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Breaking the mold: An examination of board discretion in female CEO appointments

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ABSTRACT

We propose and test a theory of board discretion in the context of the board's selection of a female CEO. We propose that boards also have discretion, an area that has typically focused exclusively on managers, and examine the conditions under which boards, facing high levels of uncertainty, have the latitude to make nontraditional choices, particularly when a negative equity market reaction to such a selection is likely. In the context of the nontraditional choice of a female CEO successor, we observe that the strong financial health of the firm and boardroom and situation-specific experience grant the board the discretion to select a female CEO. We test our model using all Standard & Poors (S&P) 1500 firms that experienced a CEO succession between 2000 and 2013. Implications for practice and research are discussed.

1. Introduction

Although still largely underrepresented, the number of female CEOs has increased among the corporate elite in recent years. There are currently more women serving as CEO of large U.S. firms than at any other time, with 13 of the 26 female CEOs in 2016 being appointed within the last several years (Covert, 2013). In 2015, there were more men named John running S&P 1500 companies than women (Wolfers, 2015). The lack of women at the top of organizations relative to the multitude of women at lower levels in the organizations suggests that businesses are not fully exploiting their talent pool (Hernes, 1987). Research provides evidence of potential benefits of diversity in the upper echelons, such as new perspectives and problem-solving (Helgesen, 1990), increased firm innovation (Torchia, Calabrò, & Huse, 2011), and board effectiveness (Nielsen & Huse, 2010). Research suggests that a woman's presence at the top of an organization evokes both positive and negative responses from key stakeholders. On the one hand, it signals equal opportunity to women at the organization's lower levels (Bilimoria, 2007). However, on the otherhand, apprehension surrounds this nontraditional successor choice. This apprehension manifests as a negative equity market reaction to women CEO announcements (Lee & James, 2007). Recent findings indicate that male corporate directors categorize women as out-group members and may possess a negative social bias toward their board appointment and their election to major board committees (Westphal & Stern, 2007; Zhu, Shen, & Hillman, 2014). Given this expected negative market reaction and the resistance to women among the corporate elite, what are the conditions under which boards have the discretion to promote a female candidate or make other strategic changes that may be perceived as unconventional?

The literature establishes that one of the board's most important responsibilities is CEO selection (Vancil, 1987). Boards focus largely on maintaining firm performance (e.g., Borokhovich, Parrino, & Trapani, 1996; Brickley, Linck, & Coles, 1999; Tian, Haleblian, & Rajagopalan, 2011), and managing the CEO transition is one way in which the board is directly tied to firm performance. CEO succession, a key organizational event (Kesner & Sebora, 1994), requires careful stakeholder management (Graffin, Carpenter, & Boivie, 2011). With the new CEO's ability to perform and the market's response to the CEO announcement comes uncertainty (Kesner & Sebora, 1994; Khurana, 2002; Lorsch & Khurana, 1999). Boards are held responsible for the success of the CEOs they appoint; a positive market reaction is not guaranteed; and a negative reaction may adversely affect the new CEO's early tenure (Khurana, 2002). It is reasonable that a board of directors may be hesitant to appoint a nontraditional candidate who, more than likely, will be received negatively by the market (Lee & James, 2007). Research suggests that directors associated with negative firm events are more likely to lose their board appointments, further strengthening their motivation to manage the succession process conservatively (e.g., Arthaud-Day, Certo, Dalton, & Dalton, 2006; Gilson, 1989; Srinivasan, 2005).

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Despite the board's important role in shaping firm strategy (Dalziel, Gentry, & Bowerman, 2011; Goodstein & Boeker, 1991; Tuggle, Schnatterly, & Johnson, 2010), the literature has primarily focused on the board's role in changing strategy or dismissing an inadequate CEO as a mechanism to improve performance (Tian et al., 2011; Zajac, 1990) rather than on the conditions under which a board has more or less discretion to pursue a particular strategic choice, an important antecedent to the firm performance discussion. Although many researchers have studied the board's interpersonal dynamics and bias (e.g., Zhu et al., 2014) and the board's external impression management (Graffin et al., 2011), few researchers have examined how uncertainty influences strategic board decisions, namely, the appointment of a nontraditional CEO (i.e., a woman). Research tends to treat the board's inability to execute an appropriate strategy as a function of its own resource deficiency or agency conflict rather than as an outcome of the complex interplay between external stakeholder management and internal board dynamics that accompany any major board decision. Although Rindova (1999) and Vancil (1987) both suggest boards make decisions differently than top management (e.g., via consensus-building), the constraints on the range of strategic options available to the board—in other words, the board's discretion—has not been thoroughly investigated.

The purpose of this study is to address these issues and, in doing so, make two important contributions to the literature. First, we extend Hambrick and Finkelstein's (1987) theoretical work on managerial discretion to boards of directors. We explore the conditions under which board discretion is enhanced by examining a strategically important context where the board's complex interaction with the CEO is more isolated (Krause, Semadeni, & Cannella, 2014), that is, during new CEO selection. In so doing, we identify external and internal factors that influence the board's ability to pursue a norm-violating strategy and thus move toward a broader theory of board discretion. Second, we build a set of observable predictors of nontraditional CEO appointments (i.e., women) and highlight the important role of board discretion in the decision to appoint a female CEO. We believe this is one of the first studies to explore environmental, organizational, and board-specific characteristics that influence the board's discretion to select a female CEO.

