THE OVERTHROW OF THE MANAGERIAL REVOLUTION?:
AN EXAMINATION OF MANAGERIAL, AGENCY THEORY, AND INSTITUTIONAL PERSPECTIVES

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A dissertation submitted in partial fulfillment of
the requirements for the degree of

DOCTOR OF PHILOSOPHY

WASHINGTON STATE UNIVERSITY
Department of Sociology

May 1996

UMI Number: 9711517

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Ann Arbor, MI 48103

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The members of the Committee appointed to examine the dissertation of William J. Luchansky find it satisfactory and recommend that it be accepted.

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ACKNOWLEDMENTS

I would like to thank the members of my committee, Drs. Allen, Hooks, and Lutzenhiser, each of whom has contributed significantly to my graduate education. In addition, I thank Dr. Amy Wharton, who was on my committee until very recently, and who read and commented on this work and other things I have written. Michael Allen deserves special thanks, for reading what must have seemed like endless drafts of the dissertation, and also for encouraging me in other projects that should occupy me for some time. My friendship with Mike remains the biggest surprise and the most significant unintended consequence of my graduate education.

Most importantly, I must thank Sharon, my wife, for love and patience on a journey that took a great deal longer, and had a great many more side trips, than we expected. And finally to Beck, for the sheer joy of having you around.

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Abstract

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May 1996

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The pattern of corporate ownership changed significantly in the 1980s. Prior to that time, the typical owner was an individual holding a small stake in the firm. The typical firm had thousands of small owners, none of whom was large encugh to exert significant influence. Over time, large institutional owners, such as pension or mutual funds, became the primary shareholders in many firms. This change in ownership has led some to claim that it has been accompanied by a change in governance, with owners being able to exert influence over managers who heretofore controlled the corporation. The main objective of this research is to evaluate the adequacy of this purported change in corporate governance by examining indicators of managerial autonomy, the dismissal of chief executive officers and their compensation.

This study examines poorly performing firms because they are particularly relevant to the issue of corporate governance. Boards of directors have the obligation to monitor chief executives in the interests of shareholders. When firms perform well, that monitoring should be minimal. It is only when firms perform poorly that we expect the board to take action. If a shift in governance

has occurred, then our indicators of managerial autonomy should change in significant ways. Dismissal rates should rise and compensation should be closely tied to meaningful measures of corporate performance.

The results of this study are mixed. Dismissal rates have increased over time, suggesting that governance structures now operate to remove executives who do not perform adequately. However, dismissal is not strongly related to a key explanatory variable, the presence of a principal owner. Owners were supposed to be the mechanism that brought the change in governance about, but there is no clear evidence of their effect. The analyses of dismissal suggest that the position of the chief executive has become more vulnerable, but the analyses of compensation suggest that rewards are greater than ever, and that they are not related to performance. Thus, while compensation has risen to new heights, it seems that more is expected of management. The state of corporate governance is in flux, and future research is needed to observe changes that will inevitably unfold.

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CHAPTER 1

INTRODUCTION

On the cover of the 1993 edition of the Coca Cola corporation's annual report is the phrase, "Creating Value by Refreshing 5.6 Billion People." The key word in that phrase is value, and it refers to value for shareholders, the owners of the company. Support for this interpretation of value comes from inside the report, where we read:

> We are never confused about why we exist. Although volume growth, earnings, returns and cash flow are critical priorities, our people understand those measurements are all simply the means to the long-term end of creating value for our share owners (Coca-Cola 1993).

There is an unmistakable priority expressed here: this firm, if we are to believe their publicity report, is dedicating itself to the interests of one particular organizational constituency, owners. In contrast, Coca Cola's annual reports from five and ten years earlier, 1988 and 1983, contain no such declarations. These earlier documents focus on the large number of products this firms produces, the market share of each, earnings growth, and their new customers in the developing world. Significant by its absence is any discussion of the welfare of shareholders.

The question raised by these corporate declarations is whether or not we are in the process of witnessing a significant organizational change. The purported change is a movement from management-centered to owner-centered firms. Management, because of its position of control, has for some time appropriated astounding benefits from the firms they manage, but all that is said to be changing. One commentator has proclaimed, "Booted bosses, ornery owners, and beefed-up boards reflect a historic shift in corporate power. The imperial CEO has had his day--long live the shareholders"(Stewart 1993:34). The irony in this situation is that we witnessed the opposite change some sixty years ago. Berle and Means (1932) were the first analysts to notice the decline of the influence of owners in the corporate structure and the rise of non-owning, professionally trained managers. This change later became known as the "managerial revolution" (Burnham 1941), and marked the decline of a once important economic actor, the capitalist entrepreneur. In his place came those trained in the science of administration, who had credentials and expertise in organizing productive activities and in product and capital markets (Chandler 1977).

Now the argument is being made that managers are being displaced from the pinnacle of corporate power, and that owners are returning to the fore. However, the returning owners are very different from those who left. Owners are no longer wealthy individuals or families, who both risk their capital in a productive enterprise while at the same time directing that enterprise. The owners in question today are institutional investors, such as mutual or pension funds, who invest their assets in not one, but hundreds of different firms. These funds are not simply the property of one individual, but are rather the assets of hundreds of small investors who have pooled their money in search of a larger return on their investment. They entrust what they have earned to professional money managers, who act as their agents, to search for investment opportunities. This new type of owner is now being credited with revolutionizing the productive enterprises of our economy once again (Drucker 1976; Useem 1993). The arrival of these owners raises some serious questions about the significance and the power of their chief rival, management.

Organizational Theory and the Issue of Governance

Different academic disciplines have conceived of organizations in fundamentally different ways. For example, until recently, economists have generally conceived of and analyzed corporations as production functions (Williamson 1985:65). Firms were viewed as environments where inputs to a production process were transformed into outputs for sale on the market. Price mediated this process: firms demand raw materials, labor, and capital equipment, and will purchase these items in amounts determined by the price their products obtain on the market. Interorganizational processes were neglected, and the members of a firm were assumed to behave much like an entrepreneur. Like the entrepreneur, firms were assumed to have a single goal, profit maximization.

In contrast to the economic view, the sociological approach to organizations, like sociology in general, presents a more complex picture (Hirsch, Michaels, and Friedman 1987). Where economists see firms dominated by one overriding organizational goal, sociologists are apt to see many conflicting ones, determined by the variety of participants in a firm, and the diversity of their interests. In addition, not all organizational members stand on an equal footing in the struggle over whose interests will predominate. Weber (1978:987) referring to relations of power within organizations said "as an instrument of rationally organizing authority relations, bureaucracy was and is a power instrument of the first order for one who controls the bureaucratic apparatus". It is important to recall that Weber's interest in bureaucracy was more political than purely organizational. Bureaucracy was the latest in a line of structures of domination, and in Weber's mind, the most efficient of them all.

Such a view of relationships within a bureaucracy is in sharp contrast to the economic approach. In essence, sociology has attempted to open the "black box" and see how it actually functions, rather than relying on reductionist accounts derived from basic axioms. Following Weber, sociologists look into organizations and frequently see the exercise of power. Power implies the ability to control other organizational participants, and sociological theory and research into organizations has been oriented around the concept of control (Collins 1975). Given that the focus of a sociological study of organizations is on the variety of social relationships within, it seems appropriate that the notion of control is predominant, as opposed to a contending notion, such as efficiency. Having such a "central notion" like control has allowed the study of organizations to accumulate more knowledge than many other sociological subfields (Collins 1988; Gibbs 1989).

Control in organizations has been studied in two related ways. One line of research has focused on how those in supervisory positions exercise control over subordinates. The key issue in this regard is how to get organizational participants to comply with supervisors and accomplish the desired tasks (Etzioni 1961; Tannenbaum 1968; Burawoy 1975). This work is generic in the sense that it can be applied to any particular context, whether the organization in question be a school, church, or voluntary concern. In contrast, control has been studied in a another sense, and this sense has been applied most often to business corporations. Here control is seen as something possessed by the most powerful coalition within a firm. A faction within a firm is said to have control if it is "able to realize its corporate objectives over time, despite resistance" (Zeitlin 1974: 1091). In this line of research, control is seen more as an attribute, as opposed to a process that one must go through to obtain compliance. This study will focus on this latter aspect of organizational control, often referred to as corporate control.

Control is maintained by relations of authority, and we learn about these relations by examining the process of corporate governance. A focus on control in organizations leads logically to an emphasis on governance, for it is in the governance process where issues of control and relationships of authority are decided. The structure of corporate governance involves a number of key actors, including management, the board of directors, and shareholders. Table 1 details these actors and their sources of power and the direction of their influence.

Table 1: Duties and Sources of Power for Major Constituencies in the Governance Process.

CEOs	Board of Directors
1. Superior Knowledge of company affairs.	1. Elect, Evaluate, and when appropriate dismiss the principal senior executives.
2. Control of the Board Meeting	2. Make recommendations to shareholders.
3. Nomination of Directors	3. Review and approve corporate plans and actions that the board and senior executives consider major.
	4. Exercise oversight of management.
	5. Review the firm's financial performance and the allocation of funds.
	6. Exercise the duties of loyalty, care and good business judgment in the interests of shareholders.

Source: Lorsch, Jay. 1988. *Pawns of Potentates?: The Reality of America's Corporate Boards.*

Table 1 illustrates that the most salient duty of the board of directors is to act in the interest of shareholders. They can do so in a number of ways. It is their responsibility to choose a chief executive and see that that person acts responsibly in terms of the business of the corporation. If not, the board is obliged to look for a replacement. While the board has these legal obligations and duties, there are a number of very practical obstacles in their path. First, it is the CEO, not board members, who has superior knowledge of firm affairs. This knowledge often makes board members acquiesce in matters of judgment. Second, CEOs set the agenda of board meetings, and can use this privilege to focus on issues or problems of their choosing. This power can be very influential, and what Schattschneider (1960:71) said of politics applies equally well to organizations, that "some issues are organized into politics while others are organized out." This ability of the CEO to set the agenda can turn some important issues into *nondecisions*, which are areas of potential conflict that never get discussed (Bachrach and Baratz 1962). Finally, and most paradoxically, CEOs nominate those whose function it is to provide oversight, which to objective observers is an immediate hinderance to such monitoring.

There is no discussion in Table 1 of two other organizational constituencies, owners and labor. Owners do have a limited role in governance, for they vote on the slate of directors provided to them by management. However, unless they have direct representation on the board, they have no other formal governance function. In U.S. corporations, labor's position is even more precarious. In other countries, Germany in particular, workers often have board representation, but here it is a rarity (Coleman 1988). For a brief period in the 1970s, the Chrysler corporation had a representative of the United Auto Workers on its board, but after one term, that person was not renominated.

Our focus on the relationship between the owners and managers of corporations leads to a question: how much power and autonomy do professional managers have now? Do they still *control* the corporation? Does this control mean that firms become tools "that masters use to generate valued outputs that they can then appropriate" (Perrow 1986:260)? These questions have driven much of the inquiry into corporations for the bulk of this century, and because of the changing nature of business enterprise, and the conditions under which it is practiced, they remain extremely important today. This study takes these changing conditions into account as it examines these old issues from new vantage points.

Corporate control must be understood in its historical and evolutionary context. Berle and Means (1932) began this discussion in earnest over a half century ago by arguing that a separation had occurred between the ownership and the control of large corporations. As firms grew large, and as they diversified their activities, professional managers assumed the functions and responsibilities that once were the province of individual owners or owning families. In many cases, these professionals had little or no ownership claims in the firms in which they were employed: thus, the significance of the separation of ownership and control. At present, their recognition may not seem so startling. Large corporations now employ hundreds of thousands of people, and have nearly that many stockholders. It seems preposterous to think that one individual could control such an organization. However, it must be remembered that prior to the Civil War, the corporate form was limited largely to organizations engaged in banking and railroading. Other productive activities were organized in a simpler less differentiated fashion. The corporate form of organization diffused, slowly at first, to other areas of enterprise. The Civil War produced firms associated in the public mind with their entrepreneurial founders, Gustavus F. Swift (meat), Gail Borden (dairy products), and Andrew Carnegie (LaFeber et al. 1986). The 1880s gave rise to more firms destined to become household names, such as Proctor and Gamble, Eastman Kodak, and Pillsbury, all associated with one or possibly two primary owners. In their early years, these men both owned and controlled their firms.

It is a testament to the speed of capitalist development that, in the span of just forty years, most of these firms shifted from being entrepreneurially-dominated to being managerially-dominated. Indeed, it was unusual for a founding family to be active in the management of their firm for more than two generations. While families might remain the primary beneficiaries of management-run firms, they had little say concerning important business decisions (Chandler 1977:492).

Berle and Means based their thesis on a widespread historical trend, the diffusion of ownership of large corporations. In order to finance their growth, many firms were required to seek capital from outside shareholders through the issuance of stock. Consequently, the number of shareholders in large firms grew to be quite large, even in the 1930s. After the founders of firms passed away, their heirs and descendants rarely had enough shares to control the firm. Thus, control shifted into the hands of managers, who had the authority to control the means of production without owning them.

This Study

It is now time to bring the discussion of corporate control up to date. Stanley Lieberson (1985:63-87) made an important methodological point when he urged that a distinction be made between symmetric and asymmetric causation. Symmetric causation means that a change in the independent variable, from either direction, at any point in time, results in a change in the dependent variable. In contrast, asymmetric causation operates in one direction only. He also notes that many social processes exhibit asymmetric causation. Thus, the causal factors responsible for a particular situation might change, but the situation itself will remain. For example, Max Weber recognized that the Protestant Ethic was an important causal factor in the development of capitalism. Over time, this attitude weakened, but capitalism remained nonetheless. Protestantism, and its accompanying ethic, has waned, but capitalism has not. The process, in this case, was irreversible.

Lieberson's distinction between symmetric and asymmetric causation has important implications for the study of corporate control, for we are now witnessing a change in the condition that lead to managerial autonomy. Corporate stock ownership, which for years was becoming more diffuse, is now becoming more concentrated. The major holders of these shares are not individuals, but rather institutional investors, such as pension and mutual funds, that manage the assets of others. The resources of these investors are enormous, and their stockholdings in any one company can be quite large.

If the pattern of stock ownership was the crucial factor in the rise of managerial autonomy, then a change in this pattern leads to an important question: Is the process that lead to managerial autonomy symmetric or asymmetric? Scholarly opinion is divided over this issue. As a result of this reconcentration of ownership, some theorists (Useem 1993) argue that we are witnessing a fundamental change in corporations, one that is both structural and cultural in nature. They argue that managers have become acutely aware of the interests of owners in general, and institutional investors in particular, who view the organization as a vehicle for the creation of shareholder value. This change has been so thorough that firms are now guided by an organizational logic that emphasizes *shareholder value*, and that the once divergent interests of owners and managers are now coming together. Because of the stockholdings of these investors, managers have been forced to keep ownership interests at the forefront.

