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The role of nominating committees and director reputation in shaping the labor market for directors: an empirical assessment

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THE ROLE OF NOMINATING COMMITTEES AND DIRECTOR REPUTATION IN SHAPING THE LABOR MARKET FOR DIRECTORS: AN EMPIRICAL ASSESSMENT

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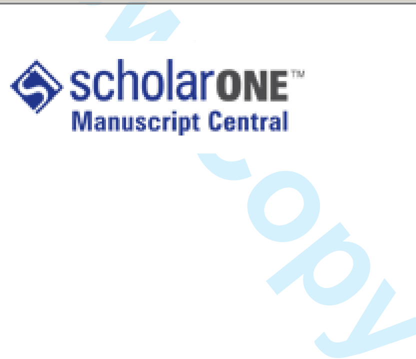
Keywords:	Nominating committee < Board Committees, Corporate Governance Codes < Board Policy issues, France < Governance Environments



THE ROLE OF NOMINATING COMMITTEES AND DIRECTOR REPUTATION IN SHAPING THE LABOR MARKET FOR DIRECTORS: AN EMPIRICAL ASSESSMENT.

ABSTRACT

Manuscript type: Empirical

Research Question/Issue: Do the presence and independence of nominating committees within boards of directors affect the extent of rewards and sanctions provided by the labor market to directors with a reputation for being active in monitoring management?

Research Findings/Insights: Results drawn from a longitudinal sample of directors sitting on the board of 200 public French firms suggest that the stronger a director's reputation for being active in increasing control over management, the larger the number of his/her subsequent appointments to (1) boards with a nominating committee, (2) to boards with a nominating committee which excludes the CEO and (3) to boards with a nominating committee dominated by non-executive directors. In contrast, we found that a director's reputation of being active in increasing control over management does not impact the number of his/her subsequent appointments (1) to boards without a nominating committee, (2) to boards with a nominating committee which includes the CEO and (3) to boards with a nominating committee dominated by executive directors.

Theoretical/Academic Implications: This study shows that the outcome of the power struggle between the CEO and incumbent directors during the candidate selection process determines the profile of directors who will ultimately obtain the board appointment. On the one hand, independent nominating committees are likely to reduce the influence of CEOs over the process of a director's appointment, and therefore are likely to increase the recruitment of directors with reputations for being active in exercising control over managers. On the other hand, nonexistence of nominating committees or presence of weak nominating committees under the influence of the CEO decouple directors' reputations for being active in controlling management from the likelihood of obtaining new appointments.

Practitioner/Policy Implications: This study offers insights to policy makers interested in increasing the efficiency of the labor market for directors. More specifically, it highlights the conditions under which directors with a reputation of being active in increasing control over management are likely to be rewarded by the labor market for directors. These conditions include (1) the creation of a nominating committee; (2) exclusion of the CEO from this committee and (3) domination of this committee by outside directors.

Keywords: Corporate governance, nominating committee, director reputation, France, labor market for directors.

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INTRODUCTION

A rich stream of research in organization theory and the sociology of corporate elites has challenged the perspective suggesting that directors who exercise their monitoring duty with due diligence are rewarded by the market for directors while those who do not accomplish this duty appropriately are sanctioned by the market. Indeed, several empirical studies have shown that powerful individual CEOs influence the director selection process by pushing for the appointment of directors who are less likely to challenge their decisions and by denying nomination or reelection of directors who are likely to do so (Lorsch & MacIver, 1989; Shivdasani & Yermack, 1999; Zajac & Westphal, 1996). Such CEOs also facilitate the appointment of directors having similar sociological and demographic characteristics as themselves; since these directors are likely to exercise less stringent control (Westphal & Zajac, 1995). Moreover, several empirical studies have indicated that social ties among members of the elite class have a higher predictive power on director appointment than director inclination to increase monitoring and control over management (Davis & Greve, 1997; Hermalin & Weisbach 1998; Mizruchi, 1996; Palmer, 1983; Pettigrew, 1992).

