those changes that can be measured continuously). The results were very similar to those reported below, suggesting that our findings do not depend on one particular specification of the independent variables.

To measure participation in reduced diversification, we used Palepu's (1985) entropy measure. This measure takes into account the number of segments in which a firm operates and weights each segment according to its contribution to total sales. It is defined as follows:

$$\sum_{i=1}^{n} P_i * \ln(1/P_i),$$

where P is the sales (dollar value) attributed to segment i and $\ln(1/P_i)$ is the weight for each segment i, or the logarithm of the inverse of its sales. We calculated reduced diversification as a decrease in the entropy measure exceeding one standard deviation, to capture relatively significant change and exclude change that reflects random alterations in segment sales levels (Amit and Livnat, 1988). The results were substantively similar using alternative thresholds, such as a decrease of one-half of one standard deviation. The standard deviation is based on change in diversification from year $t - 1$ to year t. *Participation in*

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

reduced diversification was then measured as the number of firms where the focal individual serves as director that decreased diversification from the prior year to the current year.

To assess participation in increased compensation contingency, we first calculated contingency for each year as the total value of long-term incentive grants divided by total direct compensation. Short-term bonuses were not included in this measure because they are notoriously susceptible to manipulation (Healy, 1985), but stock options were included. Although it is possible for companies to "swap" higher-priced options for lower-priced options, thus diluting their incentive effect, this practice is extremely rare. We valued stock options using the Black-Scholes (1973) method, which estimates option value based on the historical price volatility of the underlying security. Other grants (e.g., restricted stock, performance shares, etc.) were valued according to the market price at date of grant (Crystal, 1984). All compensation values were adjusted for inflation to represent 1990 constant dollars using the Consumer Price Index. This approach to measuring compensation contingency is commonly used by compensation consultants (e.g., Crystal, 1984; Ellig, 1984).

By contrast, the simple correlation between CEO pay and firm performance is a very problematic measure of compensation contingency. The most serious problem is how to treat long-term incentives in such a measure. The value of long-term incentive grants (e.g., stock options, which confer the right to buy shares of common stock in the future) depends on *future* performance, while salary, bonus, and other forms of compensation depend on *prior* performance. Thus total compensation could not be correlated with performance over a single period. Researchers have sometimes attempted to avoid this problem by excluding long-term incentives from their measures of compensation. This approach is problematic in assessing the correlation between pay and performance, however, because long-term incentive compensation is the primary mechanism that companies use to make pay contingent on performance (cf., Ellig, 1984; Tosi and Gomez-Mejia, 1989; Kerr and Kren, 1992; Westphal and Zajac, 1995; Seward and Walsh, 1996).

We calculated *participation in greater CEO compensation contingency* as the number of firms where the focal individual serves as director that increased compensation contingency from the prior year to the current year. *Participation in reduced total CEO compensation* was calculated as the number of firms where the focal individual serves as director that reduced CEO total direct compensation from the prior year to the current year.

Finally, we created five parallel independent measures gauging participation in *reduced* board independence: *participation in decreased outsider ratio; participation in CEO/board chair combination; participation in increased diversification; participation in reduced compensation contingency;* and *participation in increased total*

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

compensation. Increased total compensation does not exactly parallel decreased total compensation. Rather, we measured it as a positive change in the CEO's total direct compensation exceeding one standard deviation. This enables us to capture relatively distinctive and noticeable changes, since a large portion of companies in the sample increased total compensation in any given year. As with the diversification variables, the results were robust to alternative change thresholds, such as a positive change of one-half of one standard deviation.

Several control variables were included in the analyses. First, an individual's reputation or attractiveness in the director labor market may depend on the performance of companies where he or she has served as director (Fama, 1980). Accordingly, we included a control variable indicating the average profitability of firms at which the focal individual served as outside director in the prior year. We measured profitability as *return on assets,* industry-adjusted at the two-digit Standard Industry Classification (SIC) code level. From a human capital perspective (Becker, 1975), top managers' compensation at their home company may also indicate their worth as a corporate leader and, by extension, their value as an outside director. Alternatively, the level of a top manager's compensation could be viewed as reflecting the degree of board control at that individual's home company, thus providing another indicator of the individual's personal experience with greater or lesser board control. Thus we included the director's total direct compensation (*total compensation*) as CEO in his or her home company as a control variable in all models. This measure includes salary, short-term bonus, and the total value of long-term incentive grants.

