Board Power and Corporate Strategic Focus: A Model of Board Impact on Firm Strategy

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Decades of research on corporate boards of directors resulting in diverse and often inconsistent findings have not dampened scholarly interest in the topic. Instead, researchers attempt to more effectively model the board-firm relationship. One such approach considers the power of the board. Drawing on upper echelons thinking (Hambrick and Mason, 1984) and notions of managerial power (Finkelstein, 1992) this conceptual study develops the concept of board power in relation to corporate strategy. Based on a framework of organizational power, the study develops propositions predicting the impact of board characteristics on a key strategic outcome – the diversification of the firm.

INTRODUCTION

Corporate boards of directors have been the focus of several decades of research and continue to be of interest to scholars and practitioners alike. This continuing focus stems in part from the diverse and often inconsistent findings regarding the statistical relationships of board characteristics to firm outcomes. Such findings have prompted organizational researchers (e.g., Dalton, Daily, Ellstrand, and Johnson, 1998; Finkelstein & Hambrick, 1996) to call for study using multiple theoretical perspectives and development of constructs that more effectively model this relationship.

Among constructs recently capturing the attention of governance researchers is that of the power of the board of directors. Finkelstein, Hambrick and Cannella (2009) suggest that understanding the need for board monitoring of firm management and the capacity to do so requires a clear understanding of board power. They propose that agency conditions depend on the capacity of a board to monitor top management, and this capacity is a result of the distribution of power between a board and its CEO. In addition, Hillman and Dalziel (2003) propose that a basic assumption underlying agency theoretic investigations of boards of directors is the capacity of a board to monitor management, and this suggests the importance of power. That is to say, a board's ability, or capacity, to monitor top management is dependent on its power to effect and enforce its will. Hence, examination of the nature of board power and its antecedents and outcomes is essential to our understanding of the governance function of boards, particularly with respect to firm strategic outcomes.

A key outcome of interest to strategic management researchers is the level of firm diversification. Related diversification potentially adds to firm value through synergies resulting from complementarities among the value chain activities and resource bases within a firm's corporate portfolio (Lubatkin & Chaterjee, 1994). On the other hand, unrelated diversification is thought to reduce or destroy firm value (Amihud & Lev, 1981) because the lack of complementarities among widely diverse operations, industries, and product markets results only in a reduction of risk but not in more efficient operations or

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enhanced revenue streams (Dess, Lumpkin, & Eisner, 2010). While on average, related diversifiers tend to outperform single business firms, unrelated diversifiers tend to underperform related diversifiers. This diversification-performance relationship has been the focus of considerable scholarly investigation (e.g., Lubatkin & Chaterjee, 1994; Amihud & Lev, 1981) from multiple theoretical perspectives.

Theories of corporate diversification and firm economic performance are not in complete accord about the firm diversification-performance relationship. Financial economics, which tends to dismiss the economic impact of interfirm differences (Barney, 1991; Bettis, 1983; Lane, Cannella, & Lubatkin, 1998; Nelson, 1991), suggests that corporate portfolio diversification reduces shareholder wealth because investors can diversify their own personal portfolios at much less cost than can managers diversify a corporate portfolio. On the other hand, management theory suggests that managers are key to creating firm value through corporate diversification because they may be able to achieve efficiencies by combining value chain activities across multiple value chains, leveraging competencies across businesses, or centralizing corporate functions that support multiple business lines (Bettis, 1983; Lane, Cannella, & Lubatkin, 1998; Lubatkin & Chaterjee, 1994). Given the lack of theoretical convergence on the value of the level of diversification in the multibusiness firm, empirical investigation has not resulted in a clear consensus on the impact of related and unrelated diversification on firm outcomes (cf. Lane, Cannella, & Lubatkin, 1998; Robins & Wiersema, 1995).

The need for boards to monitor corporate strategy is inherent in the structure of the modern corporation, which is characterized by a separation of ownership and decision making (Fama & Jensen, 1983). Among the responsibilities of boards of director in carrying out their fiduciary duty (Monks & Minow, 2001) is oversight of strategies developed and pursued by the CEO. Resulting from the separation of decision management and decision control, firm management is singularly responsible for strategy formulation and implementation (decision management) while the board's focus is on ratification and monitoring of strategy (decision control) (Fama and Jensen, 1983). In addition, concern for their reputation as corporate governance experts may compel directors to monitor the strategic behaviors of CEOs including overseeing formulation and implementation of strategy (Fama, 1980; Zajac & Westphal, 1996). Recent empirical work demonstrates that boards do monitor the strategic behaviors of CEOs and hold them accountable for the level of firm diversification (Hagerty, Chon, & Das, 2011; Kavadis, 2008; Tita & Sechler, 2011).