Faced with evidence indicating the inefficiency of the labor market for directors and in the context of shareholder capitalism in which shareholders' demands for greater power are increasing (Davis & Thompson, 1994; Monks & Minow, 2004), it has been necessary to reform the way in which directors are appointed. In particular, various reports on corporate governance stressed the need to modify the process of director appointment through the creation of nominating committees within boards of directors (AMF, 2004; Bouton, 2002; Cadbury, 1992; Cuervo-Cazurra & Aguilera, 2004; The Combined Code, 2000; Vienot, 1995, 1999). The mission of these specialized committees is to define the profiles of directors needed on the board and to suggest future director candidates. The need to create nominating committees is in line with the logic established by agency theory (Fama, 1980; Jensen &

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Meckling, 1976) which underlines the need to separate the firm's control and management functions. From this perspective, nominating committees should be able to reduce the influence of firm CEOs on the process of director selection.

Despite the widespread presence of nominating committees on corporate boards, only a few studies have examined the impact of these committees on the functioning of the labor market for directors. This paper attempts to fill this gap by examining whether the presence and the independence of nominating committees moderate the relationship between a candidate director's reputation for increasing control over management and the number of his/her subsequent appointments. More specifically, we suggest that if nominating committees reduce the influence of the CEO on the process of director selection, then it is expected that director reputation for exercising monitoring duty with due diligence will be positively linked to director's number of subsequent appointments to boards having a nominating committee. On the other hand, such reputation is expected to be negatively linked to or disconnected from director's number of subsequent appointments to boards without a nominating committee; as the CEO's influence on the selection process will hinder such appointments. However, the CEO may interfere in the designation of new directors if the nominating committee is not independent, for instance, if the CEO is a member of the nominating committee or if this committee is dominated by executive directors. Therefore, it is likely that the stronger a director's reputation for actively fulfilling the monitoring mission the larger the number of his/her subsequent appointments to boards in which the CEO is not a member of the nominating committee and to boards in which the nominating committee is dominated by non-executive directors. Conversely, such director's reputation will be negatively linked to or decoupled from his/her number of subsequent appointments to boards in which the CEO is a member of the nominating committee and to boards in which the nominating committee is dominated by executive directors.

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We examined the moderating impact of the presence and independence of nominating committees on the relationship between a director's reputation and his/her number of subsequent appointments using a sample of 7135 director-year observations related to board members of 200 public French firms over the 2001-2004 period. Our results indicate that the presence and the independence of nominating committees reinforce the link between director reputation for being active in monitoring the CEO and the number of subsequent appointments. These results highlight the conditions under which the labor market rewards directors fulfilling their monitoring duty with due diligence, and hence, provides incentives for directors to adopt valued behaviors and control practices.

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This paper contributes to the literature in several ways. First, this study extends previous research by highlighting the need to take into consideration the conditions under which directors nominating process occurs in order to fully understand the effect of reputation on the operation of the labor market for directors. Indeed, our results indicate that the outcome of the CEO-directors power struggle during candidate selection process, captured by the presence and independence of nominating committees, determines the extent of association between a director's reputation and his/her future appointments. Therefore, our paper provides a possible explanation for the mixed results shown in previous studies which examined gain of appointments to bards without considering the selection context within boards. Indeed, a number of those studies have shown that external labor market rewards directors who exercise their monitoring duty with due diligence and sanctions directors who do not accomplish this duty appropriately. For instance, Coles and Hoi (2003) found that non-executive directors that rejected Pennsylvania Senate Bill 1310 antitakeover provisions are nearly three times more likely to gain new board seats than non-executive directors that retained all antitakeover provisions. Similarly, Fich and Shivdasani (2007) found that outside directors of firms accused of fraud bear a large decline in the number of their subsequent appointments.

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However, other studies have indicated that lax directors are not sanctioned by external labor market and that, in some cases, they are actually rewarded with additional board seats. For example, Agrawal, Jaffe and Karpoff (1999) found little evidence suggesting that directors of firms suspected or charged with fraud suffer a reputational impact reducing the number of their subsequent appointments, while Helland (2006) found that outside directors of firms facing class action lawsuits actually increase their net number of new board positions. Such mixed results may be attributed to methodological considerations such as differences in the way reputation was measured or in sample characteristics. They may, however, be also attributed to the failure to capture the impact of the power struggle between CEOs and directors occurring during the nomination process. Hence, the first contribution of this study is to take into account the balance of power between the CEO and directors, through the presence and independence of nominating committees, in uncovering the reputation-subsequent director appointments relationship.

