COLLABORATION IN THE BOARDROOM: BEHAVIORAL AND PERFORMANCE CONSEQUENCES OF CEO-BOARD SOCIAL TIES

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Empirical research has typically rested on the assumption that board independence from management enhances board effectiveness in administering firms. The present study shows how and when a lack of social independence can increase board involvement and firm performance by raising the frequency of advice and counsel interactions between CEOs and outside directors. Hypotheses were tested with original survey data from 243 CEOs and 564 outside directors on behavioral processes and dynamics in management-board relationships.

In recent years, corporate stakeholders have expressed increased concern about the influence of boards of directors over corporate affairs. Large institutional investors, for instance, have strongly criticized the relationships that are thought to exist between top managers and outside directors in many corporations. In particular, advocates of board reform have commonly suggested that boards lack independence from top management and that their dependence fosters board passivity in the decision-making process. This perspective is reflected in the popular media, where it is frequently assumed that social ties between top managers and outside directors (e.g., friendships) diminish board effectiveness; such relationships are often described in pejorative terms as “chummy” or even “collusive” (Wall Street Journal, 1993: B1; 1995, 1996).

Academic research on boards has also devoted increased attention to how CEO-board relationships influence board effectiveness. Empirical researchers have often assumed that a lack of social independence from management can compromise board effectiveness in the strategy-making process. It has been proposed, for instance, that CEOs keep their boards largely passive and uninvolved in strategic decision making through cooptation, or packing boards with their supporters (e.g., Herman, 1981; Mace, 1986; Wade, O’Reilly, & Chandratat, 1990). Outside directors are thought to engage in less vigilant monitoring and to exert less control over top managers with whom they have close personal ties (e.g., Fredrickson, Hambrick, & Baumrin, 1988; Spencer, 1983; Walsh & Seward, 1990).

The present study departs from this dominant view of how a lack of board social independence from management affects a board’s contribution to strategic decision making. The perspective developed in this study first builds on prior literature in which a board’s role in an organization has been broadly conceived as including two different forms of administration: the provision of advice and counsel and the exercise of oversight and control (cf. Pfeffer & Salancik, 1978). I then develop a theoretical framework that draws from the literatures on advice seeking and social ties in organizations to consider how social factors such as trust and perceived social obligations in CEO-board relationships may promote rather than hinder board involvement and effectiveness in administering a firm. In particular, although existing perspectives tend to suggest that a lack of independence should reduce a board’s involvement and effectiveness in firm administration, this study examines how social ties between top managers and outside directors may facilitate board involvement by encouraging the provision of advice and counsel in the strategy-making process.

The theoretical framework developed in this study also addresses the issue of when this alternative model of board social independence and involvement is more or less applicable than the more
traditional empirical model that focuses primarily on how board independence affects control. In particular, I explore how managerial incentive alignment may affect whether social ties between a CEO and board enhance involvement by encouraging CEO-board collaboration rather than reduce board involvement by hindering vigilant control. The proposed theoretical framework was tested with a comprehensive data set that combines longitudinal archival data on board structure, CEO compensation, and performance with primary survey data from a large sample of both top managers and outside directors regarding processes and dynamics in CEO-board relationships. The following section first describes the traditional perspective on how social ties in CEO-board relationships affect board involvement in strategic decision making and then develops an alternative "collaboration model" of the relationship between CEO-board social ties and board involvement in firm administration.

CEO-BOARD SOCIAL TIES AND BOARD INVOLVEMENT

The Independent Board Model

Much of the empirical literature examining how CEO-board relationships influence board involvement in firm governance is predicated on the assumption that effective boards influence corporate strategy and performance primarily by monitoring management on behalf of shareholders. For instance, Walsh and Seward (1990) described the board as an internal control mechanism, and Kosnik (1987, 1990) emphasized the role of outside directors in disciplining managerial decision making. Moreover, governance researchers have stressed that effective corporate directors serve shareholders by actively evaluating managerial performance (Boyd, 1994; Rechner & Dalton, 1991; Westphal & Zajac, 1995).

Theoretical support for the importance of board monitoring as a form of involvement is rooted in agency theory (Jensen & Meckling, 1976). According to this perspective, the function of boards is to reduce agency costs resulting from the delegation of strategic decision making, or "decision management," to top executives by exercising "decision control," which involves monitoring managerial decision making and performance (Fama & Jensen, 1983: 303). In doing so, boards rely crucially upon outside directors, who are considered less likely than insiders to "collude with managers to expropriate residual claimants" (Fama & Jensen, 1983: 315). The formal independence possessed by outsiders is assumed to permit more objective evaluation. Several studies have examined the influence of board independence on director involvement in strategic decision making. Johnson, Hoskisson, and Hitt (1993) and Judge and Zethaml (1992) provided evidence that including more outside directors on a board increased board involvement (cf. Pearce & Zahra, 1991). These studies have suggested that the presence of more outside directors might promote involvement by raising the level of monitoring and control.

Researchers have also recognized variation in the extent to which outside directors are truly independent. Although outside board members are formally independent of top management, powerful social and psychological factors are thought to compromise their willingness and ability to objectively monitor managerial performance. From this perspective, CEOs use their influence over director selection to render boards passive by favoring the appointment of personal friends and other individuals with whom they share close social ties (Finkelstein & Hambrick, 1988; Johnson et al., 1993; Kimberly & Zajac, 1988). Researchers have also theorized that social ties are created through the appointment process itself. Board appointments confer prestige and status, as well as financial rewards and perquisites. Thus, given norms of reciprocity, outside directors should feel socially obligated to support CEOs who favored their appointment (Johnson et al., 1993; Wade et al., 1990). Overall, the dominant perspective in prior research on CEO-board relations suggests that personal social ties and obligations between managers and directors critically impair a board's capacity to monitor and control management decision making and performance, thus diminishing effective board involvement in the strategy-making process.

The Collaborative Board Model

Although much of the empirical literature on board involvement is based on the assumption that boards contribute to strategy primarily by monitoring management, the larger literature on boards suggests an additional way in which directors can influence strategy. Pfeffer and Salancik's (1978: 170) influential discussion of the different possible functions performed by outside directors distinguished between a board's role as an administrative body and its role in linking an organization with its environment. They further identified two distinct functions within the broader administrative role: the provision of expert advice and counsel and the exercise of oversight and control.

Several other scholars have also suggested that boards can extend their involvement beyond monitoring to the provision of ongoing advice and
counsel on strategic issues (e.g., Baysinger & Butler, 1985; Gomez-Mejia & Wiseman, 1997; Johnson, Daily, & Ellstrand, 1996; Whislcr, 1984; Zahra & Pearce, 1989). Bacon and Brown (1975: 18) and Lorsch (1989) described how directors may serve as a sounding board for management in addition to exercising control, and Alderfer (1986) suggested that the best CEO-board relationships included ongoing collaboration in the decision-making process (cf. Spencer, 1983). Although several prior studies have thus considered the board role in providing advice, there is some disagreement about the role of outside directors in exercising this function. Baysinger and Butler (1985) suggested that outside directors serve primarily to exercise control and that inside directors are the main source of advice on strategic issues. Daily and Dalton (1994) argued, however, that outside directors can provide access to valuable information—about, for instance, how to secure needed resources from the environment—in addition to exercising control (cf. Judge & Zeithaml, 1992; Pearce & Zahra, 1991; Pfeffer & Salancik, 1978).

