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Cronin, Bruce (2011) Networks of corporate power revisited. Procedia - Social and Behavioral Sciences, 10. pp. 43-51. ISSN 1877-0428 (doi:10.1016/j.sbspro.2011.01.007)

Publisher's version available at:
http://dx.doi.org/10.1016/j.sbspro.2011.01.007

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ScienceDirect

Procedia Social and Behavioral Sciences 10 (2011) 43–51

Procedia
Social and Behavioral Sciences

4th & 5th UK Social Networks Conference

Networks of corporate power revisited

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Elsevier use only: Received date here; revised date here; accepted date here

Abstract

This paper examines developments through the quarter century since the publication of Stokman, Ziegler and Scott's (1985) iconic ten-nation study of the structure of interlocking directorships. The surprising decline of research in the area following the publication of *Networks of Corporate Power* is in part testimony to the rigour of the comparative methods used, raising the standard of evidence required for subsequent director interlock studies. But it also reflected a critical weakness in director interlock research to that point, the limited ability to answer what Mark Mizruchi has called the "So what?" question. While replicated studies found clear structures in director interlocks, varying from country to country, and there was some speculative fit with the distinctive political economies of these countries, there was little evidence of any effect of these structures on firm performance or activity. The more recent resurgence in director interlock research is in some ways rooted in a second generation of the original drivers; the ready availability of now large masses of data on firm governance and firm level performance and further advances in social network analytical techniques. Where Stokman and his colleagues manually compiled lists of directors scoured from company reports, these data are now routinely collected and compiled in accessible databases by government agencies and business information services in many countries. And there has been a gradual accumulation of advances in addressing the "so what" question.
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Keywords: Interlocking directors; corporate power; longitudinal network analysis; performance; elite cohesion

1. Introduction

Stokman, Ziegler and Scott's (1985) *Networks of Corporate Power* remains the most comprehensive and systematic cross-national comparison of director interlocking. Using a standard methodology, contributors examined interlocks among the 200 largest firms by turnover in ten, predominantly European, countries, together with a considerations of transnational interlocks and an attempt to measure performance effects of these ties. The research programme represented a significant consolidation on the disperse set of methods, sampling and research questions that had defined the largely US-focused director interlock studies to that point. Other cross-national comparisons,

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1877-0428 © 2010 Published by Elsevier Ltd.
doi:10.1016/j.sbspro.2011.01.007

confirming a face relationship between interlocks and capital market structure, but with less systematic comparative methodologies include Scott (1985) and Windolf (2002).

The general findings of the study were that interlocking was most widespread among large, national, domestic, public, non-retail firms and tended to be clustered around ownership groups. A face association between the national structures of director interlocks and the form of their capital markets was apparent. Transnational interlocks were predominantly bi-national and the extent of trans-Atlantic connection detected was limited by the methodological focus on the most central firms (c.f. Fennema 1982). Some small (generally negative) associations were found between interlocks and some specific performance indicators but Meeusen and Cuyvers (1985: 71) were confident that, "a fascinating research programme in industrial economics thus announces itself" .

But despite this promise, the findings and the potential to build on the systematic methodology employed in the study, *Networks of Corporate Power* was met by, what Mizruchi (1996) has described as "the 'so what?' question" and published research on interlocking directorships subsequently plummeted (see Figure 1). The "so what?" question arose from the relationship between interlock structure and national capital markets, normally strongly influenced by the regulatory framework, with little evidence that this amounted to more than epiphenomena; boards appointed directors they encountered in the funding markets they engaged with. There was no particular reason to interpret this as a matter of corporate control or power and the structure could as well arise as a result of the limited pool of potential directors or random effects. Conyon & Muldoon (2006), for example, found the "small world" phenomena in US, UK and Germany director interlocks to be statistically insignificant from that found in random networks, when the latter is appropriately paramatized (c.f. Davis et al 2003; Robbins & Alexander 2004). The effect was less so for board-board links.

As Mizruchi (1996) famously put it, while the structural features of interlocking were persistent, there was little understanding of the mechanisms of "What do interlocks do?" There were also clear methodological limitations in terms of the limited 200 firm network boundary set, albeit a formidable data collection task before the days of computerised registries, and in terms of the cross-sectional design, which was particularly problematic for the attempt to detect performance effects. The decline of this research agenda also had ideological drivers. The pioneering interlock studies at the beginning of the 20th century were undertaken to try to pin down collusive activity among big firms or more broadly the foundations of capitalist class unity; similar motivations underpinned the examination of industry-banking ties in the 1960s and 70s and the concern with control at the heart of *Networks of Corporate Power*. But the popularity of these concerns waned in the 1980s and 1990s with the rise of neoliberalism and the concept of globalisation, diverting attention away from nationally-focused structures.

