



Avoiding the “too comfortable in the saddle” syndrome: Obtaining high performance from the chairperson, CEO and inside directors



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ABSTRACT

When the chairperson and chief executive officer experience long co-tenure working together building knowledge and understanding, strategizing, and developing company-specific resources there can be significant organization performance gains. However the broader board context, especially the insider ratio – the number of executive directors as a proportion of the total number of directors – provides clues as to whether an organization is in a less productive configuration. In this study data from 102 Australian Stock Exchange listed companies is gathered on corporate governance configurations and organization performance. Australia is an interesting setting because the chairperson and chief executive officer roles are generally separated, in contrast to the United States. Results show that organizations with long co-tenure benefit from having a lower insider ratio. Implications are discussed including how the chairperson and chief executive officer working with a large number of inside directors can become “too comfortable in the saddle” negatively impacting performance.

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1. Introduction

The chairperson (chair) and chief executive officer (CEO) are the two key employees of a company that make strategic decisions with long term implications for performance. The chair leads the board of directors plus the selection and performance management processes for the CEO (Johnson, Daily, & Ellstrand, 1996; Kiel & Nicholson, 2003a; Dalton & Dalton, 2005; Krause & Semadeni, 2013). The CEO manages the company on a day to day basis and endeavors to deliver outcomes that are valued by stakeholders (Fama & Jensen, 1983; Johnson et al., 1996; Withers, Hillman, & Cannella, 2012). Having a CEO and chair with years of company specific experience in their roles is generally seen as an important asset for the company with positive performance implications (Johnson, Schnatterly, & Hill, 2013). Research on the performance outcomes of tenure is, however, quite mixed (Johnson et al., 2013) and tends to focus on CEO tenure without taking into account the broader board and governance context (e.g., the insider ratio).

Most corporate governance research to date has been undertaken using samples of the United States companies (Boyd, Haynes, & Zona, 2011). As a result, these studies tend to focus on the United States governance configurations where companies have a strong preference for chair and CEO duality, meaning that the chair and CEO are the same person. For example, duality is used in more than 68% of cases on the New

York Stock Exchange (NYSE) compared with less than 10% in Australia (Fitzroy, Hulbert, & Ghobadian, 2012).

Separation of the chair and CEO is preferred among Australian and London Stock Exchange listed companies such as BHP Billiton Limited and ANZ Banking Group Limited (Dalton & Dalton, 2005; Fitzroy et al., 2012). In Australia the chair provides an important mentoring and counter-balancing role to the power of the CEO who leads the executive team. Choices on separation and board composition in Australia reflect long run institutional pressures to adopt guidelines for best practice informed by agency theory outlined, for example, in the Australian Stock Exchange (ASX) Corporate Governance Principles and Recommendations (2014) – hence their importance. So in the Australian institutional setting, the chair has considerable power given his or her right to hire, performance manage and fire the CEO if need be (Kiel & Nicholson, 2003a). In practice the United Kingdom has followed a similar direction on corporate governance practices following findings published in the Cadbury (1992) Report and the Higgs (2003) Review (Boyd, 1996; Kiel & Nicholson, 2003a; Aguilera, 2005; Dalton & Dalton, 2005). In sum, there are similarities and differences in board structures around the globe and opportunities to develop deeper understanding based on this variation.

The key research question informing this study is: What are the organization performance implications of a wider range of configurations regarding CEO tenure, chair and CEO co-tenure, and the insider ratio in the Australian context? By taking an in-depth look at Australian governance structures and performance outcomes, this

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study tries to contribute to governance theory in general and provide a more robust theoretical underpinning of board effectiveness in different contexts. Since the Australian governance system is biased towards separation, the relationship between the chair and CEO is more likely to be interpersonal with group decision making and social exchange implications. In such a context, tenure can be an indication of harmony across the management team and board in general (Wang, Leung, & Zhou, 2014; Leung, Deng, Wang, & Zhou, 2015). However, it is also possible that high tenure is a symptom of less healthy group dynamics with limited social exchange opportunities to express different views and provide constructive critique (Leenders & Wierenga, 2008; Wang et al., 2014). Things can become “too comfortable in the saddle” among work colleagues who lose their performance edge, and the stability in the chair and CEO working together with many inside or executive directors is a sign of a disintegration motive rather than harmony and productive social exchange (Blau, 1964; Cropanzano & Mitchell, 2005). So while chair CEO co-tenure can be a good thing if the board has a limited number of inside directors, there might be specific boards with a high insider ratio (the number of inside directors as a proportion of the total number of directors on the board) where high chair CEO co-tenure is not very productive.

The contributions of this paper are threefold. First, while there has been much research into the CEO tenure and organization performance relationship in the United States, there has been little research looking at chair and CEO co-tenure and organization performance in business settings such as Australia where separation is prominent. Second, the interplay between chair and CEO co-tenure will be studied in a wider board context that can amplify or mitigate the benefits that high CEO chair co-tenure can have on organization performance. In particular, the goal is to identify configurations that signal a ‘disintegration avoidance motive’ rather than a ‘harmony motive’ where social exchange is facilitated and positive performance can be expected. Finally, this study takes a rigorous approach to performance assessment by using (parsimonious) models and a holdout sample to predict performance, which is then compared to real performance of companies as observed in the marketplace (Woodside, 2013).