Others disagree with this assessment. Jensen (1989;1993) sees no fundamental change, and claims that managerial autonomy is as prominent as ever. He argues that institutional owners cannot discipline managers effectively, and that only an active market for corporate control, where investors and management teams seek to take over poorly run firms, can do so. Without the external threat the market for corporate control provides, managers simply will not make necessary changes, and thus fail to create value for investors. For Jensen (1993:839), market discipline "provides an early warning system", which alerts firms to poor performance and gives incentives for "healthy adjustments" to changing economic conditions. Anything less means that managers simply will not make necessary changes, and thus will fail to create value for owners.

These conflicting views rely on different kinds of evidence to support their claims. Useem's evidence of cultural change is based primarily on interviews with executives from a small sample of firms. For his evidence, Jensen examines the opportunity cost of research and development expenditures. He compares the productivity of these expenditures, and the value they create, with returns that would have been garnered had that money been invested in low-risk securities. Based on the discrepancy between the two, he argues that firms do not always act in ways that create value for shareholders. While both of these studies have a degree of validity, questions remain. One which naturally arises from Useem's research is whether or not the findings can be generalized to a larger sample. Jensen examines only one indicator of interest to owners, and a problematic one at that. Clearly, other indicators are needed to corroborate one view or the other.

One way to examine the relationship between owners and management is to focus on indicators of managerial autonomy. Thus, this study seeks to bring more evidence to bear on this issue by examining two such indicators, the dismissal of chief executive officers, and their compensation.

Dismissal is a specific instance of a more general phenomenon, managerial succession. Succession is an inevitable part of organizational life, and one that is frequently associated with disruption and change (Blau and Scott 1962). Those who leave take with them valuable experience as well as the social ties they had with their fellow participants. All the changes associated with this phenomenon are magnified when the succession in question is that of the CEO. Succession is an important and valid indicator of power and strategic direction in organizations (Allen 1981).

The scholarly literature on succession, beginning with Weber's (1978:1121-1125) discussion of the routinization of charisma, has dealt primarily with its subsequent effect on organizational participants. Alvin Gouldner's (1954) study of succession in a gypsum plant is a case in point. In contrast, more recent literature focuses on tenure and dismissal, how long chief executives hold their position, and whether or not they are involuntarily replaced (Boeker 1990; James and Soref 1981).

Replacing a chief executive has been called the board of directors' "single most important task" (Black 1992a:900). To study dismissal is to study governance in action, and this is precisely why it is an appropriate indicator of managerial autonomy.

Compensation is a direct measure of what an executive appropriates from a firm, and also a direct indicator of power. Neoclassical economic approaches to compensation argue that ideally, firms should pay employees based on productivity (Blinder 1990). This provides employees with an incentive to be more productive, thus acting in the best interests of the firm. This rather neat picture of the compensation process is muddied when discussing management, for their productivity is not so easily measured. A number of other factors have been considered as determinants of compensation. Weber (1978:??) argued that compensation for an official is based on social status rather than productivity. Others argue that compensation is based on power, and those with more power will appropriate more (Perrow 1986). CEO compensation is a negotiated process, and the results of this process, much like dismissal, tell us much about corporate governance.

Succession and compensation have received a great deal of attention, but usually that attention has been directed at explaining variation between firms. In contrast, the interest in this study is to explain variation over time. To study this purported shift in the relationship between owners and managers, comparisons must be made over time. Ownership interests have been cited as both a reason for this shift, and also as the mechanism that has brought it about. A critical test of the problem of managerial autonomy would involve those firms where owner concerns are most pressing. Thus, the focus of this research is on poorly performing firms, since poor performance is likely to lead to action on the part of investors. Since the rise of ownership interests has occurred largely in the past decade, this study will compare two samples of poorly performing firms, one sample gathered prior to the alleged shift, from the 1970s, while the other was gathered between 1988 and 1992. This research deals with two key issues, the degree of managerial power and the mechanisms that limit managerial opportunism. These problems will be framed in the light of three theories, managerialism, agency theory, and institutionalism. Each offers a different assessment of the owner-manager relationship, and of power and opportunism in corporations.

CHAPTER 2

THEORETICAL PERSPECTIVES ON THE OWNER-MANAGER RELATIONSHIP

Managerialism

Managerialism is not a theory in the traditional sense. It is not an abstract set of ideas about behavior from which hypotheses are derived and tested (Homans 1987). Rather, its theoretical logic is largely implicit. Managerialism is really an empirical generalization from twentieth century trends in corporate affairs. However, this fact does not limit its usefulness, for managerialism provides a distinct perspective on these issues, as it asserts the power and influence of corporate managers. Much of the work in this tradition has been done by economists, and is geared to describing how managerial capitalism differs from its predecessor, entrepreneurial capitalism (Marris 1964; Baumol 1967).

Work in this vein has been questioned, and some of its implications have been challenged (see Glasberg and Schwartz 1983), but managerialism still presents a clear approach to studying the relationship between managers and owners in the large corporation. The general thrust of this approach is that relative to owners, professional managers have acquired a great deal of power and expertise, and that in most cases, management exercises de facto control over many corporations (Berle and Means 1967). The reason for this is the dispersion of stock ownership. By the 1930s, few firms had a dominant entrepreneur or founding family that controlled a large block of the voting stock. In effect, the separation of ownership from control has meant that owners have become an external, rather than an internal constituency of a firm (Mintzberg 1983:283).

Michels (1911) recognized that organizations are necessary to accomplish important social tasks because they achieve the greatest possible economy of energy from the participants involved. He also recognized something very important for managerialists about the nature of organizations.

> Organization implies the tendency to oligarchy. In every organization...the aristocratic tendency manifests itself very clearly. The mechanism of the organization, while conferring solidarity of structure, induces serious changes in the organized mass, completely inverting the respective position of the leaders and the led. As a result of organization, every party or professional union becomes divided into a minority of directors and a majority of directed (1911:70).

This insight lies behind much of managerial theory. As firms grew and became differentiated, the tasks of those in administration became more complex and specialized. Railroads provide us with the first example of a private enterprise with a modern administrative apparatus (Chandler 1962). Early rail lines were typically fifty miles in length, and a general superintendent was responsible for supervising labor, setting rates and schedules, purchasing needed supplies, and making contracts with shippers. As these lines expanded, it became impossible for one person to perform all these functions. Tasks became specialized, with one person responsible for accounting, another for passenger services, and another for freight handling.

These managers were then supervised by another whose task was not operational, but administrative. Single-function departments were created and it was the administrator's task to determine lines of communication and authority, and to set long-range strategic policies.

Over time, firms in other industries differentiated following the model of railroads, and internalized many economic and productive functions that were once accomplished by independent enterprises. To understand this differentiation, and the rise of professional managers, one must realize that prior to 1870 most firms were small, single-function businesses. Manufacturers manufactured, wholesalers brought together manufacturers and retailers, and retailers sold to the general public. By the turn of the century, many firms performed all of these functions, and more. However, it has been argued that such a result was not possible until a managerial hierarchy was in place to administer these functions (Chandler 1977). Those in that hierarchy possessed unique skills and information that were not available even to members of entrepreneurial families. Acquiring these skills meant that an extensive period of technical training became indispensable (Weber 1978:224).

Because of these historical realities, managerialists are critical of the notion of a change in corporate governance, whatever its source. As noted, management derives its power from the control, rather than the ownership, of assets. Control has been conceptualized in a number of ways, but is typically thought of as the ability of an identifiable group to realize their objectives, in spite of resistance (Zeitlin 1974:1091). Management has two primary prerogatives that provide autonomy from owners. First, the CEO is responsible for nominating potential members of the board of directors, and rarely are these nominations rejected. Indeed, Berle and Means (1932) conceptualize control as having the power to select members of the board. That management has this function is somewhat ironic, given that the board's responsibility is to monitor management in the interest of shareholders. Second, management is much better informed than are shareholders by virtue of their intimate knowledge of firm operations and market conditions.

There are specific features of managerial control that provide management with intrinsic advantages relative to large shareholders in general and institutional investors in particular. At this point it is necessary to examine some of those specific features, and how they favor the position of management. In this regard, Black (1992a) has reviewed the disadvantages that institutional investors face when monitoring managerial behavior. The first of these concerns collective action issues, such as the freerider problem. If an institution wages a proxy battle with management and wins, the costs of that fight reside solely with the institution, while the benefits are for all owners. Cowan (1988) estimated that the cost to an investor of a typical proxy contest was $1.7 million. This situation can reduce the incentive institutions have to intervene. A second group of problems concerns the legal obstacles that hinder shareholder action. Large shareholders face a variety of costly filing requirements with the Securities and Exchange Commission (SEC), and in some cases are liable to profit forfeiture and other adverse consequences in the event of bankruptcy (Black 1992a:822-23).

The third disadvantage shareholders have is management control of the voting agenda. For the most part, management controls on what and when shareholders vote, and when shareholders learn what is on the voting agenda. Management can also "piggyback" proposals that shareholders want with those sure to raise opposition. A common tactic is to link an unsavory proposal with a special dividend payout. The final general class of problems institutional investors have is conflicts of interest. If an institution does business with a company, it is not likely to vote against or question management's handling of company affairs. Also, there are a wide variety of types of institutions who invest in corporations, and each is presented with peculiar difficulties. For example, banks and insurance companies deal extensively with a range of firms, and because of this their monitoring capacity might be limited. They must be careful that in their monitoring they do not alienate the firms in which they invest, and lose them as potential clients. Corporate pension plans are limited even when they hire an outside money manager, since these funds are still controlled by management. All of these factors argue against the changes that have been purported. For these reasons, many still argue that management is still the strongest entity in the corporation, and still wields almost complete control over corporate affairs.

What makes managerial control problematic is when management acts in its own self-interest, rather than that of the owners. For the most part, early managerialists did not recognize that this as a potential problem (Gordon 1945). Berle and Means (1932:114-116) recognized that while the interests of owners were unambiguous, the interests of management were difficult to divine. It was possible, in their estimation, that owners and managers might be at cross-purposes. In contrast, Kaysen (1957:311) represents the more common managerial view. He was one of the first economists to assert that management focused on things other than profits, such as providing high wage jobs, establishing and maintaining community relations, and supporting liberal arts education. The vast power of management was recognized, but the absence of a profit motive meant they were not likely to misuse that power (Burnham 1941).

Later theorists recognized that the self-interest of management included such things as salary, security, power and prestige (Williamson 1963; Monson and Downs 1962). With the discretion management enjoys, they are much more likely to seek to maximize firm growth, since growth is consistent with the personal objectives of management, rather than profits (Galbraith 1967:171-175). Galbraith further argues that managers satisfice in terms of profits, enough to keep owners placid, then maximize their own utility. It was not until the 1960s that managerialists became more critical, and recognized that the difference between the interests of owners and managers might indeed be a source of conflict. This divergence of interest became the source of many empirical studies in the 1960s and 1970s.

Agency Theory and the Agency Problem

Agency relationships exist where one party "acts for, on behalf of, or as a representative for" another party (Ross 1973:134). For example, communities are generally considered to be responsible for the education of their youth. However, citizens do not perform that function *en masse*, but rather assign that responsibility to appropriately qualified teachers to do so. In this case, the teachers are agents and act on behalf of the community, the principal. Such relationships are ubiquitous in society.

Contrary to suggestions by Perrow (1986:224), agency theory does focus on a specific problem: insuring that in an agency relationship the agents act in the interest of principals. Agents, in this case CEOs, behave like any other economic actor: they seek to maximize utility, which is typically defined as the subjective pleasure or usefulness received from the products of labor (Samuelson and Nordhaus 1989). Indeed, rationality is defined as the attempt to maximize utility, taking into account the amount of effort needed to attain those useful items. (Von

Neumann and Morgenstern 1953).

The novelty of this approach is in taking these individual-level ideas and applying them to much larger entities. Until the advent of agency theory, neoclassical economists treated the firm as a black box: behavioral assumptions were made but the internal workings were never theorized about or observed (Alchian and Demsetz 1972). Corporations were equated with an entrepreneur, "who single-mindedly operates the firm to maximize profits" (Fama 1980:289). What was known in economics as the "theory of the firm" was really a theory of markets in which firms are prominent actors (Jensen and Meckling 1976:306). Agency theory introduced the notion, at least to economic theory, that the factors of production, which include management, labor, and capital, each have distinct interests, and that these interests might come in conflict. Because of this, it is a mistake to assume that firms will always seek to maximize profits. Rather, parties within a firm seek to maximize their own self-interest. This type of theorizing is quite different than that of managerial theory. The latter is inductive, building on careful observation of corporate life during the last 100 years, whereas agency theory deduces corporate life from first principals of individual human behavior.

The governance structure of corporations has been a frequent topic of theory and research for agency theorists. To describe the agency relationships therein, those using this approach invoke the metaphor of a contract (Jensen and Meckling 1976).

The notion of a contract is an appealing one, with parties joining together freely to establish their respective rights and duties, one toward another. Indeed, this concept underlies much of Western political thought since the Enlightenment (Barker 1947), which might help explain this theory's recent popularity among organizational analysts.

Contracts bind together the disparate interests represented in a firm. Indeed, according to agency theorists, an organization should not be viewed as a *sui generis* entity, but rather as a nexus of contracts between principals and agents. This origin of this conception of a firm comes from the work of R.H. Coase (1937/1988). Economic theory at that time argued that price coordinated production. Prices reflected the demand individual consumers had for a product, and consumers would contract with producers to fill that demand. If prices were high for a particular good, and profits were there to be made, individual producers would devote their efforts to making that good. If prices fell, and profits were reduced, their efforts would shift to another, more highly priced good. In sum, price movements directed production, which was carried out in a series of market transactions.

The obvious problem with such a notion is that rarely does production result from contracts between individual consumers and producers. Firms eliminate many direct market transactions, and price does not fulfill the function it once did. Coase (1988:36) claimed that entrepreneurs or managers, rather than prices, directed the process of production. What agency theory borrowed form Coase is the idea of contracts, but with a twist: where contracts were once between consumers and producers, they are now between all those involved in the production process.

Delegation is a general characteristic in agency relationships: the principal delegates duties and responsibilities to the agent. In this case, owners act as principals, delegating the duty and responsibility of running the firm to professional managers. Agency relationships would be unambiguous, and not particularly interesting, if the interests of the contracting parties were identical. Rarely though is that the case, and the gap between the interests of principals and the behavior of agents, along with the costs involved in verifying agent behavior, entail what has come to be known as the agency problem (Eisenhardt 1989). Actually, this might more appropriately be referred to as the principal's problem, for they are the party who are most at risk (Ross 1973; Fama 1980). The return on the principal's investment is uncertain, while the agent is paid according to the terms of a contract. It is the function of management to coordinate the activities of organizational participants and see that contracts are adhered to. The crux of the problem, stated succinctly by Jensen and Meckling (1976:308) is that "if both parties to the relationship are utility maximizers there is good reason to believe that the agent will not always act in the best interests of the principal."