After a long hiatus, however, a number of developments have underpinned a renaissance in director interlock research in the last decade. First, developments in social network analysis have provided a wider range of metrics providing greater insight into the nature of networks, together with the ability to more readily handle larger datasets and with automated visualisations. Second, the development of computerised registries and the aggregation of corporate data by information brokers have made very large datasets on inter-corporate relationships available. *Orbis*, for example provides ready access to the records of 60 million companies while, alongside firm-level financial series running back to the 1950s, *Worldscope* publishes more than a decade's details of the ownership of listed companies worldwide, providing the basis for the emergence of longitudinal interlock studies such as Kogut and Belinky (2008). Thirdly, a new and larger generation of analysts have sought accessible applications to test a wide variety of approaches to network research. Fourth, ideologically, the failures of neoliberalism and the evident complexities of globalisation have cultivated a renewed interest in issues of power in business at both national and inter-national levels. Finally, a slow accumulation of evidence of performance effects has provided the basis for the beginnings of an answer to the "so what?" question.

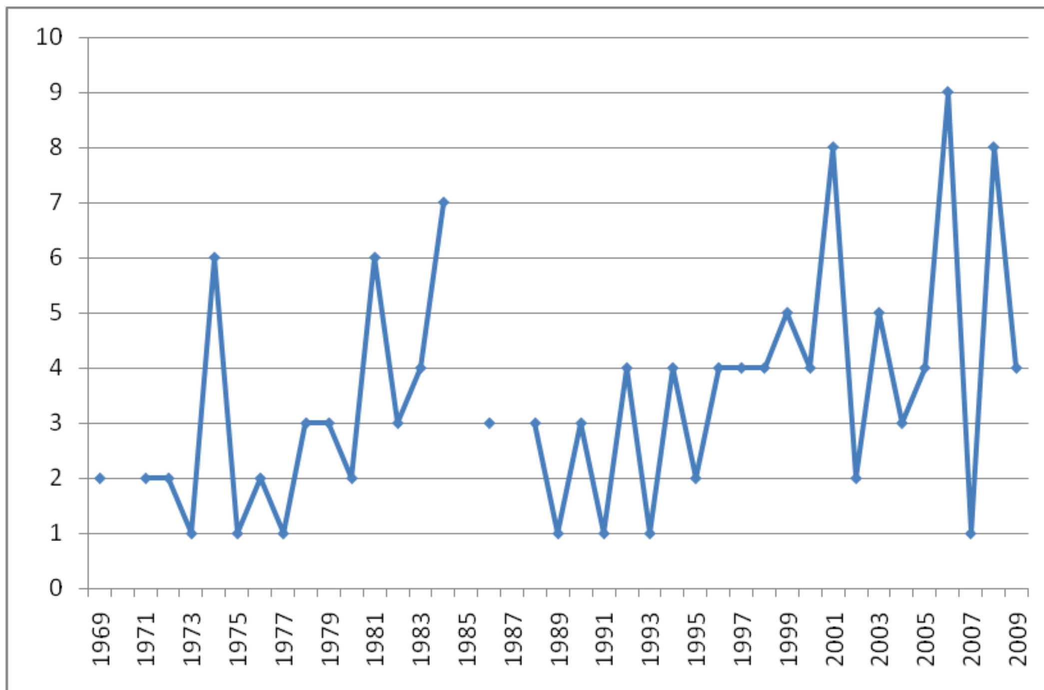

Figure 1. Published director interlock studies 1969-2009 by year

Derived from a key word search of *Ebsco Business Source Total* for the terms "interlocking directorates or director interlocks", finding a total of 142 articles.

2.Geographic and scale extensions

The renaissance of director interlock studies has extended understanding in terms of geographic scope, scale and effects. A notable feature has been the extension of studies from a developed, predominantly Anglo-American, context to consideration of small open economies and the newly industrialising countries. In particular, attention was given to the Asian exceptionalism of Japanese *kerietsu* and Korean *chaebol* to explain the industrial escape from economic dependency. Putting aside, the US, whose national characteristics were established in the 1970s and where subsequent studies tend to be more about the mechanisms and effects of interlocking in general, the pattern of geographic diversification in interlock research is apparent in Figure 2.

