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## CEO Trustworthiness: Its Antecedents and Effects on Corporate Governance

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### Abstract

We develop an integrated set of propositions describing the relationships among CEO characteristics, the perceived trustworthiness of the CEO, and the board of directors' decisions concerning the governance structure of the firm. In particular, we propose that CEO education, tenure, experience, board memberships and founder status affect the board's perception of the CEO's ability, benevolence, and integrity (the three key trustworthiness dimensions), and that these trustworthiness perceptions then affect the board's choice of governance mechanisms with regard to CEO compensation mix, CEO/board chair duality, board size, and outsider representation on the board. Our theoretical development suggests that agency theory's difficulties in explaining corporate governance may be the result of researchers' failure to incorporate CEO trustworthiness into their models.

### Keywords

CEO characteristics, Trustworthiness, Corporate governance

## 1. Introduction

Corporate scandals highlight the effects of executive power and trustworthiness on the success or failure of organizations. Recent events at Theranos, Luckin Coffee, Volkswagen, Wells Fargo and other organizations demonstrate the dramatic lengths to which unscrupulous executives will go to enrich themselves at the expense of the organization's stakeholders. Such events over the years have led numerous critics in academia and the me-

dia to suggest that corporate governance in America's largest firms has failed to align the interests of top managers with those of the shareholders and other key stakeholders. At the heart of many such criticisms is that complacent, and even complicit, boards are oftentimes unwilling or unable to reign in powerful executives. The board of directors is the governing body that has received the most attention in relation to minimizing inappropriate executive behavior (Daily & Schwenk, 1996), and the board is deemed the nexus of corporate

governance (Finkelstein & Hambrick, 1996; Hoppmann et al., 2019). Since boards of directors are to ensure the alignment of shareholder and executive interests, it is incumbent upon them to assess and adjust the firm's governance structure and to do so in a way that minimizes the potential risks of moral hazard to the firm brought about by decisions the CEO makes. Nevertheless, it is clear that powerful and unscrupulous executives are sometimes allowed to run roughshod over the governance process and, by extension, the best interests of those by whom they are employed.

Agency theory assumes that the CEO is inherently untrustworthy because he or she is a "rational actor"; that is, the CEO may have something substantial to gain by considering his or her own interests of primary importance (Graffin et al., 2020; Jensen & Meckling, 1976). From an agency theory perspective, unless the interests of the CEO and the firm are directly aligned such that each stands to gain from a given CEO decision, the appropriate action of the board would be to place controls on the CEO so that s/he does not exploit the firm for his or her own gain. That is, the board should choose governance structures that minimize any potential agency costs (Joseph et al., 2014; Zahra & Pearce, 1989). Alternatively, stewardship theory suggests that a CEO might make decisions that benefit the firm even at his or her own expense (Davis et al., 1997; Donaldson & Davis, 1991; Hernandez, 2012). This is because such a CEO may well attach great utility to outcomes that benefit the organization irrespective of personal gain (Chrisman, 2019). When a CEO is motivated to act as a steward, the recommendation would follow that the board should choose governance structures that allow the CEO discretion and latitude to make the decisions that, rather than motivated by the potential for self gain, are motivated by benefiting the organization. Thus, we have two different perspectives from which both the board of directors and the CEO might act: an agency perspective and a stewardship perspective.

While agency and stewardship theories offer the chance at greater understanding of both the board and the CEO in the context of governance structure, what is left largely unaddressed is the

context under which the board will choose an agency versus a stewardship perspective in either imposing or reducing constraints on the CEO in the governance structure it chooses. The governance options most easily influenced by directors are generally believed to be the CEO's compensation mix and the conduct and structure of the board of directors (including the decision to grant the CEO additional titles, such as board chairperson, and, by extension, more discretion). Both executive compensation and board structure have been extensively researched, but most of this work has focused on the performance-related outcomes of corporate governance rather than the factors that affect governance structures themselves.

Among the largely unanswered questions are: Why do some boards grant the CEO the additional role of board chairperson and/or president, while some do not? Why are there varying levels of board independence from management? And, why do CEO compensation plans vary across firms with similar characteristics? We argue that the perceived trustworthiness of the CEO is central to answering these questions. We develop an integrated set of propositions highlighting the relationships among CEO characteristics, perceived CEO trustworthiness, and governance structure. We propose that CEO characteristics affect the board's perceptions of his or her trustworthiness. In addition, we propose that the board's perception of CEO trustworthiness affects the degree to which the board is willing to put itself and the firm at risk through the firm's governance structure.

In pursuing this line of inquiry, we make several contributions to management theory. First, our paper represents a merging of two previously distinct domains, namely, strategic management's governance work and organizational behavior's work on trustworthiness and trust. Second, we advance work on governance by further explicating the role of CEOs' personal differences in the governance process. Third, we address the extent to which perceived CEO trustworthiness affects corporate governance structure. Fourth, we address the antecedents of governance structure, which, as noted above, have received relatively little at-

tention. Finally, we extend theory development on trustworthiness by delineating some of its potential antecedents, which have also received very little attention from either the theoretical or empirical literature.

## 2. Theory Development

Agency theory has long offered a view of the firm in which the board, representing the principals, is pitted against CEOs as agents (Eisenhardt, 1989), yet we still do not have a clear understanding of the full range of dysfunctional behaviors and their costs to organizational stakeholders and society (Bosse & Phillips, 2016). Agency theory suggests that the interests of owners and their agents can come into conflict, and when this happens, CEOs will choose to protect their own interests above those of the principals, or, more specifically, the firm. When the interests of the firm and the CEO are aligned, this presents no problem. That is because the CEO, in making decisions that benefit him- or herself, will also be protecting the interests of the firm. This occurs as a side benefit to the firm, but the benefits are nonetheless very real. When they are not aligned and the CEO chooses self-gain over the good of the firm, the firm incurs what are referred to as agency costs. The potential for these agency costs represents risk to the firm, and this risk can be minimized by the choices the board makes with regard to governance structure (Krause et al., 2017). For example, the board can align the interests of the CEO with the firm by tying part of the CEO's compensation to firm performance. Or, the board can limit the CEO's power by appointing someone other than the CEO to be the board's chair.

