# CEOS AS CORPORATE DIRECTORS: A HUMAN CAPITAL PERSPECTIVE

**Stephen V. Horner, Pittsburg State University**

## ABSTRACT

*Decades-long research on boards of directors based on the agency theoretic insider/outsider distinction (Fama & Jensen, 1983) has yielded limited results regarding the effectiveness of boards as monitors of senior management (Johnson, S., Schnatterly, & Hill, 2013) leading governance scholars to incorporate agency theory based distinctions with rich characterizations of the human capital of board composition. This study examines the human capital brought to the boards of directors by active CEOs.*

## INTRODUCTION

Decades-long research on boards of directors based on the agency theoretic insider/outsider distinction (Berle & Means, 1968; Fama & Jensen, 1983) has yielded limited results regarding the effectiveness of boards as monitors of senior management (Johnson, S., Schnatterly, & Hill, 2013). In response, governance scholars have begun incorporating such agency theory based distinctions with rich characterizations of the human and social capital content of board composition. Among these lines of inquiry are those examining the human capital of individual directors (Johnson, S., Schnatterly, & Hill, 2013) as well as the resulting human capital at the board level. Such inquiry seeks to determine what skills and experience directors bring to the board and the aggregate impact of this human capital on firm outcomes.

Among such scholarly investigations are those examining characteristics of subgroups of directors (Jensen & Zajac, 2004; Johnson, S., Schnatterly, & Hill, 2013; Lau & Murnighan, 1998) such as outside directors who are active CEOs at other firms. These scholarly investigations expand on agency theoretic research based primarily on directors' structural position by seeking to understand the human capital of boards that proceeds from the perspectives of these key strategic leaders. In this way, examination of board human capital in general and CEO director human capital specifically complements the agency theoretic emphasis on the structural position of directors by including the perspectives of these strategic leaders (Mintzberg, 1988) that result from the vantage point of this structural position. Simply put, outside directors bring more than their employment relationship to the focal firm and bring along with this structural relationship some rather unique perspectives stemming from a wide variety of direct experiences at their home firms and indirect experiences through observation of other firms.

In addition, previous research suggests that governance is more than oversight. Indeed, it depends on a balance or trade-off between inward-looking versus outward-looking perspectives (Cohen & Levinthal, 1990). As part of their external organizational role, boards link their focal organizations to critical environmental resources and information lying in a network of interlocking directorates (Finkelstein & Hambrick, 1996; Price, 1963; Pfeffer, 1972; Zald, 1969). Internally, in addition to their monitoring role, boards also perform policy roles of advice and counsel and ratification of strategy (Fama & Jensen, 1983; Finkelstein & Hambrick, 1996).

المنارة للاستشارات



www.manaraa.com

Much of these external and internal roles are heavily informed by certain levels of expertise and skill (Baysinger & Butler, 1985). CEO directors come to the board with a great deal of experience, knowledge, and expertise comprising potentially valuable human capital. This human capital may enhance the capacity of the board to advise, counsel, ratify, and monitor the firm's management and strategic direction. This study examines the human capital brought to the boards of directors by active CEOs whose experience as general managers has resulted in both general human capital and specific human capital.

## CEO DIRECTORS: WHAT IS KNOWN

What scholars know about CEO directors comes from both the finance and strategic management literatures and can be summarized in terms of their effects on the appointing firm, factors influencing acceptance by active CEOs of board appointments, and source (home) firm and appointing (focal) firm characteristics. Regarding the impact on appointing firms, Fich (2005) reported a positive stock market reaction to appointment of CEO directors to boards of Fortune 1000 firms between 1997 and 1999. Faleye (2011) demonstrated that managerial compensation is higher and less sensitive to firm performance when CEOs serve as directors, although Fahlenbrach and colleagues (2010) using a broader sample and longer time series did not observe any relationship between the existence of CEO directors on the board and managerial compensation. Fahlenbrach and colleagues (2010) also note that CEO directors' authority and strategic leadership experience may enhance the value of the board's advising and monitoring functions particularly at small and/or growing firms with high advisory needs and for young, less experienced CEOs (Hermalin & Weisbach, 1988). Fich (2005) noted an inverse relationship between appointment of CEO directors and the existence of CEO directors already on the board, while Fahlenbrach and colleagues observed that firms with CEO directors already on the board seemed to be related to subsequent appointment of new CEO directors. In fact, Fahlenbrach and colleagues noted that CEOs cluster on boards: the existence of a CEO director on the board increases likelihood of additional CEO directors. CEO directors may also influence the spread of institutional governance norms across firms. Westphal & Zajac (1997) demonstrated the impact of CEO directors as a means whereby corporate practices are diffused across firms. CEO directors were more likely to bring changes to the appointing firm's board (e.g., dual leadership or more outside directors) if they had experienced similar changes by way of board policy changes at their home firms. Noting a leveling effect, they demonstrated the effects of an equity or social comparison perspective (Festinger, 1954; Walster, Berscheid, and Walster, 1973) in which CEOs who recently experienced loss of power at their home firms saw their status as having decreased in comparison to CEOs on whose boards they served and behaved in such a way as to similarly reduce support on behalf of those CEOs on whose boards they served.