Alongside the extension of geographic scope, there has been an extension in the scale of studies, utilising the larger databases and computing power that have become available. The work on larger datasets has predominantly been in the pursuit of evidence of performance effects, which have otherwise proved somewhat elusive. This combines the examination of larger numbers of firms and directors with longitudinal series, often panel data, to provide datasets with great variation and thus greater potential to reveal the significance of persistent effects that are less detectable in small cross-sections.

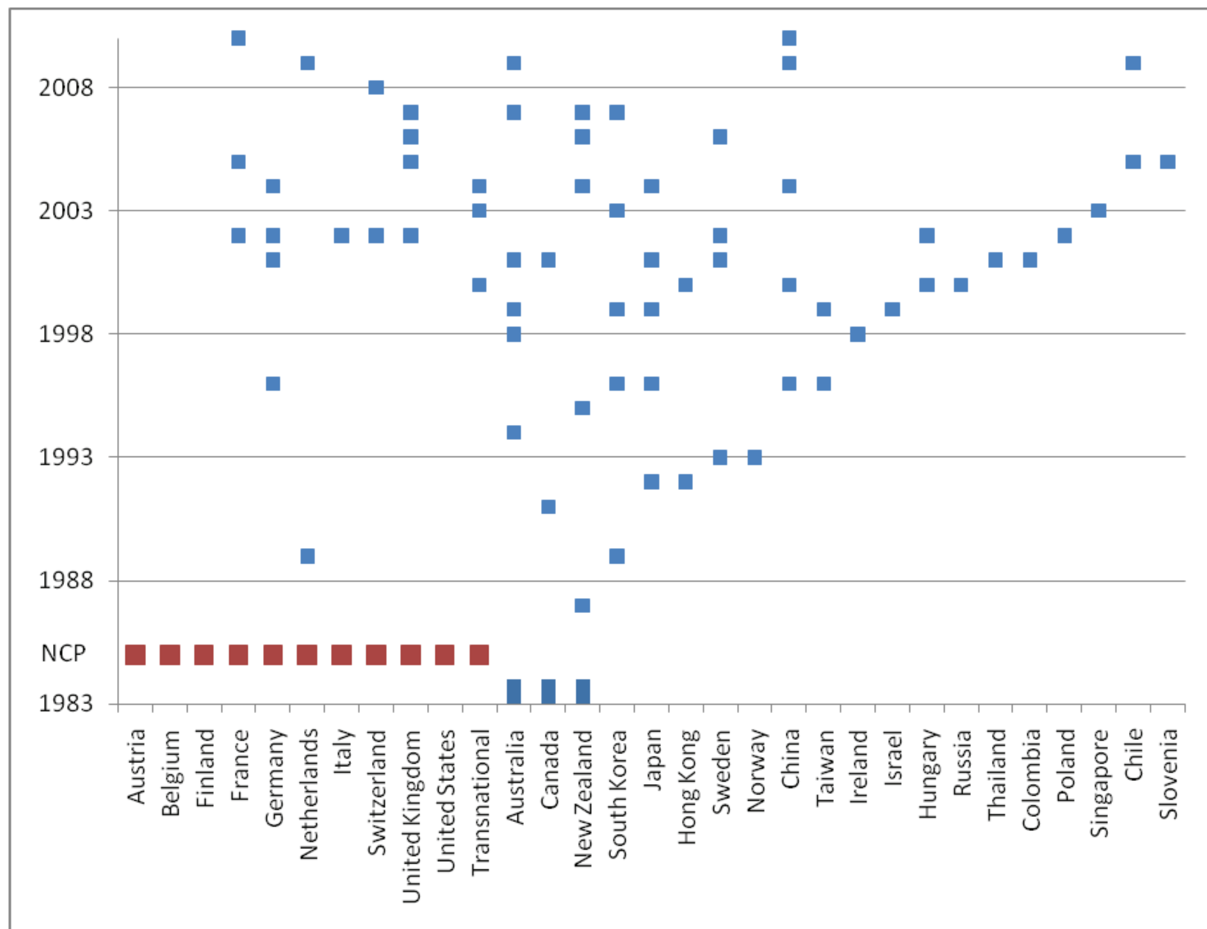

Figure 2. Geographic focus of published director interlock studies by year 1984-2010, excluding USA.

Source: *Ebsco Business Source Total* and author's compilation.

