

WHAT ATTRACTS DIRECTORS TO BOARDS OF SMALL- AND MID-SIZED COMPANIES?

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ABSTRACT

This paper explores the reasons why outside corporate directors choose to serve on the boards of small- to mid-sized companies. Resource dependence theory explains the importance of outside directors on corporate boards, especially for small- and mid-sized companies. Attracting qualified board members is both an important and sometimes difficult task for such companies. Using a sample of 102 NASDAQ companies, we find that firm performance, financial incentives, and time constraints influence the decision of an outsider to accept a board seat.

Keywords: board of directors, corporate governance, resource dependency theory

INTRODUCTION

The role of the board of directors, especially outside members, in small- to

mid-sized companies (SME) is important for several reasons. Often, SME business owners do not have access to information and resources needed to effectively run

the business. As Huse (1990) notes, business owners are often so busy, they do not recognize their need for management assistance. Thus, the service and strategic roles of the board (Zahra & Pierce, 1989) become particularly relevant for SMEs, with outside directors instilling formal processes which make managers more aware of the importance of planning and decision-making (Johannisson & Huse, 2000). In addition, while large firms with dispersed ownership may have several governance mechanisms in place for monitoring management, SMEs are generally owned and managed by a small, close-knit group of individuals, often family members. Outside directors, therefore, provide an added resource of discipline and management control.

While the benefits of direction from strong outside board members are apparent, whether the SME can attract qualified outsiders is uncertain. The question of what prompts a director to accept a position as a board member in a small family business was explored by Johannisson and Huse (2000). They surmised that seeking status, extending networks, the opportunity to use their competence to influence, and the ability to learn or gain other benefits are possible explanations. They also noted that whatever the reason for accepting the position, board members will seek to minimize risk and will select firms with both "solid management and a sound economy" (p. 355).

The process of selecting outside directors to serve on the board of SME companies

involves what Johannisson and Huse (2000) describe as both a demand and a supply side. The demand side represents the firm's need for certain qualities, and has been extensively studied using agency, resource dependence, and other frameworks. Although the supply side has not been researched as extensively, given that directors are concerned with their reputations (Fama & Jensen, 1983), prestige and social status have been identified as the main reasons why an individual would agree to serve as an outside director (Johannisson & Huse, 2000; Lester, 2008). Missing from the research, however, is what attracts an individual to a particular firm, especially when the company is not a large, well-recognized corporation. This study, therefore, explores the question, "What attributes of small- to mid-sized firms attract outsiders to serve on their boards?" The present study contributes to extant research in a SME business context by viewing the director recruitment process from the perspective of the outsider. It is also relevant for SMEs wishing to enhance their ability to attract qualified directors from their business communities.

RESOURCE DEPENDENCE AND THE NEED FOR QUALIFIED DIRECTORS

Pfeffer and Salancik (1978) developed resource dependence theory based on the open systems perspective which posits that environment plays an important role in organizational effectiveness. Pfeffer (1972) further suggested that in order to manage the potential uncertainties

created by their task environments, organizations should strive to reduce their external dependencies through absorption, such as long-term contracts, mergers, or cooptation of relevant resources. The appointment of outside directors who are representatives of important external organizations is a means of cooptation of resources (Pfeffer & Salancik, 1978, p. 167). Further, outsiders bring benefits to organizations in the form of advice and counsel, access to information and resources, and legitimacy (Pfeffer & Salancik, 1978).

Outside directors often are able to provide valuable resources that would be otherwise unavailable to the firm (Daily & Dalton, 1993). Such resources include knowledge, skills, and access to key constituents (Hillman, Cannella & Paetzold, 2000). Effective boards fulfill a firm's resource needs by acting as resource acquisition agents (Bazerman & Schoorman, 1983; Boeker & Goodstein, 1991) as well as by enhancing the reputation and credibility of the organization (Hambrick & D'Aveni, 1992). In general, if management is concerned with organizational-environmental linkages, they will seek to establish a more diverse board in terms of background and experience; accordingly, the size of the board will tend to be larger when the board is used to connect the organization with the environment (Beekun, Stedham, & Young, 1998). A recent review of the application of resource dependence theory to boards of directors reaffirms the assertion that outside directors reflect external needs and can assist in

managing environmental dependencies for the firm (Hillman, Withers, & Collins, 2009).

