

# CEO RESISTANCE: THE ROLE OF BOD DEPENDENCE/INDEPENDENCE AND CEO PROFILE

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## Abstract

The relationship between boards of directors and CEOs has been at the center of attention in the literature on Corporate Governance. However, little has been done to identify sources of friction and possible outcomes in this relationship. In this paper, drawing on the literature on Agency/Stewardship Theory, Upper Echelons perspective, and Corporate Governance, I have addressed this gap. To do so, this paper recognizes the distinction between founder and non-founder CEOs and dependent and independent boards of directors. I have hypothesized that founder CEOs will demonstrate higher resistance than non-founder CEOs in the presence of independent boards of directors and lower than non-founder CEOs in the presence of dependent boards of directors to takeover proposals.

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## 1 Introduction

The topic of mergers and acquisitions has drawn a lot of attention from strategy scholars in the past two decades. This increasing attention has mainly stemmed from revival of such actions taken by firms during the 90s (Sundarmurthy, 2000). The existing literature has proposed M&A activities to be undertaken to increase market share (Capron, 1999), gain access or control over resources that are strategically important (Pfeffer, 1991), or increase dependence of other firms on the focal firm (Pfeffer and Salancik, 1978). Most of the literature on the topic of M&A has identified numerous advantages associated particularly with acquisition strategies. Some of such advantages have included the possibility of rapid market entry into new product markets (McCardle and Viswanathan, 1994), and decreasing influence of competitors or suppliers through resource acquisition (Pfeffer, 1991). However, what seems interesting is that much of the existing literature has focused on the acquiring firms, and not the ones being acquired.

The decision on how to respond to a takeover offer is considered to be a key strategic turning point for a firm. Some of the past research has focused on firm's subsequent and post-acquisition performance to understand if firms should consider going through such a process (Sundaramurthy, 2000). There has also been some interest among scholars to understand if anti-takeover provisions have affected firm subsequent performance (Kabir, Cantrijn, and Jeunink, 1997). While much of the research on anti-takeover positions has taken the firm as its level of analysis, some researchers have also studied the individual level, mostly through Agency Theory (Walking and Long, 1984). Such literature has been mainly based on Agency Theory's underlying assumptions of

managers' self-interest pursuance and separation of ownership and control. Therefore, not much attention has been placed on situations where there is less separation between ownership and control, primarily in situations where the CEO is also the founder of the company.

Recent offers by Microsoft to acquire Yahoo (2005, 2006, and 2007) and reaction of the latter resulted in much heated debate among different stakeholders in the issue. Officially rejecting the offer on February 2008, Yahoo's board of directors referred to the offer as "substantially undervaluing", contending the offer to be neglecting the value of Yahoo's audience and its potential growth prospects. Subsequently internal disagreements erupted between Yahoo's CEO and several of its board members on whether or not the offer represented Yahoo's worth. However, the resistance to the takeover offer, its antecedents and the causal relationships that contributed to such decision being made have not fully been studied.

In this paper I will extend the existing literature, accounting for the role of founder CEOs to answer the question "do founder/non-founder CEOs differ in their attitude towards takeover proposals?" To do so, I will draw on the literature on Agency/Stewardship theory and the Upper Echelons perspective and Corporate Governance to explore the relationship between a CEO's profile and his/her attitude and level of resistance towards takeover proposals. I will also use the Corporate Governance literature to account for Board Vigilance and Board Composition to demonstrate the cases of disagreement between the CEO and shareholders under takeover situations.

## 2 Theory and hypotheses

Agency theory focuses on the divergence of interest between the principals and the agent, contending that the agent will be pursuing his/her own self-interest at the expense of the principals' (Eisenhardt, 1989). A main assumption of Agency theory is risk-averseness that defines the orientation of decisions made by agents (Wiseman and Gomez-Mejia, 1998). However, classical Agency Theory which has roots in separation of ownership from control has often been criticized as not being generalizable to all managers (Davis, Schoorman, and Donaldson, 1997). While Agency theory proposes internal and external controls to align actions of the CEO with the interest of principals, a new stream of literature – Stewardship Theory- has emerged that suggests some managers to be intrinsically aligned with the firm, viewing firm's success as their own (Davis, Schoorman, and Donaldson, 1997). Stewardship theory has also been found to have more explanatory power in situations where the managers is also the founder, and has partial ownership of the firm (Wasserman, 2006).

