

“That is OK, he is a good fellow”: introducing the outcomes dichotomy for corporate networks of interlocking directorates

“Está bien, él es un buen muchacho”: introducción a la dicotomía de los resultados para las redes corporativas de directorios entrelazados

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ABSTRACT

Firms create a formal mechanism of governance to avoid agency problems: the board of directors. At the same time, unintended informal networks emerge from those efforts that build corporate ties among firms through shared directors called interlocking directorates (IDs). These corporate networks act as moderator of behavior, and of many director's decisions within this business structure; thus, leading companies to several and distinct actions. This study presents the natural dichotomy of IDs activity from the perspective of business outcomes. A comprehensive and systematic review of 80 manuscripts related to IDs research was carried out, proposing three complementary elements that distinguish the positive and the negative side of these informal networks: i) financial benefits against financial disadvantages, ii) free competition against information asymmetries, and iii) resources acquisition against individual interests. The results of this study suggest that IDs main outcome for firms is a positive one, concentrated on acquiring resources to boost firms' decision-making processes. Finally, we propose paths for further research.

ARTICLE INFO

Received: 27 March 2019
Accepted: 13 June 2019

Keywords:

Informal networks
Corporate governance
Corporate elites
Board interlocks

RESUMEN

Las empresas evitan los problemas de agencia estableciendo mecanismos formales de gobierno corporativo, el directorio. Sin embargo, al mismo tiempo, redes informales no intencionales emergen de dicho esfuerzo, construyendo lazos corporativos entre empresas diferentes a través de directores compartidos denominados directorios entrelazados (DEs). Estas redes corporativas actúan como moderadores del comportamiento y las decisiones de los directores al interior de las estructuras de negocios, conduciendo a las compañías hacia diversas y diferentes acciones. El presente estudio está enfocado en introducir la dicotomía natural que está presente en la actividad de los DEs, desde una perspectiva de resultados para las empresas. Este artículo considera una extensa revisión sistemática de 80 trabajos relacionados a la investigación de DEs, proponiendo tres elementos complementarios que distinguen el lado bueno del malo de estas redes informales: i) beneficios financieros contra desventajas financieras, ii) libre competencia contra asimetrías de información, y iii) adquisición de recursos contra intereses individuales. Los resultados de este estudio sugieren que el resultado principal de los DEs para las empresas es positivo, concentrado en la adquisición de recursos para impulsar el proceso de toma de decisiones en las organizaciones. Finalmente, el artículo propone caminos para investigación futura.

INFORMACIÓN ARTÍCULO

Recibido: 27 de Marzo 2019
Aceptado: 13 de Junio 2019

Palabras Claves:

Redes informales
Gobierno corporativo
Elites corporativas
Directorios entrelazados

INTRODUCTION

Directors and firms create an Interlocking Directorate (ID) when one of these executives sits on more than one board, establishing an informal connection between two or more firms through a business tie. Allowing the flow of many different resources and managerial practices among them, and building a corporate network with particular characteristics and configuration (Dooley, 1969; Mizruchi, 1996; Haunschild & Beckman, 1998).

Dooley (1969) analyzed that directors interlocks are usually created for several alternatives of managerial control and supervision, and for the existence and pursuit of firms' particular interests. Following Mizruchi (1996), IDs are established in the pursuit of corporate control, it means being capable of influencing and exert control over another firms inside the corporate elite; and network embeddedness, which is understanding the premise that any economic activity results naturally embedded in social networks (Granovetter, 1985). No matter what the main incentive for firms to create these corporate links is, corporate governance literature has demonstrated that IDs were emerging as an informal network mechanism to obtain multiple valuable and strategic resources, sharing a common director between boards of two or more firms and connecting them into a corporate network. In addition, there is no consensus yet in the literature about the positive or negative outcomes for firms by establishing IDs. The spread of poison pills through IDs (Davis & Greve, 1997), as well as the spread of other managerial practices (Westphal, Seidel & Stewart, 2001), or how directors take advantage of their experience from another board to bring new information into a firm that allows it to bargain for a lower price in M&A transactions (Cai & Sevilir, 2012) are examples of what a negative outcome for firms could be, due to the presence of IDs. However, when IDs are used as informal mechanisms to deal with institutional weaknesses (Musacchio & Read, 2007) or to facilitate an auditor decision choice according to previous individual experience of directors in the board (Johansen & Petterson, 2013), a dichotomy for firms' outcome appears.