In addition to impacting appointing firm outcomes, certain factors such as reduced employment risk, enhanced compensation and reputation, and exposure to new business opportunities may influence active CEOs to accept board appointments at other firms. Fahlenbrach and colleagues (2010), noting Fich's (2005) report of a positive stock market reaction to the appointment of CEOs to corporate boards examined factors attracting active CEOs to outside board service. Learning about the new firm as a member of the board may require considerable cognitive effort (Wiersema, 2002) as well as an extended period of orientation at the new firm. Governance scholars suggest that a new director can require three to



المنارة للاستشارات
www.manaraa.com

five years to sufficiently understand the firm (Bacon & Brown, 1975). Hence, newly appointed directors face considerable opportunity costs associated with board service, and this phenomenon is especially acute for active CEOs (Wiersema, 2002). These opportunity costs may be ameliorated by acceptance by CEOs of appointments to boards of firms bearing marked similarity to their home firm on attributes such as firm size, age, financial and investment policies, and governance structures (Fahlenbrach et al., 2010) making appointing firms perhaps easier to understand. These similarities between the CEO director's home firm and the appointing firm result in decreased time and effort to understand the appointing firm's strategic context allowing these directors to "economize on governance costs" (Carpenter & Westphal, 2001: 654). In contrast to the risks and high opportunity costs just described, board service may bring benefits and rewards to CEO directors in the form of more knowledge of business opportunities, enhanced prestige and other potential improvements regarding an active CEO's position (Fahlenbrach et al., 2010) perhaps bringing value beyond financial compensation to individuals who are already rather well compensated (Fich, 2005). Service by active CEOs on boards of other firms presents risks to their jobs and reputations but also provides tangible and intangible rewards as well as opportunities for further strategic leadership development.

Looking beyond CEO directors' individual characteristics, empirical research has examined the characteristics of these CEO directors' home firms and those of appointing firms. Prior discussion points up the role that similarities between the source (home) and appointing (focal) firms play in attracting active CEOs as directors. Regarding other source firm characteristics, Booth and Deli (1996) noted that CEOs of firms with growth opportunities hold fewer outside directorships but also demonstrated that CEOs with strong top management teams to whom they may transfer decision making tend to hold more outside directorships. Furthermore, with respect to appointing firms, appointments of active CEOs as directors tend to come from older CEOs than those making non-CEO director appointments (Fahlenbrach et al, 2010)

In sum, this line of research demonstrates that active CEOs are highly sought after for board service, that such directors seek favorable tradeoffs between total compensation (including intangible incentives in the form of prestige and expected networking opportunities) and the workload associated with board service, and that investors favorably view the appointment of active CEOs as outside directors by bidding up the appointing firm's stock price. The next section addresses the nature of human capital and the types of human capital brought to firms' boards of directors by active CEOs serving as directors.

## HUMAN CAPITAL: GENERAL, SPECIFIC, AND FIRM-SPECIFIC

Human capital consists of knowledge and skills and is composed of general and specific human capital. General human capital such as education or general business experience is deployable across multiple and somewhat varied contexts (Becker, 1964; Dimov & Shepherd, 2005; Hatch & Dyer, 2004; Le, Kroll, & Walters, 2013; Nonaka, 1994). Other human capital is specific (e.g., industry experience, functional experience, general management experience (Kotter, 1982)) and deployable across similar contexts (Amit & Schoemaker, 1993). Yet other types of human capital are firm specific (e.g., context specific experience, firm specific procedures, routines, and practices) (Hatch & Dyer, 2004; Le, Kroll, & Walters, 2013). Firm specific human capital is that which can be applied in a particular firm (Amit & Schoemaker, 1993). In some cases, firm specific knowledge may be so specific that it is only imperfectly



المنارة للاستشارات
www.manaraa.com

deployable in other firms. Human capital acquired from rivals often requires "dynamic adjustment costs" (Hatch & Dyer, 2004: 1156) in the process of adapting the human capital to the new context (Cappelli & Singh, 1992; Hatch & Dyer, 2004; Mahoney and Pandian, 1992; Mahoney, 1995; Penrose, 1959; Prescott & Visscher, 1980; Teece, Pisano, & Shuen, 1997). Thus, human capital ranges from highly generalized knowledge and skills to context specific knowledge and skills to sets of knowledge and skills that are applicable only in a single firm creating "isolating mechanisms" (Dyer & Singh, 1998: 671) and resulting in resource heterogeneity and resource immobility (Barney, 1991) that lie at the core of a firm's competitive advantage (Rumelt, 1984).

## BOARD HUMAN CAPITAL OF CEO DIRECTORS

Board human capital is the capacity of directors and their respective boards to provide to the focal firm unique skills and expertise in corporate governance. More specifically, board human capital consists of the set or bundle of skills, knowledge, and perspectives that outside directors collectively bring to the board (Johnson, S., Schnatterly, & Hill, 2013). Experience developed at their home firms combined with additional experience developed through multiple board appointments and industry experience represent valuable board human capital. However, suggesting limits in network diffusion, imitation, and social learning simply through director ties to other boards, the impact of CEO directors' experience as outside directors at other firms showed no systematic relationship to board policy changes at these other firms (Westphal & Zajac, 1997). The greatest value of CEO directors' experiences in terms of board human capital may come directly from their first-hand experience at their home firms rather than indirectly from their service as outside directors at other firms.

