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ORIGINAL PAPER

# The possible pitfalls of boards' engagement in the strategic management process

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**Abstract**
Scholars endorsing the embeddedness outlook call for directors' greater engagement in the strategic management process. In contrast, scholars endorsing the control outlook argue that directors should focus on fulfilling their fiduciary duty of supervising top executives. Based on the behavioral-agency theory, this paper outlines a conduct outlook on boards. Recognizing the benefits of directors' participation in the strategic management process, we hypothesize that it may boost directors' satisfaction with firm's performance, strategic planning, and strategy. This could lead to cognitive entrenchment and spur inertial tendencies. Structural equations modeling analysis of the data from a survey of 367 Canadian directors supports the hypotheses. These findings add knowledge to latest research on the advantages vs. disadvantages of activist boards.

**Keywords** Boards of directors · Strategic planning · Firm performance · Firm strategy

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## 1 Introduction

Shareholders, legislators, government agencies and academics have long urged boards of directors to become more involved in the strategic management process encompassing strategy formulation, monitoring of strategy implementation, strategic planning and evaluation and control (Andrews 1981a, b; Huse 2007; Pugliese et al. 2009; Fernandez, Burnett, and Gomez 2019; Basco et al. 2019). Theorists subscribing to the embeddedness outlook on corporate governance (Geletkanycz and Boyd 2011) based in stewardship theory (Donaldson 1990; Donaldson and Davis 1991; Davis et al. 1997) insist that boards of directors should actively participate in the strategic management process, and in general, focus on their roles as advisors to the top management team (TMT) (Zahra 1990; Pearce and Zahra 1991; Rindova 1999; Pugliese et al. 2009). In contrast, theorists subscribing to the control outlook on corporate governance (Geletkanycz and Boyd 2011) based in agency theory (Jensen and Meckling 1976; Fama and Jensen 1983a, b) insist that boards of directors should not actively participate in the strategic management process as this could detract them from performing their principal duty as TMT's supervisors (Westphal and Zajac 1995; Golden and Zajac 2001; Westphal et al. 2001; Westphal and Graebner 2010).

Recent research has provided some additional arguments supporting the control outlook by showing that, similar to managers, board members can be driven by self-interest and may not effectively contribute to the strategic management process, especially during the time of strategic change (Hoppmann et al. 2019). Furthermore, scholars have shown that, counterintuitively, domain experts on boards of directors may undermine effective decision making (Almandoz and Tilcsik 2016; Tilcsik and Almandoz 2016, 2017). This paper seeks to contribute to this emerging body of research casting into doubt the ability of boards of directors to contribute positively to the strategic management process due to directors' self-interest and reluctance to engage in self-evaluation and self-reconfiguration (Hoppmann et al. 2019) and their cognitive limitations (Almandoz and Tilcsik 2016). Applying the behavioral-agency theory as our overriding theoretical perspective (Wiseman and Gomez-Mejia 1998; Sanders and Carpenter 2003; Pepper and Gore 2015), we argue that directors may become emotionally attached to the practices they helped to develop, and hence, succumb to cognitive entrenchment, that is, become resistant to changing the strategies they have designed (Dane 2010; Almandoz and Tilcsik 2016; Tilcsik and Almandoz 2017; Hoppmann et al. 2019).

To test our hypotheses, we have surveyed over three hundred board members from Canada sitting on boards of various public and private companies, from very small to very large, from unprofitable to very profitable. Subsequently, we applied the structural equations modeling (SEM) to examine the data. Our analysis provided support to the proposed hypotheses. Overall, this study indicates that as directors begin to participate in the strategic management process, their satisfaction with firm's performance, strategic planning and strategy increases significantly. From an embeddedness perspective, such increasing satisfaction may be regarded positively as it could boost directors' intrinsic motivation and drive their deeper engagement in the strategic management process (Zahra 1990; Pearce and Zahra 1991; Rindova 1999; Pugliese et al. 2009). From a control perspective, such increased satisfaction with firm's performance could make directors more reluctant to consider adjusting corporate strategy (Zajac and Westphal 1996; Golden and Zajac 2001; Westphal et al. 2001; Westphal and Graebner 2010). Applying a conduct perspective outlined in this study, based on the behavioral-agency theory (Wiseman and Gomez-Mejia 1998; Sanders and Carpenter 2003; Pepper and Gore 2015), we suggest, however, that increased boards' activism may have its advantages as it may allow boards to become more knowledgeable about the firm. However, we also point our that increased participation in the strategic management process could activate an affect bias (Kahneman et al. 2011) and other biases (Weber and Wiersema 2017) and make directors less critical of the strategies they helped to design.

Our study contributes to the existing literature on corporate governance by showing that directors' active participation in the strategic management process may have some possible pitfalls. As directors become deeper involved in strategy formulation and implementation, and respectively, more satisfied with the firm's performance, they may succumb to cognitive entrenchment (Dane 2010; Almandoz and Tilcsik 2016; Tilcsik and Almandoz 2016, 2017). Such cognitive entrenchment could increase directors' inertial tendency, and thus, make them unwilling to adjust firm's strategy in response to the shifting environment (Hoppmann et al. 2019). Agency theory emphasizes the role of extrinsic motivation as the driver of executive actions (Jensen 1998, 2000). In contrast, behavioral-agency theory suggests that there is a trade-off between intrinsic motivation and extrinsic motivation (Wiseman and Gomez-Mejia 1998; Sanders and Carpenter 2003; Pepper and Gore 2015; Rivera-Santos et al. 2017). This study contributes to the behavioral-agency theory by showing that, similar to excessive extrinsic motivation that may motivate executive fraud (Pfarrer et al. 2008), excessive intrinsic motivation could make directors uncritical of firm's performance and strategy.

The paper is structured as follows. In the first section, we provide a review and reconceptualization of the literature on boards of directors. In the second section, we hypothesize that, not only financial outcomes, but also directors' participation in the strategic management process will be positively associated with directors' satisfaction with firm performance. In the third section, we conjecture that directors' participation in strategy formulation and monitoring of its implementation will be related positively to boards' satisfaction with the firm's strategic planning. In the fourth section, we propose that boards' satisfaction with firm's performance and strategic planning will be related positively to their satisfaction with the firm's strategy. In the discussion section, we point out this study's contributions, discuss its limitations, highlight its practical implications for corporate governance, and finally, outline directions for future research.