The focus of this paper is to shed light on how the transmission and imitation capacity of IDs turns into benefits or disadvantages that impact firms decisions or performance by the establishment of interlocks, a perspective that is actually disperse and scarce in the literature. This study aims to explore about

the interlocks' dichotomy related to organizational outcomes, solving (i) how IDs research so far has identified negative and positive outcomes delivered by the corporate network?; (ii) how is IDs literature distribution so far according to its negative or positive outcomes for firms?; and (iii) how different regions are involved with negative or positive outcomes of IDs research literature?

The importance of this study consists in contributing to interlocks literature with an overview about how this dichotomy between positive and negative outcomes for firms underlies the presence of shared directors among companies. There is no evidence yet in the literature of corporate networks that exhibits the results or effects of IDs, related if they are a positive or a negative practice. In addition, the results will contribute also to the still discussed Mizruchi's question about what do really interlocks do? (Mizruchi, 1996), regarding their diffusion capability (Shropshire, 2010), conflict of interests (Szalacha, 2011) among others current topics of debate. Furthermore, this research will add significant and novel contribution to informal networks literature explaining how IDs, as a corporate governance informal network, could play as facilitator or constrainer for management and control between organizations. Managerial implications of these results will be oriented to shareholders, who need to overcome agency problems, considering the possible effects of IDs formation. Results according to dichotomy analysis of interlocks will permit to propose different paths for further research.

The second part of this study is focused on explaining the methodology of the study, regarding data collection and how the categories for IDs positive or negative outcomes were set. The third section describes how IDs research literature fits into the six categories proposed. The fourth part opens the discussion about the neutrality of IDs research, identifying positive and negative trends according to the specific outcomes for each study. Finally, the paper ends answering the three research questions proposed at the beginning of the manuscript and shedding light on further research paths, departing from the results of this study.

METHOD AND DATA

This manuscript consists in an extended literature review of over 80 IDs related papers, identifying their neutrality or positive/negative outcome for firms. To

explain if a study provides evidence for a negative or a positive outcome for firms this paper used a firm's perspective rather than an individual director one, basing the analysis on Social Networks and Interlocking Directorates theories.

This paper sets three main outcomes: (1) Financial, (2) Market behavior, and (3) Resources. In addition, it proposes two opposite outcomes for each of those three, considering the positive or negative effects for firms: (1.1) Financial benefits (BF), (2.1) Free competition (FC) and (3.1) Acquiring resources (AR); and negative outcomes following these criteria: (1.2) Financial Disadvantages (FD), (2.2) Information asymmetries (IA), and (3.2) Individual interests (II).

Financial concept includes: financial growth performance; management reports and managerial practices, remarking differences when those elements turn into an advantage or disadvantage from firms perspective. Market behavior refers to how IDs contribute to ensure a free competition environment among firms or conversely means a constraint, generating information asymmetries in the business environment, undermining fair conditions for doing business. Resources concept is related to how director interlocks represent a means for attracting unique resources from external sources, and in the opposite way, how directors use their position to obtain benefits and resources aiming their individual interests.

The sample includes 80 interlocks related studies: 72 papers and eight book chapters. The study follows the main guidelines about systematic review (Tranfield, Denyer & Smart, 2003; Kohtamäki, Rabetino & Möller, 2018), including the selection of three types of journals on Scopus database: (i) Business, Management and Accounting, (ii) Social Sciences, and (iii) Economics, Econometrics and Finance. In addition, the search considered five different terms: "interlocking director*" or "interlock* director*" or "board interlock*" or "director* network*" or "board network*", obtaining 398 results on Scopus database, without considering 2019's released papers. This initial number of papers was reduced because some of them were not related to companies' boards (e.g. editorial boards) and other results exhibited alternatives for board networks that were outside the focus of the study. These papers were removed from the sample. Moreover, the study selected papers with different periods of publication, between the 1960's and the 2010's, in order to obtain a heterogeneous sample.

An additional criterion for search's method was considering concluded papers and books' chapters, and the inclusion only of two languages, English and Spanish. The distribution of the papers shows that 84% of the publications included in this review were Web of Science (WoS) indexed and ranked as Q1-Q2 studies (Scimago Journal ranking, 2017). Finally, the study considers 34 different periods of papers' release (from 1969 to 2018) and 42 different top-tier journals in order to obtain and heterogeneous and relevant dataset of previous studies.

