INTERLOCKING DIRECTORATES: A COMPREHENSIVE LITERATURE REVIEW

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ABSTRACT

In general, global corporations are not isolated actors in an economic war of 'all against all' but members of a common network with common interests and global reach. This is a review of literature on interlocking directorates, which is claimed to be one phenomenon that shows the blurring of difference between the 'actors'. This review covers the different perspectives followed in the study of interlocking directorates, different strands of studies under these perspectives, relation between board composition studies and interlock studies, methodologies followed in interlocking studies and the criticisms about studies on interlocking directorates. The debates in each area are also discussed parallelly.

Keywords: Interlocking directorates · Corporate governance · Board composition · Resource dependence · Social class perspective · Inter-corporate relations

1 INTRODUCTION

The growth in the size of banks and financial trusts and increase in their power on various industries and finances of United States in the initial decades of 20th century lead to lot of debate about anti-competitive behavior by these corporations. This lead to the formation of Pujo committee, a United States congressional subcommittee formed in 1912 to the investigate the 'money trust', which included a community of bankers and financiers who had powerful control over the finances of the country. Despite obstacles[1], the committee report concluded in 1913 that a community of influential financial leaders have gained control over major manufacturing, telecommunication, transportation, mining and financial markets of United States. The report identified $22 billion in resources and capitalization controlled through 341 directorships held in 112 corporations by members of the empire headed by J.P. Morgan. Public support created by the Pujo committee report, among other things, lead to the passage of Clayton Act in 1914, which prohibited interlocking directorates between companies competing in the same markets. The findings of Pujo committee and the passing of Clayton act lead to lot of research in the area of interlocking directorates.

2 INTERLOCKING DIRECTORATES AND CONTROL OF CORPORATION

After publication of Berle and Means' (1932) classical work, 'The Modern Corporation and Private Property', managerialism was accepted as the dominant model of corporate control. With the turn of twentieth century, the US corporations grew larger and the ownership became more and more dispersed. This lead to separation of ownership from control; the control of corporation was with the management. Berle and Means (1932) defined management as board, which essentially means that directors, and not officers, are the dominant force in management-controlled firm. There is debate about the independence of boards from top-management in controlling the firm. One group of scholars claim that boards

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are mere tools of top-management and others claim that even though officers control the day-to-day activities they actually don't control the firm. Some scholars argue that even boards which are passive for many years might become assertive and even oust the CEO during times of crisis.

By controlling (or considerably influencing) the board of firm, the firm can be control (or considerably influenced). This control or influencing can be done by other firms i.e. when one firm has control or influence over the other. The influence can be mutual too i.e. boards of two firms influencing each other. Director interlocks is considered to be one of the main tool for exercising the control/influence over the boards. Studies about corporate interlocking are, (a) about the causes and consequences of director interlocks and the resulting control/influence over the firms, (b) relation between the firms which the director interlocks indicate. Directorship interlocks are also considered as a unit for the structural analysis of inter-corporate relations.

2.1 Definition of Interlocking Directorate

The definition of interlocking directorate is not clear in literature, scholars seem to define interlock based on the way it is employed in the study. An interlocking directorate happens between two firms in following cases:

1) Direct interlock: When a person sits on the board of directors of two firms.
2) Indirect interlock: A director from each firm sits on the board of a third firm.
3) An officer of one firm sits on the board of another firm.

In the first two cases the director can be (a) executive director or non-executive director[2], or, (b) inside director or outside director[3]. It has to be noted that the third case is different from the first two because in the first two cases interlocking happens through directors (who can be an executive) but in the third case interlocking happens through an officer who is not a director. As per the theory of separation of ownership from control, only board of directors, and not officers, have control over the firm. Whether the interlock happens through board members (directors) or officers will decide the causes/consequences of the interlocks, so this distinction is important in research on interlocking directorates. The difference between the first two cases are considered by some researchers but the difference of the last from first two is not considered by many.

Some studies consider interlocks as the link between firms in the network of interconnected firms. Studies classify the links based the number of interlocks in the link; usually these links are referred as ties. Fennema's (1982) categorization of the ties into four different types is followed by many scholars for analyzing the interlocking network:

4) Primary tie (when an officer of one company sits in another company) and secondary tie (when an outside director of one corporation serves as outside director of another corporation)
5) Thick lines (multiple director interlock) and thin lines (single director interlock).

