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Trust, Firm Life Cycle, and Actual Board Behavior

Evidence from “One of the Lads” in the Board of
Three Small Firms

Abstract: *Processes outside and inside the boardroom and actual board behavior in small firms are investigated in this empirical study where one of the authors was a participant observer. A firm’s life-cycle approach was used. The study shows that actual board behavior changes along the life-cycle phases: in the start-up phase, board involvement is in legitimacy tasks; in the growth phase, board’s involvement is in advisory tasks; and in the firm crisis stage, the board’s involvement is in control tasks. We argue, based on the observations, that boards are empowered to these tasks based on different types of trust relationships between internal actors, external actors, and the board members.*

The board of directors is one of the topics receiving great attention in the current corporate governance debate and studies. The 1990s and the beginning of the new century has been considered an era when empowerment has swept corporate boardrooms. However, despite the increasing attention of scholars to studying boards of directors, previous studies have produced ambiguous results, and there are still few significant findings about board effectiveness and contribution to the firm’s success (Dalton et al. 1998, 2003; Hermalin and Weisbach 1991, 2003). The lack of clear results about the contributions of boards is often explained by three common characteristics of extant research on board of directors: the use of samples from

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large U.S. firms and the paucity of studies on board of directors in other countries or in small firms; the overemphasis on the search for significant relationships between board demographic variables on the one hand, and firm performance on the other hand; and the adoption of cross-sectional research design and the lack of evolutionary studies (e.g., Daily, Dalton, and Cannella 2003; Gabrielsson and Huse 2004; Roberts, McNulty, and Stiles 2005).

The lack of significant results has led management scholars to argue that research about boards of directors is at an infancy stage, and there is a need for more studies analyzing samples different from large U.S. corporations, using board process variables, and adopting an evolutionary approach (e.g., Daily et al. 2003; Pettigrew 1992). We still know very little about the relational dynamics in and around the board, for example, between the chairperson and the chief executive officer (CEO; e.g., Cadbury 2002; Kimberly and Zajac 1988; Pettigrew 1992), among directors inside and outside board meetings (e.g., Ravasi and Zattoni 2006), and the empowerment of boards of directors (e.g., Carter and Lorsch 2004; Lorsch 1995; Stiles and Taylor 2001). The objective of this paper is to explore aspects of board empowerment through some of the dynamics in actual board behavior. We focus on the importance of trust in board–stakeholder relations in small firms. Boards of firms in different life-cycle phases are studied in a “one of the lads” study employing participant observation methods.

In addition to the contributions about opening the “black box” of actual board behavior and the use of participant observation in research about boards of directors, this paper presents four main contributions. These are about the processes leading to the empowerment of boards of directors; the relationship between boards’ tasks involvement and firm’s life-cycle phases; the relationship between various dimensions of trust and boards’ tasks involvement; and a more general understanding of boards’ behavior in small firms.

Boards, stakeholders, and trust

Understanding actual board behavior

A review of empirical board research published between 1990 and 2002 in six major journals (Gabrielsson and Huse 2004) reveals that the majority of publications (77 percent of 127 empirical articles) follows an input–output approach and treats the board as a black box. Some studies use a contextual perspective where corporate governance systems are compared across countries or other contexts (10 percent), and some studies use surveys to explore actual board behavior (10 percent). Just a few studies use qualitative approaches to understanding actual board behavior and processes from holistic and evolutionary perspectives. To move governance research forward, management scholars are invited to dismantle their own fortresses by exploring alternative theoretical and empirical approaches (Daily et al. 2003). The search for alternative research directions

implies the development of contingency, behavioral, and evolutionary perspectives (Gabrielsson and Huse 2004).

The first challenge includes studying boards in different contexts than only large U.S. corporations. Arguments for developing effective boards in small firms are fast growing in both business practice (Johannisson and Huse 2000) and in theory developments (Gabrielsson and Huse 2005), but the research on boards in small firms is still limited and fragmented (Huse 2000). Recent literature has also positioned the importance of understanding the relationships between firm's life cycle and board tasks (Lynall, Golden, and Hillman 2003). Some studies have been conducted to explore how the role of boards varies when firms are passing various thresholds (e.g., Filatotchev and Wright 2005), but a few studies have explored differences in boards' behavior during the life-cycle phases such as start-ups, growth, and crisis.

The second challenge is to develop research on behavioral perspectives of boards (Daily et al. 2003; Forbes and Milliken 1999). Previous studies have been characterized by the search for a significant relationship between board demographic variables (such as CEO duality, number of nonexecutive directors, CEO incentives, and so on) and firm-level outcomes. They have treated boards of directors as a black box and inferred board's behavior from its composition and structure. However, a growing number of calls for contributions has emphasized that to understand board effectiveness, governance scholars need to open this black box and to explore the intermediate intervening processes between board composition and firm's performance (Finkelstein and Mooney 2003; Forbes and Milliken 1999; Letendre 2004). In sum, there is a need to devote more attention to the internal processes of the board, such as interactions and strategizing, trust and emotions between internal and external actors, the board leadership, the board working style, its decision-making culture, and actual board task performance (Huse 2005, 2007).

The third challenge is to study boards of directors from an evolutionary perspective. Previous studies have most often followed a cross-sectional design and used archival data on board composition and structure to infer board behavior. In this way, scholars have been able to collect easy-to-access data, but at the cost of ignoring or undermining board dynamics and processes (Ravasi and Zattoni 2006). Governance studies should instead directly investigate board processes and should conceptualize board dynamics as a set of ongoing evolutionary processes embedded in a complex network of relationships and interactions among shareholders, board members, top managers, and other actors in and around the firm (e.g., Aguilera and Jackson 2003; Monks and Minow 2004; Pettigrew 1992). In sum, process studies are needed to understand many aspects of the evolutionary dynamics inside and outside the boardroom.

In this paper, we have tried to meet the three above-mentioned challenges. We studied small firms and used a firm's life-cycle perspective. Our attention has been paid to understanding actual board behavior, including trust and interactions. A process research design was chosen to meet the need to understand the evolutionary dynamics inside as well as outside the boardroom.

