Freek Vermeulen reveals to Alan Hosking what goes on behind closed doors at board meetings.

Why are boards considered elitist? Professor James Westphal – currently at the University of Michigan – conducted an elaborate study in which he collected data on 417 firms, interviewed scores of top managers and directors, obtained surveys from no less than 1,098 managers and directors, and 197 CEOs at multiple points in time, and came up with an intriguing answer.

He found that the top managers and board members of the US’s biggest companies together form an “elite”, which acts very much like “the clique of popular kids in high-school”. Let me explain.

Specifically, Jim tracked directors’ voting behaviour when any of the following four measures were being proposed in the company (each which limit top managers’ power):

1. CEOs can not concurrently also hold the seat of chairman of the board (so that the board can operate independently);
2. The company should have a nominating committee to appoint new board members, rather than the members of the boards of other companies. If a particular board member, at some point in time, had voted for one of the above measures, which remove privileges from top managers (that is, members of the elite) and gives it to investors (who are not considered part of the elite), that fellow directors at other boards would subsequently start to give them the cold shoulder. The board member would become unpopular with the rest of the in-crowd, and get treated as “a traitor”.
3. The director at some point, had voted to dismiss the (underperforming) company’s CEO (a measure clearly not in the interest of the CEO); and
4. The company should revoke a so-called poison pill construction – a mechanism that makes it difficult for a firm to be acquired against top management’s will (so that even when top management is doing a poor job, and the company is underperforming, they still can’t be ousted by new owners).

Jim examined what had happened to the directors that had voted in favour of adopting one or more of these (“controversial”) measures.

First, what you have to realise, is that people who hold board memberships more often than not also are members of the boards of other companies. If a particular board member, at some point in time, had voted for one of the above measures, which remove privileges from top managers (that is, members of the elite) and gives it to investors (who are not considered part of the elite), that fellow directors at other boards would subsequently start to give them the cold shoulder. The board member would become unpopular with the rest of the in-crowd, and get treated as “a traitor”.

One director, who had once voted in favour of one of the measures, related to Jim his own experience: “After we fired the CEO I got the cold shoulder from colleagues at another board…. I didn’t get invited to an important meeting”.

Isn’t this a bit juvenile? It certainly does remind one of one’s high school days… Water in your locker, a “Kick me” sign on your back, unpopularity with the rest of the in-crowd, and get treated as “a traitor”.

How did this manifest? The questionnaires and interviews (conducted with both the “unpopular board members” themselves as well as with their former “friends”) clearly indicated that the other boards’ members would start to engage in subtle behaviour intended to punish the deviant person, such as neglecting to invite him to an informal meeting, not asking his opinion or advice in formal meetings, not acknowledging or building on his comments in discussion, engaging in exclusionary gossip whereby they would talk about other people and events with which the director was not familiar, and so on. Basically the good old pretend-you’re-not-there kind of stuff.

Board members said that the deviant persons “can expect to be ostracised”, and that “people are less interested in working with them”. One director said, “The directors (who had voted for one of the four changes) get treated differently – I think they get put on notice a bit”, while another commented, “It will hurt you. You won’t get thrown off the board, but you definitely won’t get treated the same. In a way you get treated like the enemy – or at least as suspect”.

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Does the current board agree with this? No, usually not; they think the new board member should be much more like them. This sort of sums up the research that professors James Westphal and Ed Zajac (at the time both at Northwestern University) did in the mid-1990s on CEO successors and the background characteristics of newly appointed board members. Surprising it is not – we all like who people are like us, and think that they are so much more competent than the next guy – but I still find it quite striking (if not shocking) how Jim and Ed could so easily uncover evidence of these tendencies using a few simple statistics.

They measured some straightforward background characteristics of all of these guys (sorry…yes, usually guys), such as their age, their functional background, education and so forth, in 413 Fortune 500 companies. Using these measures, they computed how dissimilar newly appointed CEOs and board members were from the prior CEO and from existing board members.

If the incumbent CEO was in a powerful position (because he was both CEO and chairman of the board, had long tenure, the firm had been performing relatively well, and because there were few outside directors on the board, who owned little stock), incoming CEOs and board members would be much more like the previous CEO – obviously this guy used his powerful position to make sure someone was selected who could be mistaken for his clone. Yet, the reverse was true too; if the board members had more power, they would select someone quite unlike the CEO and much more similar to themselves.

Is this a good thing? Not at all. The tricky thing is, of course, when the CEO succeeds in selecting more and more board members who are just like him. Then the process escalates because board members and CEO start liking the same people! Eventually, everyone in The Firm starts to look alike, talk alike, has the same background, education, taste in cars, dress, entertainment, and so on and so on. Sounds familiar? Know any companies like that? Perhaps you’re employed by a firm just like that (and good chance that you fit in nicely…), or perhaps it reminds you of this phenomenon called “the success trap”, or perhaps – and even worse – both!

Interestingly, Jim and Ed also analysed what happened to the compensation packages that firms offered to their CEO, if the CEO succeeded in selecting more and more people like them. Guess what, the percentage of his pay that was...
First of all, he found that the boardroom friends hardly ever engaged in less “monitoring” of the CEO (that is, checking strategic decisions, formal performance evaluation and so on) – the traditional stuff that directors are supposed to do. They were still quite active in that sense, despite being the CEOs personal friend.

In addition, Jim found that boardroom friends engaged a lot in another type of behaviour towards the CEO: ongoing advice...

“Psychologically, it is just a bit more secure to listen to criticism from someone you know and trust than from a formal stranger.”

and counselling. They gave their CEO informal feedback about the formulation of the firm’s strategy; they acted as a ‘sounding board’, continuously providing general feedback and suggestions, etcetera. All this happened outside the company’s formal board meetings. Directors who were not personal friends hardly engaged in this type of behaviour.

Usually CEOs don’t easily do this; accept or even ask for ongoing counselling and opinion. It is well-known from research that a primary inhibitor to seeking advice is the perceived effect it could have on the advice seeker’s status. People often believe that others will view their uncertainty or dependency and as an indication that they are less than fully self-assured – have these tendencies expected to be confident, proud and self-reliant. Little doubt that CEOs – who are expected to be confident, proud and self-assured – have these tendencies too! Fierce, testosterone-driven CEOs are pretty much personal friends of the CEO will just protect him and never really be critical, asking the nasty and awkward questions they should be asking.

Yet, is this necessarily so? Do “friends” make for bad directors? Professor James Westphal, of the University of Michigan (yes, him again), became sceptical of the sceptics. He investigated whether social relations between board members and CEOs really are as important as assumed. He extensively surveyed 243 CEOs and 564 of their board members.

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