Thus, the provision of advice has been recognized as a potentially important form of board involvement, but empirical researchers have neither explicitly modeled advisory relations nor examined how social factors may enhance a board's ability to exercise this function. Whereas the independent board model focuses on how social ties in the CEO-board relationship may diminish board involvement in firm decision making by reducing monitoring activity, it is suggested here that boards may provide advice and counsel as well as engage in control and that social ties may increase the prominence of advisory interactions as a form of involvement. Social ties with outside directors should enhance the propensity of top managers to solicit their advice on strategic issues while also increasing the outside directors' tendency to offer such advice. According to the larger literature on advice seeking, a primary inhibitor to seeking advice is the perceived effect it could have on the advice seeker's status. Employees tend to believe that others will view their need for assistance as an admission of uncertainty or dependency and as an indication that they are less than fully competent or self-reliant (Blau, 1955; Rosen, 1983). Moreover, individuals seeking advice from a superior may need to disclose the existence of problems and to admit their own limitations in solving them—implicitly or explicitly—thus relinquishing power derived from information asymmetry in the agency relationship (Jensen & Meckling, 1976).

This concern about losing status has been shown to inhibit a variety of different kinds of advice seeking. Allen (1977) showed that engineers sought relatively few technical ideas from others because they feared that such requests would engender skepticism about their competence. Ashford and Northcraft (1992) found evidence that feedback seeking by managers was impeded by impression management concerns, or a fear of appearing uncertain or dependent, and these concerns were particularly salient in an evaluative context, when the information providers (e.g., directors) were in a position to evaluate the person seeking information (e.g., a CEO). Studies have shown, however, that personal relationships increase employees' tendency to seek advice from either friends or others in their work units by creating a sense of social security that reduces the perceived risk (Anderson & Williams, 1996; Fischer, 1982; Rosen, 1983). Personal ties encourage advice seeking by enhancing mutual trust. Trust has been described as the willingness to take risks, or to make oneself vulnerable (cf. Mayer, Davis, & Schoorman, 1995). Thus, social ties should encourage CEO advice seeking by increasing a CEO's willingness to take the perceived social and professional risks associated with such behavior. Much research in organizational behavior has shown that interpersonal trust promotes cooperative problem-solving activity in groups (Zand, 1972) and enhances upward communication in superior-subordinate dyads (Roberts & O'Reilly, 1974).

The literature on helping behavior also suggests that people feel more comfortable offering advice to individuals with whom they have a social relationship, and research on friendship has shown that people feel socially obligated to give advice to friends who appear in need of assistance (Shah & Jehn, 1993). Moreover, dyadic social ties may have additional, board-level effects. The small-groups literature suggests that as the proportion of individuals offering advice increases, social conformity pressures may increase the likelihood that remaining group members will engage in similar behavior (Hackman, 1992).

Thus, the perspective developed in this study suggests that although boards may engage in both monitoring and advice giving, CEO-board social relations can determine the relative emphases they place on these roles; according to the independent board model, social ties should decrease involvement by reducing monitoring activity; in contrast, according to the collaboration model, such relations should increase involvement by encouraging the provision of advice and counsel on strategic issues. I next develop specific hypotheses.

**CEO-board friendship ties.** Silver characterized friendship as “prototypical [of] personal relations that are normatively free of instrumental and calculative orientations” (1990: 1474). Krackhardt (1992) noted that friendship implies trust, or the...
expectation of personal loyalty. Similarly, Segal (1979) noted that certain social obligations are normatively part of the friendship relationship: for instance, a friend is expected to come to one’s aid or defense when needed. The friendship relation is governed by communal norms, whereby individuals are obligated to care for each other’s welfare, rather than exchange-based norms, whereby individuals are concerned with reciprocation of benefits (Clark & Mills, 1982; Jehn & Shaw, 1997). Thus, friendship ties between a CEO and outside directors should increase a board’s loyalty to the CEO. Although the independent board model suggests that such loyalty should diminish board monitoring activity, the collaboration model discussed above suggests that perceived friendship ties may increase a CEO’s advice-seeking behavior by enhancing his or her trust in the board’s support, while also enhancing the board’s perceived social obligation to provide assistance. Thus,

**Hypothesis 1a.** Friendship ties between a CEO and a board will be negatively associated with the board’s monitoring of the CEO.

**Hypothesis 2a.** Friendship ties between a CEO and a board will be positively associated with interactions between them involving advice and counsel on strategic issues.

**Director appointment by a CEO.** As discussed above, norms of reciprocity may cause outside board members to feel socially obligated to support the CEO who was responsible for nominating them to a board (Boeker, 1992; Daily & Dalton, 1995). In fact, several empirical studies have provided evidence that the portion of a board appointed by a CEO can enhance the board’s support for the CEO’s leadership. Studies have linked the percentage of CEO appointments to the size of CEO compensation packages and explanations for CEO incentive compensation as well as to the adoption of antitakeover provisions (Lambert, Larcker, & Weigelt, 1993; Main, O’Reilly, & Wade, 1995; Zajac & Westphal, 1995). Thus, the conventional independent board model would suggest that boards comprised largely of a CEO’s appointees would be less likely to engage in vigilant monitoring of CEO performance, because most of the directors feel socially obligated to return the favor of appointment by supporting the CEO’s leadership. According to the collaboration model, however, a high proportion of outside directors appointed by a CEO may engender a closer, more collaborative working relationship by enhancing the CEO’s trust in the support of his or her directors. Thus,

**Hypothesis 1b.** The portion of outside directors appointed after a given CEO’s appointment will be negatively associated with board monitoring of the CEO.

**Hypothesis 2b.** The portion of outside directors appointed after a given CEO’s appointment will be positively associated with interactions between the CEO and board involving advice and counsel on strategic issues.

**Incentive Alignment and Board Involvement**

The discussion thus far has developed two models of how CEO-board relations affect board involvement in managerial decision making. This section considers how normative agency theory might help determine when each model is most applicable. On the one hand, the costs of lower levels of board control may depend on whether partial substitutes for monitoring are available. Although some level of board monitoring is necessary and valuable, agency theorists recognize financial incentives as a partial substitute for monitoring activities, suggesting that the need for monitoring declines as agent incentives are aligned more closely with the interests of principals (Gomez-Mejia & Balkin, 1992; Gomez-Mejia & Wiseman, 1997; Kosnik, 1990). Empirical evidence suggests that relatively large reductions in agency costs are derived from the mere introduction of financial incentives, or from relatively small levels of incentive alignment (Rediker & Seth, 1995; Zajac & Westphal, 1994). Thus, when CEO incentives have been introduced, the agency costs associated with CEO-board social ties should be relatively small.

Further, CEO financial incentives should not only reduce the costs of CEO-board social ties, but should also enhance the benefits of such ties. From an agency perspective, incentive alignment motivates a CEO to use corporate resources to the advantage of shareholders (Jensen & Murphy, 1990). Several studies in the small groups literature have shown that when mechanisms are in place to motivate groups’ members to pursue stakeholder objectives, social cohesion facilitates productive group interaction; the absence of such mechanisms, however, can lead to a negative relationship between cohesion and productive interaction (Guzzo & Shea, 1992; Schachter, Ellerston, McBride, & Gregory, 1951; Seashore, 1954). Thus, incentive alignment should motivate CEOs to use their social capital as a resource in developing more effective policies for shareholders. Accordingly, financial incentive alignment should moderate the effects of CEO-board social ties on board involvement: when incentive alignment is present, the collaboration model is more applicable, and when incentive
alignment is absent, the independent board model is more germane. Thus,

**Hypothesis 3.** The higher the level of CEO incentive alignment, the weaker the negative relationship between (a) CEO-board friendship ties and board monitoring of a CEO and (b) the portion of outside directors appointed after the CEO and board monitoring of the CEO.