Stakeholders and boards of directors in small firms

Stakeholder approaches in understanding firms evolved during the 1960s and were related to the industrial democracy discussions (Rhenman 1964; Rhenman and Stymne 1965). Stakeholder theory was, however, popularized by Freeman (1984), and stakeholders in an organization were defined as “any group or individual who can affect or is affected by the achievement of the organization’s objectives” (Freeman 1984, 46). The term “stakeholders” includes a large set of persons and organizations, such as shareholders, management, employees and unions, suppliers, financial institutions and other creditors, society, consumers and consumer groups, and tax authorities (Freeman 1984). Management scholars developed some dichotomies to discriminate among different stakeholder groups. One distinction is between internal and external stakeholders (Carroll and Näsi 1997). Managers and employees are often considered to be important internal stakeholders. Customers, competitors, the state, the media, and many others are considered to be important external stakeholders. Shareholders are usually considered to be external stakeholders (Monks and Minow 2004), but in the case of small firms, and particularly family firms, shareholders are often internal. In the following, sometimes we use the “stakeholder” concepts, and sometimes we use the “actor” concept. When using the actor concept, we acknowledge that some actors important for understanding actual board behavior do not necessarily meet the various stakeholder definitions.

Three main bodies of theories are often used to prescribe board roles and task performance: agency theory, strategy literature, and resource dependence theory (Gabrielsson and Huse 2005; Johnson, Daily, and Ellstrand 1996). Agency theory prescribes that boards should have monitoring or control tasks (Fama and Jensen 1983), strategy literature and managerial hegemony theory prescribes advisory tasks (Andrews 1980; Mace 1971), and resource dependence theory prescribes legitimating and networking tasks (Pfeffer and Salancik 1978). Recent board research (Gabrielsson and Huse 2004) is mainly based on agency theory and is aimed at solving the problem shareholders in large public companies have in avoiding managerial opportunism. Boards of directors may, however, play important roles also in small firms (Castaldi and Wortman 1984; Gabrielsson and Huse 2005), where the manager is usually also a major owner and as such also a residual risk-bearer (Fama and Jensen 1983). It has been argued that in small firms, the board of directors may reinforce the CEO and the top managers’ competencies and experiences, making comments or refining strategic proposals (Castaldi and Wortman 1984). Furthermore, small firms have fewer resources and are more dependent on external stakeholders than are large firms (Pfeffer and Salancik 1978), and the board can thus actively contribute to stabilize interorganizational relationships with important stakeholders and legitimate the firm in its environment (Johannisson and Huse 2000). Finally, in small firms, the board may have control tasks if there are diverging interests among majority and

minority shareholders (Schulze et al. 2001) or as long as there are debt-holders and thus a separation between risk takers and management. For example, in small firms with high debt financing, stakeholders such as financial institutions and other creditors are likely to be main stakeholders. Their residual claims may be larger than those of an owner/manager (Pettit and Singer 1985). In sum, in small firms, like in large ones, the board of directors is considered to be the supreme organizational body within a firm taking care of stakeholder issues (Freeman and Reed 1983; Wang and Dewhirst 1992).

Past qualitative studies show that directors and boards perform their tasks with varying degrees of commitment and task involvement (Lorsch and MacIver 1989, 104–105). On the one hand, members of passive boards do not collect independent information on the firm, and they attend meetings without raising critical issues, and “rubber stamp” management decisions (Herman 1981)—that is, the only contribution made by directors is to satisfy the requirements of company law (e.g., Demb and Neubauer 1992; Mace 1971; Stiles and Taylor 2001). In the most extreme cases, the board consists entirely of executives and it is simply a legal fiction (Stiles and Taylor 2001, 36). On the other hand, members of active boards carefully scrutinize the information provided prior to board meetings, search for further information, push the CEO to explain critical issues, and participate actively in the board decision-making process (e.g., Lorsch and MacIver 1989; Mace 1971; Stiles and Taylor 2001). This large variety of situations indicates that it is important to open the black box of a board of directors and to investigate board internal processes and dynamics.

The role of trust

Trust is important in understanding directorates (Borch and Huse 1993; Huse 1993), and “relational norms and trust seem to be of greater importance in understanding and monitoring small firms than large firms” (Huse 1993, 235). Furthermore, the role of trust may vary depending on the stakeholder’s perspective being considered (Huse 1993). Classical and neoclassical economics operate within an undersocialized, atomized conception of human action in a utilitarian tradition (Etzioni 1988; Frank 1988; Granovetter 1985). The usual focus is on the specialized control mechanisms, price, and authority, neglecting the role of more general control mechanisms that may be assigned the label “trust” (Bradach and Eccles 1989; Macneil 1980). Pervasive evidence from numerous disciplines supports the inclusion of trust as a critical factor (e.g., Browning, Beyer, and Shetler 1995; Ring 1993; Saporito, Chen, and Sapienza 2004) and indicates that trust is essential for understanding interpersonal and group behavior and managerial effectiveness (Hosmer 1995; McAllister 1995). Trust is seen as highly beneficial to the functioning of organizations (Argyris 1964). It is considered to be important as a control mechanism in establishing and sustaining cooperative exchange structures and networks (Dwyer, Schurr, and Oh 1987; Jarillo 1988; Larson 1992). A dominant approach and perspective of trust

emphasizes the direct effects that trust has on more positive attitudes, higher level of cooperation, and superior levels of performance (e.g., Jones and George 1998; Mayer and Gavin 2005; Mayer, Davis, and Schoorman 1995). A second, less-developed perspective points to the enabling or empowering effects of trust, whereby trust provides the conditions under which certain outcomes (e.g., cooperation and higher performance) are likely to occur (e.g., Dirks and Ferrin 2001). This paper focuses on this second perspective.