Wasserman (2006) has found that managers do not necessarily function as either a steward or an agent, but that the pattern of change in behaviour is more like a continuum. In his research he found that CEO's behaviour as an agent, or steward, is strongly related to their share of equity and their profile as a founder or non-founder of the company. These findings also support the previous research by Jensen and Meckling (1976) who had found equity ownership to be positively related to agent's behaviour.

The losses that principals incur from agent's actions are often considered to be as a result of information asymmetry (Eisenhardt, 1989). Agents can hide or hesitate to disclose information that could provide principals of better judgment of his/her actions. In order to minimize losses that result from divergence of interest between the principals and the agent, principals put in place monitoring mechanisms such as board of directors or information systems that can assist them in forcing the manager to stay aligned with their goals (Eisenhardt, 1989). However, the effectiveness of board of directors as a control mechanism largely depends on its vigilance, experience, and independence (Kroll, Walters, and Wright, 2008).

The issue of board independence has also attracted considerable attention in past years (e.g., Rhoades, Rechner, Sunaramurthy, 2000; Sundaramurthy and Lewis, 2003). While independent boards are often considered to be less influenced by CEO's informal power, they suffer from the limitations in accessing information required to monitor actions of the CEO. A main advantage of independent board members is their ability to represent the principals' wishes, as a result of being less influenced by the CEO. However, researchers have found that because of limitations in having

access to firm's inside information, independent directors to be more reliant on financial controls, and less on strategic ones. Vigilance and past relevant experience have also been found to be contributing factors to independent board of directors' effectiveness. Some researchers have suggested that a combination of dependent and independent directors to be more effective, and therefore suitable.

Board of directors are concerned with monitoring CEO's actions to ensure their alignment with principals' interests. Principals' interests are usually best served when firm is at its optimal performance. Upper Echelon's perspective literature contends firm performance to be a result of managerial actions and decisions (Hambrick and Mason, 1984). Desirable performance of a manager has been considered to be a reflection of the manager's adaptive capacity, absorptive capacity, and managerial wisdom (Boal and Hooijberg, 2001), and their cognitive maps (Hambrick and Mason, 1984). The decision to respond to an upcoming situation, such as a takeover proposal, also rests on the manager's cognition, and intentions. Under such conditions, a manager might choose to pursue the interests of principals, the firm, or him/herself. The manager might perceive a divergence between interests of the principals and interests of the firm, if he is intrinsically motivated to ensure firm's long-term survival. However, an independent board of directors are put in place to also control for CEO's choice in such situations.

If the board of directors that has been put in place is not independent, CEO is able to exert more influence on them. Although such boards of directors have the benefit of having access to firm's inside information, they will be hesitant to use it as leverage against the CEO and risk their position in the firm. As a result, such boards of directors are weak representations of principals' interests and their vigilance and information is not very likely to constrain CEO's actions. If a CEO is a non-founder, he is less likely to be a large shareholder of the company (Wasserman, 2006). Therefore, a takeover will not be aligned with his/her interests and will more be perceived as a threat to his/her position. When the board of directors in non-independent, the CEO will have more leverage to resist a takeover proposal, knowing that he/she will not be pressured by members of the board. Such CEOs will not face much disagreement from the principals until a new and more independent board is appointed.

However, this situation is different for founder CEOs. Founder CEOs have characteristics that make them be more as stewards than agents (Wasserman, 2006). Also, Wasserman (2006) has shown that founder CEOs are likely to have more ownership in the firm. A founder CEO will not resist a takeover proposal only because it would limit his authority. Best interest of the firm is the intrinsic motive for the founder CEO which is usually a positive response to what he/she perceives to be the highest possible bid

for takeover that the firm receives. When the board of directors are non-independent, the founder CEO, similar to non-founder CEO, will receive minimal friction from the board members. In the case of the founder-CEO, the friction is even less, since he/she not only usually has partial ownership, but also holds high informal power as the longest tenured member in the company. Therefore, grounds for disagreement are not strong and the founder CEO is also receptive of proper proposals. Hence, the following hypothesis is made:

*Hypothesis 1: in the presence of non-independent boards of directors, founder CEOs is more likely to show lower resistance to takeover proposals than non-founder CEOs.*