Some of the specific difficulties that beset the principal-agent relationship, at least from the point of view of the principals, are moral hazard, where agents shirk their responsibilities, the adverse selection of agents, where agents misrepresent their qualifications to principals, and agent opportunism. The terms moral hazard and adverse selection come from the theory of insurance, and better terms for these phenomenon might be hidden action and hidden information (Arrow 1985). These problems arise from the assumptions neoclassical economists make about human nature. For example, the quest for maximum utility involves the expenditure of effort on the part of the agent. The amount of that effort is hidden from principals, particularly in the case of a corporate manager, whose tasks are rarely routinized, and thus difficult to quantify. Principals prefer maximum effort on the part of agents, but effort detracts from the utility of agents. Thus, when given the opportunity, agents will shirk effort and responsibilities, as long as utility is not sacrificed. Shirking is highly probable in situations where it is difficult to judge the contribution of an agent, or where it is expensive to verify that contribution (Alchian and Demsetz 1972).

Principals hire agents because of their qualifications, one of which is superior information about organizational functions, as well as product and capital markets. More often than not, these qualifications, and the information that makes them possible, are hidden from the principal. Thus, it becomes very difficult for the principal to evaluate whether or not an agent uses the information he or she has most effectively.

Hidden action and hidden information mean an increase in the probability of managerial opportunism, defined as "self-interest seeking with guile" (Williamson 1985:65). Because of these problems, principals must monitor the behavior of agents, and this monitoring results in what theorists refer to as agency costs (Jensen and Meckling 1976). The costly part of monitoring results from principals searching for information, bargaining, and policing and enforcing agreements (Dahlman 1979). These are costs to the principal that result from having to delegate necessary tasks to another party. The need for monitoring results from the fact that as owners delegate responsibilities to management, they lose much of their direct involvement with a firm. This lack of involvement contributes to managerial autonomy, and creates a situation that can foster opportunistic behavior. Much of the empirical work using agency theory has been an effort to aid in resolving the problems inherent in a principal-agent relationship.

The monitoring of corporate management is accomplished in one of three ways, either by the market for managerial labor, where success is rewarded and failure punished, by managers monitoring each other, or by a firm's board of directors (Fama 1980). The first two monitoring techniques are very difficult to observe, and their value has been questioned. For instance, the managerial labor market seems to reward success to the extreme, while failing to punish failure (Loomis 1982). While theorists have emphasized lower-level managers monitoring those above, it is difficult to tell what motivations they would have to do so. Because of these problems, much of the empirical literature focuses on the behavior of boards of directors.

Agency theory's emphasis on contracts also leads to a proposed solution to the agency problem: contracts must be specified in such a way as to align the interests of agents with those of principals. It is the task of the board of directors to write contracts in the interest of the principal that provide the maximum amount of incentive for agents. An example of this alignment in owner-manager relationships is contingent compensation contracts for management (Singh and Harianto 1989).

Institutional Theory

Agency theory is rooted in neoclassical economics, and relies heavily on basic, timeless assumptions about human behavior, such as the maximization principle, and the rationality, though bounded, of human actors (Eisenhardt 1989). Individual choice is determined by individual utilities: an organization is a nexus of contracts, in which utilities are played one against another. In contrast, institutional theory goes beyond simple economic reductionism, viewing choice as a product of social rather than individual reference points such as customs, social norms, or legal obligations (DiMaggio and Powell 1990). Practical choice, rather than rational choice, is emphasized, and involves actors carrying out "interaction ritual chains" that reflect preconscious processes and schemas, rather than a conscious maximization of utility (Collins 1989).

Building on this view of microsociology, institutionalists view action within an organization far differently than agency theorists. In a firm, action is often based on the taken-for-granted, or on conventions that have taken on a rule-like status, rather than rational calculation. Meyer and Rowan (1977:341) argue that often the formal structures of organizations "reflect the myths of their institutional environments" rather than productive or administrative demands. This represents a direct challenge to the functional argument that structure follows from organizational strategies (Chandler 1962). In this regard, Tolbert and Zucker (1983) found that while cities which reformed their civil service early did so based on organizational requirements, those late adopters did so because such innovations had become institutionalized. Thus, organizations are influenced by normative pressures and legitimated elements, and not simply by technical requirements and efficiency concerns (Zucker 1987).

For the most part, the emphasis of institutional theory has been on homogeneity rather than variation, on stability rather than change (DiMaggio and Powell 1983). In this case, we are dealing with a purported shift in emphasis on the part of major firms, from an emphasis on acting based on managerial interests to one where shareholder interests prevail. While some institutional theorists acknowledge limits in attempting to explain such change (DiMaggio 1988:12), others have used this theory tc great benefit (Davis et al. 1994; Leblebici et al. 1991). Useem's thesis, rooted in institutional theory, is that the managerial revolution of this century is being challenged by the recent rise of one particular type of owner, institutional investors. There are a number of key concepts, or components to this approach. The first is that of organizational logics. These refer to the principles that guide a firm, and the strategies of action. Currently, he argues, we are witnessing the rise of an ownership-disciplined logic, where organizational actions are judged on the basis of their contributions to shareholder value. The criterion of shareholder value, the second key component, has implications for company decisions "ranging from the choice of new managers and development of strategic decisions to performance review and executive compensation"(1993:7). Competing logics may exist within a firm, such as one favoring the interest of management, yet Useem argues that now there is a systematic bias in favor of stockholders (1993:11).

Why has this change occurred? For institutional theorists, the state, professions, and powerful firms in particular organizational fields have been identified as key agents of change (DiMaggio and Powell 1983; Fligstein 1990). Useem posits a different sort of actor at work, not powerful firms, but rather a powerful constituency within a firm. For years shareholding became more and more dispersed. Firms had literally thousands of owners, all holding very small fractions of the total stock. Such a situation created greater managerial autonomy, since no individual stockholder had a large voice, and there were few links between stockholders. Challenging management meant engaging in a proxy fight, a costly process requiring a great deal of organization, which is precisely what stockholders lacked. What turned this situation around was the rise of institutional shareholdings. This rise was quite dramatic in the 1980s, when both the total value, and percent of all equities that institutional investors held, rose greatly. Ownership, once "dispersed and detached", was becoming "concentrated and involved" (Useem 1993:31-37). These investors then mobilized and acted in a number of ways to insure management in the interest of shareholders.

In this view, the result of ownership pressure has been an enduring change in how management in particular, and firms in general view their role. Cognitive elements emphasized by institutional theorists, such as the appropriate way to manage firms, and appropriate goals, were changing. Thus, a structural change in ownership patterns led to changes in organizational culture. Useem states:

> What was strikingly evident among the seven companies was a cultural ambience in which the references were neither occasional nor a gloss. Daily movements in stock price, proxy challenges, analysts' reports, and investor complaints had etched an enduring presence. They were now a factor in management calculus, an impetus for change if not always a valued one (1993:7).

and

> These elements together constituted what Ann Swidler (1986) might term a management's new "cultural repertoire" or "strategy of action." Executives acquired a fresh cognitive and interpretive frame for making and evaluating major decisions. Ownership-disciplined alignment did not contain explicit guidance on specific decisions, but it did furnish a template for judging and specifying action. It offered what David Cohen and Michael Garret (1975:21) have called a "grand story"; a "large and loose set of ideas about how a company works (1993:8).

Clearly, culture is invoked as an important explanatory factor, independent of the structural change which brought it about. Culture, as most social scientists are aware, has been notoriously difficult to define explicitly. Broadly, it is seen as a "tool kit of symbols, stories, rituals, and world-views which people may use in varying configurations to solve different kinds of problems" (Swidler 1986:273). Culture is important in institutional theory because it can act as a carrier of institutionalization (Jepperson 1991). Practices or particular behaviors are more likely to be reproduced by a "relatively self-activating social process" if they have cultural support and sanction. The standard of shareholder value had such support in Useem's sample of firms.

Culture's use in organizational analysis has been narrowed somewhat to refer to "cognitive maps" (Lenz 1981), or "conceptions of control" (Fligstein 1990). Both of these refer to collections of ideas or strategies managers have on how to solve their competitive problems. These widely held cultural ideas can change over time, and this change results in changes in the ways firms behave. The change emphasized by Useem concerns the priority now given to the interests of shareholders.

Comparing the Theories

These theories have similarities as well as differences. Managerialism is simply a generalization about the degree of power held by managers in a corporate setting. In this regard, it is similar to other approaches emphasizing power (Perrow 1986). However, little attention paid to the complexities of social action within a firm. Agency theory and institutionalism are more complete and more highly developed. Both are theories of individual motivation and action, with formal organizations serving as the context for that action. The contrast between the two is that they find sources of motivation and action in very different places. Institutionalism's counterpart to the utility of agency theory are preconscious schemas, and widely accepted norms. When viewed together, these three theories provide appropriate lenses through which problems inherent in corporate governance. Another fact that enhances their usefulness is that because of their differences, they often make diametrically opposed predictions as to the outcomes of interest in this research.

Each of these perspectives, when applied, is structural in nature, focusing on rules and resources, and what the contending parties possess in relation to one another (Giddens 1984). Sewell (1992) points out that structure consists of elements that are actual and virtual in nature. For example, positions within a corporation are actual elements of structure, while the rules, norms, and schemas that guide action are virtual. Thus, an organization as complex as the large corporation has many structural elements, and these theories differ in terms of emphasis. For example, agency theory's primary emphasis is on ownership, and on the interests ownership generates. On the other hand, managerialists delve deeper into corporate procedures, noting that even though managers may not have ownership claims, they have control, and the perquisites that it provides. Institutionalism emphasizes the virtual elements of structure, with a particular emphasis on cultural schemas that structure action. Table 1 summarizes the theories, emphasizing the key ideas of each as well as their differences.

There are two key facts that differentiate these approaches. The first is the degree of autonomy accorded to managers, from very high in managerialism to very low in institutionalism. The second is the mechanism that places limits on managerial opportunism. There is no such mechanism in managerial theory, while agency theory relies on active boards of directors, and institutional theory emphasizes the effectiveness of a new cultural schema, as well as continued pressure from institutional investors.

Table 2: A Summary of the Theoretical Perspectives on the Owner-Manager Relationship.

Theory	Key Idea	Limits on Managerial Opportunism
Managerialism	Dominance by professional managers as a result of their control over assets, strategic direction, and information.	None
Agency Theory	Managers are agents of owners and are given to acting opportunistically unless checked by principals.	Effective monitoring of management by boards of directors or by aligning the interests of owners and managers
Institutionalism	Recent pressure by institutional investors has generated a new cultural schema favoring the interests of owners. This schema structures and influences managerial decisions.	Continued pressure from institutional investors.

CHAPTER 3

RESEARCH DESIGN

The Samples

There are a wide variety of ways to measure corporate performance (Kanter and Brinkerhoff 1982; Perrow 1977). The reason this is so is because firms are composed of a variety of constituencies. There is no single measure that captures adequately the key nature of performance for each and every constituency. For example, labor's chief concerns are wages, benefits and job security, while suppliers seek long-term supply contracts, which are evident primarily in Japanese industry. Our interest is in investors, thus, total return on investment, a combination of stock price change and stock dividends, is the most relevant measure of performance.

The notion that stockholder welfare should be an important measure of firm performance is relatively recent. More common measures, such as return on equity or profits, were standard benchmarks for years. These standard measures tell us about the size of the surplus a firm generates, which is important in its own right. However, from them we learn nothing about management's decision concerning the distribution of that surplus, and that is a serious omission. Large surpluses are not necessarily distributed to shareholders. Often, they are retained as organizational slack. For example, the Chrysler corporation is under sharp attack from its shareholders for failing to distribute its surplus. Likewise, the Ford Motor Company has accumulated over $14 billion of cash, which it currently holds. That figure represents $14 for every share of stock outstanding, and is three times their yearly expenditure for capital projects. Rather than make payments to their owners, these firms have chosen instead to keep their surpluses. These examples show why traditional measures of surplus do not accurately measure shareholder welfare.

Given that total return on stockholder investment best represents performance in terms of shareholder welfare, it forms the basis of this sampling strategy. Firms were included in the sample if they were in the lowest 20 percent of all Fortune 500 industrial companies in terms of total return to stockholders for two consecutive years, over the course of a five year period. The *Fortune 500* is an appropriate sampling frame in that all firms share a similar regulatory environment. The result of this effort is a sample of firms that during a specified time period were clearly failing on the criterion of shareholder value in relation to other firms.

In order to examine the effects of the historical shift in corporate governance, we examine samples of poorly performing firms at two points in time. One sample contains poorly performing firms during the period between 1978 and 1982. Thus, if a firm was in the lowest 20 percent in terms of total return for two consecutive years during this period, it was included in the sample. Then a second panel was chosen, using the same criterion, from 1988 until 1992. These samples did not necessarily contain the same firms.

These time periods were chosen for a very specific reason. If institutional investors, as Useem claims, are the driving force behind the change in corporate governance, then an adequate comparison must involve a time period when institutional investors were prominent, and a period when they were not. In the early 1980s, the holdings of these investors began to rise, and this rise shows no sign of subsiding. Thus, the first period represents a time when institutional investors did not have the holdings, or the accompanying power, that they would have at the end of that decade.

These represent the primary samples upon which this study is based. However, other comparisons are of interest as well. Aside from comparisons over time, each sample needs to be compared with firms in the same time period. Specifically, we need to examine whether or not poorly performing firms differ from others at the same point in time, and not just whether they differ over time. I will compare the probability of succession in my primary samples with that of all the corporations of the *Forbes 800*.

Obviously, this sampling strategy is not based on random selection. Indeed, one of the key variables associated with succession, corporate performance, has been restricted somewhat in terms of its variation. Thus, a number of comments are in order. Individual units of analysis are chosen for study, in most cases, based on the process of random selection to insure representativeness. However, it is possible to choose a sample of firms from a population, very few of which have had two consecutive years of poor performance. In such a case, one would expect to see very few instances of CEO dismissal, since poor performance is very nearly a necessary condition for such an event. Thus, we would learn very little about corporate governance during adverse conditions, and little about how boards and institutional investors act during such conditions. Every study in the extant literature has found an inverse relationship between performance and the probability of dismissal. Thus, a simple replication is not necessary, since it would do little more than strengthen an already corroborated finding. This research aims to go beyond this association and study governance mechanisms under conditions of adversity. In essence, this research, rather than analyzing the overall probability of an event, focuses on a conditional probability. The action of governance structures is of interest, under the condition of poor performance.