These resource-based arguments for the importance of outside directors become even more relevant for small firms, which face greater environmental uncertainty than larger firms, based on their "liability of smallness" (Bruderl & Schussler, 1990). Relationships through board membership not only provide outside resources not otherwise available to SMEs, but often complement the company's internal resources (Gnyawali & Madhavan, 2001). In the case of SME firms, this may include technical knowledge, specific industry experience or an understanding of how to effectively manage a business. Gabrielsson and Huse (2002) note that SMEs are often managed by entrepreneurs who have little management experience and need to rely on their experienced outside board members for such support. Thus, Huse (2000) concludes that SMEs need a special set of skills and characteristics and must establish a strategy to attract directors with such abilities to their boards if they wish to maximize their opportunities for success.

THE FACTORS THAT ATTRACT OUTSIDE DIRECTORS TO SMALL- AND MID-SIZED FIRMS

In examining the attributes of small- and mid-sized firms that would draw an outsider to serve on its board, we rely on the Lorsch and MacIver (1989) study which, through questionnaires and interviews, examined the reasons why a director chooses to join a board. At the

outset, they note that the majority of directors in U.S. corporations are senior level executives, lawyers, government officials, and academics; thus, the most pressing issue in deciding whether or not to join a board is the nature of the opportunity compared to other available options (1989, p. 23). When competing with larger, more prestigious firms, it becomes critical for SMEs to identify the qualities of their firms that would be attractive to outside directors.

Firm Quality and Prestige

In their research on corporate directors, Lorsch and MacIver (1989) found that the quality of a company was the most important reason for joining a board. As noted by Fama and Jensen (1983), board directors are concerned with protecting their reputations as expert decision-makers and thus would avoid serving on boards of low quality firms (Certo, Daily, & Dalton, 2001). Pearce and Zahra's (1992) data showed that past poor performance is positively associated with smaller boards, and Gilson (1990) reported that only 46 percent of outside directors remained on the board of firms following a bankruptcy or debt restructuring. These results are similar to those of D'Aveni (1990) who found that prestigious managers will leave a firm shortly before bankruptcy in order to avoid damaging their careers.

While the prestige of the firm was listed as the fourth most important reason in Lorsch and MacIver's survey (1989), SMEs are generally not able to offer the same prestige of board service as larger firms. Thus, SME firms must rely on

their reputations as quality organizations in order to attract outside board members. We suggest that quality is best measured by firm performance and propose the following hypothesis:

H1: Outside membership on boards of small- to mid-sized firms will be positively related to firm performance.

Board Power

Corporate directors also report that the challenge of serving as a director is an important reason for joining a board (Lorsch & MacIver, 1989). Becoming involved in strategic decision-making is an important objective of board membership; yet, opportunities in this area are often thwarted by opportunistic CEOs who prefer a more complacent board (Lorsch & MacIver, 1989; Mace, 1986). When the CEO also holds the board chair position, researchers generally agree that the power of the board as a strategic decision-maker is weakened (Zahra, Neubaum, & Huse, 2000). By serving as both CEO and chair, the CEO has greater control over the board and its oversight process (Daily & Dalton, 1993), thereby reducing the board's power to challenge the CEO. Lorsch and MacIver (1989, p. 170-171) point out that the "most obvious impediment to outside directors exercising their power" is a CEO whose power is greater by virtue of his or her chair position and who thus wields the power to control the agenda, meeting processes, and flow of information.