3 THEORETICAL PERSPECTIVES ON INTERLOCKING DIRECTORATES

Directorship interlocks are studied through below perspectives:

6) Resource dependence perspective
7) Social class perspective
8) Combination of both

3.1 Resource Dependence Perspective

The basic assumption of this perspective is, organizations operate in an environment of uncertainty, so they need to have strategies to secure scare resources and to avoid price wars. In other words organizations need to find ways to avoid inter-organizational conflict. According to this perspective, interlocks are viewed as a tool of corporate strategy to avoid inter-organizational conflict. Broadly there can be two types of interlocks:

9) Horizontal interlocks: interlocking with competing companies
10) Vertical interlocks: interlocking with firms in the value chain like supplier or client. This can include banks also.

Various traditions of studies under resource dependence perspective are:

11) Collusion -- mainly horizontal interlocks
12) Cooptation and monitoring -- mainly vertical interlocks
13) Legitimacy -- can be both horizontal and vertical interlocks

3.1.1 Collusion

Firms form interlocks to constrain competition and collude (in legal or illegal ways). Collusion between competing firms can be done either by restricting competition in output market or by restraining trade in input market. Interlocking directorates is claimed to be one of the way by which corporations collude. Organizations use director interlocks for sharing information, so that they can better judge and predict the actions of other firms. Interlocks are employed by firms to share information and better coordinate their actions and thereby minimize uncertainty and conflict. When competing firms have interlocks, their board members get information about other firms' strategies, especially about short-term tactics and this may lead to stabilizing of prices.

3.1.2 Cooptation and Monitoring

Cooptation theory, introduced by Selznick[4], states that interlocking directorates are means through which organizations absorb important external actors into their decision making process to neutralize threat to their functioning and stability. Horizontal interlocks among firms competing in same market usually need not involve absorption because when someone sits on the boards of both firms and collusion occurs, the decision is usually made jointly by both boards and is not the decision by one board and absorption by another board. So, cooptation theory is usually applied in cases of vertical interlocks, which include interlocking between firm and banks.

According to this theory banks coopt firms by placing their directors (or directors with ties to them) on boards of firms. When cooptation happens, the coopted director need not influence all the decisions; they may influence only the most important decisions, thereby preventing the coopted firm from taking decisions which are detrimental to the coopting firm. So, firms which are dependent on banks would have directors representing bank interest. Recent studies have shown that interlocking with financial institutions increases during periods of capital dependency and financial constraint (Mizruchi and Stearns 1994; Stearns and Mizruchi 1993).

Monitoring of firm by banks is a related concept. Bank monitoring theory (as opposed to cooptation) is more applicable in cases where firms initiate the interlocking. Directors who sit on other boards have better information about operations and opportunities. So, firms want to have directors from other firms on their boards for the expertise and information they provide, which includes access to the connections of the interlocking director. This theory was further extended by studies which state that firms want any knowledgeable director and not necessarily directors from specific firms from whom they want to seek legitimacy. So, presence of director interlocks is not only because of inter-firm relations but also because of relations between individual directors. This lead to another theory called social class perspective, which is discussed in the next section.

3.1.3 Legitimacy

According to legitimacy theory, firms want to have directors from prestigious firms on their boards and want their directors to be on prestigious firms. The main argument is, interlocking with a prestigious firm signals outside constituents that the firm is of high quality, especially during situations where it is difficult to demonstrate their quality. Legitimacy of firm's actions is increased when the decision-making body of firm includes prestigious directors. It is argued that interlocking with prestigious firms act as a signal to investors and other stakeholders. Studies also suggest that firms imitate the actions of prestigious firms and having prestigious firms' directors on board provides a channel for information about best practices and successful strategies. This diffusion of best practices through interlocking has been demonstrated in adoption of multidivisional form (Palmer et al. 1993), golden parachutes (Davis 1991; Singh and Harianto 1989; Wade et al. 1990; Cochran et al. 1985), and poison pills (Davis 1991).

3.2 Social Class Perspective

According to social class perspective, interlocks are considered as an indicator of social relations. Some studies consider these social relations as relation between firms and some consider these relations as relation between social elite who form the interlocking directorates. Interlocks are viewed, by these studies, as means through which dominant classes transcend internecine conflicts. Various aspects studied under social class perspective are:

14) Political unity
15) Impact on corporate strategy
16) Dominance of finance capital
17) Interlock networks
18) Comparative analysis between countries
19) Transnational business community

The main difference between resource dependence and social class perspective is, in the former, analysis about the relation between firms is predominant, and in later, analysis about relation between directors is predominant.