Second, this study extends previous research which has considered the moderating role of the context in which director nomination occurs. For example, Zajac and Westphal (1996) showed that the balance of power between the CEO and directors during the selection process, reflected by the ratio of outside directors, CEO/board chair separation, firm diversification and CEO compensation design, moderates the impact of a director's reputation and the likelihood of subsequent appointments. Our study extends Zajac and Westphal (1996) research by considering the moderating impact of another important dimension which defines the balance of power between CEO and directors in the selection process: the nominating committee. This dimension is particularly important since nominating committees, which are nowadays highly diffused across firms, lie at the heart of directors' selection process and are very likely to influence its outcome.

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Finally, this paper complements other studies which have examined the impact of nominating committees on director selection process and outcome. For example, Shivdasani and Yermack (1999) showed that when a focal CEO serves on the nominating committee or no nominating committee exists, firms appoint fewer independent outside directors and more gray outsiders with conflicts of interest. Our study extends Shivdasani and Yermack, (1999) research by adopting a different level of analysis as well as an action-oriented operationalization of director reputation. More specifically, in this study we consider new board appointment at the individual level of analysis (vs. firm level) and we operationalize director reputation using the number of actual actions increasing control over management initiated by the director instead of directors' potential conflict of interests (insider, outsider, gray).

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This paper is structured as follows. First, we describe the role of director reputation in the operation of labor market for directors. Next, we discuss how the introduction of nominating committees has brought about changes in the market for directors. Then, we present the moderating impact of the composition of nominating committees on the relationship between director reputation and the number of subsequent appointments. Next, we describe the empirical context and methodology we used to test our hypotheses and present the main results of our empirical study. We conclude by a discussion of major implications of our findings to agency and institutional theories.

THEORY AND HYPOTHESES

The Role of Director Reputation in the Labor Market for Directors

Agency theory and signaling theory suggest that director's reputation plays a pivotal role in the efficient functioning of the labor market for directors, as it may provide a relevant signal on which the sanctioning/rewarding system operated by the market can rely (Certo, 2003; Fama, 1980; Spence, 1974). Indeed, very often there exists information asymmetry

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between the board of directors in charge of director selection and the potential director candidates (Akerlof, 1970). This information asymmetry occurs because the board of directors is not in possession of all the relevant information concerning the potential director candidates and because the latter may have an incentive to misrepresent important information. This information asymmetry can lead to mistaken assumptions about competencies and the future behavior of the potential director candidates. When market conditions are conducive to such errors, the board of directors will rely on signals to obtain a more reliable evaluation of competencies and future conduct of the potential director candidates. To be credible, such signals must be both observable and costly to imitate (Certo, 2003; Spence, 1974).

A rich stream of research in corporate governance literature suggests that director candidates' reputation may represent a trustworthy signal on which the board of directors can rely in the selection process (Agrawal et al., 1999; Fama, 1980; Fich & Shivdasani, 2007; Helland, 2006; Coles & Hoi, 2003; Huse, 2007; Kim & Cannella, 2008; Zajac & Westphal, 1996). Most often, director candidates' reputation is built upon their previous experiences and past actions (McGuire, Sundgren & Schneeweis, 1988, Zajac & Westphal, 1996). The main assumption being that such experiences will shape the behavior of the director in the future and that past actions are expected to be reproduced in future appointments.

Directors' reputation, as a signal for their competencies and behavior, has been appraised in several different ways in the literature. For instance, research studies adopting primarily a resource dependence perspective have investigated the role of directors' human capital (Huse, 2007), social capital (Kim & Cannella, 2008), as well as the size and performance of firms in which they holds mandates (Fama, 1980) in determining the number of their subsequent appointments. On the other hand, research studies taking an agency perspective have mainly examined the impact of signals capturing directors' inclination in exercising control and monitoring duties on the likelihood of obtaining future board

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appointments (Agrawal et al., 1999; Fich & Shivdasani, 2007; Helland, 2006; Coles & Hoi, 2003; Zajac & Westphal, 1996). This reputation is established by the director's previous experience on a board that effectively exercised the monitoring function. This experience, in turn, demonstrates the ability of the director to be active in exercising increased control over management. Inversely, if the director participated in boards on which little monitoring was undertaken, the reputation for passiveness made that director a preferred candidate on boards that had a powerful CEO (Zajac & Westphal, 1996). Accordingly, Agrawal, Jaffe and Karpoff (1999) and Fich and Shivdasani (2007) examined whether directors of firms suspected or charged with fraud suffer a reputational penalty reducing the number of their subsequent appointments. Helland (2006) studied whether outside directors of firms facing class action lawsuits experience a negative reputational effect. Similarly, Coles and Hoi (2003) investigated whether directors' rejection of antitakeover provisions has any reputational consequences on the labor market for directors.

