

Corporate board 'interlocks' lead to managerial entrenchment

December 1 2016, by Phil Ciciora



The Rolodexes of the business elite help account for the surprising resilience of managerial control of publicly held corporations, leading to an entrenched management structure that comes at the expense of shareholder value, says research from U. of I. labor professor Richard Benton. Credit: L. Brian Stauffer

It turns out the old saying that "It's not what you know, but who you

know" still holds a measure of truth in corporate America.

New research from a University of Illinois expert in social network analysis indicates that, through 2006, the Rolodexes of the business elite help account for the surprising resilience of managerial control of publicly held corporations.

According to a forthcoming paper from Richard Benton, a professor of labor and employment relations at Illinois, the "interlock" of corporate [board members](#) and managers are ties that bind, leading to an entrenched management structure that comes at the expense of [shareholder](#) value.

"The 'old boys club' still exists, but it's less about gender and more about two different interest groups - entrenched management and activist shareholders - vying for control over publicly held corporations," Benton said.

On the one hand, shareholders and institutional investors are interested in seeing corporations managed and directed to reflect their interests. On the other, managers, executives and board members want to preserve their power and autonomy.

"One way to think about this network is it's about who has the power: shareholders or managers," Benton said. "But managers are able to tilt the playing field and surround themselves with a board of directors that thinks like they do."

The paper points to the incestuous nature of corporate boards and C-suite executives, Benton said.

"What this shows is that networks of people who work together and have common interests - unsurprisingly - do things to support each other," he said. "Basically, directors affiliated with manager-oriented firms self-

select into dense groups, which leads to firms appointing directors from similarly governed firms to their board. They end up supporting the interests of top executives, and not necessarily the shareholders. The end result is that these interlocks help spread a passive governance orientation, and shareholders' interests are neglected."

And a board of directors that reflexively defers to the CEO isn't necessarily the best shareholder advocate, Benton said.

"If they all know each other through their social connections, and they all take care of each other and run in the same social circles, are they really going to be critical or a vigilant watchdog of a [chief executive](#) - especially if that same chief executive also happens to be a buddy who sits on the board of their company?" he said.

"It's all very incestuous. There's a façade of independence, but they're really well-connected with one another."

The paper's findings suggest that a select group of corporate insiders have remained cohesive and continue to play a central role in maintaining managerial entrenchment in the modern era, even as the broader network has continued to fracture in the face of increased pressure from shareholders.

"A key source of shareholder power in a corporation is concentrated institutional investor ownership," Benton said. "When you have large concentrated [institutional investors](#) who own large blocs of shares, they have outsize power and influence because they can vote their shares and thereby put a lot of pressure on the board through activism."

But at corporations with high levels of institutional investor ownership, that impact is blunted by the deeply embedded old boys network, which is less susceptible to shareholder pressures, Benton said.

The practice isn't illegal, "it's just normatively questionable," Benton said.

"These are contested practices, something that most investors don't see as being in their interests and would like to see changed, but managers and board members still find ways around them," he said.

The good news for investors: The network has become more fractured and less cohesive in the wake of corporate scandals.

"This paper tracks companies through 2006, and we can already start to see the coalition start to splinter," Benton said. "One of the key reasons why it's become more fractured is that there's been more scrutiny on heavily networked firms and corporate directors."

The paper will be published in the *American Journal of Sociology*.

Provided by University of Illinois at Urbana-Champaign

Citation: Corporate board 'interlocks' lead to managerial entrenchment (2016, December 1) retrieved 19 September 2024 from

<https://phys.org/news/2016-12-corporate-board-interlocks-managerial-entrenchment.html>

<p>This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.</p>
--