In their study of the balance of power between the board and the CEO, Zajac

and Westphal (1996) proposed that the source of power would predict the selection of individual board members based on their prior experience and thus shape the composition and effectiveness of the board. They hypothesized that powerful boards (those with less CEO power) will seek to maintain their control by favoring new directors with a reputation for more active management and avoid appointing directors with experience on passive boards. Lower levels of board power were observed with members' participation on a board in a company with a decreased ratio of outsiders, CEO/chair duality, increased diversification, increased total CEO compensation, and decreased contingent compensation.

In addition to CEO duality, the power of the CEO can also be measured by the CEO's tenure. CEO tenure is predictive of power because the CEO's influence over firm operations increases as his years of tenure increase and the CEO becomes better able to control governance decisions due to his leadership position (Hambrick & Fukutomi, 1991; Wright, Kroll, & Elenkov, 2002). As noted by Ocasio (1994), longer tenure leads to increased legitimacy of the CEO's authority and ability to maintain power. Since CEO tenure is correlated with the number of board members appointed by the CEO and directors who are appointed by the CEO are likely to feel an obligation to the CEO (Boeker, 1992; Wade, O'Reilly, & Chandratat, 1990), thereby enhancing the CEO's power, we posit that CEO

tenure is positively associated with increased CEO power.

Recognizing the outside director's desire for challenging opportunities as a board member, a potential nominee will be more apt to seek out those appointments where the board has a greater amount of power vis-à-vis the CEO. In the case of small- to mid-size companies, we propose:

H2a: Outside membership on boards of small- to mid-sized firms will be negatively related to CEO/Chair duality.

H2b: Outside membership on boards of small- to mid-sized firms will be negatively related to CEO tenure.

Financial constraints

While compensation and stock ownership were the least important reasons for joining a board, according to the Lorsch and MacIver (1989) study, they were nevertheless included in the list. However, as reported earlier by Lorsch and MacIver (1989) and reiterated by numerous governance experts (e.g., Linck, Netter, & Yang, 2009; McGee, 2005), it has become increasingly difficult to attract qualified independent directors, largely because of time constraints and, more recently, liability concerns. Accordingly, compensation is a "lure" (McGee, 2005, p. 36), especially for SMEs who traditionally do not offer the six-figure annual retainers paid by large corporations.

In addition to cash compensation, there has been a trend toward increasing the equity-based compensation paid to directors, either in the form of stock options or outright stock ownership (Meyer, 1998; Zong, 2004). From an agency theory perspective, stock ownership will align the board members' interests with those of the shareholders, thus making the board a more vigilant monitor of management (Shen, 2005). In addition, some evidence suggests that equity ownership can empower the board, making it more likely to question management decisions (Finkelstein, 1992), a behavior that is more often associated with directors recruited from outside of the firm. Thus, we hypothesize:

H3: Outside membership on boards of small- to mid-sized firms will be positively related to the annual retainer and the equity-based compensation paid to non-executive directors.

Time constraints

Lorch and MacIver (1989) identified that a key concern of outsiders considering a board nomination is whether they will have sufficient time to devote to fulfilling their roles as board members. Recent research points to the additional responsibilities imposed by corporate regulators, especially on members of audit and compensation committees, concluding that directors are accepting fewer board appointments in light of the increased workload (Linck, Netter, & Yang, 2009). One study estimated that outside directors spend over 170 hours

annually on board duties, which include preparing for and attending meetings, travel, and discussions (King, 2001). In a study of 52 director resignations occurring between 1990-2003, half of the directors left their board positions due to reasons associated with being "too busy," such as time constraints, other professional commitments, and family business requirements (Dewally & Peck, 2010). Accordingly, we hypothesize that outside prospective board members will be less likely to join boards with a higher level of time commitment, as compared with other firms.

H4: Outside membership on boards of small- to mid-sized firms will be negatively related to the number of board meetings.