This study examines the impact of board power on focal firm diversification, conceptualizing board characteristics in terms of board power. Using a framework of managerial power composed of structural, ownership, expertise, and prestige power (Finkelstein, 1992) and extending upper echelons thinking (Hambrick & Mason, 1984) to the domain of board study, board power is conceptualized within the context of firm critical contingencies to examine its impact on firm diversification.

BOARD POWER

Power is the capacity of an individual to "overcome resistance in achieving a desired outcome or aim" (Lynall, Golden, & Hillman, 2003; Pfeffer, 1981). In an organizational context, the capacity to control the premises and choices of decisions as well their consequences (Roy, 1997) is the basis of the power to influence others and tends to be concentrated among strategic leaders. Organizational leadership is focused on two key strategic decision making groups – the top management team and the board of directors. Compared to top managers, boards may have limited discretion. However, in certain situations boards have exclusive decision making authority and in these cases exhibit the type of discretion normally associated with a decision-making group (Finkelstein & Hambrick, 1996). Hence, as a strategic decision making group, the board possesses a certain degree of organizational power.

Consideration of board power suggests several sources or dimensions of organizational power (Finkelstein, 1992). Board structure has been conceptualized in terms of the separation of the chair and CEO roles (Finkelstein & Hambrick, 1996). Separating the two roles places the board in a superordinate relationship to the CEO. However, the source of this power lies not strictly in the separation itself but in the authority of the board to create the separation, and this authority stems from the fiduciary relationship

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of the board to the shareholders. Boards derive structural power from their legal authority to oversee the activities of the CEO and not simply from their relative position in the organizational hierarchy. In spite of the preeminent focus of structural power in the CEO, because the CEO role derives authority from its relationship with the board, the board does possess a certain degree of structural power by virtue of this relationship. Indeed, the board can bestow the chair role on the CEO as well as take it away as Disney's board did from Eisner. Structural power of the board stems not strictly from the separation of the chair and CEO roles but from the board's legitimate authority to separate or combine the two positions.

In addition to structural power, boards possess a certain amount of ownership power. Finkelstein (1992) defines managerial ownership power as stemming from 1) capacity of managers to act as agents on behalf of the firm's principals, 2) the level of share ownership held by managers, and 3) managers' interpersonal links to the firm's founders. Ownership power of the board likely stems from similar sources. First, the board is legally empowered to act on behalf of the owners. Second, directors often have some ownership interest in the focal firm. Indeed, corporate governance reform efforts have focused specifically on the importance of directors holding an equity position in the firm, and the issue of director ownership has been the focus of considerable empirical scrutiny (e.g., Byrd & Hickman, 1992; Johnson, Daily, & Ellstrand, 1996; Miller, Le Breton-Miller, & Lester, 2005). Third, directors' personal links to the firm's founders provide some base of ownership power. For example, Susan Buffett's long-held position before her death on the board of Berkshire Hathaway was fairly unassailable despite the criticism the firm's corporate governance invokes from corporate governance activists (Langley, 2003). In addition to its base in links to the firm's founder, board ownership power may also stem from directors' personal links to institutional investors and blockholders. In sum, board ownership power is based in directors' capacity to act on behalf of firm owners, in directors' personal ownership stakes in the firm, and in personal links to firm founders and/or key firm investors.

In addition to structural and ownership power, board power stems from directors' expertise as directors and as managers. Such expertise may be evident in directors' capacity to deal with environmental contingencies impacting the focal firm (Finkelstein, 1992; Finkelstein & Hambrick, 1996). This capacity may be based in a director's interpersonal relationships with elements in the task environment as well as in the director's breadth of experience either as a board member (at the focal firm or at other organizations) or as a manager. Multiple directorships have been the target of criticism by corporate reform advocates, many of whom propose limits on the number of directorships one director can hold. In spite of the intense criticism of the practice, the scant empirical evidence on the outcomes of multiple directorships suggests that focal firm performance does not suffer when directors serve on boards of other firms (Ferris, Jagannathan, and Pritchard, 2003). Experience with general business conditions at the strategic level whether as a manager at one's home firm or as a director at another firm may afford focal firm directors the expertise necessary for effective monitoring.