Table 1. Large-Scale Studies of Performance Effects

Country	Firms	Period	Type	Performance indicator	Reference
US	78	1988 (200 days)	Longitudinal	Abnormal stock price returns	Cordeiro (1993)
China	535	1988-90	Panel	Profit, output per worker	Keister (1998)
Israel	104	1974-87	Longitudinal	% interlocks among affiliated firms	Maman (1999)
US	433	1986-95	Panel	Advertising/sales Net plant & equip/sales Admin/sales Debt/equity # related & diversified acquisitions Stock grants / CEO direct comp.	Westphal et al. (2001)
UK	6428	2004	Cross-sectional	Return on investment Return on assets	Cronin & Popov (2005)
Sweden	328	2000-03 (daily)	Panel survival	Stock repurchase	Bohman 2006 (2006)
US	8000	2000-07	Panel	Purchase by private equity	Stuart & Yim (2010)
Hungary	1696	1987-01	Longitudinal	Revenue growth	Vedres & Stark (2010)

3. Performance effects

Mizruchi's (1996) comprehensive review of director interlock research went some way to answer the "so what?" question, identifying a broad range of studies that had found elements of corporate activity associated with director interlocks. These were predominantly forms of mimetic isomorphism (M. S. Mizruchi & Fein, 1999); sharing directors provided a channel for the transfer of business practices from one firm to another. A number of these concerned corporate tactics in the aggressive corporate acquisition environment of the 1980s, which undoubtedly would have been a major discussion point in boardroom circles. These included greenmail (Kosnik, 1987), the poison-pill defence (G. F. Davis, 1991), golden parachutes (Wade, O'Reilly, & Chandratat, 1990) and acquisition propensity in general (P. R. Haunschild, 1993). Other mimicry concerned organisational structure and financing, again a major preoccupation of boards. These included adoption of the multi-divisional form (Fligstein, 1985; Palmer, Jennings, & Zhou, 1993), financial restructuring (Fligstein, 1990), external financing (M. Mizruchi & Galaskiewicz, 1994) and CEO salaries (Bearden & Mintz, 1985; Hallock, 1997; O'Reilly III, Main, & Crystal, 1988). Finally, various studies found director interlock patterns underpinning similarities in political campaign contributions (Koenig, Gogel, & Sonquist, 1979; M. S. Mizruchi, 1992; Neustadtl & Clawson, 1988) and corporate philanthropy (Galaskiewicz & Wasserman, 1989), reflecting board pre-eminence over stakeholder relationships.

But while this highlighted an important diffusion and homogenising process around understandable preoccupations at board level, few studies were indentified that revealed an impact of director interlocks on everyday operations or performance. Haveman (1993) had found mimicry in the markets that leading firms entered, associated with director interlocks. But evidence on direct performance effects of interlocking was mixed, with some (B. D. Baysinger & Butler, 1985) or no significant association in general (Fligstein & Brantley, 1992), little association with interlocking within the same industry in the US, though some outside the US (Burt, 1983; Carrington, 1981; Pennings, 1980) and some positive association with links with financial firms, particularly at low performance levels (Bunting, 1976; Meeusen & Cuyvers, 1985). However, this research was limited by its predominantly cross-sectional or comparative cross-sectional nature; longitudinal approaches were needed for confident assessments of causality (Kanter & Eccles, 1992; M. S. Mizruchi, 1996).

In any case, corporate performance, particularly in terms of residual categories such as profitability, is more appropriately analysed in longitudinal terms, possible only now with the larger datasets available. Consequently, more recent studies in these terms have highlighted some modest performance effects, with UK interlocking associated with profit margins and returns on shareholders' funds but weaker impact of financial "distress" than in the USA (Cronin & Popov, 2005). Performance of joint ventures is higher in the presence of director interlocks, due to the mediation of agency effects (Cordeiro, 1993), reciprocal interlocking by CEOs has a small positive association with Tobin's Q (Fich & White, 2005) and interlocks with politicians increases cumulative abnormal returns in daily stock returns (Faccio, 2006; Fisman, 2001).

Since the late 1990's there have been a number studies on the effects of director interlocks on corporate governance, often utilising financial market data. These effects include executive compensation in the presence of reciprocal interlocks (Core, Holthausen, & Larcker, 1999; Hallock, 1997; Hwang & Kim, 2009; Westphal, Seidel, & Stewart, 2001), golden parachutes (Gerald F. Davis & Greve, 1997), external director scrutiny (Westphal & Zajac, 1997), listing decisions (Edling & Sandell, 2001), option-backdating (Bizjak, Lemmon, & Whitby, 2009) and decision-making styles (Westphal, Seidel, & Stewart, 2001). These studies generally suggest firms utilise the communication channels provided by director interlocks in conditions of uncertainty, such as that following regulatory change.