However, despite the agreement on the importance of trust, there is no generally accepted definition of the concept (Hosmer 1995). In a review of definitions of trust in the management literature, Hosmer proposes the following definition: “Trust is the reliance by one person, group, or firm upon a voluntary accepted duty on the part of another person, group, or firm to recognize and protect the rights and interest of all others engaged in a joint endeavor or economic exchange” (Hosmer 1995, 393). Trust is a multifaceted concept and many distinctions could be made (Hosmer 1995; McAllister 1995). Because existing trust research is relatively diverse and multidisciplinary, researchers should focus on particular problems, and then use concepts and methods appropriate for the problems (Dirks and Ferrin 2001). An important distinction in management studies is between fragile and resilient trusts (Ring 1996). A similar distinction is between cognition and affect-based trust (McAllister 1995). With cognition-based trust, individuals may improve professional relationships and enhance professional collaboration, while with affect-based trust, they may develop shared values and social intimacy (McAllister 1995). Fragile and cognition-based trust is related to capabilities of the trusted person. Its basis is cognitive reasoning, and its antecedents are the extent of reliable role performance and of professional qualifications of the evaluated person. Resilient and affect-based types of trust are related to the integrity and the ethics of the trusted party. Its basis is the emotional tie linking the individuals, and its antecedents are the level of citizenship behavior and the frequency of informal interactions.

We use here the terms “competence-based” types of trust (fragile and cognition-based types) and “integrity-based” types of trust (resilient and affect-based types). The different types of trust have different effects. In this paper, we explore relations among internal and external stakeholders and the board members with the focus on how different types of trust may empower boards of directors.

Research methods: life cycle and participant observation

Our study is aimed at investigating the impact of processes inside and outside the boardroom on the empowerment of boards. In order to benefit from both the richness and the realism of longitudinal grounded studies, our study relied on a multiple-case design (Eisenhardt 1989; Yin 1984). In particular, we compared evidence across three cases, searching for discernible patterns and for plausible antecedents of the observed differences (Eisenhardt 1989).

Research setting

The study was conducted in three firms. The selection of cases relied on theoretical sampling (Miles and Huberman 1994). We selected firms in three different life-cycle phases: start-up, growth, and crisis. All firms were small. One firm increased the number of employees from 5 to about 40 during the project period, and the other two firms had around 20 employees. All firms were located in the same geographical area—in a town in the northern part of Norway. The actual town in Norway was selected because of the first author's social networks in this area. This was a crucial requirement for the implementation of the actual research design. Variations with respect to industry and ownership existed across the firms. Industries represented were construction (start-up), fish processing (growth), and auto retailing (crisis). The auto retailer and the constructor worked in the local markets, and the fish food producer was one of the largest in Norway. Finally, the ownership structure differed: in the start-up firm, the CEO controlled 40 percent of the shares and internal stakeholders owned the remaining part; the growth firm was totally controlled by the CEO; and in the firm in crisis, the CEO owned 40 percent of the shares, other managers controlled 40 percent, and external stakeholders (a bank) 20 percent of the shares. See Table 1 for a summary of firm characteristics.

In Norway, there is a tradition supplemented by legislation to have boards, even in small firms. In particular, all joint stock firms must have a board of directors and—if the share capital is higher than three million Norwegian crowns (approximately \$500,000)—the board must consist of at least three persons. The CEO is not allowed to be the board chairperson. The research design required that one of the authors should be “one of the lads” in that he should serve as the board chairperson and, consequently, as a participant observer in all three firms.

The number of board members, the outsider ratio, and the age of the actors of the selected cases as reported in Table 2 were fairly representative compared to similar small firms in Scandinavia (Gabrielsson and Winlund 2000; Haalien and Huse 2005; Huse 1990).

Research design

Leading contributions presenting the state of the art about boards of directors highlight the importance of understanding the general conduct of board affairs and how and why board processes impact on empirical patterns of choice and change (e.g., Daily et al. 2003; Pettigrew 1992; Zahra and Pearce 1989). The stage of development of the field and the availability of data should be considered when researchers choose the research method; otherwise, crucial issues in a research field may remain uninvestigated because of the difficulties in obtaining information (Kriger and Malan 1993).

Exploring processes between the board and various stakeholders requires close-

Table 1
The main characteristics of the three firms investigated

	Firm A	Firm B	Firm C
Life cycle	Start-up	Growth	Crisis
Industry	Construction	Fish processing	Car dealer
Size (number of employees)	5–40	20	20
Ownership			
CEO	40%	100%	40%
Other internal stakeholders	60%	0%	40%
External stakeholders	0%	0%	20%

Table 2
Board composition and the number of board meetings of the three firms investigated

	Firm A: <i>Start-up</i>	Firm B: <i>Growth</i>	Firm C: <i>Crisis</i>
Number of board members	3 + CEO	5 + deputy	4
Number of outsiders	2	3	2 + employee representative
Age of CEO	35	56	62
Mean age of other board members	49	50	50 (45)*

*The first mean age does not include worker director, but the second one includes worker director.

ness, and for many purposes, a direct involvement in the question being studied (Leblanc 2005; Pye and Pettigrew 2005; Samra-Fredericks 2000a). The possibility for studying these processes was achieved by adopting a participant observation method (e.g., Borch 1994; Fetterman 1989; Hammersley and Atkinson 1995; Lee 1999; Van Maanen 1988). This method is particularly valuable in the study of phenomena that involve interpersonal interactions and interpretations, are hidden from public view, and are not well understood (Waddington 1994). The primary advantages of participant observation derive from the firsthand knowledge about organizational phenomena as they occur in real-world context and in real time (Lee 1999).

Participant observation methodology, in particular, has been recommended in studies of boards of directors (O'Neil and Thomas 1995; Selvik 1995). Among

the few examples of studies having used participant observation methodology in understanding boards of directors are projects conducted by Hoffman (1980), Winkler (1987), Galaskiewicz (1987), Brannen (1987), Olzon and Huse (1997), Currall et al. (1999), Samra-Fredericks (2000a, 2000b, 2003), Huse, Minichilli, and Schøning (2005), and Leblanc (2005). Moyser and Wagstaffe (1987) present several contributions that discuss challenges and opportunities in using participant observation in elite studies.

