

CEOs' Social Capital and Corporate Governance Practices

Ever since Berle and Means (1932) seminal study, researchers have been grappling with the essential question of who controls the corporation, and recent corporate events have provided additional anecdotal evidence of the ability CEOs have in influencing board of directors, and obtaining very favorable contractual conditions, not necessarily in line with shareholders' interests. How do CEOs influence their boards even after for many years corporate governance reforms tried to curb their power? In my dissertation, I suggest that to understand the CEO-board relation and the outcomes of corporate governance processes, it is essential to investigate the social position of CEOs and board members in the corporate elite. So, the research question of my dissertation is: How can CEOs take advantage of their social capital to weave influence on their boards?

Over the last several years, researchers have paid attention to the relation between managers' social capital and achievement. In organizational research, social capital, *an individual's social network*, influences career success (Burt, 1992; Podolny & Baron, 1997), executive compensation (Belliveau, O'Reilly III, & Wade, 1996; Burt, 2000), managerial performance (Moran, 2005) and job finding (Baker, 2000; Granovetter, 1973) among other things. Surprisingly, to the best of my knowledge there has been little consideration of how CEOs may use their social relationships in order to obtain personal benefits that might go against shareholders' interests.

According to agency theory, information asymmetry encourages managers' self-serving behavior. Agency problems boost when there is an accumulation of power in CEOs' hands. More powerful or influential CEOs make decisions and choices regarding the use of corporate resources that benefit them personally at the cost of the firm (Fama & Jensen, 1983). Therefore they have less probability of being replaced, obtain more latitude in determining corporate strategy and extract higher wages and larger perquisites from shareholders (Shleifer & Vishny, 1989). Jensen extended these ideas to controversial

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governance practices as golden parachutes arguing that CEOs may abuse of this protection provision (Jensen, 1984).

In order to control and limit CEOs' self-serving behavior, corporate governance and agency theory researchers proposed different governance mechanisms as equity ownership by managers (Jensen & Meckling, 1976), corporate takeovers (Fama, 1991) and independent board of directors (Fama & Jensen, 1983). Over the last two decades, a corporate takeover market emerged, stock option programs were adopted by public companies and board of directors were strengthened through the appointment of outsider directors and the creation of dual board leadership (Sundaramurthy, 1996). However cross sectional variation among firms regarding CEOs' beneficial provisions persist.

Economic sociologists have convincingly argued that economic actors, such as managers, are embedded in concrete social relations that contribute to shaping their actions (Granovetter, 1985, 1992; Uzzi, 1997). However, studies of CEO self-serving behavior frequently focus on aspects such as information asymmetries, economic incentives (Jensen & Meckling, 1976), market control (Fama, 1991), board composition, leadership structure, tenure of board members (Sundaramurthy, 1996) and internal board dynamics (Westphal, 1998; Westphal & Khanna, 2003). So far the effect of CEOs' corporate elite network on CEOs' opportunistic behavior has been neglected. My goal is to investigate how CEOs' social positions in the corporate elite can affect their ability to obtain favorable conditions from their boards. Implicitly, my analysis recognizes the shareholder/management agency problem. However, in my view CEOs' self serving behavior is not seen solely as a result of weak formal corporate control mechanisms. Rather, CEOs' opportunism can be curbed, or enhanced by the social structure of the corporate elite surrounding them. I use data on board of directors' network of US corporations as a proxy for CEOs' social capital, and investigate how it affects the occurrence of two controversial governance provisions: Accelerated cash out and Golden parachutes.

HYPOTHESES

One measure of social capital used in the present study is CEOs' structural holes. Ronald Burt's theory uses the term structural holes for "separation between nonredundant contacts" (Burt, 1992, 2000).

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Structural holes create a competitive advantage for an individual whose relationships span the holes because they are a source of information. Burt also argues that non redundant networks provide a control advantage given that structural holes yield control benefits, basing his argument on Simmel's conception of the "tertius gaudens" (third who benefits) (Burt, 1992). A third individual connecting two unconnected players can exploit the lack of connection.