Furthermore, because an individual's *age* might be taken as an indication of his or her likely openness to new ideas about board independence and control, we also controlled for age in all models. In addition, the total number of board appointments held by an individual could affect subsequent appointments in several ways. The total number of appointments a person holds might independently affect his or her prestige in the director labor market (Davis, 1993), but workload limitations may prompt CEOs with many appointments to decline further invitations. Accordingly, we controlled for the total number of directorships held in the prior year (*number of prior appointments*). Finally, we also controlled for director participation in CEO succession events (*participation in succession*) on other boards. Although Boeker (1992) suggested that succession is less indicative of board control than outright dismissal, which is more difficult for individuals outside the organization to detect, participation in succession may be related to some of the other indicators of board control used in this study (Harrison, Torres, and Kukulis, 1988) and thus is included as a control variable in all models. This variable is defined as the number of firms at which the focal individual serves as director that experienced CEO succession within the prior year.

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

Dependent Variables

Analyzing change in appointments to boards with high or low control over management required defining and identifying high- and low-control boards. We addressed this by developing an overall measure capturing the extent to which a firm's board displays a relatively enduring orientation toward board control (high control) or board passivity (low control). We began by standardizing the five indicators of board control discussed above and summing these five measures together for each board in the sample. This measure was calculated as the average value over a moving three-year period (i.e., year $t - 2$ to year t) to avoid measurement error that would otherwise arise from temporary fluctuations in relative control. We then distinguished between high- and low-control boards by taking the median split for this measure, separately for each year. Using this information, we constructed two dependent measures: *Additions/subtractions in appointments to boards with low control over management* and *Additions/subtractions in appointments to boards with high control over management.*

We developed separate measures for additions and subtractions in appointments to examine the robustness of our results in predicting losses, as well as gains, in subsequent appointments and thus were able to assess director selection and retention, respectively. In creating these variables, we first calculated an overall change measure in each year as the number of appointments to boards with low or high control in year $t + 2$ minus the number of appointments to boards with low or high control in year t. We measured change in board appointments over a multiyear interval because employment contracts for directors limit the number of openings that are available in any given year. From the two overall change measures we then created four count variables indicating the net increase or decrease in appointments to low- or high-control boards over the two-year period. Table 1 provides the means, standard deviations, and bivariate correlations for all data pooled.

Analysis

We used poisson regression analysis to assess change in board appointments (Maddala, 1983). This technique is suitable for estimating models predicting the number of discrete occurrences (i.e., counts) of some event, in this case, additions or subtractions in board appointments. Separate models were created to analyze change in appointments to boards with high control or low control over management. The individual models analyze the effect that a board member's prior participation (from year $t - 1$ to year t) in each of the five governance-related changes in board structure and strategy or policy decisions has on subsequent additions or subtractions (from year t to year $t + 2$) in appointments to boards with high- or low-control orientations. All control variables were lagged by one year. We observed relationships over five time periods, yielding 2,455 CEO-years of data.

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

Table 1

Descriptive Statistics and Pearson Correlation Coefficients

Variables	Mean	S.D.	1a	1b	1c	1d
1. Participation in:						
a. Increased outsider ratio	.308	.550				
b. CEO/board chair separation	.206	.449	.15			
c. Reduced diversification	.176	.435	.06	.09		
d. Greater compensation contingency	.439	.611	.19	.16	.05	
e. Reduced total compensation	.173	.422	.21	.27	.19	.28
2. Participation in:						
a. Decreased outsider ratio	.173	.454	−.22	−.18	−.19	−.13
b. CEO/board chair combination	.100	.352	−.23	−.16	−.06	−.08
c. Increased diversification	.137	.413	−.09	−.12	−.18	−.06
d. Reduced compensation contingency	.092	.332	−.20	−.17	−.19	−.20
e. Greater total compensation	.091	.321	−.14	−.15	−.05	−.26
3. Average return on assets	.001	.059	−.09	.15	.06	.07
4. Total compensation (in millions)	1.875	2.218	−.11	−.17	−.08	−.13
5. Age	58.519	5.680	−.18	−.05	−.12	−.10
6. Number of prior appointments	4.388	3.212	.08	.11	.12	.07
7. Change in appointments to boards with high control						
a. Subtractions	.746	.767	−.15	−.27	−.23	−.16
b. Additions	1.094	.940	.14	.21	.25	.26
8. Change in appointments to boards with low control						
a. Subtractions	.873	.777	.27	.32	.18	.21
b. Additions	.944	.947	−.25	−.26	−.15	−.23

We also conducted a series of separate analyses using two other models: a generalized least squares (GLS) model and a negative binomial model. The results were substantively consistent with the results of poisson regression analysis reported below (i.e., the tests of statistical significance supported the same set of hypotheses).

