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Dan R. Dalton and Catherine M. Dalton

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Invited Editorial

Integration of Micro and Macro Studies in Governance Research: CEO Duality, Board Composition, and Financial Performance

Dan R. Dalton
Indiana University
Catherine M. Dalton
Indiana University

The authors provide two examples of contemporary and contentious issues related to the governance of publicly traded corporations—the composition of boards of directors and the choice of CEO or board chairperson leadership structures. In each case, despite voluminous empirical attention, there is virtually no evidence related to the financial performance of the firm with regard to either of these fundamental elements of firms' governance structures. The authors suggest that these null results may be related to the inadequacy of analyses relied on to examine such issues, an inadequacy that might be constructively addressed by more attention to multilevel alternatives.

Keywords: *board composition; corporate governance; CEO duality*

There are a series of outstanding articles in this special issue of the *Journal of Management,* "Bridging Micro and Macro Domains." Our role, as invited by Herman Aguinis, Brian Boyd, Chuck Pierce, and Jeremy Short, the guest editors for the special issue, is to provide some perspective on the potential applications of this body of work. In that spirit, we have elected to examine the integration of micro and macro studies and public policy in the area of corporate governance.

Corresponding author: Dan R. Dalton, Institute for Corporate Governance, Kelley School of Business, Indiana University, Bloomington, IN 47405-1701, USA

E-mail: dalton@indiana.edu

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In subsequent sections, we provide two examples of contemporary, and intensely contentious, issues related to the governance of publicly traded companies—the composition of boards of directors and the choice of leadership structures (a concept also referred to as *duality*) by boards of directors. For board composition, the fundamental concern is the independence, or otherwise, of the members of boards of directors. In the case of leadership structure, the debate is whether the firm's CEO should serve simultaneously as the chairperson of the board or whether these roles should be separately held. As will be apparent in succeeding sections, despite an extensive body of research, there is virtually no empirical support related to the financial performance of the firm to provide any level of applied guidance for practitioners in these areas.

We suggest that this veritable dearth of direction may be a function of the inadequacy of the analyses relied on to examine these open issues that constitute the very soul of corporate governance. Indeed, based on a computer-aided search (search terms: *multilevel, hierarchical linear model, HLM*) of the years 1990 to 2010 of 24 major journals in organizational studies, finance, and accounting, we were able to identify only one study (Simsek, Veiga, Lubatkin, & Dino, 2005), and it was not directly on point with our focus, that relied on a multilevel analytical approach.

This is a bit awkward since the overwhelming majority of research on board independence and board leadership structure is, by its very nature, multilevel in character. In that regard, empirical examinations of board composition and board leadership structure are textbook examples of the potential for bridging micro and macro domains as contemplated in this special issue.

In the following sections, we examine the intersection of corporate governance and public policy and provide brief overviews of the theoretical foundations and extant research addressing the composition of boards of directors and board leadership structure. We also illustrate the multilevel character—individual, group, and organization—of this body of work and the potential to improve the next generation of research in this space by focusing more attention to the integration of these several levels of analyses.

Corporate Governance and Public Policy

In the wake of unprecedented corporate malfeasance, accounting scandals, and enterprise failures (e.g., Adelphia Communications, Arthur Anderson, Quest, Enron, HealthSouth, Tyco, and Worldcom), the Public Company Accounting Reform and Investor Protection Act of 2002 (also known as the Sarbanes-Oxley Act, SARBOX, or SOX; see Sarbanes-Oxley Act, 2002, for the full text) was passed by the U.S. Congress with an imposing bipartisan and bicameral mandate (423-3 vote in the House of Representatives; 99-0 vote in the Senate). This act has been referred to as "the most significant piece of federal legislation concerning public corporations since the post-1929 stock market crash legislation creating the SEC" (Monks & Minow, 2008: 329; see also Bebchuk, Cohen, & Ferrell, 2009; Bhagat, Bolton, & Romano, 2008; Linck, Netter, & Yang, 2009; Romano, 2005).

In the year following the SOX legislation, the listing exchanges (e.g., New York Stock Exchange, NASDAQ) dramatically revised their corporate governance guidelines

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(see NASDAQ Stock Exchange guidelines, 2010, and New York Stock Exchange guidelines, 2010, for full text of the respective exchange guidelines; see also Cain, 2003, for a broad history and discussion concerning listing exchange standards). These guidelines included requirements regarding the independence of members of the board, guidelines for which such independence might be assessed, and the independence of certain board committees. More recently, the Securities and Exchange Commission (SEC; 2009) adopted new guidelines (effective February 2010) for a host of corporate governance issues, including disclosure requirements for a publicly traded corporation's choice to have the roles of chairperson of the board and CEO held simultaneously by one individual.