In addition to such general management or governance experience, expertise power may also be based on the strategic relevance of a director's expertise with respect to a particular strategic choice (Finkelstein, 1992). Strategic relevance means that the impact of a director's expertise may lie in the director's capacity to reduce uncertainty stemming from the firm's dependence on task environments most problematic to the organization (Pfeffer, 1972a, 1973, 1988; Pfeffer & Salancik, 1978). Citing Carpenter and Westphal (2001), Hillman & Dalziel (2003) noted that boards with experience in a particular situation facing the firm showed effective monitoring. The expertise power of the board may be based in directors' general experience as top managers or directors as well as in prior experience gained through familiarity with events similar to those that a focal firm's managers face at a specific moment in time.

Finally, board prestige power may lie in the reputation of directors within the institutional environment (Scott & Meyer, 1983), among the managerial elite (Useem, 1979), from their formal authority within a social organization or institution (Giddens, 1972), or from ties to other organizations through interlocking directorates (Mizruchi & Stearns, 1988; 1994). Prestige power differs from expertise power in that the latter is based on experience whereas the former is based on perceived position within social networks. Prestige power, while a general source of power for most strategic leaders, may have unique application

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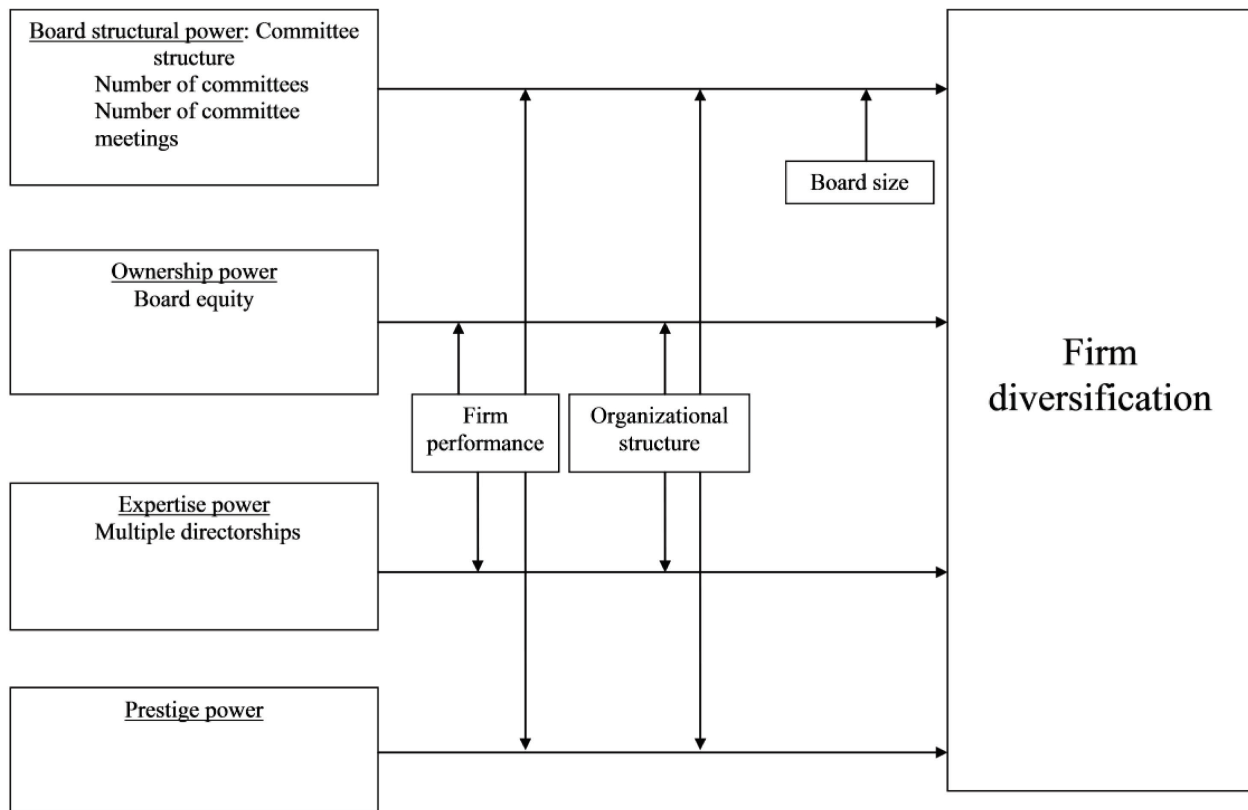
within the context of boards of directors. Although a leader's prestige is likely a premium with any appointment to a strategic leadership position, prestige tends to be more heavily weighted in board appointments than in top management appointments. Indeed, a central tenet in the resource dependence perspective (Pfeffer, 1972, 1973, 1988; Pfeffer & Salancik, 1978) is that prestigious individuals are recruited as directors to enhance the legitimacy of the focal firm. Hence, the prestige power of the board and its individual directors may be a singularly apt application of Finkelstein's concept of power to the domain of boards due to the importance of external interconnections directors often bring. Such formal and informal connections with and authority within organizations in the focal firm's institutional environment may be sources of external information that, when included as inputs to the focal firm's information processing system, lead to a reduction of uncertainty for the focal firm (Pfeffer, 1972, 1973, 1988; Pfeffer & Salancik, 1978).