Stewardship theory offers an alternative viewpoint of the relationship between the CEO and the firm (Chrisman, 2019; Davis et al., 1997; Donaldson & Davis, 1991; Hernandez, 2012). Stewardship theory suggests that some CEOs make decisions that benefit the firm irrespective of, and perhaps even at the expense of, their own potential for self-gain (Hernandez, 2012). That is because such CEOs see utility not in their own accumulation of tangible benefits so much as in identifying with the success of the firm. Such CEOs will forego

decisions that benefit themselves if, in doing so, they would bring harm to or miss the chance to benefit the firm. In this instance, the board should be much less concerned about minimizing agency costs and more concerned with creating situations in which the CEO can do what comes naturally to him or her and benefits the firm. For a CEO who is inclined to act as a steward, the board may do well to choose governance structures that minimize constraints on the CEO and give him/her more latitude. Here, the board might not feel compelled to tie a portion of the CEO's compensation to firm performance and might allow the CEO more discretion by, for example, appointing the CEO to also serve as the board's chair.

Davis et al. (1997) gave an extensive treatment of stewardship theory and its comparison to agency theory. They also discussed at length the benefit of having the CEO and the board aligned in their motivations and world views. They suggested that an appropriate match is when a CEO with an agency mindset (meaning he or she is self-interested) is matched with board that places appropriate constraints on the CEO. Another appropriate match occurs when a stewardship-minded CEO is matched with a board that is likeminded and, in turn, minimizes constraints on the CEO. Undesirable situations occur when a CEO with a stewardship focus is paired with a board that assumes the CEO is highly self-interested, or when a highly self-interested CEO is matched with a board that assumes the CEO has a stewardship focus. Davis et al. (1997) go on to discuss conditions that might contribute to a CEO adopting a stewardship perspective, citing influences such as the CEO's value commitment to the organization and the management philosophy of the CEO (control vs. commitment). They also argue that, whereas the appropriate agency scenario minimizes potential costs, the mutual stewardship relationship has the potential to maximize performance.

However, only hinted at, and not formally developed in previous work of which we are aware, are the conditions that would influence the board's perceptions of the CEO's mindset and whether or not s/he would be considered to be more agency-oriented or stewardship-oriented. While a match

is important, to arrive at this point, the board must (hopefully) correctly assess the CEO's leanings. Very simply, a CEO might have a stewardship perspective, but under what conditions will the board provide the CEO with the governance structure to act as a steward? Davis et al. (1997) suggested that trustworthiness would be important to this process, but they did not go beyond this suggestion. We draw on this suggestion, first outlining the characteristics of the CEO that will make the board more likely to view him or her as trustworthy and then delineating the effects of these perceptions of trustworthiness on the board's decisions regarding governance structure. Hence, our view places the perceived trustworthiness of the CEO as the intervening variable between the CEO's characteristics and governance structure.

### CEO Characteristics as Antecedents of Trustworthiness

Trust in management has long been thought to be important for organizational performance (Argyris, 1994; Davis et al., 2000; Dirks, 2000), and it has received a considerable amount of attention in the literature. However, one of the problems associated with this work has been the variety of ways trust has been defined and operationalized (Bigley & Pearce, 1998; Sitkin & Roth, 1993). To deal with these problems, Mayer et al. (1995) developed a conceptual model that separated trustworthiness from trust. Trust is defined in their model as a willingness to be vulnerable to the actions of another person or party when that party cannot be monitored or controlled. While trust can be assessed as a willingness to engage in certain actions that put oneself at risk, it is manifested as risk taking in a relationship (RTR) with a party in one's actions or decisions in a specific setting. Thus, according to Mayer et al. (1995) model, a trustor's perceptions of a trustee's characteristics (i.e., trustworthiness) will influence the degree to which the trustor is willing to make him- or herself vulnerable to the trustee (i.e., trust). This, in turn, is the primary antecedent to the trustor's actions and decisions that directly put him or her at risk (i.e., RTR). While other theoretical frameworks are available to invoke trust (Lewicki & Bunker, 1996;

McAllister, 1995; Rousseau et al., 1998), we chose to draw upon Mayer et al. (1995) because it specifically distinguishes among the trustee's characteristics, the trustor's willingness to put him- or herself at risk, and the actual behaviors that do so.

In the context of the present paper, this allows us to distinguish clearly between the board's perceptions of the CEO's trustworthiness and the board's risk taking (trust manifested) through the decisions they make in the governance structures affecting the CEO. More specifically, the board's trust in the CEO is, in part, manifested in the extent to which governance structures either impose or lift constraints on the CEO's autonomy. Trustworthiness is a perceived property of the trustee, and it is comprised of the board's perceptions of the CEO's ability, benevolence, and integrity.

*Ability* refers to "that group of skills, competencies, and characteristics that enable a party to have influence within some specific domain" (Mayer et al., 1995, p. 717). It is generally believed to be domain/task specific such that an individual can be seen as capable in some domains but not in others. In a chief executive context, we suggest that ability deals with the extent to which the CEO is perceived by the board to be capable of leading the firm to acceptable levels of performance. As an agent for all the firm's stakeholders (both those who own shares and those who do not), the CEO's actions are influenced by the presence of both stakeholder and shareholder representatives on the board of directors (Harrison, 1987; Luma & Goodstein, 1999). A stakeholder-agency view (Hill & Jones, 1992) would suggest, then, that directors consider CEOs to have ability when they have the skills, competencies, and characteristics necessary to guide the firm toward added value for a wide variety of stakeholders, including both shareholders and non-shareholding stakeholders alike (Barney, 2018).

