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The Social Nature of Boards

Rakesh Khurana†
Katharina Pick‡

I. INTRODUCTION

Still reeling from a series of high-profile and extremely costly corporate scandals involving dysfunctional board behavior, lawmakers and scholars are scrambling to make sense of the gaps in understanding that clearly exist in governance research. Inevitably, these scandals provoked a surfeit of Monday-morning quarterback explanations. Some argued that these problems should have been anticipated as the inevitable consequence of the proliferation of high-powered pay-for-performance plans. Others talked about investors' misplaced faith in a firm's stock price as an indicator of corporate governance quality. Ironically, the same fields of finance and law that are now offering these retrospective judgments previously advocated increased stock option grants and an unyielding faith in the efficiency of the stock market.

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As well-intentioned and wise as many of these judgments are, we cannot help but feel that they perpetuate a false understanding as to the nature of boards. At the root of this finance and law perspective is the assumption that directors are fully motivated to act in the interests of the firm and its shareholders only when they have an individual interest to do so. Advocates of this perspective have argued, for example, that without financial inducements such as stock options or share grants, directors “have little incentive to extend themselves beyond relatively superficial oversight of their firms’ affairs. They mechanically fulfill their specified duties (certain approvals and audits) and watch for egregious derailments, but not much more.” Much of the corporate governance research and prescription of the last twenty or more years is rooted in this individualistic explanation of board and director behavior.4

We believe that the dominating focus on individual director incentives in governance scholarship misses a critical element of director behavior. As we will argue in this paper, a board is not a simple aggregation of individuals but is, in fact, a complex social system and must be understood as such. Financial considerations do not figure centrally in shaping a director’s behavior, particularly as it relates to boardroom culture. In fact, directors are highly cognizant of their membership, not only on a particular board, but also as members of a broader community.5 They have a clear sense of their own boundaries—how far their territory extends, who belongs, and who does not. The actions of a board, therefore, cannot be understood as being the aggregate product of each individual director’s behavior. Rather, their actions express the sum of connections and relationships of a group.

We know from decades of research on groups that they are enormously powerful social environments.6 Group

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7 For a review, see J. Richard Hackman, Group Influences on Individuals in Organizations, in 3 HANDBOOK OF INDUSTRIAL AND ORGANIZATIONAL PSYCHOLOGY 199 (M.D. Dunette & L.M. Hough eds., 1992).
influences on individuals, as well as factors that emerge purely at the group level and through the group’s situation in a wider social context shape members’ behaviors, beliefs, and attitudes. Our argument is that in order to understand the factors contributing to board culture and board outcomes—whether dysfunctional or functional—we must treat boards as complex social systems, and use the group as the basic unit of analysis when we study them. We must understand both the factors that are driven by group dynamics and culture and those that result from environmental influences on the board.

We acknowledge that several organizational scholars have indeed already approached boards as social systems, bringing a behavioral perspective to boards research. Lorsch and MacIver produced one of the earliest qualitative studies of directors describing the subtle mechanisms shaping behavior in board rooms and how the resulting conditions can yield both active and passive boards. William Ocasio explored how institutionalized action shapes board outcomes in CEO succession. Edward Zajac and James Westphal collaborated on several studies exploring how power dynamics, interlocks, director reputation, and demography shape board outcomes. Mark Mizruchi studied the power relations between boards of directors and management to explain how these manifested themselves in control over corporations. Finally, network studies conducted by Gerald Davis among others revealed how the interlocked nature of the director community shapes the diffusion of ideas and practices among boards.

Recognizing these important contributions, our aim here is simply to call attention to some of the significant ways in which boards function as social systems, and more specifically

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as groups. Because it is a review piece, our paper benefits from the flexibility to incorporate examples from recent corporate governance scandals, drawing together theory and practice.

We begin in Part II with a brief review and critique of agency theory, the dominant theoretical approach that now underlies corporate governance research in both finance and law. Because we find these individualistic conceptualizations problematic, in Part III we look outside the economic and legal literature and incorporate some of the tools developed in organization theory that explain board behavior. We apply these theoretical tools to some of the better-known cases of corporate malfeasance. Finally, in Part IV we discuss the implications of this approach for the future of governance research, particularly in light of recent environmental factors that now affect corporate boards.

II. AGENCY THEORY

A. What is Agency Theory?

More than any other approach, agency theory has focused on boardroom dynamics and the fundamental nature of the factors driving director behavior. Although this approach has spawned hundreds of articles and its conceptual language is now widely used by scholars and practitioners alike, our purpose here is to explore only two of its key assumptions regarding director behavior. First, agency theory conceptualizes the etiology of director behavior at the individual level. Second, even when an agency perspective considers the board as a unit, boards are treated as mere aggregations of individual director behavior as opposed to complex social groups.

In the United States, all large public companies have a board of directors that is approved by the shareholders. Legally, the board of directors is vested with enormous decision-making power over the activities of the company. In large companies, directors often delegate decision-making to corporate executives. Even when such delegation occurs, however, the ultimate power rests with directors. Almost all existing governance theory produced by economists, which has

had the dominant influence on law, defines the relationship between directors and shareholders as one instance of an agency relationship. The firm itself is described as a legal fiction that serves as a nexus of individual contracts.