There has also been further progress in identifying the impact of director interlocks on the diffusion of operational processes important to business performance, including ISO quality accreditation (Wai Fong & Petty, 1999), acquisitions (Westphal, Seidel, & Stewart., 2001), particularly by firms outside the interlock core (Pamela R. Haunschild & Beckman, 1998), corporate strategy in general (B. Baysinger & Hoskisson, 1990; Geletkanycz & Hambrick, 1997). These effects tend to be greatest within industries rather than across different industries as the business environment and strategic priorities differ between industries.

4. Elite cohesion

In parallel with the accumulation of findings on the performance effects of director networks, further evidence has been uncovered on the way director interlocks contribute to elite cohesion. Director interlocks have long been suggested as an important constituent of capitalist elite cohesion (Domhoff, 1975; Mills, 1956; Zeitlin, 1974), with Useem (1984) identifying an "inner circle" of managers who are interlocked on company boards and socialise in elite clubs. More recently, evidence has been found of conservative political partisanship among groups of interlocked directors, particularly among executives (Allen, 1991; Bond, 2004; Burris, 1991; Neustadtl & Clawson, 1988). This extends to indirect interlocks, particularly those with financial institutions (M. S. Mizruchi, 1992), but also similarity in donations to politicians by directors as far as six steps away from each other (Burris, 2005).
Such director groupings are distinct from the specific interests of the boards on which they serve (Burris, 1991). Multiple interlocking is associated with membership of elite clubs (Johnsen & Mintz, 1989; Soref, 1976), prior service on the boards of the 100 largest firms and with business associations (Windlof, 2002). Similarly, alongside "old wealth", service on business associations was a key characteristic of directors contributing to the early Reagan campaign and the New Right in 1980 (Burris, 1991). The existing director network is a channel for the search for new directors and CEOs (Conyon & Muldoon, 2006; Khurana, 2002) and the longer a CEO's tenure, the greater the number directors that are drawn from the CEO's informal social network (Hwang & Kim, 2009). Director interlocks also reinforce CEO power within the board, where appointments reflect the CEO's own preferences for board passivity or activity (Zajac & Westphal, 1996). Director interlocking, then, is a clear factor in elite grouping outside the boards themselves.

A secondary dynamic is apparent in the relationship of some directors with wealthy families. In a pioneering study, Sweezy (1953) identified eight "interest groups", each controlled through ownership or director appointments by a wealthy family and financial associates, linking half the top 200 US corporations and banks. Allen & Broyle (1989) found wealthy individuals more likely to make political donations if they were prominent as directors of companies, foundations or otherwise listed in *Who's Who*. They were more likely to donate in general and more likely to donate to the Republican Party where they were members of families with large shareholdings in the oil industry or in government contractors. Burris (1991) found directors in general more likely to donate to the early Reagan campaign, but not the New Right in general, where their firms were defence contractors.

Finally, in something of a synthesis of the elite and operational perspectives, there has been a growing body of research on the effects of informal social ties, such as friendship and common schooling, on inter-organisational relations and corporate performance in contrast to the standard restriction to formal board positions. Informal social ties are associated with middle-market bank lending (Uzzi, 1999), increased revenue per room among competing hotels through informal market sharing (Ingram & Roberts, 2000) and information advantages to mutual fund managers and analysts (Cohen, Frazzini, & Malloy, 2008). Managers of vertically dependent firms tend to form social ties, presumably to limit the potential for opportunist behaviour (Westphal, Boivie, & Ming Chng, 2006) and firms face lower legal fees when they have developed social ties with legal firms, as the risks of adverse selection are reduced (Uzzi & Lancaster, 2004).

5. Conclusion

The notion of corporate power has remained somewhat ambiguous within the vast field of director interlock research. Much research has focused on corporate power over the immediate business environment and relationships with external organisations, the performance issue. But, as discussed, the power to perform is conditioned by the tools available and many of these are themselves products of diffusion among social networks. Access to specific networks, then, influences performance and changes the focus to concepts of elites and elite cohesion. Much of the focus of this side of director interlock research is on the business-political interface, which has the potential to strongly influence the business environment and thus corporate performance. Yet here too, the informal social ties that contribute to elite unity also prove to have specific performance effects.

The tools, techniques and indicative findings in director interlock research over the last 25 years suggest it is time to revisit *Networks of Corporate Power*, this time with more systematic reference to performance effects. The 1985 project clearly demonstrated the value of a structured, comparative approach. Today there is capacity to extend this

project well beyond Europe and the USA, utilising the large standardised longitudinal datasets and panel design to identify persistent effects in what are otherwise disguised in residuals. At the same time, in the spirit of the original study, such a project demands a nationally-distributed research team because the national context remains so important.

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