*Benevolence* deals with the extent to which the individual in question is thought to be predisposed to act in ways that are advantageous for the trustors (Mayer et al., 1995). In this case the trustors are the directors. In the case of the chief executive, benevolence is the extent to which the CEO is believed by the board to care about the board

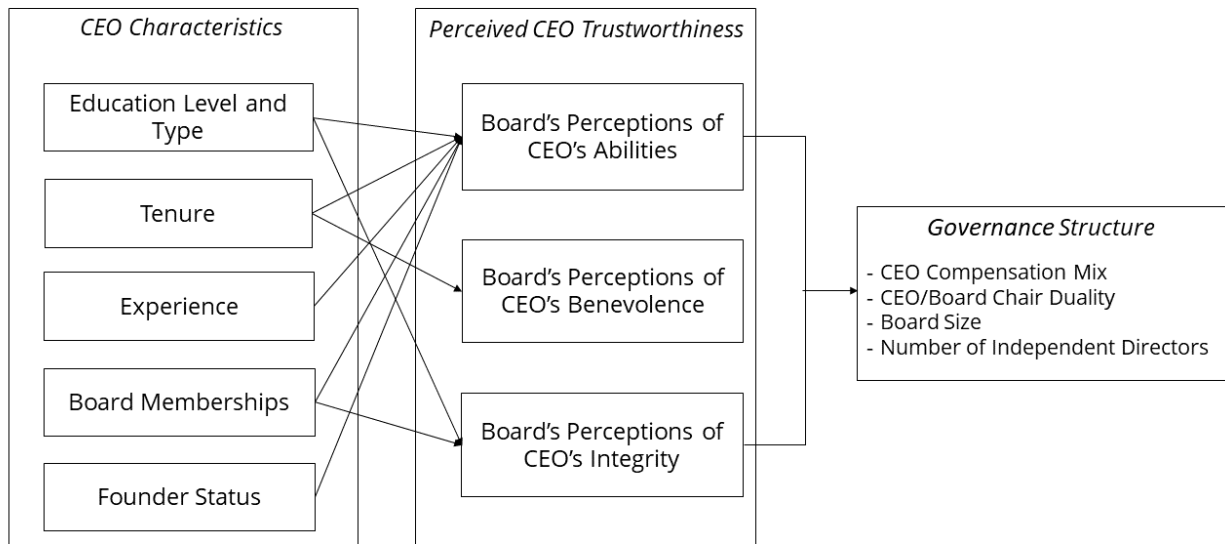
members and their needs, which is likely to put the organization's needs ahead of his or her own. Mayer and colleagues note that, "Benevolence is the extent to which a trustee is believed to want to do good to the trustor, aside from an egocentric profit motive" (Mayer et al., 1995, p. 718). Importantly, regarding the trustee's belief that the CEO wants to do good, relationships the CEO develops with individual board members can be expected to affect the board's perception of the CEO's benevolence.

Finally, *integrity* concerns the extent to which "the trustee adheres to a set of principles that the trustor finds acceptable" (Mayer et al., 1995, p. 719). In the context of the CEO-board relationship, the board should perceive the CEO to have integrity when s/he is thought to believe that his or her purpose is to maximize the value of the firm to its various stakeholders (including shareholders), and acts consistently to reflect this belief. Thus, integrity deals with the CEO's *beliefs*, as perceived by the board, about his or her role as a steward of the organization's resources and constituents, while benevolence deals with the board's perceptions of the CEO's intentions to protect the board's interests. In other words, in applying Mayer et al. (1995) conceptualization of integrity to a CEO-board context, what is important to perceptions of integrity is what the CEO is thought to believe about his or her purpose in the organization and putting the organization's needs first in strategic decisions, not whether he or she intends to take care of the board members' interests (which would be regarded as benevolence). Mayer et al. (1995) address the issue of profit-centricity as it relates to integrity when they note that, "The issue of acceptability precludes the argument that a party who is committed solely to the principle of profit seeking at all costs would be judged high in integrity (unless this principle is acceptable to the trustor)" (Mayer et al., 1995, p. 719). Given that financial performance maximization is an important principle to shareholders, it may be that CEOs will be seen as having more integrity in the eyes of shareholder representatives on the board, in the Mayer et al. (1995) conceptualization of "integrity as acceptability," when they are profit-

centric. Of course, profit maximization may not be the only basis on which the CEO's integrity is assessed. Profit maximization represents an end state, and directors may care about the means for achieving end states as well. For example, in addition to the emphasis on profit maximization, a board might assess a CEO's integrity on the basis of how he or she will accomplish profit maximization (i.e., honesty, fairness, etc.); moreover, it may place particular value in balancing the desire to make a profit for the shareholders with the needs of the employees, environment, and other stakeholders.

Given that non-shareholding stakeholders oftentimes have relatively little representation on boards (Crucke & Knockaert, 2016), and those types of directors appear to have only a minor effect on organization strategy (Hillman et al., 2001), it may be that the most salient factors determining the board's perception of the CEO's integrity are those that affect his or her profitability philosophy. We acknowledge, however, that each board member will assess the integrity of the CEO relative to his and her own set of criteria, and these criteria may well differ based on such things as each member's values and/or the type of role they play on the board (e.g., shareholder vs. non-shareholder). At the core of Mayer et al. (1995) model is the idea that perceptions of an individual's trustworthiness (ability, benevolence, and integrity) are the antecedents of the willingness to trust that person, as well as antecedents of actions that manifest that willingness (RTR). Both on the basis of Mayer et al. (1995) model and others, much organizational research is focused on what trust is, the effects of trustworthiness on trust and risk taking in relationship, and the consequences of trust and risk taking in a relationship. As for the latter, evidence has emerged that trust can have impacts on such things as individual attitudes and behavioral outcomes (Dirks & Ferrin, 2002) and on the performance of higher-level units, such as teams and organizations (Davis et al., 2000; Dirks, 2000). As such, it remains to be determined what specific factors affect a corporate board's perceptions of the CEO's trustworthiness, as well as how those perceptions affect corporate governance. What

Figure 1: Relationships among CEO Characteristics, Perceived CEO Trustworthiness, and Governance Structure



is clear from prior research, however, is that an individual's characteristics likely affect others' beliefs in that person's trustworthiness. With regard to the CEO-board relationship in particular, several CEO characteristics may be uniquely relevant. Specifically, we suggest that CEO education, tenure, breadth of functional experience, exter-

nal board memberships, and founder status affect the board's perceptions of the CEO's trustworthiness. Below, we develop propositions specifically dealing with how these factors affect perceived CEO ability, benevolence, and integrity. The proposed relationships are shown in 1.