On the other hand, independent boards of directors can be a strong instrument in orienting CEO's decision making. As mentioned previously, boards of directors are usually put in place to ensure that CEO's actions are aligned with interests of the principals. A non-founder CEO can be controlled either through internal or external controls (Eisenhardt, 1989). Since presence of independent board members is associated with the risk of higher information asymmetry, such boards of directors will become more interested in reacting to observable events. Also, independent directors can be selected from people who have backgrounds similar to that of the firm. An independent board of directors will provide the non-founder CEO with less latitude to resist the will of principals and therefore will submit easier to their demands. Therefore, a non-founder CEO will show little resistance to the firm, since he is does not perceive him/herself to be able to alter the decision of the principals.

A founding CEO is more interested in firm's best interest on the other hand. While he/she would be willing to accept the best possible offer, he/she will resist offers lower than his/her expectations. This is while principals don't necessarily share the long-term vision of the founding CEO. Due to less visionary ambitions for the firm, they will be more likely to settle for a bid that does not meet the founder CEO's expectations. Trying to exert their will through the independent board members is more difficult in this case, since the founder CEO is also usually a significant owner (Wasserman, 2006), with power both as a principal, and an agent. This means that, unlike the situation of a non-founding CEO, in the presence of an independent board of directors, there is more friction to be expected between the founder CEO and the directors. Hence, the following hypothesis is made:

*Hypothesis 2: in the presence of an independent board of directors, founder CEOs is more likely to show higher resistance to takeover proposals than non-founder CEOs.*

While being a founder CEO influences the decisions made when it comes to a take-over proposal, the commitment of the founder CEO is also influenced by the degree of ownership that is still invested in the company. Research has shown that the level of ownership still held by a founder CEO influence the level of performance of the company (Bhagat and Black, 2004). Founder CEOs with greater ownership are more likely to resist take-over proposals than CEOs who have gradually given up ownership of their companies to other investing shareholders. Therefore:

*Hypothesis 3a: The relationship in Hypothesis 1 is attenuated when there is less ownership held by the founder CEO.*

And,

*Hypothesis 3b: The relationship in Hypothesis 2 is attenuated when there is less ownership held by the founder CEO.*

### 3 Data and methodology

The data for this research was acquired from publicly available sources and through Compustat. The initial data was collected from companies included in the Industrials, Information Technology, and Telecommunications services from the Global Industry Classification Standard (GICS) classification. The years selected for data collection were limited to a 7-year period and from 1994 to 2000. The data collection was intentionally restricted to years prior to 2001 to avoid influences of the effects from the internet bubble-burst which could possibly taint the understanding of the motives for acceptance or rejection of acquisition proposals. Only companies listed in the United States were kept in the dataset in order to avoid influences from contextual conditions.

The data collected from Compustat was complemented by a secondary dataset that consists of publicly traded Fortune 500 companies available on ExecuComp (2000). The names and the sample of CEOs were obtained from the data, which also includes financial information for the companies and the status of CEO ownership and tenure. The final sample consisted of 3767 complete firm-years comprising of 485 companies during the 1994-2000 period. In the sample dataset, companies with Founder-CEOs-a total 116 included in the data- were coded as '1' and those with non-Founder-CEOs were coded as '0'.

To acquire data regarding board dependence/independence and composition, data on share ownership was obtained from proxy statements (Bhagat and Black, 2004). The data obtained included the percentage of ownership by the CEO, the percentages of ownership by all directors, and the percentage of ownership by all outside directors. The ratio of independent to dependent members of board of directors was used to capture this variable.

To capture the resistance of a Founder-CEO to acquisition proposals, I conducted a thorough content analysis of textual data in form of newswires and news articles published and available on the Factiva database. The search was conducted for the companies included in the database and was kept restricted to archives of Reuters News. Only news articles were used that included the name of the company in the sample. I specifically focused on any press release or report that contained information about a proposal for take-over, whether it was through mutual agreement or a hostile bid. The data collection was limited for the 1988 Every event was recorded, with those that were refused-whether they were successful or not-coded as '1', and the ones that were accepted, coded as '0'. Altogether, 6631 documents were collected and evaluated, which led to recording of 942 events.

#### 4 Results

Logistics regressions were performed to analyze the data for this research. The dependent variable included in the study –acceptance/rejection of take-over- is operationalized as a dichotomous variable which logistic regressions a suitable choice in this study. Furthermore, the presence of two continuous moderating effects-board composition and CEO

ownership- provide more justification for the use of logistic regressions.