**Hypothesis 4.** The higher the level of CEO incentive alignment, the stronger the positive relationship between (a) CEO-board friendship ties and interactions between the CEO and board involving advice and counsel on strategic issues and (b) the portion of outside directors appointed after the CEO and these interactions.

**Board Involvement and Firm Performance**

Prior evidence regarding the ultimate performance consequences of board independence from management has been inconsistent (cf. Finkelstein & Hambrick, 1996). This inconsistency can be resolved, in part, by specifying the different behavioral processes (that is, forms of board involvement in strategic decision making) that could mediate this relationship (Cook & Campbell, 1979). According to the collaboration model, social ties may ultimately enhance firm performance by enabling boards to extend their involvement beyond decision control to decision management (Fama & Jensen, 1983: 303). From this perspective, board advice and counsel complement board monitoring as a form of involvement: when involvement extends beyond control to include advisory interactions, directors participate in formulating strategic decisions as well as in evaluating them (through periodic CEO performance reviews, for instance), so that boards influence each major phase of the decision-making process.

Several researchers have recognized the potential value of outside director advice and counsel in generating strategic proposals. Johnson, Daily, and Ellstrand (1996) suggested that advice and counsel interactions may enable top managers to tap the breadth of knowledge possessed by outside directors, thus complementing the depth of firm-specific knowledge held by insiders. Pfeffer and Salancik (1978) also discussed how advice and counsel from outside directors can broaden the range of strategic options considered by management, and Judge and Zeithaml (1992) suggested that fresh perspectives and new information provided by outside directors can help managers identify promising strategic opportunities. This view is consistent with the larger literature on group decision making, which has shown that a closed leadership style characterized by a failure to incorporate outside perspectives in making decisions can lead to truncated consideration of alternatives and adherence to faulty or obsolete assumptions (Janis, 1982; Tetlock, Peterson, McGuire, Chang, & Feld, 1992). Conversely, the solicitation of outside opinions can help expose unrealistic assumptions or alternatives and prevent premature conclusions.

Moreover, as agency theorists have acknowledged, although board monitoring can help partially resolve the agency problem between managers and shareholders, its effectiveness is limited by information asymmetries in the CEO-board relationship (Jensen & Meckling, 1976). Outside directors may not become aware of organizational problems in a timely fashion (cf. Baker, Jensen, & Murphy, 1988). To the extent that CEOs must often disclose information about organizational problems in seeking advice from outside directors, advice seeking reduces this information asymmetry and results in more informed board involvement. This formulation is consistent with prior research on leader-member exchange showing that superior-subordinate relationships characterized by frequent advisory interactions (in addition to supervisory control interactions) yield the highest performance (Bauer & Green, 1996). Thus, the quality of board involvement may be higher where monitoring activity is complemented by relatively high levels of director advice and counsel.

This discussion suggests two additional hypotheses. In the first, a positive relationship between board monitoring and subsequent firm performance is predicted; this hypothesis, together with Hypotheses 1a and 1b, addresses whether social ties ultimately reduce firm performance by lowering the level of board monitoring, as suggested by the independent board model. The second hypothesis, together with Hypotheses 2a and 2b, addresses whether social ties ultimately enhance firm performance by raising the level of board advice and counsel, as the collaboration model suggests.

**Hypothesis 5.** Board monitoring of CEOs will be positively associated with subsequent firm performance.

**Hypothesis 6.** CEO-board interactions involving advice and counsel on strategic issues will be positively associated with subsequent firm performance.
Incentive Alignment, Board Involvement, and Firm Performance

Finally, agency theory also suggests that CEO incentive alignment moderates the effects of board involvement on firm performance. To the extent that CEO incentives can partially substitute for board monitoring as a solution to the agency problem (Jensen & Meckling, 1976), higher incentive alignment should lessen the need for monitoring activity, reducing the relationship between monitoring and performance. In effect, where CEO interests are already well aligned with shareholder interests, there is less incremental benefit from a marginal increase in monitoring activity. In addition, incentives should also increase the relationship between CEO advice seeking and performance. From an agency perspective, incentive alignment should focus managerial attention and effort toward using corporate resources in a way that benefits shareholders. Thus, incentives should motivate managers not only to seek advice from outside directors (as argued above), but also to follow through and incorporate useful information and perspectives gained from those interactions into strategic decisions. Thus,

Hypothesis 7. The higher the level of CEO incentive alignment, the weaker the positive relationship between board monitoring of a CEO and subsequent firm performance.

Hypothesis 8. The higher the level of CEO incentive alignment, the stronger the positive relationship between CEO-board interactions involving advice and counsel on strategic issues and subsequent firm performance.

Overall, then, incentive alignment was expected to moderate relationships between CEO-board social ties, board involvement, and firm performance. As incentive alignment increases, the behavioral and ultimate performance consequences of CEO-board social ties should become more consistent with the collaborative board model and less consistent with the independent board model.

METHODS

Sample and Data Collection

The sample frame for this study consisted of 600 companies randomly selected from the Forbes 1,000 index of U.S. industrial and service firms. I sent a questionnaire to all 600 CEOs from these companies and, to permit interrater reliability assessments, sent a second survey to the outside directors of each company whose CEO responded to the first survey (N = 1,312). Directors who sat on more than one board in the survey sample were asked to respond for only one company (the company was randomly selected and specified in the cover letter); similarly, CEOs who sat on another board in the survey sample were not surveyed twice. The surveys were distributed in April 1995.

Surveys of corporate top managers have often suffered from response rates of less than 25 percent, and response rates above 40 percent are exceptional (Judge & Dobbins, 1995). To ensure the highest possible number of responses in this case, I took the following steps (Forsythe, 1977; Fowler, 1993; Groves, Cialdini, & Couper, 1992): (1) an in-depth pretest (described below) was used to streamline the survey, making it easier and more appealing to complete, (2) requests for participation linked the current study with an ongoing series of surveys on top management issues conducted by a major business school to which hundreds of the surveyed CEOs' and directors' peers had responded, and (3) nonrespondents were sent a new questionnaire about 21 days after the initial mailing. The response rate for CEOs was 44 percent (N = 263), and for directors, it was 43 percent (N = 564). Data on incentive alignment and ownership were obtained from proxy statements, and data on board composition and board structure were obtained from proxies, Standard and Poor's Register, the Dun and Bradstreet Reference, and Who's Who in Finance and Industry. I used the COMPUSTAT and CRSP (Center for Research on Securities Prices) databases to obtain performance, size, and industry data. Archival data were unavailable for 20 of the companies with responding CEOs, leaving a final sample of 243 CEOs and an effective response rate of 41 percent.1 Firms in the final sample represented 27 different two-digit Standard Industrial Classification (SIC) categories in both the manufacturing and service sectors, including financial services firms and electric utilities, and ranged from single-product firms to highly diversified conglomerates. In addition, these firms ranged from 260 million to 58 billion in sales, from 500 to 200,000 employees, and from 500 million to 195 billion in assets.

For the 543 companies for which complete archival data were available, I examined whether respondents and nonrespondents differed significantly on variables derived from archival sources using the Kolmogorov-Smirnov test (Siegel & Castel-

1 On average, 2.14 directors responded per firm (minimum of 0, maximum of 5).
lan, 1988). This test assesses whether significant differences exist in the distribution of respondents and nonrespondents for a given variable. This is a stringent test, because if the sample distributions differ significantly at any point, it is concluded that the samples come from different populations. The results of this test provided consistent evidence across multiple variables that respondents and nonrespondents came from the same population; the variables were incentive alignment, firm performance, size, and the number of a firm’s directors appointed after its CEO ($p = .32-.77$).

