Deciding Who Will Rule: Examining the Influence of Outside Non-Core Directors on Executive Entrenchment

Abstract
We examine the contingencies that sway independent non-core directors of S&P500 firms to heed the norms of the corporate elite or the disciplining forces of the efficient directorial labor market in the context of executive entrenchment. We find support for the corporate elite perspective as the number of independent non-core directors is positively associated with an entrenchment index score. However, the positive association is moderated by contextual factors that influence whether these directors reflect the expectations of the corporate elite or the efficient directorial labor market. Specifically, this study shows that the association becomes more positive when these directors are highly embedded in the corporate elite network or have shorter board tenure, but less positive when independent CEO directors’ equity ownership is high. We also found a crossover interaction effect where the association is negative (positive) when firm performance is low (high). These results shed light on an under-explored group of independent directors that play an increasing role in the effective governance of publicly-listed firms.
Introduction

Outside directors play an important role in the governance of publicly-listed firms. Extant studies examining outside board member proclivities toward corporate governance often contain conflicting arguments regarding such directors’ inclinations toward governance provisions that restrict shareholders’ rights and entrench top executives, such as staggered boards, poison pills, or supermajority requirements for mergers (e.g., Harford 2003, Westphal and Khanna 2003). A good portion of the corporate governance literature has adopted the view that control of major industrial enterprises is largely the purview of the corporate elite (Davis 2005). Board seats in this domain go to those in good standing in the corporate elite, and who are sufficiently connected socially. There is evidence to suggest that board nominating committees and CEOs are perhaps less concerned with outside board candidates’ efforts to enhance firm performance, and more concerned with candidates conforming to the norms of the corporate elite (Westphal and Graebner 2010, Westphal and Khanna 2003, Westphal and Stern 2007). This body of work appears to suggest that being part of, and perhaps more importantly, supportive of the corporate elite is a central issue in the board selection process (Westphal and Graebner 2010). Others have argued for the orthogonal efficient directorial labor market view (Fama 1980, Fama and Jensen 1983). The efficient directorial labor market argument is based on the agency theory conceptualization of the firm as a nexus of efficient, market-based contractual relationships, with the management serving as hired agents of the shareholders (Jensen and Meckling 1976). This market rewards outside directors both in the present and future for pursuing shareholders’ interests through active monitoring, minimization of agency costs, and controlling managerial discretion (Ferris et al. 2003).

While the corporate elite view suggests that outside directors function within the norms of that group and favor governance provisions that aid executive entrenchment, the efficient directorial labor market view suggests that the norms of the corporate elite might not sway these directors to acquiesce to their expectations, as economic self interest generally trumps all else. There is empirical evidence supporting both views. Works such as Yermack (2004) make a good case for the economic benefits both in the
present and future for outside directors who limit executive entrenchment. However, studies such as Westphal and Stearn (2007) tell a very different story of outside directors suffering adverse outcomes for encroaching upon management’s control. We postulate Davis (2005 p. 149) was correct in observing: “while the contractarian approach [underpinned by the efficient market perspective] contemplates a world relatively free of the friction of social structure and politics, systematic empirical work have found pervasive influence of both in the operations of corporate governance mechanisms.” However, he then observes corporate governance must be reasonably responsive to markets which provide vital resources, and will not likely support firms that abuse shareholders.

Rather than consider outside directors collectively, we wish to take a finer-grained view and study a subset of outside directors we refer to as independent or outside non-core directors. Extant studies have previously shed light on the behavioral responses of various categories of outside directors to the conflicting forces emanating from the corporate elite and efficient directorial labor market with regard to executive entrenchment. For instance, affiliated directors (i.e., outside directors with business ties to the firm or CEO) are expected to support entrenchment given their lack of independence stemming from potential conflicts of interests that precludes them from opposing entrenchment (Ryan and Wiggins 2004). Independent executive directors, often being core members of the corporate elite, may be expected to reciprocally support their fellow executives by not actively pursuing actions that limit managerial discretion (McDonald and Westphal 2011, Useem 1982, Westphal and Zajac 1997). However the inclinations of independent non-core directors are less clear.

In defining the corporate elite, Useem (1980, 1982) suggests those who manage or sit on the boards of major corporations are members of the corporate elite. However, Useem as well as others (Berg and Zald 1978) observe that the corporate elite is not homogeneous. It appears senior executives of major corporations form the cohesive core membership of the corporate elite. However, those members of the corporate elite who do not hold such positions, but rather serve as directors of such firms we might refer to as “non-core members” of the corporate elite. Specifically, the directors we wish to focus on, outside or independent non-core directors are those who have no formal ties with the focal firm other than their
board service, are not former executives of the firm, nor are they currently executives of other public or large private firms (a list of which is published by Forbes). Examples of such directors include John Deutch who was an independent director of Citigroup Inc. in 2004 and did not hold any executive appointments other than his position as faculty of Massachusetts Institute of Technology, or John Walter who was an independent director of Abbott Laboratories in 2003 without any other executive appointments at or outside of the firm.

We know little about independent non-core directors’ proclivities toward governance provisions that entrench top executives. As described above, while independent non-core directors may be viewed as members of the corporate elite by virtue of their board appointments, they do not share the same level of affiliation with the corporate elite as their executive director counterparts (Davis and Thompson 1994, McDonald and Westphal 2011). Hence, they may be more responsive to the demands of shareholders and eschew the norms of the corporate elite. Alternatively, in an attempt to ingratiate themselves with the core members of the corporate elite, they may be more supportive of executive entrenchment.

The response of independent non-core directors to the conflicting disciplinary forces emanating from the corporate elite and efficient directorial labor market is an important issue that has not been theoretically or empirically examined. This is surprising given the evidence that these directors play an increasing role in the governance of publicly-listed firms. Recently published reports by Spencer Stuart (2011, 2012), an executive search firm which specializes in board searches, offers evidence of the changing composition of corporate boards. According to Spencer Stuart (2011, 2012) statistics, 25 years ago the ratio of outsiders to insiders at U.S. publicly-held firms was 3 to 1, while today that ratio is over 5 to 1. Of these outsiders, active CEO board service in other firms is in decline. Active CEOs are stepping away from board service as the passage of Sarbanes-Oxley has increased the demands on directors materially (Hembrock-Duam 2010). According to Spencer Stuart (2012), 24% of 2010 new board appointments were active CEOs, versus 53% ten years earlier. The average active CEO held 1.4 directorships in 2000 compared with 0.6 directorships by 2011 (Spencer Stuart 2012). Affiliated director membership is also declining as a result of Sarbanes-Oxley and securities exchange requirements, along
with pressure from institutional investors (Chhaochharia and Grinstein 2009). In sum, as of 2011, independent non-core directors represented 37% of the average S&P 500 board recruits (Spencer Stuart 2012). Ten years earlier they represented about a quarter of director recruits. Given the simultaneous demands for more outsiders without ties to the firm, and active CEOs’ waning involvement, it would seem reasonable to anticipate that the role independent non-core directors play on boards will if anything be increasing. Given their increasing presence on boards, independent non-core directors will almost certainly play a greater role in deciding issues related to corporate governance, including arbitrating the appropriate level of managerial entrenchment between management and investors.

Our study contributes to governance research by exploring the question of whether independent non-core directors influence the level of entrenchment in the firms they oversee. According to Weisbach (1988 p. 435) “Managerial entrenchment occurs when managers gain so much power that they are able to use the firm to further their own interests rather than the interests of shareholders.” Following Bebchuk, Cohen and Ferrell (2009), we specifically assess the level of managerial control of the firm by examining the number of governance provisions that corporate boards adopt to provide incumbent executives protection from removal or the consequences of removal, specifically provisions pertaining to staggered boards, poison pills, golden parachutes, restrictions on bylaws, restrictions on charter amendments and supermajority requirements for mergers. Board members’ willingness to accept executive entrenchment is an important issue as entrenchment has been shown to harm shareholders. Among the adverse consequences that have been identified are: CEO pursuit of sub-optimal investments as part of empire-building efforts (Jung et al. 1996, Shleifer and Vishny 1989); sub-optimal capital structures designed to reduce risk of firm failure and CEO removal (Zwiebel 1996); sub-optimal dividend policies (Hu and Kumar 2004); and excessive diversification in order to reduce firm risk (Denis et al. 1997).

Given the conflicting forces impacting independent non-core directors, it is important we explore what contingencies may sway this group of directors to conform to the expectations of the corporate elite view or the efficient directorial labor market view. We first propose competing baseline hypotheses which seek to determine whether the efficient directorial labor market view or the corporate elite view is more
reflective of reality. We then undertake a midrange analysis that focuses on contextual factors we believe moderate the baseline relationship between independent non-core directors and executive entrenchment. We argue that there are contexts in which these directors will be associated with less entrenchment, as anticipated by the efficient directorial labor market view, while in others the corporate elite view may be more applicable. We anticipate independent non-core directors will be associated with greater executive entrenchment when they are more embedded in the network of corporate elites. Independent non-core directors will be associated with less entrenchment as their length of service on the board and their equity holdings in the firm increase. We expect that as outside CEO director equity ownership in the focal firm grows larger, they will facilitate independent non-core directors’ support for less executive entrenchment. Finally, we hypothesize they will acquiesce to more entrenchment when firm performance has been good, but agree to less entrenchment when performance has been poor.