THE NATURAL DICHOTOMY OF INTERLOCKING DIRECTORATES

Financial benefits against financial disadvantages of IDs

IDs corporate network is capable of enhancing firms' financial performance, in the following situations: (i) when the business context has high levels of uncertainty (Martin, Gözübüyük & Becerra, 2015), (ii) when non-financial firms are connected through their board with financial ones (Richardson, 1987), (iii) when shareholders' voting rights are low, facilitating faster decisions among fewer decision-makers (Silva, Majluf & Paredes, 2006), and (iv) when resource-constrained firms have their board interlocked with a resource-rich firm (Zona, Gomez-Mejia & Withers, 2018).

Financial appointments on firms' boards follow strategic interests of having a financial representative to obtain advice and valuable information, to get access to capital, to obtain benefits for solving or long-term debt (Mizruchi & Brewster Stearns, 1988; Mizruchi & Brewster Stearns, 1994), and advantages and opportunities to develop strategic alliances such as joint ventures (Gulati & Westphal, 1999).

On the other hand, having an interlocked board produces a contagion effect among firms and network could be a conduit for spreading not just good practices or resources, but bad ones as well. An earning management practice could spread from one firm to another, in a three-year period of connectivity through IDs (Chiu, Teoh & Tian, 2013), negative practices related to financial reporting transmit through the corporate network (Godigbe, Chui & Liu, 2018), and financial fraud spreads with the contagion effect through IDs as well, damaging firms' and directors' reputation (Fich & Shivdasani, 2007).

IDs could be a constraint for managerial activities such as resources acquiring (Zona et al., 2018) when one of the board interlocked firm is a resource-constrained one, and or strategic alliances, for instance joint ventures formation, due to a strong controlling CEO-board relationship (Gulati & Westphal, 1999), avoiding the developing of trust-based relations inside the corporate network.

Finally, IDs represent a reliable source of financial resources to the organization, and capital access and financial benefits are strategically important for entrepreneurs as well as for established companies. However, IDs are also reliable conduits for negative practices that could undermine the supervisory role of the board of directors and endanger the shareholder wealth.

Promoting free competition in the market or keeping information asymmetries?

Second degree connected boards; it means that two firms have a director who sits on a third board, tend to find a balance between opportunities for bargaining and negotiating in M&A transactions (Cai & Sevilir, 2012), enhancing free competition in the market through IDs activity. However, there is no evidence from literature that firms create IDs to collude each other (Buch-Hansen, 2014). Moreover, Simmons (2011) found few cases of intra industry interlocked firms, which could make possible to think in a collusion scenario. Antitrust regulation in the United States set under control the multiple formation of IDs between competing firms (Windolf, 2009), decreasing the density of the corporate network, which has not happened in other regions or countries that had not enforced antitrust laws.

On the other hand, formation of IDs could be driven in order to deal with the uncertainty in the business environment, but firms do not tend to abandon or disconnect their IDs, even if the turbulent context turns stable and government addressed institutional voids (Bucheli, Salvaj & Kim, 2018), generating information asymmetries in the market which impede a free competitive one.

Some of the effects of information asymmetry generated by IDs is the unbalanced situation in takeovers, private equity deals or M&A transactions, where some directors have first-hand information and they use it to obtain a lower price, damaging shareholder value (Stuart, & Yim, 2010; Szalacha, 2011; Cai & Sevilir, 2012). In addition, IDs act

as reliable conduits for the diffusion of practices through the corporate network, such as quarterly early guidance cessation (Cai, Dhaliwal, Kim & Pan, 2014), that damages the reputation of the firm and undermines the stakeholders visibility.

In summary, we found little evidence of risk for collusion activity through IDs in the literature reviewed. Companies create IDs in order to deal properly with the adversity of the business environment. Nevertheless, the flow of novel information in the corporate network leads firms to take decisions that could be against free competition in the market. Taking advantage of their superior level of knowledge, they prefer to maintain the asymmetry of information and use it to their own individual purposes.

Acquiring resources for firm or going after individual interests?

