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Boards of Directors, Top Managers and Four Management Styles

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Abstract

This paper investigated the different styles of corporate governance, namely, *chaos* management, *entrepreneurship* management, *marionette* management, and *partnership* management. These four styles have been explored regarding the philosophies behind each style and the dynamics associated with each style.

Examples of organizations that adapt a certain management style have been described. Review of literatures that speculate the effectiveness and prevalence of each style have been sited. A common underlying theme, under most of normal conditions, has been proposed.

About the Author

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Introduction

Corporate Governance refers to the relationship among the board of directors, top management, and shareholders in determining the direction and performance of the corporation (Wheelen & Hunger, 2007).

The role of the board of directors varies a lot from a country to another, from industry to another and from company to another.

Many scholars consider that the primary responsibility of the board of directors is to protect the shareholders' assets and ensure they receive a decent return on their investment (Kennon, 2008). In contrast to that in some European countries, the sentiment is much different; many directors there feel that it is their primary responsibility to protect the employees of a company first, the shareholders second. In these social and political climates, corporate profitability takes a back seat the needs of workers (Kennon, 2008).

The degree of involvement of the Board of Directors in the decision making process varies a lot, as shown in the Continuum in Figure 1. This continuum ranges from an extreme of no involvement at all, to the other extreme of full control of the top management (Wheelen & Hunger, 2008).

The relationship between the board of director from one side and top management from the other side determines the Style of Corporate Governance. This style depends on the degree of involvement of each side. Figure 2 summarizes the four different styles of Corporate Governance (Addison, 2006).

The first style of Corporate Governance is Chaos Management; it is characterized by the following:

- When both the board of directors and top management have little involvement in the strategic management process.

- The board waits for top management to bring its proposals.
- Top management is operationally oriented and continues to carry out strategies, policies, and programs specified by the founding entrepreneur who died years ago.
- There is no strategic management being done here.

The second style of Corporate Governance is Entrepreneurship Management; it is characterized by the following:

- A corporation with an uninvolved board of directors but a highly involved top management has entrepreneurship management.
- The board is willing to be used as a rubber stamp for top management's decisions.
- The CEO, operating alone or with a team, dominates the corporation and its strategic decisions.

The third style of Corporate Governance is Marionette Management; it is characterized by the following:

- Marionette management occurs when the board of directors is deeply involved in strategic decision making, but top management is primarily concerned with operations.
- Such a style evolves when a board is composed of key stockholders who refuse to delegate strategic decision making to the president.
- This style also occurs when a board fires a CEO but is slow to find a replacement.

The fourth style of Corporate Governance is Partnership Management; it is characterized by the following:

- Partnership management is epitomized\embodied by a highly involved board and top management. The board and top management team work closely to establish the corporate mission, objectives, strategies, and policies.

- Board members are active in committee work and utilize strategic audits to provide feedback to top management on its implementations of agreed-upon strategies and policies.
- Considered by some scholars; the most effective style of strategic management under normal conditions (Daily and Schwenk, 1996).

Styles of Corporate Governance

There is some divergence of opinion regarding the appropriate style of corporate governance. Dr. Rebecca Abraham suggests a simple heuristic saying that if the CEO is Chairman of the Board, entrepreneurship management is the preferential style (Abraham, 2005). She also suggests that if there are more outside than inside directors, partnership management is the preferential style. There are several other factors affecting such a decision as will be described.

The efficacy of a dominant power or balanced power structure may be dependent upon several *attendant conditions.* These conditions include ownership concentration (institutional ownership, five percent equity holders), portfolio exposure (strategic focus and globalization), and resource dependence and information requirements. As will be demonstrated, the board of directors may be most salient with respect to ownership concentration and resource dependence requirements. Top management may be most critical for portfolio exposure and information requirements (Daily and Schwenk, 1996).