This definition of the firm is critical to agency theory because it suggests the relationship between individuals and the firm is fundamentally a contractual one. An agency relationship is thus a contract under which one or more principal(s) (e.g., shareholders) engage an agent (e.g., directors) to perform some service on their behalf by delegating some decision-making authority to the agent. Because directors and shareholders are unique individuals, it is hypothesized that their respective interests will diverge. Consequently, shareholders will take the necessary means to ensure that directors will act in ways concomitant with their interests. Much of the research in this area involves identifying the means, and the efficacy of those means, by which this convergence of interests is achieved.

This research has translated into many individual-oriented reforms. Boards have adopted partial stock option compensation for directors in order to align directors’ interests with those of shareholders. Director independence requirements have been formulated primarily with regard to preventing individual directors from having conflicts of interest. Qualifications for committee membership, and audit committee membership in particular, have become clearer and more demanding so as to ensure that individuals possess the expertise and knowledge required for the position.

B. Why Agency Theory is Problematic

Is it realistic or useful to view the modern corporate board as comprising only, or even principally, a set of individual contracts? We think not, and we argue that the radical individualism embedded in this contractualist view is unreasonable. It blinds us to most of those features of modern boards that are distinctive and in accordance with directors’

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15 See generally Jensen & Meckling, supra note 14.
own empirical experiences. For example, R.C. Clark notes that most of the particular rules that make up the relationships among corporate officers, directors, and stockholders—that is, the relationships that give operational meaning to the concept of the corporation—are not the products of individual contracts.17

Some readers may concede that while a large firm is not a nexus of individual contracts in a strict definitional sense, the distinction is insignificant given that we can still analyze boards or firms usefully as if there were actual contracts in action. We believe such a response is inadequate. Viewing the board as an instance of individual contracting may have at least two objections. First, this individualistic and undersocialized view of boards, while consistent with agency theory and economic explanations of human behavior, has proven to be inadequate when evaluated vis-à-vis the autopsies of recent corporate misconduct. Moreover, it does not reflect the real nature of board behavior. Second, academic research could help a great deal in improving corporate governance, but a narrow individualistic approach may make it difficult to realize this potential contribution. Answering the question of how we are to understand directors’ behavior in boardrooms requires not only locating the etiology of their behavior, but also developing defensible premises about director behavior that can guide theory building and focus empirical investigation. As Jeffrey Pfeffer and his colleagues have noted, assumptions about human behavior tend to become self-fulfilling:

To the extent people believe in a particular theory, they may create institutional arrangements based on the theory that thereby bring the theory into reality through these practices and institutional structures. To the extent people hold a theory as true, they will act on the basis of the theory and expect others to act on that basis also, creating a normative environment in which it becomes difficult to not behave on the basis of the theory because to do so would violate some implicit or explicit expectations for behavior. And to the extent that people adhere to a theory and therefore use language derived from and consistent with the theory, the theory can become true because language primes both what we see and how we apprehend.


the world around us, so that talking using the terminology of a particular theory also makes the theory become true.\footnote{See Fabrizio Ferraro et al., Economic Language and Assumptions: How Theories Can Become Self-Fulfilling, 30 ACAD. MGMT. REV. (forthcoming 2005).}

In the next section we call attention to some of the important ways in which board outcomes may be shaped by mechanisms that operate within groups. Specifically, we will highlight the importance of group norms on individual director behavior, the effect of social influence on the way directors interpret information, the effect of group membership on directors’ attitudes, and finally the potential effect of habitual routines that develop at the group level and compromise mindful group decision-making. While these group mechanisms will be familiar to students of organizational theory, they have yet to penetrate the dominant law and economic perspective that continues to inform corporate governance research and legislation. Indeed, even within organizational research, many concepts specific to group behavior have not been applied to work on governance and boards of directors.

III. BOARDS AS SOCIAL GROUPS

Social influence in groups and through groups is extremely powerful in shaping the behavior of both members and non-members. A group environment influences how people behave, what they believe, and how they feel.\footnote{See Hackman, supra note 7, at 1.} The board environment is no different. Despite meeting episodically and infrequently, boards are groups in a truly psychological and sociological sense. Boards have clear boundaries, with membership that is stable over time and readily identifiable by both members and non-members. A board’s members are engaged in a common task that requires sharing information and making joint decisions, and this task is ongoing and does not end when the board is not in session. Finally, directors interact face to face at least part of the time.\footnote{See J. Richard Hackman, Leading Teams: Setting the Stage for Great Performances 41-59 (2002) (discussing the essential features of teams in the work setting); Donald C. Hambrick, Top Management Groups: A Conceptual Integration and Reconsideration of the "Team" Label, 16 RES. ORGANIZATIONAL BEHAV. 171, 188-89 (1994).}
A. Board Cohesiveness

Importantly, boards have several characteristics that make them highly cohesive groups. This is crucial because, as social psychologists have long recognized, social influence of the kind that we will be discussing throughout the remainder of this paper is stronger in groups that are cohesive.\textsuperscript{21}

First, boards are cohesive because they tend to be very homogenous. Although this is beginning to change with respect to gender and race, boards continue to be homogenous with respect to age, occupation, class, and status position.\textsuperscript{22} This gives boards the likelihood of shared mental models, attitudes, beliefs, and experiences that contribute to group cohesion.