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Reputation is a social construct. It is formed and legitimized by an institutional environment that defines which individual characteristics are desirable and appropriate. Reputation signals the position of a particular individual within a symbolic environment to the outside world justified by a set of shared norms and beliefs (DiMaggio, 1991; Feldman & March, 1981; Rao, 1994). Recently, numerous institutional changes have contributed to the definition of "best practices" on boards of directors (Aguilera & Cuervo-Cazurra, 2009; Bouton, 2002; Cadbury, 1992; Cuervo-Cazurra & Aguilera, 2004; The Combined Code, 2000; The Working Group on Corporate Governance, 1991; Vienot, 1999). Directors' reputations, therefore, have been established based on whether the behavior of these directors could be considered active within the framework of board "best practices" seeking to strengthen the monitoring of managers by directors. Therefore, in this study we adopt an action-oriented definition of director reputation capturing the number of actual actions, intended to increase

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control over management, initiated by the director and advocated by institutionalized "best practices" codes. Such actions include the increase in the percentage of outside directors, the creation of nominating and remuneration committees, the adoption of the two-tiered board structure, or the separation of the CEO and board Chair functions. Potential director candidates past participation in implementing such actions may provide a relevant signal on their inclination to exercise their monitoring duty because these actions are observable and costly to imitate. First, these actions are observable because board members in charge of the selection process can verify their implementation in annual reports, proxy statements and business media coverage. Second, they are costly or difficult to imitate because implementing such actions is both effort and time consuming. Indeed, the adoption of norms increasing control over management is likely to face strong resistance from the CEO. Moreover, director reputation is not necessarily a reflection of his/her number of attempts to put in place practices that increase control over management, but it is rather, a reflection of the number of successful attempts. A director may fight fiercely for the adoption of specific monitoring practices, but if such resolutions are voted down by the board, director attempts would have little affect his/her reputation.

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The Moderating Impact of Nominating Committees on the Market for Directors

According to both the agency theory based view and the political view of director selection, the market for directors is influenced by two opposing forces. On the one hand, the shareholders' preference for increased monitoring and control over management pushing for the appointment of "active" directors exercising their duty with diligence (Lorsch & MacIver, 1989; Richarson, 1987; Zajac & Westphal, 1996). On the other hand, the resistance of the managerial elite to increased shareholder controls pushing for the appointment of "passive" directors less likely to challenge their decisions (Davis & Greve, 1997; Hermalin & Weisbach 1998; Pettigrew, 1992). These conflicting preferences are likely to initiate a power struggle

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during the director selection process between the CEO and incumbent directors, acting on behalf of shareholders. The balance of power between the CEO and incumbent directors is likely to determine the profile of directors who will ultimately obtain the board appointment.

Empirically, several studies have documented that the power struggles between CEOs and incumbent directors during director selection process are very often won by powerful CEOs. For instance, Westphal and Zajac (1995) found that CEOs were able to influence the director selection process and nominate directors having similar sociological and demographic characteristics as themselves and who are less likely to exercise stringent control. Similarly, Shivdasani and Yermack (1999) found that CEOs, who were members of the nominating committee, were able to resist to the appointment of independent outside directors and to favor the appointment of non independent executive directors. This CEOs influence over the director appointment process is problematic because it weakens the monitoring functions of the board. In light of such evidence, the idea that active directors are selected thanks to efficient market mechanisms appears, according to many studies, to correspond only to theory and not to observed practices.