**Theory Development and Hypotheses**

Let us now explore how independent non-core directors may relate to executive entrenchment through either the lenses of the efficient directorial labor market model or the corporate elite view.

**The Case for Independent Non-Core Directors’ Resistance to Executive Entrenchment**

Over the years various agency theory scholars have distilled a set of expectations of outside director conduct we refer to as the *efficient directorial labor market model*. They have both argued and found support for the proposition that outside directors act in shareholders’ interests, promote shareholders’ prerogatives, and limit managerial entrenchment in pursuit of their own self interests (Fama 1980, Gibbons and Murphy 1992, Yermack 2004). There are at least three reasons for us to anticipate outside directors in general, and non-core outside directors in particular conform to these expectations.

First, there are the immediate adverse financial consequences outside directors sustain if they fail to rein in entrenchment. Entrenchment appears to adversely impact share prices, and outside directors in recent years have received more and more of their compensation in the form of equity (Coles and Hoi 2003, Ferris et al. 2003, Yermack 2004). Yermack (2004) reports that outside directors receive an average of 60% of their directors’ fees in equity-related securities (e.g., restricted stock and options). As major
corporations paid outside directors an average of $227,250 in 2011 (Kelly 2012), it appears outside
director equity-based compensation now averages about $136,000 per year at major firms. As a
consequence, outside directors who have accumulated a few years worth of stock options or restricted
stock would have a fairly powerful market-driven incentive to take steps to enhance shareholder wealth
and eschew executive entrenchment. Such incentives may be more relevant to non-core outside directors
who, unlike their active executive director counterparts, may not be earning the compensation of a major
corporate executive. As a point of reference, according to a Hay Group/Wall Street Journal survey, the
average CEO of a top 300 U.S. firm received total compensation of $10.3 million in 2011 (Hay

Second, it has long been argued (Fama 1980), and empirically documented that the directorial labor
market rewards outside directors who preside over firms with superior performance with additional board
seats (Harford 2003). Contrarily, Fama (1980) and Fama and Jensen (1983) contend the labor market for
directors will deny additional board appointments to those who fail to look after shareholder interests, as a
form of ex-post settling up for past transgressions against shareholders. This may be of more concern to
non-core directors than outside executive directors. As reported earlier, the post-Sarbanes-Oxley trend has
been for active CEOs to reduce their outside board service, while non-executives have materially stepped
up their participation.

Third, Fama (1980) contends there is also a reputational motivation for outside directors to defend
shareholders’ interests and enhance shareholder value. Presiding over a poorly performing firm or one
that rides roughshod over shareholder prerogatives damages a director’s prestige (Gilson 1990). Again,
this may be less of an issue for active outside executive directors whose primary reputational concerns
would obviously be focused on their employing firms, rather than the firms on whose boards they serve.

For these reasons, from an efficient directorial labor market perspective, it seems reasonable to
anticipate that outside non-core directors will pursue shareholders’ interests, which would include reining
in managerial entrenchment. However, there is another perspective on this question, that of the corporate
elite view.
The Case for Independent Non-Core Directors’ Association with Executive Entrenchment

An alternative take on outside director conduct, which we refer to as the corporate elite view has evolved along a parallel track (Davis 2005). There are at least four reasons why this body of work suggests outside non-core directors may be inclined to support managerial entrenchment.

First, given Useem’s (1980) definition of the corporate elite, outside directors are members of the elite if for no other reason than their board appointments. It is believed members of the corporate elite have been socialized to some extent to share certain corporate elite values, beliefs, and norms (Palmer 1983, Useem and Karabel 1986). One such norm is an appreciation of the need to support other members of the elite and to maintain the members’ decision control and autonomy (Useem 1984). Westphal and Zajac (1997) contend that a key elite class norm for outside directors is to support their CEO’s discretion owing to their mutually-felt obligations as members of the corporate elite class. However, it is worth pointing out that unlike directors who are executives of major corporations, outside non-core directors, who hold more peripheral membership in the corporate elite, may be somewhat less inclined to conform to the expectations of the corporate elite model’s assumed priorities (Cancian 1967, Hirsch 1986, Menzel 1960).

A second reason the corporate elite model suggests outside directors will support managerial discretion and entrenchment is that in order to be retained as a board member, or appointed to new boards, one must be a member in good standing of the corporate elite. The corporate elite model envisions a more political selection process that is not so much focused on firm outcomes. As Davis and Greve (1997) observe, ones standing in, and fidelity to the corporate elite appears to be far more important in securing board seats than presiding over superior firm performance. While executives of major corporations serving as directors are by definition core members of the corporate elite (Davis et al. 2003, McDonald and Westphal 2011), as described above, non-core directors are more peripheral members. While they may not feel the same sense of fealty to the corporate elite, in order to retain their board seats and acquire others, non-core outsiders may feel compelled to demonstrate their willingness to support the corporate elite by supporting managerial entrenchment efforts. As described earlier, the efficient directorial labor market model would anticipate that in order for an outside non-core director to achieve the same outcome.
of retaining or adding board seats, he/she would seek to rein in entrenchment. This would be the case as the efficient directorial labor market perspective envisions directorial performance being objectively estimated and appropriately rewarded or punished (Davis 2005).

A third possible reason found in the corporate elite literature for outside non-core directors’ support for executive entrenchment is the intra-board member disciplining that has been found to occur when board members fail to support CEO discretion. Westphal and Khanna (2003) as well as Westphal and Stern (2007) document how fellow board members impose sanctions on their colleagues such as informal exclusion from board activities and loss of their board seats. They also report that offending directors acknowledge these sanctions and respond to them. The potential for such sanctions to influence outside non-core directors may be greater owing to their less-than-central position in the corporate elite. While their colleagues who are leaders of major corporations appear to be somewhat insulated from sanctions owing to their positions in the elite (Westphal and Khanna 2003), non-core directors may perceive they have more at stake in not supporting the CEO and risking the disapproval of fellow directors.

Finally, oftentimes outside directors in effect owe their board seats to the CEO who may have encouraged their appointment, knowing the new director can be counted upon to support the CEO while appearing to be independent of the CEO (Finkelstein and Hambrick 1989, Westphal and Graebner 2010). Outside non-core directors, who may value their board seats and its associated entree into the corporate elite more than their executive counterparts could be expected to be more compliant with CEO expectations of support for greater entrenchment.

Given the expectations of various works related to the efficient directorial labor market model, as opposed to those of the corporate elite perspective, it may be well to recall Davis’s (2005) earlier observations. He acknowledges agency theory scholars view the firm as a nexus of efficient contractual relationships, with directors responding to an efficient directorial labor market and their own economic interests, as they assume away social structure and political dynamics. However, he then notes that others believe reality is quite different, and that social and political standing are critically important. He
concludes both perspectives have merit in that while social and political standing matter greatly, investor expectations and the disciplining power of markets cannot indefinitely be ignored.

In order to define a baseline relationship between non-core outsider board participation and executive entrenchment as a foundation for our subsequent mid-range analysis, we offer competing hypotheses. The first reflects the expectations of the efficient directorial labor market reviewed earlier, while the second reflects the corporate elite view’s expectations for outside non-core directors’ inclinations.

\textit{H1a:} Given the expectations of efficient directorial labor market model arguments, more independent non-core directors will be associated with less executive entrenchment.

\textit{H1b:} Given the expectations of the corporate elite view, more independent non-core directors will be associated with more executive entrenchment.

While one or the other perspective may prevail generally, it is unlikely one will always prevail to the exclusion of the other. Impressions of board oversight may be managed so as to allow board members to appear to be credible shareholder representatives, while still accommodating entrenchment, but the costs of entrenchment may become apparent and investors grow restive (Shleifer and Vishny 1989). We anticipate that rather than one view always being fully dominant, a select set of contextual factors will cause independent non-core directors to reflect more or less of the two alternative views. We will now consider these factors.

**Moderators of the Independent Non-Core Director - Entrenchment Relationship**

The midrange analysis portion of our paper seeks to explore how contextual factors might lead independent non-core directors to heed the disciplining forces of an efficient directorial labor market or conform to the norms of the corporate elite. Specifically, we consider the moderating potential of the extent to which such directors are embedded in the network of governing corporate elites, independent non-core director service length on the board, their equity holdings in the focal firm, major equity holdings of independent CEO directors in the focal firm, and firm performance.

\textit{Embeddedness of Independent Non-Core Directors.} As mentioned earlier, the corporate elite are non-monolithic, and some members are inevitably more tightly networked than others (McDonald and
Westphal 2011). In effect, it is likely there are degrees of membership in the corporate elite. CEOs of major firms with prestigious board seats are likely to constitute the “pinnacle” or “inner circle” of the corporate elites (McDonald and Westphal 2011, Palmer and Barber 2001), but others who do not hold top-level corporate positions likely vary in the degree to which they are interconnected. Though independent non-core directors have not been explicitly examined, it appears reasonable to anticipate there are varying levels of relational embeddedness among these directors, with some more closely affiliated within the corporate elite than others (Palmer and Barber 2001).