Second, boards have high group distinctiveness, meaning that their membership is readily identifiable both to insiders and outsiders. Even when not face to face, the group membership is almost constantly salient given their names are often listed on websites and company documents and because the title “IBM Board of Directors” is synonymous with the list of names that comprise it. Contributing to the distinctiveness is the fact that membership requirements and tenures are clearly spelled out and that membership is stable. Indeed, it is rare that someone is expelled from the group.

Finally, boards are small, ranging from ten to twelve directors. This makes them small enough for directors and interactions to be highly visible. Anonymous action is nearly impossible, and directors are aware of each other both as directors and as individuals.

Cohesive groups, like boards, have the potential to realize benefits from diversity of ideas, skills and expertise, and to make process gains by operating more efficiently. However, they also have the potential for incurring costs and process losses.\textsuperscript{23} The gains and losses associated with group behavior are inherent in the very nature of boards, and must therefore be addressed in any explanation of board outcomes.

\textsuperscript{21} See generally Leonard Berkowitz, Group Standards, Cohesiveness, and Productivity, 7 Hum. Rel. 509 (1954); Hackman, supra note 7, at 252; Stanley Schachter et al., An Experimental Study of Cohesiveness and Productivity, 4 Hum. Rel. 229 (1951).

\textsuperscript{22} See Khurana, supra note 6, at 84.

\textsuperscript{23} See Hackman, supra note 20, at 169-75. See generally Norman R.F. Maier, Assets and Liabilities in Group Problem Solving: The Need for an Integrative Function, 74 Psychol. Rev. 239 (1967).
In a recent *Wall Street Journal* article, Useem reiterated what many governance scholars have suggested before: although they are important, individual flaws like lack of expertise, prolonged tenure, and conflicts of interest (not to mention board level problems like inappropriate committee structures that governance critics like to harp on) will always be trumped by what ultimately happens when directors meet behind closed doors and are confronted with important decisions. What transpires there and over the course of meetings and telephone conversations cannot be reduced to individual or structural characteristics, but rather must be understood as the result of complex relationships of the board as a group.

**B. How Groups Regulate and Shape Behavior**

Reflecting on board decisions gone awry, it is always striking that individual directors were able to sit by and not pursue issues that later turned out to be consequential. The board at Hollinger International Inc. approved more than half of the $400 million worth of transactions that Lord Black and his colleagues improperly pulled from the company. They made these decisions in infrequent meetings that were described as “brief, casual affairs,” some lasting no longer than an hour and a half. The board adopted behavioral routines like rapidly shuffling through and approving Lord Black’s proposed transactions, discussing unrelated and trivial but intellectual affairs during lunch breaks, and allowing Black to dominate and flatter directors into acquiescence.

These norms, and the behavior they created, came back to haunt the Hollinger board. Though Lord Black and his

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colleagues also consistently misled and lied to the board, the board passively accepted a process that prevented judicious oversight—a critical failure. The Hollinger board’s practices seem negligent in the extreme. But less obviously harmful behavioral patterns with potentially similar consequences exist on all boards.

Social norms, particularly in groups, are one of the most powerful forms of social control over people. Directors, like all members of groups, rely on norms as social indicators of what behaviors are, or are not, appropriate within the group context. Particularly within cohesive groups, which the Hollinger board had all signs of being, such norms are extremely difficult to challenge. As investigators discovered, Lord Black displayed consistent and profound loyalty toward his directors, offering generous donations to charities they supported, and often flattering them not only with perks but also with personal compliments. Having hand-picked the entire board, it was not difficult for him to mold the individuals into a group for whom the norm was to trust management, feel privileged by their membership among such an elite group, and not insult each other or waste valuable time with caution and skepticism.

Groups tend to create norms around behaviors that they consider to be important to effective group functioning and performance. On boards these behaviors are likely to include the content and flow of board discussions, the sharing of air time among directors and with management, the leadership and power balance on the board, the effective use of information, the proper availability and use of expertise, and the structure of meetings. It appears that the Hollinger board, for example, had developed a norm of brevity and cursoriness that likely undermined each individual director’s freedom to interrupt or hold up discussion no matter what the reason. Other boards with which we are familiar have norms governing the interruption of management presentations, or the appropriateness of asking questions in the last half hour of a meeting. Still others have norms regarding director participation; some discourage full-board discussions while others require each director to provide an opinion on any given topic of discussion.

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28 See generally Frank & Cherney, supra note 26.

29 See Hackman, supra note 7, at 235-36.
Whatever their nature, norms are extremely resilient once they have become established. Groups reinforce norms through sanctions and feedback to members who violate them. Ambient stimuli, the back-drop characteristics of the board’s surroundings and interactions (for example, how directors and the CEO are situated in the board room, what the board room looks like, and how directors speak to one another at a meeting) create a subtle but powerful normative inertia. In fact, ambient stimuli are often more powerful than the discretionary stimuli because they are “rarely noticed or discussed.” Instead, they function through directors’ implicit assumptions about what is appropriate based on the cues provided by the environment.