A second comment concerns generalizability. Samples are supposed to be chosen so that information from them can be used to make accurate inferences about a population. The determination of a population always involves some degree of arbitrariness. In every case there are units excluded from the possibility of being sampled. This is particularly true when the units being analyzed are corporations. For example, the *Fortune 500* list of the largest industrial firms is typically chosen as a sampling frame. Thus thousands of other slightly smaller industrial firms are excluded from consideration. Such a decision is not wholly arbitrary, for the smaller the firm, the more difficult it is to obtain quality data.

In many research studies, all 500 firms in the *Fortune* list are analyzed. Such a strategy, while increasing sample size and decreasing the effect of any outliers, seems to make the application of inferential statistics redundant. In this research, 151 firms, of the 500, have been chosen. Since the choice of these firms was not the result of random selection, a key question concerns how chosen firms compare to other firms in general. Table 3 illustrates this comparison.

TABLE 3

Descriptive Statistics of Sampled Firms and the Fortune 500

		Sample	Fortune 500	T-Score
1st Panel	Sales	2352.54 (3244.3)	2527.74 (5487.27)	-.856
	Assets	2056.2 (2245.17)	1859.00 (3631.25)	-.446
2nd Panel	Sales	2918.45 (6194.77)	3419.53 (8163.9)	-.500
	Assets	3360.52 (8270.71)	3547.3 (10961.0)	-.160

Note: all figures are in thousands of 1982 dollars.

This table shows the sales and assets figures of firms belonging to the samples, and to the Fortune 500 list as a whole. The t-tests show that there is no significant statistical difference between the two groups. In terms of sales and assets, the firms sampled are representative of the population as a whole. The sampled firms also come from a wide variety of industry groups, and no one industry was overrepresented. Firm performance has become more volatile in recent years, and even dominant industrial companies, such as General Motors and IBM, have suffered. This makes it likely that any firm could fall victim to poor performance.

The above information shows that these samples of poorly performing firms are indeed not so different from the population to which they belong. While the selection criterion for these samples is somewhat unusual, the descriptive statistics suggest that the results of the upcoming analyses should be generalizable to the population.

The final comment concerns variation in the data. I have argued that these firms approximate the *Fortune 500* in terms of variation in most of their variables. They are less representative in terms of performance, where there is less variation, but variation is a statistical requirement, and not necessarily a substantive one (see Lieberson 1985:88-109). When theories or explanations are stated unambiguously, a test of that theory need not involve a sample with the maximum amount of variation in the variables. An important part of theorizing is stating scope conditions, situations where the theory is expected to be true. In this case, if ownership interests and the standard of shareholder value now guide firms, then we should expect to see evidence of this among poorly performing firms. Thus, this research represents an appropriate test of those theories that propound a profound change.

Measures

Coding the first dependent variable, CEO dismissal, is not a straightforward process. The event is often shrouded in euphemisms, such as "early retirement", which makes an accurate assessment difficult. The process involved a number of steps. To reiterate, a firm had to have two consecutive years of poor performance in a five year period to be included in these analyses. The occupant of the CEO position was recorded at the beginning of this period, and then checked each year thereafter, until the end of the panel. Firms with poor performance during the last two years of the panel presented a problem, since the process of dismissal can take some time to work out. For these firms, the occupant of the CEO position was checked for two more years, and any succession was coded as such.

Sixty of the 151 firms experienced a change in CEO during or at the end of their period of poor performance, a 40 percent rate of succession. However, many of these were orderly successions, and not dismissals. The next step was to consult the business press to determine the nature of these changes. There were a number of clues that lead to the conclusion that the change was indeed orderly and voluntary on the part of the chief executive. The first factor observed was age, as many companies have a mandatory retirement age of 65. This fact was often noted in articles concerning the change in leadership. Another clue had to do with who made the choice of successor. If the incoming CEO was handpicked by the man he succeeded, then it is highly unlikely a dismissal took place.

There were also clues leading to the decision that a succession was a dismissal. In most cases, the press reports were unambiguous, with the event being referred to as a firing. The *Wall Street Journal* was used as an initial data source. If the *Journal's* report was inconclusive then the *Business Periodical Index* was used to find other sources. These included *Forbes, Fortune, Business Week*, and various industry and trade publications. There were cases that were not directly called a dismissal that were nevertheless coded as such. However, great care was taken in doing so. In each of these cases, there was evidence of pressure from the board of directors or from a major stockholder to replace the CEO. In two such cases, the authority of the CEO was greatly reduced immediately prior to his "early retirement". However, if a succession was reported as an early retirement, and there was no evidence of pressure or loss of authority, that event was coded as a normal succession. The end result of this procedure was a very strict criterion for making the determination of dismissal. If errors were made in this determination, they probably resulted in underestimating rather than overestimating the number of dismissals.

Other researchers have used less stringent criterion. For example, James and Soref (1981:4) state that "For one thing, firings of top management are never called firings. Chief executives and companies usually prefer to treat the matter delicately; hence "resignations" are accepted, or "early retirements" are taken, but firings do not occur." Their data was from the mid-1960s, and quite possibly the conventions of the business press have changed, for now firings are indeed labelled as such. Clearly, a problem with their approach is arbitrariness, which could affect the quality of analysis. Boeker (1992) relied on "major market research firms" to code dismissals in his study of the semiconductor industry. An advantage in this approach is the access these research firms had to those in top management, yet curiously enough the identity of these research firms was never divulged.

The second dependent variable concerns CEO compensation, which was examined in a number of different ways. Data on two varieties of compensation was collected, first, the sum of a CEO's salary and bonus, and second, the total of all forms of compensation. These are the measures that are reported in the firm's proxy statement. While the determination of a CEO's salary and bonus is unambiguous, the same is not true of total compensation. Until recently, the Securities and Exchange Commission had few requirements as to reporting format. In the absence of guidelines, firms often made it difficult to determine the precise total remuneration paid to officers. Total compensation includes a variety of perquisites, such as the value of stock options, loans to executives that were not paid back, compensation that was deferred, and the value of outright grants of stock. Finding all these forms of compensation requires a careful reading of proxy statements. This data was gathered from one of two places, either the firm's proxy statement, or from *Forbes* magazine's annual report on CEO compensation. The latter report was checked for accuracy by comparing it to the proxy statements. Data on both salary and bonus, and on total compensation was gathered at the beginning and the end of each five year period.

Proxy statements also report the compensation of all executive officers and directors of a firm, and this information is of interest as well. Thus, in addition to data on CEOs, compensation data was collected on the top three executive officers, usually the CEO, President, and executive Vice-President. These data are most often analyzed cross-sectionally, but one interesting facet of compensation is its rapid increase over time. Until now, compensation change has only been analyzed in a descriptive way. This research attempts to go further by finding determinants for this change.

Since this research involves two time periods, variation in compensation over time can be analyzed. However, another interesting analysis concerns the difference in this variable across types of firms. Thus, an equal number of other *Fortune*

500 firms were chosen randomly during each period, so that compensation in poorly performing firms could be compared with firms whose results were more positive.

The primary independent variables pertain to a variety of individual and organizational characteristics. These were of three types, CEO attributes, board of director attributes, and ownership characteristics. Data on the tenure and stockholdings of the CEO were gathered from proxy statements. While this information can sometimes be found in the business press, details are often lacking. For example, proxy statements often differentiate stock owned by the CEO from that of his wife or children, with the press reporting only that owned directly by the CEO. In this analysis, these holdings were aggregated, as it seems logical to assume CEO control over these assets.

Another group of independent variables had to do with attributes of a firm's board of directors. One of the more common measures of board composition is simply the proportions of inside versus outside directors, insiders being those who at the time were employed by the firm. This research took this a step further, by identifying different types of outside directors. It is common for corporations to select as directors those who are or have been managers of other firms. These are referred to as external officers. Consequently, we can measure the proportion of active external officers, the proportion of retired external officers, and the proportion of civic directors, who are those prominent individuals who lack business experience. This data was gathered from proxy statements and from the biographical database, **Who's Who in America**, and **Who's Who in Business and Finance**.

Finally, since ownership has been hypothesized to play a crucial role in changes over time, each firm was classified as to whether or not it had a principal stockholder. A principal stockholder is defined as any individual, family, or organization owning at least five percent of the outstanding voting stock. Five percent is typically seen as the amount necessary to exert significant influence within a firm (Burch 1972; McEachern 1977). There a variety of types of such owners, and they were classified as being either a family interest, ownership by another corporation, or an institutional money manager. Employee stock option plans often hold this much stock or more, but their voting rights are in the hands of management, and thus they were not considered to be principal owners. This data was compiled from proxy statements. Disclosure requirements concerning principal stockholders have changed over time and the five percent criterion for disclosure is relatively recent. Thus, in some cases ownership data was gathered from government reports on economic concentration or from studies done by the *Corporate Data Exchange*.

It is important that these independent variables be measured in the years prior to the dependent variables. In each case, data was gathered at the beginning of the five year period, and then again at the beginning of the first year of a firm's poor performance. Thus, a variety of different volumes of each data source had to be consulted to gather data that was relevant.

Statistical Models

The quality of multivariate analysis depends on model specification, which is particularly important in statistical analyses. It involves two choices the analyst must make: first, establishing the mathematical form of the relationship, (whether it be linear, log-linear, quadratic, etc.), and then determining which variables should be included to predict the phenomenon of interest.

Analyzing CEO dismissals presents us with the problem of functional form. Regression analysis assumes a linear relationship between a dependent variable and its predictors. This implies that the effect of the independent variables on the dependent variable occurs at a constant rate. Thus, a unit change in an independent variable will mean a constant change in the dependent variable, regardless of the value of the independent variable. It also assumes that there are no constraints on the values on either side of the equation. However, if the dependent variable is dichotomous, taking on values of zero or one, the above assumptions are violated. Specifically, the expected value of a dichotomous variable is equivalent to a probability, which can range on a continuous scale from zero to one. A problem arises because the other side of the equation is under no such constraint. In such a situation, the regression estimates are unbiased, but they do not have the smallest possible variance, which becomes problematic when testing hypotheses about those regression estimates.

The solution to the above problem is to use a particular log-linear model, maximum likelihood logistic regression. The boundaries of the dependent variable must be extended beyond their zero-one constraints, and thus, it must be transformed in two ways. To eliminate the upper bound, of $P_i=1$, we examine the ratio, $P_i/(1-P_i)$. As the probability approaches one, the value of that ratio approaches infinity. This ratio is in the form of an odds, where we divide the probability of an event occurring by the probability that it will not occur. Then, to eliminate the lower bound one takes the natural logarithm of that ratio. This log-odds ratio, or "logit" is now related in a linear fashion to the independent variables. Thus:

$$\log[P_i/(1-P_i)]=\Sigma bX$$

Solving for P in the above equation yields:

$$P=\exp(\Sigma bX)/(1+\exp(\Sigma bX))$$

This particular function, common in mathematics and statistics, is the logistic function. While another nonlinear function might be chosen, such as the cumulative normal curve, the logistic function is most commonly used.

Analyzing changes in compensation presents us with different problems. Compensation change is just a specific example of a more general statistical problem, the analysis of growth rates. Growth rates examine not simply a dependent variable, but rather the change in a dependent variable over time.

Heteroskedasticity is the condition of having unequal variances of the error term over the range of values of the dependent variable. This problem is common in research on organizations or nations, where the size of the units might differ dramatically. In this study, compensation growth differs widely, and the result is that as growth rises, so does its variance. While this situation does not bias coefficient estimates, it does bias statistical tests. Weighted least squares regression corrects this problem, and will be used in the upcoming analyses.

Influential cases are those observations that, when deleted, produce a large change in one or more coefficient estimates (Bollen and Jackman 1985). There are a number of diagnostic statistics that attempt to measure the influence of individual observations, and once identified, there a number of ways to deal with them. While there is a degree of consensus on identifying influential cases, there is not a consensus on how to deal with them (Berk 1990). One approach is to use a method called robust regression, which is an iterative rather than a single-solution approach. This procedure begins by calculating one particular influence statistic, Cooks D, for each case, then uses that information to calculate weights which are applied to those observations deemed influential. Then, a regression is performed. This process is repeated, and all the while the size of the calculated weights are compared. When the difference of the weights falls below a predetermined level, the process stops and final coefficient estimates are given. The goal of this approach is to lessen the influences of certain cases, without deleting them. The second approach to dealing with this problem is to delete cases based on the size of a particular influence statistic, Cooks D. After deletions, coefficients and their standard errors are checked. If large differences in these figures are present, and in particular if the standard errors are smaller, then the cases in question remain deleted. This method is sometimes considered to be unduly radical, but it can be justified if the deleted cases are substantively different from others in the population (Fox 1990).

By design and intent, the statistical models in the upcoming analyses will be somewhat simple in terms of the number of variables used. Predictors will be limited to those that are theoretically relevant. It is typical in statistical analysis to control for the wide variety of other possible causes which might influence dependent variables. However, such a practice is not necessarily benign. Consequently, the number of control variables in the upcoming analyses will be limited as well (Lieberson 1985). It is necessary at this point to explain which potential causes need to be controlled for and why.

When analyzing dismissal, it is particularly important to control for the effect of one variable, economic performance. A strong association between performance and dismissal has been found in numerous studies, but performance is by no means a sufficient cause. Actors in a governance structure, and not performance, dismiss CEOs. Performance, no doubt, influences these actors, but our chief interest is in the behavior of this governance structure, holding performance constant. This will be done by including the total return on investment in the second year of poor performance in the multivariate analyses. A corporate executive is rarely dismissed after one bad year, making what happens in the subsequent year especially crucial. For this reason, performance in that subsequent year will be included in the analyses.

Two variables will be controlled for when analyzing compensation growth. Recall that compensation was measured at the beginning of a five year period, and then again at the end. Firm performance was poor in at least two of those five years. Institutional theory would expect poor performance to diminish compensation. However, the design of this research introduces a possible problem. If a firm's total return to investors was low early in the five year period, it would have a few years to rebound. If a rebound occurred, it might be responsible for the growth in compensation. Thus, such a condition must be taken into account.

Finally, the upcoming descriptive data will show that growth in compensation appears to be related to succession. In particular, when succession from outside the firm occurred, compensation growth was unusually high. Thus, in the multivariate equations, a dummy variable for succession type will be included.