In sum, boards operate from a basis of organizational power that, while similar to managerial power, differs in the sources of its power and in the ways that power might be used to influence firm outcomes. Extension of upper echelons thinking (Hambrick & Mason, 1984) and the notion of dimensions of managerial power (Finkelstein, 1992) may inform our understanding of corporate governance in instances where boards clearly have discretion in a specific realm of decision making. Furthermore, conceptualizing the board in terms of board power may provide value in modeling the relationship between board characteristics and a focal firm's strategic outcomes. Following are propositions articulating such a model, and these are graphically represented in Figure 1.

FIGURE 1
A MODEL OF BOARD POWER AND CORPORATE STRATEGIC FOCUS



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BOARD POWER AND FIRM DIVERSIFICATION

The impact of a firm's business portfolio on firm outcomes is the object of conflicting theoretical perspectives, but management theory tends to treat firm diversification as providing potential benefits to the owners of a firm. Financial economics has argued that diversification reduces firm value by reducing the variance in returns (Amihud & Lev, 1981). On the other hand, management theory suggests that the business portfolio of the firm differs from an investment portfolio in stocks in at least one important way and that is the human capital (i.e., firm management) that makes the portfolio more valuable than the sum of returns (Lubatkin & Chaterjee, 1994). Furthermore, related diversification may create synergies that other types of diversification do not and may reduce the effects of systematic variation (Lubatkin & Chaterjee, 1994). The key difference between the corporate business portfolio and a securities portfolio is the assumption of active management in the case of the firm and passive management in the case of securities (Lubatkin & Chaterjee, 1994). That is to say, the officers of the firm are charged with creating value through active management of the assets while securities management is focused primarily on creating a portfolio of stock that performs as well as or better than the market portfolio (Brealey & Myers, 2003). From the standpoint of strategic management theory, corporate portfolio diversification is a potential source of firm value.

Because boards are charged with the fiduciary responsibility of overseeing productive management of firm assets, monitoring managerial pursuit of firm diversification strategies is a vital aspect of corporate governance. Boards are responsible for approving strategic direction (ratification) as well as monitoring its results (control) (Fama & Jensen, 1983) and are, therefore, responsible for monitoring strategy as well as performance. In terms of organizational control, boards may make use of both financial controls ensuring favorable outcomes for shareholders and of strategic controls (Baysinger & Hoskisson, 1990) ensuring that policies pursued by managers are those most likely to result in favorable outcomes. Hence, boards are responsible both for outcomes and for the means intended to produce those outcomes – overseeing management's strategic behaviors.

Boards' evaluation of strategic behaviors has received relatively little empirical investigation. Recently, Kavadis (2008) demonstrated that the likelihood of CEO dismissal increases with an increase in unrelated diversification while that likelihood decreases with an increase in related diversification. This is one of the few studies demonstrating that boards act not only in response to results of CEOs' strategies but also in response to those strategies themselves and demonstrates that boards react to what are perceived to be value destroying strategies through CEO dismissal. Earlier in a reexamination of Amihud and Lev's investigation of the relationship between ownership control and firm diversification, Lane and colleagues (1998) demonstrated that vigilant boards did not account for differences in levels of diversification. Here board vigilance was measured using a composite of the proportion of outsider directors and the proportion of firm shares owned by outside directors.

