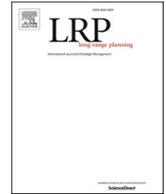




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Can you catch two birds with one stone? The impacts of nominating committee composition on board monitoring and resource provision

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ABSTRACT

While it has long been recognized that boards of directors perform two primary functions – monitoring and resource provision – little research has systematically examined the relationship between these two functions in public corporations. Given the growing external emphasis on the monitoring function by investors and advocates of corporate governance reforms, it is important to understand how such an emphasis impacts the resource provision function. In addition to identifying the composition of the nominating committee as a key to understanding the relationship, we propose two mechanisms through which the formation of an independent nominating committee in response to the external emphasis on monitoring leads to a decline in board resource provision. One mechanism is through a decline in information sharing between top managers and the nominating committee in new director selection, which results in a divergence between board capital and the firm's specific resource needs. The other is through decreased trust between the CEO and the board, which results in a less collaborative CEO-board relationship. To alleviate this negative impact that an external emphasis on monitoring has on resource provision, we propose that boards can bring non-CEO executives back onto nominating committees as inside directors. Our theoretical analysis contributes to the understanding of how the composition of the nominating committee influences board monitoring and resource provision, and has important implications for corporate governance research and practices.

Introduction

Scholars have long shown a strong interest in the functions of the boards of directors of public corporations and their impact on firm performance (e.g., Adams et al., 2010; Boivie et al., 2016; Hambrick et al., 2015; Johnson et al., 1996; Judge and Zeithaml, 1992; Misangyi and Acharya, 2014; Mizruchi, 1996; Pfeffer and Salancik, 1978; Shen, 2003; Sundaramurthy and Lewis, 2003). The discussion has mainly revolved around the two primary broad functions – monitoring and resource provision (Hillman and Dalziel, 2003). Monitoring focuses on the assessment and approval of major management decisions, as well as giving rewards and punishments to top managers based on firm performance, on behalf of shareholders (Eisenhardt, 1989; Fama and Jensen, 1983). In contrast, resource

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provision focuses on helping top managers gain access to needed resources as well as advice and counsel on major strategic decisions (Hillman and Dalziel, 2003; Pfeffer and Salancik, 1978). A large body of research has examined extensively the factors that may influence the board's capacity to perform the monitoring function from an agency theory perspective, or the resource provision function from a resource dependence theory perspective in public corporations (Adams et al., 2010; Dalton et al., 2007; Hillman et al., 2009).

Despite the extensive research on the boards of public corporations, the extant literature remains equivocal about the relationship between these two functions, particularly regarding how boards' engagement in the monitoring function may impact the resource provision function. Indeed, prior research has largely analyzed boards' monitoring and resource provision functions in separate silos (Hillman et al., 2009; Boivie et al., 2016; Dalton and Dalton, 2011), with the exception of research on the boards of privately owned new ventures (e.g., Garg, 2013, 2020; Garg and Furr, 2017).¹ Although Hillman and Dalziel (2003) discuss board monitoring and resource provision simultaneously and propose that both have a positive effect on firm performance, they stop short of addressing whether a board can excel in both functions, or how engagement in one function could influence the other. Other scholars (e.g., Sundaramurthy and Lewis, 2003; Zhu and Yoshikawa, 2016) propose that boards tend to emphasize one function over the other based on their views of managers as opportunistic agents or trustworthy stewards. Hambrick et al. (2015) suggest that boards of directors, if left free to choose, generally prefer to focus on resource provision rather than monitoring, because engagement in monitoring tends to create a contentious relationship with the CEO.

In practice, recent changes in institutional developments suggest that the boards of public corporations are increasingly constrained in choosing between monitoring and resource provision as they have been under strong external pressure from investors and activists to focus on monitoring (Boivie et al., 2016). Boards of public corporations have long been criticized for not performing their fiduciary duty of monitoring management decisions on behalf of shareholders because of their lack of independence from management, particularly from the CEO (Cadbury, 1992; Useem, 1996). The corporate scandals in the early 2000s further highlighted the urgent need to strengthen the monitoring function of the boards (Bebchuk and Fried, 2004; Roberts et al., 2005). In response, a series of rules, regulations, and codes of good corporate governance have been introduced worldwide, with an emphasis on increasing board independence and improving board monitoring (Adams et al., 2010; Aguilera and Cuervo-Cazurra, 2009; Finkelstein et al., 2009). One of the key measures introduced has been the formation of an independent nominating committee composed entirely of independent directors (Chen and Wu, 2016; Monks and Minow, 2011; Spencer Stuart, 2019).

However, empirical research has not consistently shown that this external emphasis on board monitoring, along with the measures designed to improve board oversight, lead to a significant increase in firm performance, making some scholars question whether the newly implemented changes are sufficient (Hambrick et al., 2015) or whether the boards have the capacity to effectively monitor management decisions at all (Boivie et al., 2016). Other scholars have pointed out that the increased emphasis on the board's monitoring function may have some unintended consequences that undermine firm performance. For example, because an increase in board monitoring increases the CEO's employment risk, it demotivates the CEO from taking strategic risks, engaging in innovation, or seeking advice from independent directors (Guldiken and Darendeli, 2016; Hoskisson et al., 2009; Ma et al., 2020). It also reduces managerial discretion, and thus reduces managers' incentive and ability to actively pursue strategic opportunities (Knapp et al., 2011; Ponomareva et al., 2019). However, this research has not examined how the emphasis on monitoring impacts the board's capacity to perform the resource provision function. Given that both monitoring and resource provision influence firm performance (Hillman and Dalziel, 2003), it is important to understand whether the increase in board monitoring as a response to the external pressure comes at the expenses of board resource provision, why this may occur, and what can be done to prevent or lessen the negative impact on board resource provision.

The purpose of our paper thus is to contribute to the understanding of how the external emphasis on board monitoring by investors, activists and regulators may impact board resource provision in public corporations. Our overarching argument is that this external emphasis on monitoring leads to the formation of a nominating committee composed entirely of independent directors, which subsequently undermines the board's capacity to perform the resource provision function. We propose two mechanisms through which the formation of an independent nominating committee undermines board resource provision. One is through a decline in information sharing between top managers and the nominating committee in new director selection, which results in a divergence between board capital and the firm's specific resource dependence needs. The other is through decreased trust between the CEO and the board, which results in a less collaborative CEO-board relationship. We further propose that divergence between board capital and firm-specific resource dependence needs, and a less collaborative CEO-board relationship both have a negative impact on board resource provision. Finally, to alleviate the negative impacts, we suggest bringing a non-CEO executive back to the nominating committee as an insider director so that the committee can have a better understanding of the firm's specific resource needs in the nomination of independent directors, and the board can develop a more collaborative relationship with the CEO.