CHAPTER 4

HYPOTHESES

A cursory glance at recent academic journals reveals that the derivation of hypotheses has fallen out of favor. In most cases they remain implicit, and the reader must do the work of relating concrete findings to the abstract ideas of theory. Clearly derived hypotheses eliminate that problem, and make explicit the link between the abstract and the concrete. These three theories present clear alternatives in terms of outcomes, and the mechanisms which are supposed to bring those outcomes about. In what follows, I will show the different ways these theories view important issues, then state hypotheses based on a single theory.

Dismissals

The first empirical issue of this research concerns CEO dismissal, and the choice of successor. On the one hand, managerial theory emphasizes the power of professional managers, and their ability to control the productive power of firms. Both managerial theory and agency theory emphasize the difficulty and the cost of closely monitoring the behavior of CEOs. This is why, these theories argue, managers have power and autonomy. An implication of this power is that managers should be able to retain their positions, in spite of environmental changes. In contrast, institutional theory proposes a cultural change hypothesis, with a significant shift in owner-manager relations. The more tenuous position of CEOs would lead to higher probability of dismissal. This theory would also expect firms that as firms seek to increase shareholder value they would change their strategic direction, which usually comes about through outside succession (Pfeffer 1972). In the past, boards have been reluctant to look outside the firm for CEO replacements, but whether or not that still remains the case is open to inquiry (Mace 1971; Dalton and Kessler 1984). Thus, institutional theory would hypothesize:

Hypothesis 1a: Because of the ascendancy of ownership interests, the odds of CEO dismissal will increase over time.

Hypothesis 1b: In an effort to change the strategic direction of firms, the odds of a dismissed CEO being replaced by an outsider will increase over time.

Because of the separation of ownership and control, owners no longer have the kind of detailed knowledge of firms that they once did. To deal with this problem, agency theorists emphasize the role of the board of directors an information resource for stockholders (Fama 1980) Singh and Harianto (1989:11) claim that, "the power of a board becomes apparent especially when a company is in crisis, for instance, when its performance is poor or when it becomes a target of acquisition." It has been suggested that certain types of directors are better suited to fulfill this function than others. Outside directors, because of their relative independence, can be more effective in acting on shareholder interests (Singh and Harianto 1989; Weisbach 1988). Institutional theory expects that the effect of these external directors on succession will be more prominent in the latter panel. Agency theory, at its core, is about utility. Utility will be very different for directors who simply sell their services to a firm, than for those who hold an equity stake in the firm. Thus, a more important attribute of the board might be the amount of stock owned by its members. The more stock a board member owns, particularly if they are independent directors, the more likely they are to act in ways that protect and enhance their ownership interests. Thus:

Hypothesis 2a: The proportion of independent directors on the board will be positively related to the probability of dismissal, especially in recent years.

Hypothesis 2b: There will be an positive relationship between the stockholdings of independent directors and the probability of dismissal, regardless of time period.

Useem's thesis centers on the influence of institutional investors, even though these investors do not have a formal place in corporate governance. Although managerialists would downplay their influence, institutional theory emphasizes it. Despite their lack of representation, they have the potential to be powerful actors. Paradoxically, there has been little systematic research to verify their influence. If institutional investors have power, that power must have been acquired recently. Thus, one would expect changes over the course of this study. Also, Black (1992a;1992b) suggests that a lone institutional owner bears a high cost when challenging management, though the benefits will be shared by all owners. However, if a firm has two or more large shareholders, they might be likely to work together for their common economic interest. Thus:

Hypothesis 3a: A firm having a principal stockholder, one holding at least five percent of the stock, will have a higher probability of dismissal than other firms, especially in recent years.

Hypothesis 3b: Firms with two or more principal owners will have a higher probability of succession than other firms, and this probability will has increased over time.

As tenure increases, chief executives accrue certain advantages, which are emphasized by managerial theorists. We assume that they will have acquired a certain degree of expertise, which can be a valuable resource for the firm. They will have established more lasting relationships with important business partners, such as key suppliers, labor, and sources of finance. As time passes, a larger proportion of the members of the board will be their appointees (Fredrickson, Hambrick, Baumrin 1988). This situation should lead to a lower probability of dismissal. However, institutional theory proposes a modification of that hypothesis. If the cultural change argument is correct, we expect this relationship to be mediated by time. There are sound reasons for such a hypothesis. Because of their fiduciary responsibility to shareholders, directors have become increasingly liable for poor performance, leading some to argue that directors may no longer be as loyal to CEOs as they once were (Baysinger and Hoskisson 1990). Thus:

Hypothesis 4a: Because of the advantages of incumbency, there will be an inverse relationship between tenure and dismissal.

Hypothesis 4b: Over time, the inverse relationship between tenure and dismissal should disappear.

Changes in Compensation

The compensation given to a CEO is an important indicator of the power of the person occupying that position, as well as the state of governance in a firm (Allen 1981). The most basic descriptive hypothesis deals with compensation change over time, and our theories provide us with differing predictions. In a sample of firms that have performed poorly, institutional theory would expect the "madness" associated with CEO compensation to diminish, for a variety of reasons (Loomis 1982). First, during declining periods of economic performance investors suffer, and since these investors have acquired power relative to management, they should be able to insure that losses are experienced by all constituents. Second, Useem (1993) and others emphasize the rise of performance based compensation contracts for CEOs, which closely link pay to performance. However, in contrast to the above scenario, a managerialist would to point to the specifics of how compensation is determined. In many cases, an outside compensation consultant, hired by the CEO, creates a contract which is then subject to ratification by the CEO (Crystal 1990). This process is often insulated from other involved in corporate governance. Thus, according to managerial theory, rather than compensation coming down, it is most likely to rise over time.

Hypothesis 5: Over time, the compensation of chief executive officers will rise, in spite of poor performance.

The remaining hypotheses will focus on determinants of the change in compensation. The advantages tenure provides were discussed earlier, and research has demonstrated a link between the length of tenure and compensation (Ungson and Steers, 1984). Thus, tenure and compensation change should be positively related:

Hypothesis 6: As tenure increases, the compensation will grow, regardless of the time period.

Cross-sectional analyses of compensation demonstrate that there is a strong positive relationship between CEO pay and the size of a firm (Allen 1981; McEachern 1977). Finkelstein and Hambrick (1989) argue that this is so because a larger firm means that the CEO has more to oversee. More responsibility should mean more compensation. However, it should be noted that institutional theory's notion of a shift in the relationship between owners and managers expects that relationship to change over time. If shareholder value has come to predominate, then size should not influence compensation nearly as much as return to shareholders. In contrast, this finding is easily explained from a managerial perspective: a CEO's power is directly related to the value of the firm he controls. Compensation consultants, hired by the CEO to write compensation contracts, often claim that CEOs of similar-sized firms deserve the same sorts of compensation (Finkelstein and Hambrick 1988). In addition, this implies that if a firm grows over time, compensation should rise accordingly. Since most of the empirical studies on compensation have been cross-sectional, the relationship between compensation and change in size has not been tested. Thus:

Hypothesis 7: There will be a positive relationship between the change in size of a firm (measured in terms of assets) and CEO compensation, regardless of time period.

The logic of agency theory was presented in the discussion of earlier hypotheses. In short, the behavior of management is controlled through the monitoring of the board of directors, and that independent directors monitor more effectively than those employed by the firm (Boeker 1992; Weisbach 1988). Fama (1980:293) refers to independent directors as "professional referees", who provide an antidote to those who are both directors and employees. Research is sparse on this issue, but McEachern (1975) did find that firms with dominant non-management stockholders on the board were associated with lower levels of pay. Appropriate compensation is an important problem in the principal-agent relationship, for it is the principal's job to set a fee schedule that will insure the agent acts in the principal's interest. Thus:

Hypothesis 8: As the proportion of independent directors on the board rises, compensation will fall over time, rather than grow.

Hypothesis 9: As the stockholdings of independent directors rise, the change in compensation will fall over time, rather than grow.

Two hypotheses can be derived directly from institutional theory. If institutional investors have changed the relationship between owners and managers, then we expect to see a number of important new relationships. Economists have long argued that wages are determined by productivity, and such a relationship is easy to verify if productivity is quantifiable. Such is not the case with corporate managers. However, total return to investors is quantifiable, and represents a good measure of shareholder welfare. Profit rate has been used as a proxy for shareholder welfare, and positive relationships have been found between it and compensation, but profits are not necessarily distributed to owenrs (Larner 1970). If Useem is correct, a relationship should exist between total return and compensation. This relationship has not been examined directly, but others have found a positive relationship between compensation and the change in stock price stock price, which is a key component of total return (Murphy 1985; Benson 1985). Thus:

Hypothesis 11: In the latter panel, the presence of a principal owner will be associated with a decline in compensation change, controlling for the total return provided to shareholders.

Hypothesis 12: In the latter panel, the change in compensation will be positively related to the total return to investors.

CHAPTER 5

FINDINGS

Table 4 lists a number of indicators that demonstrate the level of performance of the sampled firms.

TABLE 4

Select Descriptive Statistics of Sampled Firms

	1st Panel	2nd Panel
Total Return to Investors	-17.13% (14.02)	-27.4% (20.01)
Asset Growth	$95.18 (1904.0)	-$154.12 (1448.28)
Employment Change	-4770 (19830)	-4788 (18182)
Sales Growth	-$481.3 (4929)	$118.05 (1138.92)

Note: Asset and sales growth figures are in thousands of 1982 dollars.

Investors in these firms lost on average over 17 percent during the first panel. In contrast, the average *Fortune 500* firm had a 12 percent gain during the same period. The losses in the second panel rose to 27 percent, while the population had a 14 percent gain. Clearly, these were firms that lagged far behind their market peers. Employees fared even worse than investors, as firms shed over 4700 jobs during both time periods. This downsizing might have been a rational response to adverse conditions during the first panel, since sales lagged over the period, but during the second panel sales, on average, rose. Nonetheless, jobs were cut.

Dismissal Analyses

Tables 4 and 5 address the first set of hypotheses, and provide some descriptive evidence in support of institutional theory. Our first question concerns the frequency of dismissal, and table 4 addresses that issue.

TABLE 5

Odds of Dismissal, 1978-82 and 1988-92

	Dismissed	Not Dismissed
1978-82 (N=75)	.08	.92
1988-92 (N=76)	.28	.72

Odds of Dismissal, 1978-82=.087
Odds of Dismissal, 1988-92=.389

Odds Ratio=4.47

Institutional theory expects the idea of shareholder welfare to increasingly be the driving force behind firm behavior. Thus, if managers are not successful at garnering an adequate return for owners, they should be replaced with increasing frequency over time. Table 4 shows that indeed, that was the case. The odds of dismissal increased more than four times in just ten years, making the position of poorly performing managers much more precarious.

The frequency of dismissal is not the only important descriptive statistic. A closely related issue is the origin of the successor, whether that person comes from inside or outside the firm. The difference between succession and dismissal must be noted. Dismissal is a specific type of succession, where the CEO is forced from his position. Succession is just a change in the occupant of that position, for whatever reason. For the most part, inside succession, where a current employee ascends the hierarchy, is seen as a maintenance strategy, meaning that the core policies and procedures of the firm are not likely to change (Dalton and Kessner 1985). In contrast, outside succession signals change, and the upsetting of the power structure of a firm (Pfeffer 1981). Table 6 shows changes in succession type over time.

TABLE 6

Odds of Outside Succession, 1978-82 and 1988-92

	Succession Type		
	None	Inside	Outside
1978-82 (n=75)	.64	.31	.05
1988-92 (n=76)	.57	.28	.15

Odds of an Outside Succession, 1978-82=.056
Odds of an Outside Succession, 1988-92=.172

Odds Ratio=3.07

Institutional theory looks for strategic change in firms, and thus expects an increase in outside succession. While the amount of succession has changed little over time, inside succession has declined, while outside succession has increased. The odds of outside succession have increased over three times, corroborating Useem's view of a cultural change in corporate affairs.

While suggestive, these data on dismissal do not provide a rigorous examination of the theories. Dismissal is a dichotomous dependent variable, and must be analyzed statistically using a nonlinear technique. Table 7 shows logistic regression analyses predicting dismissal, and firms from both time periods are included in these analyses. This is done for two reasons. First, there are some hypotheses that are independent of time. These hypotheses should be supported whether the firms are in the first or second panel. For instance, managerial theory argues that an increase in tenure should increase the power of the CEO and lessen the probability of dismissal, regardless of the time period. In a similar vein, the hypotheses derived from agency theory are based on the concept of utility, and should be supported in both panels. Actors should seek to maximize utility, and a cultural shift should not change that. A second, and more important reason to analyze all firms together is to see whether or not a significant statistical difference exists between firms in the two panels, as institutional theory expects. To do this, a dummy variable is included in the analyses, with a zero value if the firm is in the first panel, and a one if it is in the second.

The results in Table 7 add support to both the managerial power theory and to institutionalism. There is a statistically significant inverse relationship between tenure and the probability of dismissal, suggesting that the more entrenched

TABLE 7

Results of Logistic Regression Analyses Predicting CEO Dismissal, 1978-92. (N=151)

Theory	Independent Variables	1	2	3	4
Managerial Power Theory	Tenure	-.117** (.050)			-.110** (.053)
	CEO Stock	-.029 (.038)			-.028 (.042)
Agency Theory	Proportion of Independent Directors		2.19 (1.62)		.936 (1.92)
	Stock of Independent Directors		.013 (.019)		.014 (.019)
Institutional Theory	Principal Owner			-.536 (.517)	-.436 (.558)
	1988-92 Period			1.58** (.532)	1.02* (.40)
Control Variable	Total Return on Investment				-.020* (.011)
	Constant	-.744	-3.08**	-2.17	-2.39*
Chi-Squared		11.44	2.31	10.35	24.38

*=p<.10

**=p<.05

CEOs are more difficult to fire. Institutionalism is supported from the fact that firms in the latter time period, from 1988 to 1992, were much more likely to dismiss their CEOs than firms were earlier. These results corroborate the descriptive statistics, and suggest in a stronger fashion that a profound change in corporate governance has occurred. Agency theory is not supported by these analyses, as neither the proportion, nor the stock, of independent directors is a significant predictor of dismissal. Other variables concerning the board, such as the proportion of external officers and the proportion of company directors were analyzed as well, with similar nonsignificant results. Because they are highly collinear, these variables were not analyzed together.

The final model in Table 7 includes variables from each theory, as well as a control for performance. Controlling for performance is important, for although we know the total return to investors in these cases was far below average, there was a substantial amount of variation between firms on this variable. The results from this model strengthen the findings of the simpler models, with both tenure and the dummy variable for time period retaining their statistical significance.