Top Management Dominance (Entrepreneurship Management):

The CEO dominance configuration is characterized by the joint CEO/board chairperson structure and an insider dominated board. Such structures would be anticipated to be accompanied by low institutional holdings and a limited number of large block holders. Consistent with agency theory arguments, the potential for management to behave opportunistically, at shareholders' expense, is enhanced with this governance configuration (Eisenhardt, 1989). It is clear that a recent series of institutional holder activism is driven in part by demands for changes opposite those governance structures represented here. Moreover, a suspect would be expected that most five percent owners and corporations holding substantial equity interests would have little long-term confidence in firms configured in this manner.

The CEO dominance structures is expected to have relatively few resource dependence requirements, as this configuration largely substitutes inside officers of the corporation for outside board members. While inside directors, as high ranking officers of the corporation, would be expected to have superior knowledge about firm operations.

While power is clearly concentrated in favor of the CEO for this configuration, there may be situations in which this choice is well advised. Periods of organizational change or transition may require the centralization of authority provided by the CEO dominance configuration. Venture capitalists, for example, have recognized the benefits of a visionary CEO/founder with intense centralization of authority and discretion (Beam & Carey, 1989). A primary consideration in venture capitalists' support of a new venture is the skill and capability of the founder/CEO seeking financial assistance. This profile is not considered to be a permanent state; however, as the entrepreneurship literature also reflects the importance of a transition from the founder/CEO to a more decentralized form (Barnes & Hershon, 1989).

Similar arguments could be marshaled for a firm in crisis. The turnaround literature, as well as that of organizational decline, often notes the necessity of replacing CEOs and empowering their successors with centralized autonomy. A centralized leadership structure may engender confidence among firms' stakeholders that the firm is not "headless" (Daily and Schwenk, 1996). Once again, this arrangement is not advantageous in the longer term. In the shorter term, however, the expediency and control provided by such means may be indispensable.

An example of entrepreneurship management style was Wal-Mart when the CEO was Mr. Glass who was the one running the company and making the decisions of becoming a major food supplier, operating more supercenters and expanding overseas (Abraham, 2005).

A series of propositions may be sensibly offered with regard to the CEO dominance governance configurations:

- Firms, irrespective of their governance structures, with modest portfolios, low globalization, and low information requirements will have a higher incidence of homogeneous top management teams.

- Firms, irrespective of their governance structures, with extensive portfolios, high globalization, and high information requirements have heterogeneous top management teams.

- Firms with congruent top management teams matching their portfolio, globalization, and information requirements have higher performance than their incongruent counterparts.

- Firms in periods of organizational change or transition have a higher incidence of CEO dominance governance structure.

- Firms with low institutional and low outside ownership positions have a higher incidence of CEO dominance governance structure.

- Firms with low resource dependence requirements have a higher incidence of CEO dominance governance structure.

- Firms in a period of organizational change or transition with a CEO dominance governance structure have higher post-change/transition performance than with alternative governance structures.

Board Dominance (Marionette Management):

A second dominant configuration is that of board dominance. Here, the CEO and board chairperson roles are held separately. Also, the board is comprised largely of outside members. This is the structure most favored by institutional holders and large block holders (Salwen & Lublin, 1992). Under this structure, the CEO may have great discretion to manage the affairs of the corporation but has, at all times, the oversight of the board in its service, control, and resource-based roles.

As contrasted with the CEO dominance structure, it is expected to find high levels of institutional ownership and five percent block holders. This governance configuration may be preferred by outside equity holders because it holds greater potential for effective board oversight. As previously noted, institutions and large block holders have demonstrated a propensity to engage in firm monitoring; however, this activity can be costly and time consuming. Therefore, these groups would presumably be attracted to firms with boards who attend to this responsibility (Daily and Schwenk, 1996).

With the board dominance structure, an additional ownership variable may be salient--outside director stockholdings. Institutions and large block holders' confidence in the firm may be bolstered when outside directors hold significant portions of firms' stock. Kesner's (1987) study may illustrate the rationale for increased confidence. She found a positive association between firm financial performance and director stock holdings for firms operating in high growth industries, indicating that ownership interests may enhance directors' monitoring function arid consequently firm performance. It is found that outside directors with substantial equity interests are associated with faster restructuring periods and higher market performance (Daily and Schwenk, 1996). Also, outside directors with substantial stock ownership may be able to limit managerial behaviors not isomorphic with the interests of shareholders. Outside directors with little or no ownership in the firm may be less vigilant.