## 2 Literature review and reconceptualization: competing outlooks on boards of directors

Literature on corporate governance encompasses contrasting theories regarding boards of directors' principal roles, and the recommended levels of boards' involvement in the strategic management process encompassing strategy formulation, implementation, strategic planning and evaluation and control (Zahra and Pearce 1989; Golden and Zajac 2001; Daily et al. 2003; Nadler 2004; Ferrero-Ferrero et al. 2012; Pugliese et al. 2009; Fernandez-Gago et al. 2016). Thus, agency theorists have argued for a long time that the strategic functions of boards should be limited to oversight of the top management's activities whereas the company's top executives should specialize in making strategic decisions (Fama 1980; Fama and Jensen 1983a, b). Such insistence on a clear separation of the roles of managers and directors is based on agency theory's principal contention that directors should be alert and tirelessly look out for shareholder interests (Daily et al. 2003).

Importantly, agency theory suggested that corporate executives are mostly driven by extrinsic motivation so that their behavior could be regulated and aligned with shareholders' interests via pecuniary incentives (Jensen 1998, 2000). Additionally, sociopolitical and impression management theories sought to expose opportunistic CEOs plotting intended to subjugate boards to their control and dominance (Westphal and Graebner 2010). While distinct, agency perspective (Jensen 1998, 2000) and sociopolitical and impression management perspective (Zajac and Westphal 1996; Westphal and Graebner 2010) on boards of directors' principal roles could be regarded as complementary. Agency theory is concerned with aligning the interests of executives and shareholders and using boards of directors to control executives' conduct (Jensen 1998, 2000). In contrast, sociopolitical and impression management theories emphasize the difficulties of controlling executives' behavior because of their Machiavellian strategies (Westphal and Graebner 2010). The resulting control outlook stresses the need for management oversight and warns about the dangers of executive omnipotence, maneuvering, and scheming (Zajac and Westphal 1996; Jensen 1998, 2000; Golden and Zajac 2001).

In contrast, other studies argue that directors should be more involved in strategy formulation, monitoring and implementation because of their ready access to various resources, including information, political connections and social ties (Boyd 1990a, b, 1995; Hillman et al 2000; Brunninge and Nordqvist 2004). According to this perspective based in stewardship theory (Donaldson 1990; Donaldson and Davis 1991; Davis et al. 1997), the main role of directors is to serve as advisors to the top management team (TMT). This view has been reinforced by institutional theory that regards compliance and conformity with laws, rules and common perceptions as firm's key capability (Balkin 2008). According to this approach, boards' enhanced access to institutional resources reinforced via compliance, conformity and political connections attained via lobbying (Judge and Zeithaml 1992) may improve information flows in the company and enhance firm's ability to use boundary spanning to foresee environmental changes and adjust its actions via continual strategy overhaul (Balkin 2008; Harms et al. 2009).

Overall, the embeddedness perspective (Granovetter 1985; Geletkanycz and Boyd 2011) assesses CEOs' political action and manipulation as positive rather than negative consequences of executives' rootedness in a particular social context and their connectedness to influential actors (McDonald and Westphal 2003, 2010, 2011). Embeddedness perspective is comprised of divergent research streams. Thus, institutional theory examines acquiescence, avoidance, defiance, compromise and manipulation as legitimate responses to institutional pressures (Oliver 1991). Social network analysis indicates that different types of social ties facilitate achievement of actors' goals (Burt 1991). Resource dependence perspective recommends employing the strategy of resource mobilization and cooptation that may help to adjust continually to the immensely challenging environmental change (Pfeffer and Salancik 1978a, b). These distinct yet complementary currents suggest that CEOs should be trying to access directors' resource endowments to improve firm's grasp of its milieu and its ability to operate with maximum efficiency.

A cognitive approach toward corporate governance within the embeddedness outlook investigates how directors' experience, expertise and superior cognitive skills could bolster their ability to provide advice to the TMT (Zahra 1990; Pearce and Zahra 1991; Rindova 1999; Pugliese et al. 2009). From this perspective, directors as decision making experts could help managers with problem identification and representation as well as problem solving (Zahra 1990; Judge and Zeithaml 1992; Rindova 1999). In addition, scholars that adhere to the cognitive approach to corporate governance have proposed that boards of directors could combine the contrasting functions of monitoring and advising executives in a synergistic fashion (Pugliese et al. 2009). Integration perspective merging agency theory and resource dependence perspective also insists that boards of directors should act as both controllers and advisors (Hillman and Dalziel 2003; Dalziel et al. 2011).

Based on the idea that board members have ample cognitive resources including experience and expertise, scholars have argued that boards need to be more involved into formulating and implementing the company's strategy and strategic planning (Zahra 1990; Rindova 1999). Specifically, researchers have proposed that directors may apply their cognitive skills for "scanning, interpretation and choice" to facilitate dealing with uncertainty and complexity (Rindova 1999: 953). However, this optimistic view on experts as effective advisers has been challenged in the recent literature on cognitive entrenchment (Dane 2010). It has shown that domain experts on boards of directors could actually have a negative impact on firm strategy (Almandoz and Tilcsik 2016; Tilcsik and Almandoz 2016, 2017).

Furthermore, there is an abundant evidence in the literature that directors do not do well as strategists (Siciliano 2005, 2008). Ironically, directors themselves are often critical of their purported ability to contribute to company's strategy and skeptical about each other's competence and commitment (Thomas et al. 2007). In fact, only 60% of directors believe that all board members understand the key operating issues or the principal sources of risk in the business (Thomas et al. 2007). In addition, fewer than 55% of directors feel that they have a clear understanding of their stakeholders' objectives (Thomas et al. 2007). Only 70% of directors think that their colleagues show up for board meetings prepared (Thomas et al. 2007). Merely 60% of directors say that other board members participate in board meetings effectively

(Thomas et al. 2007). Finally, only two-thirds assess their boards' decisions as being high-quality (Thomas et al. 2007).