In conducting participant observation research, an important decision to be taken is about the involvement of the researcher, varying from pure observation to full participation (Gold 1958). The main types of approaches are the “fly on the wall,” “following directors,” and “one of the lads” (Brannen 1987; Huse 2005; Winkler 1987). There are, however, advantages and disadvantages in any design (Gustavsen 1996; Hammersley and Atkinson 1995). In order to get access to “soft and invisible” relevant data about board processes, we decided to use a design where the first author should become an active board chairperson in the firms to be studied. A “one of the lads” design was thus selected. We then sacrificed some of the sacred methodological “rigor of scientific objectivism” (Kriger and Malan 1993; Parkhe 1993). Having had previously extensive board experience, the first author could be elected as board chairperson in the three firms. The selection of firms was made together with SND Nordland, the main founder of the research project. This was a nongovernmental organization (NGO) supporting industry development. The first author was a board chairperson during the project period, and all firms formally accepted the research situation. The project period was initially defined as one year.

Data collection

Following prescriptions for case-based research (Yin 1984), firm data were collected from different sources: field notes, board minutes and reports, and semistructured interviews with all directors and various stakeholders.

Field notes

Field notes are the most common method used to collect data in participant observation studies. Through the whole period, the notebook was the best friend and the main instrument of the first author. All events, actions, comments, and even perceived feelings were registered (Boje 1991; Fetterman 1989; Van Maanen 1988). The notes were written in separate diaries for each of the firms.

Board minutes and reports

In addition to field notes, we had access to all board minutes, all background material, and correspondence regarding the boards and the firms. The chairperson and the CEOs have jointly written evaluation reports about the project in each firm.

Board minutes and reports were triangulated with information collected in the interviews and in the field notes, which increased our confidence in the reliability of our assessment.

Interviews with directors and stakeholders

Field notes and boards' minutes and reports helped us prepare semistructured interviews, aimed at collecting detailed information on boards' involvement in strategic decisions. We asked graduate students taking a course about boards of directors to conduct interviews with the CEOs, all board members, and various stakeholders of the three firms. A formal report, written for a main stakeholder in one of the firms, also evaluated the importance of the board of directors in that firm.

One of the primary problems with participant observation studies is the potential for conflict between researchers' efforts to establish trust and their possible observation of hidden knowledge and private acts (Lee 1999, 99). Because of the sensitivity of much of the information assessed in the study, detailed analyses of the observations were only done with some trusted coresearchers. During the project period, we had, however, a group of reference following ethical and methodological aspects of the research process. Ethical considerations made it necessary to avoid presenting and publishing the private life of recognizable actors and the business decisions of identifiable firms. A comprehensive research project report was therefore cleared with all the CEOs. A particular feature of this study was that the board chairperson (the first author of this article) was the same in all three firms, and market pressures (for academics and board members) made him exert his utmost business-related efforts in each of the three firms.

Data analysis

Data analysis combined common methods for grounded-theory building (Glaser and Strauss 1967) and comparative case analysis (Eisenhardt 1989). Accordingly, data collection and analysis proceeded in an iterative way, as new data were gathered, in order to test the robustness of emerging interpretations about possible explanations of stakeholder-board relationships and the type of trust among them.

In an early stage of our analysis, we carefully examined data collected, aiming at producing a rich representation of the interactions between boards and external stakeholders. In particular, we carefully scrutinized boards' minutes and reports, field notes, and students' papers reporting the interviews. With regard to board tasks, a comparison of the rankings of the prevalent activities of the boards produced by members of the same board showed consistent agreement, reinforcing our confidence in the reliability of the assessment. Further cross-case comparison revealed three prevailing configurations that, building on previous studies (e.g., Johnson et al. 1996; Zahra and Pearce 1989), we labeled as "legitimizing," "monitoring," and "servicing," emphasizing the prevailing activities performed by the board.

In a further round of comparative analysis, combining within-case analysis with cross-case comparison, we searched for variables that could explain differences in the observed patterns across board tasks. We adopted a comparative logic closer to the one described by Eisenhardt (1989), according to which within-case analysis based on rich, often anecdotal, information was used to generate insights to be developed further and tested in cross-case analysis. We constructed comparative tables to identify discriminating variables that could explain similarities and differences in patterns of involvement. We found good antecedents of board tasks in the interactions between boards and stakeholders and the type of trust (competence based versus integrity based) among actors involved in the governance process.

Provisional interpretations were developed in an iterative way, as emerging insights called for additional data collection, and tentative explanations were checked across cases; in this respect, each case was used to confirm or disconfirm inferences drawn from other cases (Eisenhardt 1989). Following Eisenhardt's (1989) indications, we referred to the existing literature to refine and enrich inductively derived theoretical insights.

Findings: the boards in “start-up,” “growth,” and “crisis”

Firm (A): “Start-up”

Firm (A), called “Start-up” in the rest of the presentation, had filed for bankruptcy the winter previous to the start of the research project. The bank that held much of the debt of “Start-up” had suffered severe losses because of the bankruptcy, but in order to reduce its own losses, it gave the previous owner/manager the opportunity to reestablish. The reputation of the previous owner/manager was mixed. Some stakeholders considered him to be very clever, while others did not trust him because he lacked integrity in their views. Important people in the municipality were included in the latter group. This lack of integrity-based trust was exemplified by the following citations:

Mr. X [a politician] commented that he was not sure “whether the owner/manager broke the laws. His political party has been very skeptical towards him.”

Mr. Y [a board member of the bank] told the first author privately and confidentially “to be careful in relation to the affairs of the owner/manager.”

Representatives of the bank thought he had set the time for bankruptcy so that the bank suffered the largest possible losses. In “Start-up,” one of the owner/managers' former executives was appointed to the new CEO position. The new CEO then acquired about 40 percent of the share capital. Four of the other core executives, including the former owner/manager, acquired the residual part. In the previous firm, no real board of directors existed. In “Start-up,” they wanted a board that could help them avoid some of the pitfalls that led the previous firm to bankruptcy.