METHODS AND RESULTS

Sample

Using a random number generator (Ocasio, 1994), a random sample of 120 companies listed on the NASDAQ was selected for this analysis. While there are some fairly large companies listed on this exchange, companies traded on the NASDAQ primarily represent much smaller firms, based on sales, than those of the Fortune 1000. After eliminating three of the largest firms in the sample, the average annual sales for our sample population were less than \$500 million, which is much lower than the revenue for the smallest firm in the Fortune 1000. Further, the mean market capitalization of the companies included in the sample was \$800 million, which falls within the range of the S&P Small Cap profile.

Thus, while the definition of SME on the basis of a specific criterion is not uniform (Ayyagari, Beck, & Demirguc-Kunt, 2007), it appeared that our sample represented a reasonable cross section of small- to mid-sized firms. After eliminating several firms for missing or incomplete data, our study examined 102 companies.

Variables

All board data were obtained from the proxy statements filed with the SEC and contained in the Edgar System. Firm performance data were obtained using Compustat. Because the sample included firms across several industries, we used the change in the performance variables as the predictor. Regardless of industry, a director may judge the quality of the firm according to whether its performance has improved or declined over the past few years. Therefore, we examined whether the mean change (determined using a difference score) in these measures from one three-year period (2000-2002) to the following (2003-2005) three-year period had the predicted effect on board composition and structure.

Dependent Variable. The number of outsiders was measured by the number of non-employee or former employee directors. Outsiders did not include members of venture capital firms, as venture capitalists are active investors who seek to become members of the board in order to monitor their investments (Macmillian, Kulow, & Khoylian, 1989).

Predictors. To test Hypothesis 1, we used improvement or decline in firm performance as the main predictor variable. When selecting appropriate performance variables, we note that many measurements of performance have been used in the governance literature and it is generally recognized that no single measure is universally ideal (Cameron, 1986; Venkatraman & Ramanujam, 1986). We follow a traditional approach by using the accounting measures Return on Assets (ROA) and Return on Equity (ROE), and market return (Allen & Panian, 1982; Harrison, Torres, & Kukalis, 1988).

Hypothesis 2 was tested using two variables: a dichotomous variable representing whether or not the CEO was also the chair and the CEO's years of tenure with the company. Hypothesis 3 was tested using three variables: the annual retainer paid to outside directors, the amount of stock options awarded to outside directors, and the number of shares issued to outside directors each year. To test hypothesis 4, the number of board meetings was the number of meetings required of board members in 2005.

Controls. Control variables were included to account for institutional ownership, firm size, and average performance for the period between 2003 and 2005. The percentage of shares owned by institutional or large blocks of shareholders was added as a control variable as external owners apply pressure on CEOs to appoint independent board members (Huse, 2000). Firm size,

operationalized as the log of sales in thousands of dollars, was also added as a control variable as board structure is often related to firm size (Gabrielsson & Huse, 2002). As our predictor variable for performance captured the change in performance of each company, we did not make an industry adjustment; however, we included the average baseline performance (2003-2005) as a control variable.

Results

The means, standard deviations, and correlations for the variables of interest are shown in Table 1. Our hypotheses were tested by examining the zero-order correlations and by performing additional regression analyses while controlling for baseline performance.

Hypothesis 1 stated that there would be a positive relationship between firm performance and the number of outside members present on its board of directors. Examination of the correlations in Table 1 showed a significant positive relationship between the change in outside directors and

change in return on assets ($r = .20, p < .05$). The correlation with change in market return (.19) approached significance ($p = .06$). To further test these relationships, we performed a hierarchical regression in which we controlled for baseline firm performance in the first step and added the change in firm performance variables in the second step. (The change in price-to-earnings ratio was eliminated from this analysis due to its high multicollinearity [$r = .82$] with the baseline ratio.) The results of the hierarchical regression are presented in Table 2. After controlling for baseline performance, a change in performance explained an additional 11% of the variance in outside board members, with a total variance of 21% ($p < .05$). As seen in step 2, the performance indicators that predicted an increase in outsiders were a positive change in market return ($\beta = .33, p < .01$) and baseline sales ($\beta = .32, p < .05$). In other words, improvements in a firm's market return or baseline sales were related to an increase in the number of outside members present on the board of directors. Thus, hypothesis 1 was partially supported.