By examining how an external emphasis on board monitoring impacts the independence of the nominating committee and subsequently board resource provision in public corporations, our paper has significant implications for corporate governance research and practice. Our in-depth analysis of how the external emphasis on monitoring influences board resource provision enhances the understanding of the extent to which boards of directors can contribute to shareholder value creation through the monitoring function. Instead of suggesting board monitoring has a monotonically positive effect on shareholder value as advocated by some corporate governance scholars and activists, our analysis reveals a more complex relationship by highlighting the unintended effect of board monitoring on the board's capacity to perform the resource provision function.

¹ Because there are important differences in board composition between public corporations and private new ventures (Garg, 2013, 2020), our analysis and discussion are limited to the boards of public corporations.

Moreover, by identifying the independence of the nominating committee as a key to understanding how the external emphasis on board monitoring leads to a decline in board resource provision, we are able to offer suggestions that can help alleviate the unintended negative impact of an external emphasis on board monitoring. For example, we propose that it is important to bring non-CEO inside directors back onto nominating committees. Given the increasing external pressure in recent institutional developments for the boards of public corporations to focus on the monitoring function by having a nominating committee composed entirely of independent directors (Chen and Wu, 2016; Monks and Minow, 2011; Spencer Stuart, 2019), our paper is especially important and timely for corporate governance research and practice.

Lastly, our theoretical analysis highlights the composition of the nominating committee as the linchpin in the relationship between board composition and board functions. Because of its fundamental responsibility in identifying and recommending director nominees, the nominating committee can have a direct impact on board composition (Withers et al., 2012). However, the existing literature has primarily taken an agency perspective and emphasized the importance of having an independent nominating committee to improve board monitoring (Guo and Masulis, 2015; Kolev et al., 2019; Monks and Minow, 2011; Shivdasani and Yermack, 1999). With few exceptions (e.g., Callahan et al., 2003; Faleye et al., 2011), little research has systematically analyzed how the composition of the nominating committee influences the resource provision function via its impact on board composition (Chaudry et al., 2020). In this regard, our paper has important implications for future research on the relationships among nominating committee composition, board composition, and board functions.

The rest of the paper is organized as follows. We first provide a brief review of the two primary functions of corporate boards – monitoring and resource provision, giving special attention to the factors that impact a board's capacity to fulfill these functions. Next, we present our theoretical model, and explain in detail how and why an external emphasis on board monitoring will lead to the formation of an independent nominating committee and subsequently a decline in board resource provision, as well as how such an effect can be alleviated. We conclude with a discussion of our theory's implications for future research and practice.

Functions of corporate boards

Research on the two primary functions of corporate boards, monitoring and resource provision, has distinct theoretical origins (Hillman and Dalziel, 2003). Research on the monitoring function is rooted in organizational economics, particularly in agency theory (Fama and Jensen, 1983; Jensen and Meckling, 1976), which views the board of directors as an essential ingredient of internal corporate governance mechanisms designed to contain managerial opportunism and protect shareholder interests in public corporations (Hambrick et al., 2015; Hermalin and Weisbach, 1998; Misangyi and Acharya, 2014; Walsh and Seward, 1990). Directors exercise their monitoring function either through ratification of management decisions or through alignment of managerial incentives with the interests of shareholders (Jensen and Meckling, 1976).

To perform these activities effectively, there are several requirements for the boards of directors. First, independence from management is proposed to be pivotal for their ability to objectively assess management decisions (Jensen and Meckling, 1976; Walsh and Seward, 1990). For example, friendship and business ties between directors and executives can bias directors' assessment and make it difficult for them to question or challenge management decisions. Second, the boards need to possess relevant knowledge, skills, and expertise that enable them to correctly assess the strategic contingencies faced by the firms (Carpenter and Westphal, 2001; Fama and Jensen, 1983). Third, directors need to have the requisite bandwidth to allow them to devote sufficient time and attention to board duties (Carter and Lorsch, 2004; Roberts et al., 2005). To assess management decisions and managerial performance accurately, directors need to possess a significant amount of relevant information, which demands time, energy and attention (Cashman et al., 2012). In addition to bandwidth at the individual level, the board as a group needs to allocate sufficient time to monitoring (Tuggle et al., 2010). Lastly, directors' incentive or motivation to protect shareholders' interests constitutes another important ingredient of effective monitoring (Shen, 2005). For example, directors are proposed to be more dedicated to the monitoring function when they identify strongly with the organization, shareholders, customers, and suppliers, and when they identify weakly with top managers and the CEO (Hillman et al., 2008). Hambrick et al. (2015), after reviewing the large body of research on factors impacting the effectiveness of board monitoring, propose a quad model stipulating that a director needs to simultaneously possess all four of the following qualities to be an effective monitor: independence (ability to be objective), expertise (ability to comprehend the issues at hand), bandwidth (ability to devote the requisite time and attention), and motivation to protect shareholder interests.

In contrast, research on the boards' resource provision function is rooted in organizational sociology, particularly the resource dependence theory (Pfeffer and Salancik, 1978), which views the board of directors as an important organizational mechanism for firms to actively manage their resource dependence needs. Early studies of interlocking directorates between two organizations viewed them as representing both an effort by the receiving organization to mitigate its resource dependence needs as well as an instrument for monitoring by the sending organization (Mizruchi, 1996). For example, financial institutions such as banks that provide financial resources to a firm tend to put a representative on the firm's board to ensure that their interests are not compromised by the firm's decisions. While early studies focus on representatives from the sending organizations who perform both resource provision and monitoring on the boards of the receiving organizations (Mizruchi, 1996; Pfeffer and Salancik, 1978), later research on the boards' resource provision function has almost exclusively focused on independent directors who have no other business relationship with the firm beyond serving on its board. In performing the resource provision function, these independent directors help firms to create value through the provision of access to valuable resources based on their specialized knowledge and social connections, often at the request of management (Hillman and Dalziel, 2003). In addition to helping firms gain access to valuable resources, another major component of the resource provision function is to provide advice and counsel to executives, particularly the CEO, in strategic decision-making (Carpenter and Westphal, 2001; Withers et al., 2012). Research following the resource dependence theory generally expects boards

to have a positive effect on firm performance by engaging in the resource provision function, as doing so the firms to benefit from directors' human capital and social capital in value creation (Haynes and Hillman, 2010; Jiang et al., 2020).

To effectively perform the resource provision function, boards need to possess human and social capitals that match the strategic or resource dependence needs of their firms (Jiang et al., 2020; Withers et al., 2012). Previous research has viewed directors' human and social capitals as primary antecedents of board effectiveness in fulfilling the resource provision function (Hillman and Dalziel, 2003). Directors' expertise and social ties with the executives are positively associated with their engagement in the provision of advice and counsel to executives (Carpenter and Westphal, 2001; Hoitash, 2011; Westphal, 1999), and the effects are stronger if board capital is well aligned with the firm's strategic needs (Ma and Seidl, 2018). Furthermore, when directors' general and industry-specific knowledge complements management's, it sends a powerful signal to the stock market about the value of the firm and its business potential (Kor and Misangyi, 2008; Sundaramurthy et al., 2014). To ensure that board capital is aligned with the firm's strategic needs, top managers, particularly the CEO, used to be actively involved in the director selection process, nominating candidates whom they believed possessed human capital or social capital that met the firm's strategic needs (Carter and Lorsch, 2004; Lorsch and MacIver, 1989).