The theoretical underpinning for this study is provided by social exchange theory (Blau, 1964) together with more traditional governance theories such as agency theory, stewardship theory, resource dependence theory, institutional theory, legal theory and social network theory (Zahra & Pearce, 1989; Shen, 2003; Lynall, Golden, & Hillman, 2003; Boyd et al., 2011). Multi-theoretic research into corporate governance including the integration of theories to enhance the explanatory power of the study (Boyd et al., 2011; Westphal & Zajac, 2013) is useful in building theoretical and practical insight into the complex human and social interactions of the chair, CEO and inside directors (Johnson et al., 1996; Hillman & Dalziel, 2003; Dalton & Dalton, 2005). In addition, theories on team decision making and the value and limitations of having different perspectives are introduced (Wang et al., 2014). As stated before, the aim is to understand the performance amplification and mitigation effects around the co-tenure dyad of the two key positions in most organizations - the chair and CEO. The key argument that is explained in the theoretical framework is that chair CEO co-tenure can deliver high performance outcomes but can also have negative consequences when the inside director ratio is also high, leading to a situation where high performance is not achieved, social exchange is not happening or not adding decision quality. In other words, these key board of director colleagues become “too comfortable in the saddle” working together.

The article is structured as follows. First the theoretical background and hypothesis development are provided. Second is the explanation of the method and the data. Third the results are presented followed fourth by the discussion and conclusion.

2. Theoretical background and hypotheses

2.1. Theoretical background

There has been a greater interest in and focus on governance research and practice since the stock market crash of 1987, and the global financial crisis of the 2000s has reinforced this trend. Governance research considers a wide range of issues including but not limited to chief executive officer (CEO) and director selection, the job attributes and tenure of the chair and CEO respectively, the average tenure and ratio of inside directors, the ratio and tenure of outside directors, board size, teamwork on the board, and board effectiveness. Achieving and maintaining the effective contribution of the chair, CEO and board of director members to organization performance through selection, tenure and board process are matters of robust debate in business and academic communities around the world (Johnson et al., 1996; Dalton & Dalton, 2005; Hambrick, Verder, & Zajac, 2008; Fuenzalida, Mongrut, Artega, & Erasquin, 2013). Time and employee tenure are important research concepts (Mosakowski & Earley, 2000; Simsek, 2007).

Agency theory argues that CEOs and inside directors in a position of power and influence will make opportunistic decisions in their own interests possibly to the detriment of the firm's goals and the interests of the owner's they are working for (Johnson et al., 1996; Hillman & Dalziel, 2003). A recommended solution to the principal-agent problem is separation of the role of the chair and the CEO (Dalton & Dalton, 2005; Kakabadse & Kakabadse, 2007). A trend in the governance literature is greater emphasis on the importance of a strong outside director ratio, a voting majority of outside directors, an outside director as chair and high outside director average tenure to counter balance the principal-agent problem that can emerge in the work performance of the CEO and inside directors (Johnson et al., 1996; Walters, Kroll, & Wright, 2007). Advocates of agency theory also recommend a small number of inside directors on the board to provide an internal monitoring role and to advise the board on the activities and work performance of the CEO (Fama & Jensen, 1983; Johnson et al., 1996).

Stewardship theory argues that company directors are essentially trustworthy individuals and good stewards of firm resources. There is a high level of goal alignment between the shareholders, inside directors and outside directors. Each of these stakeholders is committed to the long run survival and prosperity of the firm and therefore will work in the firm's best interests (Lynall et al., 2003). Advocates of stewardship theory support the presence of inside directors on the board. With this approach inside directors take on more of an advising role (Fama & Jensen, 1983). They argue that board of director design prescriptions of agency theorists can be counter-productive and an impediment to decision-making. A balance of inside and outside directors improves board deliberation and organization performance (Johnson et al., 1996). Stewardship theory also applies well to small and medium size enterprises which are characterized by strong executive identification with the firm, an involvement-oriented executive, low levels of institutional power, social fulfillment and personal fulfillment of the executives (Johnson et al., 1996; Kroll, Walters, & Le, 2007).

Directors in their role may be representing particular institutions, knowledge domains, or are serving some legitimizing function (Selznick, 1949; Pfeffer, 1972; Johnson et al., 1996). Daily and Dalton (1992) found that the resource dependence role is important for access to capital, legal services, financial services and/or other organization resource needs (Johnson et al., 1996). In this respect inside directors can provide a useful firm resource in an advisory and monitoring role, keeping the outside directors informed of the activities and job performance of the CEO (Fama & Jensen, 1983; Johnson et al., 1996). Productive social exchange occurs when there is sufficient critical reflection and reciprocity (Westphal & Zajac, 1997).

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