If a group environment is characterized by formality, with directors sitting stiffly around a conference table and interacting only in formal language at predetermined times, a director with an important but loosely formulated idea would be unlikely to present that idea because he could not do so in a sufficiently coherent and formal fashion. Note that his withholding of the idea may be based on his perception of what behavior is appropriate or desirable, however, and not necessarily on any real evidence about what is appropriate. Unfortunately, this may often prevent ideas and processes that would be beneficial to groups from surfacing and becoming part of the group norms. Instead existing norms are supported and perpetuated since members are more inclined to surface perceptions through behaviors from which they expect positive feedback. Members are unlikely to test behaviors that they think may yield negative responses. Thus individual members can quietly hold false assumptions about the group that cannot be revised because no real information is ever exchanged.

One director’s recent comments reflect the impact even assumed norms can have on board room behavior:

One of the good things, for all the unpleasantness associated with the post-Enron period, it is true that boards are much more assertive than they used to be. And it’s sort of like a natural change, they have to be, but they don’t have to do anything unclublike in order to be

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31 Hackman, supra note 7, at 209.
that way. So that’s a good outcome. It’s expected, you know they’ve got to ask tough questions and expect answers. It’s hard to describe precisely, but back prior to this period and certainly in periods in our history, you really had to kind of stick your neck out if you were going to really object, even if there were good substantial reasons for doing it. It’s just that the norms were such.33

By pointing to how external scrutiny has legitimated directors’ asking of tough questions, these comments highlight the extent to which being assertive in the boardroom can be perceived as undermining the board as a group or “club.” External influences, like those that resulted from recent corporate scandals, do not always occur and thus do not alter directors’ perceptions and experiences of norms. Absent these types of influences, norms usually persist over long periods of time.

C. Transmitting and Sustaining Norms

The norms developed in groups are not only stable over time, but often survive even membership turnover. Unless there is a shock to the group, either in the form of individuals deviating from the norm or a change induced by an external investigation, norms survive even as the composition of the group changes. This resilience is the result of a number of important factors, some of which are reinforced by characteristics specific to boards.

First, board membership usually changes incrementally, with no more than two or three new directors joining at a time. Second, new and inexperienced directors who have not been socialized into board culture and thus learn the behaviors befitting a board member primarily from those around them. One now very prolific director described his early board experience in the following way:

When I first started going on boards I was the youngest thing in the board room. And so it was very helpful to me to talk to experienced directors. You know when I first started going to board meetings I wouldn’t say anything. And obviously I’d listen to the conversation. Because my mother always taught me to . . . if you go to a big dinner and there’s a lot of silverware and a lot of crystal and you don’t know

33 Katharina Pick, The Adoption and Framing of a Corporate Governance Innovation: How Directors Make Sense of the Lead Director Position (2004) (unpublished Ph.D. qualifying paper, Harvard Graduate School of Arts and Sciences) (on file with author). All quotes from directors in this article are from directors of Fortune 500 companies to whom confidentiality was assured.
which one to pick up, just watch the hostess. So I spent my early meetings watching. And that’s a way to learn. And then you think “I would like to ask this question.” And then you see some guy who’s been there a long time who’s very smart and he asks the same question that you were thinking about. And that’s helpful to you. So that gives you some sense of confidence that you’re not exactly stupid. And then you hear a question that you really think is stupid and then at lunch some director will tell you “Wasn’t that a stupid question?”

Finally, because boards are so homogenously comprised of elites, the primary way in which people achieve status on a board is through tenure. This means that the people most able and likely to challenge norms (i.e., people of high status within the group), are the people who have been there the longest and are likely the most entrenched in the board’s norms.

In order to explore the nuances and consequences of norms we must first understand why they are so important to groups. The enduring norms of a group are functional in sustaining two critical features of groups: the diversification of roles within the group and the achievement of uniformity in the group. Although these can appear to be contradictory forces, they are both critical to how groups achieve organization, order, and predictability in a way that maintains the group. However, both the tendency toward diversification and the tendency toward uniformity also have importance consequences for behavior in groups.

1. Role Diversification

Diversity comes in the form of role differentiation, which is clearly visible in the formal structure of boards. Here, committees and committee chairs take on additional duties with respect to specific areas of expertise. This role differentiation is also reflected in a board’s informal structure. A recent study on Lead Directors showed that even where

34 All quotes from directors in this article are from directors of Fortune 500 companies to whom confidentiality was assured.
boards had not formally named a person to serve as Lead Director, there were individuals on the board who, in times of crisis or indecision, would be expected to assume responsibility or speak up on behalf of everyone else. Directors in most situations were confident that they could identify that person and that their selection would be consistent with the expectations of others. It is not surprising that many boards should have such informal role differentiation given their structure, where the independent directors usually have no formal leader with the exception of the CEO, whom the board is essentially evaluating. In these conditions an informal leadership structure is almost certain to emerge.

Subtle role differentiation can become problematic, however, because when that particular person does not speak up, it is less likely that others will, even if they feel uneasy about an issue. This is generally the case because: (1) the unwillingness of the person to speak up establishes, informally, that concern is not required; and (2) it feels inappropriate to violate the implicit roles that have been established. This dynamic undermines the true function of boards of directors, which is to allow an opportunity for individuals with different ideas to come together and share information. In effect, group dynamics undercut the positive effects of diversity.

2. Achievement of Uniformity

Another reason groups develop norms, and one reason they are so resilient and consequential to particular outcomes, is because groups have a tendency toward uniformity. Norms, by bringing individual members together into a behavioral pattern, are one means through which uniformity is created in groups.