RESULTS

Tables 2 and 3 report the results of poisson regression analysis of change in board appointments. The models in Table 2 predict change in appointments to boards with low control over management, while the models in Table 3 predict change in appointments to boards with high board control. As noted earlier, we provide two models in each table to reflect the fact that while our hypotheses apply to change in appointments, we can analyze such changes separately in terms of additions or subtractions to further assess the robustness of the findings. Hypothesis 1a, for example, predicted that participation in increasing the proportion of outside directors would lead to a decrease in appointments to boards with low control over management and an increase in appointments to boards with high control over management. The findings, as shown in Table 2, support this hypothesis: Participating in increasing the outsider ratio is negatively related to subsequent appointments to boards with low control over management. This holds true both in terms of fewer additions to new boards and more subtractions from current boards. The expected converse pattern of results emerged in models predicting appointments to boards with high control over management. The results in Table 3 show that participation in increasing the outsider ratio is positively associated with subsequent appointments to boards with high control over management (both in terms of more additions and fewer subtractions).

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

Table 1 (*continued*)

1e	2a	2b	2c	2d	2e	3	4	5	6	7a	7b	8a
−.30												
−.11	.17											
.01	.11	.13										
−.25	.27	.36	.20									
−.33	.09	.21	.19	.34								
−.12	−.08	−.08	.06	.09	−.12							
−.19	.02	.09	.11	.09	.21	.08						
−.14	.10	.15	.09	.10	.08	.07	−.03					
.05	.14	.06	.14	.10	.09	−.01	.07	.19				
−.07	.24	.29	.05	.22	.11	−.15	.16	.20	−.13			
.08	−.26	−.32	−.04	−.23	−.15	.13	−.09	−.19	.10	−.34		
.22	−.16	−.31	−.07	−.17	−.08	.06	−.20	−.17	−.10	−.38	.21	
−.18	.18	.32	.08	.15	.11	−.05	.18	.12	.14	.33	−.25	−.37

Table 2

Poisson Regression Models of Change in Appointments to Boards with Low Control over Management (N = 2455)*

Independent Variables	Change in Appointments: Subtractions	Change in Appointments: Additions
1. Participation in:		
a. Increased outsider ratio	.408 (.100)•••	−.344 (.118)••
b. CEO/board chair separation	.531 (.157)•••	−.417 (.174)••
c. Reduced diversification	.312 (.138)•	−.374 (.163)•
d. Greater compensation contingency	.270 (.102)••	−.408 (.151)••
e. Reduced total compensation	.389 (.162)••	−.450 (.226)•
2. Participation in:		
a. Decreased outsider ratio	−.170 (.086)•	.206 (.072)••
b. CEO/board chair combination	−.594 (.135)•••	.393 (.142)•••
c. Increased diversification	−.077 (.097)	.040 (.089)
d. Reduced compensation contingency	−.227 (.095)••	.208 (.081)••
e. Greater total compensation	−.256 (.140)	.280 (.154)
3. Average return on assets	.572 (.594)	−.524 (.612)
4. Total compensation	−.00002 (.00001)•	.00003 (.00001)••
5. Age	−.015 (.007)•	.010 (.005)•
6. Number of prior appointments	−.021 (.017)	.016 (.014)
7. Participation in succession	.195 (.389)	−.169 (.163)••
Constant	.273 (.175)	.755 (.312)••
Chi square	465.69•••	488.18•••

•$p \leq .05$; ••$p \leq .01$; •••$p \leq .001$; t-tests are one-tailed for hypothesized effects, two-tailed for control variables.
* Unstandardized coefficients are reported. Standard errors are in parentheses.

Hypothesis 1b predicted opposite consequences from participating in decreasing outsider ratios as an outside director. Consistent with this hypothesis, the results indicate that experience with decreasing the outsider ratio is positively associated with subsequent appointments to low-control boards (more additions and fewer subtractions) and negatively associated with subsequent appointments to

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

high-control boards (fewer additions and more subtractions). Taken together, the tests of hypotheses 1a and 1b are quite robust in suggesting that a director's prior experiences with a governance change involving altering the outsider ratio can result in predictable changes in subsequent appointments.