Extant studies suggest that independent non-core directors with higher network embeddedness are more likely to align with and ingratiate themselves to the corporate elite by acquiescing to managerial entrenchment. Bourgeois and Friedkin (2001) found socialization a key element in the development of solidarity among board members where there is agreement on opinions, objectives, and standards as well as the acknowledgement of interpersonal influence. Such a finding is consistent with the broader observation by Strang and Soule (1998 p. 272) that close social relations “lead actors to take the perspective of the other and to exert powerful pressures for conformity.” Given the importance of relational ties in perpetuating group norms and behavioral expectations, it may be that independent non-core directors with more direct ties within the corporate elite may exhibit higher levels of cohesion, and a greater inclination to be associated with managerial entrenchment.

Conversely, independent non-core directors with lower network embeddedness are less susceptible to the socialization and gravitational pull of the corporate elite and may be more inclined to thwart entrenchment. Stearns and Allan (1996) suggest that persons near but not within the core of the corporate elites (Useem 1984) may not be as committed, as they have not been acculturated or socialized into the corporate elite to the same degree, and are perhaps prepared to act in a manner contrary to the corporate elite’s expectations owing to their more marginal positions within the network. It may be that as independent non-core directors’ embeddedness decreases, they may feel less fidelity to the corporate elite (Useem 1984, Useem and Karabel 1986). Less allegiance may mean the possible sanctions described earlier carry less weight for some board members and rather than work to ingratiate themselves, they act
more independently (Palmer and Barber 2001, Stearns and Allan 1996). While it is possible that peripheral directors may instead work harder to ingratiate themselves by conforming to the corporate elite norms of entrenchment so as not to jeopardize their positions on the board, there is empirical evidence to suggest that these directors are more likely to act in a manner contrary to the elite’s expectations. Studies have found that low-status actors are less inhibited to defy accepted norms because of their marginal positions (Dittes and Kelley 1956, Phillips and Zuckerman 2001). Given that independent non-core directors do not constitute the “inner circle” of the corporate elites, those residing at the periphery of corporate elite networks have lower status when compared with top executives of major firms. As a result, peripheral directors may engage in riskier non-conforming behaviors since it is not uncommon for individuals located further from central positions and less integrated into their peer network to act in non-conforming ways (Cancian 1967, Hirsch 1986, Menzel 1960). Given the variance that may exist in terms of embeddedness of outside non-core directors in the network of corporate elite, we anticipate as average independent non-core director embeddedness increases, their association with executive entrenchment will also grow. As a consequence, we offer the following hypothesis:

**H2**: The average embeddedness of independent non-core directors in the network of corporate elites will moderate the association between the number of independent non-core directors and the level of executive entrenchment such that the association is more positive when the independent non-core directors are on average highly embedded in the network of corporate elites.

*Length of Service of Independent Non-Core Directors.* There are reasons to anticipate the length of service of outside non-core directors may either diminish or increase the odds of outside non-core directors endorsing managerial entrenchment. We will now explore these and offer competing hypotheses.

There is a good basis for anticipating service length negatively moderates the relationship between independent non-core directors and executive entrenchment. First, evidence suggests that as board members’ service lengthens, barring mandatory retirement, they appear to become entrenched themselves, and their odds of leaving the board decline (Pettigrew and McNulty 1995, Yermack 2004). It seems directors’ political positions and statures strengthen and solidify with time (Pettigrew and McNulty 1995). A long-serving board member may be less susceptible to pressure from either firm management or other
board members (Gilson 1990). As tenure lengthens, outside non-core directors may also grow more concerned about directorial labor market perceptions of their performance. Yermack’s (2004) work suggests that the odds go up of securing additional board seats as board service lengthens, but only if acceptable firm performance is achieved at the firm on whose board the focal director has served. In contrast with Davis and Greve’s (1997) assertion that position in the corporate elite trumps performance, Yermack (2004) may be correct in observing directors prove themselves worthy over a period of years before additional board seats are forthcoming. As thwarting entrenchment tends to enhance a firm’s stock performance (Coles and Hoi 2003, Shleifer and Vishny 1989), longer-serving independent non-core directors may well choose to do so. Access to more board seats may be less of a concern for outside directors who work for major corporations given their declining board involvement (Spencer Stuart 2011), but the availability of high status and prestigious board seats may be important for independent non-core directors who do not hold executive positions at public corporations.

In addition, and as described earlier, board members now typically receive non-trivial portions of their directorial stipends in the form of stock options and restricted stock (Ferris et al. 2003). In all likelihood, longer-serving directors hold larger equity stakes in the firms they oversee, and as a result may be less inclined to support shareholder-wealth diminishing managerial entrenchment efforts. It seems reasonable to anticipate the various motivations outlined above will cause long-serving outside non-core directors to resist executive entrenchment.

Alternatively, we must also recognize the possibility that director service length will positively moderate outside non-core directors’ willingness to support greater entrenchment given the expectations of social exchange theory (Lawler et al. 2000, Westphal and Zajac 1997, Wong and Boh 2010). Social exchange theory would anticipate that over time, as relationships with firm executives and fellow board members develop, independent non-core directors’ inclinations to pursue actions counter to the management team’s or fellow directors’ desires will subside. There is considerable social exchange theory work suggesting that length of relationship and numbers of interactions increase feelings of trust and obligation (Blau 1964, Gouldner 1960, Kollock 1994). This literature seems to indicate length of service
should positively moderate the outside non-core director-entrenchment relationship, as the deepening relationships between such directors, other directors, and management would strengthen ties to other members of the corporate elite. In the context we examine, board service may create bonds between board members and management, so the reality may be that despite the potential for adverse personal outcomes, longer-serving board members may grow more willing to support greater managerial entrenchment.

Given the two opposing perspectives just presented, we offer competing hypotheses addressing the relationship between outside non-core board member service length and executive entrenchment:

\[ H3a: \text{The length of service of independent non-core directors will moderate the association between the number of independent non-core directors and the level of executive entrenchment such that the association is less positive when independent non-core directors have greater length of service.} \]

\[ H3b: \text{The length of service of independent non-core directors will moderate the association between the number of independent non-core directors and the level of executive entrenchment such that the association is more positive when independent non-core directors have greater length of service.} \]

\textit{Equity Ownership of Independent Non-Core Directors.} An essential element of the agency theory view of the firm as a nexus of efficient, market-driven contractual relationships is the belief that equity ownership by agents (managers and directors) tends to motivate pursuit of shareholders’ interests (Jensen 1993, Jensen and Meckling 1976). Hambrick and Jackson (2000) also contend such ownership motivates outside directors to more fully invest themselves in the firms they oversee and be more vigilant in their monitoring roles. Kroll, Walters, and Wright (2008) found that greater outside board member ownership motivates greater involvement in, and oversight of major acquisitions. In light of evidence that less executive entrenchment tends to be associated with higher share prices (Coles and Hoi 2003, Shleifer and Vishny 1989), it would seem reasonable to anticipate that greater equity ownership, which creates greater shareholder-director alignment (Kroll et al. 2008), would temper independent non-core director support for executive entrenchment. Additionally, independent non-core directors may attach greater importance to their equity holdings in the focal firm than their executive director counterparts who likely receive large stock and options grants from their home firms. We therefore offer the following hypothesis:
**H4:** The equity ownership of independent non-core directors will moderate the association between the number of independent non-core directors and the level of executive entrenchment such that the association is less positive when independent non-core directors hold a larger equity ownership stake.

*Equity Ownership of Independent CEO Directors.* While the earlier moderators focus on the internal characteristics of independent non-core directors, we posit that there are other contextual factors that influence the behavior of these directors. Obviously, independent non-core directors do not operate in a vacuum, but in concert with other classes of directors. In terms of which other groups of directors they may align themselves with in limiting CEO entrenchment, outside CEO directors who have accumulated large equity stakes in the focal firm are likely candidates as they are in a political position to restrain entrenchment. Insiders and affiliated outsiders will not likely pursue such a course owing to loyalty to the CEO and pursuit of self interests (Ryan and Wiggins 2004). This may leave only powerful outside CEO directors, who may be in a position of parity or even superiority relative to the focal CEO with regard to their positions in the corporate elite. These directors may be in the strongest position to impose their views on the focal firm given their stature among the corporate elite as a CEO (D'Aveni and Kesner 1993, Westphal and Fredrickson 2001). It appears CEO directors enjoy higher stature within the elite and are least affected by social distancing from other elite members if they participate in governance changes that increase board control (Westphal and Khanna 2003). However, as central members of the corporate elite, there is reason to believe independent CEO directors will generally not align themselves with, or initiate efforts to rein in CEO entrenchment. Rather, out of a sense of fidelity to the focal firm’s CEO, a co-member of the corporate elite, independent CEO directors may not wish to frustrate moves for greater entrenchment (Westphal and Zajac 1997). However, as those same CEOs accumulate more and more equity in the focal firm, they may find the need to foster shareholders’ interests more compelling than their loyalty to a fellow member of the corporate elite. Independent CEOs with large equity stakes may be the only available center of power on the board with whom outside non-core directors may align themselves to control entrenchment. Indeed, absent powerful independent CEO director allies, outside non-core directors may feel it politically irrational to support the restraint of managerial entrenchment.
Alternatively, independent CEOs may be unwilling to restrain entrenchment despite their equity positions if the board is largely made up of insiders and affiliated directors who are inclined to support their CEO. These possibilities motivate our next hypothesis.