In concert, the requirements of SOX, the listing exchanges (e.g., New York Stock Exchange, NASDAQ), and the updated SEC guidelines include a host of requirements and disclosures, but those germane to our examination are guidelines for the composition of the overall board (e.g., a majority of directors must be independent, certain board committees composed of and chaired by independent board members) and the corporation's leadership structure. An obvious question is the extent to which either the composition of the board or its leadership structure is related to the financial performance of the firm. In both cases, there is a distinguished—and enduring—tradition of research, discussion, narrative reviews, and meta-analyses on which we can rely to base our conclusions.

Composition of the Board and Firm Performance

The composition of the board of directors is one aspect of the independence concerns set forth in agency theory (e.g., Eisenberg, 1976; Fama, 1980; Fama & Jensen, 1983a, 1983b; Jensen & Meckling, 1976; see also Dey, 2008). It has been repeatedly argued that a board's willingness and ability to responsibly monitor the enterprise is related to board members' independence (e.g., Dalton, Hitt, Certo, & Dalton, 2008; Fogel & Geier, 2007; Gordon, 2007). Directors who are not officers or employees of the corporation and who are otherwise unaffiliated with the corporation (thus, independent directors) are considered to be "the crucial corporate governance mechanism for monitoring managers" (Bhagat et al., 2008: 1808). This is a timeless sentiment echoed by Supreme Court Justice William O. Douglas (1934) in an essay titled "Directors Who Do Not Direct."

There is an extensive body of multidisciplinary research and commentary addressing the issue of board composition and firm financial performance (e.g., Bhagat et al., 2008; Dalton, Daily, Ellstrand, & Johnson, 1998; Dalton et al., 2008; Walsh & Seward, 1990). Notably, this literature is astonishingly inclusive. Consider, for example, that it comprises more than two dozen operationalizations of board composition (Daily, Johnson, & Dalton, 1999) and multiple operationalizations of financial performance—return on assets, return on equity, return on investment, Tobin's *Q,* return on sales, shareholder returns, earnings per share, abnormal returns, Jensen's Alpha, market-to-book ratio, price-to-earnings ratio, and profit margin (e.g., Dalton et al., 1998; DeRue, Petersen, Mannor, & Morgeson, 2009; Rhoades, Rechner, & Sundaramurthy, 2000).

In addition to the body of primary studies, there are four meta-analyses that have addressed the relationship between board composition and corporate financial performance (Dalton

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et al., 1998; DeRue et al., 2009; Rhoades et al., 2000; Wagner, Steimpert, & Fubara, 1998). Based on these data, there is no evidence of systematic relationships between board composition and corporate financial performance (Bhagat et al., 2008; Dalton et al., 2008; Fogel & Grier, 2007; see Walsh & Seward, 1990, for an earlier assessment).

Fogel and Geier (2007) provide a direct and succinct summary of this body of work, noting that "there is no predicate, either in logic or in experience, to suggest that a majority of independent directors on a board will guarantee good corporate governance or better financial returns for shareholders" (p. 35). Bhagat et al. (2008) are equally as candid, concluding that there is "no relation between director independence and performance, whether measured by accounting or stock return measures" (p. 1814; see also Bebchuk et al., 2009; Coles, Daniel, & Naveen, 2008).

Board Leadership Structure

Another element of the general concern for board independence is the manner by which the roles of CEO and chairperson of the board are structured. In one choice, referred to as the *duality option,* the positions of CEO and board chairperson are held simultaneously by one person. The other option for the board's leadership structure is to assign these roles to two individuals: There is a CEO and there is a different chairperson of the board (e.g., Boyd, 1995; Dahya, Garcia, & van Bommel, 2009; Dalton et al., 2008; DeRue et al., 2009; Dey, Engel, & Liu, 2010). Even at the onset of the formal development of agency theory, Fama and Jensen (1983a, 1983b; see also Mizruchi, 1983) were uncomfortable with the dual structure and argued that it would compromise the ability of the board to independently monitor the CEO. Jensen (1993) concurred with the observation and noted, "Without the direction of an independent leader, it is much more difficult for the board to perform its critical function" (p. 866). MacAvoy and Millstein (2003), perhaps the most avowed advocates for the separate structure, have suggested that "the failure to have independent board leadership might, in the new world of judicial review, give rise to challenges in connection with directors' duty of good faith" (p. 117).

Accordingly, advocates for separating these leadership roles are actively adamant that directors are unable, or unwilling, to dispassionately evaluate the performance, policies, and practices of a firm's CEO when that CEO serves simultaneously as chairperson of the board (Chi, 2009; Conger & Lawler, 2009; Jensen, 1993; MacAvoy & Millstein, 2003; Monks & Minow, 2008). This has been noted as the functional equivalent of the "CEO grading his own homework" (Brickley, Coles, & Jarrell, 1997: 190). In fact, it has been suggested that a fundamental omission of SOX was its silence on a requirement to separate the CEO and chairperson roles (Green, 2004).