It may be that powerful boards are more inclined to monitor strategic behaviors before the point (*ex ante*) at which dismissal is warranted and to inhibit pursuit of potentially value-destroying strategies than react ex post to unsuccessful behaviors that result in poor performance. Finkelstein and Hambrick (1996) suggest that consideration of agency conditions with respect to the board and CEO are really assumptions about the balance of power between them. Consideration only of boards' ownership power based on proportion of board equity holdings may omit consideration of other forms of capacity and incentive to influence management. In addition, Hillman and Dalziel (2003) suggest that boards must have both the capacity for monitoring and the incentive to do so. Such capacity implies the power to enforce its will, and one way that a board may enforce its will is by overseeing the choices of strategies a CEO pursues.

Literature on corporate strategies demonstrates a marked trend toward more focused portfolios during the last two decades of the twentieth century (Bigley & Wiersema, 2002; Comment & Jarrell, 1995; Maremont, 2004; Markides, 1990) such that strategies emphasizing a more focused portfolio have become nearly institutionalized (Kavadis, 2008; Lazonick & O'Sullivan, 2000). Such practices have certainly not been lost on boards of directors, which have experienced trends during the same period toward increasing outsider dominance and greater independence (Carey & Ogden, 2000; Parnell, 2003).

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Governance research suggests that the corporate refocusing of the period was driven at least in part by stronger governance (Johnson, 1996). Powerful boards possess a certain capacity to influence the CEO's choice of strategies and may be motivated and empowered to inhibit a CEO's pursuit of value-reducing diversification strategies and to encourage pursuit of value enhancing diversification strategies.

Structural Power and Corporate Focus

While the board's position in the organizational hierarchy giving it the authority to oversee the CEO does not in itself vary, (by its very nature, the position of the board is rather static) certain aspects of board structure may make the organizational position of the board relatively dynamic. Organizational theory posits that structure defines the allocation of tasks, specifies reporting relationships, and defines formal coordination mechanisms and interaction patterns, and these concepts may have some application to the organization of the board of directors. As a strategic decision making group, the board is often seen as rather amorphous in terms of structure. Expect for the role of chair, there is little vertical differentiation within the board. The division of the work of the board into committees represents a certain amount of horizontal differentiation within the board. If organization design is considered to facilitate efficiency and effectiveness in organizations, examination of board organization may yield fruitful insights about board functions and outcomes.

The work of the board increasingly relies on committees (Lorsch & MacIver, 1989) as a means to facilitate board decision-making processes (Conyon & Peck, 1998; Singh & Harianto, 1989b). The past three decades have seen an increasing incidence of committees (Vance, 1983). Although researchers have increasingly acknowledged the importance of board committees, in comparison to the volume of research on the board at large, this structural aspect of boards has received relatively little empirical scrutiny. However, organizational scholarship recently has begun to recognize the importance of committees as an aspect of board structure, which has typically been characterized by the dimensions of board leadership and of board size. Indeed, Finkelstein, Hambrick and Cannella (2009) in their recent review of scholarship on strategic leadership include board committees as a structural element of the board.

Some boards have many committees in addition to those mandated legally or by the firm's listing stock exchange (i.e., nominating, compensation, and audit). Such boards likely have relatively decentralized information systems diffusing the power of the entire board. All things being equal, the proliferation of board committees may excessively divide the work of the board reducing the cohesiveness of board interaction. In contrast, allocation of board work into fewer committees may effectively focus directors' efforts on specific issues and allow more efficient interaction among committee chairs and individual committee members. Increased efficiency and effectiveness of the board through its committee structure may enhance the capacity of the board to monitor strategic behaviors of the CEO such as choices affecting the level of corporate diversification.

P1: The smaller the number of standing committees of the board, the more focused the level of firm diversification.

Eisenhardt (1989) suggests that the number of meetings enhances the information processing of the board. More frequent committee meetings increases the amount of director interaction with each other and with firm managers enhancing the quality and quantity of the board's information reducing their reliance on insiders for information and increasing their independence. Freedom from dependence tends to make one more powerful in deciding one's fate and in making decisions within one's decision making purview. The increased power and independence from enhanced information makes the board less likely to allow the CEO to pursue self-interest at the expense of shareholder interests.