**Dependent Measures**

To enhance the construct validity of the survey measures, I conducted a pretest involving in-depth pilot interviews with 22 top managers and board members (cf. Fowler, 1993: 102). After each individual had completed the pilot questionnaire, I asked him or her to identify questions that were unclear, difficult to answer, or potentially subject to bias. I also used these interviews to ensure that questions were interpreted as expected, to identify improvements to the format of the survey, and to modify its length. To reduce response bias, multiple response formats were used, and items measuring each construct were scattered throughout the survey (DeVellis, 1991). Moreover, drawing on input from the pilot interviews, I carefully worded the final questions to minimize the likelihood of social desirability bias.

Advice and counsel interactions and board monitoring were assessed with two multi-item scales in the CEO survey (see Appendix A for the texts of these scales). In developing the wording of the questions, I drew from available qualitative research suggesting how top managers and directors describe CEO-board interaction and a board’s role vis-à-vis management; feedback from the pilot interviews was used to further improve the clarity and face validity of each question. The items were factor-analyzed with the iterated principal factors method. A “scree” test indicated two common factors, and “promax” rotation verified that the advice and monitoring items loaded on different factors as expected, with loadings for each item greater than .5 on one factor and less than .2 on the other. Cronbach’s alpha was .88 for the advice and counsel scale and .92 for the monitoring scale, suggesting acceptable interitem reliabilities (Nunnally, 1978). I estimated advice and monitoring factors using the Bartlett method.

I examined interrater reliability by comparing CEO and outside director responses for the monitoring and advice items, calculating kappa coefficients for each item. Kappa is a correlation coefficient that corrects for the expected level of correlation between raters. The sample included companies with a responding CEO and at least one responding outside director ($n = 188$). As shown in Table 1, kappa coefficients exceeded .75 for all but one survey item, and the overall kappa was .82, which represents an exceptional level of agreement according to criteria set forth by Fleiss (1981).^3

Two measures of firm performance were used: return on equity (an accounting-based measure) and the market-to-book value of equity (a market-based measure). The latter measure gauges a firm’s effectiveness in creating value for shareholders by comparing its market value with the cost of capital contributed by shareholders. Following Johnson and colleagues (1993) and Judge and Dobbins (1995), I adjusted each measure for industry differences by subtracting the average value for the firm’s primary industry. Performance was measured two years after the survey date ($year_{t+2}$). In other analyses, I measured performance in $year_{t+1}$, and the results reported below were substantively unchanged.

**Independent Measures**

The portion of a board appointed after a CEO was calculated as the number of outside directors appointed during a CEO’s tenure divided by the total number of outside board members. To assess the level of CEO-board friendship ties, CEOs were asked to consider their personal relationships with outside board members and to indicate (1) how

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^2 Although this test could not be applied to board leadership structure, a difference of proportions test showed that respondents and nonrespondents did not differ significantly on the proportion of firms with separate CEO and board chair positions (.29 versus .27, $p = .37$). Respondents and nonrespondents were also not significantly different with respect to the number of board memberships they held ($p = .69$), and separate analyses confirmed that the subset of firms with a responding CEO and at least one responding outside director ($n = 188$) was also not significantly different from other firms in the sample frame on the independent and dependent variables measured with archival data.

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^3 Correlations between the monitoring variable and several control variables provided further evidence for construct validity. The monitoring measure was positively associated with archival variables that have been used in prior studies as causal indicators of monitoring, including CEO–board chair separation ($p = .34$), director stock ownership ($p = .27$), blockholder ownership ($p = .17$), and institutional ownership ($p = .20$).
TABLE 1
Results of Interrater Reliability Assessment*  

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<tr>
<th>Itemb</th>
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<td></td>
<td></td>
<td>Observed</td>
<td>Expected</td>
<td>κ</td>
<td>Z^</td>
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<tr>
<td>Board monitoring</td>
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</tr>
<tr>
<td>1. To what extent does the board monitor top management strategic decision making?</td>
<td>86.50%</td>
<td>24.86%</td>
<td>.82</td>
<td>24.80</td>
<td></td>
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<tr>
<td>2. To what extent does the board formally evaluate your performance?</td>
<td>85.65</td>
<td>21.16</td>
<td>.82</td>
<td>24.97</td>
<td></td>
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<tr>
<td>3. To what extent does the board defer to your judgment on final strategic decisions?</td>
<td>87.76</td>
<td>25.82</td>
<td>.84</td>
<td>25.47</td>
<td></td>
</tr>
<tr>
<td>Advice and counsel interactions</td>
<td></td>
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</tr>
<tr>
<td>1. To what extent do you solicit board assistance in the formulation of corporate strategy?</td>
<td>79.32</td>
<td>24.00</td>
<td>.73</td>
<td>21.75</td>
<td></td>
</tr>
<tr>
<td>2. To what extent are outside directors a “sounding board” on strategic issues?</td>
<td>85.73</td>
<td>21.11</td>
<td>.81</td>
<td>24.65</td>
<td></td>
</tr>
<tr>
<td>3. How often have directors provided advice and counsel in discussions outside of board/committee meetings (by telephone or in person)?</td>
<td>87.09</td>
<td>24.65</td>
<td>.83</td>
<td>25.14</td>
<td></td>
</tr>
<tr>
<td>Overall κ</td>
<td></td>
<td></td>
<td></td>
<td>.82</td>
<td>24.98</td>
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</table>

* N = 188. Where multiple outside directors responded for the same company, director responses were averaged. This procedure helped to ensure that reliability estimates were not inflated by common perspectives derived from respondents’ holding the same position.

b The phrasing of each item is taken from the CEO survey; most items were altered appropriately for the director survey. For purposes of comparison across items, I calculated kappas for continuous-scale items by converting them into categorical variables (i.e., dividing into quartiles).

c Z-statistics for all kappas are highly significant.

d Although this item restricts advice and counsel to CEO-initiated interactions, the results reported for the regression analyses were substantively unchanged when this item was excluded.

many they considered to be acquaintances but not friends and (2) how many they considered to be friends. Excluding mere acquaintances allowed a more precise measure of perceived friendship (cf. Chatman & Brown, 1995). The number of perceived friends was then divided by the total number of outside board members. This approach to measuring friendship is commonly used in organizational research (e.g., Brass, 1984; Krackhardt, 1992). It was not necessary to validate the survey measure of friendship ties against some alternative, behavioral measure, because the theoretical arguments regarding advice seeking required only that CEOs perceived the presence of friendship. Moreover, a separate analysis of interrater reliability showed a high level of agreement between CEOs and responding board members about the number of outsider directors who were friends of the CEO (κ = .76).^4

I used two measures of CEO incentive alignment commonly used in the governance literature (e.g., Bergh, 1995; Kosnik, 1990; Johnson et al., 1993). First, CEO ownership was measured as the number of common shares owned by the CEO divided by the total amount of common stock outstanding. This definition captures the extent to which an agency problem exists by measuring the extent to which ownership and control are separated. It also reflects evidence in social psychology and organizational behavior for the “mere ownership effect” (Beggan, 1992: 229), which suggests that individuals feel more motivated to protect property as their ownership stake increases, independent of the property’s financial value. Second, long-term incentive plan compensation indicated the extent to which CEO compensation was contingent upon the achievement of specific performance goals. Goal specificity has been identified as a critical determinant of motivation (Locke, Shaw, Saari, & Latham, 1981), and Larcker (1983) and Jarrell (1993) both discussed how incentives can lengthen executives’ time horizons and focus their attention on creating shareholder value. Long-term incentive plan compensation was calculated as the total value of long-term incentive grants made in the year prior to the

* Although high interrater reliability should allay concerns about response bias, I also conducted an analysis in which friendship was measured with the CEO survey and advice was measured with the director survey; the results were unchanged. Since the advice items preceded the friendship items on the director survey, these relationships cannot be attributed to response bias. I also conducted an analysis in which friendship ties excluded relationships formed after the director(s) joined the boards and, again, the results were unchanged; this finding rules out the possibility that advice interactions encouraged the formation of friendship, rather than the reverse.
survey date divided by total compensation in that year (cf. Westphal & Zajac, 1995).