**H5:** *The equity holdings by independent CEO directors will moderate the association between the number of independent non-core directors and the level of executive entrenchment such that the association is less positive when independent CEO directors hold larger equity ownership stakes.*

**Firm Performance.** If firm returns have been poor, we anticipate outside non-core directors may preside over less entrenchment for two reasons. First, outside non-core directors’ holdings in the focal firm’s securities (e.g., stock options) will either lose value or never gain value. In order to restore investor confidence, independent non-core directors may grow more willing to demonstrate to the market their diligence and willingness to rein in managerial discretion (Jensen and Meckling 1976). Second, these same directors’ attractiveness to the directorial labor market may suffer from poor performance, which again may be more of an issue for independent non-core directors than for their executive colleagues (Harford 2003). As described earlier, Sarbanes-Oxley’s demands on directors has caused CEOs to retreat from board service, while non-executives have become more involved. Being associated with poor performance may also damage the reputations and prestige of independent non-core directors (Fama 1980, Gilson 1990). As a consequence, independent non-core directors may, in such a situation, wish to be associated with less entrenchment.

There is empirical evidence board members essentially defer to management when firm performance is acceptable (Tuggle et al. 2010). Such findings may not only reflect a lack of director focus, but also director reluctance to undermine their standing with the CEO and other members of the corporate elite. However, directors start to engage management when performance declines (Bhagat and Bolton 2008, Tuggle et al. 2010). We submit such engagement may reflect board members’ motivation to convey to the directorial labor market an awareness of performance issues and the need to manifest greater shareholder focus. It has also been observed that CEO stature and influence rise and fall with firm performance (Combs et al. 2007, Ocasio 1994). Declining performance may degrade the relevance of the CEO’s
position in the corporate elite in the minds of outside non-core directors relative to concerns for labor
market perceptions, thus promoting a desire for less executive entrenchment.

**H6:** Firm performance will moderate the association between the number of independent non-core
directors and the level of executive entrenchment such that the association is less positive
when firm performance is poor, assuming the corporate elite view is supported, or more
negative if the efficient directorial labor market view finds support.

**Sample and Methods**

**Sampling**

We test our hypotheses using a sample of S&P500 firms included in the Risk Metrics database from 2001
to 2006. The starting panel dataset has a total of 575 unique S&P500 firms with 2,943 observations from
2001 to 2006. After accounting for missing data and a lag structure in the empirical model, the final panel
dataset covers 516 unique S&P500 firms with 1,777 observations from 2003 to 2006. A Kolmogorov-
Smirnov two-sample test (Siegel and Castellan 1988) revealed no significant differences in executive
entrenchment, the number of outside non-core directors, and firm size between the 59 unique S&P500
firms dropped from the starting panel dataset and the 516 unique S&P500 firms in the final panel dataset.
The average board in the final dataset comprises 73% outside directors, 15% inside directors and 12%
affiliate directors. Of the 73% outside directors, 26% are categorized as non-core directors, 18% are
CEOs, while the remaining 29% are non-CEO executives. These statistics suggest that outside non-core
directors are not insignificant when compared with other sub-categories of directors.

**Dependent Variable**

Executive entrenchment is measured with the entrenchment index (E-index) score computed from the
Risk Metrics database. Bebchuk et al. (2009) constructed the E-index by selecting six takeover-defense
governance provisions that have been the subject of significant shareholder opposition and considered to
contribute the most to executive entrenchment: staggered boards, poison pills, golden parachutes,
restrictions on bylaws, restrictions on charter amendments and supermajority requirements for mergers.
According to Bebchuk et al. (2009 p. 788), these six provisions provide executives with “protection from
removal or the consequences of removal.” For instance, staggered boards prevent shareholders from
replacing the majority of directors and offer a key defense against control challenges that result in executive removal (Bebchuk and Cohen 2005). Likewise, golden parachutes not only insulate executives from the economic costs of losing control, but may deter potential bidders by shifting the burden of compensation to acquirers through higher takeover premiums (Choi 2004, Sundaramurthy 2000). Masulis, Wang and Xie (2007) found results consistent with their argument that executives at firms with these takeover-defense governance provisions receive more protection from the discipline imposed by the market for corporate control. Since hostile takeover activity decreases when shareholder rights are less protected from the discretion of the incumbent executives (Schneper and Guillén 2004), takeover-defense governance provisions such as those in the E-index can entrench executives by reducing the likelihood of receiving a takeover bid (Field and Karpoff 2002, Jarrell et al. 1988). Thus, the E-index score of a firm offers a suitable proxy for executive entrenchment. The computation of the E-index for each firm is straightforward: one point is added for each provision adopted. For example, a firm that adopts staggered boards, poison pills, and supermajority requirements is assigned an E-index score of three. Hence, higher E-index scores reflect greater executive entrenchment. The E-index score of each firm is adjusted by the industry mean to control for industry effects on the dependent variable.

**Independent and Moderating Variables**

The independent and moderating variables are computed using data extracted from Compustat, the Corporate Library, or proxy statements of the firms. The independent variable is the number of outside non-core directors. Outside non-core directors are defined as independent directors that do not have any business ties to the focal firm, are not former executives of the focal firm, and are not currently holding any executive titles (CEO or otherwise) at other publicly-held corporations and the 500 largest private firms published by Forbes. To shed more light on the background of these directors, we also extracted information from the biography of these directors that are disclosed in the respective firms’ proxy statements. Approximately 63% of these directors do not have any stated organizational appointments, 3% are from government or non-profit institutions, 12% come from universities or research institutions, 8% are employed by small private investment firms, and the remaining 14% are executives at small private
for-profit firms from a wide range of industries. Of those directors that do not have any stated organizational appointments, 82% appear to be professional directors without any current firm affiliations except as outside directors or trustees, 9% are independent consultants, 8% are private investors, and the remaining 1% are self-employed. About 31% of outside non-core directors are retired executives of other public or large private firms. Table 1 presents sample profiles of directors that fall into the various categories stated above.

Insert Table 1 Here

The moderating variables included in the empirical model are measured as follows. First, the embeddedness of outside non-core directors in the corporate elite network is computed using the mean number of ties the outside non-core directors of each firm have with other directors in the network of interlocking directorates among S&P500 firms. A tie between two directors exists when both directors are present on the same corporate board of an S&P500 firm. The more ties that directors have with other directors in the same network, the more embedded the directors are in the corporate elite network. We used UCINet 6 to generate the number of director ties. Second, the tenure of outside non-core directors for each firm is computed as the mean tenure among outside non-core directors that serve on a firm’s board. Third, the equity ownership of outside non-core directors and independent CEO directors are separately measured by first extracting the number of shares owned by these directors and then multiplying these values by the year-end stock price. We use the dollar value of a firm’s equity instead of the more traditional measure of equity ownership percentage since we are concerned with how much wealth these directors have committed to the firm (Bhagat et al. 2008). The natural log of these variables was entered into the regression model to reduce the influence of extreme values. Finally, firm performance is computed as a firm’s industry-adjusted return on equity (ROE). We first expressed a firm’s ROE as net income over shareholders’ equity and then deduct the industry ROE to arrive at a firm’s performance relative to its rivals. Industry ROE is computed using 2-digit SIC codes.

Control Variables
We included several control variables to partial out their possible influence on executive entrenchment. Unless otherwise stated, all control variables are extracted from Compustat, the Corporate Library, and proxy statements of the firms. First, we included total sales to control for firm size. Firm size may influence executive entrenchment since larger firms may be less susceptible to takeover threats (Sundaramurthy 1996). The natural log of this variable was entered into the regression model to reduce the influence of extreme values. Second, we included the number of independent CEO directors, the number of independent non-CEO directors, and the number of inside directors as control variables.

Third, given that the embeddedness and tenure of outside non-core directors are moderators in the empirical model, we also controlled for the embeddedness and tenure of independent CEO directors, independent non-CEO directors, affiliate directors, non-CEO inside directors and the focal firm’s CEO. Similarly, the natural log of the dollar value of a firm’s equity held by independent non-CEO directors, affiliate directors, non-CEO inside directors and the focal firm’s CEO are also included as control variables. Fourth, we used other proxies to control for the CEO’s power to influence entrenchment. Specifically, we included a dummy variable, CEO duality, coded as one if the CEO is also the board chair and zero otherwise. CEOs holding board chair positions may have more structural power (Kang and Zardkoohi 2005) to entrench themselves. We controlled for the number of independent directors appointed after the CEO as the power of CEOs is likely to be stronger when they are able to influence the board appointments of these directors (Wade et al. 1990). CEO power is also measured using the ratio of the CEO’s total compensation over the total compensation of the next highest paid executive (Finkelstein 1992).