On one hand, uniformity can be beneficial to groups. It produces order and predictability as well as a sense of harmony that enables the group to move toward its goals. It can prevent too much individualistic behavior from undermining productive discussions and make the group easier to maintain, for example when everyone in the group has bought into a common set of principles.

38 See Festinger, supra note 37, at 272-73; Nemeth & Staw, supra note 37, at 176-89.
39 See Nemeth & Staw, supra note 37, at 189.
40 See Hackman, supra note 7, at 214.
On the other hand, pressures toward uniformity also undermine the group's willingness (and ability) to recognize and adapt to changing circumstances. In fact, we argue below that pressures toward uniformity actually can negatively impact board performance on a number of different levels.

D. Influences on Group Beliefs

A popular criticism leveled by legislators and scholars against boards involved in recent corporate scandals is that they did not have the courage or the conviction to challenge senior management and/or the CEO on important issues. In fact, some have accused directors of being “indifferent.” While some directors, no doubt, have been indifferent, this sweeping generalization overlooks the enormous pressures toward conformity in group environments. Groups have a strong tendency to conform around ideas and specifically to congregate around those held by a majority within the group, often relying on consensus to signify accuracy. Boards are subject to the same conformity pressures.

Observers say that even a lone dissenter can make a big difference in the board room. Bill George, former CEO and Chairman of the Board of Medtronic Inc., a leading medical technology company headquartered in Minneapolis, recently cited an instance in which all but one director on his board approved of a proposed acquisition. That one director telephoned George after the meeting had ended and made such a convincing argument for his position that George reconvened the board by telephone and together the directors decided to reverse their initial approval. According to George, the board eventually made the right decision. Unfortunately, social psychological research suggests that such persistence on the part of an individual member, and such deliberation and reassessment on the part of a group, are rare. In fact, studies show that, unless addressed deliberately through appropriate norms, the structure of group relations simply does not

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41 See Nemeth & Staw, supra note 37, at 190. See generally Irving L. Janis, Groupthink, 5 PSYCHOL. TODAY 43 (1971).
42 See Useem, supra note 24.
43 See Nemeth & Staw, supra note 37, at 189.
encourage dissent and does not enable groups to handle it productively when it does occur.\(^45\)

1. Conformity

There are two types of influence that generate conformity: normative influence, which happens when people try to gain approval by conforming to group expectations, and informational influence, which happens when people accept information from other people as “evidence about reality” and thus conform to their view.\(^46\)

The power of conformity via these two mechanisms is best demonstrated in a classic study by Solomon Asch in which subjects were asked to match the length of one line to “one of three obviously unequal lines.”\(^47\) Each subject was situated in a group of eight with seven confederates who each, when asked to state their answer aloud, provided the same incorrect answer.

One third of the time, subjects responded in agreement with the confederates, providing the incorrect answer despite the fact that the correct answer was plainly obvious. When interviewed after the study, subjects provided three different explanations for their incorrect choices. Some said they were truly unaware that their estimates were distorted by the majority. Others said that the majority seeing it differently led them to doubt their own assessment and change their answer. Finally, some said they knew their own perception was correct but did not want to “appear different from or inferior to others.” Subsequent conformity studies have produced similar results. One striking nuance to the results is that the judgments groups converged around often tended to persist in people's individual judgments even outside of the group setting.\(^48\)

Although we like to think of board members as highly experienced, independent, and empowered individuals, as

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\(^45\) See Nemeth & Staw, supra note 37, at 185-89.


\(^47\) See generally Asch, supra note 46.

members of groups they are susceptible to the same pressures toward conformity that all group members are. Moreover, there are some features of boards that render members particularly susceptible to conformist behavior. Research shows that there are several conditions under which informational influence can be very powerful.

First, members of groups are more likely to rely on each other in shaping their beliefs when the group’s environment or the stimulus for the group task is highly ambiguous.49 Certainly, most situations directors face are highly ambiguous. The issues they confront are usually complex and subject to interpretation. They rarely face an objective reality and clarity regarding outcomes and costs. Instead, decisions they make require judgment about tradeoffs required to achieve various outcomes and often must be based on incomplete, complex, and subjective information. Moreover, directors must make these decisions while being conscious of the fact that they must answer to shareholders, even when it is not clear whether or not short-term tradeoffs will benefit those shareholders and/or the company in the long run. This ambiguity is even more pronounced in the tumultuous post-Sarbanes-Oxley and post-Enron environment where directors are adjusting to new regulations, making sense of changing expectations, and are, in some sense, being cast in a newly conceived role that is more scrutinized than ever before.

The second condition under which informational influence is particularly powerful is when the relevant group providing the information is perceived to be credible and competent.50 Boards are usually made up of very smart, highly influential, and experienced people. Moreover, directors are often predisposed to respect those serving on the board with them, especially when such people are hand picked. Perceived expertise also plays a major role, as directors are likely to defer to each other on items where they believe others have greater expertise.

This relates to the final condition under which informational conformity is particularly strong: when a person

49 Richard S. Crutchfield, Conformity and Character, 10 AM. PSYCHOL. 191, 193 (1955).
believes him or herself to be relatively unqualified to make a particular judgment.\textsuperscript{51} Despite the fact that directors are generally highly qualified individuals, the flood of information with which they must work likely leaves them never feeling \textit{completely} informed. Directors are often inundated with pages of information prior to board meetings. Given time constraints, directors are usually unable to process this information and it is likely that this could make a director feel as though he or she is not entirely “qualified” to respond and/or act.