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As a result of growing evidence provided by both practitioners and academics indicating that CEOs wield major influence in selecting new board members, several reports on corporate governance all over the world have recommended the creation of nominating committees within boards of directors (Aguilera & Cuervo-Cazurra, 2009; Bouton, 2002; Cadbury, 1992; Cuervo-Cazurra & Aguilera, 2004; The Combined Code, 2000; The Working Group on Corporate Governance, 1991; Vienot, 1995, 1999). The roles of nominating committees are primarily to define the profile of directors to be recruited, to identify potential directors which match the defined profile and to suggest the nomination of suitable candidates. The assumption underlying the expectation that nominating committees are likely to reduce the influence of CEOs on the selection process and, consequently, to favor the

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appointment of active directors relies on three main arguments. First, the establishment of a nominating committee is likely to improve the separation of management and control in the firm (Shivdasani & Yermack, 1999). Second, these committees provide the resources and the legitimacy necessary for committees' members to independently exercise their duties on the board (Huse, 2007; Pettigrew & McNulty, 1995). Third, nominating committee members will be judged, more than other board members, with regard to the recruitment decisions taken. Nominating committee members have a strong interest in maintaining their own reputations by recruiting directors who will prove to be effective monitors of management. Financial authorities generally require that the annual report presents not only the financial results of listed companies, but also the names of the members of nominating committees and a review of the work carried on during the year by these committees. The transparency provided by this report regarding the nomination process of new board members increases the accountability of nominating committee members, since the report gives shareholders access to information related to the nomination process.

Hence, nominating committees are likely to reduce the influence of CEOs over the process of director appointment, and therefore increase the recruitment of directors with reputations for being active in increasing control over managers. That is, directors with a reputation of being active in implementing reforms and new procedures that have been called for by corporate governance codes and reports will be rewarded by the market for directors by gaining new appointments in firms with a nominating committee. Conversely, the CEO is more likely to influence director selection process to his/her advantage in firms without a nominating committee. Indeed, a focal CEO is likely to successfully push for the nomination of director candidates with a reputation of being passive if the balance of power against incumbent directors is noticeably in his/her benefit or to successfully decouple potential director candidates reputations' from the likelihood of appointments if the balance of power

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against incumbent directors is equal. In the latter case, both active and passive directors are likely to be appointed to the board, which means that neither active nor passive directors will receive a higher reward/punishment in the labor market for directors.

Thus, we suggest that the strength and the sign of the relationship between a director's reputation and the number of his/her subsequent board appointments depend upon the presence or not of nominating committees. A director's reputation for increasing control over management will be positively related to the number of his/her subsequent appointments to boards with a nominating committee. On the other hand, a director's reputation for increasing control over management will be negatively or non-significantly related to the number of his/her subsequent appointments to boards without a nominating committee. This moderating role of the presence of a nominating committee is illustrated by the following hypothesis:

Hypothesis 1: the presence of a nominating committee moderates the relationship between a director's reputation for increasing control over management and the number of his/her subsequent appointments.

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The Moderating Impact of Nominating Committees Composition on the Market for Directors

Some researchers have suggested that creating nominating committees does not necessarily reduce the influence of CEOs over the director appointment process. The creation of a nominating committee may only shift the problem of CEO influence away from the board as a whole to the nominating committee (Garcia Osma & Gill-de-Albornoz Noguer, 2007; Shivdasani and Yermack, 1999). Under certain circumstances, in fact, the CEO might be able to exercise his strong power and influence over the nominating committee in order to reduce the likelihood that active directors will be appointed and that the monitoring of management will be increased.

The CEO can significantly influence the nominating committee, in order to neutralize its impact on the type of director recruited, in several manners. In particular, the CEO may

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increase his/her power over the director selection process if he/she is a member of the nominating committee or if the committee is dominated by executive directors. Indeed, if the CEO is a member of the nominating committee, he/she will be able to influence discussions, put pressure on other committee members, or come to implicit contracts with certain committee members that would favor the appointments that he/she supports. For instance, Shivdasani and Yermack (1999) have shown that CEO membership in the nominating committee reduces the chances of recruiting an independent outside director and increases the chances of recruiting a non-independent executive director. In line with these findings, we suggest that if the CEO is not a member of the nominating committee, the committee is likely to be more willing to and capable of appointing active directors. Accordingly, an active director is likely to be rewarded by the market for directors in firms with a nominating committee which excludes the CEO. On the other hand, if the CEO is a member of the nominating committee he/she is likely to effectively press for the appointment of director candidates with a reputation of being passive if the balance of power in comparison with incumbent directors is clearly in his/her favor. If the balance of power against incumbent directors is even, then the CEO is likely to successfully decouple potential director candidates' reputations from the likelihood of their appointments. In this case, active and passive directors are as likely to be appointed to the board and no specific reward or punishment will materialize in the labor market for directors.