In the past, the former owner/manager regularly had businesspeople visit him to have a sauna, discuss business, and have a few drinks. During such a sauna meeting, the owner/manager of firm B (“Growth”) told the former owner/manager of “Start-up” about the present research project on boards of directors. Hearing about it, the previous owner/manager got interested, and he invited the first author to his office for discussions. As a consequence, a new board of “Start-up” was set up consisting of three members. The first author was elected as board chairperson, and the firm was included in the research project. The local community and the bank considered the new chairperson to be a person of good reputation. His background in strategy and his previous board experiences were used as arguments for selecting him. Another outside director was also selected. His background was in accounting and auditing, and he was familiar with the industry. He also worked as an independent agent with present business partners of the firm. He had earlier been a colleague of the former owner/manager. The former owner/manager was selected as the third board member. The latter wrote the minutes. In addition to the three formal board members, the CEO attended the board meetings.

In analyzing board minutes and field notes, the main board tasks in “Start-up” were found to be (1) giving advice to management, (2) having a disciplinary task, (3) discussing partners and having consoling or comforting tasks for “a lonesome small business CEO,” (4) legitimizing the firm in relation to the stakeholders, (5) influencing stakeholders, (6) performing formal tasks in relation to annual stockholders’ meetings and annual reports, and (7) being involved in some kinds of operational and financial control. The five first tasks were executed as service for the management, while the latter two were tasks on behalf of external stakeholders.

The firm’s stakeholders had varying influence. In “Start-up,” it was expressed informally by the CEO that the board had its greatest role in legitimating the firm in relation first to the bank, then to municipal authorities, the media/press, the public in general, and residents who lived in proximity to the firm’s activities. Residents were important because of environmental pollution. However, it did not seem as though the board was intended to have an active role in relation to the owners, customers, business partners, and employees. The power of the bank was primarily related to giving loans and guarantees necessary for the enterprise. In “Start-up,” the bank had given the firm some guarantees that no other bank would take over. The municipal authorities had several potential ways to make life difficult for the new firm, and the media and public in general became important because of their potential influence on the authorities and on customers.

In “Start-up,” the role of sentiments in boardroom processes was illuminated. These processes were particularly alive as the outside board members tried to get into various control and strategy formulation issues. One of the outside directors and the former owner/manager had known each other for a long time, and they had many common interests and friends. Their friendship excluded in some ways the board chairperson from the social fellowship around the board meetings. During the board meetings, the former owner/manager also repeatedly consulted his old friend

about how to be a constructive and good board member. In contrast, sometimes, when the board chairperson presented issues to be dealt with, the former owner/manager tried to move the discussion to other topics, or he expressed grievance regarding the proposals of the chairperson. The chairperson considered these situations as attempts to manipulate the board.

Firm (B): "Growth"

Firm (B), called "Growth," was established about ten years before the research project started. The owner/manager owned 100 percent of the shares and had a very good reputation because of his integrity and his acknowledged skills as an entrepreneur. Due to his business success, entrepreneurial attitudes, and reputation of being a person of integrity, there generally were trusting relations between the owner/manager and all external stakeholders. In his firm, he had a board consisting of himself as a chairperson, his wife, and a friend as an outside director. The outside director was the CEO of an engineering consultancy firm. They had few and very informal meetings.

An officer from SND Nordland informed the owner/manager about the possibility of participating in the research project, and the owner/manager got interested as he saw the potential in setting up a new board of directors. After some search, a new board was set up with the first author of this paper as the chairperson, two additional outside directors, and the owner/manager and his wife. One of the other outside directors was the friend who had been a director on the "old" board, while the third outside director was selected after recommendation from the chairperson. He had an auditing background and was familiar with the industry. The CEO used all three outside board members widely as discussant partners and consultants. The accountant of the firm was deputy board member and was present at the board meetings. One of the outside directors wrote the minutes.

Analyses of the board minutes and the field notes revealed that the tasks of the board were mainly related to (1) strategy, (2) being discussing partners offering comfort and emotional support, (3) giving specialist advice within areas such as cost control and engineering, (4) networking, (5) gathering market information, and (6) hiring a new CEO. The board had mainly advisory and disciplinary tasks, insuring that important issues were put on the agenda, and mitigating the probability of the owner/manager making hasty decisions.

The initial reasons given by the owner/manager for having a board of directors seemed to be motivated by his needs related to his private situation. Main stakeholders were his family and a potential new CEO. Additionally, it became clear that the board had a *de facto* legitimacy task in relation to the bank, other financial institutions, the local community, and customers (wholesalers). Even though the bank and the other above-mentioned stakeholders did not directly interfere with the CEO's decisions, it became obvious that they found the creation of an outside board very positive for their own future involvement in the firm. This was men-

tioned explicitly in meetings with the bank and in a report for an external funding institution. Board decisions and changes in board composition would, however, be followed closely in the future by the bank.

In the evoked set of stakeholders, there were groups for which the board did not seem to have any role. Such stakeholder groups were retailers, suppliers, employees, competitors, and competitive partners. To some extent, the board had a mediator role in relation to cooperation with competitors. Several times the board chairperson met incidentally in airplanes or social events with people having interest in cooperation with the firm. This role was performed either directly with other firms or indirectly through a governmental agency.

In the case of “Growth,” the importance of trust-based relationships and the use of knowledge and skills was illuminated. In the mentioned report for the funding institution, the board in “Growth” was considered to be one of the most professional boards in the region. All members of the board had good reputations regarding their professional skills and their integrity. However, one of the board members, in spite of his good intentions, had problems in prioritizing his board engagement. He had been given the responsibilities for writing the board meetings’ minutes, but it was rare that the minutes were written according to the agreed upon time schedules. These omissions indicated that competence-based kinds of trust do not only depend on knowledge but also on capacity and involvement. Meetings were postponed several times because he “had to” prioritize other appointments. The results of these processes were that the agreed upon board structures were undermined.