Importantly, boards experience serious cognitive difficulties in integrating their members' diverse information (Zhang 2008, 2010). This supports research on small groups' collective deficiencies in information processing and decision making as teams often exhibit unjustified reliance on shared information whereas members' unique knowledge may be disparaged and ignored (Brodbeck et al. 2007). Boards may also be extremely fearful of executing strategic change (Golden and Zajac 2001). CEOs complain that as society has been putting boards of directors under greater and greater public scrutiny, they have responded by becoming increasingly risk averse and almost paranoid of executing strategic change (Sonnenfeld et al. 2013). Some boards may panic at the mere thought that the strategic initiatives introduced by CEO could alarm influential stakeholders: "the rise in stakeholder and proxy-analyst pressures has made directors sensitive to any decision that might provoke a negative reaction from the media, proxy-advisory firms, institutional analysts, or activist investors" (Sonnenfeld et al. 2013: 101). Not surprisingly, scholars have called for boards' professionalization (Pozen 2010).

One study also has shown that excessive information processing demands could limit directors' ability to focus on the focal firm and even undermine their general human capital (Khanna et al. 2013). Furthermore, scholars have identified different types of barriers to effective board oversight (Boivie et al. 2016). These include outside job demands (i.e., directors do not have enough time for performing their board duties); similarity of outside job demands (i.e., board members often lack expertise in the industry in which the firm operates and rely on their expertise in adjacent industries that may not be applicable); complexity of outside job demands (i.e., it is harder for directors to monitor highly diversified firms) (Boivie et al. 2016). Such barriers to effective board oversight may also interact and reinforce one another (Boivie et al. 2016). To be effective, board members need to combine independence, expertise in a certain domain, bandwidth and motivation (Hambrick et al. 2015). However, director independence can easily be compromised (Westphal and Stern 2006a; b; Westphal and Shani 2016) whereas director expertise, bandwidth and motivation can be undermined due to insufficient attention span and resources (Boivie et al. 2016).

Based on this recent research, it appears that scholars subscribing to the embeddedness outlook (Zahra 1990; Pearce and Zahra 1991; Rindova 1999; Geletkanycz and Boyd 2011; Hillman and Dalziel 2003; Dalziel et al. 2011; Pugliese et al. 2009) have been overoptimistic in calling for boards' enhanced involvement in firms' strategic management processes. Moreover, we believe that such increased involvement is difficult to implement (Boivie et al. 2016) and could also be counterproductive as it may undermine director independence (Westphal and Stern 2006a, b; Westphal and Shani 2016). Based on the employee participation and budgeting participation literatures (Heinle et al. 2014), we propose that boards' satisfaction with firm's performance could be influenced by their active involvement in strategy formulation and implementation as well as involvement in strategic planning.

Overall, we believe that both the control outlook based on agency theory (Jensen 1998, 2000) and the embeddedness outlook based on stewardship theory (Donaldson

1990; Donaldson and Davis 1991; Davis et al. 1997) have their strengths and weaknesses. Control outlook correctly emphasizes the importance of supervision over top executives due to their opportunism and scheming (Jensen 1998, 2000; Westphal and Graebner 2010). However, the control outlook seems to be wrong in trying to stimulate solely extrinsic motivation and ignoring its dark side since overheating extrinsic motivation could lead to fraudulent activities (Pfarrer et al. 2008). In turn, the embeddedness outlook correctly emphasizes that directors could help companies with their connections and expertise (Zahra 1990; Pearce and Zahra 1991; Rindova 1999; Geletkanycz and Boyd 2011; Hillman and Dalziel. 2003; Dalziel et al. 2011; Pugliese et al. 2009). However, the embeddedness outlook apparently is wrong in relying primarily on intrinsic motivation and ignoring its dark side since overheating intrinsic motivation could make decision makers excessively emotional and unwilling to change the decisions they have helped to develop and implement (Kahneman et al. 2011; Soll et al. 2015, 2016). In contrast, we propose that a conduct outlook based on agency-behavioral theory (Wiseman and Gomez-Mejia 1998; Sanders and Carpenter 2003; Pepper and Gore 2015; Rivera-Santos et al. 2017) represents a more appropriate conceptual perspective for assessing the principal roles and main activities of boards.

Applying agency-behavioral theory (Wiseman and Gomez-Mejia 1998; Sanders and Carpenter 2003; Pepper and Gore 2015; Rivera-Santos et al. 2017) and the conduct outlook on boards as our overriding conceptual perspective, we propose that boards of directors may seek to combine the roles of supervisors and advisors (Pugliese et al. 2009) but need to be aware of the barriers to executing each of these roles as well as of the barriers to combining these roles synergistically (Boivie et al. 2016; Weber and Wiersema 2017; Almandoz and Tilcsik 2016; Hoppmann et al. 2019). Previous studies have either approached boards of directors' participation in the strategic management process as something to be avoided (Jensen 1998, 2000; Geletkanycz and Boyd 2011) or approached it as a cure-all that could help managers conceive of and execute more effective strategies (Zahra 1990; Pearce and Zahra 1991; Rindova 1999; Pugliese et al. 2009). Based on recent research, it appears that directors, similar to executives, may act based on self-interest, suffer from various biases and experience serious cognitive difficulties in integrating various strains of information (Zhang et al. 2011; Boivie et al. 2016; Almandoz and Tilcsik 2016; Tilcsik and Almandoz 2016, 2017; Hoppmann et al. 2019). Hence, a conduct outlook could facilitate integration of the control outlook and embeddedness outlook and provide an adequate conceptual underpinning for assessing directors' activities. Such assessment would focus on examining the arrangements that would motivate directors to enhance their performance both as supervisors and advisors given their cognitive limitations. Figure 1 illustrates the concept of conduct outlook we introduce and advocate in this paper.