P2: The greater the number of committee meetings, the more focused the level of firm diversification.

A key element of board structure addressed by organizational researchers is board size (Finkelstein & Hambrick, 1996). Board size has demonstrated some effects on firm financial performance (Dalton et al.,

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1998; Hermalin & Weisbach, 2001). A meta-analysis of the board size-firm performance relationship indicated a systematic, non-zero, positive relationship between the size of the board and firm performance (Dalton et al., 1999). A narrative review of the economic literature (Hermalin & Weisbach, 2001) suggests a negative relationship between board size and performance. A larger board may be too unwieldy to adequately control and serve the focal firm's management leading to the possibility of lower performance outcomes. Alternatively, a larger board may have a broader, richer pool of experience from which to draw. Hence, there is no clear theoretical or empirical consensus on the impact of board size on firm outcomes (Dalton et al., 1999).

The larger the board, the greater its capacity for a larger number of committees, whereas a small sized board's capacity for division into committees is quickly exhausted. Therefore, the larger the board, the less pronounced are the effects of the number of committees and of committee meetings.

P3a: Board size will moderate the relationship between the number of committees and the level of focus of firm diversification.

P3b: Board size will moderate the relationship between the number of meetings and the level of focus of firm diversification.

Ownership Power

Ownership power of the board stems from directors' equity stakes in the firm and their personal links to the firm's founders (Finkelstein, 1992) and to institutional investors and large blockholders. Following an agency perspective, directors have long been encouraged (some activists would require them) to have some ownership stake in the firm. This is thought to align directors' interests with those of the stockholders thereby enhancing the board's level of fiduciary care. Such a practice is part of a larger effort to align the interests of all strategic leaders, top managers and directors alike – to the interests of shareholders. Recent research on the impact of managerial equity in the focal firm demonstrated that this may be effective only up to a certain level of ownership (Wright, Kroll, Lado, and VanNess, 2002). While the governance literature strongly supports the idea that ownership incentives align managerial and shareholder interests, Wright and colleagues showed that the relationship is not monotonic but instead inflects downward at a point when ownership is disproportionately concentrated in the focal firm leading managers to reduce the risk associated with their personal wealth portfolios through risk-reducing corporate strategies.

Research on a similar effect with regard to board equity has not been done, but it is reasonable to suggest a similar line of reasoning. It is likely that board power increases with increased ownership stakes tending to align board decisions with those of shareholders. As the ownership stakes of the board increase, directors may become increasingly risk averse and unable to diversify away their risk and choose instead to support diversifying the firm thereby vicariously reducing their risk. At relatively low levels of equity, directors will have the incentive to enhance governance through effectively monitoring the CEO. However, as their equity stakes increase, their interests begin to diverge from those of shareholders, leading to decisions favoring entrenchment and risk aversion.

P4a: The greater the ownership power of the board, the more focused the level of firm diversification.

P4b: As ownership power of the board continues to increase, the less focused the level of firm diversification.

Expertise Power

The number of multiple directorships represented on the board may enhance the board's expertise. Although theory and corporate governance critics suggest that multiple directorships represented on boards lead to complacent, entrenched boards, resulting in reduced board capacity to monitor, Ferris and colleagues (Ferris, Jagannathan, and Pritchard, 2003) found that multiple directorships were not

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significantly associated with negative performance. Boards with directors serving on multiple boards were not found to be "too busy to mind the business" (Ferris et al., 2003: 1087). These findings are somewhat at odds with the prevailing wisdom that multiple directorships reduce board effectiveness and capacity to monitor. Rather they suggest that multiple directorships enhance board expertise.

Greater expertise from multiple directorships may be attributed to a number of phenomena associated with interlocking directorates. For examples, interlocking directorates may result in greater quantity and quality of information. Such information is not necessarily about specific opportunities or threats but rather about general business conditions (Haunschild, 1993; Useem, 1984). In addition to the quality and quantity available to the focal board through board interlocks, multiple directorships may enhance the board's capacity to manage the information links between the firm and other organizations considered vital to managing the firm's external contingencies (Pfeffer & Salancik, 1978). Multiple directorships may enhance both the board's information inputs, in terms of quality and quantity, and the management, or processing, of that information.