We organize the rest of the paper as follows. First, we briefly review the literature on managerial discretion and the conditions under which a firm's constituents influence its latitude of action. Next, we develop our theory of board discretion and discuss the literature on women's advancement to explain why the board may be constrained in selecting a female CEO. Then, we identify specific circumstances where the board has the discretion to appoint a female CEO, describe our methods and analyses, and report our results. We conclude with a discussion of our findings and their implications for both scholarly research and organizational practice.

2. Conceptual framework and hypotheses

Top management responsibilities include allocating and securing resources, selecting markets, taking competitive actions, and performing administrative duties, such as staffing, establishing compensation systems, and making structural decisions (Hambrick & Finkelstein, 1987). Managerial discretion refers to executives' latitude of action, or the range of strategic choices available to them in each situation (Hambrick & Abrahamson, 1995; Hambrick & Finkelstein, 1987). Hambrick and Finkelstein (1987) argue three components shape discretion: (1) the extent to which the environment permits diversity and change; (2) the extent to which the organization supports a range of options and allows the executive to act upon those options; and (3) the extent to which the executive can envision or develop multiple possibilities upon which to act. Therefore, Hambrick and Finkelstein (1987) establish that discretion is conferred through external and internal factors.

Although current research establishes the boards' emphasis on appeasing important stakeholders (Boivie, Graffin, & Pollock, 2012), most of this research, including research focusing specifically on the top management team (e.g., Quigley & Hambrick, 2012), has not delved into what factors influence the board's range of acceptable choices. If managers' strategic choices are influenced by environmental, organizational, and individual factors (Hambrick & Finkelstein, 1987), then it is also worth investigating those factors that influence the board's strategic choices as well, all of which can significantly impact organizational outcomes.

2.1. Board discretion

Boards of directors are responsible for hiring and firing senior executives; setting compensation; reviewing, approving, and evaluating firm strategy; and serving as overseers of company business (American Law Institute, 1982). The management literature identifies two key roles boards perform in organizations. First, a resource dependence perspective suggests that boards reduce environmental uncertainty by co-opting threats to the organization and providing critical links to important resources and information found in their networks (Hillman & Dalziel, 2003; Kim, 2005; McDonald & Westphal, 2003; Pettigrew, 1992; Pfeffer, 1972; Price, 1963; Zald, 1969). Second, agency theorists posit that boards play a key role in the organization's internal control as these members are responsible for setting policy and monitoring top management (Dalton, Daily, Johnson, & Ellstrand, 1999; Fama & Jensen, 1983; Johnson, Daily, & Ellstrand, 1996; Zald, 1969). These two roles of directors are environmentally, organizationally, and individually directed and have different implications for the board's available course of action; moreover, boards appear to serve both purposes at different times (Hillman & Dalziel, 2003).

The board members' ability to shape corporate strategy and limit managerial decision-making is frequently restricted (Del Guercio, Seery, & Woidtke, 2008; Vancil, 1987). As such, their decision-making and influence depend on the support of external parties. These external groups shape decision-making by conferring or denying directors access to specific resources. Director reputation is one particularly important resource controlled by external groups, and it is immensely valuable to directors (Cowen & Marcel, 2011; Fama & Jensen, 1983). Power within the business elite depends upon directors' positions in the network, which are, at least partly, determined by the number and prestige of their board positions (Clement, 1975; Warner & Abegglen, 1995). Board positions allow directors to establish and maintain important contacts (Mariolis & Jones, 1982). Directorships also provide invaluable prestige and rewards, such as access to social clubs, business associations, and government policy forums (Allen, 1974; Davis, 1993; Mizruchi, 1982; Palmer, 1983; Useem, 1979).

Moreover, board positions beget more board positions, pressuring directors to be successful in their roles (Davis, 1993; Finkelstein, Hambrick, & Cannella, 2009). Directors on poorly performing boards may risk their position (Finkelstein et al., 2009). Directors who do not fulfill their fiduciary responsibilities risk not only their reputation but also subsequent rewards (Fama, 1980; Gilson, 1989; Hambrick & D'Aveni, 1992; Kaplan & Reishus, 1990). One study found that directors of firms filing for bankruptcy were not only more likely to turn over but were also absent on the board of any exchange-listed firm for three years after the bankruptcy (Gilson, 1989). Another more recent study found that directors of firms associated with fraud were significantly more likely to turn over (Cowen & Marcel, 2011). Thus, external and organizational forces clearly influence director decision-making.

The board's latitude of action is also impacted by internal board factors. While significant research examines board members' tendency to use their own social and human capital to benefit the firm (Hillman & Dalziel, 2003), research also highlights the importance of the directors' dynamics with each other. Specifically, the board shapes and constrains strategic actions through group processes and consensus-building