Hence, we suggest that a director's reputation for increasing control over management will be positively related to the number of his/her subsequent appointments to boards with a nominating committee which excludes the CEO. On the contrary, a director's reputation for increasing control over management is negatively or non-significantly related to the number of his/her subsequent appointments to boards with a nominating committee which includes

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the CEO. This moderating effect of CEO's membership in the nominating committee is illustrated by the following hypothesis:

Hypothesis 2: CEO's membership in the nominating committee moderates the relationship between a director's reputation for increasing control over management and the number of his/her subsequent appointments.

Even if the CEO is not actually a member of the nominating committee, committee members could consult the CEO, or the CEO could offer his/her own opinion regarding potential directors. It is for this reason that CEO membership in the nominating committee alone underestimates the CEO influence on nominating committee independence (Shivdasani & Yermack, 1999).

CEO influence over the director selection process is likely to be reduced the more the nominating committee is comprised of non-executive directors (Dalton, Daily, Ellstrand & Johnson, 1998; Higgs, 2003). Without a majority of non-executive directors, executive directors will be able to appoint the very individuals who are responsible for monitoring them. In these circumstances, the executive directors would be even further subject to the CEO's influence, since they are already answerable to him/her in the organizational hierarchy (Weisbach, 1988). This is not the case with non-executive directors. Codes of corporate governance recommend that a majority of board members sitting on the nominating committees be non-executive directors, in order to better assure the effectiveness of the committee. It is the outside directors who are called upon to ensure real competition for available board seats, and to oversee the selection of active directors who will fulfill their mission of genuine monitoring of management (Fama, 1980).

A nominating committee whose majority consists of executive directors, or one on which the CEO has a seat, is a committee on which the principle of the separation of management and control is not respected. Such circumstances work against the independence and impartiality of the committee, and corrupt the process whose aim is to ensure the

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nomination of new board members who will be impartial. Therefore, we suggest that if the nominating committee is dominated by executive directors, then both the CEO and executive directors will be able to effectively neutralize the nominating committee. On the other hand, we suggest that a nominating committee which consists of a majority of non-executive directors is likely to favor the recruitment of active directors. Accordingly, an active director is likely to be rewarded by the market for directors in firms with a nominating committee dominated by non-executive directors. On the contrary, it is likely that there will be no reward for an active director in firms in which a nominating committee is dominated by executive directors.

Accordingly, we suggest that a director's reputation for increasing control over management is positively related to the number of his/her subsequent appointments to boards in which the nominating committee is dominated by non-executive directors. In contrast, a director's reputation for increasing control over management is negatively or non-significantly related to the number of his/her subsequent appointments to boards in which the nominating committee is dominated by executive directors. Therefore, we suggest the following hypothesis:

Hypothesis 3: The ratio of non-executive directors within the nominating committee moderates the relationship between a director's reputation for increasing control over management and the number of his/her subsequent appointments.

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METHODS

Empirical Context

We tested our three hypotheses using a sample including all directors sitting on the boards of the 200 largest listed French firms, in terms of market value, over the period 2001-2004. The French context over this period offers an appropriate empirical setting to investigate the interaction between directors' reputations and nomination committees in shaping the labor market of directors for several reasons.

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Directors' reputations are shaped and legitimized by an institutional environment which delineates which characteristics and behaviors are desirable (DiMaggio, 1991; Feldman & March, 1981; Rao, 1994). In France over the period under study, directors' reputations to exercise their monitoring duty with due diligence has been largely built upon their inclination to implement corporate governance reforms recommended by three influential reports: Vienot I, (1995), Vienot II, (1999) and Bouton, (2002). This was a result, in large part, of three phenomena.

First, France has witnessed a significant increase in the level of foreign institutional ownership over the period 2001-2004, primarily from Anglo-American mutual and pension funds. These foreign institutional investors, which controlled 42.4 percent of the equity capital of CAC 40 firms in 2002 (Bank of France Bulletin, 2004), have exerted strong institutional pressure for the adoption in France of corporate governance reforms similar to those which were implemented in their countries of origin. The emergence in the UK of governance codes having an almost-legal status (Cadbury, 1992; The Combined Code, 2000) or in the United States, with references to the debates surrounding the Enron scandal or the legislative consequences of the Sarbanes Oxley Act (2002), acted as a kind of benchmark for corporate governance actors in France.