### 3. Propositions

#### CEO Characteristics

**CEO Education.** We propose that education-related CEO characteristics play an important role in the board's assessment of the CEO's abilities and integrity. Prior research has used several measures as indicators of top management ability, which we define here as the CEO's expertise at effectively managing the firm and the decisions that affect it (Finkelstein, 1992). Prior research has shown a strong correlation between education and an individual's abilities. Becker (1993) argued that education contributes to increased abilities, and that these abilities provide value to or-

ganizations. Moreover, prior work has shown education level to be related to corporate innovation and strategic change (Westphal & Zajac, 1995). Thus, education level is a possible indicator of CEO ability in the view of the board.

In addition, the prestige of the CEO's alma mater may affect perceptions of his or her ability. Chatterjee and Pollock (2017) and Miller and Wiseman (2001) suggested that the university (or universities) attended by a CEO could be an important indicator of perceived CEO attributes. Interestingly, the relationship between CEO education and middle manager perceptions of a CEO's abilities found by Miller and Wiseman (2001) became stronger

when the analysis included tenure of middle management. The more seasoned these managers became, the more emphasis they placed on the importance of elite education. Thus, it appears as though individuals with more experience highly value education in others, suggesting that a CEO's education will be particularly salient to corporate directors, who generally have many years of experience.

**Proposition 1.** *CEO education level and the prestige of the CEO's alma mater(s) have a positive effect on board perceptions of CEO ability.*

It seems reasonable to assume that shareholders, who prefer the CEO to espouse financial performance maximization values as discussed earlier, will believe the CEO is higher in integrity when his or her educational background fits a particular profile. Recall that integrity in the CEO context refers to the board's perceptions of the CEO's beliefs as to the importance of profit maximization. Scholars have argued that individuals with business degrees, and especially those with advanced business degrees, tend to be viewed as possessing greater capacities for strategic decision making (Westphal & Zajac, 1995). These business school graduates may, in turn, tend to view organizational financial performance as more important than do non-business graduates.

We suggest that corporate boards, which are generally dominated by shareholder representatives (Hillman et al., 2001), will view CEOs as having higher levels of integrity when they possess a degree in a business discipline, especially when the degree is at the graduate level. Individuals with business degrees are more likely to be viewed by the board as understanding the "rules of the game" and we believe the board will believe the CEO is likely to lead the organization accordingly. In particular, the MBA is seen by many as a hallmark of managerial knowledge. Pfeffer and Fong (2003) indicate that business-educated executives are valued and thus deemed important in the corporate world. Therefore, CEOs possessing business degrees should also be viewed by the board as being of greater ability because of the congruence between their educational background and

the demands of their position.

**Proposition 2.** *CEOs with business degrees will be perceived by directors to be of greater integrity and ability.*

**CEO Tenure.** A CEO's tenure with the organization likely affects the board's perception of the CEO's abilities and benevolence. Tenure has been widely used in CEO studies as a predictor or control variable, and it has been associated with executive succession (Cannella & Shen, 2001; Chahine & Zhang, 2020), compensation (Hou et al., 2017), and firm performance (Sigler & Porterfield, 2001). We are aware of no examinations of the effects of CEO tenure on the board's perceptions of his or her abilities and benevolence, but it is reasonable to assume that it plays a role. Indeed, tenure has been used previously as a proxy for an executive's human capital (Carpenter et al., 2001; Finkelstein & Hambrick, 1996; Geletkanycz et al., 2001; Pennings et al., 1998). In addition, Hurley et al. (1997) found that career advancement was positively affected by organizational tenure, suggesting that longer-tenured executives are viewed as increasingly competent. In part, this may be because asymmetries between agents and principals regarding their human capital will dissipate over time (Quigley et al., 2019). Clearly, executives with longer organizational tenures will have become increasingly familiar with the organization's strategy, culture, competitors, and environment. With increasing organizational tenure, CEOs build critical human and social capital that serve to increase their effectiveness, to the benefit of their organizations (Pennings et al., 1998). One aspect of social capital that CEOs may build with increasing tenure is related to their relationship with the board. Specifically, more tenured CEOs have had the opportunity to build deeper relationships with the directors, engendering trust and enhanced perceptions of ability, and allowing for heightened reciprocity and decision-making interdependence (Cropanzano & Mitchell, 2005). In addition, due to the expertise gained from tenure, seasoned CEOs are "more reasonably" held accountable for their firms' performance than are their younger tenured CEO counterparts (Buchholtz et al., 1998).

Moreover, as time passes, the increasing tenure of a CEO within a specific firm may lead to shifts in perceptions of the CEO's ability, which in turn will affect the firm's governance structure. Thus, directors should view longer-tenured CEOs having greater ability.

**Proposition 3.** *CEO tenure has a positive effect on board perceptions of CEO ability.*

As noted earlier, in a CEO context, the benevolence component of trustworthiness deals with the extent to which the CEO has the board's interests in mind when making strategic decisions. Mayer et al. (1995) argue that of the three trustworthiness factors, benevolence takes longer to develop. It takes time for CEOs to build social capital with their boards of directors (Barkema & Pennings, 1998), potentially leading the board to believe the CEO has the board's interests in mind when making decisions.