Service by active CEOs as directors provides several benefits to focal firms in the form of board human capital (Hillman, & Dalziel, 2003). First, board human capital provides a firm the benefits of directors' advice and counsel resulting from their expertise and skill. Second, board human capital brings legitimacy to the focal firm through directors' membership within the corporate elite (Finkelstein, 1992; Useem, 1979). Guarding their reputation as CEOs specifically and as strategic leaders generally, CEO directors are prone to carefully weigh the risks of associating with a poorly performing firm (Fahlenbrach et al., 2010). Noting that investors signal their approval of appointment of CEOs as outside directors, Fahlenbrach and colleagues (2010) view a CEO's acceptance of a seat on another firm's board as certification of the focal firm thereby signaling sufficiently high estimates of the firm's future prospects. Third, board human capital improves communication both internally and with external constituents through directors' timely and valuable information thereby reducing transaction costs. For example, information and expertise from service on other boards enhance the efficiency of governance through investments in time and effort on other firms' boards that increase the "return" on the time and attention invested in monitoring activities (Becker, 1964; Carpenter & Westphal, 2001: 654). Fourth, board human capital improves the focal firm's access to resources including financial resources and influence with political bodies and other important stakeholder groups (Finkelstein, 1992; Salancik & Pfeffer, 1978; Useem, 1979). In sum, CEO directors bring to the focal firm experience-based advice and counsel, legitimacy by signaling their certification of the firm's future prospects, improved communication internally and externally resulting in reduced information costs, and improved access to resources and important stakeholders.



المنارة للاستشارات
www.manaraa.com

## DEFINING GENERAL BOARD HUMAN CAPITAL

General board human capital is comprised of the knowledge, experience, and skills that directors bring to boards of directors. Just as general human capital is deployable across multiple and somewhat varied contexts, general board human capital is the set of knowledge, experience, and skills applied to the governance functions of the board in advising and monitoring firm management and connecting the focal firm with external resources. This may stem from a broad range of experiences that strategic leaders develop through exposure to a wide variety of strategic and governance contexts resulting in a somewhat "cosmopolitan view" of strategic and management issues (Useem, 1984: 48). This cosmopolitan view grows from involvement in industry value chains, service on other firms' boards, contacts with other business leaders such as through trade groups, and general exposure to the business environment resulting in a general "business scan" (Useem, 1984: 45) as part of an information processing system that becomes an important source of tacit knowledge for the focal firm.

## CEO DIRECTORS AND GENERAL BOARD HUMAN CAPITAL

One important source of general board human capital is the business experience derived from service as a CEO (Bianco & Byrne, 1997; Hillman et al., 2000). Fich (2005) observed that appointment of a CEO director was inversely related to the proportion of CEO directors already on the board, leading him to surmise that firms may be reluctant to replicate the skills of CEO directors already on the board. This suggests that the human capital brought by CEO directors is homogeneous implying that CEO director human capital is fairly general human capital rather than specific human capital. Tian and colleagues (Tian, Haleblian, & Rajagopalan, 2011) examined the impact of boards' CEO experience on CEO selection and found that investors reacted favorably to selection of CEOs when made by boards that were partly composed of directors who were active CEOs at other firms. The CEO experience brought to the board as discussed by Tian et al. (2011) appears to be general CEO experience rather than CEO experience of a specific type or specific context. The credible empirical evidence of CEO directors' human capital comes from the stock market's reaction to involvement in CEO selection by CEO directors. However, the specific nature of that experience is not evident either from the market reaction or from the authors' descriptions of the specific experience. In addition, theoretical development of board CEO experience and new CEO appointments stresses the tacit nature of CEO directors' knowledge. Experiences such as dealing with the complexity of the tasks of being a CEO, integration of functional managers' knowledge and capabilities, skills in "communication, leadership, and conflict resolution" (Mintzberg, 1973; Tian et al,.2011: p. 733; Zhang and Rajagopalan, 2004), developing firm strategic vision and communicating it to external constituents, and making strategic decisions that are typically quite complex (Lorsch & Kurana, 1999) all comprise some of the general human capital brought by active CEOs to the boards of other firms where they serve as directors. The generalized experience of seasoned CEOs involved in service as directors on other firms' boards may be considered general training that is an investment in productivity entailing high initial costs that later produce returns as higher productivity (Becker, 1964).

المنارة للاستشارات



www.manaraa.com

## CEO HOME FIRM TENURE AND BOARD HUMAN CAPITAL

CEOs who have served in the top post at their home firm develop a certain set of generalized knowledge and skills comprised of a largely tacit component that seems to be valued by the financial markets and by the appointing firm. In addition, the longer that a CEO serves as a director, the greater her/his firm specific knowledge thereby developing firm-specific human capital that is incorporated with her/his generalized knowledge and skills providing unique governance capabilities. Some scholars maintain that directors require three to five years to accumulate enough experience to adequately understand the way a firm operates (Bacon & Brown, 1973; Kesner, 1988). Thus, active CEOs with relatively longer tenure at their home firms are desired as directors at other firms for their generalized strategic leadership experience. As their service on the focal firm's board increases, this generalized board human capital becomes increasingly firm specific relative to the focal firm suggesting the following propositions.