Firm (C): “Crisis”

The firm (C), called “Crisis,” was owned by the CEO (40 percent), three of the firm executives (totally 40 percent), and by the main supplier (20 percent). For most purposes, the CEO was in control. “Crisis” had previously had a board of directors with an outsider as a chairperson, and there had been both outsiders and insiders as board members. However, the owners did not consider that the outside board members made any contribution, and as the research project started, the board consisted of only three insiders and a worker representative.

Over the last few years, the firm experienced severe financial crises, and the equity was negative. In renegotiating with the bank, the bank imposed a requirement that the firm appoint an outsider as board chairperson. Because of this requirement, the CEO contacted the first author, and the process of selecting a new board of directors started. The new board was selected by the owners and approved by the bank. The new board consisted of the first author as chairperson, another outside board member (accounting/auditing background and familiar with the industry), an employee-elected representative, and the CEO. The first author (the chairperson) recommended the second outside board member.

The main tasks of the board were (1) ratifying decision; (2) controlling decision; (3) supporting, comforting, and being discussion partners; and (4) providing some

kind of discipline. Ratifying and controlling decisions also resulted in figurehead and legitimacy tasks. The board of directors developed a strategy plan in which the most important stakeholders were identified, and the stakeholders' concerns that should be given the highest attention and importance were prioritized. Ethical considerations were given high importance. The priority list of stakeholders was as follows: employees, bank, management, the main supplier, and the owners. A second group of important stakeholders was also identified: tax authorities, building owners, the local labor commission, customers, and competitors. The distinction criteria between the two groups were found in the firm's code of ethics and the values represented by the board members. Most of the stakeholders were, however, in a position such that they could cause the elimination of the firm unless their concerns were properly addressed.

The role of firm resources was highlighted in the "Crisis" case. A shortage of internal competence and financial resources made it difficult to activate the board properly. It is difficult for outside board members to make demands on the management when there are few available resources. In this firm, the work of the board was obviously urgent, but the owner/manager was, because of a shortage of resources, unable to provide sufficient information to the board. There was an imbalance between the urgency and need for board involvement and the compensation being offered to the board members. The role of competence-based types of trust in the relation between the bank and the CEO/firm was exemplified in the following citation from the field notes: "Mr. Z [a bank executive] told the first author in a private and confidential conversation that he did not 'believe that the present CEO would have been able to get the firm out of the crisis and that the firm would not have been able to survive.'"

Analyses and propositions

Our analysis followed the suggestion by Eisenhardt (1989). We first tried to detect discernable patterns across the cases. These are summarized in Propositions 1a through 1e. Thereafter, we tried to find plausible antecedents. We used the trust concepts presented above as possible antecedents. The antecedents are summarized in Propositions 2a and 2b.

Discernable patterns: firm's life cycle and actual board behavior

Tables 3 and 4 summarize and compare the observations regarding management behaviors in the three firms.

Table 3 lists the number of board meetings, the number of additional interactions between the board chairperson and the CEOs, the bank, the press, and other stakeholders, including other board members. The table is calculated on the basis of the field notes, and we see that the highest number of interactions is in the case of "Crisis."

In "Crisis," there were 16 board meetings, 22 additional meetings between the CEO and the board chairperson, and more than 50 phone calls between them.

Table 3
Life cycle and meetings

	Firm A: <i>Start-up</i>	Firm B: <i>Growth</i>	Firm C: <i>Crisis</i>
Number of board meetings	7	10	16
Number of chairperson's meetings with:			
The bank	8	4	14
The press	5	1	2
The management	9	16	22
Number of chairperson's phone calls with:			
Management	24	33	53
Other interactions	21	75	23

Note: The number of chairperson's interactions with stakeholders (time period: 16 months).

There were close to a hundred direct points of interactions between them during the year. The numbers of interactions in "Start-up" and "Growth" were about 40 and 60, respectively.

The stakes and power of some of the stakeholders are also indicated in the exhibit when considering interactions. In "Crisis," there were 14 points of interactions with the bank. There were eight and four points of bank interactions in "Start-up" and "Growth," respectively. There were both formal and informal meetings with the bank. In "Crisis," all board minutes were sent to the bank. The table also indicates the importance of the news media and the press for "Start-up."

The large number of other interactions in "Growth" can be separated into (1) contacts with the other board members; (2) the recruitment process and interviews with new CEO candidates; (3) collection of market information; and (4) encounters and meetings with politicians, competitors, customers, and employees. The number of other interactions in the other firms was mainly related to encounters and meetings with the latter group (politicians, competitors, customers, employees, etc.), including other board members. In "Growth," all the outside board members had offices located geographically close to each other, a fact that encouraged interactions. The chairperson and each of the board members had other reasons for interactions.

The observations in Table 3 can be summarized in the following proposition:

Proposition 1a: There are relations between the firm's life cycle and the intensity of interactions among external stakeholders, internal stakeholders, and the board members.

The number of interactions, listed Table 3, may be a proxy for board power—the more interactions, the higher is the power of the board in relation to internal

Table 4
Life cycle, stakeholders, and board tasks

	(A) Start-up	(B) Growth	(C) Crisis
External stakeholders—listed in relation to perceived importance	Bank Municipal authorities Media/press Public in general Local residents	Family Potential new CEO (Bank) (Other financial institutions) (Local community) (Customers)	Bank Employees Management Importer Owners Tax authorities Owner of buildings Labor commission Customers Competitors
Main board task	Legitimizing	Advising	Monitoring
Other tasks—listed in relation to involvement	Specialist advice Discipline Discussion partner, comfort Legitimacy Influencing/lobbying Formalities Control Strategy	Strategy Discussion partner, support Specialist advice Network Market information Hiring new CEO Control	Decision ratification Decision control Discussion partner, support, comfort Discipline

stakeholders. In our cases, the board of directors seemed to have the most power in “Crisis”; the board power in the other firms was moderate. Table 4 has a listing of main stakeholders and board tasks. It follows Proposition 1b:

Proposition 1b: There are relations between the firm’s life cycle and the power of the board of directors.