But why CEOs with networks rich in structural holes have better chances to weave influence on the board? CEOs with networks rich in structural holes participate in more than one board. Ties with other boards are channels of communication and power for the CEO. A CEO that is a multiple director can use the information acquired in different board rooms to exercise power in his own board. Also, CEOs that participate in many boards acquired status and legitimacy, therefore increasing her influence in her own board of directors. Directors from the focal board have no opportunity to get together privately to compare contradictory notes by CEO that is a multiple director or to control the diverse information the CEO obtain from the different boards in which she participates. Directors might have many difficulties to figure out which CEOs goals are in play and were. In sum, directors find difficult to judge and control CEOs actions because they are evaluating at structural disadvantage. A lack of connections creates vulnerability.

Therefore, having a CEO that span structural holes will be positively associated with having controversial corporate provisions as golden parachutes or accelerated cash out. The existence or absence of structural holes is capture by the level of constraint index; this measure defines the constraint on the CEO from a lack of structural holes around his contacts (Burt, 1992). Following this line of argument a reasonable hypothesis could be:

Hypothesis 1: Firms with less constrained CEOs are more likely to have accelerated cash out and golden parachutes.

A second measure of social capital used in the present study is CEOs' nestedness. "actor's nestedness in a social network is the deepest cutest level within which the actor resides" (Moody and White 2003) p.112. Because structural cohesion facilitates influence, a CEO nested in a structural cohesive group of

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non executive directors will absorb from them a set of principles and rules of conduct which influence his strategy preferences and dispositions. Bringing together non executive director's negative disposition regarding CEOs' beneficial corporate provisions and structural cohesion, I suggest the following hypothesis:

Hypothesis 2: Firms with a CEO nested in a structurally cohesive group mainly compound by non executive directors are less likely to have accelerated cash out and golden parachutes

CEOs could also be nested in a cohesive group of other CEOs and executive directors. In such cases the CEO can also become socialized into belief systems that endorse the corporate practices through social influence from other top managers (McDonald and Westphal 2003). So, considering executive director's preference regarding corporate provisions and structural cohesion, I suggest the following hypothesis:

Hypothesis 3: Firms with a CEO nested in a structurally cohesive group mainly compound by executive directors are more likely to have accelerated cash out and golden parachutes

DATA & METHODS

I will use data on board of directors' network of US corporations as a proxy for CEOs' social capital, and investigate how it affects the occurrence of two controversial governance provisions: Accelerated cash out and Golden parachutes. Data on the network of directors connected through firms, CEOs' attributes, executives' equity ownership, institutional ownership and composition of the board of directors was obtained from Investor Responsibility Research Center (IRRC). Data on both provisions was obtained from the IRRC governance file. Firm-specific accounting variables were drawn from the COMPUSTAT.

I will use a logistic regression model for the regression analysis. Logit model is appropriate for my analysis because the dependent variable is dichotomous (Long, 2001). In my work, the unit of analysis is the board of directors because the board makes the decision of having or not a Golden Parachute or an Accelerated cash outs.

PRELIMINARY RESULTS

I found that firms guided by CEOs with a network rich in structural holes are more likely to have both provisions, accelerated cash out and golden parachutes. Additionally, I found that board exposure to both

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provisions does not contribute to understand the variation in accelerated cash outs and golden parachutes among boards.

CONTRIBUTIONS

First, my work contributes to research on interlocking directorates by examining ties among individual directors and the significance of those ties for CEO's influence over the board. The thesis that interlocking directorates influence corporate governance practices is not new, but most of this body of knowledge focuses on information diffusion and changes in governance regimes. Previous research does show that interlocking directorates influence the diffusion of strategy practices (Gulati & Westphal, 1999; Haunschild, 1993, 1994; Haunschild & Beckman, 1998) and governance regimes (Davis, 1991; Davis & Greve, 1997). However, these studies only considered the firm interlock network, without exploring the consequences of the full network of individual directors and CEOs created by common membership on corporate boards. Recent work by Burris on interlocking directorates and political cohesion among corporate elites is a noteworthy exception (Burris, 2005).

Second, I will contribute to understanding the variation in corporate governance provision among boards, linking the social position of the CEO and the board members in the corporate elite and corporate governance processes within the board, showing that CEOs might be able to take advantage of their social position to influence the governance process in their companies.

Third, by linking structural conditions with board structure, I will attempted to understand the social reality experienced and enacted by corporate participants. Social relationships facilitate not only the distribution of information but also the formation of meaning and the social construction of trust that facilitates CEOs self serving behavior.

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