## 3 Board members' satisfaction with firm performance

Based on the control outlook, prior research has suggested that boards' ability to oversee the company's top executives could be compromised if CEOs were able to recruit related, affiliated or like-minded directors (Westphal and Zajac 1995).

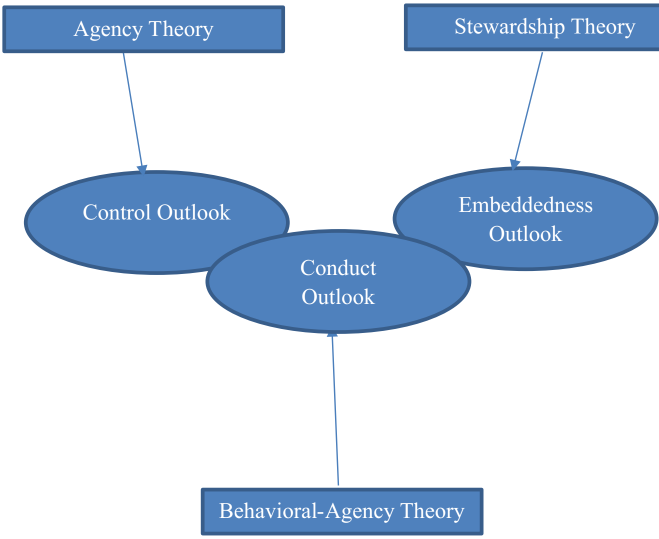


**Fig. 1** Control outlook, embeddedness outlook, and conduct outlook

Although agency theory's key principles of board independence have been institutionalized over the years through legislation, customs, monitoring procedures and shareholder expectations, there is mounting evidence that CEOs effectively use impression management tactics to enhance boards' visible manifestations of independence while subverting boards' ability to oversee top executives' actions (Westphal and Stern 2006a, b; Westphal and Graebner 2010; Westphal and Shani 2016). In contrast, studies based on the embeddedness outlook have argued that top executives' organizational identification, i.e., close association and integration with their companies, is likely to decrease the need for external control (Boivie et al. 2011).

This position is emblematic of the embeddedness outlook in the corporate governance literature (Geletkanycz and Boyd 2011). It is based on stewardship theory (Donaldson 1990; Donaldson and Davis 1991; Davis et al. 1997). In overt opposition to agency theory (Fama and Jensen 1983a, b), stewardship theory characterizes managers as dedicated and effective decision makers and criticizes close monitoring of top executives as counterproductive (Donaldson 1990; Donaldson and Davis 1991; Davis et al. 1997). In addition, scholars applying a cognitive perspective have argued that board members should play the role of experts whereas top executives should be facilitating boards' involvement into the strategic management process (Rindova 1999; Boivie et al. 2011).

Unfortunately, boards of directors do not live up to these somewhat euphoric aspirations. Studies have revealed that directors in the 1980s were mostly involved in providing advice to management on company strategy but were not directly engaged in strategic decision making (Henke 1986), especially in the key areas of strategy formulation and implementation (Siciliano 2005, 2008). However, the situation has significantly changed in the 1990s and 2000s when board's involvement in strategy ranged from monitoring top management's decisions and providing minimal analysis and counseling to probing into CEOs' assumptions and getting engaged in strategic review to collaboration between boards and top management that included generating new ideas and revising current policies (Siciliano 2005, 2008).

Still, it remains unclear if directors' increased participation in the strategic management process has been effective (Siciliano 2005, 2008). Importantly, top executives' and boards' assessments of directors' influence on firm strategy diverge (Siciliano 2005, 2008). Whereas some directors express confidence that their contribution to firm strategy has reached the highest level of creative collaboration, many top executives describe directors' contributions to firm strategy as reactive rather than proactive and do not regard board members' strategic advice as particularly innovative or even useful in terms of facilitating strategy formulation (Siciliano 2005, 2008). Although boards began to get more actively engaged in the strategic management process in the 1990s and 2000s, their contributions appear to be more ceremonial than productive in terms of spearheading companies' search for pioneering strategies (Sonnenfeld et al. 2013). Moreover, boards' greater involvement has created bureaucratic hurdles undermining push for innovation (Sonnenfeld et al. 2013).

Based on the behavioral-agency theory (Wiseman and Gomez-Mejia 1998; Pepper and Gore 2015), we propose that both the control outlook on corporate governance (Jensen 1998, 2000; Westphal and Graebner 2010; Westphal and Shani 2016) and the embeddedness outlook on corporate governance (Zahra 1990; Pearce and Zahra 1991; Rindova 1999; Pugliese et al. 2009) provide a somewhat distorted interpretation of the relationship between boards and executives. The control outlook appears to exhibit excessive suspiciousness of top executives' activities, and respectively, reduces directors' role to that of executives' supervisors (Jensen 1998, 2000; Westphal and Graebner 2010; Westphal and Shani 2016). Certainly, top executives and directors may become allies and collaborators as opposed to being designated antagonists. In turn, the embeddedness outlook appears to exhibit some unrealistic expectations regarding directors' ability to lead the strategic management process (Zahra 1990; Pearce and Zahra 1991; Rindova 1999; Pugliese et al. 2009). Certainly, directors do not have sufficient resources for acting in this capacity. Agency-behavioral theory provides a realistic outlook on corporate governance (Wiseman and Gomez-Mejia 1998; Pepper and Gore 2015).

Applying agency-behavioral theory (Wiseman and Gomez-Mejia 1998; Pepper and Gore 2015), one can argue that both extrinsic motivation emphasized by agency theory (Jensen and Meckling 1976) and intrinsic motivation emphasized by stewardship theory (Davies et al. 1997) can be useful but also may be harmful and even dangerous, if left unchecked. Applying this reasoning, we propose that more involved boards could, indeed, become more intrinsically motivated and committed. However, boards' greater involvement in the strategic management process, and thus, enhanced intrinsic motivation may also have a dark side. Such enhanced intrinsic motivation may elicit an affect bias (Kahneman et al. 2011) so that directors may lose their objectivity, develop cognitive entrenchment (Almandoz and Tilcsik 2016) and exhibit inertia (Hoppmann et al. 2019).