**Proposition 4.** *CEO tenure has a positive effect on board perceptions of CEO benevolence.*

**CEO Breadth of Functional Experience.** Both Finkelstein (1992) and Daily and Johnson (1997) proposed that an important antecedent of expert power for CEOs was functional area experience. As a CEO's breadth of functional experiences increases, his or her understanding of the complex interrelationships among the organization's diverse range of tasks is enhanced. This is suggested by Hurley et al. (1997), who found that diversity of experience positively affected career advancement, implying that those making promotion decisions believe that breadth of experience within the firm may play a role in overall competence. As a result, CEOs should be viewed as more able by the board when they have had a broader variety of functional experiences.

**Proposition 5.** *Breadth of functional experience has a positive effect on board perceptions of CEO ability.*

**CEO Board Membership.** Another important factor in the board's perceptions of a CEO's trustworthiness is the CEO's involvement on external for-profit company boards. By serving on boards of

other organizations, CEOs are likely to increase their human and social capital in ways that enhance their apparent abilities and their firm's performance (Geletkanycz et al., 2001; Zhu et al., 2020). Although a detailed discussion of the organizational benefits of a CEO's external directorships is beyond the scope of the current paper, such ties help reduce uncertainty surrounding external resource dependencies (Pfeffer & Salancik, 1978), help increase the breadth of environmental scanning activities, and signal managerial and organizational quality to external constituents (Geletkanycz et al., 2001). As a result, we propose that a CEO's external directorships will be perceived by the board to enhance the CEO's ability to run the organization effectively.

**Proposition 6.** *A CEO's service on outside for-profit company boards has a positive effect on board perceptions of CEO ability.*

We also suggest that a CEO's service on outside boards of for-profit firms will affect the board's perceptions of the CEO's integrity. Recall that integrity includes perceptions of the CEO's belief in his or her role as profit-seeker for the firm. CEOs serving on outside for-profit boards are more likely to be perceived by their employing company's directors to understand and identify with their concerns as directors about the firm's financial performance. In addition, service on outside for-profit boards suggests a degree of social similarity between the CEO and those sitting on his or her company's board, likely leading those directors to impute a congruence of values on issues of firm performance. As such, we believe that CEOs sitting on outside for-profit boards will be viewed by their directors as having more integrity, to the extent that integrity in this context concerns profit-centricity on the part of the CEO. Service on non-profit boards may signal ability, but may or may not suggest a commitment to profit centricity, and thus may not contribute to a perception of integrity.

**Proposition 7.** *A CEO's service on outside for-profit company boards has a positive effect on board perceptions of CEO integrity.*



**CEO Founder Status.** The CEO's status as founder of the organization is also likely to affect perceived CEO trustworthiness. We suggest that CEOs who are founders of the firms they lead will likely be perceived as being of greater ability and benevolence (Lee et al., 2020). Regarding ability, founder-CEOs play a key role in setting the firm's initial direction, outlining objectives, and shepherding the organization in its earliest and most vulnerable days (Gimeno et al., 1997; Vesper, 1996). In addition, Hendricks et al. (2019) argued that founder-CEOs possess deep tacit knowledge of the firm and its operations, have strong relationships with both internal and external stakeholders, and are more strongly identified with and committed to the firm, thus mitigating agency concerns.

Jayaraman et al. (2000) found inconsistent results when exploring the firm performance effects of a founder-CEO's continued leadership. Nonetheless, the CEO's abilities were clearly important to the firm's success, especially given the variety of obstacles through which a founder-CEO must successfully lead his or her organization in the firm's early years. Nelson (2003) found that the stock market reacted more positively to founder CEO-led firms than non-founder-led firms. More specifically, the fact that investors will pay a higher premium for founder CEO-led firms' IPOs is likely due to the perceived value of the competencies of the founder-led CEO. Thus, we suggest that founder-CEOs are more likely to be perceived by the board as having greater ability than non-founder CEOs.

**Proposition 8.** *Founder-CEOs will be perceived by the board as having greater ability than CEOs who were not founders.*

### **The Governance Effects of CEO Trustworthiness**

The board's perception of the CEO's trustworthiness is likely to have far reaching consequences for corporate governance. In general terms, a perceived lack of CEO trustworthiness should increase the board's concern about agency costs. On the contrary, boards overseeing a CEO who is perceived to have ability, benevolence, and integrity will be less concerned about agency costs. As Mayer et al. (1995) note, individuals are will-

ing to put themselves at risk when the other party is perceived to be more trustworthy. In a governance context, high levels of perceived CEO trustworthiness would lead the board to incorporate relatively low levels of rigor in the firm's governance structure. Indeed, Strickland (1958) suggests that low levels of trust in employees will increase managerial monitoring of their activities. In addition, Del Brio et al. (2013) found boards that perceive the CEO to be low in ability and integrity engage in higher levels of monitoring. As a result, we suggest that perceived CEO trustworthiness affects a board's approach to governing, including setting CEO compensation mix, CEO/board chair duality, board size, and the number of outside directors on the board, all of which are indicators of the rigor of the firm's governance. Given that each of the three dimensions of trustworthiness are separable and can vary independently of one another (Mayer et al., 1995), we theorize that ability, benevolence, and integrity may each have unique effects on governance structure.

**CEO Compensation Mix.** With regard to compensation mix, agency theory (Jensen & Meckling, 1976) suggests that monitoring costs can be reduced by using compensation structure to align the interests of the CEO with those of the shareholders. In doing so, agency theory indicates that boards should adjust the mix of fixed and performance-contingent compensation such that executives are induced to engage in performance-maximizing behaviors (Graffin et al., 2020; Stroh et al., 1996). When the CEO's compensation is heavily reliant on the firm's meeting its performance targets, executives are discouraged from making ill-advised investments in self-serving strategic initiatives (Baumol, 1967; Kroll et al., 1990). Consistent with agency theory, in cases where directors perceive the CEO to be particularly trustworthy, we suggest that the CEO's compensation will be comprised of a significantly higher proportion of fixed compensation. We believe the opposite is also true; boards will increase the importance of contingent compensation (such as stock options and bonuses) in a CEO's pay mix when he or she is perceived to be less trustworthy.