Fifth, we accounted for the effect of other governance variables on executive entrenchment. Given that our independent variable is the number of outside non-core directors, we controlled for board size because of its potential impact on board dynamics (Forbes and Milliken 1999, Harris and Raviv 2008, Johnson et al. 1996). The number of female directors is included as a control since female directors may serve board roles other than monitoring top executives on behalf of shareholders (Hillman et al. 2002). If female directors primarily serve non-control roles on boards, then including the number of female directors will
partial out its possible influence on executive entrenchment. We included the proportion of equity held by substantial institutional investors since these investors may engage in activism to reduce executive entrenchment (Ryan and Schneider 2002). This variable is extracted from the Thomson-Reuters Institutional Holdings (13F) Database. We also controlled for the number of outside directors who are blockholders, i.e., hold more than 5% of the firm’s equity (Bogert 1996).

Sixth, we controlled for possible isomorphic effects of executive entrenchment given that the spread of governance practices within corporate elite networks has been documented in prior studies (Davis 1991, Davis and Greve 1997). Specifically, governance provisions that entrench executives may diffuse through the corporate elite networks where directors from firms with greater executive entrenchment may adopt provisions that increase executive entrenchment in other firms where they also hold board appointments. We computed the mean E-index scores of all S&P500 firms with director interlock ties to the focal firm. Seventh, we created several dummy variables to control for year effects on executive entrenchment. Finally, we lagged the E-index score for each firm by one year and included it in the empirical model to control for model misspecifications arising from omitted variable bias.

**Endogeneity Control**

Our conceptual model infers that the number of outside non-core directors influences the level of executive entrenchment in a firm. However, it is also possible that the number of outside non-core directors may be partially determined by the level of executive entrenchment and other governance variables included in the model (Rediker and Seth 1995). In other words, it is likely that we have an endogeneity issue. We followed the method adopted by prior studies and included a control for endogeneity in the empirical model (Sanders and Hambrick 2007, Walters et al. 2010). The endogeneity control is the predicted number of outside non-core directors estimated in the following model. We regress the number of outside non-core directors against the industry-adjusted E-index score; the numbers of independent CEO, independent non-CEO, and inside directors; the embeddedness, tenure, and equity ownership of independent CEO, independent non-CEO, affiliate, and non-CEO inside directors; the equity ownership of the CEO; CEO duality; the number of independent directors appointed after the CEO;
the ratio of the CEO’s total compensation over the total compensation of the next highest paid executive; board size; the number of female directors; the equity ownership of substantial institutional investors; the number of outside directors who are blockholders. These governance-related variables in the main model are included as predictors since substitution effects of various governance mechanisms may occur (Rediker and Seth 1995). Other than governance-related variables, we also included firm size, firm profitability, and year dummy variables as predictors to account for their effects on the number of outside non-core directors.

We used the panel dataset from 2001 to 2006 to run the regression model. The endogeneity control variable was generated for years 2002 to 2006 since we lagged the predictors in the model by one year. Hence, observations for year 2001 were dropped because lag predictors were not available for year 2000. We used the Hausman specification test to compare the fixed-effects and random-effects estimators given that standard ordinary least squares regression is not suitable since the assumption of independence is violated with a cross-sectional panel dataset. The Hausman specification test suggested that the fixed-effects model is appropriate ($p < 0.001$). We ran the fixed-effects model and found it to be significant ($p < 0.001$). Thereafter, we generated the “predicted” number of outside non-core directors from the fixed-effects model, and included the predicted values as the endogeneity control variable in the empirical model for hypotheses testing.

**Results**

Table 2 presents the descriptive statistics for the variables used to test the hypotheses.

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Insert Table 2 Here
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We lagged the predictors in the main empirical model by one year such that the dependent variable at time $t+1$ are regressed against all independent and control variables at time $t$. A lag model was adopted to facilitate causal inferences for the hypothesized relationships. Given that the endogeneity control variable was generated from years 2002 to 2006, the final model used to test our hypotheses ranged from years 2003 to 2006 with 1,777 firm-year observations for 516 unique S&P500 firms. We used a fixed-effects
model instead of a random-effects model based on the results of the Hausman specification test ($p < 0.001$). We centered the continuous variables prior to creating the interaction terms. Multicollinearity did not appear to pose a problem, as the mean variance inflation factors (VIF) for the full regression model with all the interaction terms is 2.36 with none of the VIFs exceeding 10, the point at which multicollinearity is a concern (Chatterjee et al. 2000). The standard errors were replaced with Huber-White robust standard errors to correct for heteroskedasticity of the residuals (White 1980). All competing hypotheses are tested using a two-tailed test while other hypotheses are tested using a one-tailed test. Table 3 presents the results of the analyses.

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Insert Table 3 Here

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Model 1 shows the results for the control variables, model 2 includes the independent and moderating variables, model 3 includes the interaction terms used to test the hypotheses, and model 4 includes additional interaction terms that act as control variables. All four models are significant at $p < 0.001$. Model 4, the full model with all control variables, will be used for hypotheses testing.

Hypothesis 1a, based on the efficient directorial labor market perspective, suggests that the number of outside non-core directors is negatively associated with executive entrenchment. Conversely, hypothesis 1b, based on the corporate elite perspective, suggests a positive association. The coefficient for the number of outside non-core directors is positive and significant ($p < 0.05$), thus supporting hypothesis 1b. Hypothesis 2 suggests that the association between the number of outside non-core directors and executive entrenchment is more positive when these directors are highly embedded in the network of corporate elites. This hypothesis receives support as the coefficient of the interaction term between the number of outside non-core directors and outside non-core directors’ embeddedness is positive and significant ($p < 0.05$). Hypothesis 3a suggests that the tenure of outside non-core directors will moderate the association between the number of outside non-core directors and executive entrenchment such that the association is less positive when these directors have long board tenure. Conversely, hypothesis 3b alternatively suggests the association is more positive when these directors have long board tenure. The
results support hypothesis 3a. The coefficient for the interaction term between the number of outside non-core directors and outside non-core directors’ tenure is negative and significant \((p < 0.01)\).

Hypothesis 4 suggests that the association between the number of outside non-core directors and executive entrenchment is less positive when these directors’ equity ownership is high. This hypothesis is not supported since the coefficient for the interaction term between the number of outside non-core directors and outside non-core directors’ equity ownership value is not significant \((p > 0.1)\). Hypothesis 5 suggests that the association between the number of outside non-core directors and executive entrenchment is less positive when independent CEO directors’ equity ownership is high. This hypothesis receives support as the coefficient for the interaction term between the number of outside non-core directors and independent CEO directors’ equity ownership value is negative and significant \((p < 0.01)\).

Finally, hypothesis 6 suggests that the association between the number of outside non-core directors and executive entrenchment is less positive when firm performance is low or more positive when firm performance is high. The coefficient for the interaction term between the number of outside non-core directors and firm performance is positive and significant \((p < 0.001)\), thus supporting hypothesis 6.

Insert Figures 1 and 2 Here
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The graphic representations of the significant interaction effects are shown in figures 1 and 2. We followed the procedures suggested by Aiken and West (1991) and graphed the simple regression slopes of the relationship between the number of independent non-core directors and industry-adjusted E-index at one standard deviation above and below the mean of the moderating variables. A value of zero in the Y-axis suggests that executive entrenchment in a firm is no different from the average in the firm’s industry. The figures show that the interaction effects in graphical forms are consistent with the stated hypotheses. Furthermore, strong support for firm performance as a moderating variable is evident from the crossover interaction effect. Specifically, the association between the number of outside non-core directors and industry-adjusted E-index is positive under conditions of high firm performance, but becomes negative when firm performance is low. This interaction effect is consistent with our arguments that outside non-
core directors are mindful of the consequences that poor firm performance can have on their value in the directorial labor market, thus the corresponding negative association with governance provisions that entrench executives who fail to deliver above-average returns to shareholders.

We also estimate the relative effect size of each moderator in order to impute a meaning to the statistical significance of the interaction terms. From figures 1 and 2, we note that the range of the industry-adjusted E-index is largest under conditions of high embeddedness, short tenure, low independent CEO directors’ equity ownership and high performance. For instance, the industry-adjusted E-index increases by a magnitude of 0.54 under the condition of high embeddedness. This magnitude is computed by summing the absolute values of the predicted industry-adjusted E-index when the number of outside non-core directors is low and high, i.e., 0.13 and 0.41 respectively. Given that the industry adjusted E-index ranges from -3 to 3.4 in our sample, a value of 0.54 constitutes 8% (or 0.45 divided by 6.4) of the range of the industry adjusted E-index. Similarly, we computed this percentage under conditions of short tenure, low independent CEO directors’ equity ownership and high performance and derived values of 10%, 8%, and 15% respectively. Clearly, the moderating effect of firm performance is strongest when compared with the other moderators. The same conclusion is arrived at when the computation is based on the conditions of low embeddedness, long tenure, high independent CEO directors’ equity ownership and low performance.