Moreover, the mere presence of relevant board capital is insufficient because effective resource provision also requires the existence of a collaborative relationship between the CEO and the board (Sundaramurthy and Lewis, 2003). A collaborative CEO-board relationship enhances their shared identity, facilitates information exchange between them, and encourages the CEO to actively seek advice and counsel from the board, making directors more motivated and more able to engage in effective resource provision (Hillman et al., 2008; Westphal, 1999). In contrast, when the CEO-board relationship is contentious rather than collaborative, the CEO is less comfortable seeking advice and counsel from the board, weakening the latter's capacity to fulfill the resource provision function (Sundaramurthy and Lewis, 2003; Westphal, 1999).

Despite the large amount of research on corporate boards, individual studies generally focus on either the monitoring function in the tradition of agency theory and organizational economics, or the resource provision function in the tradition of resource dependence theory and organizational sociology (Boivie et al., 2016; Dalton et al., 2007; Hillman et al., 2009; Withers et al., 2012). As a result, these two streams of research, each focusing on only one function, have evolved largely in parallel and independent of one another. Recognizing this division, Hillman and Dalziel (2003) suggest the monitoring function and the resource provision function should be considered simultaneously because firm performance depends on the board's capacity and incentive to fulfill both functions; however, they stop short of discussing explicitly whether boards can effectively engage in both functions simultaneously. While recent research suggests that boards of new ventures perform both resource provision and monitoring (e.g., Garg, 2013; 2020; Garg and Furr, 2017; Wasserman, 2016), research on the boards of public corporations generally suggests the opposite. For example, Sundaramurthy and Lewis (2003) and Adams and Ferreira (2007) theorize that friendship ties between directors and top managers can help the resource provision function thrive, but undermine boards' capacity to perform the monitoring function. More recently Hambrick et al. (2015) raise two possibilities regarding the relationship between board monitoring and resource provision. First, board monitoring and resource provision may overlap and be symbiotic when directors raise negative notes about a strategic proposal from management (monitoring) while at the same time suggesting alternative actions that can potentially benefit the firm (resource provision). Second, because monitoring tends to create a more contentious relationship with the CEO, directors may gravitate to the more congenial resource provision function rather than the monitoring function. Overall, Hambrick et al. (2015) suggest that, when left free to choose, independent directors are more likely to focus on resource provision, and view their contribution in resource provision as a substitute for the monitoring function, particularly given the limited time independent directors can devote to board duties (Faleye et al., 2011). Overall, the extant literature is inconsistent and inconclusive on the relationship between the two functions of the boards in public corporations.

An issue that has not yet received much attention in the literature is how an emphasis on the monitoring function by investors, activists, and regulators influences the board's capacity to fulfill the resource provision function. This topic is especially timely and important given the institutional changes and developments that stipulate boards to be more actively engaged in the monitoring of management decisions on behalf of shareholders (Boivie et al., 2016). A series of rules, regulations, and codes of good governance have been introduced regarding board structure and composition, such as separating the board chair and CEO positions, increasing the presence of independent directors on key committees, and having board meetings without the presence of top managers, within the intention of strengthening boards' monitoring function (Adams et al., 2010; Finkelstein et al., 2009; Linck et al., 2009). Given that boards create value through both monitoring and resource provision (Hillman and Dalziel, 2003), it thus becomes imperative to understand how this external pressure on boards to increase monitoring may influence their contribution to firm performance through resource provision. Empirically, research has not yet found consistent evidence that the newly introduced changes designed to strengthen board monitoring have led to an increase in firm performance (Adams et al., 2010; Boivie et al., 2016; Dalton et al., 2007; Hambrick et al., 2015). Although the lack of empirical support may indicate that these changes are still not sufficient to make boards effective monitors (Boivie et al., 2016; Hambrick et al., 2015), it is also possible that they may inadvertently impair boards' contributions to shareholder value creation by undermining the resource provision function. In the next section, we present our theoretical analysis of how the external emphasis on the monitoring function by investors, activists, and regulators impacts the composition of the nominating committee and subsequently boards' capacity to fulfill the resource provision function.

Impacts of nominating committee on board monitoring and resource provision

Our central proposition is that the external emphasis on the monitoring function by investors, activists, and regulators will lead to the formation of an independent nominating committee, which will subsequently undermine the board's resource provision function

by two mechanisms. The first is through a decline in information sharing between top managers and the nominating committee in new director selection, which will lead to a divergence between board capital and the firm’s specific resource dependence needs. The second is through decreased trust between the CEO and the board, which will lead to a less collaborative CEO-board relationship. The divergence between board capital and firm-specific resource dependence needs, and the less collaborative CEO-board relationship will both lead to a decline in board resource provision. Fig. 1 summarizes our theoretical model, illustrating how the external emphasis on monitoring influences board resource provision through its impact on the independence of the nominating committee and the two proposed mechanisms.

External emphasis on board monitoring and independence of the nominating committee

An external emphasis on the board’s monitoring function by investors, activists, and regulators will shape the composition of the nominating committee and result in an independent nominating committee. Advocates of corporate governance reforms generally attribute a board’s weak monitoring of management decisions to its lack of independence from management (Aguilera and Cuervo-Cazurra, 2009; Monks and Minow, 2011). Studies rooted in agency theory have long and consistently found that boards are less likely to challenge management decisions or hold the CEO accountable for firm performance when they are composed of directors who are the CEO’s friends or beholden to the CEO for their directorship (Adams et al., 2010; Coles et al., 2008; Finkelstein et al., 2009; Hambrick et al., 2015). There is also research showing that powerful CEOs prefer having their friends serve on the boards in order to weaken board monitoring and protect their personal interests (Westphal and Zajac, 2013).