Prior research has revealed the existence of a positive association between employee participation in certain functions, such as budgeting, and their satisfaction with the attained results (Luft and Shields 2003; Burney and Motherly 2007; Zuriekat et al. 2011). The benefits of increased employee participation in budgeting are: (1) raising the level of target acceptance and employee commitment; (2) reducing information asymmetry between employees and management, especially when targets are imposed from above; and (3) avoiding or mitigating employee demotivation that may lead to poor performance when employees do not accept the imposed targets (Drury 2008; Zuriekat et al. 2011). Therefore, enhanced employee participation in budgeting and other management functions is supposed to increase employee acceptance of the objectives and strategies outlined by the top management and increase employee motivation and commitment to implementing management strategies (Burney and Motherly 2007; Drury 2008; Zuriekat et al. 2011).

The same kind of reasoning could be applied to boards' increased participation in the strategic management process. Board's satisfaction with firm's performance typically depends on whether or not the firm has increased shareholder value in terms of financial outcomes (Mahto et al. 2010). However, based on employee and budgeting participation research (Heinle et al. 2014), board's increased participation in strategy formulation could be another key determinant of board's satisfaction with firm performance.

Thus, there could be two main determinants of boards satisfaction with firm performance. First, boards of directors would inevitably take a look at the financial outcomes. It is clearly boards' responsibility to react to suboptimal financial results and demand that strategies were reviewed and revised in response to any financial shortfalls. Second, board members' enhanced involvement in strategy formulation could result in their increasing acceptance of top management' activities and increased satisfaction with firm performance regarded as implementation of strategies that boards have actively helped to shape and see as their own contribution. To summarize:

**Hypothesis 1a** Financial outcomes will be related positively to directors' satisfaction with firm performance.

**Hypothesis 1b** Participation in strategy formulation will be related positively to directors' satisfaction with firm performance.

## 4 Board Members' Satisfaction with Strategic Planning

Companies often develop "planning guidelines" including discussion of forecasts, scenarios and assumptions (Grant 2003). These days, the goal of strategic planning is not formulated as foreseeing the future but rather as seeking to reach stakeholder consensus (Dominguez et al. 2009). Strategic planning may be implemented to reduce the gap between top management and middle management through communication and discussion leading to shared understanding of enterprise-wide and divisional goals (Wooldridge and Floyd 1990). Similar to increased participation in budgeting, enhanced involvement in strategic planning can generate "affective and motivational effects" (Ketokivi and Castaner 2004). As boards are getting more involved in the strategic management process, they begin to share responsibility with top management for strategic planning. This is why boards of directors are often asked to assess their level of satisfaction with how effectively the company is conducting its strategic planning activities (Dominguez et al. 2009).

Boards of directors continually receive information regarding strategy implementation. Via such "strategy packages," top management communicates with the board asking for its input regarding the planning assumptions used by the staff; rationales for the proposed strategy; and the main alternatives discussed (Dominguez et al. 2009). Thus, boards do not only participate in setting strategic objectives, but also continually oversee firm's performance and control strategy implementation. Boards' involvement in these two critical activities underlying the strategic management process could make directors feel that they have shaped the strategic planning at the firm.

Individuals, however, are highly vulnerable to various decision making biases, including the endowment effect (i.e., feeling that something one owns is more valuable compared to similar but non-owned objects) and confirmation bias (giving more weight to the data that supports one's views compared to the data that disproves it) (Kahneman et al. 2011; Soll et al. 2015, 2016; Gnanlet and Khanin 2015). Moreover, directors can be strongly influenced by decision biases (Weber and Wiersema 2017). Thus, as directors become involved in strategy formulation and strategy implementation, the endowment effect and confirmation bias could affect their judgment regarding the efficacy of strategic planning at the company. Although strategic planning enhances control and evaluation, along with strategy formulation and strategy implementation (Ketokivi and Castaner 2004), directors' involvement in strategy formulation and strategy formulation could make them look positively at strategic planning in the company as a whole. This is because directors heavily involved in strategy formulation and strategy implementation would look at the company's strategy as theirs (i.e., exhibit the endowment effect) and possibly disregard any evidence that strategic planning at the company may have some problems and shortcomings or be insufficiently effective (i.e., succumb to the confirmation bias). To summarize:

**Hypothesis 2a** Participation in strategy formulation will be related positively to directors' satisfaction with the firm's strategic planning.

**Hypothesis 2b** Participation in monitoring of strategy implementation will be related positively to directors' satisfaction with the firm's strategic planning.

## 5 Boards' Satisfaction with Corporate Strategy

Strategic management process represents a comprehensive set of interrelated activities, from strategy formulation to strategy implementation, interwoven with strategic planning, evaluation and control (Ketokivi and Castaner 2004; Dominguez et al. 2009). Because of such interconnectedness of the activities that constitute the strategic management process, directors' increased satisfaction with some of its components are likely to increase their satisfaction with other components and their end products—corporate strategy, business strategy, and functional strategy (Wooldridge and Floyd 1990).

Consequently, as directors become increasingly involved in the strategic management process, and thus, more and more satisfied with firm performance, they will be more likely to express satisfaction with firm performance (Siciliano 2005, 2008). Similarly, as directors become more satisfied with strategic planning activities, they will be more likely to appreciate firm strategy. Such growing appreciation for different, interrelated constituents of the strategic management process could be due to cognitive entrenchment (Dane 2010; Furr et al. 2012; Almandoz and Tilcsik 2016), and the resulting inertial tendencies (Hoppmann et al. 2019). Directors are frequently influenced by various decision-making biases (Weber and Wiersema 2017). Their increased participation in the strategic management process, however, could increase such effect and make directors especially vulnerable. To summarize:

**Hypothesis 3a** Satisfaction with firm performance will be related positively to directors' satisfaction with firm strategy.

**Hypothesis 3b** Satisfaction with strategic planning will be related positively to directors' satisfaction with firm strategy.