To explore changes over time, it is necessary to disaggregate the samples and analyze firms in their respective time periods only. It should be noted that logistic regression results are only asymptotically unbiased, and that here we are dealing with rather small samples. Nevertheless, there are some

TABLE 8

Results of Logistic Regression Analyses Predicting CEO Dismissal, 1978-82. (N=75)

Theory	Independent Variables	1	2	3	4
Managerial Power Theory	Tenure	-.065 (.105)			-.048 (.118)
	CEO Stock	-1.27 (2.19)			-4.20 (3.45)
Agency Theory	Proportion of Independent Directors		7.50* (4.08)		10.57* (6.30)
	Stock of Independent Directors		-.010 (.086)		-.015 (.068)
Institutional Theory	Principal Owner			.490 (.899)	.491 (1.15)
Control Variable	Total Return on Investment				-.082** (.040)
Constant		-1.62** (.626)	-7.56** (3.00)	-2.74** (.729)	10.47** (4.85)
Chi-Squared		4.41	4.46	0.31	16.76

*=p<.10

**=p<.05

TABLE 9

Results of Logistic Regression Analyses Predicting CEO Dismissal, 1988-92. (N=76)

Theory	Independent Variables	1	2	3	4
Managerial Power Theory	Tenure	-.113* (.060)			-.123 (.067)
	CEO Stock	-.024 (.041)			-.020 (.045)
Agency Theory	Proportion of Independent Directors		-.551 (1.88)		-.860 (2.24)
	Stock of Independent Directors		.008 (.020)		.017 (.021)
Institutional Theory	Principal Owner			-1.09* (.634)	-1.22* (.706)
Control Variable	Total Return on Investment				-.009 (.012)
	Constant	-.277 (.387)	-.678 (1.32)	-.154 (.556)	1.61 (1.83)
Chi-Squared		7.19	0.26	2.91	11.96

*=p<.10

**=p<.05

noteworthy differences. The purpose of analyzing each panel separately is to observe any change in relationships over time. The results of agency theory hypotheses are not expected to change, but we see from the table that the proportion of independent directors, significant in the first panel, is not significant in the second. Thus, an important attribute of the key control mechanism for shareholders has no effect on dismissal. There are a number of ways to interpret this finding. First, it fails to support agency theory's contention concerning the importance of outside, independent directors, and the monitoring of management that they are bound by law to do. On the other hand, boards are acting to dismiss CEOs more now than ever before, in spite of the fact that the proportion of outside directors, those thought most likely to oppose management, is not related to dismissal. Second, while contradicting agency theory, this result is interpretable in terms of institutional theory. If schemas structure action, and a schema emphasizing shareholder value is predominant, then boards will be likely to dismiss CEOs, without regard to board attributes.

Another interesting change over time concerns the effect of the total return to investors. The effect of control variables are rarely considered to be of substantive interest, but there is an unexpected change in the influence of this performance measure on dismissal. In the first panel, as expected, as performance falls, the probability of dismissal rises. This effect is statistically significant in the earlier panel, but not later.

This is surprising, because over time, if ownership interest became dominant, this variable should have remained significant. Some have suggested that firms whose performance is extremely poor have a difficult time attracting viable candidates for the CEO position, and that this difficulty has been exacerbated over time (Dalton and Kessner 1985).

For institutional theory, the most important relationship is between the presence of a principal owner and dismissal. In the first panel, as expected, there is no statistical relationship between these variables. The importance of owners was hypothesized to rise over time, in accord with their increased holdings and newfound influence. For this reason, a positive and significant relationship between dismissal and the presence of a principal owner was expected in the second panel. Contrary to that expectation, the presence of a principal owner is statistically significant, but negatively related to dismissal.

The counterintuitive relationship in the second panel between the presence of a principal owner and dismissal raises questions and demands further analysis. Recall that Useem (1993) identified principal owners as the mechanism that prodded firms toward shareholder value as an organizational goal. This relationship might be logical if the owners in question were families, and the CEO was a family member. In such a case, it seems unlikely that a family would dismiss one of their own, and this could have influenced this particular finding. In the sample, 16 firms fit that description.

This relationship must be analyzed further, to insure that we are not dealing with a statistical artifact. To do so, corporate control type, a categorical variable, will be used to predict dismissal. Firms are controlled in one of four ways, by management, by another corporation, by a family that employs an outside CEO, or by a family with a family member as CEO. By using control as a predictor, we isolate firms that have the attribute of interest, a family member as CEO. If these firms are acting differently than others in terms of dismissal, thereby contributing to this counterintuitive relationship, that should be evident in the analyses presented in Table 10.

TABLE 10

Results of Logistic Regression Analyses Predicting Dismissal by Control Type, 1988-92.

Control Type	
Management	.584 (.727)
Corporate	.550 (.872)
Family, non-family CEO	.080 (1.29)
Constant	1.47** (.640)
Chi-Squared	0.83

When analyzing a categorical variable, one category must be omitted. The coefficient estimates presented above represent the difference between each control type and the omitted category.

Thus, the coefficients above represent how each control type differs from family control with a family member CEO. That category was omitted because it is expected to have the least amount of dismissal. However, in contrast to that expectation, the analyses show that there is no significant difference in terms of dismissal between the various control types. Indeed, in some instances, families dismissed one of the members as CEO of their firm. For example, the founder of Wang Laboratories, acting as chairman of the board, dismissed his son after years of poor performance, choosing instead to bring in an outsider to manage the firm.

To summarize, the relationship between principal owners and dismissal does not seem to be the result of the behavior of a certain type of family-controlled firms. Thus, having a principal owner is associated with a reduction, rather than an increase in the probability of dismissal. This result fails to support the contention that principal owners are responsible for a cultural change in firms.

For the most part, these results support an institutional interpretation. Over time, dismissal rates have risen. Now, when shareholders suffer losses, boards are much more likely to replace the person that they feel is responsible, the CEO. The problematic part these findings, at least for Useem's institutional explanation, is that the supposed cause of this rise, principal owners, is not associated with dismissal.

Compensation Analyses

There is a great deal of evidence to suggest that the compensation of CEOs of U.S. corporations has risen dramatically. For example, in 1979, CEOs made 29 times what the average manufacturing employee made. By 1988 that multiple had risen to 93 (Phillips 1990). Rarely though, has this change in compensation been analyzed, and it is the purpose of this section to do so. Table 11 begins this analysis by presenting some descriptive statistics.

TABLE 11

Descriptive Statistics on Compensation Growth
(all figures are in thousands of 1982 dollars)

	1978-82	1988-92
Salary & Bonus (CEOs)	-36.15 (194.58)	102.46 (497.9)
Total Compensation (CEOs)	61.53 (446.6)	378.30 (2413.4)
Salary & Bonus (top 3 officers)	-31.9 (393.59)	-67.61 (779.2)
Total Compensation (top 3 officers)	257.35 (1034.1)	150.24 (1726.2)

Table 11 lists data on two variables, growth in salary and bonus, and growth in total compensation, for the CEO and then for the top 3 executive officers, one of which is the CEO. The results show some interesting and substantively significant differences over time. For example, in the earlier panel, CEO salary and bonus declined over time, by more than $36,000, while it rose greatly in the second panel. Total CEO compensation rose in both panels, but the rise was much greater in the second panel. It is important to remember at this point that these figures are in constant 1982 dollars. Thus, these changes cannot be attributed to the effects of inflation.

Another difference between these panels becomes evident when we compare the changes in CEO compensation with that of the top 3 officers. In the 1978-82 panel, the changes are strongly correlated: salary and bonus falls for both while their total compensation rose. Between 1988 and 1992, the relationship is negative rather than positive. Both salary and bonus, and total compensation rose dramatically for CEOs, but fell dramatically for the top three officers.

These changes make for an interesting contrast with the data presented earlier on dismissal. Over time, while boards of directors have approved lucrative contracts for CEOs, they have also been much more willing to dismiss them when performance is not acceptable. Thus, boards seem increasingly willing to reward CEOs, but have far less tolerance for failure. This discrepancy seems to support both institutional and managerial theory. While CEOs can command higher and higher salaries, more is expected from them by other organizational constituencies.

While relevant, the descriptive statistics do not adjudicate between the more nuanced ideas of these theories. To do so, multivariate analyses are necessary, and these will follow the form presented earlier, analyzing the total sample first, and

TABLE 12
Analyses of Compensation Growth, 1978-92.

Theory	Independent Variables	Weighted Least Squares (n=144)	Robust Rgr. (n=144)	W/O Influential Cases (n=141)
Managerial Power Theory	Tenure	2.03 (3.14)	2.09 (2.38)	.095 (2.76)
	CEO Stock	-5.45* (2.88)	-.512 (1.87)	-2.09 (2.28)
	Asset Growth	.035** (.016)	.030** (.012)	.028** (.014)
Agency Theory	Proportion of Independent Dir.	-239.66 (161.26)	-145.79 (133.21)	-238.60 (153.34)
	Stock of Independent Dir.	1.77 (2.56)	2.28 (1.99)	-1.80 (3.18)
Institutional Theory	Principal Owner	-103.7* (61.06)	-48.61 (46.29)	-48.20 (54.16)
	1988-92 Period	260.4** (51.82)	175.42** (43.49)	205.12** (50.72)
	Total Return to Investors	.283 (.354)	.270 (.334)	.241 (.385)
Control Variables	Lagged Salary & Bonus	-.603** (.153)	-.337** (.059)	-.243** (.100)
	Outside Succession	217.32* (119.43)	62.87 (69.88)	113.76 (83.62)
	Constant	463.4**	249.72**	261.78**
R-Squared		.44	.44	.18

then splitting that sample into its respective time periods. As mentioned earlier, methodological considerations demand that each analysis be run in a number of ways, to correct for statistical problems.

Table 12 presents three models. The first is one using weighted least squares, to correct for heteroskedasticity, while the second two deal with the problem of influential cases. Both are presented because of the lack of consensus in the statistical literature on how to deal with this problem. There are two primary results in this table. First, in each of the three models, we see a distinct period effect. Compensation growth is significantly greater in the second panel than it is in the first. The second important result is that compensation growth is tied to the growth in the size of firms. This corroborates and extends earlier findings concerning the positive relationship between firm size and compensation (Larner 1970). Cross-sectional analyses are limited in making causal attributions: an association between size and compensation at a point in time does not demonstrate cause. This finding extends the earlier work be showing not that size and compensation are related at one point in time, but that growth in size is related to growth in compensation. It also shows that a change in our causal variable is related to a change in our dependent variable, which makes a much stronger case for causal attribution.

To explore changes in these relationships over time, it is necessary to analyze firms in their respective time periods,

TABLE 13
Analyses of Compensation Growth, 1978-82.

Theory	Independent Variables	Weighted Least Squares (n=70)	Robust Rgr (n=70)	W/O Influential Cases (n=67)
Managerial Power Theory	Tenure	-.246 (2.35)	-1.66 (1.98)	-.915 (2.13)
	CEO Stock	-.371 (1.64)	-.114 (1.55)	-.131 (1.64
	Asset Growth	.042** (.008)	.043** (.010)	.041** (.011)
Agency Theory	Proportion of Independent Dir.	-142.59 (124.10)	-211.54* (113.46)	-235.31* (123.85)
	Stock of Independent Dir.	-1.46 (.970)	-1.55 (2.38)	-4.00 (7.88)
Institutional Theory	Principal Owner	14.44 (44.47)	34.79 (37.94)	19.47 (40.79)
	Total Return to Investors	.339* (.197)	.446 (.282)	.317 (.295)
Control Variables	Lagged Salary & Bonus	-.372 (.101)	-.282** (.096)	-.277** (.101)
	Outside Succession	-120.12 (44.45)	-116.38 (88.22)	-126.40 (92.00)
	Constant	234.66**	214.16	247.56
R-Squared		.35	.35	.40

TABLE 14
Analyses of Compensation Growth, 1988-92

Theory	Independent Variables	Weighted Least Squares (n=74)	Robust Rgr (n=74)	W/O Influential Cases (n=71)
Managerial Power Theory	Tenure	3.14 (7.31)	-2.13 (5.37)	-2.16 (4.60)
	CEO Stock	-13.58** (6.51)	-8.16* (4.46)	-9.21* (5.46)
	Asset Growth	.028 (.030)	.024 (.027)	.006 (.024)
Agency Theory	Proportion of Independent Dir.	-535.86 (339.37)	-271.41 (289.10)	-364.26 (248.96)
	Stock of Independent Dir.	1.87 (3.47)	3.66 (3.34)	-2.24 (4.72)
Institutional Theory	Principal Owner	-243.4* (136.04)	-296.21** (111.83)	-136.66 (98.98)
	Total Return to Investors	.320 (.812)	.561 (.731)	.486 (.619)
Control Variables	Lagged Salary & Bonus	-.548** (.156)	-.661** (.104)	-.313** (.138)
	Outside Succession	233.46* (119.65)	236.74* (119.24)	166.22 (101.59)
	Constant	1028.61	943.56	675.14
R-Squared		.53	.53	.23

and then to compare the coefficients.

Tables 13 and 14 present the individual panel analysis. In the first panel, there is a significant relationship between asset growth and compensation growth. Another key finding is that as the proportion of independent directors rises, compensation declines. These findings support managerial and agency theories, but the more important question is whether these relationships hold over time. This question has a great deal more theoretical importance.

Simply put, these relationships do not hold. Asset growth and the proportion of independent directors were significant predictors of compensation growth in the first panel, but their significance declined with time. Indeed, the size of the asset growth coefficient is only half of what it was earlier, implying that while their rewards have grown, CEOs are not simply being rewarded for increasing the size of their firms. This finding contradicts one that has been consistent in the literature for a long time. Many have argued that in order to maximize their own personal utility, CEOs would attempt to increase the size of their firms, thereby increasing the size of their compensation (Galbraith 1967; Baumol 1967). In addition, the proportion of independent directors, those "professional referees" does not have the significant effect on compensation growth that was expected. This supports those who claim that compensation contracts are carried out behind the backs of the board of directors, by outside compensation consultants hired by the CEO

(Crystal 1990).

There is some evidence to support the notion that the presence of a principal owner is associated with a decline in compensation growth. That variable is significant in the weighted least squares and robust regression models. However, it must be noted that that result could be an artifact of influential cases. When such cases are dropped, the size of that coefficient drops dramatically, as does its significance. Much like the dismissal analyses, there is little in the way of strong evidence suggesting that the presence of principal owners alters important organizational processes.

The next important finding involves an expected change over time that did not materialize. In the first panel, as expected, there is no relationship between total return to investors and compensation growth. But, over time a close relationship between these variables should have developed, according to institutional theory. However, between 1988 and 1992, total return is not strongly associated with compensation growth. Recent managerial literature emphasizes the importance of making managers think like owners, meaning that they should be motivated by the same thing that motivates owners, a return on their investment (Murphy 1985). Compensation contracts were supposed to be written to insure this, but this research provides evidence that these contracts do not perform their desired function.