It is worth noting here that some characteristics which have not received sufficient scholarly attention might also work to encourage conformity and, thus, undermine the opportunity for dissent. Boards and board members are highly visible, despite the confidentiality of what happens in board meetings. The board has joint accountability and culpability in situations where the stakes are extremely high, where losses for shareholders can be in the millions and consequences for employees can be devastating. In addition, directors are also highly cognizant of the reputational effects, both within the director community and outside of that community, of misguided dissent or of any type of individual interference or failure in the board room.

2. Suppression of Dissent

It is not just the barrier to dissent that is problematic, but also what happens once dissent is expressed. Social psychological research shows a pervasive tendency for groups to follow the majority position, even when that position is erroneous,\textsuperscript{52} highlighting behaviors that the group may use to bring the views of the minority in line with those of the majority. These behaviors include increased communication with a deviant in a group,\textsuperscript{53} holding the deviant and his or her


\textsuperscript{52} See Nemeth & Staw, supra note 37, at 183.

position in disdain, and rejecting or cutting off communication with the deviant if necessary.

It is worth noting, however, that minority influence can be very beneficial to a group, especially when the group is engaged in non-routine tasks where flexibility of thinking is important. Some research suggests that “majority influence causes systematic, but convergent processing of a message, whereas minority dissent stimulates consideration of an issue from multiple perspectives, even perspectives beyond what the minority proposes” in a way that benefits group outcomes particularly in problem-solving situations. Even where minorities exert some influence, however, it is rarely outwardly manifested. Members of groups often privately shift their views in the direction of the minority influence. While such private reassessment is encouraging, a public shift does not usually follow and thus the group remains under the guise of consensus and uniformity.

3. The Costs of Conformity

The consequences of this sometimes superficial but always compelling uniformity are significant. One potential cost cited by Nemeth and Staw results from the “common assumption that truth is correlated with consensus.” Groups may stick to a consensus view, even in the face of changing information, because consensus assures them their assessment or decision is correct.

This process can lead to an escalating and eventually self-perpetuating cycle where critical thinking is swept aside by the momentum the group has developed toward uniformity. Janis labeled this phenomenon “groupthink,” where the pursuit of concurrence dominates group process and overrides realistic

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55 See Nemeth & Staw, supra note 37, at 188. See generally Stanley Schachter, Deviation, Rejection, and Communication, 46 J. ABNORMAL & SOC. PSYCHOL. 190 (1951).
58 Nemeth & Staw, supra note 37, at 189.
and critical thinking. In his analysis of the Bay of Pigs “fiasco” undertaken by President John F. Kennedy and his cabinet, Janis discovered a group characterized by strong conformity pressures and self-censorship, direct pressure on members who dissented, illusions of unanimity, and failure to search for information or explore alternative courses of action. Based on his observations, Janis suggested that groups like this tended to rush to judgment, assume invulnerability and morality in their actions, and make poor decisions.

As mentioned above, the effect of conformity pressures and uniformity in general on group performance is especially consequential to boards because they are cohesive groups. Cohesive groups tend to exert more pressure toward even greater uniformity because members have positive feelings toward their groups and value the interpersonal rewards they get from membership. As a result, members usually do not want to jeopardize these feelings or rewards by dissenting. This “affiliation” aspect of the pressure toward uniformity in cohesive groups highlights another important mechanism by which groups shape individual behavior—social identity.

E. Influence on Attitudes via Social Identity

Group memberships comprise an important part of an individual’s social identity. Studies in social psychology show that even when the grounds for group membership are arbitrarily imposed, people often have affective, cognitive, and behavioral biases in favor of the group and its members. Individuals tend to feel more positive about people in the group than about those on the outside. In fact, board members will often go as far as to believe that other group members are similar to themselves by virtue of their membership in the

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59 Janis, supra note 41, at 440.
60 See generally Janis, supra note 41.
61 See supra Part III.A.
62 See Hackman, supra note 7, at 252.
64 See Moreland, supra note 63, at 1173. See generally Jacob M. Rabbie & Murray Horwitz, Arousal of Ingroup-Outgroup Bias By a Chance Win or Loss, 13 J. PERSONALITY & PSYCHOL. 269 (1969).
same group.65 Individuals also behave in ways that favor other group members over outsiders.66 In addition, people tend to adjust their values and attitudes over time to fall in line with attitude norms of their membership groups.67 In other words, group memberships play a significant role in an individual’s self-definition.

Social psychologists suggest that individuals look to groups both to maintain a positive self-identity68 and to reduce subjective uncertainty about self-concept, which includes their beliefs, behaviors and attitudes.69 The extent to which directors have similar attitudes about their duties, about the legitimacy of various accountabilities asserted by external parties, about what makes an effective group process, and about the group membership they share, may impact how the board makes decisions together.

In thinking about group influences on attitudes and identity we must also consider directors’ memberships in other groups. Two groups in particular are likely relevant to the attitudes directors bring to the work they do on boards. First, in addition to being directors for specific boards, directors are also members of the wider population of directors. This population is densely connected through interlocks, with most directors serving on several boards at the same time.70 The changing environment for corporate governance has made this community even tighter as it becomes more bounded by opposition to external parties that scrutinize and attempt to exert influence.71 The broader population of directors now has a visible and distinct out-group, comprised of legislators, shareholders activists, and various other critics, against which to position itself.