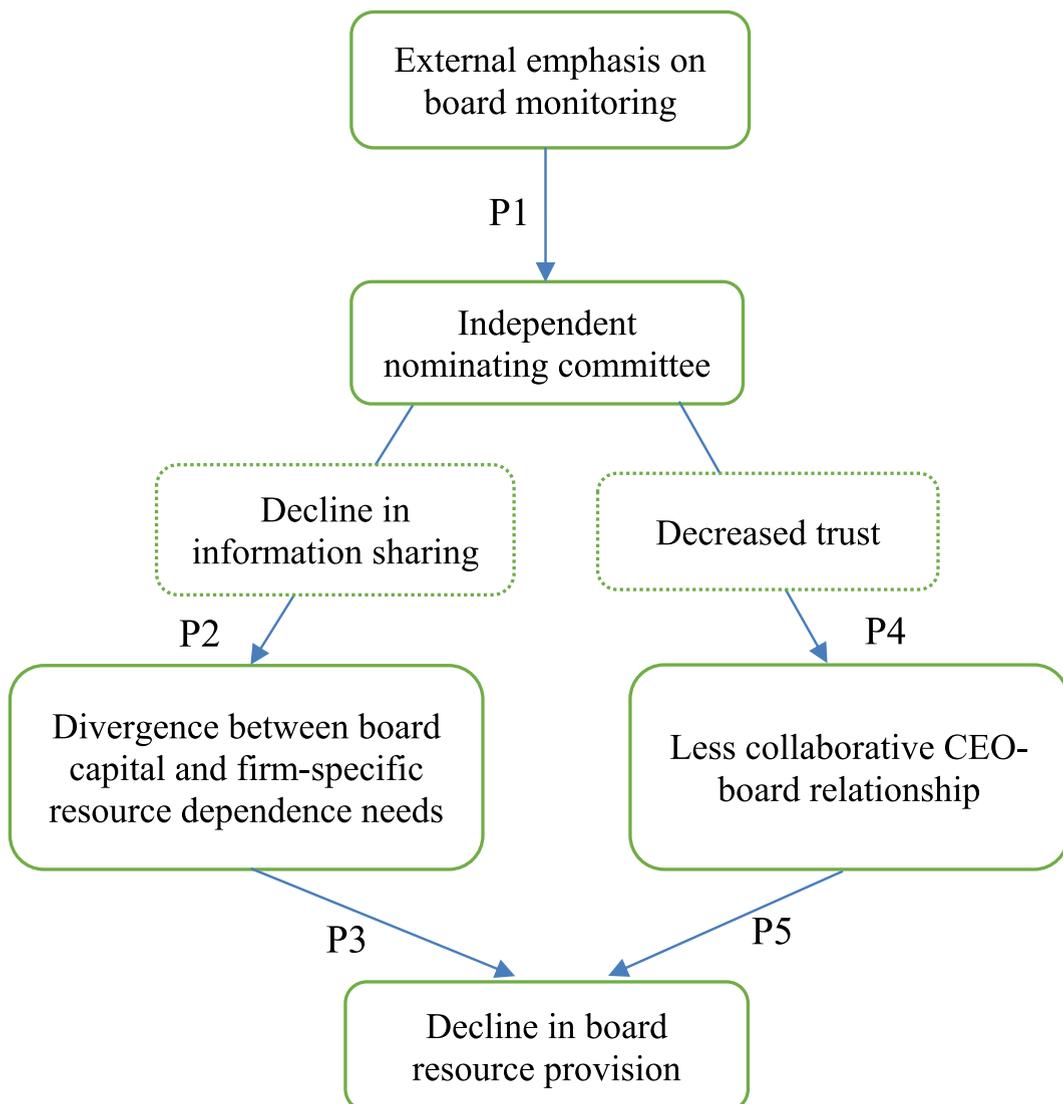


Fig. 1. Relationship between an external emphasis on board monitoring and board resource provision.

To improve board monitoring, it is thus argued to be imperative for the board to be composed of a majority of independent directors who have no other relationship with the firm and management so that the board will be able to evaluate the CEO and management decisions more objectively on behalf of shareholders (Dalton et al., 2007; Hambrick et al., 2015; Monks and Minow, 2011). For example, boards should not have a majority of inside directors who are the firm's executives directly reporting to the CEO, or affiliated directors who have other business relationships with the firm, because these directors are less able to make independent assessments of firm decisions due to their relationships with the CEO and the firm. In addition, outside directors are not considered independent if they are the CEO's friends or psychologically beholden to the CEO for their board appointments. In response to these arguments and calls, a series of rules, regulations, and codes of good corporate governance have been introduced in many countries to improve the independence of boards of directors (Adams et al., 2010; Aguilera and Cuervo-Cazurra, 2009; Finkelstein et al., 2009).

One of the key changes focuses on the composition of the nominating committee, which is responsible for identifying individuals qualified to become board members and for recommending them to the board as director nominees for elections at the next annual shareholder meeting (Spencer Stuart, 2019). Because of its fundamental responsibility in identifying and recommending director nominees, the nominating committee can have a direct impact on board composition and independence. While the existence of a nominating committee formalizes the director nomination process and makes newly selected directors feel less beholden to the CEO for their appointments (Guo and Masulis, 2015), it does not warrant nominations of independent directors or improvement in board monitoring when the nominating committee itself is not independent of managerial influence (Cohen et al., 2012; Shivdasani and Yermack, 1999). To ensure that new director nominees are independent and thus can help the board perform the monitoring function more effectively, some investor activists and advocates of corporate governance reforms call for the nominating committee to be composed of independent directors only (Monks and Minow, 2011). Such calls for the presence of a highly independent nominating committee have been echoed by stock market regulators and rule makers as a key measure to improve board independence and monitoring (Adams et al., 2010; Finkelstein et al., 2009). For instance, the New York Stock Exchange requires all listed companies to have a nominating committee composed entirely of independent directors (Chen and Wu, 2016).

In response to the new rules and the external pressure for the board to emphasize the monitoring function, the listed companies have made significant changes in the composition of the nominating committee to increase its independence (Kolev et al., 2019). According to the most recent *Spencer Stuart Board Index (2020)* survey, all S&P 500 firms have a nominating committee and 99.6 percent of the nominating committees are comprised entirely of independent directors. This finding is not surprising, given the heightened external emphasis on board monitoring and the importance of the nominating committee in the new director selection process. We thus propose that the external emphasis on the board's monitoring function by investors, activists, and regulations leads to the formation of an independent nominating committee that is comprised entirely of independent directors who have no other relationship with the firm and management.

Proposition 1. (P1): *An external emphasis on the board's monitoring function leads to the formation of an independent nominating committee that is composed entirely of independent directors.*

Independent nominating committee and board capital

While the formation of an independent nominating committee can promote the nomination of independent directors and improve board monitoring as suggested by its proponents (Cohen et al., 2012; Guo and Masulis, 2015; He et al., 2018), we contend that it may also lead to a divergence between board capital and the firm's specific resource needs via a decline in information sharing between top managers and the board in the new director selection process. To select new directors whose human and social capital are aligned with the firm's resource needs, those involved in the process must first have a good understanding of the firm's resource needs. Compared with independent directors, non-independent directors, particularly the CEO and other inside directors, tend to have a much deeper understanding of the firm's strategic challenges and resource needs because of their firm- and industry-specific knowledge accumulated over time (Baysinger and Hoskisson, 1990). In contrast, independent directors may not have the bandwidth, defined as the ability to devote the requisite time, attention, and energy, to develop the same in-depth firm- and industry-specific knowledge as non-independent directors (Hambrick et al., 2015). Given that independent directors are generally selected because of their accomplishments, stature, and connections, most of them are extremely busy and face competing demands on their time and attention (Khanna et al., 2014). Indeed, time is a significant constraint on independent directors, hindering their ability to acquire sufficient knowledge about the businesses they oversee, and even causing some of them to have difficulty attending all board meetings (Kress, 2018; Shen, 2005). As a result, independent directors tend to have less firm-specific knowledge, which makes them less able to comprehend or foresee the firm's strategic challenges and resource needs than the CEO and other inside directors (Baysinger and Hoskisson, 1990; Boivie et al., 2016).