We propose that the salient trustworthiness fac-

tors that affect compensation structure are perceived benevolence and integrity. Given that abilities or competencies are developed over a lifetime of experiences, boards will recognize that pay structure does little to compensate for relatively lower levels of CEO ability; thus, boards will tend to use other governance mechanisms under conditions of lower perceived CEO ability. Further, when boards have more representatives of non-shareholding stakeholders, they will be more likely to increase the importance of non-financial performance (such as environmental impact, employee job security and benefits, supplier relations, and so on) as a contingency for CEO compensation in the face of low levels of perceived benevolence and integrity. Nevertheless, financial performance will be the primary contingency upon which less trustworthy CEOs' compensation will be based, given the relatively low representation on boards of stakeholder directors (Hillman et al., 2001).

**Proposition 9.** *CEOs who are perceived to be higher on the dimensions of benevolence and integrity will have a lower percentage of contingent compensation.*

**CEO/Board Chair Duality.** CEO/board chair duality is clearly suggestive of enhanced executive power and increased risk of self-serving behavior by the CEO. Mallette and Fowler (1992) found that firms with CEO duality were more likely to adopt a "poison pill" than firms with a separation between the CEO and board chairperson. Zantout and O'Reilly-Allen (1996) found an association between CEO duality and corporate diversification. Magnan et al. (1999) found that CEO duality was significantly and positively related to CEO compensation. Harrison et al. (1988) found that CEO power leads to entrenchment. Finally, Hayward and Hambrick (1997) found that firms with CEO duality paid greater takeover premiums during acquisitions than firms with separate CEO/chair positions. Therefore, duality is generally believed to convey significant power to the CEO. Given that duality increases the CEO's ability to force his or her will on the organization, we suggest that each of the three trustworthiness factors affect the likeli-

hood of a board granting the CEO the dual title of board chair.

When the chair position is separate from the CEO, board members choose either an outside director or a former executive as the chairperson. We argue that an externally selected chairperson would signal a concern regarding integrity or benevolence. The board wants to ensure that the executive chosen for this important strategic position comes from the outside to safeguard the interests of various stakeholders. On the other hand, a former executive appointment may signal a concern regarding the CEO's ability, and with the invaluable experience of the former executive, such a team would bode well for effective strategic decision making.

In addition to the titles of CEO and board chair, there are other titles frequently combined with CEO that may be indicative of structural power, such as president, chief operating officer, and so on (Combs & Skill, 2003). Top executive with these additional titles of higher authority would have greater influence, since he or she would have much more discretion over critical knowledge and resources than a CEO without these added titles.

The consolidation of various positions, which includes board chair, can provide a clear signal to investors that the strategic decision process will be less bureaucratic as well as provide the CEO with a "wide latitude on objectives" (Krause et al., 2019, p. 1570). The board will effectively eliminate potential disagreements with key strategic decision makers such as the president. Although the president could be viewed as someone who is being groomed for the top executive position, thus engendering teamwork among the executives, another perspective suggests that these positions could just as easily turn combative with the CEO (Zhang, 2006). Thus, CEOs who are perceived by their boards to have ability, benevolence, and integrity will be more likely to hold the dual titles of CEO and board chair, because the board will view this centrality of decision making authority as beneficial to the pursuit of corporate initiatives. As well, boards may grant additional titles such as president to further structure efficient decision making.

**Proposition 10.** *CEOs who are perceived by the board to be higher in ability, benevolence, and integrity are more likely to hold the position of board chairperson and/or president.*

**Board Size and Outsider Representation.** Two factors related to the structure of the board itself may be affected by perceived CEO trustworthiness. These are the size of the board and the proportion of directors who are outsiders. Directors are considered here to be outsiders when they have never been employed by the organization (Jones & Goldberg, 1982; Judge & Zeithaml, 1992). When directors perceive lower levels of ability, we suggest that they will increase the size of the board. Directors clearly bring a variety of skills, social networks, and resource dependence benefits to the task of corporate governance (Gnyawali & Madhavan, 2001; Pfeffer & Salancik, 1978), and such skills and networks should prove more valuable in conditions of perceived low CEO ability. By increasing the number of directors, boards may add significant value to organizations with less capable CEOs.

Perceptions of low benevolence and integrity should also lead to increases in board size, but for different reasons. Board size is an important indicator of a firm's passive or vigilant monitoring of the CEO and the other executives (Wright et al., 2002). The larger the board, the more difficult it may be for the non-benevolent and/or low-integrity CEO to pursue a dysfunctional agenda. Prior research has suggested that such boards are regarded as most appropriate when there are concerns about agency costs (Pearce & Zahra, 1992). Given that lower levels of perceived CEO benevolence and integrity will likely be viewed by the board of directors as leading to potentially greater agency costs, we would expect board size to be inversely related to perceived CEO benevolence and integrity.