Table 3

Poisson Regression Models of Change in Appointments to Boards with High Control over Management (N = 2455)*

Independent Variables	Change in Appointments	
	Subtractions	Additions
1. Participation in:		
a. Increased outsider ratio	−.237 (.111)•	.214 (.106)•
b. CEO/board chair separation	−.527 (.157)•••	.363 (.174)•
c. Reduced diversification	−.370 (.139)••	.284 (.110)••
d. Greater compensation contingency	−.291 (.149)•	.425 (.112)•••
e. Reduced total compensation	−.179 (.171)	.329 (.211)
2. Participation in:		
a. Decreased outsider ratio	.478 (.073)•••	−.330 (.106)•••
b. CEO/board chair combination	.329 (.082)•••	−.641 (.137)•••
c. Increased diversification	.043 (.094)	−.035 (.113)
d. Reduced compensation contingency	.226 (.093)••	−.362 (.135)••
e. Greater total compensation	.203 (.182)	−.430 (.187)•
3. Average return on assets	−1.148 (.581)	1.169 (.621)
4. Total compensation	.00002 (.00001)•	−.00002 (.00001)•
5. Age	.012 (.006)•	−.016 (.007)•
6. Number of prior appointments	−.023 (.019)	.019 (.017)
7. Participation in succession	−.213 (.123)	.144 (.110)
Constant	.280 (.341)	.643 (.421)
Chi square	297.04•••	334.57•••

• $p \leq .05$; •• $p \leq .01$; ••• $p \leq .001$; t-tests are one-tailed for hypothesized effects, two-tailed for control variables.
* Unstandardized coefficients are reported. Standard errors are in parentheses.

A similar pattern of results emerged in support of hypotheses 2a and 2b. As shown in Tables 2 and 3, participation in separating the CEO and board chair positions is negatively associated with additional appointments to boards with low control over management and positively associated with subsequent subtractions, while for high-control boards, such experience is positively associated with subsequent additions and negatively associated with subsequent subtractions. Moreover, experience in combining the CEO and board chair positions is associated with fewer subsequent appointments to high-control boards (fewer additions and more subtractions) and more subsequent appointments to low-control boards (more additions and fewer subtractions).

Hypotheses 3–5 addressed the consequences of participating in additional strategy and policy changes that reflect greater (or lesser) board control over management. The findings generally support these hypotheses. For example, consistent with hypothesis 3a, participation in decreasing corporate diversification leads to fewer subsequent appointments to boards with low control over management (i.e., fewer additions and more subtractions) and also leads to more subsequent appointments to boards with high control (i.e., more additions and fewer

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

subtractions). The results of testing hypothesis 3b, however, show that participation in increasing corporate diversification is not significantly related to subsequent change in board appointments to either high-control boards or low-control boards.

Hypotheses 4a and 4b, which addressed the effects on subsequent board appointments of a director's prior participation in increasing or decreasing total CEO compensation are generally supported. As hypothesis 4a argued, a director's prior participation in decreasing total CEO compensation is negatively associated with subsequent appointments to boards with low control over management (both in terms of fewer additions and more subtractions) and also is positively associated ($p \leq .10$) with subsequent appointments at high-control boards (but only in terms of additions). Hypothesis 4a is partially supported: Participation in increasing total CEO compensation is positively associated with subsequent appointments to low-control boards (more additions and fewer subtractions) and negatively associated with subsequent appointments to high-control boards (but only for additions).

The results strongly support hypotheses 5a and 5b. Experience with increasing CEO compensation contingency is negatively associated with subsequent appointments to boards with low control (fewer additions and more subtractions) and positively associated with appointments to high-control boards (more additions and fewer subtractions). Conversely, experience with decreased compensation contingency has the opposite effect. In general, therefore, the findings appear to provide robust evidence that participation in specific changes in board structure, corporate strategy, and CEO compensation that reflect change in relative control of CEOs and boards can differentially influence subsequent appointments to boards with high or low control over management.

The control variables yielded several interesting results. The average profitability (return on assets) of firms at which the focal individual served as outside director in the prior year is not related to subsequent change in appointments to boards with low control over management. Average profitability does increase appointments to high-control boards, however (significant at alpha = .10). The director's total compensation as CEO in his or her home company is positively related to appointments at low-control boards and negatively related to appointments at high-control boards. Moreover, older directors gain more subsequent appointments at low-control boards and fewer subsequent appointments to high-control boards.

We also examined the possibility that industry differences might affect our results. In separate analyses, we regressed the changes in board structure and CEO compensation on industry, designated as the company's two-digit SIC code. The industry factors did not significantly predict increased board control over management for any of the measures of board control; *t*-statistics ranged from .810 to 1.289. Thus it appears that our results are not driven by any tendency for

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

boards to choose directors from related industries (e.g., to alleviate resource dependencies).