## 6 Methods

Data for this study was collected with a paper-based survey. Following prior research on director training (Hartmann 2007), we administered the survey to board members of Canadian firms that participated in a director training course. After the training session, directors were asked to stay in the classroom to complete the survey. No special incentives were provided. We developed the survey items based on the literature dedicated to boards' involvement in strategy (Siciliano 2005, 2008; Thomas et al. 2007). The scales were further refined based on the feedback received from five directors that participated in a pilot study.

Survey items are reported in Table 1.

Out of the 410 participants in the training course, 367 agreed to complete the survey resulting in 89.5% response rate. Data regarding directors' gender and age was not collected since we wanted to assure the participants that we will not request any sensible, personal information. We also did not inquire whether or not the board members were independent directors. Board members in the sample worked in this capacity from one to 26 years. Since directors in the sample served on 2.16 board on average, the range was 1 to 17, the respondents were asked to focus on the board of the company with which they were most familiar. 12.1% of the companies were public, 16.9% were private, 40.7% were non-for-profit, 17.1% were government "crown" corporations, 3.5% were hospitals, 2.5% were industry associations, and the remaining 7.2% were a mix of credit unions, pensions, and educational institutions. Thus, the sample represents a large cross-section of organizations. The companies' sales ranged from zero to $26 Billion, with an average of 649 Million Canadian Dollars. Companies represented in the sample

**Table 1** The main concepts and their measures

| Concept | Items |
|---|---|
| Return on Equity ROE | *For the most recent year—what is your firm's ROE:_______* |
| Board's participation in firm's strategy formulation | *Does the board Y = yes/ N = no formally review the:*<br>mission?—vision?—values?—objectives?—choice of major businesses?<br>*Does the board Y = yes/ N = no formally approve the:*<br>mission?—vision?—values?—objectives?—choice of major businesses?<br>* Each item is operationalized as the count of the components the board<br>reviews or approves i.e., the count of "yes" responses |
| Board's monitoring of firm's strategy implementation | To what extent do you receive the following information as part of your board package on strategy : 0=None; 4= to a great extent<br>Entry and exit from major products and/or services<br>Planning assumptions<br>Major strategic alternatives considered and rejected<br>Rationales for the proposed strategy<br>The degree of organizational alignment with the strategy for strategy execution |
| Board's satisfaction with firm's performance | *The Board's* satisfaction with the organization's current financial performance: 1 = Not at all satisfied; 10 = Extremely satisfied<br>*MY* satisfaction with the organization's current financial performance: 1 = Not at all satisfied; 10 = Extremely satisfied<br>Relative "performance standing" of the organization in its industry: 1 = significantly below; 10- significantly above |
| Board's satisfaction with firm's strategic planning | *Overall, how satisfied is your board with the organization's strategic planning process? 1 = Not at all; 10 = To the Greatest Extent*<br>*Overall, how satisfied is your board with its level of involvement and participation in the organization's strategic planning process? 1 = Not at all; 10 = To the Greatest Extent* |
| Board's satisfaction with firm's corporate strategy | Overall how satisfied is the board with its organization's *overall corporate strategy*? [1 = Not at all; 10 = To the Greatest Extent] |

employed between 1 to 140,000 employees, with an average of 1743 employees. The return on Equity (ROE) ranged from -50 to 145%, with an average of 18.03%. Furthermore, the boards in the sample held between 1 and 13 of meetings annually, with an average of 7.2 meetings.

To decide whether the dataset could be analyzed as a whole and what controls to use, we first performed a multivariate analysis of the variance model using SPSS 20. In the model, the items from Table 1 were included as dependent variables, organization type was a fixed factor. Pillai's Trace of 0.97, $F = 1.12$, $p < 0.26$, and sales Pillai's Trace of 0.18, $F = 0.99$, $p < 0.47$, number of employees Pillai's Trace of 0.14, $F = 0.73$, $p < 0.73$, and numbers of board meetings Pillai's Trace of 0.19, $F = 1.02$, $p < 0.44$, were used as covariates. The model has yielded non-significant Pillai's Trace indices. This indicated that there were no omnibus organization-type-based differences. Hence, we concluded that there was no need to control for sales, number of employees and board meetings in the structural model. The next section describes our analysis of the entire dataset. We controlled, however, for the covariates to check if they could be influential.

## 7 Results

As a preliminary step, descriptive statistics, correlations and reliability Cronbach alphas, for multi-item constructs were calculated see Table 2. As can be seen from the Table 2, all the reliability indices were over 0.7. Furthermore, the correlations were reasonable and in the expected direction. Consequently, the measures used in the survey appeared to be consistent and reliable.

Next, the model was estimated using the two-step approach (Anderson and Gerbing 1988) with AMOS 20. As a first step, a confirmatory factor analysis model was estimated as a means to assess the convergent and discriminant validities. The model presented good fit $\chi^2 63 = 112.7$, CFI = 0.98, IFI = 0.98, RMSEA = 0.046 with $p$ close = 0.65, and SRMR = 0.045. All loadings were significant $p < 0.001$. This indicated adequate convergent and discriminant validities. Consequently, we began estimating the structural model.

Initially, a structural model which included all the hypothesized paths, as well as the effects of the three control variables sales, employees, and number of board meeting on all endogenous constructs was estimated. This model showed a good fit $\chi^2 94 = 154.9$, CFI = 0.97, IFI = 0.97, RMSEA = 0.042 with $p$ close = 0.86, and SRMR = 0.051. All loadings were significant $p < 0.001$. The control variables did not have significant effects on the endogenous constructs. Therefore, for parsimony reasons, the non-influential control variables were removed, and the resulting model was estimated. It had good fit $\chi^2 70 = 122.3$, CFI = 0.98, IFI = 0.98, RMSEA = 0.045 with $p$ close = 0.71, and SRMR = 0.059, all the loadings were significant $p < 0.001$. The model with standardized path coefficients and squared multiple correlations is shown in Fig. 2.