**Robustness Tests and Additional Analyses**

We conducted additional analyses to check the robustness of the results. First, we adjusted our proxy for executive entrenchment by removing golden parachutes from the E-index score. Although Bebchuk *et al.* (2009) included golden parachutes into the E-index, its inclusion may be problematic since the empirical evidence on whether golden parachutes hinder takeovers and increase executive entrenchment is not conclusive (Bhagat *et al.* 2008, Buchholtz and Ribbens 1994, Lambert and Larcker 1985). Given the equivocal evidence, we replicated the steps to generate the endogeneity control variable and reran the main regression without golden parachutes in the E-index score. The results remain substantively unchanged. Second, the E-index is a subset of 24 governance provisions included in the governance index
developed by Gompers, Ishii and Metrick (2003) to measure the shareholder rights of a firm. Given that the correlation between the E-index and the other 18 governance provisions (O-index) is positive and significant in our sample, we included the O-index as an additional control for potential substitution effects among governance mechanisms (Bebchuk and Kamar 2010, Rediker and Seth 1995). The O-index is computed by adding one point for each of the 18 provisions adopted by a firm. The inclusion of the O-index as a control variable did not substantively change the results of the hypotheses testing.

Third, we checked to see if alternative measures of firm performance and firm size will influence the results. We used Tobin’s Q (Chung and Pruitt 1994), a market-based measure of firm performance, instead of ROE and found that the results remain substantively unchanged. The results also remain substantively unchanged if the natural log of total assets, instead of total sales, is used to measure firm size. Fourth, the results may be sensitive to our choice of using means to measure the embeddedness, tenure and equity ownership values of outside non-core directors. For instance, the mean tenure is identical for a group of five outside non-core directors with board tenure of three years each when compared with another group comprised of four directors with board tenure of one year and one director with 11 years of board service. However, the board dynamics for these two groups are likely to be different. We replaced these mean measures with the median and found that the results remain substantively unchanged.

Finally, we explored how an empirical model that examines independent directors as a group would compare with the results in table 3. We treated independent directors homogeneously and replicated the steps to generate the endogeneity control variable and reran the main regression with firm performance, embeddedness, tenure and equity ownership value of these directors as the moderators. While the overall model remained significant ($p < 0.001$), the results suggest that the number of independent directors is not significantly associated with the industry-adjusted E-index. Out of the four moderators, only the interaction term with firm performance is significant and positive ($p < 0.05$). These results reaffirm the

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1 The full list of 24 governance provisions may be found in Gompers et al. (2003).
merit of examining independent non-core directors as a meaningful sub-category of the broader category of independent directors in the context of this study.

Discussion and Conclusion

Our purpose was to explore whether outside non-core directors do matter in the governance of large publicly-traded firms. Extant studies have not examined the effectiveness of these directors in arbitrating the contest for firm control between executives and shareholders in publicly-traded firms (Davis and Thompson 1994). Since the representation of these directors on the boards of publicly-listed firms is not insignificant given the declining numbers of outside directors with executive appointments (Spencer Stuart 2011), it is an opportune time for scholars to theoretically and empirically examine outside non-core directors in governance research. Our first step in this nascent research topic is to address the question of whether the number of outside non-core directors is associated with an executive entrenchment index score in the firms they oversee. We examine executive entrenchment because of the evidence highlighting its negative consequences for shareholders (Denis et al. 1997, Hu and Kumar 2004, Jung et al. 1996, Shleifer and Vishny 1989, Zwiebel 1996). We draw from the corporate elite and efficient directorial labor market views to argue that outside non-core directors do matter in governance decisions that influence executive entrenchment but their impact on executive entrenchment is contingent on various exogenous and endogenous factors that sway them to conform to the norms of the corporate elite or heed the disciplining forces of the directorial labor market.

We find that the number of outside non-core directors is positively associated with executive entrenchment. While this finding is supportive of the corporate elite view, the results also suggest that outside non-core directors do not show unwavering support for the corporate elite. Instead, we find several contingencies that influence whether outside non-core directors conform to the norms of the corporate elite or heed the disciplining forces of the directorial labor market. Specifically, the results show that the association between the number of outside non-core directors and executive entrenchment is less positive when these directors have low embeddedness in the corporate elite network, short board tenure, or when independent CEO directors’ equity ownership is high. Additionally, the moderating effect
of firm performance is especially strong given that we found a crossover interaction effect where the association between the number of outside non-core directors and executive entrenchment is negative when firm performance is low but becomes positive under the opposite condition.

We did not find any moderating effect for the equity ownership of outside non-core directors. One possible reason is that a threshold in wealth effects may be needed to motivate outside non-core directors to violate the norms of the corporate elite but their equity wealth in our sample has not exceeded this threshold. Another possible explanation could be that violating the norms of the corporate elite is driven less by monetary incentives but more by the power to sustain a challenge to the incumbent CEO without losing the board seat. The results of the study are supportive of the latter explanation. While outside non-core directors are part of the corporate elite by virtue of their board appointments in large S&P500 firms, they do not belong to the “inner circle” of the elite since they are not CEOs of these firms. While some of these directors may be more tightly connected within the elite network, those at the network periphery may lack the power to make a difference in board decisions on executive entrenchment. However, power is not an attribute of a person or group but a property between actors that varies with the circumstances (Emerson 1962). Instead, the power of outside non-core directors to influence entrenchment likely varies according to the contingencies that we examine. For instance, longer-tenured directors are better able to rein in entrenchment provisions given the political power and stature that comes with length of board service (Pettigrew and McNulty 1995). Likewise, when a CEO’s influence over board decisions weakens with poor firm performance, outside non-core directors appear to exercise their influence to resist entrenchment. Finally, the influence of these directors to resist entrenchment appears to be contingent on the support they receive from their independent CEO director counterparts when the latter directors are incentivised by equity ownership to protect shareholder wealth. Hence, although outside non-core directors may conform to the norms of the corporate elite, different contextual factors may empower them to heed the disciplining forces of the directorial labor market and sustain a challenge to the incumbent CEO without losing the board seat.
The findings of several control variables are also worth mentioning. First, we did not find any significant effect of inside directors on executive entrenchment. While this result may be surprising, it is consistent with prior studies that suggest the presence of inside directors do not necessarily lead to bad outcomes (Bhagat and Black 2002, Coles et al. 2008, Rosenstein and Wyatt 1997). Furthermore, the impact of inside directors on executive entrenchment may be insignificant given that they only occupy an average of less than two seats on the boards of firms in our sample. Second, the results also show that independent executive directors, holding CEO or other executive appointments, are not significantly associated with executive entrenchment. Although these results appear to contradict the findings of Westphal and colleagues (Westphal and Khanna 2003, Westphal and Zajac 1997), a closer inspection of the profiles of these independent executive directors may shed light on these unexpected results. We discovered that the vast majority of independent executive directors in our sample are not executives of large firms. Specifically, only 456 independent directors in our sample firms are executives of S&P500 firms. Out of these 456 independent directors, 364 are CEOs and 92 hold non-CEO executive positions. Contrast these figures with 3,603 independent directors who are executives of firms smaller than S&P500 firms, of which 1,494 are CEOs and 2,109 hold non-CEO executive positions. Hence, close to 90% of independent executive directors are from firms too small to be in the S&P500 firms. Since executives from smaller firms are likely to face different circumstances and hold opposing ideologies when compared with the managerial incumbents of large corporations (Useem 1980), their inclination to support the entrenchment of executives in large corporations may be less than expected.

**Theoretical and Practical Implications**

This study is important because it provides evidence of the propensities of outside non-core directors toward supporting management’s quest for greater control of the firm versus defending the prerogatives of the shareholders. Over the past two decades, governance research has refined its classification of directors to reflect current practices and governance policies. The traditional inside/outside director distinction has evolved into a finer inside/affiliate/independent classification to better capture the independence of outside directors (Johnson et al. 1996). While a focus on independent directors has
enriched the field of governance, one potential disadvantage is that prior governance studies tend to view independent directors as a unitary class with a homogenous propensity to monitor top executives and protect against executive entrenchment. Such an assumption may be problematic given that meta-analytic examinations of board composition, such as the one by Dalton et al. (1998), yield little support for the notion that independent board members will look after shareholders’ interests. Furthermore, we showed that when independent directors are analyzed as a homogenous group in this study, the results suggest that these directors have little effect on executive entrenchment, which is vastly different from our key findings on outside non-core directors. By showing that outside non-core directors influence executive entrenchment and that their inclinations to support management or protect shareholders are conditional on various factors, we have advanced our understanding of board effectiveness in large firms by examining a sub-category of independent directors that has received scant research attention.

We also advance theoretical development in governance research by examining the utility of applying the corporate elite and efficient directorial labor market views to understand the proclivity of outside non-core directors toward executive entrenchment. We highlighted the theoretical and empirical tension that appears to exist between the rather extensive bodies of work that provides support for these two views (Coles and Hoi 2003, Davis and Greve 1997, Fama 1980, Ferris et al. 2003, Harford 2003, Palmer 1983, Useem 1982, Westphal and Stern 2007, Westphal and Zajac 1997). In addition to asking which view more accurately reflects the proclivity of outside non-core directors, we also proposed a midrange model and found that there is merit to both views in explaining executive entrenchment. The utility of the corporate elite view is that it portrays the corporate boards of large firms as domains of the corporate elite. Within these domains, outside non-core directors find it important to support fellow members of the corporate elite, the focal firm’s executives. The evidence in this study suggests that while on balance outside non-core directors’ do commit to the corporate elite, that commitment is not unequivocal. For instance, these directors appear to agitate for less executive entrenchment especially when firm performance is low or when they have longer tenure. It may be that these two conditions increase the salience of or enable these directors to convey an abiding concern for shareholders’ interests. If outside
non-core directors are truly committed to members of the corporate elite and feel a need to ingratiate themselves with the corporate elite, then we should expect these directors to provide even more support for their CEOs when firm performance is bad. Instead of closing ranks around the corporate elites and showing solidarity when firm performance is poor, these directors appear to favor less executive entrenchment. Likewise, if staying in the good graces of the corporate elite is the primary concern of outside non-core directors, then we would expect these directors to favor executive entrenchment the longer they remain on the board given the extended social exchange with other elites. However, we found the opposite to be true. By showing the conditional merits of applying the corporate elite and efficient directorial labor market views, we provide the impetus for scholars to direct their research efforts to understand the boundary conditions of these contrasting perspectives. In other words, instead of asking exclusively whether the corporate elite view or the efficient directorial labor market view better explains governance choices, a more fruitful approach may be to examine the conditions under which directors of large firms would exhibit strong commitment and support for fellow elite members above all else or gravitate toward protecting the interests of shareholders.