DISCUSSION

Overall, the findings of this study strongly support our notion that internal organizational politics in the CEO-board relationship can significantly affect the selection and retention of directors and, more generally, the formation and dissolution of board interlocks. The first set of results showed how a director's prior participation on boards engaging in specific changes in board structure and strategy or policy that reflect greater board control can affect subsequent change in board appointments. In general, prior experience with changes indicating increased board control over top management enhanced an individual director's attractiveness at companies with relatively high board control while decreasing his or her attractiveness at companies with relatively passive boards. This result was robust over five different indicators of increased board control: increases in the ratio of outside to inside directors, separation of the CEO and board chair positions, reduced corporate diversification, increased CEO compensation contingency, and decreased total CEO compensation. The results were also quite robust in terms of the type of change (i.e., additions and subtractions) in board appointments.

A second set of results showed the effect on subsequent board appointments of a director's prior participation in specific governance-related changes in the opposite direction, i.e., indicating greater CEO control over management. Overall, prior experience with such changes reduced a director's attractiveness to firms with relatively high board control while increasing his or her attractiveness to firms with more powerful CEOs and weak boards. Again, these results held for multiple indicators and for additions and subtractions in subsequent appointments. Taken together, these two sets of results provide strong evidence that prior experience with increased or decreased board control over management provides an important basis for selecting or retaining directors.

The control variables used in this study provide additional support for a sociopolitical perspective on director selection and board composition. For example, director age is also positively associated with subsequent appointments to low-control boards and negatively associated with appointments to high-control boards. Older directors may be perceived in the market for corporate directors as being more accepting of board passivity in controlling management and less likely to embrace newer perspectives reflecting more active board involvement and control in management decision making. Moreover, directors' own total executive compensation at their home company is positively related to subsequent appointments at companies with low board control and negatively related to appointments at companies with high board control. This suggests that highly paid CEOs may be perceived as individuals who are accustomed to weak board control, which would increase their attractiveness at low board-control companies and decrease their attractiveness at high board-control companies.

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

Finally, the results show that the profitability at companies on whose boards the focal director sits is unrelated to subsequent change in appointments at companies with low board control but is positively related to change in appointments to high-control boards. Thus it appears that an individual's attractiveness in the market for directors may be increased by sitting on boards of highly performing companies, as some financial economists have suggested (Fama, 1980), but this attractiveness applies only within the subsegment of boards with relatively high control over management. Our political perspective shares the economists' interest in the reputation of corporate directors, i.e., how prior director experience can provide a signal to other interested parties, but our theoretical framework is more nuanced. It suggests that reputational effects may be more complex than previously assumed. The market for corporate directors is not driven by a simple "ex post settling up" process in which "high-quality" (active and shareholder-oriented) directors are rewarded and "low-quality" (passive and management-oriented) directors are punished (e.g., Fama, 1980). Our results suggest, instead, that the market for directors in U.S. corporations can reward either type of director, and our theoretical perspective identifies the mechanisms than can generate and sustain such a segmented market for corporate directors.

This study contributes to research on corporate boards of directors by synthesizing three largely nonoverlapping theoretical literatures pertaining to board behavior: the economic literature on director reputation, the sociological literature on board interlocks, and the behavioral literature on CEO-board relationships. The findings show how powerful actors in CEO-board relationships can manage the content of board interlocks to maintain or increase their intraorganizational power. In this way, powerful CEOs can effectively exclude individuals who might import norms of active board monitoring and shareholder representation (i.e., at the expense of managerial preferences), while including individuals who have been socialized into a passive board role (Burt, 1987). In effect, our findings suggest that directors' experience on other boards may serve as a relatively direct reputational indicator of their "sympathy" (Finkelstein and Hambrick, 1989: 124) toward management or shareholder interests, thus providing a primary basis for director selection and retention. Moreover, this interpretation is consistent with the broader literature on power in organizations, which emphasizes control over employee selection and retention as an efficient means of building and maintaining political coalitions (Pfeffer, 1981).

The findings also have implications for theory and research on the formation of board interlocks. While theorists have typically emphasized the role of interorganizational dependencies or classwide interests in determining interlock ties (Useem, 1982; Palmer, 1983; Mizruchi and Stearns, 1988), the results of this study suggest that parochial political interests within the firm may also be an important determinant of interlock structure. In seeking to maintain or increase their influence in CEO-board relationships, powerful

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

corporate leaders help maintain a "segmented" interlock network with relatively few ties between active and passive boards and relatively dense ties between boards with similar power structures. For example, 82 percent of the total number of ties observed are within-group ties, while only 18 percent are between-group ties. Thus, while our results could be viewed as consistent with the notion that interlock ties help elites to "close ranks" in the face of "deviant" behavior (Palmer, 1983: 42), interlocks appear to serve this function for competing subcultures within the broader class of corporate elites. The "rise of shareholder power" documented by Useem (1992: 19), Davis and Thompson (1994), and others (e.g., Zajac and Westphal, 1995) appears to have engendered a managerialist response that has affected the dynamic structure of board interlocks.