According to current IDs research literature, corporate networks may operate in order to obtain new and valuable strategic resources for the firm, or follow individual interests of the directors giving cohesion to business elite (Phan, Lee & Lau, 2003). Some of the strategies for acquiring resources through board interlocks are: (i) dealing with institutional weakness in the environment (Musacchio & Read, 2007), (ii) establishing appointments with financial firms and in strategic industries (Burt, 1980; Pombo & Gutiérrez, 2011), (iii) getting decisions support and provision of new strategies (Ortiz-de-Mandojana, Aragón-Correa, Delgado-Ceballos & Ferrón-Vilchez, 2012), (iv) better specialists recruitment process (Johansen & Pettersson, 2013), (v) reputation and status reinforcement (Bennett, 2013), and important resources such as information and good managerial practices (Mazzola, Perrone & Kamuriwo, 2016; Ginesti, Sannino & Drago, 2017).

On the other hand, IDs are utilized to maintain power and control, exert influence over another firm or enhance individual professional interests of the directors. Some of the negative effects of IDs are: (i) CEO-board connections to decide the selection and retention of particular directors (Zajac & Westphal, 1996; Fracassi & Tate, 2012), (ii) personal and professional individual interests (Zajac, 1988; Carroll, Graham, Lang, Yunker & McCartney, 2018), and (iii) adoption of negative managerial practices such as poison pills or golden parachutes (Davis, 1991; Davis & Greve, 1997).

Finally, IDs could serve as conduits through resources

flow into the organization, but at the same time, they could be levers aiming to boost individual plans and careers of the directors, or even for firms' individual interests.

An overload neutrality for a controversial managerial practice

Results of this review show that there is a 59% of the IDs studies pointing out non-positive, neither

negative, but neutral practices/findings regarding IDs activity (See Table 1). Findings of these studies are different, such as: (i) Firms' business decisions and IDs composition and diffusion capacity; (ii) broken and reconstitution of these corporate ties; (iii) Explore the reasons of IDs creation; (iv) Uncertain management of firms, and (v) Describe the characteristics and evolution of the corporate networks of IDs.

Table 1. Neutral studies reviewed from the perspective of positive/negative outcomes
Source: own elaboration

Findings	Study
Firms' business decisions and, IDs composition and diffusion capacity	<input type="checkbox"/> Useem (1980)
	<input type="checkbox"/> Haunschild & Beckman (1998)
	<input type="checkbox"/> Mizruchi & Koenig (1991)
	<input type="checkbox"/> Moore, Sobieraj, Allen Whitt, Moyo-rova & Beaulieu (2002)
	<input type="checkbox"/> Burris (2005)
	<input type="checkbox"/> Mizruchi, Brewster Stearns & Marquis (2006)
	<input type="checkbox"/> Canyon & Muldoon (2006)
	<input type="checkbox"/> Khanna & Thomas (2009)
	<input type="checkbox"/> Shipilov, Greve & Rowley (2010)
	<input type="checkbox"/> Shropshire (2010)
	<input type="checkbox"/> Geletkanycz, Boyd & Finkelstein (2011)
	<input type="checkbox"/> Larcker, So & Wang (2013)
	<input type="checkbox"/> Fracassi (2017)
<input type="checkbox"/> Fuad & Sinha (2017)	
Broken and reconstitution of these ties	<input type="checkbox"/> Palmer (1983)
	<input type="checkbox"/> Palmer, Friedland & Singh (1986)
Explore the reasons of IDs creation	<input type="checkbox"/> Dooley (1969)
	<input type="checkbox"/> Mizruchi (1996)
	<input type="checkbox"/> David & Westerhuis (2014)
Uncertainty management of firms	<input type="checkbox"/> Pfeffer (1972)
	<input type="checkbox"/> Boyd (1990)
	<input type="checkbox"/> Beckman, Haunschild & Phillips (2004)
Describe the characteristics and evolution of the corporate networks of IDs	<input type="checkbox"/> Mizruchi & Bunting (1981)
	<input type="checkbox"/> Mariolis & Jones (1982)
	<input type="checkbox"/> Windolf & Beyer (1996)
	<input type="checkbox"/> Davis & Mizruchi (1999)
	<input type="checkbox"/> Kogut & Walker (2001)
	<input type="checkbox"/> Carroll (2002)
	<input type="checkbox"/> Davis, Yo & Baker (2003)
	<input type="checkbox"/> Salvaj and Ferraro (2005)
	<input type="checkbox"/> Khanna & Rivkin (2006)
	<input type="checkbox"/> Salvaj, Ferraro & Tapiés (2008)
	<input type="checkbox"/> Salvaj (2013)
	<input type="checkbox"/> Ginalski, David & Mach (2014)
	<input type="checkbox"/> Lluch, Salvaj & Barbero (2014)
	<input type="checkbox"/> Salvaj & Lluch (2014)
	<input type="checkbox"/> Schnyder & Wilson (2014)
	<input type="checkbox"/> Westerhuis (2014)
	<input type="checkbox"/> Cárdenas (2015) / (2016)
	<input type="checkbox"/> Takes & Heemskerck (2016)
	<input type="checkbox"/> Salvaj & Couyoumdjian (2015)
	<input type="checkbox"/> Lluch, Rinaldi, Salvaj & Vasta (2017)
<input type="checkbox"/> Naudet & Dubost (2017)	
<input type="checkbox"/> Wilson, Buchnea & Tilba (2017)	
<input type="checkbox"/> Buchnea, Tilba & Wilson (2018)	
<input type="checkbox"/> Buck (2018)	