*Proposition 1: The longer a CEO director's service as an active CEO the greater her/his general board human capital.*

*Proposition 2: The longer an active CEO serves on a focal firm's board, the greater her/his firm-specific board human capital relative to the focal firm.*

These preceding propositions suggest that longer serving CEO directors are useful to the focal firm's governance rather than a hindrance. However, the usefulness of a CEO director's long service must be balanced with a fairly powerful board. The longer the collective tenure of the board, the more likely the board is to be coopted by a powerful CEO (Westphal & Zajac, 1997). However, board tenure heterogeneity my reduce this potential cooptation. In addition, the power of the CEO may be further balanced by such board structural arrangements as outside chairs, lead outside directors, and smaller boards.

## INDUSTRY EXPERIENCE OF CEO DIRECTORS

Governance research on CEO directors points up the importance of similarities between the source/home firm and the appointing/focal firm that reduce information costs in "learning the ropes" at the new firm. For example, information and expertise derived from service on other firms' boards enhances the efficiency of governance by affording strategic leaders the opportunity to "economize on governance costs" (Carpenter & Westphal, 2001: 654) through investments in time and effort that increase the "return" on those efforts (Becker, 1964). Similarly, CEO directors serving on boards of firms in a similar industry as that of her/his home firm helps achieve efficiency for the focal firm's governance activities by facilitating the application of common cognitive structures, shared frames of reference, and similar practices and their associated outcomes. Pointing up the importance of industry knowledge among board members, Vancil (1987) suggests that successful CEO selection requires the board's understanding of the focal firm's industry environment. Inferring from Vancil's observations concerning CEO succession, because one of the board's key duties is employing the CEO, providing proper monitoring and oversight of the CEO would certainly be enhanced by the board's collective knowledge of the focal firm's industry. This collective knowledge would be further strengthened by such industry knowledge as seen from the perspective of a CEO director with experience in the focal firm's industry.



المنارة للاستشارات
www.manaraa.com

CEO directors with experience in the focal/appointing firm's primary industry may enhance both the advising and monitoring functions of the board. A diverse set of experiences among board members may impede the ability of the board to relate to one another (Kosnik, 1990), while common experience such as work in similar industries may improve board functions. A CEO director with industry experience similar to that of the focal/appointing firm may enhance the effectiveness of interaction within the board at large, among outside directors, and with the firm's top management team. The business experience of strategic leaders is shaped in part by their industry context and the nature of industry-specific strategic decisions these leaders may have faced in the past (Bluedorn, Johnson, R. A., Cartwright, & Barringer, 1994; Mintzberg, 1988). For example, industry experience of boards is positively associated with sales growth of high technology firms (Kor & Sundaramurthy, 2009), with stock market reactions following acquistions (Walters, Kroll, & Wright, 2008), and with CEO successions (Tian, Halbelian, & Rajagopalan, 2011). CEO directors from industry contexts similar to that of the focal/appointing firm are more likely to perceive their ability to contribute strategically and to become more effective advisors and monitors (Carpenter & Westphal, 2001). By virtue of their position in the supply chain, managers of upstream firms tend to face similar strategic choices (Harrison, Hitt, Hoskisson, & Ireland, 1991); in much the same manner, managers of downstream firms face similar strategic choices. Hence, CEO directors' industry experiences may impact the quality of board processes.

CEO directors bring to the board industry-specific knowledge (Bacon & Brown, 1975) that may become part of the board's store of knowledge (Nelson & Winter, 1982) thereby enhancing board human capital. Industry experience brings with it a base of cognitive assumptions about the future, knowledge concerning alternative courses of action, and the likely consequences of such alternatives (Hambrick & Mason, 1984). An individual's cognitive base is a function of experiences including training and background (Cyert & March, 1963), and common cognitive frames may influence the capacity of boards to address strategic issues at the focal firm. For example, research on the impact of experience with specific types of strategic events demonstrates the association of prior acquisition experience with post acquisition performance of acquirors (Kroll, Walters, & Wright, 2008; McDonald, Westphal, & Graebner, 2008). CEO directors whose experience is similar to the focal firm's primary industry may bring to the board valuable human capital enhancing the likelihood of positive firm outcomes.

Scholarly inquiry into antecedents and outcomes of service of active CEOs on the boards of other firms confirms the attractiveness of these strategic leaders on the basis of their unique structural position and the human capital associated with that position in terms of experience and knowledge gained throughout their management careers. Active CEO directors bring legitimacy to the appointing firm by signaling their certification of the firm's future prospects (Booth & Deli, 1996; Fahlenbrach, Low, & Stulz, 2010) leading investors to view board characteristics as signs of firm quality (Certo et al. 2001; Higgins & Gulati, 2006). In addition, CEO directors' home firm experience, exposure to other firms' strategic contexts through other board appointments, and their industry experience combine to make active CEOs highly sought after for board service. However, the greatest value of CEO directors' experience in terms of board human capital may come directly from first-hand experience at their home firms rather than indirectly from their service as outside directors at other firms (Westphal & Zajac, 1997). Although this first-hand experience may come in many forms, one important aspect of this experience is the CEO director's experience in the focal/appointing firm's primary industry.



www.manaraa.com

*Proposition 3a: Service by active CEOs on a firm's board will be associated with similarity in each firm's primary industry.*

*Proposition 3b: The association of a CEO director's industry experience with the focal firm's primary industry will be stronger at the time of appointment and when the CEO director's tenure as CEO is short but her/his organizational tenure is long.*