Table 1 includes descriptive statistics and the zero-order correlations. The findings from the analysis provide general support to all of the hypotheses. Hypothesis 1 which predicted lower resistance from a founder CEO in presence of a non-independent board of directors is supported. The results show that the positive relationship between CEO profile (founder vs. non-founder) and response to take-over (reject/resist vs. accept) is significantly ( $p < 0.01$ ) moderated by board composition (independent/dependent ratio). Further analysis of the results show that with the increase in the number of non-independent members on the board of directors, the relationship will change direction, while remaining statistically significant. This finding lends support to Hypothesis 2. The results for Hypothesis 1 and Hypothesis 2 are included in Model 2 in Table 2.

The results also show support for Hypotheses 3a and 3b. Model 3 in Table 3 shows that with the addition of the second moderator –CEO ownership- to the Model 2, the direct relationship between CEO profile (i.e., founder vs. non-founder) become weaker. Therefore, lending support to Hypothesis 3a and Hypothesis 3b.

**Table 1.** Descriptive Statistics

Variables	Type of Variable	Mean	Minimum	Maximum	Standard deviation
CEO profile	Binary	0.24	0	1	0.455
Board Composition	Continuous	0.61	0	1	0.323
CEO Ownership	Continuous	0.16	0	0.64	0.39
Response to takeover	Binary	0.31	0	1	0.51

**Table 2.** Results of Logistic Regression Analysis; DV: Response to takeover offer

Variable	Model 1	Model 2	Model 3	Model 4
Industry type	(cat) <sup>†</sup>	(cat) <sup>†</sup>	(cat) <sup>†</sup>	(cat) <sup>†</sup>
Company size	0.005*	0.004*	0.004*	0.004*
CEO profile		0.23*	0.18*	0.14*
Board Composition			0.03	0.03
CEO ownership			0.11*	0.11*
CEO profile × Board composition			-0.16*	-0.12*
CEO profile × CEO ownership				0.17*
$\chi^2$	61.33**	72.14**	88.54**	110.12**
Pseudo R <sup>2</sup>	0.11	0.14	0.16	0.21

N= 485

<sup>†</sup>  $p < 0.10$ ; \*  $p < 0.05$ ; \*\*  $p < 0.01$

#### 5 Discussion and conclusion

The issue of disagreements between board members and the CEO has not been addressed much in the Corporate Governance literature. Most of the literature

has been concerned with the role and effectiveness of boards of directors as monitoring and orienting instruments. Also, most literature has been drawn on assumptions that consider the agent as opportunistic and self-interested. Moreover, the complementary

theories such as Stewardship Theory lack clarity in addressing the distinction between firm's best interests and principals' best interests. This lack of clarity has resulted in a gap in this literature.

In this paper, I have focused on the gap that exists on the distinction between firm's best interest and those of the principals. The hypotheses made in this paper are based on a perceived moderating effect of board dependence/independence on the attitude of founder/non-founder CEO towards takeover proposals. While the proposed hypotheses require empirical testing to be confirmed, they suggest that a reconciliation of the gap between firm's best interest and principals' interests should be made.

In order to develop the hypotheses, I have drawn on the literature on Agency Theory and Stewardship Theory to demonstrate the difference between founder and non-founder CEOs. I have also used the literature on Corporate Governance to show the distinctions and limitations of independent and non-independent boards of directors. Then, I have used an Upper Echelons theoretical lens to demonstrate the role of CEO's perceptions and cognition (here expectation of bidding offer) to influence the decision made and connecting it to the attitude towards a takeover proposal. Based on my arguments, I have made two hypotheses, demonstrating the inverting effect of board dependence/independence on the attitude of founder/non-founder CEOs.

The findings of this research show support for all of the hypothesized relationships. The results from the statistical analysis shows that while compared to non-founder CEOs, founder CEOs show lower resistance to take-over offers in presence of non-independent board of directors, and greater resistance in presence of independent board members. I also find that the difference between founder and non-founder CEOs diminishes with the decrease in the level of ownership retained by the founder CEO. These findings shed light onto the dynamics between founder CEOs and the board of directors and provide us with a better understanding and prediction of the likely responses of CEOs when bids for acquisition exist.

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