3.2.1 Political Unity and Corporate Strategy

Mills (1956) argued that top executives of large corporations form an upper class which share common values and interests and they manage their differences of interests through interlocking. This is later developed by Useem (1979, 1984) as inner circle thesis, which states that certain directors or senior managers are members of an inner circle who sit on many boards; they transcend their organizational moorings and scan issues at inter-organizational or even national level rather than concentrating only on their own firm. By exercising influence across firms, these inner circle members shape not only the political unity and behavior of business community as a class but also the strategy followed by

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individual corporations. Studies have shown that members of this inner circle and the individual executives with many directorships are more likely to be politically active (Useem 1979, 1984; Mizruchi 1992). Inner circle can have impact on strategies of individual firms also. Mizruchi (1989) showed that political behavior of firms which had directors from inner circle was more similar to each other than firms which had no directors from inner circle.

3.2.2 Dominance of Finance Capital

Theory of finance capital was developed by Rudolf Hilferding. According to this theory, banks gain increasing control over industry due to the concentration of capital. Banks don't merely grant loans to firms but they actually have a say in the decision making of these firms through representation in their board. This theory is extended by studies which claims that interlocking with banks lead to emergence of finance capital, leading bank to control manufacturing corporations and eventually the whole economy (Mintz and Schwartz 1985). Bank centrality theory states that banks are at the heart of the interlocking network and they control major firms. Banks can be considered central in corporate network in two ways: banks have large number of linkages with other firms and are therefore more influential, or they serve as important intermediaries linking otherwise disconnected firms (Mariolis 1975). Recent empirical studies have provided mixed results regarding the financial hegemony thesis, with some studies questioning the extent of bank control in modern economies.

3.2.3 Network Analysis and Transnational Business Community

Network analysis approaches focus on identifying central actors, measuring network density, and analyzing patterns of connectivity in interlock networks. These studies have evolved from simple descriptive statistics to sophisticated network metrics including betweenness centrality, eigenvector centrality, and community detection algorithms. Recent studies have expanded the analysis to examine transnational interlocking directorates, investigating whether a global business elite exists that transcends national boundaries. This debate has generated substantial discussion about the nature of globalization and the formation of transnational capitalist class (Carroll and Fennema 2002, 2004, 2006; Kentor and Jang 2004, 2006; Burris and Staples 2012).

3.3 Combination of Resource Dependence and Social Class Perspective

The main argument of this perspective is, interlocks might be formed between firms due to inter-firm relations but later these interlocks create inter-director relations which may lead to formation of more interlocks. So, according to this perspective, inter-firm relations and inter-director relations both are responsible for director interlocks and both lead to interlocking directorates. Granovetter (1985) states that, economic actions are embedded in social relations so inter-firm relations cannot be treated as independent of inter-director relations. Recent research has increasingly recognized this embedded nature of corporate networks, showing how board interlocks simultaneously serve strategic organizational purposes while reinforcing social cohesion among business elites.

4 BOARD COMPOSITION AND INTERLOCKING DIRECTORATES

Studies about board composition and studies about interlocking directorates are related. Board composition studies focus on the characteristics of individual directors and how these characteristics influence board effectiveness and firm outcomes. Interlocking studies, on the other hand, focus on the relationships created when directors serve on multiple boards. The composition of boards determines the nature and extent of interlocking relationships. Mace (1971) through his interviews found that CEO plays important role in selecting directors. If this is the case, is interlocking a passive phenomena which occurs incidentally with

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executive's selection of directors, or is it an active phenomena where firms deliberately create interlocks? Studies have shown that both passive and active creation of interlocks happens. Recent research has focused on how board diversity (gender, ethnicity, expertise) affects both board effectiveness and the nature of interlocking relationships formed.