Table 1-Means, Standard Deviations and Correlations

	Mean	s.d.	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.
Δ Return on Assets	7.94	51.14										
Δ Market Return	-.52	433.74	.06									
Δ PE Ratio	-2.42	65.18	.03	-.05								
Δ Return on Equity	15.90	137.26	.37***	.04	.02							
CEO and Chair Separation	.51	.50	.08	-.13	-.05	.02						
CEO Tenure	11.68	9.52	-.08	.05	.08	-.12	-.19					
Annual Retainer	22260	16614	-.10	-.10	-.11	-.04	.02	-.11				
Num. of Stock Options granted	6640	10636	-.16	.06	-.20	.18	-.10	-.07	.21			
Value of Shares	12401	51813	.00	.04	.02	-.04	.11	-.17	.12	-.15		
Num. of Required Meetings	6.14	4.05	-.20	-.11	-.12	-.08	.11	-.01	.59***	.04	.02	
Δ Number of Outside Dirs.	.74	1.93	.20*	.19	.06	.06	.05	-.08	-.18	.21	.12	-.36*

* $p < .05$; ** $p < .01$; *** $p < .001$; $n=104$.

Table 2-Results of Hierarchical Regressions on Change in Number of Outside Directors^a

Hypotheses	Firm Performance		CEO Duality and CEO Tenure		Number of Board Meetings	
	Step 1	Step 2	Step 1	Step 2	Step 1	Step 2
Control Variables						
Log Sales	.21*	.32*	.25	.25	.30	.47*
Return on Assets	-.12	-.25	-.39*	-.38	-.06	-.13
Market Return	-.02	-.05	.09	.09	-.34	-.46*
PE Ratio	-.05	-.03	-.06	-.05		
Return on Equity	.22	.27	.39*	.38*		
Institutional Ownership	-.12	-.14	.03	.02		
Firm Performance						
Δ Return on Assets		.13			.39	.36
Δ Market Return		.33**			.37	.40*
Δ Return on Equity		-.09				
CEO Variables						
CEO Duality				.06		
CEO Tenure				-.03		
Num. of Board Meetings						-.52**
<i>F</i>	1.39	2.10*	1.50	1.20	1.44	3.34*
<i>R</i> ²	.10	.21*	.11	.11	.21	.44*
Adjusted <i>R</i> ²	.03	.11*	.04	.02	.07	.31*
Δ <i>R</i> ²		.11*		.01		.23**

^a*n* = 82. Table contains standardized regression coefficients.

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

Hypotheses 2a and 2b stated that outside membership on boards would be negatively related to CEO/Chair duality and CEO tenure, respectively. As shown in Table 1, the number of outside board members was neither related to the separation of CEO/Chair responsibility ($r = .05$), nor the tenure of the CEO ($r = -.08$). As indicated by the nonsignificant R^2 and β values in Table 2, testing these relationships while controlling for baseline performance did not alter the results. Therefore, hypotheses 2a and 2b were not supported.

Hypothesis 3 stated that outside membership on SMEs' boards would be positively related to the size of the annual retainer and the extent of equity-based compensation paid to board members. Surprisingly, outside membership was related neither to the annual retainer ($r = -.18$), nor the amount of stock options ($r = .21$) nor shares issued to directors ($r = .12$). Upon further examination of the data, we found that a large percentage of organizations provided no director compensation; therefore, the large zero base-rate attenuated the correlations.