Table 4 presents the list of important stakeholders and board task involvement in the three firms. The list of important stakeholders may indicate the distribution of stakeholder power in the different life-cycle phases, and the number of important stakeholders being listed may be a proxy for the power of stakeholders.

It is displayed in Table 4 that the longest list of powerful stakeholders are in the case of “Crisis,” followed by “Start-up.” The shortest list is in the case of “Growth.” These observations may be summarized in the following proposition:

Proposition 1c: There are relations between the firm’s life cycle and the power of the stakeholders.

The distribution and type of stakeholders listed in Table 4 differ across the firms. This was also emphasized in the case presentations. The stakes and power of the stakeholders also seem to differ. We thus suggest the following proposition:

Proposition 1d: There are relations between the firm's life cycle and the power distribution among external stakeholders, internal stakeholders, and the board members.

Table 4 also contains lists of the board tasks being performed. Some tasks are comparable among the firms (e.g., that of being a discussion partner). However, there is a major difference in the overall picture. The main board task in "Start-up" is legitimacy, the major board task in "Growth" is advice, and the major task in "Crisis" is control. The following proposition is thus suggested:

Proposition 1e: There are relations between the firm's life cycle and the priority of board tasks.

Possible antecedents: trust and board empowerment

We have so far indicated that both the importance of the stakes and the power distribution among the stakeholders depended on the life-cycle phase the firms were in. In "Start-up," the stakeholders' stakes and power were overall considered to be moderate to high; in "Growth," low to moderate; and stakes and power were high in "Crisis." It was obvious that the empowerment and the tasks of the board varied in the three firms studied. In "Crisis," the board's main tasks were related to monitoring. In "Start-up," its main tasks were related to legitimacy; in "Growth," the board had mainly advisory tasks.

Furthermore, we have in this paper introduced a trust framework that may help us explain the empowerment of boards and the prioritizing of different board tasks. First, we introduced two types of trust: competence-based and integrity-based types of trust (McAllister 1995; Ring 1996). Second, we highlighted that trust is relational (Hosmer 1995), and it is thus important to know between whom trust relations are important. Third, trust is also directional, and it is thus also important to understand the direction of trust relations (Hosmer 1995). We used this framework to go beyond the observations and propositions presented that were based on Tables 3 and 4.

The boards were empowered in various ways in the three firms. In "Crisis," the board was empowered directly by the bank; in "Growth," the board was empowered directly by the CEO; and in "Start-up," the board was empowered indirectly by both the internal and external stakeholders. The various CEOs also seemed to have various responses to empowering a board. In "Growth," the owner/manager acted proactively to empower the board; in "Start-up," the response was more adaptive; and in "Crisis," the response was reactive.

Our first observation in the study was that reality is much more complex than

simple models can grasp. There are many actors, internal as well as external, and the board may not be homogeneous. We found several examples in which the CEOs did not trust some of the employees, and we also found that some external actors trusted the CEO, but others did not. There are also varying trusting relations within each of the main groups of actors. In the propositions below, we specify three groups of actors—internal actors, external actors, and the board members—but a distinction could also be made between the board as such, the chairperson and the various board members. The trust relation may differ depending on the actors. However, to simplify the presentation and discussion, we treat the board as a homogeneous entity, and the perceptions are from and about the board chairperson.

The general observations were that in all three firms, external actors had both integrity- and competence-based trust in the board and the chairperson. In the other trust relations we identified some differences.

External actors did not have integrity-based trust in internal actors in “Start-up,” and in “Crisis,” the external actors did not have any type of trust in internal actors. Internal actors’ trust in external actors did not seem to be important, but in “Start-up,” internal actors did not have integrity-based trust in external actors. Internal actors generally trusted the board members, but the competence-based trust did not seem to be important in “Start-up,” and the integrity-based trust did not seem to be important in “Growth.”

The importance of trust in empowering boards is illuminated in the various cases. The “Start-up” case illustrated several aspects of legitimacy and trust: first, the internal actors in “Start-up” did not trust the board chairperson to interfere in the internal business of the company, and second they wanted a chairperson (and other board members) whom external actors trusted. Legitimacy is created when external actors trust the board. The legitimacy will be stronger if both integrity- and competence-based trust exist. However, legitimacy can be achieved also when internal actors do not trust the board. Often, the board in this case will be just a window display or a rubberstamp. Legitimacy tasks become particularly important when external actors do not trust the internal actors, but boards are generally empowered to legitimacy tasks by internal actors, and it follows arguments from resource dependence theory. The internal actors in “Start-up” wanted the board chairperson to head all meetings with the bank, municipal authorities, news media, and other external actors perceived as hostile.

The advisory tasks of boards are a function of the internal actors’ competence-based trust in the board members. First, the owner/manager in “Growth” continually asked the board members, including the board chairperson, for different kinds of advice and services, and yet at the same time, he did not necessarily trust the board to interfere in his business. Integrity-based trust is of less importance for the advisory tasks. Advisory tasks may also be related to the board members’ positive integrity-based trust and lack of competence-based types in the CEO and internal actors. The board in “Growth” was empowered to perform advisory tasks by the internal actors to advance managerial hegemony and strategic management.

The monitoring tasks of the board become particularly important when the external actors do not trust the internal actors. This was the case in “Crisis.” External actors trusted the competence and integrity of the board members, and they empowered the board to control tasks. Agency theory has proven to be important for describing board task performance in the “Crisis” case.

Based on these examples, we suggest the following propositions on the relationships between trust and the empowerment of boards of directors:

Proposition 2a: There are relations between the direction of trust and the prioritizing of board task involvement.

Proposition 2b: There are relations between the types of trust and the prioritizing of board task involvement.

Conclusion and implications

In this paper, we have explored, based on three empirical cases, unresearchable, black-box processes outside and inside the boardroom. In addition to the contributions about opening the black box of actual board behavior and the use of participant observation in board research, this paper presents four main contributions. The first contribution highlights the empowerment of boards of directors for tasks such as legitimacy, advice, and monitoring. The second contribution deals with the explorations of boards in different firm’s life-cycle phases as start-up, growth, and crisis. The third contribution is that of the use of various dimensions of trust, such as types and direction. The last contribution is to the understanding of boards in small firms.