Directors are also members of groups in their various professional roles. For example, there is a sub-group within the

65 See Vernon L. Allen & David A. Wilder, Group Categorization and Attribution of Belief Similarity, 10 SMALL GROUP BEHAV. 73, 79 (1979).
70 See Davis, supra note 12, at 592-98.
71 See infra Part IV.
population of directors that is comprised of current CEOs. When this part of a director's identity becomes salient in the board context, it is likely to shape his or her behavior in a given situation.\footnote{See generally Seymour Lieberman, The Effects of Changes in Roles on the Attitudes of Role Occupants, 9 HUM. REL. 385 (1956).} Given that a primary function of the board is to oversee and evaluate the CEO's performance, this particular role affiliation may strongly influence the director role.

While economic theory describes directors who are motivated primarily by the economic incentives of membership, social psychological research suggests that there are more important reasons for becoming a board member. In fact, some corporate governance research suggests most directors join boards not for money, but rather for the sake of learning from their peers and contributing their expertise and experience to the management of other companies.\footnote{See Lorsch & MacIver, supra note 8, at 23-30.} Thus, in order to properly study board outcomes, we must understand not just the economic incentives of directors, but the benefits and incentives derived from being part of the group and the broader director community.

\section*{F. Habitual Routines}

A look inside one crucial board meeting at Enron Corporation, the now bankrupt energy company whose leaders concocted off-the-books partnerships, twisted accounting rules, and manipulated the energy market to inflate the company's profits and siphon money into their own accounts, shows how even the most alarming signs of wrongdoing can be missed. On June 25, 1999, three days prior to their next board meeting, each director of Enron received a proposal in their fax machines for suspending the ethics code of the company. CFO Andy Fastow had asked for the approval of a self-serving partnership which required the suspension of the code's mandate that “even an appearance of an improper transaction must be avoided” and that “no employee should gain separately from company service.”\footnote{See generally Useem, supra note 24.} The subsequent board meeting was conducted by phone in less than one hour and was “jam-packed” with important agenda items and topics requiring the board's approval. Directors proceeded expediently through transactions and proposals and, although no committee had
vetted the suspension of the ethics code, it was approved by the group. This decision turned out to be a terrible mistake, as Fastow went on to add millions to his personal fortune by exploiting Enron and its shareholders.

Habitual routines, in the terminology of social psychologists, can undermine the activation of careful and scrutinizing decision-making in situations like the one just described. “A habitual routine exists when a group repeatedly exhibits a functionally similar pattern of behavior in a given stimulus situation without explicitly selecting it over alternative ways of behaving.” Habitual routines are distinct from norms because they do not emerge from group assumptions about appropriateness and their enforcement does not involve a response to someone who deviates from expectations. Rather, these behavioral patterns happen to the group as a whole.

Habitual routines can be both functional and dysfunctional for any group. First, because they function automatically in the absence of members’ conscious attention, they save the group time and energy, particularly in stable environments. Under such conditions, the group does not have to actively manage every situation but, rather, automatically engages in behaviors cued to a particular situation. Because the group is not actively assessing whether or not its habitual routine is appropriate in the given circumstance, however, it always runs the risk of failing to adapt to important changes in environmental stimuli. Specifically, the group may miscode a situation and proceed with a particular set of processes that are inappropriate to the situation and, thus, undermine the group’s performance.

The 1982 crash of Air Florida Flight 90, as analyzed by Gersick and Hackman, illustrates the disastrous outcomes that can result when habitual routines govern group behavior. The data collected from the cockpit voice recorder reveal that the crew carried out its ordinary takeoff routine, including a confirmation that the “anti-ice” indicator was “off” despite the fact that the current weather conditions required that it be on. The sad irony was that the crew continued to comment as to the frigid conditions and difficult weather while carrying out

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76 Id. at 65-67.
their behavioral routine as if the conditions were dry and warm. The experiences of Flight 90 show how powerfully a group can be governed by its routines.

Habitual routines govern a good deal of group behavior and are likely vital factors when it comes to explaining board behavior as well. Perhaps it was reasonable for the Enron board to expediently approve the agenda items that, while important, probably resembled transactions they had discussed countless times before. This time, however, the directors were approving a suspension of their code of ethics, certainly not a routine matter and most likely one that was qualitatively different from anything they had done before. Because of the board’s habitual routine of disposing of agenda items, this distinct undertaking was not cued as something that required a reassessment of how the group would discuss and process the decision.

Boards have been shaken up by the fallout from recent oversights like this. Experiencing failure or receiving an intervention are two of only a few factors that can make habitual routines salient and make group members aware of a need to recode certain situations. Indeed, even boards not beset by scandal are becoming aware of the pertinent issues at hand, and many of them are now reflecting on, and revising, their own organizational processes.

A prominent director of a Fortune 500 company has noted how executive session processes can be reconceptualized when stimulated by new conditions.

[This is where collegial process really worked, where somebody comes up with a thought that maybe is not even a prearranged thought in the person’s mind, he just says “well you know I’ve been thinking about this” . . . it sparks a comment from somebody else and then somebody else and then you come up with something. Sometimes it’s strategy, sometimes it’s nuance, sometimes it’s something we don’t like sometimes it’s something we do like.]