**Control Variables**

Several control variables were included in the analyses. First, "problemistic" search could lead firms' leaders to react to poor performance with higher levels of monitoring or advice interactions (Cyert & March, 1963). Prior studies have offered mixed evidence on the relationship between firm performance and changes in board composition thought to increase monitoring capacity (Daily & Dalton, 1995; Hermelin & Weisbach, 1988), but two recent studies have provided evidence for a negative relationship between firm performance and overall board involvement (Johnson et al., 1993; Judge & Zeithaml, 1992). Thus, I controlled for firm performance in the year prior to the time the survey was administered in models of board monitoring and advice. I also controlled for the prior value of firm performance in models predicting subsequent performance, consistent with prior research (e.g., Haveman, 1992).

Although prior evidence regarding the effect of firm size on board decision making is also mixed (Finkelstein & Hambrick, 1996), one might expect the greater complexity involved in governing large organizations to make directors at such firms more inclined to delegate decision-making responsibility, reducing their involvement (Zajac & Westphal, 1994). Thus, I controlled for sales (measured as a logarithm) in all models. Prior research has suggested that directors lack the structural power to control management decisions when the CEO also serves as board chair, and some evidence links board leadership structure to responsible decision making (Mallette & Fowler, 1992; Westphal & Zajac, 1995); thus, a variable indicating *separation of the CEO and board chair positions* was included in the monitoring models (this variable was not necessarily expected to influence advice interactions, and separate analyses confirmed that it was unrelated to advice and did not affect the hypothesized results). I also controlled for *CEO tenure*. CEOs are most likely to consider major strategic changes early in their tenures (Gabarro, 1985), so length of tenure may be related to board involvement in strategy making. Daily (1996) suggested that directors who are affiliated with a focal firm through a family or business relationship may have access to valuable sources of information, raising the possibility that director affiliations could influence the level of board involvement. Thus, I controlled for the percentage of outside directors who were affiliated with a focal firm using two measures: *affiliated directors: family ties* and *affiliated directors: business ties*. The measures were based on the Securities and Exchange Commission's definitions of the relevant relationships.

Given some prior evidence that ownership by outside directors or other external blockholders may increase a board's motivation and/or power to exercise control, I included both ownership measures in the analyses (Bergh, 1995). *Director ownership* was measured as the percentage of total common equity held by outside directors, and *blockholder ownership* was measured as the percentage held by owners of 5 percent or more of a firm's common voting shares, excluding managers, directors, and institutions (e.g., Bergh, 1995). Although prior evidence is mixed (e.g., Bethel & Liebeskind, 1993; Black, 1998; Wahal, 1996), some authors have suggested that institutional owners, in particular, are active in compelling higher levels of board control (Davis & Thompson, 1994). Thus, I controlled for *institutional ownership*, measured as the percentage of total common stock held by pension funds, banks and trust companies, savings and loans, mutual fund managers, and labor union funds (Kochhar & David, 1996; Hill & Hansen, 1991; Kochhar & David, 1996). Given that powerful owners could also affect management decision making independent of their influence over board involvement, these variables were included in the models of performance calculated for this study, as well as in the models of board monitoring and advice. Finally, I controlled for change in corporate strategy in the models of performance, given that strategic change can disrupt organizations in a way that impairs performance or can facilitate adaptation that enhances performance (cf. Hannan & Freeman, 1989; Zajac & Shortell, 1989). Finally, I measured *change in corporate strategy* as the change in the entropy measure of diversification over the two-year period prior to survey administration.

**Analysis**

Since the proposed relationships between CEO-board social ties, monitoring, and advice interactions were recursive, I used ordinary least squares (OLS) multiple regression analysis to estimate models of monitoring and advice (Johnston, 1984). The performance models were estimated using two-stage least squares regression. To the extent

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5 In separate analyses, I restricted this measure to ownership by institutions classified as "pressure-resistant" by Kochhar and David (1996), including public pension funds, mutual funds, and foundations. The results were substantively unchanged from results presented below.
that the models of board monitoring, advice, and performance encompassed a larger system of equations in which some variables that predict board monitoring and/or advice might be independently related to performance, OLS regression could yield biased estimates in modeling performance (Johnston, 1984). Two-stage least squares regression corrects for this bias by generating reduced-form estimates of monitoring, advice, and prior performance and then including predicted values from these equations as instruments in a second-stage equation estimating subsequent firm performance.

RESULTS

Descriptive statistics and bivariate correlations are displayed in Table 2. The results of multiple regression analyses of board monitoring and advice and counsel interactions are provided in Table 3. The first set of results was inconsistent with the independent board model. Neither the level of CEO-board friendship ties nor the portion of a firm’s board appointed after its CEO was significantly related to the level of board monitoring activity. The main effects did support the collaborative board model, however. Consistent with Hypothesis 2, friendship ties and subsequent board appointments were both positively related to the level of advice and counsel interactions on strategic issues.

The results also generally supported the hypothesized effect of the interaction between social ties and incentive alignment on board monitoring and advice interactions (Hypotheses 3–4). As CEO ownership or long-term incentive plan compensation increased, the negative effect of friendship ties on board monitoring grew weaker (i.e., more positive), and the positive effect of such ties on advice interactions grew stronger. Similarly, for two of the interaction terms, as incentives increased the negative effect of subsequent board appointments on monitoring grew weaker, and the positive effect of subsequent board appointments on advice interactions grew stronger.

A further analysis of simple effects (Jaccard, Turrisi, & Wan, 1990) indicated that both social tie variables were insignificant in predicting advice interactions at low levels of CEO ownership or long-term incentive plan compensation (for example, at zero), and the significant effects in model 6 indicate that social ties were positively related to advice and counsel interactions at average levels of each incentive variable. Conversely, although the effects of social ties on board monitoring were insignificant at average levels of CEO ownership and long-term incentive plan compensation, they became significant at low levels of incentive alignment. In general, these results support the proposition that incentive alignment moderates the effects of CEO-board social ties on board involvement. When incentive alignment is absent, the independent board model is more appropriate in predicting

![Table 2](image-url)