To ensure that new directors possess human and social capitals aligned well with the firm's specific resource dependence needs, the CEO and other inside directors, because of their in-depth knowledge about the firm's strategic challenges, used to play an important role in director selection, taking initiatives to identify candidates who could provide resources to address these challenges (Lorsch and MacIver, 1989). However, because of the concern that directors nominated by top managers may not be able to exercise independent judgment of management decisions given that they are likely either to be friends of top managers or beholden to the top managers for board appointments (Coles et al., 2008; Westphal and Zajac, 2013), advocates of corporate governance reforms have called for the nominating committee to be composed entirely of independent directors to ensure board independence from management (Monks and Minow, 2011). Indeed, laws and regulations have been passed in many countries to exclude the CEO and other inside directors from the nominating committee (Aguilera and Cuervo-Cazurra, 2009; Finkelstein et al., 2009). This structural change in the composition of the

nominating committee has been found to significantly reduce CEOs' influence over director selections (Cohen et al., 2012; Eminent and Guedri, 2010; Westphal and Zajac, 2013), though it does not eliminate CEOs' influence completely (Zhu and Westphal, 2014).

While the formation of an independent nominating committee reduces top managers' influence over new director selections and leads to an increase in board independence from management, it can also limit information sharing between the CEO and the nominating committee regarding the desired qualities of the new directors. When the CEO shares information with the nominating committee about the firm's strategic challenges and qualified candidates who can help the firm to address these challenges, independent directors may view it as an attempt to influence the director nomination and selection process. To ensure that the process is not compromised by influences from management, the nominating committee is likely to rely heavily on independent directors to identify director candidates. Without actively seeking inputs from the CEO and other top managers, the nominating committee prevents itself from benefiting from top managers' in-depth knowledge about the firm's strategic challenges to identify potential director candidates who can help to address these challenges. Consequently, the more independent the nominating committee is, the less in-depth firm-specific knowledge it possesses, and the less likely it is to identify individuals whose expertise closely matches the firm's specific resource dependence needs in new director selection. Although an independent nominating committee can select individuals who possess extensive general knowledge and/or specialized business expertise, these individuals are still limited in their ability to help top managers address firm-specific strategic challenges because they are not specially selected to address these challenges.

Moreover, changes in the rules and regulations have also encouraged the independent nominating committee to prioritize specific skills relevant to monitoring in the selection of new independent directors. For example, the provision of SOX calls for all firms to have at least one independent financial expert on the audit committee, leading to an increase in the number of financial experts serving on corporate boards (Linck et al., 2009). According to one survey, financial experts comprised 25.5% of all new directors appointed in 2018 (Spencer Stuart, 2019). Another important skill that has seen an increase in demand is legal expertise. Krishnan et al. (2011) noted a sharp increase of lawyers among newly appointed directors during the post-SOX period. Meanwhile, the percentage of active executives serving on other boards decreased sharply from 31% to 19% between 2008 and 2018 (Spencer Stuart, 2018). These trends indicate that current director selection practices put a high priority on independent directors' financial and legal expertise in monitoring, overshadowing firm- and industry-specific knowledge and executive experience. Because such practices are intended to improve board monitoring, they can further discourage top managers from sharing information with the nominating committee about their desired candidates' qualifications, making the committee become increasingly less able to benefit from top managers' in-depth, firm-specific knowledge in new director selection. Although the newly selected independent directors possess valuable human and social capitals, they are selected more for the purpose of increasing board independence and improving board monitoring, rather than fulfilling the resource provision function. Thus, they are probably less able to address the firm's specific strategic challenges or resource dependence needs, compared to new directors selected by the CEO and other inside directors. Taken together, the above arguments suggest the following:

Proposition 2. (P2): *The formation of an independent nominating committee leads to divergence between board capital and the firm's specific resource dependence needs via a decline in information sharing between the top managers and the nominating committee members.*

The divergence between board capital and the firm's specific resource dependence needs will undermine the board's capacity to fulfill the resource provision function. CEOs normally seek advice and counsel from directors whom they know well and believe to possess knowledge and expertise valuable to their strategic decisions (Boivie et al., 2016; Kor and Misangyi, 2008; Sundaramurthy et al., 2014). When CEOs are removed from the director selection process, they are less likely to know well the new independent directors nominated by the independent nominating committee. After the CEOs learn more about the new directors over time, they may find out that these new independent directors' knowledge, expertise, and connections are not well aligned with their firms' specific strategic or resource dependence needs. As a result, they are less likely to actively seek advice and counsel from the new independent directors, limiting the latter's capacity to fulfill the resource provision function.

In addition, the time constraints that independent directors face in carrying out their board duties may make them focus even more on the monitoring function, and use the engagement in monitoring as a substitute for the resource provision function (Faleye et al., 2011). Because independent directors are extremely busy and face many competing demands and obligations, they tend to devote limited time to board duties (Boivie et al., 2016). According to one survey, independent directors on average spend only about one hundred hours per year on board duties, including the time spent outside board meetings on their own to gather information and review company reports (Carter and Lorsch, 2004). Furthermore, this limited amount of time is increasingly devoted to monitoring related activities such as auditing financial reports, assessing management performance and compensation, and nominating new directors (Faleye et al., 2011; Heidrick and Struggles, 2007). Thus, there is little time for independent directors to acquire in-depth knowledge about the firm's businesses, engage in meaningful discussions on firm strategies in board meetings, or provide advice and counsel to the CEO on important strategic decisions (Hambrick et al., 2015; Lorsch, 2012). Aware of their time constraints and limitations in firm-specific knowledge, independent directors may decide to focus mainly on monitoring so that they can fulfill the duty they are primarily selected for as independent directors. In other words, they will give priority to monitoring over resource provision due to the divergence between their capital and the firm's resource dependence needs in the presence of time constraints.

In sum, the divergence between board capital and the firm's specific resource dependence needs will make it more challenging for independent directors to provide relevant and valuable strategic advice to the CEO. The board's capacity to fulfill the resource provision function will be undermined by its lack of relevant firm-specific knowledge and by time constraints, leading to a decline in board resource provision. Thus, we propose the following:

Proposition 3. (P3): *A divergence between board capital and the firm's specific resource dependence needs leads to a decline in board*

resource provision.