Here, the director draws a contrast between an “old way” and a “new way” of doing things. The routines and processes directors once adhered to are currently being reshuffled and being actively shaped, most likely to the benefit


78 All quotes from directors in this article are from directors of Fortune 500 companies to whom confidentiality was assured.
of the process. As the external shock subsides, however, whatever processes boards adopt will reflect the same tendency toward routine that usually shapes group behavior.

IV. BOARDS IN A CHANGING ENVIRONMENT

As we consider the social influences that shape group behavior and board outcomes from within, we must not forget that boards are also embedded in a wider, social context—a complex and increasingly institutionalized environment. Corporate governance researchers in the 1990s recognized the importance of this environment to boards but focused primarily on the role of investors and their interests in driving board processes and outcomes. Although these issues are important, we believe there is a more subtle and more powerful environmental shift affecting boards.

There is no doubt that boards have evolved from being practically impenetrable groups to being more easily pressured to adopt certain forms and functions to have legitimacy. In fact, an increasingly organized environment has, and will, continue to affect boards through its ability to exercise authority over how boards should work. It does this by creating a set of broader norms that are thought to improve governance and lead to expectations that must be met to establish legitimacy. Sociologists would term such an evolution the “institutionalization” of the board, an evolution that certainly will penetrate the group context of the board and add another dimension of social influence to those which have been described above. By institutionalization, we mean a range of influences, controls, patterns, and tacit understandings that make up the whole corporate governance field. Institutional pressures emanate from the relational networks of organizations that arise in the broader societal context. This includes many elements beyond the boundaries of any single board. It includes the consensual notions held by ordinary investors about what a board ought to be like, how institutional investors believe board members ought to behave, and the network of governance rating agencies seeking to influence board behavior and governance outcomes, among others.

Concretely, the three domains effecting this institutionalization are the legal, the consultative, and the educational domains. First, legislators have just completed, through Sarbanes-Oxley, a prescriptive intervention more extensive than any that has come before, putting forth new
independence requirements, stipulating committee structures and frequency of meetings, and mandating director qualifications. Many of the recent actions boards have taken are efforts to demonstrate compliance to new legal standards. Organizational scholarship suggests that boards can easily go through the theatre of achieving legal compliance while doing little to improve the underlying quality of their governance. Compliance to legal mandates of what defines an independent director, for example, doesn’t guarantee psychological independence. The adherence to legal prescriptions does not necessitate that those principles are manifest in board behavior. Given the opaque nature of corporate governance activities, it is fairly easy for boards to adopt the structures that signal good governance on paper but are, in fact, loosely coupled to actual board activities. Requiring board committees to have a written charter does not ensure that directors will adhere to the spirit and not just the letter of that charter. As several commentators have noted, Enron’s board was upheld as a paragon of high quality, independent governance.

The various intermediary institutions that have evolved with respect to corporate governance have been even more influential in shaping the language and the expectations around boards of directors. Ratings agencies scrutinize boards based on checklists of desirable structures and processes, implicitly linking conformance to these standards to board performance. A whole industry has emerged around peddlers of governance best practices, with scores of consulting firms opening corporate governance practices and offering both consulting and training programs to directors. Even the public relations firms have gotten into the game, recognizing how important it is for boards to communicate to shareholders and the media in a way that is in line with best practice and restores trust. Several PR giants, including WPP Group PLC and Interpublic Group of Cos. Inc., have devoted business units to corporate governance.79

Finally, there is an emerging “professional” logic of the director position. Universities and business schools, in addition to consulting firms, have seen the need to develop executive programs for directors. Business schools are making an effort to include corporate governance courses in their MBA

curriculum. Ethics courses have appeared in response to the corporate scandals, discussing director roles in corporate governance outside of explicitly director focused courses. Built into the educational process itself is a system socializing students to a particular set of norms, values and dispositions that are created simply by living in, and responding to, institutional expectations and the routines of the course work.

As this continues, and as other influences including auditors and regulators contribute to professionalization, a stronger set of norms will shape board room behavior. Boards will be increasingly concerned with, and driven by, concerns for legitimacy. Thus far, and as evidenced in a recent study on the adoption of the Lead Director position, directors’ pursuits of legitimacy have been primarily concerned with the opinions of other directors on their boards and perhaps those of the wider population of directors, when it comes to signaling legitimacy. As the environment around boards more effectively imposes its own set of norms, however, the ways in which boards function as groups will surely change to respond to what is seen as legitimate in that environment.

We end our essay where we began, calling for a reconsideration of the dominant law and economics perspective about the nature of boards. Radical theoretical individualists will undoubtedly disagree and contend that all corporate phenomena can be reduced to individual motivation and the firm to a nexus of individual contracts. But this hypothesis does not adequately account for corporate behavior today, as several autopsies of corporate governance failures have illustrated. We have suggested that there is much to be gained by examining boards not simply as an aggregation of individual contracts, but also as a singular social unit. This road may be more arduous than the dominant perspective. Its research and study requires a detailed analysis of the social structure of the board and recognition of the complexity of motivations that underlie behavior. We believe, however, that this route is more analytical and empirically defensible than the current theory. We also believe it opens up tremendous opportunities for new types of research methods, especially qualitative research that emphasizes field work and interviews.

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80 See Pick, supra note 33.