## SPECIFIC BOARD HUMAN CAPITAL: CEOS AS SPECIALISTS

Chief executive officers and other top "C-level" managers are often considered to be generalists due to their position as general managers of an organization. However, these "general managers" may be more nearly specialists (Kotter, 1982). Notions in the business press and in scholarly literature of the "professional" manager as a generalist may be overblown, and heterogeneity rather than homogeneity in the skill sets of general managers may be more the norm than the exception. Kotter (1982) reported that across all the age groups in his study general managers had spent 80% of their career in one firm and 90% of their career in one industry. Their very experiences were the result of life's paths that made each one unique resulting in specialized sets of interests, skills, knowledge, and relationships (Kotter, 1982). For example, Ron Johnson, formerly of Apple, was attractive to the board and activist investors of J. C. Penney for his special expertise in retailing a very strong brand. Likewise, Angela Ahrendts, former CEO of Burberry, was recruited to fill the open position left by the departure of Johnson's successor in part for her experience in turning around the British luxury brand (Gordon, 2013). Allen Mulally, CEO of Ford, was considered for the top spot at Microsoft to succeed Steve Ballmer in part as a result of his long association with the software maker collaborating in development of on-board software for vehicles (Langley, 2013). Hence, despite deeply held notions of management as a generic process, general managers may be more specialized than popularly thought and characterized. One implication of this heterogeneity of general management human capital means that the proper fit in selection, especially for the top spot of CEO is vital (Kotter, 1982), and proper fit for service on the board of directors may be equally vital, especially in light of the increased perception of the importance of boards and increased scrutiny of the decisions and actions of boards.

The appointment of a CEO as a corporate director will take many factors into account among which is likely to be her/his specialized human capital. A CEO newly appointed as a director may reflect her/his tenure and experience at her/his home firm. A CEO who succeeded from inside the firm (internal succession) is more likely to be recruited for board service on the basis of her/his industry experience if the source/home firm is in a similar primary industry. Tian and colleages (2011) reported that experience among board members working in the appointing firm's industry brought positive reactions from investors upon the board's selection of a new CEO. Industry experience is important because firms in similar industries face similar sets of technologies, competitive practices, customer and supplier characteristics, and regulatory requirements (Kor & Misangyi, 2008). The industry-specific experience of outside directors enhances a board's ability to make sound acquisition decisions that receive positive investor reactions (Kroll, Walters, & Wright, 2008). In addition, boards are more likely to hire from within a firm's industry even when hiring from outside the firm (Parino, 1997).

*Proposition 3c: A CEO who succeeded from inside the firm will show a stronger association of her/his industry experience than a CEO who succeeded from outside the firm.*



المنارة للاستشارات
www.manaraa.com

## IMPACT OF HOME FIRM ORGANIZATIONAL TENURE OF CEO DIRECTORS

Organizational tenure at the home firms of CEO directors should also play a role in their board human capital. Brickley, Linck, and Coles (1999) reported average CEO tenure of retired CEOs to be 9.6 years with total firm tenure of 27.5 years. The longer the organizational tenure of the newly appointed insider CEO, the greater her/his industry experience. Industry specific human capital (experience) of top executives is related to commitment to the *status quo.* Industry experience tends to result in shared perspectives stemming from common actions, contexts, and outcomes leading to "social construction of reality" (Hambrick et al., 1993: 412). Such common perspectives may be harmful if so deep seated and tacit that they impede capacity to recognize alternative ways of thinking (Huff, 1982). Thus, while helpful at certain levels, "industry wisdom" (Hambrick et al., 1993: 412) may be harmful when taken to extreme. However, industry experience may be beneficial to a firm's governance if existing in moderate amounts and included among a variety of experiences brought to the board by outside directors. Industry experience in the focal firm's primary industry among directors when combined with other types of experience among directors may beneficial to board decision processes. This may be particularly true since the board is responsible for particular functions of strategic decision making processes. Specifically, boards are not directly responsible for strategy formulation and implementation but are directly responsible for ratification of management's strategy formulation and monitoring of management's implementation (Fama & Jensen, 1983). Thus, while industry experience among the top management team (TMT) may result in negative outcomes, industry experience among directors may be desirable by better equipping boards to perform their governance functions as distinct from the firm's managers' performance of its decision functions of strategy formulation and implementation.

Furthermore, effective boards will tend to benefit from a board's industry experience when brought to the board by an active CEO with long organizational tenure in the source firm and appointing firms' common primary industry rather than by populating the board with a large number of directors with focal firm primary industry experience. Effective boards will have an optimal amount of industry experience when limited to that of a CEO director with long organizational tenure at her/his home firm that complements other types of experiences among the other outside directors. Indeed, the value of a board's focal firm primary industry experience will be enhanced if brought to the board by a CEO director whose industry specific human capital is combined with other types of general and specific human capital on the board. The value of collective knowledge of the appointing/focal firm's industry (Vancil, 1985) may come not so much from the number of those on the board with industry experience but from the quality of directors' industry knowledge through similar industry experience of a CEO director with long service at the home/source firm. Hence, the quantity of knowledge in terms of the number of directors with focal firm industry experience may be less important than the quality of knowledge in terms of a CEO director's long service at a firm in the same industry.

*Proposition 3d: The longer the organizational tenure of the inside successor, the stronger the association of the CEO's industry experience with that of the appointing firm's primary industry.*

At the same time, the longer a CEO's tenure in the top spot, the more s/he may be regarded as a generalist and the less valuable will be the industry experience of that individual. A CEO director's industry specific human capital may be most beneficial during the early years of her/his CEO tenure. Therefore, CEO directors with long organizational tenure at their home firm



المنارة للاستشارات
www.manaraa.com

but short CEO tenure will be more likely recruited for their specific human capital – industry experience and context specific experience.