Table 3-Results of Director Compensation on Board Composition

	Change in Number of Outside Directors		Statistical Tests	
	Mean	Std. Error	t statistic	p-value
Annual Retainer				
> 0 ($n = 92$)	.86	.19	1.99	.049
None ($n = 10$)	-.40	.73		
Stock Options Awarded				
> 0 ($n = 67$)	.87	.22	.95	.346
None ($n = 35$)	.49	.37		
Restricted Shares Awarded				
> 0 ($n = 27$)	.74	.34	.02	.986
None ($n = 75$)	.73	.23		

To account for the base-rate problem, we performed a t-test, comparing companies that provided any director compensation with those that did not. As shown in Table 3, there was a significant difference in the change in outside directors when comparing companies

that paid an annual retainer with those paying no retainer ($t[100] = 1.99, p < .05$). Companies that paid an annual retainer displayed an increase in the number of outside directors from 2003 to 2005 ($\bar{x} = .86, SE = .19$), compared with a decrease in outside directors in

companies that paid no retainer ($\bar{x} = -.40$, $SE = .73$). The mean difference in the number of outside directors for the other forms of director compensation (i.e., stock options, restricted shares) was not significant. Thus, partial support was found for hypothesis 3.

Hypothesis 4 stated that the number of meetings board members were required to attend would be inversely related to the number of outsiders present on the board. As shown in Table 1, there was a significant negative correlation between the number of meetings that board members were required to attend annually and the number of outside board members ($r = -.36$, $p < .05$). We tested to see if this relationship persisted after controlling for the firm performance variables that our prior analyses identified as being predictive of board membership. The regression results are shown in Table 2. As indicated by the significant change in R^2 , the number of required board meetings ($\beta = -.52$, $p < .01$) explained 23% of the variance in outside board membership above and beyond the performance measures. Thus, hypothesis 4 was supported.

DISCUSSION

Our goal in this study was to identify those features of a SME that would attract outsiders to serve on its board. Our findings demonstrated that certain performance measures – both market return and sales – as well as the ability to pay an annual retainer are positively related to outside board membership. We also found that the time commitment expected of directors, as measured by

number of director meetings, was negatively related to outside board membership.

With respect to financial performance, we were concerned with determining the direction of causation: does good performance predict attraction to the firm's board or does the presence of outsiders on the board predict good performance? In using a time-lagged approach by measuring firm performance in a period of years prior to measuring the number of outsiders on the board, we felt that this problem was addressed. This does not necessarily mean that having outsiders on the board will not improve performance. In fact, resource dependence theory suggests that having a diverse group of outside directors may provide a company with strategic advantage. However, prior research suggests that if performance declines, outside directors are likely to resign in order to preserve their reputations (Gilson, 1990). Our findings support this phenomenon, leading to the conclusion that performance influences the processes of both attracting and retaining qualified outside directors.

Whether or not a company pays its outside directors an annual retainer affects the decision of a potential non-executive director to serve on a board. Offering some monetary compensation to outside members thus encourages their consideration of director service for SMEs. If a SME wishes to attract qualified outside members to its board, it must compensate those directors for their service and time. On the other hand,

while there is some evidence that larger companies are using stock grants as opposed to stock options in compensation packages for their non-executive board members, SMEs continue to award both stock grants and stock options to their outside members (Archer, 2005). We expected, in light of our hypothesis that improvements in share price would predict outsider presence on boards (a hypothesis that was supported by our results), that the use of equity-based compensation in director remuneration would be an attractive incentive to join a board. However, this was not demonstrated.

Our finding that the expected amount of hours of service, measured by the number of board meetings, was negatively related to outside membership indicates that directors take into account the time investment associated with board membership in deciding whether to accept a nomination. Time constraint issues become particularly pertinent given current economic conditions, with more firms struggling for survival and looking to directors to provide advice and counsel. Our findings were consistent with those of Lorch and MacIver (1989) who found that lack of time was the primary reason potential directors declined to serve on the boards of mid-sized companies. This study extends those results insofar as it examines the issues with respect to SMEs as measured by revenues and data collected more than 20 years later. We also note that the Lorch and MacIver study examined companies in the S&P 400, which includes mid-range

companies based on market capitalization, while our study focused primarily on small companies.