**Proposition 11.** *Perceptions of low levels of CEO ability, benevolence, and integrity will positively affect board size.*

Regarding outsider representation, outsider-dominated boards are more apt to challenge

strategic choices that are not conducive to superior firm performance. Hill and Snell (1988) found that the ratio of outside board members to total board members was positively associated with board involvement in restructuring. Evidence suggests that a greater proportion of outsiders on the board is associated with an increased likelihood that the board will replace the CEO after a period of poor corporate performance (Coughlan & Schmidt, 1985; Newman & Mozes, 1999; Weisbach, 1988). Both types of board members (outsiders and insiders) have a duty to ensure that strategies pursued are in the best interest of the shareholders (J. L. Johnson et al., 1996). Yet, an inside director may feel indebted to the CEO because of his or her employment history with the CEO, and may perceive more benevolence from the CEO based on this existing relationship. Therefore, while inside directors will have more knowledge of the daily operations, they will also be less likely to challenge the CEO or other executives on important strategic issues (R. A. Johnson et al., 1993). Outside board members, however, are not as beholden to the CEO. Moreover, these board members are not involved in the daily operations of the company and will not have to deal with the uneasiness of working closely with a CEO with whom they may disagree. Also, outside directors may have the added incentive of maintaining their own reputations as directors and avoiding the risks of negative publicity for duties poorly performed (Fama & Jensen, 1983). Firms with outside, more independent boards will be more vigilant in monitoring the CEO, which is particularly important when the CEO is perceived to be low on some combination of integrity, ability, and benevolence. However, where the CEO is perceived to be higher on those dimensions, fewer outsiders will be needed to monitor the CEO, because the board will perceive the CEO to be less of a risk with regard to agency costs.

Hillman et al. (2000) argue that outside board members serve in three important capacities: business experts, support specialists, and community influentials. Business experts impart skills in problem solving and decision making. Support specialists provide legitimacy and access to vital

resources. Community influentials represent non-business perspectives such as outside interests. CEO trustworthiness in these capacities would help determine the type of outside representation boards would seek. For example, boards may want business experts and support specialists if the CEO's abilities are in question.

**Proposition 12.** *Perceptions of low levels of CEO ability, benevolence, and integrity will positively affect outsider representation on the board.*

#### 4. Board Perceptions of CEO Trustworthiness: Individual Assessments and Group Decisions.

Our model, as developed above, suggests that board members will make judgments about the perceived trustworthiness of CEOs based on a variety of CEO characteristics. We go on to suggest that it is the board's perceptions of the CEO's trustworthiness that will, in turn, directly influence the degree to which the board imposes or lifts constraints on the CEO through the choices the board makes with regard to governance structure. While we acknowledged that different board members may have different perceptions of the CEO's trustworthiness, what becomes apparent is that, in working toward governance structure decisions, the individuals comprising the board and its decision-making committees must act in unity. Given that perceptions of trustworthiness originate within individual board members, the question that arises is how the board arrives at a shared perception on which to act.

The effects of trustworthiness perceptions on governance structure decisions represent what Currall and Inkpen (2002) referred to as a Group → Person trust situation in their taxonomy of trust in international joint ventures. This Group → Person label is appropriate for our theorizing in that our context depicts the degree to which a group (the board of directors or a committee thereof) perceives an individual (the CEO) to be trustworthy or not. How the board uses the perceptions of its individual members to arrive at governance structure decisions will largely be a function of each board and its established procedures and norms.

At one extreme would be the situation in which the board as a whole, or various subcommittees, makes decisions by consensus. Here, each board member would need to perceive the CEO to be relatively trustworthy before there would be a decision to remove constraints on the CEO. Said another way, the board members would need to share perceptions of CEO trustworthiness. At the other extreme would be a situation in which one of the board members plays a dominant role on the board (or a committee thereof) and other members defer to him or her. This could occur for a variety of reasons, including the rest of the board viewing the dominant member as trustworthy him- or herself, and allowing themselves to be vulnerable to him or her. In any event, under such a scenario, the trust relationship boils down to a dyadic phenomenon, or what Currall and Inkpen (2002) labeled a Person → Person situation. Here, the amount of latitude the CEO is given in the governance structure will largely be a function of not how the board (or a committee) as a collective perceives his or her trustworthiness, but how the dominant individual views it.

Of course, between these two extremes lie various scenarios in which subsets of the board drive the decision (e.g., majority rules voting patterns and the like). In such cases, the key issue would be the extent to which the majority views the CEO as trustworthy and essentially shares in those judgments. However, this goes beyond the focus of the current paper. We raise these issues here to acknowledge that perceptions of trustworthiness about the CEO are made by individual board members but they oftentimes will be acted upon by the group of board members collectively (either the entire board or a board committee).

#### 5. Discussion and Conclusions

This paper has attempted to link individual CEO characteristics with governance structure by discussing the intervening variable of trustworthiness. In particular, we have suggested that CEOs' education, tenure, functional experience, board membership, and founder status affect the board's perceptions of the CEO's trustworthiness. These trustworthiness perceptions will lead the

board to exhibit varying levels of trust in their CEOs as evidenced in their decisions regarding governance structure. This has important implications for both research and practice.

### Implications for Research

Agency theory and stewardship theory provide alternate theoretical lenses through which the antecedents and outcomes of CEO trustworthiness may be viewed. Agency theory suggests that CEOs are rational actors concerned with maximizing their own rewards (Jensen & Meckling, 1976). Stewardship theory, by contrast, suggests that CEOs will behave in ways that benefit the firm, oftentimes to their own personal detriment (Davis et al., 1997; Donaldson & Davis, 1991). Our model suggests that both of these two competing theories may explain governance conditions within the firm quite well, but that the extent to which each apparently explains governance within a firm depends on the underlying trustworthiness of the firm's top executive. In other words, whether researchers find support for agency theory or stewardship theory in their empirical studies of compensation and governance structure may hinge on trustworthiness, which until now has not been explored as an antecedent of governance. Under conditions of high CEO trustworthiness, one would expect the predictions of stewardship theory to hold. Those CEOs who are characterized by high levels of trustworthiness are given greater authority within their firms to affect organizational outcomes. Thus, we would expect greater incidence of duality, higher levels of fixed compensation, fewer outsiders on the board, and a smaller board overall. By contrast, under conditions of low CEO trustworthiness, agency theory should have the most predictive ability in empirical studies dealing with governance and compensation.