**Descriptive Statistics and Pearson Correlation Coefficients**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>s.d.</th>
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<th>3</th>
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<th>13</th>
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<tr>
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</tr>
<tr>
<td>2. Portion of board appointed after CEO</td>
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</tr>
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</tr>
<tr>
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<td>0.09</td>
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<td>7. Blockholder ownership</td>
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<tr>
<td>8. Institutional ownership</td>
<td>0.29</td>
<td>0.16</td>
<td>-0.06</td>
<td>0.16</td>
<td>-0.07</td>
<td>-0.12</td>
<td>-0.11</td>
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<td>9. CEO tenure</td>
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<td>-0.22</td>
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<tr>
<td>10. Affiliated directors: Family ties</td>
<td>0.08</td>
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<td>0.12</td>
<td>0.01</td>
<td>0.03</td>
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<td>11. Affiliated directors: Business ties</td>
<td>0.35</td>
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<td>0.09</td>
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<td>0.06</td>
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<td>12. Separation of CEO and board chair positions</td>
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<td>-0.26</td>
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<td>0.15</td>
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<td>0.05</td>
<td>0.22</td>
<td>0.02</td>
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<tr>
<td>13. Change in corporate strategy</td>
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<td>0.65</td>
<td>0.02</td>
<td>-0.03</td>
<td>-0.05</td>
<td>0.03</td>
<td>0.01</td>
<td>-0.04</td>
<td>0.06</td>
<td>0.09</td>
<td>-0.08</td>
<td>-0.05</td>
<td>0.02</td>
<td>0.04</td>
<td></td>
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<td>14. Board monitoring</td>
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<td>-0.04</td>
<td>-0.16</td>
<td>-0.19</td>
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<td>0.17</td>
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<td>0.03</td>
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<td>15. Advice and counsel interactions</td>
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<td>0.06</td>
<td>0.07</td>
<td>-0.13</td>
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<td>0.05</td>
<td>-0.14</td>
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<tr>
<td>16. Return on equity</td>
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<td>0.14</td>
<td>0.11</td>
<td>-0.06</td>
<td>0.05</td>
<td>0.02</td>
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<td>0.14</td>
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<td>0.03</td>
<td>0.04</td>
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<td>0.05</td>
<td>0.22</td>
<td>0.25</td>
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<td>17. Market-to-book value of equity</td>
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<td>-0.03</td>
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<td>0.12</td>
<td>0.08</td>
<td>-0.02</td>
<td>0.06</td>
<td>0.01</td>
<td>0.03</td>
<td>0.07</td>
<td>0.18</td>
<td>0.33</td>
<td>0.19</td>
</tr>
</tbody>
</table>

*a N = 243. Correlations greater than .13 are significant at p < .05.

*b Logarithm.
TABLE 3
Results of OLS Regression Models

<table>
<thead>
<tr>
<th>Variable</th>
<th>Monitoring</th>
<th>Advice and Counsel Interactions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Model 1</td>
<td>Model 2</td>
</tr>
<tr>
<td>1. CEO-board friendship ties</td>
<td>-0.15 (0.16)</td>
<td>-0.15 (0.16)</td>
</tr>
<tr>
<td>2. Portion of board appointed after CEO</td>
<td>-0.27 (0.21)</td>
<td>-0.26 (0.21)</td>
</tr>
<tr>
<td>3. Prior return on equity</td>
<td>-0.77 (0.50)</td>
<td>-0.76 (0.50)</td>
</tr>
<tr>
<td>4. Prior market-to-book value of equity</td>
<td>-0.06 (0.05)</td>
<td>-0.06 (0.05)</td>
</tr>
<tr>
<td>5. Salesb</td>
<td>-0.01 (0.04)</td>
<td>-0.01 (0.04)</td>
</tr>
<tr>
<td>6. CEO ownership</td>
<td>-1.47 (0.65)*</td>
<td>-1.46 (0.65)</td>
</tr>
<tr>
<td>7. Long-term incentive planc compensation</td>
<td>-0.47 (0.22)*</td>
<td>-0.46 (0.22)*</td>
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<tr>
<td>8. Director ownership</td>
<td>2.46 (1.00)*</td>
<td>2.43 (1.00)*</td>
</tr>
<tr>
<td>9. Blockholder ownership</td>
<td>0.46 (0.26)</td>
<td>0.36 (0.26)</td>
</tr>
<tr>
<td>10. Institutional ownership</td>
<td>0.55 (0.33)</td>
<td>0.56 (0.33)</td>
</tr>
<tr>
<td>11. CEO tenure</td>
<td>-0.01 (0.01)</td>
<td>-0.01 (0.01)</td>
</tr>
<tr>
<td>12. Affiliated directors: Family ties</td>
<td>-1.05 (0.56)</td>
<td>-1.00 (0.54)</td>
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<tr>
<td>13. Affiliated directors: Business ties</td>
<td>-0.40 (0.28)</td>
<td>-0.36 (0.27)</td>
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<tr>
<td>14. Separation of CEO and board chair positions</td>
<td>0.50 (0.13)**</td>
<td>0.50 (0.13)**</td>
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<tr>
<td>15. Friendship ties × CEO ownership</td>
<td>7.32 (2.34)**</td>
<td>5.36 (2.12)**</td>
</tr>
<tr>
<td>16. Friendship ties × LTIP compensation</td>
<td>1.29 (0.61)*</td>
<td>1.58 (0.55)**</td>
</tr>
<tr>
<td>17. Portion of board appointed after CEO × CEO ownership</td>
<td>7.02 (3.63)*</td>
<td>4.36 (3.37)</td>
</tr>
<tr>
<td>18. Portion of board appointed after CEO × LTIP compensation</td>
<td>1.26 (0.82)</td>
<td>2.00 (0.72)**</td>
</tr>
<tr>
<td>Constant</td>
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<tr>
<td>$F$</td>
<td>5.19***</td>
<td>5.04***</td>
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<tr>
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<td>.19</td>
</tr>
<tr>
<td>$\Delta R^2$</td>
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<td>.19***</td>
</tr>
</tbody>
</table>

*$N = 243$. Standard errors are in parentheses. T-tests were one-tailed for hypothesized effects and two-tailed for control variables.

**Logarithm.

*Abbreviated below as “LTIP.”

* $p \leq .05$

** $p \leq .01$

*** $p \leq .001$

The results of a two-stage least squares regression analysis of firm performance are presented in Table 4. Hypothesis 5 predicted a positive relationship between board monitoring of CEOs and subsequent firm performance. The results support this hypothesis for both return on equity and market-to-book value. Hypothesis 6 is also supported: the level of advice and counsel interactions was positively related to each measure of subsequent firm performance. Hypotheses 7–8 predicted that incentive alignment would determine when each kind of involvement is most effective. Neither kind of incentive alignment interacted with board monitoring to influence firm performance, but the results do support Hypothesis 8: The relationship between advice interactions and subsequent firm performance became stronger as the level of CEO ownership or the level of CEO long-term incentive plan compensation increased for both measures of performance.6

DISCUSSION

The findings of this study appear to have important implications for the corporate governance literature. The first set of results showed not only that social ties typically fail to reduce the level of board involvement, and when incentive alignment is average to high, the collaborative board model fits better.