The enhancement of the board's information management processes enhances the strategic relevance of the board's expertise within the context of the focal firm's strategy. As an information processing system, the board's information inputs and its capacity to manage and process those inputs enhance the board's capacity to interpret that information in ways that are meaningful to specific strategic alternatives available to the firm's management. The board's broad exposure to a variety of external conditions and the board's experience at addressing these conditions (and seeing them addressed by other firms' managers on whose boards they serve), affords the learning necessary to convert these general observations into choice-specific information inputs to a decision or strategic process at hand thereby making their expertise relevant to a specific strategic context. This seems the core of the idea of strategic relevance - the capacity to infer information about a specific situation from a variety of generalized experiences and bring this information to bear on a specific decision. Hence, the board's expertise is enhanced by strategic relevance of directors' individual experiences within the general context of business conditions and through the variety of their exposure and involvement in concurrent conditions. Thus, a board characterized by a high number of multiple directorships will have more expertise.

Greater board expertise results in less reliance on the inside information of the CEO due to the board's superior capacity for interpreting and applying business information, and this leads to greater independence. While the board still relies on the CEO to formulate and implement strategy, the board will be in a better position to evaluate and monitor firm strategies (Fama & Jensen, 1983). Hence, the number of multiple directorships held by focal firm directors will be associated with a greater degree of focus in the level of firm diversification. Hence,

P5: The greater the number of multiple directorships represented on the board the more focused the level of firm diversification.

Prestige Power

The prestige power of the board is rooted in directors' stature as strategic leaders. The standing of directors as strategic leaders in the eyes of other important organizational actors (Finkelstein, 1992) is often considered a manifestation of an individual's social embeddedness in the business elite (Granovetter, 1985; Mizruchi & Stearns, 1988; 1994; Useem, 1979). Members of the business elite generally seek to preserve or enhance their positions. Directors represent not only shareholder interests but also their own reputations (Baysinger & Butler, 1985) staking their reputation on the effective governance of a firm (Baysinger & Hoskisson, 1990). A chief dimension of effective monitoring is ensuring that firm strategies result in sustaining and improving shareholder value and one means to that end is ensuring that the firm is engaged in pursuit of value enhancing strategies. The greater the prestige power of the board, the more likely is the board to ensure managerial pursuit of value enhancing strategies.

P6: The greater the prestige of the board the more focused the level of firm diversification.

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Performance Implications

Firm performance may moderate the impact of board power on firm diversification. Poor performance may be perceived as evidence of a weak board. If a firm is experiencing poor performance, the board may be less likely to allow the CEO broad discretion in pursuing strategies to improve performance. During periods of high performance, managers may be more prone to use organizational slack to pursue their own interests and even powerful boards may be more likely to allow such managerial behavior. Finkelstein and D'Aveni (1994) noted that when firm performance is low powerful boards may be less likely to favor CEO duality while vigilant boards may prefer the arrangement when performance is high. CEO duality is often considered a kind of managerial perquisite, and CEOs often seek the post of board chair to enhance their reputations. CEOs are motivated to enhance their reputations also by expanding the firm through increased diversification (Amihud & Lev, 1981). When firm performance is high, powerful boards may be more likely to allow greater managerial discretion in diversifying the firm than when firm performance is poor.

P7: Firm performance will moderate the relationship between board power and the level of focus of firm diversification.

Organizational Structure

Organizational structure may impact the effects of firm diversification on firm performance. The multidivisional form has been seen as attempts by managers to adapt structure to the needs of the diversified firm seeking to create managerial efficiencies (Chandler, 1962). Diversified firms tend to rely on variants of the multidivisional form (Hill, Hitt, & Hoskisson, 1992; Markides & Williamson, 1996; Pitts, 1977; Robins & Wiersema, 1995; Rumelt, 1974). These forms are attempts to increase firm value through enhanced market power, managerial economies, and economies of scale and scope (Bergh, 1997; Seth, 1990). Consequently, not all cases of diversification result in destruction of shareholder value. The value of diversification varies with the structures used to implement that strategy. Accordingly, the structure used at a firm will impact the value created through diversification. Boards of firms with the appropriate structures for implementation of diversification strategies may be more likely to allow pursuit of diversification in the interests of enhancing firm value. Therefore,

P8: The relationship between board power and the focus of firm diversification will be moderated by the structural form used at the firm to implement diversification strategies.