There are several avenues for future research that may yield theoretical, empirical, and practitioner-oriented benefits. First, empirical research on the factors that drive CEO trustworthiness perceptions (and the resulting governance effects) by boards of directors would add richness to the growing body of literature on trust and trustworthiness. Such research would extend both the-

ory and empirics. With regard to empirical contributions, scholars would have to determine the appropriate methods for modeling the way(s) in which boards as a group come to make decisions based on individual trustworthiness perceptions. Once this was demonstrated empirically, say, by assessing within-board agreement (using, for example, the  $r_{wg}$  index of James et al., 1984, 1993) on perceptions of CEO trustworthiness or by assessing the interrater reliability (using, for example, the ICC(1) or ICC(2) – see Bliese, 2000) of perceptions of CEO trustworthiness, the board's shared perception could be represented by an aggregate of the individual board members' perceptions of CEO trustworthiness. This is similar to what Davis et al. (2000) did when they aggregated employee perceptions of trust in the store manager and related these scores to store performance (though they were not representing the aggregation as a group-level phenomenon). However, doing this empirically in a governance context (i.e., with boards and CEOs) would perhaps prove to be particularly challenging.

Second, future empirical research on the topic may indeed shed light, as we suggest above, on the relative explanatory power of agency theory versus stewardship theory. Given the difficulties that prior researchers have had in, for instance, explaining variance in executive compensation, empirical tests employing a trustworthiness approach may be particularly useful in extending the significant body of research on compensation.

Third, empirical research on CEO trustworthiness perceptions and governance structure/conditions may extend research on trustworthiness by potentially demonstrating the generalizability of the Mayer et al. (1995) framework. Although this framework has been widely employed, little, if any, of this work has been done with samples of top executives and boards of directors.

Fourth, research on CEO trustworthiness may include not only observable, objective characteristics but also attitudinal and psychological states. Our paper focuses on objective measures; however, the impression created by the CEO's actions and mannerisms surely provide predictive ability in determining the perceived abilities, benevo-

lence and/or integrity of the CEO.

Fifth, research could explore more complex relationships among the constructs of interest. Consider, for example, nonlinear relationships. The human capital literature generally supports the positive relationship between CEOs' experience and tenure and more favorable perceptions of their ability. In contrast, Hildebrand et al. (2020) found that CEOs with less prior experience were more likely to have a long-term orientation as well as a more balanced focus between profitability and revenue growth, resulting in higher firm performance. Also, studies could explore the interaction effects of, say, CEO board memberships and founder status on ability. CEOs who are founders and who sit on multiple for-profit boards may benefit from significantly higher board perceptions of ability because of the associated enhanced credibility and human capital that they would enjoy.

Finally, governance structure is dynamic across time within organizations, and it clearly varies across organizations. Future researchers may wish to consider the frequency and severity of changes in governance (such as changes to the size of the board, the percentage/number of independent directors, duality, and more), and how those changes are driven by perceptions of CEO trustworthiness. In addition, future research may wish to explore the extent to which boards of directors seek out new CEOs who fit their governance framework using perceptions of CEO trustworthiness as their indicators of fit.

We must be careful to point out that the antecedents of a board's perception of the CEO's trustworthiness are surely multifaceted, complex, and difficult to assess/measure. As a result, an important limitation of our paper is that there are likely to be numerous confounding effects that should be controlled for in empirical studies on this topic, such as the financial and operating performance of the firm, among others.

Given the complex, dynamic, and multifaceted nature of the research questions associated with the relationship between CEO trustworthiness and corporate governance, we propose that much insight can be gained via research methods that employ small sample, intensive studies. As suggested

by Harrigan (1983, pp. 398–399), "fine grained treatments of strategy benefit from their attention to important details that help researchers characterize the complexities of strategy formulation...(and) can include meticulous attentions to detail, relevance to business practice, and access to multiple viewpoints." Such efforts can yield new insights as well as lead to inductive theory building which is invaluable given that research is, of course, a continual process of rediscovery.

### Implications for Governance Practice

Our theoretical model implies that corporate governance structure varies across firms, and that this variance hinges on the trustworthiness of the CEO. Firms employing CEOs who are high on ability, benevolence, and integrity may find that their boards create less value, and that compensation structure is unrelated to subsequent organizational performance (because the CEO would "do the right thing" regardless of pay-related effects). As noted by Zahra and Pearce (1989), boards perform three primary functions, namely, control, strategy, and service. The control role would be most valuable in situations where the CEO is low in integrity or benevolence. In such cases, the board will engage in both monitoring and incentive alignment such that CEOs who have low integrity and/or benevolence are forced to engage in behaviors that are beneficial to the firm, thus minimizing agency costs. However, incurring costs associated with monitoring and incentive alignment is less necessary under conditions of high CEO benevolence and integrity. In addition, the strategy role played by boards is less necessary under conditions of high CEO ability, because highly competent CEOs should have the knowledge, skills and abilities to lead the company strategically. Finally, the service role of boards of directors may be unaffected by CEO trustworthiness, because much of the service role of boards of directors has little to do with the characteristics of the CEO since those are responsibilities of the board rather than of the CEO.

The above discussion is not meant to suggest that boards are irrelevant under conditions of high CEO trustworthiness. Clearly, their social and hu-

man capital may still be of value. However, we suggest that corporate governance, and specifically the board of directors, may be viewed as a means for helping low-ability CEOs with leadership and strategy issues, and ensuring that CEOs with relatively low integrity (in the sense of profit-centricity motives) or benevolence pursue goals preferred by key stakeholders, particularly the board and, by extension, the shareholders.

In summary, our model suggests that characteristics of CEOs affect the board's perception of their trustworthiness. These perceptions manifest themselves in risk-taking by the board, specif-

ically in terms of how the board is structured (insiders versus outsiders, number of directors, and CEO/board chair duality), which affects the board's monitoring function, and how the CEO is compensated (the mix of fixed and performance-contingent pay), which affects incentive alignment. While a great deal of prior research has explored governance, CEO compensation, and trust/trustworthiness, we believe our model provides the first integration of these important topics. Accordingly, we contend that research in this vein holds promise for the development of both descriptive and normative theory.

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