There is a large amount of papers related to neutral findings, in accordance with the positive/negative perspective for this study, explained before in method and data. This neutrality is related to IDs research, but not to IDs effects on firms, so further research is needed in order to reveal the dichotomy of board interlocks to finally be capable of identifying a more positive or negative impact of IDs on firms.

RESULTS AND DISCUSSION

Dichotomy of IDs related to firms' outcomes put some decisions in the positive side of these informal networks, in terms of promoting free competition, looking for new valuable resources or bringing directly different financial benefits for firms. On the other hand, other decisions belong to the negative side of IDs, regarding following individual interests besides organization's needs, looking to maintain asymmetries

of information in order to take advantage of that differences with other companies, and generating several financial disadvantages that the firm have to deal with.

According to the results of this study, 59% of the sample of papers is related to neutral outcomes for firms (See Table 2). This finding is also important, because it means that most of IDs research is oriented not to managers, but to scholars, trying still to understand how IDs operate in different contexts and learning about corporate network structure and their main characteristics. Moreover, Table 2 also exhibits that 19% of the sample IS oriented to positive practices and 16% is oriented to negative ones. Positive practices are more than negative ones, but not for too much. This result demonstrates that IDs are mostly capable of delivering positive outcomes for firms, rather than negative ones.

Table 2. Sample according to the type of practice which papers are related to. Source: own elaboration.

Type of practice	Studies	%
Positive	15	19%
Negative	13	16%
Both	5	6%
Neutral	47	59%
Total	80	100%

Considering positive outcomes, Table 3 shows that 45% of the papers related to this type of outcome are focused on acquiring resources (AR) for firms. Second is the financial benefits (FB) with 35% and finally the free competition (FC) in the market with 20%. Since Dooley (1969) and Mizruchi (1996), IDs are suppliers of important resources that could improve firms'

decision-making process. So, this result supports that IDs are valuable informal mechanisms for firms to obtain resources such as information, capital access, reputation, and others. According to this result, acquiring resources through IDs could be even easier than financial benefits for firms.

Table 3. Sample according to positive/negative outcome for firms. Source: own elaboration

Positive outcomes	20	100%
FB	7	35%
FC	4	20%
AR	9	45%
Negative outcomes	18	100%
FD	5	28%
IA	5	28%
II	8	44%

Table 3 also shows that the negative outcome that most frequently appears on IDs research is going after individual interests rather than firms' real needs. Individual interests (II) have 44% of the sample, where financial disadvantages and information asymmetries are tied with 28%. According to these results, directors tend to use the corporate network for their own benefit, trying to boost their careers and their professional perspectives in the market. Perhaps there is no contradiction among the major IDs positive outcome, acquiring resources, and the major IDs negative outcome, individual interests, regarding that directors' efforts focused on leveling up their professional background in the market, could

be delivering important resources for firms at the same time. Not just precisely resources that firms may need, but new ones that could drive them to take decisions and develop their business projects.

Finally, Figure 1 shows how IDs outcomes for firms were studied per region. The study found that North American region shows the higher number of IDs research oriented to positive outcomes, contrary to Latin America region where negative outcomes are higher than positive ones. Europe shyly appears just with negative outcomes studies and no one positive. Asia region needs further research on IDs, because it presents just one neutral paper.