Our findings indicate that while organizational practices may spread through the network of interlocking directorates, powerful actors in CEO-board relationships can block or redirect the diffusion of those changes that diminish their control by cutting off interlock ties to other adopters of those practices and steering the diffusion of changes that protect or increase their control over the focal board by adding ties to prior adopters. The theoretical perspective and empirical findings of this study may generalize to the diffusion of other organizational phenomena by suggesting how *intra*organizational political interests can influence the course of *inter*organizational diffusion. Thus, while the role of existing social network ties in facilitating the diffusion of various structural and strategic changes within an organizational field is well understood (cf., Davis, 1991; Haunschild, 1993; Palmer, Jennings, and Zhou, 1993), future research could consider further the endogeneity of such ties, i.e., how they are created or severed and how they may reflect and reinforce the parochial political interests of already-powerful organizational decision makers.

Another question that merits additional research attention is the origin of CEO-board power relationships and how reversals in that relationship might occur. Beatty and Zajac (1994) noted, for example, that the small and young firms they studied (i.e., initial public offering firms) have compensation contracts and corporate governance mechanisms different from those found in large *Fortune* 500 firms. Qualitative and quantitative historical approaches might provide additional insight into how and why such changes occur over time and the implications of such changes on shifting the relative power balance in the CEO-board relationship.

We began our study by asking why increased board independence and control over top management may have spread to some organizations and not to others. We sought to answer this question by developing a cross-level theory of interlock tie creation and dissolution that explains the simultaneous coexistence and persistence of both board-controlled and CEO-controlled firms. Specifically, we showed how powerful CEOs and powerful board members seek directors whose prior director experiences (i.e., reputation) suggest a shared belief about board passivity or activity, respectively, and how this politically rational

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

"matching" and segmentation process of like-minded individuals can influence the dynamic formation and dissolution of corporate interlock ties. These dynamics help to explain the fractured diffusion of increased board independence across large U.S. corporations. More generally, the findings illustrate the promise of developing "meso-level" theoretical frameworks integrating micropolitical factors and macro-social factors to explain organizational behavior. While such "meso-level" frameworks may be more complex than frameworks that address only micro or macro factors, they may offer the greatest potential to account for the simultaneous existence of what appear to be contradictory or opposing organizational phenomena.

REFERENCES

Alderfer, Clayton P.
1986 "The invisible director on corporate boards." Harvard Business Review, 64(6): 38–52.

Amihud, Yakov, and Baruch Lev
1981 "Risk reduction as a managerial motive for conglomerate mergers." Bell Journal of Economics, 12: 605–617.

Amit, Raphael, and Joshua Livnat
1988 "Diversification and the risk-return trade-off." Academy of Management Journal, 31: 154–166.

Baysinger, Barry, and Robert E. Hoskisson
1990 "The composition of boards of directors and strategic control: Effects on corporate strategy." Academy of Management Review, 15: 72–87.

Beatty, Randolph P., and Edward J. Zajac
1994 "Top management incentives, monitoring, and risk sharing: A study of executive compensation, ownership and board structure in initial public offerings." Administrative Science Quarterly, 39: 313–335.

Becker, Gary S.
1975 Human Capital, 2nd ed. New York: National Bureau of Economic Research.

Bettenhausen, Kenneth, and J. Keith Murnighan
1985 "The emergence of norms in competitive decision-making groups." Administrative Science Quarterly, 30: 350–372.

Black, Fischer, and Myron Scholes
1973 "The pricing of options and corporate liabilities." Journal of Political Economy, 81: 637–659.

Boeker, Warren
1992 "Power and managerial dismissal: Scapegoating at the top." Administrative Science Quarterly, 37: 400–421.

Burt, Ronald S.
1987 "Social contagion and innovation: Cohesion versus structural equivalence." American Journal of Sociology, 92: 1287–1335.

Crystal, Graef S.
1984 Questions and Answers on Executive Compensation. Englewood Cliffs, NJ: Prentice-Hall.
1991 In Search of Excess: The Overcompensation of American Executives. New York: W. W. Norton.

Davis, Gerald F.
1991 "Agents without principles? The spread of the poison pill through the intercorporate network." Administrative Science Quarterly, 36: 583–613.
1993 "Who gets ahead in the market for corporate directors: The political economy of multiple board memberships." Academy of Management Best Papers Proceedings: 202–211.

Davis, Gerald F., and Tracy A. Thompson
1994 "A social movement perspective on corporate control." Administrative Science Quarterly, 39: 141–173.