The model offered support for the hypothesized relationships since all path coefficients were significant. ROE (H1a) and board participation in strategy formulation (H2b) were positively related to boards' satisfaction with firm performance. Together, these two factors explained 16% of the variation in director satisfaction with firm performance. However, the effect of participation in strategy formulation looked stronger. To test the significance of the observed difference, a chi-square difference test was performed, contrasting the model depicted in Fig. 2, with a

**Table 2** Variable descriptive statistics, correlations, and reliability*

| | Construct | Mean SD | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|---|---|---|
| Model | 1 Return on equity | 18.02 11.2 | ***NA*** | | | | | | | |
| | 2 Participation in strategy formulation | 4.25 1.24 | 0.00 | ***0.72*** | | | | | | |
| | 3 Monitoring of strategy implementation | 2.25 0.81 | 0.00 | 0.35** | ***0.84*** | | | | | |
| | 4 Satisfaction with firm performance | 6.98 1.63 | 0.20** | 0.27** | 0.28** | ***0.83*** | | | | |
| | 5 Satisfaction with strategic planning | 6.62 1.72 | 0.03 | 0.41** | 0.45** | 0.46** | ***0.85*** | | | |
| | 6 Satisfaction with corporate strategy | 7.03 1.61 | 0.05 | 0.31** | 0.39** | 0.53** | 0.67** | ***NA*** | | |
| Control variables | 7 Number of board meetings | 7.20 2.99 | 0.06 | 0.13* | 0.22** | 0.12* | 0.18** | 0.21** | ***NA*** | |
| | 8 Sales M $ CAD | 648.99 1649.9 | − 0.04 | − 0.05 | 0.02 | − 0.06 | 0.03 | 0.03 | − 0.03 | ***NA*** |
| | 9 Number of employees | 1743.13 8040.03 | − 0.01 | − 0.04 | 0.00 | 0.02 | 0.06 | − 0.06 | 0.09 | 0.06 |

Cronbach's Alphas are reported on the diagonal bolded for multi-item constructs

* $p < 0.05$

** $p < 0.001$

model in which the effects of ROE and participation in strategy formulation were constrained to be equal. The new model $\chi^2 71 = 150.47$ was inferior to the original model $\chi^2_{diff} = 28.17$, $df_{diff} = 1$, $p < 0.000$. This indicated that the effect of participation in strategy formulation was significantly stronger than that of firm's financial performance measured by ROE.

Providing support for H2a and H2b, participation in strategy formulation and monitoring of strategy implementation strengthened board members' satisfaction with the strategic planning process, and explained 35% of the variation. Finally, providing support for H3a and H3b, satisfaction with firm performance and satisfaction with strategic planning was shown to be positively related to directors' satisfaction with overall strategy explaining jointly 56% of the variation.

## 8 Discussion section

Research on boards of directors has long been split between the control outlook and embeddedness outlook (Geletkanycz and Boyd 2011). These two contrasting perspectives have both strengths and weaknesses. Supporters of the control outlook have argued appropriately that boards of directors need to focus on monitoring top executives' activities so that they could promptly halt those of them that may be opportunistic, and thus, run counter to shareholders' interests (Fama 1980; Fama and Jensen 1983a, b). Hence, studies following the control outlook frequently sought to expose executives' egregious scheming and manipulation of the boards (Fama 1980; Zajac and Westphal 1996; Golden and Zajac 2001; Westphal and Graebner 2010; Westphal and Shani 2016). At the same time, the limitation of the control outlook is that it approaches the relationship between boards and top management as fraught with conflict and controversy (Sundaramurthy and Lewis 2003; Garg and

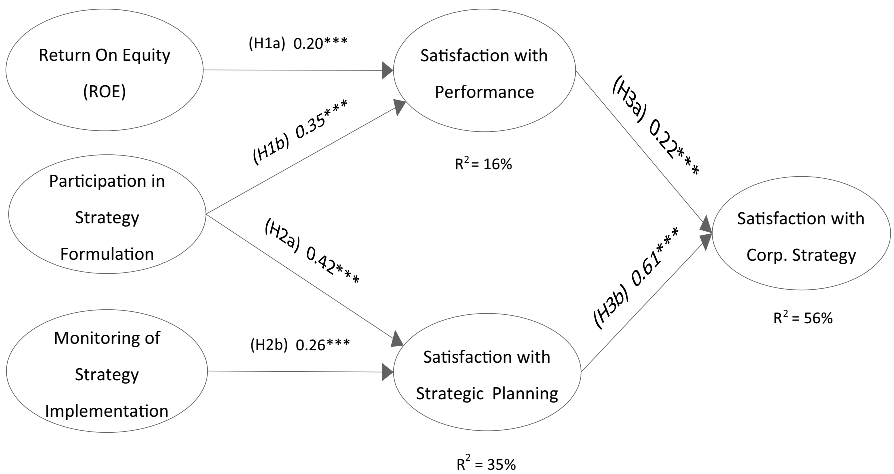


**Fig. 2** The research model

Eisenhardt 2017). In reality, this may not be the case, top executives may be dedicated and effective, and boards may help them do their job.

In contrast, supporters of the embeddedness outlook have aptly emphasized that boards of directors can provide valuable resources to top executives and that boards can also act as professional experts sharing their inside track information, knowledge and expertise with the TMT (Zahra 1990; Pearce and Zahra 1991; Rindova 1999; Pugliese et al. 2009). It is certainly true that boards could be more than supervisors and serve as a key resource for top executives. The limitation of the embeddedness outlook, thought, is that it has little to do with reality. Many studies have shown that both directors and top executives express serious doubts as to boards' knowledge of the company, and boards of directors' ability to contribute meaningfully to firm strategy (Siciliano 2005, 2008; Thomas et al. 2007; Zhang 2008, 2010). Moreover, latest research has revealed that it is hard for boards to serve as effective monitors because of excessive information processing demands (Khanna et al. 2013), and various barriers to boards' performance (Boivie et al. 2016). Scholars also have shown the negative impact of cognitive biases (Weber and Wiersema 2017) and cognitive entrenchment on boards' decision-making (Almandoz and Tilscik 2016). For example, some boards can suppress change when performance drops (Desai 2016).

