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The cognitive dimension of corporate governance in fast growing entrepreneurial firms

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Summary This article explores the specific morphology and functioning of the governance system of fast growing entrepreneurial firms. Corporate governance is conceptualized as a complex system composed of different mechanisms and various actors, reaching beyond the corporate board and its members. To explain the link between the governance system at large and growth, I build on a general model of corporate governance first proposed by Charreaux (2008), where governance potentially influences managerial behavior through two levers: financial discipline and cognition. I argue that, in the specific case of entrepreneurial firms, corporate governance may play a central role in sustaining high levels of growth through the extensive use of the cognitive lever. Beyond its theoretical implications, the model is also instrumental in providing a consistent framework for an exploration of existing empirical research. I review research specifically devoted to the governance of entrepreneurial firms which experience strong growth and find support for the rationale underlying the proposed model.

Introduction

Young entrepreneurial firms are potentially major players in tomorrow's economy, to the extent that they experience strong and sustainable growth. Not all young ventures however are able to engage in growth strategies and succeed. Those which do may have to tackle specific challenges brought about by rapid changes in scale and scope (Hambrick & Crozier, 1985). Those challenges concern the access to and utilization of different resources. Among the latter, certain immaterial resources, such as specific strategic knowledge and managerial capabilities can be assumed to play a central role (Penrose, 1959). Corporate governance, broadly defined as all mechanisms which influence managerial discretion and thus govern the CEO's conduct (Charreaux, 1997), may contribute to the acquisition of such resources, by favoring processes of individual and organizational learning (Zahra & Filatotchev, 2004). Charreaux (1997) actually defines corporate governance as ''the set of mechanisms that define powers and influence decisions of the chief executive, in other words, the mechanisms that 'govern' his conduct and define managerial discretion''. This definition is rather large in scope. It is broader than the mainstream definition of corporate governance due to Shleifer and Vishny (1997), which is essentially concerned with interest alignment and the exercise of strict financial discipline. According to the

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mainstream definition, the CEO has to be controlled in the interest of shareholders, and must be sanctioned in case of deviant behavior. Charreaux's definition is compatible with an approach, where certain governance mechanisms may assume a broader role, such as assisting the CEO in the task of strategy formulation (McNulty & Pettigrew, 1999). It should also be noted that, contrary to much of the literature, this definition is not focused on the corporate board alone, but comprises such diverse mechanisms as instances of direct shareholder control, the top management team (TMT) surrounding the CEO, interpersonal trust, the market of corporate control, the managerial labor market, and legal rules for instance, which all may have a bearing on the chief executive's conduct.

Multiple actors (such as members of the top management team, specific shareholders, directors) have been shown to influence managerial discretion and thus govern the CEO's behavior. In fact, different governance mechanisms and the people who make them work may substitute for each other or assume complementary roles according to circumstances. According to Brunninge, Nordqvist, and Wiklund (2007, p. 295), ''the notion of corporate governance as dealing with the interaction between a firm's ownership, board and top management has not been sufficiently explored in the literature''.

Concerning the role of corporate governance, much research has been devoted to large publicly listed firms and has been conducted from the perspective of agency theory (Berle & Means, 1932; Fama & Jensen, 1983; Jensen & Meckling, 1976). According to the latter, the principal role of any governance mechanism is to assure financial discipline through appropriate monitoring. The latter helps control agency conflicts and thus contributes to corporate success.

The broader governance literature has however identified other roles to be played by corporate governance, especially in the case of young growing firms, depending on particular strategic contingencies (Pearce & Zahra, 1992). In addition to corporate control, certain governance mechanisms have been shown to play a role in the formulation, shaping and proper implementation of strategy (Ingley & van der Walt, 2001; McNulty & Pettigrew, 1999; Stiles, 2001; Van den Heuvel, van Gils, & Voordeckers, 2006; Zahra & Pearce, 1989). Moreover, the evolution and function of governance may be tied to specific stages in the firm's development and growth (Lynall, Golden, & Hillman, 2003; Zahra & Filatotchev, 2004).[1]

A general model of corporate governance, extending beyond a single mechanism (the board of directors which is only one particular, albeit important, governance mechanism) and role (strict financial monitoring), would be helpful in giving structure to our investigation into the specifics of the governance of high-growth entrepreneurial firms. One such model has recently been proposed in the French literature on corporate governance (Charreaux, 2008). The present article applies this general model of corporate governance to the specific case of the high-growth entrepreneurial firm. This allows us to reflect on the potential role of corporate governance as a cognitive lever enabling entrepreneurs to effectively pursue and assume a strategy of strong growth. The model is also instrumental in a systematic exploration of existing empirical research on the governance of entrepreneurial firms featuring high growth. Such literature appears to be rather fragmented and lacks an integrative theoretical framework.

Our contribution is threefold: we bring Charreaux's integrative framework of corporate governance, initially published in French, to English publication, we apply this model to the entrepreneurial firm and make theoretical propositions on the cognitive role played by corporate governance when striving for strong growth, and we provide a review of empirical works linking growth and various governance mechanisms along the dimensions of the model.

A meta-model of governance and managerial discretion

Building on Charreaux's (1997) definition, corporate governance may be portrayed as a complex system, within which mechanisms of different levels and natures co-exist and interact. Table 1 illustrates the diversity of the governance mechanisms which typically apply in the case of entrepreneurial high-growth firms. It is developed from the literature review, and its content will be commented on in more detail in the next section. Its overall structure is inspired by a classification initially introduced by Charreaux (1997) who distinguishes four different types of governance mechanisms, according to their scope (specific to firm vs. general) and operating mode (intentional/deliberate decision making vs. spontaneous order). This representation underscores the breadth and the systemic nature of corporate governance as defined in the present study.

There are mechanisms specific to particular firms (e.g. the board of directors of a particular firm is made up of certain people, with certain characteristics, etc.) as well as non-specific mechanisms (e.g. regulations and legal frameworks) that apply to a larger population of enterprises. In addition, within these two levels, there are intentional mechanisms (e.g. institutional stockholders can intentionally pursue a strategy of imposing high levels of independent directors within the corporate board) and mechanisms that emerge spontaneously from the interaction between various actors of governance and the CEO and which are not written (work atmosphere and the trust that can exist between directors and managers as a result of their specific interactions).[2] The entirety of these mechanisms form, in the case of one particular firm, a complex and dynamic system that will interact with the CEO and thus influence the formulation and implementation of strategic decisions. The above classification bears some closeness to, but does not exactly match, other distinctions that can be made. One classic dis-

[1] Some of this research adopts the metaphor of adolescence (Lynall et al., 2003; Zahra & Hayton, 2005) or refers to specific organizational thresholds (Zahra & Filatotchev, 2004), to characterize periods where an entrepreneurial firm's rapid development may outgrow the entrepreneur's initial cognitive resources and competencies. This does not signify, however, that strong growth is restricted to the stage of adolescence, allthewhile life-cycle models based on a deterministic succession of a fixed number of stages have been heavily criticized (Levie & Lichtenstein, 2010).

[2] Mustakallio, Autio, and Zahra (2002), for example, examine the importance of informal mechanisms of social control in the governance of family firms.