DISCUSSION

A general goal of social science research is to continually strive for more representative models of social behavior. While several decades of governance research have improved scholars' ability to model the board-management relationship, there is still much to be learned. In one sense, the agency relationship existing between the board and top management (particularly the CEO) is essentially about power (Finkelstein et al., 2009). Success in effectively monitoring the CEO depends on a board's capacity to carry out its collective fiduciary duty to the firm's shareholders. This capacity goes beyond motivation and implies the board's power to effectively monitor management (Hillman and Dalziel, 2003). The capacity of the board to oversee management on behalf of firm owners is dependent on its power to effectively discharge these duties. Managers themselves are powerful actors in terms of the assets, resources, and human capital under their charge. A board's ability to carry out its fiduciary responsibilities means relying on its own sources of power.

Boards that are dependent on firm insiders, particularly the CEO, for information about strategy formulation and implementation lack effective power, as the very essence of the notion of dependence implies a lack of power. Drawing on boards' natural bases of power in terms of structural, ownership, expertise, and prestige power, directors may be able to influence firm strategic direction that balances the natural power base of managers. Balancing the power bases of the board and the CEO more likely may

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afford opportunities for collaboration between the two to the benefit of shareholders and other stakeholders.

Finkelstein's (1992) four dimensions of management power when extended into scholarly understanding of board-management dynamics may more fully represent the notion of board independence. Board structural power is rooted in its formal authority to appoint both the CEO and the chair. Ownership power of the board rooted in its equity holdings provide both incentive and authority to act in the best interests of shareholders. Expertise and prestige power are based in directors' position in the social network of organizational leaders, and these forms of board power may be uniquely applicable to boards because directors often are chosen on the basis of their experience and social status. Expertise lies at the very heart of the advice and counsel role of the board (Zahra & Pearce, 1989), and prestige lies at the root of the role that directors play in lending legitimacy to the firm (Pfeffer & Salancik, 1978). The power of the board lies at the very core of the board's capacity for governance, and the notion of board power may provide a fuller representation of board independence than does the notion of non-employee directors.

One important focus of board monitoring of management is the pursuit of strategies supporting creation of shareholder value. Rather than simply react to poor performance through CEO dismissal, directors may take a more active role in monitoring not only the results of management's strategies but also the strategies themselves. Among the strategies believed to impact shareholder value is diversification of the firm's corporate business portfolio. Potential synergies among businesses within that portfolio may provide greater firm value, although diversification can also benefit managers at the expense of the value of the firm. Boards intent on monitoring firm strategies may keep a watchful eye on the level of corporate focus with respect to diversification strategies reacting to potential over-diversification by opposing management's policies to do so.

In addition to boards' response to their own fiduciary duty in monitoring corporate diversification, such increased controls by boards may be in response to institutional pressures toward greater corporate focus. The past three decades have been characterized by increasingly focused diversification strategies (Amihud & Lev, 1981; Bettis, 1983; Hagerty, Chon, & Das, 2011; Lane, Cannella, & Lubatkin, 1998; Lubatkin & Chaterjee, 1994; Maremont, 2004; Tita & Sechler, 2011), and this trend toward more focused companies has diffused across industries specifically and across the economy in general. This diffusion has created increased institutional pressures, particularly mimetic forces (DiMaggio & Powell, 1978; Judge & Zeithaml, 1992; Meyer & Rowan, 1977), to conform to this trend. Hence, boards' tendency to monitor firms' level of diversification may be driven not only by the trend for increased monitoring of management in the interests of shareholders but also increased institutional forces toward corporate focus.

A key limitation of this model of board power is underrepresentation of CEO power. This early attempt at modeling board power is focused primarily on the nature of the power of boards of directors. Rather than attempt to understand how board power might interact with the power of the CEO, this model attempts to understand the nature of board power. Consideration of CEO characteristics would greatly improve the ability of the model to explain governance processes. However, the inclusion of CEO characteristics in the empirical investigation of the relationships proposed in this study may strengthen the theory underlying the model.

Another limitation of the concept of board power is that it shares along with much of corporate governance research a limited ability to see inside the "black box" of governance processes. Because of the nature of boards and managers as organizational leaders and the privacy associated with strategic deliberations, much of governance research is hampered by dependence on constructs that indirectly represent the processes of firm governance that are truly the object of scholarly interest. In spite of the relative obscurity of the "black box" of governance, decades of research into governance and the board of directors have yielded considerable insight into the mechanisms of firm governance. In spite of that, there is much we still do not know.

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