The results of a two-stage least squares regression analysis of firm performance are presented in Table 4. Hypothesis 5 predicted a positive relationship between board monitoring of CEOs and subsequent firm performance. The results support this hypothesis for both return on equity and market-to-book value. Hypothesis 6 is also supported: the level of advice and counsel interactions was positively related to each measure of subsequent firm performance. Hypotheses 7–8 predicted that incentive alignment would determine when each kind of involvement is most effective. Neither kind of incentive alignment interacted with board monitoring to influence firm performance, but the results do support Hypothesis 8: The relationship between advice interactions and subsequent firm performance became stronger as the level of CEO ownership or the level of CEO long-term incentive plan compensation increased for both measures of performance.6
TABLE 4
Results of Two-Stage Least Squares Regression Models of Firm Performance

<table>
<thead>
<tr>
<th>Variable</th>
<th>Return on Equity</th>
<th>Market-to-Book Value of Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Model 1</td>
<td>Model 2</td>
</tr>
<tr>
<td>1. Advice and counsel interactions</td>
<td>0.01 (0.01)**</td>
<td>0.01 (0.01)**</td>
</tr>
<tr>
<td>2. Board monitoring</td>
<td>0.02 (0.00)</td>
<td>0.00 (0.00)</td>
</tr>
<tr>
<td>3. Prior return on equity</td>
<td>0.03 (0.03)***</td>
<td>0.01 (0.01)**</td>
</tr>
<tr>
<td>4. Prior market-to-book value of equity</td>
<td>0.01 (0.09)</td>
<td>0.00 (0.00)</td>
</tr>
<tr>
<td>5. Sales</td>
<td>-0.00 (0.00)</td>
<td>-0.00 (0.00)</td>
</tr>
<tr>
<td>6. CEO ownership</td>
<td>0.03 (0.04)</td>
<td>0.00 (0.00)</td>
</tr>
<tr>
<td>7. Long-term incentive plan compensation</td>
<td>0.11 (0.07)</td>
<td>0.01 (0.02)</td>
</tr>
<tr>
<td>8. Director ownership</td>
<td>0.02 (0.02)</td>
<td>0.02 (0.02)</td>
</tr>
<tr>
<td>9. Blockholder ownership</td>
<td>0.04 (0.02)</td>
<td>0.04 (0.02)</td>
</tr>
<tr>
<td>10. Institutional ownership</td>
<td>0.00 (0.01)</td>
<td>0.00 (0.01)</td>
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<tr>
<td>11. Change in corporate strategy</td>
<td>0.17 (0.06)**</td>
<td>0.17 (0.06)**</td>
</tr>
<tr>
<td>12. Advice interactions × CEO ownership</td>
<td>0.05 (0.02)**</td>
<td>0.05 (0.02)**</td>
</tr>
<tr>
<td>13. Advice interactions × LTIP compensa-</td>
<td>-0.10 (0.06)</td>
<td>-0.10 (0.06)</td>
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<tr>
<td>14. Board monitoring × CEO ownership</td>
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<td>-0.03 (0.02)</td>
</tr>
<tr>
<td>15. Board monitoring × LTIP compensation</td>
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<td>0.05 (0.03)*</td>
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<tr>
<td>Constant</td>
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<tr>
<td>F</td>
<td>17.07***</td>
<td>20.26***</td>
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<td>.47</td>
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<tr>
<td>ΔR²</td>
<td>.11**</td>
<td>.16**</td>
</tr>
</tbody>
</table>

* N = 243. Standard errors are in parentheses. T-tests are one-tailed for hypothesized effects, two-tailed for control variables.
^ Logarithm.
* Abbreviated below as "LTIP."
* p < .05
** p < .01
*** p < .001

monitoring activity, but also that such ties enhance the provision of advice and counsel from outside directors on strategic issues. These results offer perhaps the first large-sample empirical evidence that addresses how boards can extend their involvement in corporate governance beyond monitoring to provide ongoing advice and counsel to management on strategic issues. Baysinger & Butler, 1985; Johnson et al., 1996; Zahra & Pearce, 1989). Much of the empirical literature on boards of directors has proceeded from the assumption that social ties in CEO-board relationships diminish the involvement and effectiveness of outside directors by reducing their tendency to control management decision making. This literature has shown that personal relationships between colleagues in a work unit increase the level of advice-seeking behavior by alleviating impression management concerns, such as the fear of appearing uncertain or dependent, and concerns about revealing sensitive information, especially when the colleagues are in a position to evaluate the advice seekers' performance. The results support the view that CEOs are more willing to take the social and professional risks associated with advice-seeking behavior when they can rely on the loyalty of their boards. Similarly, the results are also consistent with research on friendship in organizations, which has shown that friendship ties among group members lead to higher levels of decision making. The findings are also consistent with results of behavioral research on advice seeking at lower levels of organizations. This literature has shown that personal relationships between colleagues in a work unit increase the level of advice-seeking behavior by alleviating impression management concerns, such as the fear of appearing uncertain or dependent, and concerns about revealing sensitive information, especially when the colleagues are in a position to evaluate the advice seekers' performance. The results support the view that CEOs are more willing to take the social and professional risks associated with advice-seeking behavior when they can rely on the loyalty of their boards. Similarly, the results are also consistent with research on friendship in organizations, which has shown that friendship ties among group members lead to higher levels of decision making.
of task-related communication and mutual assistance by enhancing interpersonal trust.

Further results showed that CEO incentive alignment moderated relationships between social ties and board involvement: Higher levels of CEO ownership or long-term incentive compensation further enhanced the positive relationship between social ties and board advice while reducing the negative relationship between social ties and board monitoring. This moderation is consistent with the view that management incentives decrease the need for board monitoring as a control mechanism and also motivate CEOs to use their social capital (their social ties to directors) as a resource in strategic decision making. Although some prior research has linked management incentives to corporate strategy and overall firm performance (e.g., Abowd, 1990; Gibbs, 1993), the present study extends this literature by addressing how incentives affect behavioral processes (here, advice seeking) that may mediate these relationships.

The last set of results addresses the ultimate performance consequences of each kind of board involvement, showing that CEO-board collaboration and control are independently and positively related to subsequent firm performance. These findings provide systematic empirical support for the view that boards can contribute to strategy not only by independently evaluating managements, but also by serving as sounding boards for top managers who are in the process of formulating strategy (Bacon & Brown, 1975: 18; Johnson et al., 1996; Lorsch, 1989). Together with the first set of results, these findings challenge the dominant assumptions that underlie most empirical research on boards and that characterize social ties narrowly as frictions that reduce the efficiency of corporate governance (Fama & Jensen, 1983; Hirsch, Michaels, & Friedman, 1987). Rather than impairing corporate governance by reducing the vigilance of board monitoring, social ties can ultimately contribute to board effectiveness and firm performance by fostering collaboration between CEOs and directors in the strategy-making process without reducing board control.

It might be suggested that CEOs are more comfortable seeking advice from their friends and appointees because those individuals may be less experienced or knowledgeable than themselves, and thus less capable of challenging them. To explore the validity of this interpretation, I analyzed the effect of director expertise and experience on the observed relationships. I used four indicators of expertise, averaged across directors (Pinkelstein, 1992; Wiersema & Bantel, 1992): the number of different management positions a director had held, the number of different functional areas the director had worked in, the number of years the director had served as a top manager, and the director's level of education. Factor analysis confirmed that all four indicators loaded on the same factor. A separate regression analysis showed that the effects of social ties on advice and counsel interactions were unchanged when director expertise and experience were controlled for. Also, as shown in Appendix B, the interaction between director expertise and social ties had a positive effect on advice interactions, indicating that social ties were especially likely to increase advice when the level of director expertise was relatively high. These results are inconsistent with the view that social ties increase advice seeking because boards that have more social ties with CEOs are populated by less experienced or knowledgeable directors whose input might be less threatening to the CEOs.

**Future Research Directions**

Although this study focused on the administrative role of boards, future research should examine how CEO-board cooperation and control affect a board's ability to exercise its other major functions, including its role in managing resource dependence and enhancing organizational legitimacy. One could investigate, for instance, whether advice and counsel interactions between CEOs and manager-directors (outside directors who serve as top managers at another firm) might help managers to identify opportunities for interorganizational cooperation (for instance, strategic alliances) that secure needed resources and resolve interdependencies between firms. Conversely, CEO-board relationships characterized only by independent board control might reduce the likelihood that CEOs and manager-directors will identify and pursue such opportunities. Similarly, although in prior research on interlocking directorates the assumption has been that managers use outside directors to secure needed resources from the environment (for a review, see Mizruchi [1996]), the effectiveness of this cooptation mechanism may hinge on the particular content of CEO-board relationships.