*Proposition 4: The shorter a CEO director's tenure as CEO at the home firm, the stronger the association of the the CEO's industry experience with that of the appointing firm's primary industry.*

## FIRM DIVERSIFICATION AND CEO DIRECTORS' GENERAL HUMAN CAPITAL

The level of diversification of the appointing firm will likely impact the attractiveness of some active CEOs as members of the board of directors. The more diversified the CEO director's home firm, the less vital will be the role of experience in a particular industry. This effect will be particularly true if the appointing firm is also broadly diversified across a number of industries. Similarity of primary industry will become less vital while similarity on other dimensions will likely increase in importance.

*Proposition 5: The greater the total diversification of the appointing firm, the weaker the association of the CEO director's industry experience.*

## DISCUSSION

Governance research has traditionally explored effectiveness of the board of directors based on directors' structural position with respect to the focal firm. More recent investigations have begun to examine governance effectiveness based on the perspectives directors bring to the corporate board resulting from this structural position in the form of board human capital. Human capital consists of expertise, experience, knowledge, reputation, and skills (Becker, 1964; Coleman, 1988). Applied to corporate boards of directors, board human capital is composed of the skills, knowledge, and experiences directors bring to the board (Hillman & Dalziel, 2003) and may include industry experience, financial expertise including venture capital, and experience with specific activities (Johnson, S., et al., 2013) in addition to general management experience. Governance researchers suggest that the quality of board human capital impacts the capacity of boards to perform their governance roles of advice and counsel, resource provision, and monitoring management (Kroll et al., 2008).

One aspect of board human capital thought to be of particular value to the quality of corporate governance is experience as a CEO at another firm (Johnson, S., et al., 2013). Empirical investigation of effects of CEO directors on appointing firm outcomes includes impact on firm reputation through signaling "certification" of that firm's future prospects (Booth & Deli, 1996) and reactions by investors to appointments of CEOs to directorships and appointment of new CEOs by boards that include CEO directors (Tian et al., 2011). Governance researchers examining the roles of active CEOs serving as corporate directors tend to treat the human capital of CEO directors as largely homogeneous suggesting that CEO director human capital in the context of corporate governance is general human capital deployable across a multitude of settings. However, CEO directors come from a variety of contexts and tend to have relatively personalized experiences.

This study examines the potential heterogeneity implicit in CEO director board human capital by distinguishing among the general, specific, and firm-specific board human capital that CEO directors provide to appointing firms. CEO directors are products of their experiences including their service as CEOs. Early in a CEO's tenure, her/his attractiveness as a corporate



المنارة للاستشارات
www.manaraa.com

director will be based on industry experience and context specific experience such as acquisition experience suggesting that relatively short-tenured CEOs are attractive as director candidates for the specific human capital based on their roles as specialists within a particular industry or a specific organizational or functional domain (Kotter, 1982). With an increase in a CEO's tenure, factors influencing her/his attractiveness will tend to be based on more generalized experience as a strategic leader and member of the corporate elite.

In summary, board human capital provides a number of benefits to focal firms, although its impact is difficult to assess, its measurement difficult, and the direction of its effects likely non-monotonic or dependent on context (Johnson, S., Schnatterly, & Hill, 2013). A key source of board human capital that directors bring to the board comes from their experiences both as managers at their home firm and as directors on the boards of other firms. These contexts result in rather unique perspectives on strategic leadership (Mintzberg, 1988) stemming directly from formulating and implementing the strategies of the firms they manage as well as indirectly from ratifying and monitoring the strategies of firms on whose boards they serve.

## REFERENCES

Amit, R. & P.J.H. Schoemaker (1993). Strategic assets and organizational rent. *Strategic Management Journal, 14*(1), 33-46.

Andrews, K. (1971). *The concept of corporate strategy.* Homewood, IL: Dow-Jones-Irwin.

Bacon, J. & J.K. Brown (1975). *Corporate directorship practices: Role, selection and legal status of the board.* New York: The Conference Board.

Barney, J. (1991). Firm resources and sustained competitive advantage. *Journal of Management, 17*(1), 99-120.

Baysinger, B., & H.N. Butler, 1985. Corporate governance and the board of directors: Performance effects of changes in board composition. *Journal of Law, Economics, and Organization, 1*, 101-124.

Becker, G.S. (1964). *Human Capital: A Theoretical and Empirical Analysis, with Special Reference to Education.* Chicago, IL: University of Chicago Press.

Berle, A.A. & G.C. Means ([1932] 1968). *The Modern Corporation and Private Property.* New York: Harcourt, Brace & World.

Bianco, A., & J.A. Bryrne (1997, March 3). The rush to quality on corporate boards. *Business Week*, 34-35.

Bluedorn, A.C., R.A. Johnson, D.K. Cartwright & B.R. Barringer (1994). The interface and convergence of the strategic management and organizational environment domains. J*ournal of Management*, 20(2), 201-262.

Booth, J.R., & D.N. Deli (1996). Factors affecting the number of outside directorships held by CEOs. *Journal of Financial Economics, 40*(1), 81-104.