We found no support for CEO power as a negative influence on the decision to accept a board nomination. One plausible explanation is that in the case of smaller companies, directors are not as concerned with the power of the CEO. As surmised by Boyd (1995), firms facing financial or environmental uncertainty are better off with a powerful CEO in command, evidenced by the combined CEO and chair positions. SMEs and newly formed companies are presented with greater uncertainties than larger, more well-established firms (Bruderl & Schussler, 1990). Thus, having a powerful leader with a keen sense of direction for the company may be seen as a positive characteristic and a harbinger of future success, rather than a deterrent to board service.

Our study and the resource dependence perspective in general suggest some direction for SMEs in recruitment of outside directors to their boards. Based on our results showing a negative relationship between number of meetings and outside director representation, SMEs may be at an advantage relative to larger companies in recruiting outside directors due to the likelihood that larger companies have more committees and more meetings. Moreover, smaller companies might want to consider reducing the number of meetings expected of directors, allowing attendance via electronic communications, and providing concise

summaries of meeting agenda items, in order to attract such talent. Implementing an orientation process for newly appointed directors may also help in their understanding of the company, which may reduce the number of hours needed to prepare for each meeting (Long, 2006).

Resource dependence theory suggests that directors play a vital role in meeting the resource needs of firms when their internal assets are insufficient to address environmental uncertainties that may inhibit firm success (Hillman et al., 2000; Pfeffer, 1973; Pfeffer & Salancik, 1978). As we pointed out earlier, SMEs may suffer from the “liability of smallness” identified by Bruderl and Schussler (1990) that could limit their power vis-à-vis their external environments. Outside directors should, according to resource dependence theory, be selected based on their individual abilities to address firm needs. When recruiting an outside director candidate to serve on its board, a SME may want to emphasize the fit between the role the director will play in governing the firm and helping to fulfill its resource needs, thereby providing the director with a clearer understanding of his/her ability to contribute to the firm’s success. Such information may make the position more attractive to the potential director who wants to make the most productive use of his/her time while serving on a corporate board.

LIMITATIONS AND FUTURE RESEARCH

We note that the lack of findings for some of our hypotheses may be due to the relatively small size of our sample. A larger sample affording more power for analyses may yield greater insight into the predictors of outside director representation on the boards of SMEs.

Nicholson and Kiel (2007), in their study comparing the explanatory power of the three primary theories of governance, agency theory, stewardship theory, and resource dependence theory, found that no one theory adequately predicted firm performance differences among the cases they studied. In their discussion, they noted that “it is likely that any board effect on firm performance will be highly dependent on context-specific situations such as stage of organizational life cycle (Johnson, 1997)” (Nicholson & Kiel, 2007, p. 602). We agree with their observation and note that Mace (1986), in his research related to small firm governance practices, found that the most important role directors served was in providing resource support to the companies’ management teams. We thus rely principally upon resource dependence theory in our study of SMEs to explain the potential value of outside directors to such firms. In so doing, we did not examine the potential of either agency theory or stewardship theory to explain the value of outside directors serving on SME boards. This area may prove to be fruitful in future research for scholars who are interested in other roles

that outside directors may play in governing SMEs.

Another area of potential further investigation of the predictors of outside director participation on the boards of SMEs would be to determine what board and management processes may serve as attractants or deterrents to outside director recruitment. Hambrick (2007) points out that the use of demographic characteristics to predict organizational outcomes ignores the “black box” of psychological and social processes that are the actual drivers of executive behavior (Lawrence, 1997). Nicholson and Kiel (2007) also note that what happens within firms is often more explanatory of phenomena than the more readily measured attributes of directors so often relied upon in governance research. Designing research studies that assess how board or executive dynamics impact outside director membership on the boards of SMEs may well produce supplemental findings adding to our understanding of this phenomenon.

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