In terms of implications for practitioners, our findings suggest that shareholders’ optimism that their interests will necessarily be looked after by independent directors may be misplaced. It will be recalled that as a result of the corporate governance crisis that occurred in the early 2000’s, both the Sarbanes-Oxley Act as well as changes in the listing requirements of the major exchanges were enacted to place much greater control of publicly-held firms’ boards in the hands of independent directors. Boards were mandated to have a majority of outsiders, and new board member candidates were to be selected by a nominating committee made up entirely of independent directors (Petra 2006). These changes, as well as others, were intended to insure that boards would fulfill their roles as guardians of shareholders’ interests. However our findings, and those of others, suggest that the mere requirement to have independent directors on corporate boards is insufficient. If governance policies place too much emphasis on having independent directors, then the likelihood of firms adopting symbolic, as opposed to substantive, governance reforms is likely to increase (Westphal and Zajac 1994). Instead, our study suggests that
governance policies should direct more attention to understanding the propensities of different types of independent directors, and examine ways to empower and incentivize these directors, including outside non-core directors, so that they are enabled and motivated to pursue shareholder interests instead of perpetuating those of the corporate elites.

Limitations and Future Research

Notwithstanding these contributions, the present study has some limitations that present opportunities for future research. First, the Securities and Exchange Commission has indicated their commitment to make it easier for shareholders to nominate candidates to corporate boards (Securities and Exchange Commission 2011). To the extent that shareholder access rules are successfully adopted, such rules should strengthen the disciplinary capacity of the directorial labor market as incumbent directors should concern themselves with the potential to be replaced by disgruntled shareholders. Thus, the contingencies that sway outside non-core directors toward the concerns of the directorial labor market may be strengthened since the directorial labor market may become more efficient and more dominant relative to the corporate elite. However, given that the Business Roundtable (an organization comprising the CEOs of the largest public U.S. companies) and the U.S. Chamber of Commerce have successfully filed petitions to overturn the recent shareholder access rule 14a-11 (Securities and Exchange Commission 2011), the findings of this study continue to be of relevance for corporate boards or activist shareholders who seek to rein in the influence of the corporate elite. Even if shareholder access rules are successfully implemented in the future, the results of this study may be used to guide shareholders’ choice on the type of independent directors that are enabled and motivated to eschew executive entrenchment. Second, and related to the first point, the results are generalizable only to large U.S. firms since we focus on corporate elites in America. Future research may examine the role of outside non-core directors in smaller-sized firms where the pressures to engage in ingratiating behavior in support of the CEO may be weaker. It is also unclear whether outside non-core directors of large firms outside of the U.S. are more shareholder-centric or exhibit tendencies to support their CEOs. Third, there is reason to believe that demographically similar directors are likely to be more supportive of each other (Westphal and Zajac 1995). For instance, outside
non-core directors may be more supportive of their CEOs if they are of similar age, have the same functional or educational backgrounds, join the same associations/clubs or attend the same school as their CEOs. Thus, future research may empirically test for potential effects of demographic similarity on executive entrenchment and offer shareholders a guide to identify outside non-core directors that are most likely to support their fight for corporate control. Fourth, we restricted the scope of this study to the monitoring role of independent directors by examining executive entrenchment. While we acknowledge that outside non-core directors may play other board roles such as advisory and resource provisioning, an examination of their effectiveness in alternative roles is beyond the scope of this study. Hence, future research may examine whether outside non-core directors matter for the formulation or implementation of strategy when compared with their executive counterparts (Geletkanycz and Boyd 2011).

Clearly, more research is needed to understand the factors that influence executive entrenchment in a firm. Extant studies have largely looked at the impact of executive entrenchment on firm value or other dependent variables (Bebchuk et al. 2009, Cai et al. 2009, Masulis et al. 2007). Instead of joining the debate on the consequences of governance provisions that entrench executives (Bhagat and Bolton 2008, Stráška and Waller 2010), we take a fresh perspective and treat executive entrenchment as a choice variable that is arbitrated by the corporate board. This approach has revealed interesting findings not touched on by prior works. For instance, while Bebchuk et al. (2009) may have made an excellent case for executive entrenchment negatively influencing firm value, we find evidence that prior firm performance may have an indirect impact on future executive entrenchment by affecting the propensity of outside non-core directors to favor more or less governance provisions that facilitate entrenchment. A greater understanding of how executive entrenchment is impacted by board- and other firm-level factors would contribute to the effective governance of publicly-listed firms.

A potentially interesting avenue for future research is to examine the influence of independent executive directors on executive entrenchment. Although not the focus of this study, the results of our analyses suggest that these directors have no significant associations with executive entrenchment in focal firms. While these results may call into question the validity of the corporate elite perspective, we caution
against such an inference because no single perspective is likely to be dominant in explaining executive entrenchment. Instead, we continue to advocate a midrange approach to understand how the predictions of the corporate elite perspective may be mitigated by other forces at play. For instance, our results suggest that independent non-CEO directors appear to agitate for less executive entrenchment when firm performance is low. Furthermore, independent executive directors may agitate for greater (or lesser) entrenchment in focal firms if they experience the same outcomes in their home firms (Westphal and Zajac 1997). We surmise that key mitigating factors are likely to stem from pressures in the executive labor market since independent executive directors (unlike outside non-core directors) hold executive positions in publicly-listed or large private firms. In other words, while outside non-core directors are concerned with the directorial labor market, the proclivity of independent executive directors toward executive entrenchment has to account for how supporting entrenchment in focal firms may influence their value in the executive labor market. There is evidence to suggest that the executive labor market penalizes executives for acting in a manner detrimental to shareholder wealth (Semadeni et al. 2008, Sutton and Callahan 1987). Given that the negative consequences of detrimental actions by an executive in one firm may diffuse to other firms that the executive is affiliated with (Cannella et al. 1995, Kang 2008), independent executive directors are unlikely to unilaterally support executive entrenchment without a careful consideration of firm-specific factors in their home firms, and how such support may influence the value of their home firms as well as their reputation in the executive labor market (Booth and Deli 1996, Fahlenbrach et al. 2010, Perry and Peyer 2005).
References


McDonald, M.L., J.D. Westphal. 2011. My brother’s keeper? How CEOs’ social identification with the corporate elite affects the provision of social support to fellow CEOs and the consequences for leader effectiveness *Academy of Management Journal* 54(4) 661-693.


Westphal, J.D., I. Stern. 2007. Flattery will get you everywhere (especially if you are a male caucasian): How ingratiation, boardroom behavior, and demographic minority status affect additional board appointments at U.S. companies. *Academy of Management Journal* 50(2) 267-288.


Table 1  Sample Profiles of Outside Non-Core Directors

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<thead>
<tr>
<th>Category</th>
<th>Director Names and Sample Profiles</th>
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<tbody>
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<td>Government or non-profit institutions / associations</td>
<td>William H. White: “Mr. White has been the Mayor of the City of Houston, Texas since January 2, 2004.” Carleton T. Rider: “For more than the last five years, Senior Administrator, Mayo Foundation (a non-profit health care organization).”</td>
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<tr>
<td>Universities or research institutions</td>
<td>John M. Deutch: “Mr. Deutch has been an Institute Professor at the Massachusetts Institute of Technology since 1990. He joined the MIT faculty in 1970 and served as Dean of Science from 1982 to 1985 and Provost from 1985 to 1990.” Marie-Josée Kravis: “Mrs. Kravis was appointed a senior fellow of the Hudson Institute Inc., in 1994. Prior to that time, and since 1978, she served as Executive Director of the Hudson Institute of Canada.”</td>
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<tr>
<td>Small private investment firms</td>
<td>George W. Tamke: “George W. Tamke is a Principal with Clayton, Dubilier &amp; Rice, Inc., a private investment firm.” William Porter Payne: “Partner in Gleacher Partners LLC (investment banking and asset management), Atlanta, GA since July 2000.”</td>
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<td>Other small private for-profit firms</td>
<td>Marvin D. Brailsford: “Marvin D. Brailsford, 63, has been Vice President of Kaiser-Hill Company LLC, a construction and environmental services company, since 1996.” Willie D. Davis: “President, All Pro Broadcasting Incorporated, Los Angeles, California (radio broadcasting), since 1977.”</td>
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<tr>
<td>Independent consultants</td>
<td>John L. Doyle: “From September 1991 to July 1993, and from December 1993 to the present, Mr. Doyle has been an independent consultant. In addition, Mr. Doyle also serves as a director of Analog Devices, Inc., and DURECT Corporation.”</td>
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<td>Private investors</td>
<td>Albert A. Eisenstat: “Director of public companies and private investor (since 1993).”</td>
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### Table 2  Descriptive Statistics and Correlations among Study Variables\(^a\)