There is some disagreement regarding the level or quality of monitoring from outside directors when they hold equity in the firms they serve. Much of the basis for the assertion that outside directors are more efficient monitors, as compared to inside directors, is their independence from firm management. In the instance where outside directors hold substantial amounts of firm stock, independence may be limited. Daily and Dalton (1992) have noted this tension:

If, in fact, board members did have an increased financial interest in the firm, it might be reasonably expected that their interests and those of the shareholders--the group they presumably represent--might converge. At the same time, however, the notion of "outside" direction would be lost. In general, one could hardly expect a director with a large equity stake in the firm to be a dispassionate observer. It might also be difficult to anticipate that a director would be independent of the very management which provided this largess.

Additionally, this structure would presumably provide more access to critical external resources and information based on its preponderance of outside board members.

An example of Marionette Management occurred at Winnebago Industries where the company's Board of Directors is chaired by its founder John K. Hanson (Daily and Schwenk, 1996).

A series of propositions may be sensibly offered with regard to the Board dominance governance configurations:

- Firms not experiencing periods of organizational change or transition have a higher incidence of board dominance' governance structure.
- Firms with high institutional and concentrated outside ownership positions have a higher incidence of board dominance governance structure.
- Firms with high resource dependence requirements have a higher incidence of board dominance governance structure.
- Firms with the board dominance governance structure and homogeneous TMTs will have greater numbers of non-affiliated directors among the outside director ranks.
- Firms not experiencing periods of organizational change or transition with a board dominance governance structure have higher performance than with alternative governance structures.

Balanced Governance Configurations (Partnership Management):

For the balanced configurations, low institutional ownership, limited outside ownership and generally low resource dependence are expected. The nature of these attendant conditions may be accounted for by the compromises resulting from the CEO duality/outside directors and the independent board leadership structure/inside directors profiles. It initially appears that these configurations are balanced; e.g., a strong CEO (CEO duality structure) with a strong board (outsider-dominated). Such balance between officers and directors may be interpreted as desirable (Daily and Schwenk, 1996). An effective balance between these groups, however, would be unusual; more likely in this case the preponderance of outside board members are affiliated directors. Accordingly, such boards are far more likely to facilitate the power of CEOs rather than the board. However, this dominance is always somewhat tempered by either the presence of a non-executive chairperson or non-affiliated outside directors.

Consider the case of CEO duality and a board populated with a host of affiliated directors. Typically affiliated directors are either related to firm management or maintain business relationships with the firm; however, outside director independence may also be compromised if directors feel indebted to the CEO for their board membership. This is increasingly likely in the case of a dominant CEO with the power to appoint directors. Even if the board does not have this character, the governance structure is hybrid in form. It does not provide the CEO dominance which may be indicated under some conditions; also, it does not capture the accountability which a board dominated structure provides.

The alternative board configuration represents a hybrid form as well. In this case, we have a separate CEO/board chairperson structure with an insider dominated board. Here CEOs are favored with insider boards comprised largely of corporate officers who work for them on a day-to-day basis. The only distinction between this form and the CEO dominance structure is that someone else is the chairperson of the board. In such cases the chairperson is almost certainly the founder, past-CEO, or both of the firm. Moreover, because CEOs gain power over time it is typical that this chairperson personally selected his or her successor. This may be particularly true in the family-controlled firm (Berenbeim, 1990). Once again, this configuration departs from both the CEO dominance and board dominance models.

Scholars speculate that institutional investors and large block holders would have little interest in such firms based on the inadequacy of the governance structures represented by the balanced configurations (Daily and Schwenk, 1996). These groups apparently anticipate that firm performance will suffer under these configurations. As previously noted, institutions in particular have been active in the board reform movement. Reforms directed at firms' strategic leaders have been largely directed toward separating the positions of CEOs and board chairpersons and toward majority representation by independent outsiders.