Independent nominating committee and CEO-Board relationship

The relationship between the CEO and the board has significant implications for firm outcomes (Ma and Seidl, 2018; Shen, 2003). Previous studies have characterized the CEO-board relationship as intense and complex, where demands for both control and collaboration with executives are present simultaneously (Sundaramurthy and Lewis, 2003). As two distinct domains of interaction, control and collaboration are guided by opposite logics and are closely intertwined, where change in one has immediate implications for the other. We expect that the formation of an independent nominating committee will undermine the CEO-board relationship, making it less collaborative via decreased trust between the CEO and the board.

First, the formation of an independent nominating committee means the board will become composed of fewer directors whom the CEO knows well personally and considers to be his or her friends (Zhu and Westphal, 2014). When the board removes the CEO from the nomination process, it not only signals the board's lack of trust in the CEO, but also makes it more difficult for the CEO to influence director appointments via nominating individuals whom they trust and feel comfortable working with as new directors (Westphal, 1999; Kaczmarek et al., 2012). Second, in response to an external emphasis on monitoring and the pressure to increase board independence, the independent nominating committee is likely to nominate individuals who have no business connections with the firm or management as new directors (Cohen et al., 2012). Because these new directors are nominated by the independent nominating committee to increase board monitoring, they are not psychologically beholden to the CEO for their board appointments and thus take monitoring more seriously (Coles et al., 2008). Lastly, the increase in board independence, along with an emphasis on monitoring, sends the CEO a signal that he or she is watched closely and not fully trusted by the board (Sundaramurthy and Lewis, 2003). The CEO thus is more likely to see the independent directors as monitors of his or her decisions, and becomes less willing to discuss strategic issues with them candidly for the fear of being evaluated negatively (Westphal, 1999).

Furthermore, the increase in external pressure for boards to focus more on monitoring is also likely to influence independent directors' perceptions of their roles, making them identify more strongly with shareholders and less strongly with management. Advocates of corporate governance reforms, shareholder activists, and the media have consistently and strongly argued over the last two decades that independent directors are representatives of the shareholders and carry the fiduciary duty of protecting shareholder interests (Adams et al., 2010; Aguilera and Cuervo-Cazurra, 2009; Boivie et al., 2016; Cadbury, 1992; Monks and Minow, 2011). Although directors have multiple social identities (Lorsch and MacIver, 1989), the social movement toward shareholder-centered corporate governance reforms (Davis and Thompson, 1994) not only highlights the identity of directors as representatives of the shareholders but also provides a social context that promotes independent directors' identification with such an identity (Ashforth, 2001). Thus, independent directors are likely to become more strongly identified with shareholders and less so with management (Hillman et al., 2008). Such a social identity can in turn create an "us vs. them" social divide between independent directors and top managers (Knapp et al., 2011), undermining independent directors' trust in management and the CEO in particular.

The decreased trust between the CEO and the board resulting from the formation of an independent nominating committee and the subsequent increase in board independence will not only make the CEO less willing to discuss strategic issues with independent directors openly, but will also lead to more negative evaluations by both sides toward each other (Tajfel and Turner, 1979). When independent directors make comments or suggestions on management proposals, the CEO may view them as being less relevant to the firm's specific contexts or needs (due to both independent directors' limited firm-specific knowledge, as we explained above, and the CEO's bias toward them), and thus they will be less likely to take them seriously. Similarly, when the CEO initiates strategic proposals, independent directors may question her motives and assess the proposals more negatively. If the CEO becomes less engaged in interactions with the board, independent directors may perceive her as being less transparent with them about the firm's strategic challenges or even as trying to conceal important information from them. Such a perception is likely to further decrease independent directors' confidence and trust in the CEO's leadership, making them monitor the CEO more closely and creating a self-reinforcing cycle to undermine the CEO-board relationship (Sundaramurthy and Lewis, 2003). Taken together, the above arguments suggest that the formation of an independent nominating committee will lead to a less collaborative CEO-board relationship via decreased trust between the CEO and the board. We thus propose the following:

Proposition 4. (P4): *The formation of an independent nominating committee leads to a less collaborative CEO-board relationship via decreased trust between them.*

The relationship between the CEO and the board is an important factor that influences the board's capacity to perform the resource provision function (Lorsch and MacIver, 1989; Roberts et al., 2005; Westphal, 1999). When the relationship is more positive and collaborative, CEOs trust their directors to be supportive; thus, they will feel more comfortable discussing strategic challenges with the directors candidly, and will actively seek their advice about how to cope with these challenges. There is evidence that friendship ties between CEOs and directors are positively associated with informal interactions that involve advice-seeking and provision on strategic issues (Westphal, 1999). Positive personal relationships also encourage the CEO to engage in dyadic relationships with each director more informally, as opposed to interacting with the board formally as a group, allowing the CEO to tap into the specific expertise of each director (Garg and Eisenhardt, 2017).

Similarly, a more collaborative CEO-board relationship also keeps directors more informed about the firm's ongoing business activities and makes them more comfortable providing advice to the CEO (Adams and Ferreira, 2007; Sundaramurthy and Lewis, 2003). Because directors often sit on multiple boards and have full-time jobs, their knowledge about the firm is limited and they largely depend on the CEO for information about its businesses. A more collaborative CEO-board relationship facilitates the information flow

from the CEO to the board, keeping the directors more informed about the firm and its environments. Through frequent interactions with the CEO, the board is likely to have a good understanding of the firm's resource needs, and thus will be better able to provide relevant advice and counsel to the CEO. Moreover, open communication between the CEO and the board promotes the development of domain consensus, where both the CEO and the board understand their respective roles and expectations, which in turn increases directors' willingness and capacity to engage in resource provision (Hillman et al., 2008).

In contrast, a less collaborative CEO-board relationship will result in more formal communications and fewer informal contacts and interactions between board and CEO. The CEO, aware of being monitored by the board, is likely to engage less in advice-seeking from independent directors for fear that such behavior might be interpreted as lack of competence or confidence (Larcker and Tayan, 2011; Westphal, 1999) or that the information she reveals will be used against her in evaluations (Dalal and Bonaccio, 2010; Tian, 2014). Because directors typically offer advice and counsel at the request of the CEO (; Lorsch and MacIver, 1989), lack of input from the CEO can significantly weaken their motivation and limit their capacity to perform resource provision proactively (Adams and Ferreira, 2007; Westphal and Zajac, 2013). Taken together, the above arguments suggest the following proposition:

Proposition 5. (P5): *A less collaborative CEO-board relationship leads to a decline in board resource provision.*