We presented propositions about trust, firm’s life cycle, and actual board behavior in small firms. By studying the processes outside and inside the boardroom in “Start-up,” “Growth,” and “Crisis,” the role of trust in empowering their boards was explored. These explorations go beyond those found in research using archival or survey-based data and may give indications of how to solve the ambiguity of studies about the importance of board composition (Daily et al. 2003). It is up to future research to validate and refine our observations and suggestions about antecedents.

There are various ways to test hypotheses based on the propositions. It should be possible to test the first two propositions based on secondary data. Firm’s life cycle can then be measured, for example, by using firm’s age, growth rate, and filing for bankruptcy as proxies. However, the use of survey instruments may be more suitable—in particular, when being more specific on prioritizing stakeholders and board task involvement. Huse (1993) presents how board involvement in various control and advisory tasks can be measured on Likert-type scales, and the data can be collected from CEOs and board chairpersons. Responses from CEOs can be used in measuring advisory tasks, and responses from chairpersons may be used to measure control tasks. Life-cycle phase can also be measured through survey instruments. Lynall et al. (2003) suggests how this can be done.

Trust has been measured on Likert-type scales in various studies, and it will also be possible to measure integrity and competence-based trust on this type of scale. However, the main challenge will be to validate the trust relations presented by the various actors. Some of these problems may be overcome when the variables are generated by responses from several respondents. Huse (1993) presents an example of how relational norms may be measured as a function of responses from CEOs and chairpersons.

The main theoretical contribution of this paper is the demonstration of the heavy dependency of the value added of a board on the trust relations between the board, the internal stakeholders, and the external stakeholders. By employing the trust in discussing board empowerment and board tasks, we go beyond the present discussion of demographic descriptions of independence (Roberts, McNulty, and Stiles 2005). We indicate that the perceptions of competence and integrity are more important than real or formal independence when empowering boards of directors for various tasks. In this study, we demonstrated the existence and importance of different board tasks, structures, and processes and the need to draw from a larger array of theoretical perspectives, not only from agency theory (Daily et al. 2003). We also demonstrated that if codes of best board practices should be made for boards in small firms, they must be flexible enough to account for differences in governance needs in each firm. We have seen how the firm's life cycle may be of particular importance in understanding board tasks, structures, and processes.

The present study contributes to the understanding of the theory of trust in the boardroom in small firms. Constructs such as board tasks, the role of trust, and board empowerment in small firms should be added to the model of the relationship between firm's life cycle and trust. There are relationships between firm's life cycle and actual board behavior, and competence- and integrity-based trust between various actors may explain differences in relationships. The study has two kinds of practical contributions. First, the project had a direct contribution to the CEOs and the stakeholders in the three firms. Second, the results of this study may guide both external stakeholders and CEOs in understanding how the boards of directors may be used.

Study the board from inside

A "one of the lads" participant observation design was used in the data collection. The use of a participant observation method in this project was challenging and fertile, but it was very time-consuming and demanding in terms of balancing the role of a full participant with the role of a researcher. Both authors, through the experience of one of the two as chairperson of the three firms, got wiser in understanding actual board behavior. One of the challenges was that the whole research project was loaded with ethical considerations. Many were related to questions of liability, and after the end of the research period it took the first author more than a year to terminate the involvement as a participant. The project gave both of

us, however, a confirmation that venturesome research design may facilitate the understanding of “unresearchable issues.”

In the research design, it was considered to be more important to meet criteria of relevance than criteria of traditional “scientific objectivism.” Hence, the use of participant observation methodology has been undertaken. There is a need for venturesome research designs in theory generation to meet the flaws in much of the present mainstream strategy and management research (Kriger and Malan 1993; Parkhe 1993). This paper gives an example of a venturesome research design. This study is one of a few using a participant observation approach in the fields of strategy and corporate governance. Even though such a method may be criticized in many ways, it opens the doors for the understanding of phenomena that otherwise would have been difficult, if not impossible, to investigate into, such as processes outside and inside the boardroom (Brannen 1987; Winkler 1987).

In this project, the first author was not only a passive observer, but he was also one of the main actors. This fact compounds the importance of clarifying subjectivity. By being an actor, he might also have influenced the outcome. His role as chairperson in all the boards had, however, several advantages. First, it made it possible to control for the effect of different chairpersons. Second, observations and information were made available that otherwise would not have been assessable. Third, having a researcher as a board member facilitated the coordination of the work with three different boards at the same time.

Directions for future research

The observations in the study gave birth to propositions about relations that may stimulate theory development and empirical testing. We have in this paper focused on the role of trust in empowering boards of directors and examined processes outside and inside the boardroom in three small firms in different life-cycle phases. A related question would be whether the observations from this study could be applied to other small or large firms. One apparent difference compared to large firms is the effect of the institutional power of the firm. The implications of power differential may vary between small firms and large corporations. In large corporations, it is more likely that stakeholder diffusion will occur, which makes coordination between individual stakeholders more problematic. Another difference is related to the corporations’ ownership structure that is usually more dispersed and separated by management in large companies (Fama and Jensen 1983).

Future research, based on the experiences from this study, can follow several paths. One path could be to refine the instruments of analyses to explore other concepts and relations indicated in the present paper. In this study, we also made other observations related to feelings, the abilities of CEOs to circumvent stakeholder and board control, and the importance of formal and informal structures in and around the boardroom. These observations were not emphasized here, but they may be worth investigating further in other projects. Another direction could be to

replicate this study in other firms focusing on the findings from this contribution. Comparisons between small and large firms could be of interest. A fourth direction could be to operationalize and measure the key concepts for quantitative deductive studies. This was suggested in relation to the propositions in this paper. Studies operationalizing trust and actual board tasks, going beyond the use of outsider ratio to predict board effectiveness, might provide results more consistent with theoretical reasoning than what is found in most studies of directorates (Pye and Pettigrew 2005).

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