An alternative argument may be that institutions and large block holders would maintain high levels of equity holdings and simply choose to actively seek changes in the organization. Evidence has found that firms' market value increases with the purchase of large blocks of firm equity, providing some evidence that investors expect these groups to initiate corrective action in undervalued firms (Daily and Schwenk, 1996). Also, institutions may elect to hold substantially the same amount of equity in firms with balanced governance configurations due to the costs associated with; withdrawing completely from these firms.

Some controversy exists regarding the propensity of institutions and large block holders to align themselves with managers versus shareholders when the interests of these parties diverge.

The more effective solution for institutions and large block holders is to maintain ownership interests in firms where outside directors perform the monitoring function (Daily and Schwenk, 1996). Moreover, institutions and large block holders have been found to exhibit preferences in board composition. Daily and Dalton (1994), for example, reported a negative association between these groups and affiliated directors. It is suggested that large block holders may be willing to bail out of unprofitable firms based on her findings that large block holders were associated with a preference for liquidation, as compared to reorganization.

This style appears to be the style emerging in a number of successful corporations such as General Electric Company (Daily and Schwenk, 1996).

A series of propositions may be sensibly offered with regard to the balanced dominance governance configurations:

- Firms with balanced governance structures have poorer performance than firms with CEO dominance structures in a period of organizational change and/or transition than firms with board dominance structure.

- Firms with balanced governance structures have lower institutional and more limited outside ownership positions as compared to firms with board dominance structure.

- Firms with balanced governance structures have lower resource dependence requirements as compared to firms with board dominance structure.

Conclusion

This paper described the four possible styles of corporate governance. As stated there is some divergence of opinion regarding the appropriate reliance on CEO/board chairperson structures, homogeneous/heterogeneous board and top management composition. It may be that some of the disparity noted in the extant literature is in part related to the conditions under which the subject firms operate (Daily and Schwenk, 1996).

No systematic approach for recommending appropriate configurations has been offered; but only some guidelines favoring each style. A common underlying theme under most of normal conditions, however, is a balance between executive and board powers.

List of Figures

Phantom	Rubber Stamp	Minimal Review	Nominal Participation	Active Participation	Catalyst
Never knows what to do, if anything; no degree of involvement.	Permits officers to make all decisions. It votes as the officers recom-mend on action issues.	Formally reviews selected issues that officers bring to its	Involved to a limited degree in the perform-ance or review of selected key decisions, indicators, or programs of management.	Approves, questions, and makes final de-cisions on mis-sion, strategy, policies, and objectives. Has active board committees. Performs fiscal and manage-ment audits.	Takes the leading role in establishing and modifying the mission, objectives, strategy, and policies. It has a very active strategy committee.

Figure 1. Board of Directors Continuum

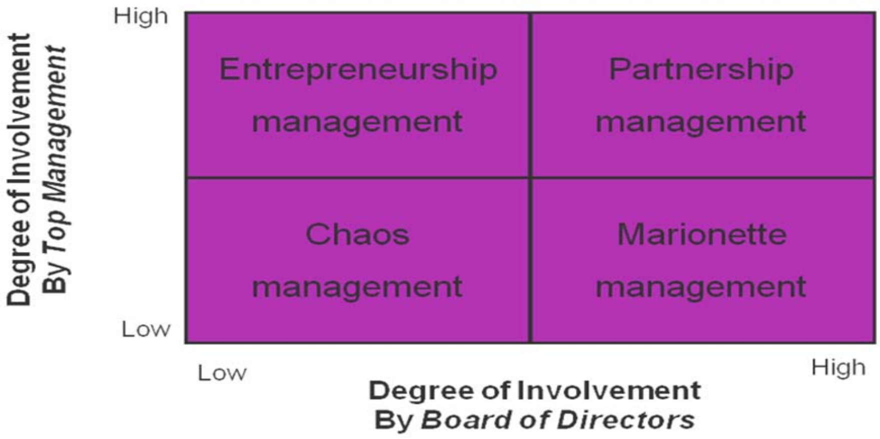

Figure 2. Styles of Corporate Governance

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