Overall, the findings from these analyses of compensation growth support a managerial interpretation. Over time, CEOs have appropriated more of more of firm resources. Compensation has risen in dramatic fashion, but what makes this especially interesting is that this rise is not associated with traditional measures of managerial power. Increased tenure and stock ownership do not mean that more remuneration will be procured. It could be that managers now have other sources of power that have not been considered, or that compensation is a function of other factors. Institutional theory is not supported by these analyses. The period effect is opposite of expectations, and principal owners have not successfully halted the growth of compensation, or in tying that growth to a meaningful measure of firm performance.

The Exit of Ownership Interests

In Useem's institutional explanation of the change in corporate affairs, owners play the key role, for they are the mechanism that has changed managerial behavior from being self-interested to being shareholder-interested. However, the above analyses do not support the notion that ownership interests have had a significant impact on firms, at least in terms of the variables used here. This lack of effect leads to a question: what do owners do when the performance of the investment is not adequate? To provide some perspective on this question, it is necessary to consider the influential work of political scientist Albert Hirschman (1970). Hirschman argues that in any sort of exchange where a party is dissatisfied, three options are available. The first is to simply remain passively loyal, and to hope for better results in the future. The second is to exit, and end the transaction. This option is most common in economic exchanges. For example, a customer dissatisfied with a product or service will simply cease being a consumer of that product or service. An aggrieved party may also choose the third option, that of voice, where grievances are aired in an effort to improve the situation. Voice is typically used in political situations, where exit is not so easily accomplished. This final option is more involved, and necessitates a certain level of commitment.

We find differing speculation, and little empirical research, on what owners of corporate stock do in response to decline. Jensen (1989) argues that large investors simply "vote with their feet", and in the face of poor returns choose the exit option. They sell their holdings and look for other investment opportunities. In this scenario, their involvement in a firm will be limited to that of being a passive investor. There is some logic to support such a choice: these investors have interests and expertise in portfolio management, as opposed to managing corporations, and this leads to the sale of holdings in unprofitable companies (Herman 1981).

In contrast Useem sees the issue differently, and states that:

> Exit was no longer necessary, since they (large investors) had now accumulated the power to be heard by management. Equally important, exit was no longer feasible. Few untapped domestic opportunities remained, and few international opportunities were appealing (1993:28).

To add some substantive evidence to this debate, Table 15 shows the principal investors by type, and their decisions concerning their holdings in the face of declining performance.

TABLE 15

Types of Principal Shareholders and their Portfolio Decisions 1988-92.

Investor Type	Percent Retaining Their Holdings
Corporation (n=11)	64%
Institutional Money Manager (n=68)	16%
Family Interest	68%
Employee Stock Option Plan (n=9)	78%
Management Team (n=2)	100%
Total	40%

Overall, only 40 percent of these investors chose to retain their holdings, and most of those who did were family interests, or others actively involved in management. These stockholders have interests in their firms far beyond a simple return on investment, and thus were likely to retain their ownership interests. Powerful families derive power from their companies, and selling can mean losing power as well as identity. Decisions by institutional investors, by far the largest type of principal owner, were quite different. In overwhelming numbers, these investors followed what has become known as the "Wall Street

Rule" and simply took their assets elsewhere. Contrary to Useem's assertion, in the face of poor performance institutional investors were more likely to choose the exit option over that of voice. Rather than remaining with a firm and attempting to revitalize it, these investors chose to sell their holdings. This finding supports Jensen's notion of the role played by large investors, and suggests that if firms are to change, they will do so for reasons other than ownership pressure.

CHAPTER 6

DISCUSSION

This study was designed to test a general proposition. If a profound change has been brought about in corporate governance, and that change has been triggered by large, institutional shareholders, then that change should be most evident among poorly performing firms. Poor performance is theoretically important, for it is the condition that should stimulate actors in the governance structures to act. If firms are supplying investors with what they desire most, a satisfactory return on their investment, then they would not be likely to intervene. The converse, on the surface, seems true as well: if investors are not receiving an adequate return, then one would surmise that investors would act on behalf of their interests.

The results concerning this general proposition are mixed. On the one hand, dismissal rates have risen, suggesting that boards have become more active, and less likely to display loyalty to non-performing CEOs. From this perspective, the managerial revolution, first proclaimed in the 1940s, seems to have been toppled. CEOs are not immune from performance pressures, and possession of their office has become precarious. Indeed, there were even a number of cases where controlling families ousted one of their members in the face of lost profits.

On the other hand, compensation has risen dramatically, which on its face does not suggest a governance revolution. CEOs of U.S. corporations are being rewarded like never before, and reap earnings far above their foreign peers (Kirkpatrick 1994). What is particularly puzzling about this situation is that there is no evidence to suggest that this rise is associated with performance, particularly the measure of performance of interest to owners, total return on investment. Thus, we are left with a situation where two key indicators of the state of corporate governance point in different directions. We lack convergent validity, and the key question is why.

What might make boards of directors dismiss executives on the one hand, and reward them lavishly on the other? Might there be a belief that these rewards contribute to shareholder value? This question cannot be answered conclusively, but there is evidence to suggest that such a belief indeed does exist. One former director has stated that "Boards of directors perceive there's a fairly limited number of individuals capable of running these large, complex organizations. And they're willing to pay to get them" (Dumaine 1994).

In the business press, market forces, a limited supply with a very large demand, are typically cited as the reasons for the explosion in CEO compensation. This is a very difficult argument to test, for it is nearly impossible to estimate the supply of potential CEOs. The argument is used in an post hoc fashion: compensation rises dramatically, therefore there must be market, and only market forces at work. While directors may indeed believe that high salaries and incentives trickle down to shareholders, there are costs involved, costs that usually go unrecognized. Cash remuneration, salaries and bonuses, are evident to all, but stock incentives are not. For example:

> Compensation committees have strong and misguided incentives to grant stock options. Under current rules of accounting, the cost of options offered at market prices never hits the income statement. Apparently, by magic, a company can deliver millions of dollars to an executive and not diminish profits by a nickel (Crystal 1988:71).

Such incentives increase the number of shares outstanding, and thereby dilute their value as well (Dumaine 1994). The Financial Accounting Standards Board has proposed a rule that will require companies to determine a value for options and record them as an expense, but that rule has not been instituted. If it is, profits will show a decline. In a study commissioned by *Fortune* magazine, researchers calculated the value of stock options given to the CEO, then subtracted that value from company earnings. The earnings for the median company declined a startling 4.1 percent, while the most generous firm saw its earnings decline 38 percent (Fortune 1994).

Evaluating the Theories

To evaluate the purported changes in the relationship between owners and managers, hypotheses were derived from three competing perspectives. What do these results indicate about our theories? Theories should provide "explanations for recurrent explanatory problems" (Tilly 1981:11) and add depth to our understanding. Compensation and executive succession are certainly the kind of recurrent processes that Tilly had in mind, and thus they have received a great deal of study. To begin this evaluation, it must be said that agency theory helps us little in understanding these processes. When it comes to governance issues, this approach has focused on the board of directors as a control mechanism. In particular, it focuses on independent directors, those with no employment history with the firm, and the important role that they are uniquely equipped to play. But this research shows that this type of director is not strongly associated with dismissal, or with restraining compensation growth, in either time period. In an attempt to provide this theory with a fair appraisal, this research went further by categorizing independent directors, assuming that certain categories might be more active than others. In this regard independent directors were categorized as external officers, retired external officers, or civic directors, those prominent people without business experience. While one would expect external officers to be the most critical, the results do not bear this out.

Agency theory's central notion is utility, and this raises serious questions about the status this theory gives to independent directors. Their chief role is to monitor management, but what incentive do they have to do so? How do they maximize their utility in the process of monitoring? In the context of this theory, these are crucial questions. In response to them, it is necessary to look at a typical director compensation package. International Business Machines was one corporation in the sample. In 1992 they paid their directors a salary of $55,000, plus an additional $5000 if they headed a committee. There were 12 board meetings that year, an unusually high number for a firm, and probably reflective of the difficulties this firm was having at the time. In addition, directors received 100 shares of stock as a gift, and 100 more shares for every year of service. They also received $1000 in meeting fees, for every meeting attended and travel and accommodation expenses were reimbursed by the company. In total, it was possible for an IBM director to receive $77,000 for just one year of service. It is difficult to imagine that a director would look critically at one who provides so much for them.

A variable that is more consistent with this theory is not the proportion of independent directors on the board, but rather the amount of stock they own. Stock ownership should provide an incentive to monitor, since the more stock these directors own, the more managerial actions will directly affect their wealth. Indeed, while this is a minority position among agency theorists, some have suggested that directors should be required to place a certain amount of their wealth in equities of the companies they serve, in an effort to make them more diligent.

In contrast to expectations, the stock of independent directors is not strongly related to our two indicators. We expected a significant inverse relationship between stockholdings and the two independent variables, but such results were not forthcoming. There are a number of possible explanations for this. First, even with their assets on the line, social factors might play a role. Again, directors might be reluctant to dismiss someone who has given them a job. Second, an important factor could be the source of their stock ownership. Directors, like executives, are sometimes given options to buy stock at below market rates, or give restricted stock grants, which are outright gifts of stock for a certain period of service. It might be that stock acquired in these ways is not as valuable as it is to those who buy it on the open market, and it might not provide the incentive necessary to monitor effectively.

From all accounts, removing a CEO is a very difficult decision (Carroll 1993: Black 1992). On its face, it might seem that formulating a reasonable compensation structure for that CEO would be a much easier task, and that independent directors should do a credible job in this regard. However, compensation schedules have become incredibly complex, and are usually constructed by a specialist in the field with a detailed knowledge of other compensation schedules in an industry. Compensation comes in a large number of forms, including cash salaries and bonuses, stock options, stock grants, stock appreciation rights, and even insurance policies. How all these elements function, and how they might benefit the CEO is quite complex, and a proper understanding requires detailed study. Samuel Silberman (1991), a former director and compensation committee member of the Gulf and Western corporation, has stated that directors need a compensation consultant to help with this process. He states that:

> It is clear that outside professional help is needed to establish what is competitive and what are the limits. Most companies have a full spectrum of consultants, lawyers, accountants, architects, engineers, real estate

> experts, and so on. The compensation consultant should serve the board through its compensation committee in much the same way the independent auditors serve the board through its audit committee. While the consultant must be able to work with management, it should be firmly established that the ultimate responsibility is to the board (1991:349).

In summary, it seems that agency theory's trust in the independent members of the board of directors to monitor and discipline is somewhat misplaced. This research finds little or no evidence to support its claims.

The managerial approach fares better than agency theory, and is supported by much of the data on compensation growth. Indeed, even from the data on dismissal it is obvious that such an action is not exactly a common event, even in the face of the most dismal performance. But compensation is where CEOs seems best able to exert their power. It has become dogma in management studies that incentives in the form of various stock bonuses align the interests of owners and managers. In a limited sense that might be true, but the benefit is not necessarily equal for each party. A hypothetical case will illustrate this point. For example, a firm might give option on 50,000 shares of stock to its CEO, at a price of $15 per share. Let us say the stock sold at $20 when the options were granted, but eventually rose to $30. If at this time the CEO exercised his options, he will own stock valued at $1,500,000, for which he paid only $750,000. For sure, the shareholders have done well during this time, as the price of the stock rose 50 percent. But is was the CEO who made out particularly well, with a 100 percent return on investment. Indeed, such situations are far from unusual (see Crystal 1990 for more complex details of individual cases). While options to buy 50,000 shares of stock might seem unusually beneficent, they are not. Michael Ovitz, CEO of the Disney company was given options to by five million shares in 1995.

Though the results from compensation growth support managerialism, this research raises an important question for this theory. The traditional measures of managerial power, including length of tenure, and the amount of stock ownership, are not strongly related to compensation growth. This is a theory built on the notion of power and of executive autonomy, but common indicators of that power do not predict important outcomes of interest. There are a number of possible explanations. First, it could be that compensation growth is a function of factors that have little to do with CEO power. Changing norms, boardroom cultures, or just free market forces might explain this rise, independent of the CEO. While possible, these explanations ring hollow. It is difficult to imagine a situation where the party that benefits so much is not intimately involved.

A more likely explanation is that compensation growth is the result of indicators of power that were not considered. For example, the composition of the compensation committee might have an effect. If all its members were appointed by the standing CEO, that CEOs rewards might be higher. Another factor might be who appoints the compensation consultant. If this is the CEO's choice, then we would expect a choice to be based on the attractiveness of the compensation package. Unfortunately data on who chooses the compensation consultant is not readily available. In sum, the support for managerialism would be greatly strengthened if indicators could be found to predict outcomes of interest.

The data on dismissal lends support for institutional theory. Over time, firms became much more likely to dismiss a CEO during periods of poor performance. In addition, there were cases where some very powerful CEOs were dismissed in some very unfriendly circumstances. For example, Kenneth Olsen, the CEO and founder of computer manufacturer Digital Equipment, was dismissed from the firm he did so much to build. This happened despite the fact that he was the company's largest shareholder owning more than two million shares. In response to such events, management scholar John Pound said "Henceforth the CEO will look less like an emperor than like a Congressman, trying to represent his various constituents and, to the extent he succeeds, being reelected" (Stewart 1993).

However, contrary to Useem's explanation, there is no evidence that large shareholders are the mechanism responsible for this change. These results do not support those who argue that activist owners have had direct impacts on the dismissal process, or for that matter on compensation. Considering the corporate governance structure, this result is not particularly surprising. Recall that in most cases owners simply own stock: they rarely have representation on the board of directors, and rarely do they seem to want it. This lack of representation leaves them with no formal and direct access to management. The one element of power that they do have is that they are able to vote on proxy issues, the most important of which is the election of directors. While this voting creates some leverage for shareholders, it is management who nominates potential directors, and to challenge those nominations shareholders must engage in a costly proxy fight. It is far easier in such a situation to sell one's holdings and invest in another firm, and the results of this research bear this out. What James March (1962:674) said about owners some time ago still seems to be true, that "their demands form loose constraints on the more active members of the governing coalition. Their initiative in policy formation and in determining the nature of the coalitions is small."

If one applies a historical perspective to corporate governance, the lack of an evident impact from large shareholders is not surprising. Indeed, fearing the power of financial institutions, state and federal legislators, beginning in the New Deal period, have limited the role institutional investors can play in their portfolio companies (Roe 1990). Worried about the power financial giants like J.P. Morgan might wield, a variety of restrictions were applied to each major type of institutional investor, including pension and mutual funds, insurance companies, and banks. Under current law, Black (1992a) suggests that an appropriate role for institutional investors might be to produce procedural governance changes, rather than substantive ones.