Studies are also needed that examine how different kinds of CEO-board relationships are perceived by internal and external stakeholders and the consequences of these relationships for organizational legitimacy. There is evidence that institutional investors respond positively to changes in board structure that are thought to increase a board's monitoring capacity (for a review, see Westphal and Zajac [1998]). It is uncertain, however, whether external constituents also assess the actual behavioral processes occurring in CEO-board relation-
ships (for example, monitoring and advice giving) in evaluating corporate governance. Given the potential decoupling of formal board structure and actual behavior (Meyer & Rowan, 1977; Westphal & Zajac, 1994), it is important to examine the depth at which external stakeholders evaluate corporate boards. According to an institutional perspective, firms with strong CEO-board social ties could satisfy external constituents by adopting formal structures that implied independent control (the socially legitimate CEO-board relationship) but could decouple these structures from actual board processes.

The findings of this study may also suggest new directions for research on management incentives. The confirmed interactions between incentive alignment and social ties suggest that incentives can be more effective in raising performance when managers have more social connections to draw upon for information and advice. Compensation researchers should further explore the role of social capital as an important contingency factor in the effectiveness of incentive compensation plans. Researchers investigating management incentives in particular might explicitly consider how managers are either constrained or enabled in responding to economic incentives by the social relationships in which they are embedded. Research is also needed that explores in more detail how incentives affect CEO behavior such as advice seeking. Stewardship theory suggests that managers are motivated by the intrinsic satisfaction their work provides rather than by extrinsic rewards (Davis, Schoorman, & Donaldson, 1997). This view might appear inconsistent with evidence that incentive compensation increases the tendency for CEOs to draw on their social ties for advice. However, it is possible that incentives influence CEOs' behavior primarily by communicating goals and directing the CEOs' attention toward them, and not strictly by motivating the CEOs to increase their financial compensation. Future studies should examine the psychological mechanisms that mediate the effects of incentives on CEO behavior toward boards.

**Limitations and Managerial Implications**

Several limitations of the study should be acknowledged. First, this research focused on advice interactions initiated by CEOs. A somewhat different set of social and economic factors may lead directors to initiate such interactions. Separate questions in the survey indicated that a large portion of such advice interactions (approximately 92 percent, on the average) were initiated by the CEOs, a finding that is consistent with prior descriptive surveys suggesting that such interactions are typically CEO initiated (Alderfer, 1986; Bacon & Brown, 1975; Demb & Neubaueer, 1992). Nevertheless, board-initiated advice giving does occur, and it could become a more significant form of involvement in the future. Second, this study did not address the specific content or quality of board advice—for instance, I did not examine whether and when directors furnished information about developments in the external environment, as opposed to giving opinions about strategic options for coping with them. In this study, I did not seek to explain variation in the value or quality of advice or the accuracy of information furnished by outside directors, qualities that could moderate the effects of collaboration on performance; unique information or experience provided by outsiders could represent an especially valuable resource (Pfeffer & Salancik, 1978). Finally, as noted above, in this research I did not investigate how board collaboration and control affected a board's ability to perform certain external roles, such as managing resource dependence or building organizational legitimacy.

The present findings may have important normative implications for corporate boards. Institutional investors, management consultants, and the popular press have all strongly advocated greater board independence from management. Directors with close ties to management are routinely characterized in cynical terms as "pals of the CEO" or "hand-picked appointees," and their relationships to CEOs are described as overly "chummy" (e.g., Wall Street Journal, 1993: B1; 1995: B1; 1996). This study suggests that in fact board effectiveness and ultimately, firm performance may be enhanced by close, trusting CEO-board relationships combined with moderate to high levels of CEO incentive alignment. Thus, rather than dividing top managers and outside directors into independent groups, a firm might profit by using team development techniques that unify managers and directors into a single, cohesive team. Interestingly, although such interventions are commonly used to develop teamwork among lower-level employees, they have not been applied at the highest levels of organizations.

Overall, this study contributes to the corporate governance literature by providing empirical evidence on how CEOs and outside directors collaborate in the strategic decision making process and then demonstrating that such collaboration independently and positively contributes to firm performance. The results challenge dominant assumptions in the prior empirical literature on boards by showing how social ties in CEO-board relationships can enhance rather than diminish board involvement and firm performance by encouraging advice seeking in the strategic decision making pro-
cess. More generally, the findings suggest the value of conducting rigorous empirical research that examines the behavioral processes and dynamics that underlie corporate governance.

REFERENCES


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APPENDIX A

Survey Scales

Possible responses for the board monitoring and advice and counsel items were 1, "minimally"; 2, "moderately"; 4, and 5, "very much so."

Board Monitoring

1. To what extent does the board monitor top management strategic decision making?
2. To what extent does the board formally evaluate your performance?
3. To what extent does the board defer to your judgment on final strategic decisions?

Advice and Counsel Interactions

1. To what extent do you solicit board assistance in the formulation of corporate strategy?
2. To what extent are outside directors a "sounding board" on strategic issues?
3. How often have directors provided advice and counsel in discussions outside of board/committee meetings (by telephone or in person)?

Friendship Ties

How many of the outside directors would you consider to be acquaintances or friends?
Acquaintances but not friends: ______ (number of directors).
Friends: ______ (number of directors).

APPENDIX B

Results of Supplementary OLS Regression Model

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Advice and Counsel Interactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. CEO-board friendship ties</td>
<td>0.36 (0.15)**</td>
</tr>
<tr>
<td>2. Portion of board appointed after CEO</td>
<td>0.42 (0.20)*</td>
</tr>
<tr>
<td>3. Prior return on equity</td>
<td>-0.83 (0.43)</td>
</tr>
<tr>
<td>4. Prior market-to-book value of equity</td>
<td>-0.03 (0.05)</td>
</tr>
<tr>
<td>5. Sales b</td>
<td>-0.05 (0.03)</td>
</tr>
<tr>
<td>6. CEO ownership</td>
<td>0.55 (0.57)</td>
</tr>
<tr>
<td>7. Long-term incentive plan compensation</td>
<td>0.24 (0.19)</td>
</tr>
<tr>
<td>8. Director ownership</td>
<td>1.20 (0.88)</td>
</tr>
<tr>
<td>9. Blockholder ownership</td>
<td>0.08 (0.22)</td>
</tr>
<tr>
<td>10. Institutional ownership</td>
<td>0.16 (0.28)</td>
</tr>
<tr>
<td>11. CEO tenure</td>
<td>-0.01 (0.01)</td>
</tr>
<tr>
<td>12. Affiliated directors: Family ties</td>
<td>0.58 (0.50)</td>
</tr>
<tr>
<td>13. Affiliated directors: Business ties</td>
<td>0.51 (0.24)*</td>
</tr>
<tr>
<td>14. Director expertise and experience</td>
<td>0.10 (0.05)</td>
</tr>
<tr>
<td>15. Director expertise and experience \times friendship ties</td>
<td>0.44 (0.15)**</td>
</tr>
<tr>
<td>16. Director expertise and experience \times appointments after CEO</td>
<td>0.51 (0.21)*</td>
</tr>
<tr>
<td>17. Constant</td>
<td>-0.06 (0.30)</td>
</tr>
<tr>
<td>F</td>
<td>7.65***</td>
</tr>
<tr>
<td>R²</td>
<td>.27</td>
</tr>
</tbody>
</table>

* N = 243. Standard errors are in parentheses.

b Logarithm.

** p ≤ .01
*** p ≤ .001

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