Alleviating the negative impact of an external emphasis on board monitoring

Our theory has so far suggested that an external emphasis on board monitoring will likely lead to a decline in board resource provision. In this section we would like to point out that this scenario is not inevitable; instead, boards can prevent or at least alleviate the negative impact that an external emphasis on monitoring may have on resource provision, and the key to the solution is the composition of the nominating committee. Our earlier analysis suggests that the external emphasis on the monitoring function has called for boards to become more independent of management, because the lack of board independence has been long recognized as the primary cause of boards' inability to perform the monitoring function on behalf of shareholders (Adams et al., 2010; Dalton et al., 2007; Hambrick et al., 2015; Jensen and Meckling, 1976). To increase and ensure board independence, a major proposal in the rules, regulations, and codes of good corporate governance is to remove top managers from the nominating committee and reduce their influence over the director selection process (Finkelstein et al., 2009; Monks and Minow, 2011). Our theory suggests that the formation of an independent nominating committee is the common origin of the two paths that lead to a decline in board resource provision, i.e., it is responsible both for the divergence between board capital and the firm's resource dependence needs, and for a less collaborative CEO-board relationship. Thus, to alleviate the negative impact of an external emphasis on board monitoring on board resource provision, we contend that it is critical to bring back top executives as inside directors to the nominating committees.

There are two primary benefits of having a top executive on the nominating committee. First, because top executives tend to have a better understanding of the firm's current or future strategic needs (Baysinger and Hoskisson, 1990; Fama and Jensen, 1983; Boivie et al., 2016), they can provide independent directors with valuable information about the desired qualities of new director candidates who can help the firm better address its resource dependence needs. Such inputs from top executives can help alleviate the divergence between board capital and the firm's resource dependence needs. Second, it signals to top executives that independent directors respect their input and do not view them as opportunistic agents to guard against. In response, top executives are likely to be more appreciative of independent directors' efforts to nominate the right candidates and be more transparent in their communications about the firm's strategic challenges. Such mutual understanding and respect can help build a more collaborative relationship between top executives and independent directors, as well as between the CEO and the board.

Meanwhile, we are fully aware of, and agree with, the importance of having a majority of independent directors sitting on the nominating committee and on the board as a whole. Therefore, we do not propose the nominating committee should be composed entirely of inside directors or have a majority of them. Instead, we propose it should have a majority of independent directors. For example, for a three-member nominating committee, it can have two independent directors and one inside director. Moreover, we argue that it is probably preferable to have a top executive other than the CEO on the nominating committee, because that would give independent directors an opportunity to hear other top executives' views on the firm's strategic challenges in the nomination process. Essentially, the non-CEO top executive on the nominating committee serves as a conduit of information or the linchpin between independent directors and the firm's other top managers, including the CEO (Fama and Jensen, 1983; Shen and Cannella, 2002). Furthermore, to ensure that the newly selected directors are independent (i.e., have no personal connections with the top executives or are not psychologically beholden to them), the non-CEO top executive on the nominating committee may only communicate to independent directors specific strategic challenges that the firm is expected to face and the desired qualities of the candidates, while leaving the nomination of specific candidates to independent directors.

Although adding a non-CEO top executive as an inside director may seem to weaken the independence of the nominating committee, that is not necessarily so because the committee is still composed of a majority (two thirds or more) of independent directors. More importantly, such a change can help reduce the divergence between board capital and the firm's specific resource dependence needs, and create a more collaborative relationship between the board and management. Consequently, it helps to alleviate the negative impact that an external emphasis on board monitoring may have on board resource provision. Thus, we propose the following:

Proposition 6. (P6): *Having a non-CEO top executive as an inside director on the nominating committee weakens the negative impact of an external emphasis on board monitoring on board resource provision.*

Discussion and conclusions

By analyzing how and why the external emphasis on monitoring may lead to a decline in board resource provision as well as what boards can do to alleviate this negative impact, our paper makes a number of important contributions. First, it contributes to the understanding of why the literature has not yet witnessed a substantial positive impact of an increase in board monitoring on firm performance expected by advocates of corporate governance reforms, an issue that has been of great interest to organizational scholars and practitioners (Adams et al., 2010; Dalton et al., 2007; Finkelstein et al., 2009; Monks and Minow, 2011). Although many changes have been proposed and implemented to strengthen board independence and monitoring, the empirical evidence is inconclusive about their effects on firm performance. This lack of empirical support has motivated some scholars to either propose new measures (Hambrick et al., 2015) or question the plausibility of effective board monitoring (Boivie et al., 2016).

Our paper adds to this conversation an alternative perspective that addresses the decline in board resource provision caused by an external emphasis and pressure on board monitoring. While an increase in board monitoring can help reduce agency costs as suggested by agency theorists and advocates of corporate governance reforms (Adams et al., 2010; Fama and Jensen, 1983; Monks and Minow, 2011), we argue that it can also lead to an unintended consequence of undermining boards' contributions to organizational value creation through resource provision. More specifically, the formation of an independent nominating committee in response to an external emphasis on monitoring can cause (1) a divergence between board capital and firm-specific resource needs via a decline in information sharing between top managers and the committee in new director selection, and (2) a less collaborative CEO-board relationship via decreased trust between the CEO and the board, both of which reduce the board's capacity to perform the resource provision function. While our focus is on the board's capacity to perform the resource provision function, we would like to note that the dysfunctional dynamics in the CEO-board relationship can have negative consequences for the entire firm and its performance (Shen, 2003).

Second, by explaining how the external emphasis on board monitoring can lead to a decline in board resource provision, our paper also contributes to the understanding of the relationship between the two primary functions of corporate boards that have long been studied by organizational scholars from distinct theoretical perspectives (Hillman and Dalziel, 2003). Moreover, we pinpoint the removal of inside directors from the nominating committee (done to increase board independence) as a key to understanding the impact of an external emphasis on monitoring on the decline of board resource provision. Consequently, we suggest that bringing non-CEO top executives back onto the nominating committees could help to (1) reduce the divergence between board capital and firm resource dependence needs, and (2) create a more collaborative CEO-board relationship, alleviating the unintended negative impact of an external emphasis on monitoring on board resource provision.

While we propose that having a non-CEO inside director on the nominating committee can facilitate information sharing between top management and the board about the firm's resource needs and the development of a more collaborative relationship, we recognize that there are other mechanisms that may alleviate the negative impact of an external emphasis on monitoring on board resource provision. For example, boards may incentivize independent directors to devote more time to acquiring firm-specific knowledge by linking their pay to long-term firm performance (Shen, 2005). Moreover, boards may appoint a few outside directors who (or whose firms) invest resources in exchange for the power to monitor, as research on interlocking directorates and new ventures suggests that these directors have stronger incentives to both monitor and advise top managers than independent directors (Garg, 2013; Mizruchi, 1996). When top managers perceive that these outside directors' interests are also aligned with the firm's success, they are more likely to engage in interactions and information exchanges with outside directors to discuss their firm's strategic challenges and resource needs, leading to a more collaborative and productive relationship between top managers and the board (Garg and Eisenhardt, 2017). Finally, independent directors may turn to industry experts and consultants to help them acquire industry and firm-specific knowledge (Werther et al., 1995). All these mechanisms can potentially complement our focus on the nominating committee to enhance board resource provision in value creation.