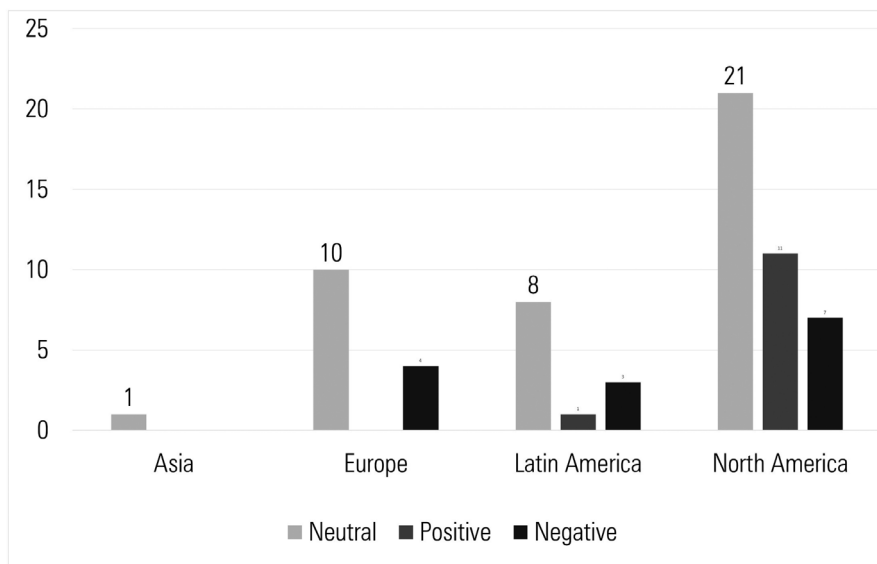


Figure 1. Sample according to the type of outcome for firms per region. Source: own elaboration.

IDs outcomes for firms, considering the whole sample under study, tend to be positive, having a strong relevance on acquiring resources. However, negative outcome-oriented studies are not too far from positive ones and their major numbers are related to the pursuit of individual interests, regardless firm's needs or its strategy. Regarding regional differences, North America is the most studied, but its main number of papers is focused on neutral outcomes. Nevertheless, North America also shows a high number for positive outcomes (11) and for negative outcomes studies (7), being the region with the most studies oriented to IDs research.

CONCLUSIONS AND FURTHER RESEARCH

The study does not find in literature a specific explanation about how director interlocks could influence positively or negatively firms' outcomes. Considering this, the present study adds an important contribution for this literature, and introduces the dichotomy related to IDs outcomes for firms and proposes three complementary elements to overview the positive/negative effects on organizations: (1) Financial outcomes, (2) Market behavior outcomes, and (3) Resources outcomes.

Results of the study suggest that there are more positive outcomes for firms than negative ones, but with a minor difference between them. From a managerial perspective, this finding could stimulate on firms the formation of director interlocks and the reinforcement of current strategic ones, but shareholders have to deal with the asymmetry of information that IDs could generate as well, due to possible situations where being a "good fellow" means take part of a business elite that goes after its own purposes. These results partially respond Mizruchi's question (1996) about what IDs really do, from the stand of the dichotomy of outcomes proposed. Regarding Table 2, acquiring resources is the most important positive outcomes, and individual interests are the same for negative ones. Due to this finding, firms could be tempted to promote a managerial strategy based on increasing their director interlocks with other firms. However, firms also need to be aware about which resources they lack of and the possible control risks related to agency problems. It will be necessary further research on this possible contradiction between acquiring resources and following individual interests, in order to find empirical evidence about directors' behavior and how they could be delivering unintended resources. That means directors may pretend to accept an appointment in another board on behalf companies' interests and, while they are going after their personal interests, the corporate relationship could delivers benefits for the interlocked firms anyway.

There are regions such Asia that need more attention from interlocks research. North America shows the higher number of studies focused on neutral, positive and negative outcomes, followed by Europe and Latin America. An interesting finding regarding Figure 1 is that Latin America and Europe exhibit more negative outcomes oriented studies than positive ones, contrary to North America region. A possible explanation for this is the presence and enforcement of antitrust laws, which prevent collusion and other bad practices using corporate networks. However, it is relevant also to highlight that Latin America has a completely different business environment than Europe, so further research on this could help to have a complete overview about this phenomenon.

Additional research is also needed in order to enlarge the sample of this study and support the tendency of results. IDs are reliable conduits that facilitate the transmission and diffusion of resources and practices, but their power relies beyond a thin line of action that

barely distinguishes between positive and negative sides of these informal networks.

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