Others, however, remain unconvinced (Baliga, Moyer, & Rao, 1996; Dahya et al., 2009; Dalton et al., 2008; Dey, Engel, & Liu, 2009; Faleye, 2007; Finkelstein & D'Aveni, 1994). Dahya et al. (2009), for example, concluded that the abandonment of the combined CEO/chairperson of the board position "appears to be wide of the mark" (p. 179). Faleye (2007), too, suggests that insistence to "separate CEO and chairman duties may be counterproductive" and "may not produce the desired results" (p. 256).

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Fortunately, there is a distinguished tradition of multidisciplinary primary research, narrative reviews, and meta-analyses extending over many years and relying on multiple elements of corporate performance dedicated to the issue of the leadership structure of boards of directors. Notably, this work can be easily and uniformly summarized. There is no evidence of substantive, systematic relationships between corporate financial performance and board leadership structure (Dalton et al., 1998; Dalton et al., 2008; Dey et al., 2009; Faleye, 2007; Iyengar & Zampelli, 2009).

Does This Lack of Evidence Result From Inattention to the Multilevel Nature of Corporate Governance Research?

What, then, do we conclude about the nature of relationships between corporate performance and board composition and leadership structure? The extant literature is, in concert, eminently clear. Indeed, we are not aware of a body of literature in corporate governance—or elsewhere—where null results present with such consistency. Does such a conclusion suggest that future research addressing these elements of corporate governance is misguided? When is enough, enough?

Before we abandon the enduring interests in these elements of corporate governance, perhaps we should revisit the unicorn metaphor relied on in a recent overview of agency theory (Dalton et al., 2008). In that spirit, it could be fairly summarized that, to our knowledge, no searches to find the mythical unicorn have been successful. A derivative conclusion, then, is that there are no unicorns. That conclusion, however, may be premature. Are we certain that these searches were not incomplete, not having been conducted in the right place, or the right time, or under the appropriate circumstances? While noting that we are aware of Kaplan's (1964) classic admonition, "Wishful thinking . . . has its counterpart in wishful seeing" (p. 128), we are not inclined to abandon the search in the corporate governance context.

Our reticence to abandon such searches is based on a fundamental flaw in the analyses of the observed null results for relationships with corporate performance both for board composition and leadership structure. As noted in an earlier section, we are not aware of a single example of governance research addressing CEO duality or board composition that relies on a multilevel protocol. Consider an archetype example of an opportunity to leverage a multilevel protocol. Let's assume that the academic achievement of students will be some function of their individual differences and those of their teachers. We would also expect some contribution to that achievement provided by the social context of other students in the classroom. Similarly, we would expect additional contributions from the entity level—the school itself and/or the school district—and how these differ from other such entities. At some level, then, student achievement may be defined by variables at the individual, group, and enterprise levels.

Research on many elements of corporate governance has exactly that character. Consider the issue of the composition of boards of directors. Obviously, issues relating to individual directors of the board (e.g., their independence) will be at the individual level. Issues relevant to boards of directors, however, address a group-level phenomenon. The financial performance of the enterprise served by these directors and boards is an organization-level

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issue. Notably, a multilevel analytical approach can provide information about the unexplained variability associated with each of the levels. Such information provides a useful diagnostic about which level has the most promise as the focus of future research.

Actually, the promise for multilevel research and analyses is arguably even more promising than we have suggested in the case of corporate governance because of the number of levels. Boards of directors are composed of several committees, three of which (audit, compensation, and nominating/corporate governance) are required by the guidelines of SOX and the guidelines of the listing exchanges. These, from an analytical perspective, are groups—subgroups of the full board. Moreover, the corporation (an organizational-level entity) is often composed of multiple strategic business units (e.g., subsidiaries, products, regions) for which separate performance assessments are common.

The analytical dimensions of leadership structure have a similar profile. In addition to the other level-of-analysis issues we have noted, consider that a CEO (presiding officer of the enterprise—an individual) is often the chairperson (an individual) of the board (a group). Presumably, these entities—the CEO, the board chairperson, and the board—have an influence on the performance of the enterprise (an organization). Multilevel research including these dimensions of board leadership structure and the composition of the board would be unprecedented and may well be the search that discovers our metaphorical governance unicorn.

Conclusion

Twenty-five years ago, Rousseau (1985) provided an early and iconic discussion of the level of analysis in organizational theory and research. She—very rightly—noted that organizational studies have a notable—and uncommon—character. Our colleagues in psychology, social psychology, micro- and macro-economics, and sociology, for example, focus largely on a single level of analysis. Organizational studies, however, by their very nature focus across the individual, group, subgroup, strategic business unit, and enterprise levels. Having said that, however, we—as have other members of the Academy of Management—have poorly leveraged the opportunities to integrate our research across these multiple levels.

Such deficiencies are consequential in several ways beyond the design and execution of a given study. As we have noted, the work of the Academy can—and does—inform the practice of enterprise and public policy. And, disconnects between our relevant theoretical foundations and empirical research—however well intentioned—can and, in our view, have misinformed practice and public policy. Our attention to these integrative issues will, in fact, facilitate the bridging of the gap between the micro and macro domains to which this special issue of the *Journal of Management* is addressed.

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