In this paper, we sought to develop an integrative, but more realistic and less one-sided and restrictive outlook on boards of directors compared to the control outlook and embeddedness outlook. We described this integrative outlook as the conduct outlook. Whereas the control outlook is based on agency theory (Jensen 1998, 2000) and the embeddedness outlook is based on stewardship theory (Donaldson 1990; Davies et al. 1997), the conduct outlook is based on behavioral-agency theory (Wiseman and Gomez-Mejia 1998; Pepper and Gore 2015). Behavioral-agency theory seeks to combine agency theory and Prospect Theory (Tversky and Kahneman 1979). Behavioral-agency theory recognizes that executive behavior may not respond merely to external incentives, but succumb to cognitive biases (Kahneman et al. 2011; Soll et al. 2015, 2016; Weber and Wiersema 2017), and exhibit loss aversion rather than merely risk aversion (Wiseman and Gomez-Mejia 1998; Pepper and Gore 2015).

Developing the conduct outlook, we argued in this paper that making boards more active participants in the strategic management process may have its pluses and minuses. On the positive side, active boards could become more knowledgeable about the company and the industry in which it operates, and consequently, make more informed decisions in strategic matters. Furthermore, it would be harder for opportunistic CEOs to manipulate more knowledgeable and involved boards, a concern often raised by the adherents to the control outlook (Zajac and Westphal 1996; Golden and Zajac 2001; Westphal and Graebner 2010; Westphal and Shani 2016). On the negative side, as we argue in this paper, the greater directors' participation in the strategic management process, the greater the likelihood that they may suffer from cognitive entrenchment (Almandoz and Tilcsik 2016; Tilcsik and Almandoz 2016, 2017) and exhibit various decision-making biases (Weber and Wiersema 2017) leading to inertial tendencies (Hoppmann et al. 2019).

From an empirical perspective, this paper demonstrates that directors' participation in the strategic management process that represents a set of interrelated activities from strategy formulation to strategy implementation, from strategic planning to evaluation and control (Wooldridge and Floyd 1990; Grant 2003; Ketokivi and Castaner 2004; Dominguez et al. 2009) may have its pitfalls. Because these activities are interrelated and iterative, directors' participation in one activity may influence satisfaction with another activity. Specifically, our study demonstrates that boards' satisfaction with firm performance is influenced not only by financial returns (Mahto et al. 2010), but also by directors' participation in strategy formulation. Furthermore, participation in strategy formulation is a stronger determinant of directors' satisfaction with firm performance compared to financial returns. Needless to say, if directors actively participating in strategy formulation continued to be satisfied with firm performance despite the deteriorating financial returns, that would make directors reluctant to change firm strategy. Such inertial behavior on the part of directors is actually observed in reality and is dangerous (Hoppmann et al. 2019).

In addition, our study shows that both directors' participation in strategy formulation and directors' involvement in monitoring strategy implementation can affect their level of satisfaction with strategic planning. Strategic planning represents a more quantitative, data driven process compared to strategy formulation (Dominguez et al. 2009). The fact that directors' active participation in strategic activities could influence their satisfaction with allocation of resources or budgeting represents an important finding that needs to be taken by the boards very seriously. This could lead to an anchoring effect (Weber and Wiersema 2017), e.g., choosing previous resource allocation templates as the starting point even though they need to be revised.

Finally, the study demonstrates that directors' satisfaction with strategic planning and firm performance is positively associated with directors' satisfaction with firm strategy. Once again, it is important to realize that although both firm strategy and strategic planning are part of the strategic management process, they are not the same. Furthermore, satisfaction with firm performance should not necessarily lead to satisfaction with firm strategy. For example, firm performance could reflect previous commitments of resources and forms of strategic thinking whereas continual success may require a strategy overhaul even despite the impressive level of current success. Hence, the fact that directors may be swayed by their satisfaction with firm performance and strategic planning and do not consider adjusting the current strategy may be troubling.

Directors should form their opinions regarding firm's performance and strategic planning activities objectively and independently (Hamrick et al. 2015). We demonstrate, though, that directors' participation in strategy formulation and monitoring of strategy implementation is significantly correlated with their assessments of firm performance and its strategic planning activities. The pitfall here is that directors could gradually accept top managers' mental schemas. Influenced by these anchors (Kahneman et al. 2011), directors could approve of suboptimal, unchanging policies instead of pressing top management to develop innovative and effective initiatives (Desai 2016).

## 9 Future directions

More in-depth studies are needed of the benefits and challenges of directors' participation in the strategic management process, and the role of cognitive entrenchment that may raise directors' satisfaction with suboptimal companies' strategies. Similar to other employees, directors are likely to succumb to various cognitive biases, and it would be important to examine which of such cognitive biases could actually subvert directors' ability to fulfill their fiduciary duties.

## 10 Conclusions

This paper introduces a conduct outlook on boards of directors and the benefits vs. challenges of their participation in the strategic management process. Applying agency-behavioral theory (Wiseman and Gomez-Mejia 1998; Pepper and Gore 2015), we argue that directors' increased participation in the strategic management process could enhance their satisfaction with firm performance, strategic planning, and firm's strategy. Structural equations modeling analysis of the data received from a survey of 367 Canadian directors supports all the hypotheses.

Importantly, we discuss in this paper the relationship between directors' involvement in the strategic management process and their satisfaction with firm performance and strategic planning as well as the relationship between directors' satisfaction with firm performance and strategic planning and their satisfaction with firm strategy. We also point out that as a result of their increased participation in the strategic management process related to enhanced satisfaction with firm performance, strategic planning and firm strategy directors may become susceptible to such decision-making biases as the confirmation bias, affect bias and the anchoring bias (Kahneman et al. 2011; Weber and Wiersema 2017). Nevertheless, we did not measure in this study directors' decision-making biases. Moreover, while Canadian boards can be similar to other boards, the Canadian context can have its own unique features (e.g., culture, financial regulations, risks, and priorities), which makes generalization from this study to other contexts uncertain. Hence, the reader is recommended to approach cautiously the statements in the paper regarding the possible pitfalls related to directors' activism.

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