Brickley, J.A., J.S., Linck & J.L. Coles (1999). What happens to CEOs after they retire? New evidence on career concerns, horizon problems, and CEO incentives. *Journal of Financial Economics, 52*(3), 341-377.

Carpenter, M.A., & J.D. Westphal (2001). The strategic context of external network ties: Examining the impact of director appointments on board involvement in strategic decision making. *Academy of Management Journal, 44*(4), 639-660.

Cappelli, P. & H. Singh (1992). Integrating strategic human resources and strategic management. In Lewin, D., Olivia, S. (Eds.), *Research Frontiers in Industrial Relations and Human Resources,* (pp. 165-192). Madison, WI: Industrial Relations Association.

Certo, S. T., C.M. Daily, & D. R. Dalton (2001). Signaling Firm Value through Board Structure: An Investigation of Initial Public Offerings. *Entrepreneurship Theory and Practice, 26*(2), 33-50.

Cohen, W.M., & D.A. Levinthal (1990). Absorptive capacity: New perspective on learning and innovation. *Administrative Science Quarterly, 35*, 128-152.

Coleman, J.S. (1988). Social capital in the creation of human capital. *Journal of Sociology, 94*(Supplement), S95–S120.

Cyert, R. & J. March (1963). *A behavioral theory of the firm.* Englewood Cliffs, N. J: Prentice Hall.

Dimov, D. P., & D. A. Shepherd (2005). Human capital theory and venture capital firms: Exploring "home runs" and "strike outs." *Journal of Business Venturing, 20*, 1-21.



المنارة للاستشارات
www.manaraa.com

Dyer, J. H., & H. Singh (1998). The relational view: Cooperative strategy and sources of interorganizational competitive advantage. *Academy of Management Review, 23*(4), 660-679.

Fahlenbrach, R., A. Low & R.M. Stulz (2010). Why do firms appoint CEOs as outside directors? *Journal of Financial Economics, 97*(1), 12-32.

Fama, E. & M. Jensen (1983). Separation of ownership and control. *Journal of Law and Economics, 26*(June), 301-325.

Faleye, O. (2011). CEO directors, executive incentives, and corporate strategic initiatives. *Journal of Financial Research, 34*, 241-277.

Festinger, L. (1954). A theory of social comparison processes. *Human Relations, 7*(2): 117-140.

Fich, E. (2005). Are some outside directors better than others? Evidence from director appointments by Fortune 1000 firms. *Journal of Business, 78*(5), 1943–1971.

Finkelstein, S., & D. Hambrick (1996). *Strategic Leadership: Top Executives and Their Effects on Organizations.* Minneapolis/St. Paul: West Publishing.

Finkelstein, S. (1992). Power in top management teams: Dimensions, measurement, and validation. *Academy of Management Journal, 35*(3), 505-538.

Gordon, K. (2013, October 15). Angela Ahrendts to Oversee Retail; Christopher Bailey to Take Over at Fashion House. *The Wall Street Journal.* Retrieved October 15, 2014, from (http://online.wsj.com/news/articles/SB10001424052702304561004579136642448489128)

Hambrick, D.C., & P.A. Mason (1984). Upper echelons: The organization as a reflection of its top managers. *Academy of Management Review, 9*(2): 193-206.

Harrison, J. S., M.A.,Hitt, R.E. Hoskisson & R.D. Ireland (1991). Synergies and post-acquisition performance: Differences versus similarities in resource allocations. *Journal of Management, 14*(1), 173-190.

Hatch, N.W. & J.H. Dyer (2004). Human capital and learning as a source of sustainable competitive advantage. *Strategic Management Journal, 25*(12), 1155-1179.

Hermalin, B.E., & M.S. Weisbach (1988). The determinants of board composition. *RAND Journal of Economics, 19*, 589-606.

Higgins, M.C. & R. Gulati (2006). Stacking the Deck: The Effects of Top Management Backgrounds on Investor Decisions. *Strategic Management Journal, 27*(1), 1-25.

Hillman, A.J., A.A., Cannella, Jr. & R.L. Paetzold (2000). The resource dependence role of corporate directors: Strategic adaptation of board composition in response to environmental change. *Journal of Management Studies, 37*(2), 235-255.

Hillman, A.J. & T. Dalziel (2003). Boards of directors and firm performance: Integrating agency and resource dependence perspectives. *Academy of Management Review, 28*(3), 383-396.

Hitt, M.A., & B.B. Tyler (1991). Strategic decision models: Integrating different perspectives. *Strategic Management Journal, 12*(5), 327-351.

Huff, A.S. (1982). Industry influences on strategy formulation. *Strategic Management Journal, 3*(2), 119-131.

Jensen, M. & E.J. Zajac (2004). Corporate elites and corporate strategy: How demographic preferences and structural position shape the scope of the firm. *Strategic Management Journal, 25*(6), 507-524.

Johnson, S.G., K., Schnatterly and A.D. Hill (2013). Board composition beyond independence: Social capital, human capital, and demography. *Journal of Management, 39*(1), 232-262.

Kaplan, S., & B.A. Minton (2012). How has CEO turnover changed? *International Review of Finance, 12*(1), 57-87.

Kesner, I.F. (1988). Directors' characteristics and committee membership: An investigation of type, occupation, tenure, and gender. *Academy of Management Journal, 31*(1), 66-84.

Kor Y.Y., & V.F. Misangyi (2008). Outside directors' industry specific experience and firms' liability of newness. *Strategic Management Journal, 29*(12), 1345–1355.