Demb, Ada, and F.-Friedrich Neubauer
1992 The Corporate Board: Confronting the Paradoxes. Oxford: Oxford University Press.

Ellig, Bruce R.
1984 "Incentive plans: Over the long-term." Compensation Review, 16: 26–37.

Fama, Eugene F.
1980 "Agency problems and the theory of the firm." Journal of Political Economy, 88: 288–307.

Fama, Eugene F., and Michael C. Jensen
1983 "The separation of ownership and control." Journal of Law and Economics, 26: 301–325.

Finkelstein, Sydney, and Richard A. D'Aveni
1994 "CEO duality as a double-edged sword: How boards of directors balance entrenchment avoidance and unity of command." Academy of Management Journal, 37: 1079–1108.

Finkelstein, Sydney, and Donald C. Hambrick
1989 "Chief executive compensation: A study of the intersection of markets and political processes." Strategic Management Journal, 10: 121–134.

Fortune
1993 "The king is dead: Why more boards are waking up and pushing out the CEO." January 11: 34–50.

Fredrickson, James W., Donald C. Hambrick, and S. Baumrin
1988 "A model of CEO dismissal." Academy of Management Review, 13: 255–270.

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

Galaskiewicz, Joseph, and Stanley Wasserman
1989 "Mimetic processes within an interorganizational field: An empirical test." Administrative Science Quarterly, 34: 454–479.

Gibbs, Philip A.
1993 "Determinants of corporate restructuring: The relative importance of corporate governance, takeover threat, and free cash flow." Strategic Management Journal, 14: 51–68.

Gladstein, Deborah
1984 "Groups in context: A model of task group effectiveness." Administrative Science Quarterly, 33: 334–365.

Harris, Milton, and Artur Raviv
1979 "Some results on incentive contracts with imperfect information." Journal of Economic Theory, 20: 231–259.

Harrison, J. Richard, David L. Torres, and Sal Kukalis
1988 "The changing of the guard: Turnover and structural change in the top-management positions." Administrative Science Quarterly, 33: 211–232.

Haunschild, Pamela R.
1993 "Interorganizational imitation: The impact of interlocks on corporate acquisition activity." Administrative Science Quarterly, 38: 564–592.

Healy, Paul M.
1985 "The effect of bonus schemes on accounting decisions." Journal of Accounting and Economics, 7: 85–107.

Herman, Edward S.
1981 Corporate Control, Corporate Power. New York: Cambridge University Press.

Hill, Charles W. L., and Scott A. Snell
1988 "External control, corporate strategy, and firm performance in research-intensive industries." Strategic Management Journal, 9: 577–590.

Hoskisson, Robert E., Richard A. Johnson, and Douglas D. Moesel
1994 "Corporate divestiture intensity in restructuring firms: Effects of governance, strategy, and performance." Academy of Management Journal, 37: 1207–1251.

Jensen, Michael C.
1988 "The takeover controversy: Analysis and evidence." In J. C. Coffee, L. Lowenstein, and S. Rose-Ackerman (eds.), Knights, Raiders, and Targets: 314–354. Oxford: Oxford University Press.

Jensen, Michael C., and William H. Meckling
1976 "Theory of the firm: Managerial behavior, agency costs, and ownership structure." Journal of Financial Economics, 3: 305–350.

Kaufman, Bruce E.
1986 The Economics of Labor Markets. Orlando, FL: Dryden Press.

Kerr, Jeffrey L., and Leslie Kren
1992 "Effect of relative decision monitoring on chief executive officer compensation." Academy of Management Journal, 35: 370–397.

Kesner, Idalene F., and Roy B. Johnson
1990 "An investigation of the relationship between board composition and stockholder suits." Strategic Management Journal, 11: 327–336.

Koenig, Thomas, and Robert Gogel
1981 "Models of the significance of interlocking corporate directorates." American Journal of Economics and Sociology, 38: 173–186.

Kosnik, Rita D.
1987 "Greenmail: A study of board performance in corporate governance." Administrative Science Quarterly, 32: 163–185.

Lorsch, Jay W., and Elaine MacIver
1989 Pawns or Potentates: The Reality of America's Corporate Boards. Boston: Harvard Business School Press.

Mace, Myles L.
1971 Directors: Myth and Reality. Boston: Harvard Business School Press.

Maddala, G. S.
1983 Limited-dependent and Qualitative Variables in Econometrics. Cambridge: Cambridge University Press.

Main, Brian G., Charles A. O'Reilly III, and James Wade
1995 "The CEO, the board of directors and executive compensation: Economic and psychological perspectives." Industrial and Corporate Change, 4: 293–332.