Procedures of interest include the timing of elections to the board, whether a whole slate of people are elected simultaneously or whether terms are staggered, and whether or not large owners can directly elect directors. These changes are of interest because they can act as a check on managerial power and prerogative.

While there is little evidence that large shareholders have brought about a cultural change in firms, there is no doubt that change has taken place. What then has changed in corporate affairs over the decade of the 1980s and why have dismissals risen, if the factors that once increased their probability are no longer significant? While this research cannot address this question conclusively, some suggestions will be made. When looking for evidence of a cultural change, the focus of institutional theorists should be on the board of directors, for these are the key actors in the governance process. The structure of this process leaves little room for owners to exercise agency, thus to focus on them is inappropriate.

A key question in this regard is whether or not members of the board of directors have had reason to reevaluate their roles. If they have, then board attributes, such as the employment history of directors, or how much stock they own, might matter less than they once did.

Institutional theory's focus is on worldviews and cognitions, and there were a number of changes in the 1980s that changed the cognitive map of directors. As a result, boards became more active in governance, for a number of reasons. First, if they remained passive in the face of poor performance they placed themselves at risk of class-action suits from shareholders. Indeed, one of the most outspoken shareholder groups, the California Public Employee Retirement System (CALPERS), has chosen to target directors, rather than corporate officers (Ferguson 1992). While investors might not have direct influence with officers, directors do, and at least some investors have recognized this. Whether or not shareholders will sue is probably less important to the board than knowing that a suit is a distinct possibility.

Second, board members, particularly those from outside the firm, are now more heavily involved in corporate affairs. They have become so in two primary ways. First, they are increasingly adopting rationalized standards to judge CEO performance (Lublin 1993). This is typically done by having the chief executive list personal and firm goals, subject to the board's ratification. At the end of a specified period the CEO is evaluated, based on those goals. Another way they are increasing their involvement is through their committee system. Boards are typically divided into any number of special-purpose committees, to oversee numerous aspects of corporate affairs. The number of these committees is on the increase. For example, in 1979, Eastman Kodak had just two board committees, one of which was completely staffed by employees of the firm. In 1993, that number had grown to six, half of which were staffed solely by outside directors. These additional committees allow directors exposure to a wider range of corporate concerns.

Finally, there is one less tangible reasons for the increasing frequency of CEO dismissals. To become a director of a large firm, one has to have achieved a degree of success in their field, and thus established a reputation for business accomplishments. Quite clearly, sitting on the board of a floundering firm, particularly as investors are calling increased attention to such failings, might damage a director's reputation (White and Ingrassia 1992). James Burke, a director at IBM and former CEO at Johnson and Johnson, is credited with being responsible for the management changes at IBM in 1992. As that firm spiraled downward, he confided that he couldn't go anywhere without someone asking him what was wrong with IBM (Carroll 1993: 337). While not directly responsible for IBM's troubles, it was his responsibility to act in the interest of the firm and its owners. A failure to do so would have done damage to his reputation.

Future Research

The issue of corporate governance warrants future concern for a variety of reasons. First, this is an example of an enduring conflict that will continue for some time. Corporations serve a variety of public functions, such as manufacturing goods, providing employment, and allocating capital. They are also the site of various constituencies struggling to protect their interests. The constituency presently most active in this struggle are owners, but in the future it might be labor, or suppliers, or the communities in which a firm does its business. Though Weber (1978:222) claimed that the top of an organization is rarely bureaucratized, this research shows that such a result is possible, and this holds promise for those who believe public corporations should be democratized further.

Finally, though at present the power of institutional investors might be circumscribed, the future is less certain. Much of the legislation that put limits on the power of financial institutions is now under political attack. For example, the Glass-Steagall Act of 1934 is currently being challenged in the Congress. That piece of legislation put limits on the economic power of banks and the range of their activities, and if those limits are repealed, the face of corporate governance could look much different in the future than it does today. In addition, Congress recently overrode a presidential veto to make it easier for shareholders to sue management and directors when performance is lower than expected. In one way or another, corporate governance will change in the future, and these changes should make this issue particularly important for those interested in macrosocial power.

APPENDIX A

THE SAMPLES

APPENDIX A

THE SAMPLES

1978-82	1988-92
Allis Chalmers	AM International
Armco	AMAX
Armstrong Cork	Advanced Microdevices
Arvin Industries	Anacomp
Atlantic Richfield	Avondale
Avon Products	Black & Decker
Baker International	Boise Cascade
Beatrice Foods	Brooke Group
Borden	Brunswick
Briggs & Stratton	Cincinnati Milacron
Bucyrus Erie	Coca Cola Enterprises
CBI Industries	Commerce Clearing House
CBS	Cray Research
Charter	Crown Central Petroleum
Chicago Pneumatic	Crystal Brands
Chrysler	Data General
Cluett Peabody	Digital Equipment
Coastal	Doskicil
Coca Cola	Eagle Picher
Combustion Engineering	Eastman Kodak
Crown Central Petroleum	Figgie International
Crown Cork & Seal	Fina
Cummins Engine	Gaylord Container
Dana	Gencorp
Deere	General Dynamics
Diamond Shamrock	Goodyear
Envirotech	Guilford Mills
Firestone	H.B. Fuller
Fleetwood	Harcourt Brace Jovanovich
Ford Motor	Hartmarx
Foster Wheeler	Hewlitt Packard
General Motors	IBM
Getty Oil	IMO Industries
Grace, W.R.	Imperial Holly
Gulf Resources	Inspiration Resources
Harris	Interco
Ingersoll Rand	Intergraph
Inland Steel	Kellwood
International Harvester	LTV
Jim Walter	Lone Star Technologies
Kellwood	Masco Industries
Koppers	Maxus Energy
Litton Industries	Maxxam
Louisiana Land & Exploration	McDonnell Douglas
Magic Chef	Media General
Mattel	Millipore

1978-92	1988-92
Midland Ross	NL Industries
Mitchell Energy	National Semiconductor
Mohasco	Navistar
Murphy Oil	Nerco
Nashua	Nortek
Norton Simon	Oryx Energy
Pennwalt	Outboard Marine
Pepsico	Pennzoil
Phillips Petroleum	Quantum Chemical
Pillsbury	Raychem
Polaroid	SPX
Proctor & Gamble	Safety Kleen
Schlitz	Sequa
Scovill	Standard Products
Shell Oil	Stone Container
Sheller Globe	Storage Technology
Smith, A.O.	Sudbury
Standard Oil of Ohio	Tandem Computer
Stokely Van Camp	Tektronix
Sybron	Texas Instruments
United States Steel	Total Petroleum
Union Pacific	Trinity Industries
United Merchants & Manufacturers	United States Gypsum
Warner Lambert	Unisys
Whirlpool	Wang Laboratories
Williams Companies	Weirton Steel
Xerox	Western Digital
Zenith Radio	Westinghouse Electric
	Whitman
	Zenith Electronics

APPENDIX B

PRINCIPAL OWNERS OF FIRMS IN 1988 AND 1992

APPENDIX B

Principal Owners of Firms in 1988 and 1992

Firm	Principal Owner 1988	Principal Owner 1992
AM International	Kamori Printing	Wisconsin Investment Board
	ESOP	ESOP
AMAX	Chevron	FMR
	Equitable Life Assurance	Edward C. Johnson III
	United Banks, CO	Wellington Management
		Norwest Corporation
		Windsor Funds
Advanced Microdevices	Siemans Capital	FMR
		The Capital Group
Anacomp	Melvin Simon	Merrill Lynch
		Wellington Management
Avondale Industries	ESOP	ESOP
		R.B. Haave Associates
Black and Decker	None	None
Boise Cascade	Lazard Freres	ESOP
		Dodge & Cox
		Sanford Bernstein
		State Farm Insurance
		Donald Smith & Co.
Brooke Group	B.S. LeBow Inc.	B.S. LeBow Inc.
Brunswick	None	None
Cincinnati Milacron	J.A.D. Geier	J.A.D. Geier
	ESOP	ESOP
	Chase Manhattan Bank	FMR
	Putnam Trust	PNC Financial
		Bankers Trust, NY

Firm	Principal Owner 1988	Principal Owner 1992
Coca Cola Enterprises	Coca Cola	Coca Cola
		Brinson Partners
		S.K. Johnson
		SE Asset Management
Commerce Clearing House	Thorne Family	Thorne Family
		Ariel Capital Management
Cray Research	Equitable Life Assurance	State Treasurer, MI
	Prudential Insurance	
	Kemper Financial	
Crown Central Petroleum	American Trading & Production	American Trading & Production
		AIC Ltd.
		Heine Securities
Crystal Brands	Forstmann-Leff	Connor Clark & Co.
	FMR	State of Wisconsin Investment Board
Data General	Capital Group	Norwest Corporation
	Sanford Bernstein	Merrill Lynch
	State of Wisconsin Investment Board	State of Wisconsin Investment Board
		FMR
Digital Equipment	None	None
Doskocil	Larry Doskocil	Littlejohn & Levi Fund
		Airlie Group
Eagle Picher	PNC Financial	Wachovia Bank
Eastman Kodak	None	None

Firm	Principal Owner 1988	Principal Owner 1992
Figgie International	Figgie Family	Figgie Family New South Capital Management
		Merrill Lynch
		ESOP
		FMR
Fina	Petrofina Delaware	Petrofina Delaware
Gaylord Container	M.A. Pomerantz	M.A. Pomerantz
	Grinnell College	Grinnell College
	W.J. Hayford	
Gencorp	Lazard Freres	ESOP
	First National Bank, OH	Gabelli Group
	FMR	
General Dynamics	Crown Family	Crown Family
		Berkshire Hathaway
		National Indemnity
		National Fire & Marine Insurance
		ESOP
Goodyear	None	None
Guilford Mills	C.A. Hayes	C.A. Hayes
	Templeton, Galbraith	Victor Posner
	Investment Counselors	
	Maurice Fishman	
	Prudential Insurance	
	George Greenberg	
H.B. Fuller	Elmer L. Anderson	Elmer L. Anderson
	First Bank System	

Firm	Principal Owner 1988	Principal Owner 1992
HBJ	ESOP	None
	First Boston	
Hartmarx	Continental Illinois	Continental Illinois
	Cooke & Bieler	Abdulla Taha Bakhis
		Norwest Corporation
Hewlitt Packard	David Packard	David Packard
	Wm. R. Hewlitt	Wm. R. Hewlitt
IBM	None	None
IMO Industries	T. Rowe Price	State of Wisconsin Investment Board
	FMR	
Imperial Holly	Kempner Family	Kempner Family
	ESOP	ESOP
	Fayez S. Sarofim	Fayez S. Sarofim
		Daniel K. Thorne
		U.S. National Bank
Inspriration Resources	MINORCO	MINORCO
	Olympic Capital	Sasco Capital
		Pioneer Management
Interco	Delaware Management	Apollo Interco Partners
		TCW Management
Intergraph	Meadlock Family	Meadlock Family
	ESOP	ESOP
	Sanford Bernstein	Sanford Bernstein
	State Treasurer, MI	
	Jennison Associates	
Kellwood	Forstmann-Leff	FMR
		Neuberger & Berman

Firm	Principal Owner 1988	Principal Owner 1992
LTV	None	None
Lone Star Technologies	State Farm Insurance	Fund American Enterprises
	FMR	Sasco Capital
	Fireman's Fund	Brinson Partners
		Alpine Capital
Masco Industries	Manoogian Family	Manoogian Family
Maxus Energy	Thomas E. Turner	Prudential Insurance
		Kidder Peabody
		State Treasurer, MI
Maxxam	Federated Developers	Federated Developers
		The Stockholder Group
McDonnell Douglas	McDonnell Foundation	McDonnell Foundation
		Chase Manhattan Bank
		Sanford Bernstein
Media General	D.T. Bryan	D.T. Bryan
	ESOP	ESOP
	First Manhattan	Gabelli Group
	GIANT Group	
Millipore	Jennison Associates	Regents, University of California
	Wellington Trust	Brinson Partners
NL Industries	Valhi Corporation	Valhi Corporation
		Tremont Corporation
National Semiconductor	Capital Group	Capital Group
	Equitable Life	FMR
		State of Wisconsin Investment Board
		TCW Management

Firm	Principal Owner 1988	Principal Owner 1992
Navistar	State Treasurer, MI	State Treasurer, MI
		State of Wisconsin Investment Board
Nerco	Inner Pacificorp	Inner Pacificorp
Nortek	Richard Bready	Richard Bready
	R.R. Pappitto	Phoenix Associates
	Batterymarch Financial	Gabelli Group
		UBS Asset Management
Oryx Energy	Glenmeade Trust	Glenmeade Trust
Outboard Marine	Batterymarch Financial	FMR
	Templeton, Galbraith	Sanford Bernstein
	Torchmark Investments	GSB Investment Council
		Loomis, Sayles & Co.
		Confederation Life
		Invista Capital
Pennzoil	Fayez Sarofim	Fayez Sarofim
	State Farm Insurance	State Farm Insurance
	Proven Properties	Wellington Management
Quantum Chemical	Panhandle Eastern	Windsor Funds
	Loomis, Sayles & Co.	American Express
		ESOP
Raychem	None	None
SPX	None	None
Safety Kleen	Emery Family	Emery Family
Sequa	Paine Webber	GAMCO Investors
	N.E. Alexander	N.E. Alexander
		State Farm Insurance

Firm	Principal Owner 1988	Principal Owner 1992
Standard Products	J.S. Reid	J.S. Reid
	J.D. Drinko	
	Society National Bank	
Stone Container	Stone Family	Stone Family
		Sanford Bernstein
		FMR
		Equitable Life
Storage Technology	None	None
Sudbury	HTV Industries	Mutual Life
	Suter	Jacques R. Sardas
Tandem Computer	Equitable Life	Capital Group
Tektronix	Jean Vollum	Jean Vollum
	Capital Group	Quantum Fund
	Dodge & Cox	Capital Group
	Primecap Management	State Teachers, OH
	Lord Abbott	
Texas Instruments	ESOP	ESOP
		FMR
Total Petroleum	TOTAL	TOTAL
	Walter McKenzie	
Trinity Industries	Equitable Life	FMR
	Loomis, Sayles & Co.	Gabelli Group
USG	Desert Partners	Settsu Corporation
Unisys	None	None
Wang Labs	Wang Family	Wang Family
	Martin Kirkpatrick	William J. Pechili
Weirton Steel	ESOP	ESOP
		Wellington Management
		U.S. Trust

Firm	Principal Owner 1988	Principal Owner 1992
Western Digital	None	None
Westinghouse Electric	None	None
Whitman	ESOP	Oppenheimer Group
		SE Asset Management
Zenith Electronics	BEA Associates	Mannning & Napier
	FMR	First National Bank, Chicago
	Kemper Financial	

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