Kor, Y.Y. & C. Sundaramurthy (2009). Experience-based human and social capital of outside directors. *Journal of Management, 35*(4), 981-1006.

Kosnik, R. (1990). Effects of board demography and directors' incentives on corporate greenmail decisions. *Academy of Management Journal, 33*(3), 129-150.

Kotter, J. P. (1982). The General Managers. New York: The Free Press A Division of Macmillan, Inc.

Kroll, M., B.A. Walters & P. Wright (2008). Board vigilance, director experience, and corporate outcomes. *Strategic Management Journal, 299*(4), 363-382.

Langley, M. (2013, November 17). Ballmer on Ballmer: His Exit From Microsoft. *The Wall Street Journal.*

Lau, D.C., & J.K. Murnighan (1998). Demographic diversity and faultlines: The compositional dynamics of organizational groups. *Academy of Management Review, 23,* 325-340.



المنارة للاستشارات
www.manaraa.com

Le, S., M. Kroll & B.A. Walters (2013). The influence of board composition on top management team industry- and firm-specific human capital in young IPO firms. *Journal of Managerial Issues, 24*(4), 412-432.

Lorsch, J.W. & R. Khurana (1999). Changing leaders: the board's role in CEO succession. *Harvard Business Review, 77*(3), 96–105.

Mahoney, J.T. (1995). The management of resources and the resource of management. *Journal of Business Research, 33*(2), 91-101.

Mahoney, J.T. & R. Pandian (1992). The resource-based view within the conversation of strategic management. *Strategic Management Journal, 13*(5), 363-380.

McDonald, M.L., J.D. Westphal & M.E. Graebner (2008). What do they know? The effects of outside director acquisition experience on firm acquisition performance. *Strategic Management Journal, 29*(11), 1155-1177.

Mintzberg, H. (1973). *The Nature of Managerial Work,* Harper & Row.

Mintzberg, H. (1988). Opening up the definition of strategy. In J. B. Quinn, H. Mintzberg, & R. M. James (Eds.), *The Strategy Process: Concepts, contexts, and cases.* (pp. 13-20). Englewood Cliffs: Prentice-Hall.

Nelson, R.N. & S.G. Winter (1982). *An evolutionary theory of economic change.* Cambridge, MA: Harvard University Press.

Nonaka, I. (1994). A dynamic theory of organizational knowledge creation. *Organization Science,* 5(1), 14-37.

Parrino, R. (1997). CEO turnover and outside succession: A cross-sectional analysis. *Journal of Financial Economics, 46*(2), 165–197.

Penrose, E.T. (1959). *The Theory of the Growth of the Firm.* Wiley: New York.

Pfeffer, J. (1972). Size and composition of corporate boards of directors: The organization and its environment. *Administrative Science Quarterly, 17,* 218-228.

Prescott E., & Visscher, M. (1980). Organizational capital. *Journal of Political Economy,* 88(June), 446–461.

Price, J.L. (1963). The impact of governing boards on organizational effectiveness. *Administrative Science Quarterly, 8*(3), 361-378.

Rumelt, R. (1984). Towards a strategic theory of the firm. In R. Lamb (Ed.), *Competitive Strategic Management* (pp. 556-570). Englewood Cliffs, NJ: Prentice-Hall.

Salancik, G.R. & J. Pfeffer (1978). A social information processing approach to job attitudes and task design. *Administrative Science Quarterly, 23*(2), 224-253.

Teese, D.J., G. Pisano & A. Shuen (1997). Dynamic capabilities and strategic management. *Strategic Management Journal, 18*(7), 509-533.

Tian, J., J. Haleblian & N. Rajagopalan (2011). The effects of board human and social capital on investor reactions to new CEO selection. *Strategic Management Journal, 32*(7), 731-747.

Useem, M. (1979). The social organization of the American business elite and participation of corporation directors in the governance of American institutions. *American Sociological Review, 44*(4), 553-572.

Useem, M. (1984). *The inner circle: Large corporations and the rise of business political activity in the U.S. and U.K.* New York: Oxford University Press.

Vancil, R.F. (1987). *Passing the baton: Managing the process of CEO succession.* Boston: Harvard Business School Press.

Walster, E., E. Berscheid & G.W. Walster (1973). New directions in equity research. *Journal of Personality and Social Psychology, 25*(2), 151-176.

Walters, B.A., M.J, Kroll & P. Wright (2008). CEO tenure ownership and effective boards: Impacts on firm outcomes. *Strategic Organization, 6*(3), 259-283.

Westphal, J.D. & E.J. Zajac (1997). Defections from the Inner Circle: Social Exchange, Reciprocity, and the Diffusion of Board Independence in U.S. Corporations. *Administrative Science Quarterly, 42*(1), 161-183.

Wiersema, M. (2002). Holes at the top: Why CEO firings backfire. *Harvard Business Review*, *80*(12), 70-77.

Zald, M.N. (1967). Urban differentiation, characteristics of boards of directors, and organizational effectiveness. *American Journal of Sociology, 73*, 261-272.

Zhang, Y. & N. Rajagopalan (2004). When the known devil is better than an unknown god: an empirical study of the antecedents and consequences of relay CEO successions. *Academy of Management Journal, 47*(4), 483–500.



المنارة للاستشارات
www.manaraa.com

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

www.manaraa.com