Mallette, Paul, and Karen L. Fowler
1992 "Effects of board composition and stock ownership on the adoption of 'poison pills.' " Academy of Management Journal, 35: 1010–1035.

Marris, Robert L.
1964 The Economic Theory of Managerial Capitalism. London: MacMillan.

Mizruchi, Mark S.
1982 The American Corporate Network. Beverly Hills, CA: Sage.
1992 The Structure of Corporate Political Action: Interfirm Relationships and Their Consequences. Cambridge, MA: Harvard University Press.

Mizruchi, Mark S., and Linda Brewster Stearns
1988 "A longitudinal study of the formation of interlocking directorates." Administrative Science Quarterly, 33: 194–210.

Ocasio, William
1996 "Boards as normative arenas." Working paper, Northwestern University, J. L. Kellogg Graduate School of Management.

Ornstein, Michael D.
1980 "Assessing the meaning of corporate interlocks: Canadian evidence." Social Science Research, 9: 287–306.

Palepu, Krishna G.
1985 "Diversification strategy, profit performance, and the entropy measure." Strategic Management Journal, 6: 239–255.

Palmer, Donald
1983 "Broken ties: Interlocking directorates and intercorporate coordination." Administrative Science Quarterly, 28: 40–55.

Palmer, Donald, Roger Friedland, and Jitendra V. Singh
1986 "The ties that bind: Organizational and class bases of stability in a corporate interlock network." American Sociological Review, 51: 781–796.

Palmer, Donald A., P. Devereaux Jennings, and Xueguang Zhou
1993 "Late adoption of the multidivisional form by large U.S. corporations: Institutional, political, and economic accounts." Administrative Science Quarterly, 38: 100–131.

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions

Pennings, Johannes H.
1980 Interlocking Directorates. San Francisco: Jossey-Bass.

Pfeffer, Jeffrey
1981 Power in Organizations. New York: Harper and Row.
1992 Managing with Power. Boston: Harvard Business School Press.

Pfeffer, Jeffrey, and Gerald R. Salancik
1978 The External Control of Organizations: A Resource Dependence Perspective. New York: Harper & Row.

Seward, James K., and James P. Walsh
1996 "The governance and control of voluntary corporate spin-offs." Strategic Management Journal, 17: 25–39.

Stearns, Linda Brewster, and Mark S. Mizruchi
1986 "Broken tie reconstitution and the functions of interorganizational interlocks: A reexamination." Administrative Science Quarterly, 31: 522–538.

Tosi, Henry L., and Luis R. Gomez-Mejia
1989 "The decoupling of CEO pay and performance: An agency theory perspective." Administrative Science Quarterly, 34: 169–189.

Useem, Michael
1982 "Classwide rationality in the politics of managers and directors of large corporations in the United States and Great Britain." Administrative Science Quarterly, 27: 199–226.
1984 The Inner Circle. Oxford: Oxford University Press.
1992 Executive Defense: Shareholder Power and Corporate Reorganization. Cambridge, MA: Harvard University Press.

Vance, Stanley C.
1968 The Corporate Director: A Critical Evaluation. Homewood, IL: Dow Jones-Irwin.
1983 Corporate Leadership: Boards of Directors and Strategy. New York: McGraw-Hill.

Wade, James B., Charles A. O'Reilly, and Ike Chandratat
1990 "Golden parachutes: CEOs and the exercise of social influence." Administrative Science Quarterly, 35: 587–603.

Wall Street Journal
1995a "Despite poor returns, Champion's chairman hangs on for 21 years." October 31: A1.
1995b "Irate shareholders target ineffective board members." November 6: B1.
1995c "How do you fire a CEO? Very, very slowly." January 20: B1.

Westphal, James D., and Edward J. Zajac
1995 "Who shall govern? CEO/board power, demographic similarity, and new director selection." Administrative Science Quarterly, 40: 60–83.
1997 "Defections from the inner circle: Social exchange, reciprocity, and the diffusion of board independence in U.S. corporations." Administrative Science Quarterly, vol. 42 (in press).

Zajac, Edward J.
1988 "Interlocking directorates as an interorganizational strategy: A test of critical assumptions." Academy of Management Journal, 31: 428–438.

Zajac, Edward J., and James D. Westphal
1995 "Accounting for the explanations of CEO compensation: Substance and symbolism." Administrative Science Quarterly, 40: 283–308.
1996 "Who shall succeed? How CEO/board preferences and power affect the choice of new CEOs." Academy of Management Journal, 39: 64–90.

This content downloaded from 128.83.205.78 on Thu, 26 Feb 2015 20:57:09 UTC
All use subject to JSTOR Terms and Conditions