5 METHODOLOGIES IN INTERLOCKING DIRECTORATES RESEARCH

Various methodologies have been employed in the study of interlocking directorates. These range from simple descriptive statistics to sophisticated network analysis techniques. Early studies primarily used case studies and descriptive statistics. With the advancement of social network analysis and computational methods, researchers have begun employing more complex techniques including:

20) Network density measures and centrality metrics
21) Regression analyses to test hypotheses about determinants and consequences of interlocks
22) Event studies to examine market reactions to interlock formations
23) Qualitative case studies and interviews with directors

The choice of methodology often depends on the research question being investigated and the theoretical perspective adopted. Resource dependence studies tend to use quantitative methods focusing on firm-level outcomes, while social class perspective studies often employ network analysis to map elite structures. Recent advances in big data analytics and machine learning have opened new possibilities for analyzing large-scale interlock networks across time and geography.

6 CRITICISMS AND DEBATES

Despite extensive research, the study of interlocking directorates faces several criticisms. There are three major criticisms:

24) Interlocking directorates are dependent variable. They are created by resource dependency but they are not a tool to manage it.
25) Interlocks are automatically created due to the overlap in the pool of director candidates, given the small size of director community and the selection criteria for directors.
26) Interlocking directorates are neither the cause nor the consequence. They are passive, vacuous and epiphenomenal and don't have any consequences which they are claimed to have.

First criticism is answered by the argument that interlocking is not the only way to manage resource dependency but it is one of the ways. Second criticism is answered by the social class perspective research on interlocking, which explains the phenomena of automatic creation of interlocks also. According to this perspective interlocks are 'instruments of discretion which can be used in a system defined by constraints'.

There are criticisms for the usage of interlocks for predicting corporate behavior, they are:

27) The first criticism accepts that quantitative parameters can be used for predicting corporate behavior but they argue that interlocking directorates fail to account for such behavior.

28) The second criticism rejects the use of quantitative indicators all together and argues that interlocking directorates not only fails to capture the richness and complexities of board dynamic but even the general outlines.

There are studies which claim that there is no relation between interlocking and parameters like profitability; these studies try to prove this using data. Scholars who are of the opposite view argue that there are number of studies which show that there is relation between interlocking and behavior of firm.

There are two categories of scholars who subscribe to the second criticism. First category argue that the complexities involved in a phenomena like corporate behavior cannot be captured in quantitative form, they argue for conducting a qualitative analysis. Second category argue that usage of variables ignores the historical contexts of the organizational decision making. According to these scholars the complexities and historical context can be captured through interviews or surveys from people who are involved in this i.e. people who are part of this interlocking directorate. But the problem with conducting these kind of studies by kind of interviews is, whenever it is a question of power then informants responses about their power are notoriously unreliable. For example, as Mizruchi noted, "JP Morgan denied before the Pujo committee that he held a disproportionate power in American business community; David Rockefeller denied to Bill Moyers that he was any more powerful than the average American" (Mizruchi 1996, p. 293). Even-though it is difficult to define power objectively, subjective reports are also unreliable and most of the times invalid. So, in these kind analysis about power even qualitative data cannot be relied completely. There is another problem of lack of data, so scholars have been/to draw conclusions based on analyzing publicly available data. In-spite of these shortcomings and criticisms there is more and more studies about interlocking directorates because of their ability to explain aspects of inter-corporate relations which other studies fail to explain.

7 CONCLUSION

The study of interlocking directorates has evolved significantly since the Pujo committee investigations in the early 20th century. This literature review has examined the major theoretical perspectives, methodological approaches, and ongoing debates in this field. Despite various criticisms, research on interlocking directorates continues to provide valuable insights into inter-corporate relations, corporate governance, and the structure of economic power. The phenomenon of interlocking directorates remains relevant in understanding how corporations navigate uncertainty, coordinate activities, and how business elites maintain social cohesion. Future research would benefit from integrating multiple theoretical perspectives, employing mixed methods approaches, and examining how digitalization and globalization are reshaping patterns of corporate interlocking in the 21st century.

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Footnotes

[1] Refusal of aid by comptroller of currency, lack of any authoritative decisions by courts sustaining the rights of the committee to access the books of the banks

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[2] Executive director is one who holds an executive position in the firm, e.g., if CEO is a director, then he/she is an executive director

[3] Inside directors include executives working in the firm and shareholders holding more than a particular percentage of shares. Others are outside directors, which includes independent directors and officers from other organizations

[4] Selznick through his 1949 study about Tennessee Valley Association (TVA) has shown how absorption of potentially disruptive elements in environment into TVA's decision making structure has changed the goals of TVA to a considerable extent