Third, our paper contributes to the literature on corporate boards by explicitly considering and explaining the tradeoffs between monitoring and resource provision. While a few scholars have investigated how an increase in board independence (aimed at strengthening the monitoring function) demotivates the CEO from taking strategic risks, engaging in innovation, or seeking advice from independent directors (Faleye et al., 2011; Guldiken and Darendeli, 2016; Hoskisson et al., 2009), the literature has not yet systematically examined the potential tradeoffs between board monitoring and resource provision. We extend this limited research by proposing two mechanisms to explain how the formation of an independent nominating committee composed entirely of independent directors, intended to increase board independence and strengthen the monitoring function, may undermine boards' capacity to fulfill the resource provision function, thus leading to a tradeoff between board monitoring and resource provision.

Recognizing this tradeoff and understanding the underlying mechanisms are important, given the increasing regulatory and scholarly emphasis on the monitoring function of corporate boards (Aguilera and Cuervo-Cazurra, 2009; Finkelstein et al., 2009; Monks and Minow, 2011). Although the changes intended to improve board monitoring may contribute to a firm's performance through reduction of agency costs (Adams et al., 2010; Aguilera and Jackson, 2010; Boivie et al., 2016; Linck et al., 2009), policy makers and practitioners should be aware of the negative impact these changes may have on boards' contributions to firm performance through resource provision. Thus, instead of solely emphasizing the monitoring function, they may consider introducing new measures to help corporate boards balance monitoring and resource provision in shareholder value creation. Our theoretical analysis suggests that having a nominating committee composed of at least one non-CEO inside director and a majority of independent directors is key to ensuring a board's capacity to perform both the monitoring and the resource provision functions.

Fourth, we contribute to the literature on nominating committees by highlighting the nominating committee's important role in the relationship between board monitoring and resource provision functions. While scholars have advocated greater independence of the

nominating committee from an agency perspective (Guo and Masulis, 2015; Kolev et al., 2019; Monks and Minow, 2011; Shivdasani and Yermack, 1999), our theory suggests that a nominating committee composed entirely of independent directors may reduce the board's capacity to engage in resource provision. By identifying the composition of the nominating committee as key to both board monitoring and resource provision, our theoretical analysis integrates agency and resource dependence perspectives, and thus provides a deeper understanding of the link between nominating committee composition and board functions.

Implications for future research and practice

Our paper not only calls for greater attention to studying the relationship between the two primary board functions, but also provides some specific directions for future research on this important issue. First, researchers can investigate the negative relationship we propose and the two paths we identify between an external emphasis on monitoring and board resource provision. Although it is difficult to directly measure the tradeoffs between board monitoring and resource provision, many of our propositions are empirically testable. For example, to study the negative impact of an external emphasis on monitoring on board resource provision, researchers could survey top managers and directors about their perceptions of the external emphasis on monitoring as well as its impact on the CEO-board relationship, the alignment between board capital and their firms' resource dependence needs, and directors' engagement in resource provision. Alternatively, researchers could collect information from public sources such as company announcements, annual reports, and media coverage to develop measures of the above variables (e.g., Faleye et al., 2011).

Future research could also investigate and compare how the external emphasis on monitoring influences small, medium, and large firms differently. Given that large firms tend to be under greater external pressure to adopt corporate governance reforms (Knippen et al., 2019), we expect the external emphasis on monitoring to have a stronger negative impact on board resource provision in large firms than in small firms. In addition, researchers could investigate and compare how public versus private firms may respond differently to the calls for stronger board monitoring by appointing more independent directors. Research on the boards of private new ventures suggests that independent directors have less incentive to engage in monitoring and resource provision than non-independent directors who provide resources (such as capital) in exchange for the power to monitor (Garg, 2013; Garg and Eisenhardt, 2017). We thus expect private firms to be less responsive to calls for greater board independence and monitoring than public firms, and the dominance of non-independent directors to continue at the boards of private firms. Relatedly, future research may investigate how differences in ownership type, such as family ownership, state ownership, and institutional ownership, influence board responses to the external calls for greater monitoring, given that recent research indicates that ownership type has important implications for the extent to which boards emphasize monitoring versus resource provision (Federo et al., 2020).

Furthermore, we suggest that future research should pay special attention to the composition of the nominating committee, as our theory and propositions suggest that it plays a key role in the relationship between the board and top management. Although researchers in accounting, finance, and management have become increasingly interested in the impacts of board committees, most studies focus on the auditing and compensation committees (Kolev et al., 2019). Among the few studies of the nominating committee, the focus is largely on how its independence impacts firm performance from an agency perspective (e.g., Grinstein and Hribar, 2004; Guo and Masulis, 2015; Nguyen and Nielsen, 2010), and the findings are mixed (Kolev et al., 2019). Our paper not only explains why having an independent nominating committee may not have a positive impact on firm performance (i.e., by leading to a decline in board resource provision), but also points out specific directions for future empirical research on the nominating committee.

For example, researchers can investigate how the composition of the nominating committee (as indicated by the presence of a non-CEO among the directors) influences the appointments of new directors as well as the relationship between the board and top management. Extending our focus on non-CEO inside directors, future research could also pay attention to the backgrounds and experiences of independent directors on the nominating committee. Given that independent directors may acquire firm-specific knowledge over time, having independent directors with a longer tenure might help us to better understand the firm's specific resource dependence needs and then identify candidates who can address these needs. Meanwhile, unless these long-tenured independent directors have a good relationship with the CEO, their presence on the nominating committee might not contribute to the development of a more collaborative CEO-board relationship. We would like to note that our paper, nonetheless, is only a first step toward gaining a better understanding of the effect of the nominating committee on the relationship between the board and top management. Moving forward, we urge researchers to investigate other mechanisms through which practices designed to strengthen board monitoring may influence board resource provision as well as the relationship between the board and top management.

Lastly, our theory has important practical implications. The recent developments in corporate governance theory and practices toward tightening control over management through increased board monitoring are intended to improve firm performance. However, our theory suggests that these changes may have a negative effect on firm performance by inadvertently reducing boards' contributions to firm performance through resource provision. Firms thus should be aware of the tradeoffs between agency cost reduction and organizational value creation when deciding the extent to which they want to increase the level of board monitoring. More importantly, they should consider what they can do to increase board monitoring to a certain extent without significantly undermining boards' capacity to fulfill the resource provision function, such as giving top executives a minority position on the nominating committee, as our theory suggests.

CRedit authorship contribution statement

Wei Shen: Conceptualization, Writing – review & editing. **Yuliya Ponomareva:** Writing – original draft, Conceptualization. **Timur Uman:** Writing – review & editing, Project administration.

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