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Table 2 (cont’d.) Descriptive Statistics and Correlations among Study Variables

| Variable                                         | Mean  | s.d.  | 1     | 2     | 3     | 4     | 5     | 6     | 7     | 8     | 9     | 10    | 11    | 12    | 13    | 14    | 15    | 16    | 17    | 18    |
|--------------------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 20 CEO duality                                   | 0.76  | 0.43  | 0.05  | 0.09  | 0.11  | 0.00  | -0.11 | 0.08  | 0.08  | -0.14 | -0.05 | 0.02  | 0.01  | -0.31 | -0.14 | 0.02  | -0.16 | -0.16 | 0.21  | 0.23  |
| 21 Independent directors appointed after the CEO | 4.06  | 2.88  | -0.06 | 0.16  | 0.21  | 0.27  | 0.07  | 0.15  | 0.10  | 0.06  | 0.04  | -0.02 | -0.09 | -0.03 | -0.04 | 0.07  | 0.02  | -0.04  | 0.30  | 0.58  |
| 22 Relative CEO compensation                     | 2.26  | 3.80  | -0.02 | 0.00  | 0.04  | 0.04  | 0.07  | 0.00  | 0.02  | 0.06  | 0.03  | -0.01 | -0.01 | -0.05 | -0.01 | 0.00  | -0.08 | -0.03  | -0.01  | -0.05  |
| 23 Board size                                    | 10.80 | 2.67  | 0.37  | 0.18  | 0.25  | 0.02  | 0.24  | 0.27  | 0.13  | 0.14  | 0.02  | 0.07  | 0.05  | 0.06  | 0.09  | 0.00  | 0.01  | 0.26  | 0.06  |
| 24 Female directors                              | 1.47  | 1.00  | 0.03  | 0.37  | 0.18  | 0.25  | 0.02  | 0.24  | 0.27  | 0.13  | 0.14  | 0.02  | 0.07  | 0.05  | 0.06  | 0.09  | 0.00  | 0.01  | 0.26  | 0.06  |
| 25 Substantial institutional ownership           | 9.78  | 6.50  | 0.02  | -0.14 | -0.10 | -0.09 | -0.13 | -0.14 | -0.10 | -0.09 | -0.06 | 0.00  | -0.03 | -0.04 | -0.02 | -0.13 | -0.09 | -0.07  | -0.02  |
| 26 Outside directors blockholders                | 0.18  | 0.55  | -0.15 | -0.07 | -0.10 | -0.04 | 0.05  | 0.06  | 0.04  | 0.00  | 0.02  | -0.03 | 0.03  | 0.05  | 0.19  | 0.01  | 0.04  | 0.20  | 0.05  | 0.19  |
| 27 E-index scores of interlocked firms           | 1.53  | 1.41  | 0.09  | 0.19  | 0.06  | -0.09 | -0.09 | 0.12  | 0.14  | 0.01  | 0.02  | -0.01 | 0.11  | -0.07 | -0.11 | 0.00  | 0.07  | -0.13  | 0.17  | -0.12  |
| 28 Lag E-index(Industry-adjusted)                | 0.00  | 1.19  | 0.95  | -0.13 | 0.03  | 0.02  | 0.12  | 0.00  | 0.03  | 0.04  | 0.06  | 0.05  | 0.07  | 0.07  | 0.07  | 0.02  | 0.10  | 0.11  | 0.01  | 0.12  |
| 29 Endogeneity control                          | 3.04  | 0.69  | 0.05  | 0.14  | 0.03  | 0.04  | 0.06  | 0.08  | 0.08  | -0.03 | -0.11 | 0.03  | 0.09  | 0.01  | 0.02  | 0.01  | 0.06  | 0.18  | 0.01  |
| 30 Outside non-core director embeddedness       | 15.61 | 8.76  | 0.01  | 0.43  | 0.23  | 0.12  | 0.02  | 0.35  | 0.40  | 0.12  | 0.16  | 0.05  | 0.01  | 0.05  | 0.05  | 0.14  | 0.00  | -0.01  | 0.36  | -0.09  |
| 31 Outside non-core director tenure             | 7.90  | 4.89  | -0.01 | 0.05  | 0.01  | -0.05 | 0.06  | 0.08  | 0.07  | 0.08  | 0.04  | 0.11  | 0.13  | 0.06  | 0.09  | 0.03  | 0.08  | 0.04  | 0.07  | 0.16  |
| 32 Outside non-core director equity ownership value | 0.08  | 0.88  | -0.08 | 0.11  | 0.02  | 0.08  | 0.05  | 0.07  | 0.08  | 0.07  | 0.09  | 0.02  | 0.05  | 0.02  | 0.10  | 0.15  | 0.08  | 0.13  | 0.12  | 0.10  |
| 33 Independent CEO director equity ownership value | 0.03  | 0.81  | -0.09 | 0.01  | 0.03  | 0.08  | 0.08  | -0.17 | -0.01 | 0.08  | 0.05  | 0.18  | 0.05  | 0.05  | 0.03  | 0.07  | 0.09  | 0.08  | -0.03  | 0.11  |
| 34 Firm performance                              | 0.02  | 1.18  | -0.01 | 0.01  | 0.01  | 0.02  | 0.01  | 0.00  | 0.01  | 0.02  | 0.00  | 0.01  | 0.01  | 0.01  | 0.01  | 0.01  | 0.01  | 0.01  | 0.03  | 0.04  |
| 35 Outside non-core directors                    | 3.05  | 1.82  | 0.05  | 0.10  | 0.15  | 0.24  | -0.03 | 0.09  | 0.08  | 0.01  | 0.06  | 0.04  | 0.05  | 0.10  | 0.13  | 0.06  | 0.05  | 0.17  | 0.14  | 0.03  |
Table 2 (cont’d.) Descriptive Statistics and Correlations among Study Variables

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*a n=1,777 observations for 516 unique S&P500 firms from 2003 to 2006. All variables lag the dependent variable, industry-adjusted E-index, by one year. All dollar values are expressed in hundred millions of US$. Correlations of magnitude 0.05 and above are significant at p < .05 and below.
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<td></td>
<td></td>
</tr>
<tr>
<td>Independent non-CEO directors x Independent non-CEO director tenure</td>
<td>0.01 0.02</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Independent non-CEO directors x Independent non-CEO director equity ownership value</td>
<td>-0.02 0.02</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Independent non-CEO directors x Firm performance</td>
<td>0.14 0.05 **</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year dummies included</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Number of Observations (Firms)</td>
<td>1,777 (516)</td>
<td>1,777 (516)</td>
<td>1,777 (516)</td>
<td>1,777 (516)</td>
</tr>
<tr>
<td>Model F</td>
<td>19.47 ***</td>
<td>17.07 ***</td>
<td>18.98 ***</td>
<td>17.26 ***</td>
</tr>
<tr>
<td>R² (within)</td>
<td>0.154</td>
<td>0.161</td>
<td>0.183</td>
<td>0.189</td>
</tr>
<tr>
<td>ΔR² (within)</td>
<td>0.007</td>
<td>0.022 **</td>
<td></td>
<td>0.006</td>
</tr>
</tbody>
</table>

*p < .05; **p < .01; ***p < .001

All variables lag the dependent variable, industry-adjusted E-index (a proxy for executive entrenchment), by one year.
Figure 1 Plots of the Relationship between Number of Outside Non-Core Directors and Industry-Adjusted E-index for Outside Non-Core Directors’ Embeddedness and Tenure as Moderating Variables
Figure 2  Plots of the Relationship between Number of Outside Non-Core Directors and Industry-Adjusted E-index for Independent CEO Directors’ Equity Ownership Value and Firm Performance as Moderating Variables

Independent CEO Directors’ Equity Ownership as Moderator
- Low Independent CEO Directors’ Equity Ownership
- High Independent CEO Directors’ Equity Ownership

Firm Performance as Moderator
- Low Firm Performance
- High Firm Performance

Number of Outside Non-core Directors

Low | High
--- | ---
Industry-adjusted E-index
0.00 | 0.40
0.10 | 0.30
0.20 | 0.20
0.30 | 0.10
0.40 | 0.00

Low | High
--- | ---
Industry-adjusted E-index
0.00 | 0.80
0.10 | 0.60
0.20 | 0.40
0.30 | 0.20
0.40 | 0.00

Low | High
--- | ---
Number of Outside Non-core Directors
-0.20 | 0.40
-0.10 | 0.20
0.00 | 0.00
0.10 | -0.20
0.20 | -0.40

Low | High
--- | ---
Number of Outside Non-core Directors
-0.24 | 0.70
-0.18 | 0.04