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Second, the three French corporate governance reports have been produced under the leadership of two highly influential CEOs of *Société Générale* bank and were strongly supported by the French business confederation (MEDEF). This strong support has been motivated by a fear that the French state put in place stringent and compulsory laws for regulating the operation of the board of directors after several governance scandals. The media attention devoted to governance scandals (e.g. Vivendi, Rhodia) and subsequent board reforms considerably increased the central role played by directors' inclination to implement reforms on the shaping of their reputation.

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Third, the adoption of the Vienot I (1995), Vienot II (1999) and Bouton (2002) corporate governance reforms, recommending the separation of CEO and Chairman of the board positions, the establishment of specialized committees such as the nominating and compensation committees as well as a higher proportion of independent directors, is entirely voluntary. The Euronext Paris stock exchange neither conditions a firm's listing to the adoption of these corporate governance reforms nor does it participate in elaboration and enforcement of reports' recommendations (Christiansen & Koldertsova, 2009). Similarly, the French financial markets authority (AMF) does not require listed companies to adopt practices recommended by French reports, but only recommends firms to refer to one of these reports as a reference for drafting the annual report. As the adoption or non-adoption of reforms is at directors' discretion, it represents a strong signal depicting the extent to which directors' are inclined to control and monitor management. This is particularly true for directors which resist to institutional pressures and do not implement recommended reforms. Such directors are likely to be identified as passive directors under the influence of CEOs.

As reported in table 1, a large number of firm boards have adopted over the 2001-2004 period the set of reforms advocated by French corporate governance reports such as increasing the ratio of outside director, creating nominating and compensation committees and separating the CEO and board Chair functions. However, due to the non compulsory nature of such recommendations, several other firm boards have resisted to such institutional pressures and did not comply with these best practices. This high variance along key variables capturing directors' reputations and the presence of nominating committees constitutes a pertinent empirical context to test our hypothesis. In our sample, we observe a continuous increase in the number of firms having created a nominating committee. Indeed, while only 18.5 percent of our sample had a nominating committee in 2001, 41 percent of our sample had a nominating committee in 2004. The same trend is observed for the other dimensions as the

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proportion of firms which established compensation committees increased from 38 percent to 63 percent, the average ratio of non-executive directors increased from 59 percent to 67 percent and the ratio of firms separating the roles of CEO and Chairman which increased from 4 percent to 12 percent. In contrast, the ratio of firms that have adopted the two-tier board structure has remained stable at 32 percent. Over the period under study, an average of 16.6 percent of nominating committees included the CEO while 10 percent were dominated by executive directors.

Insert Table 1 about here

Another interesting feature of the French context is related to the social structure of elites in France. Indeed, there exists a highly dense social network of ties among the French elite, institutionally created through the grande écoles, grands corps and business associations, facilitating the diffusion of information related to individuals' actions (Burt, Hogarth & Michaud, 2000; Kadushin, 1995; Maclean, Harvey & Press, 2006). That is, signals related to directors' reputations, shaped by the number and type of reforms they adopts, are easily and rapidly diffused and captured by the different actors in the network. This in turn, increases the observability of actions aiming at increasing control over management in the labor market for directors, which is a necessary condition for the signal to be influential.

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Finally, despite an increasingly growing diffusion of nominating committees in French and continental European firms, to our best knowledge empirical investigation of the impact of these committees on the operation of the labor market for directors outside the U.S. context is nonexistent. This literature gap motivated our use of the French context to test our hypotheses.

Dependent Variables

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Gain of appointments to boards. To calculate the number of new mandates obtained by each director in year $_{t+1}$, we first identified all mandates he/she held in year $_t$ and year $_{t+1}$. Then, we counted the number of mandates occupied by the director in year $_{t+1}$ which he/she did not hold in year $_t$. In total we created six dependent variables capturing the number of new mandates obtained by a focal director in year$_{t+1}$ in each of the six situations described by the hypotheses. Hence, for hypothesis 1 we created two count variables indicating the number of new mandates obtained by each director in year$_{t+1}$ on (a) firms having nominating committees and on (b) firms without nominating committees. Similarly, for hypothesis 2, we created two count variables indicating (a) the number of new mandates obtained by each director in year $_{t+1}$ on firms having nominating committees in which the CEO is a member and (b) the number of new mandates obtained on firms having nominating committees in which the CEO is not a member. For hypothesis 3, we defined two count variables indicating (a) the number of new mandates obtained by each director in year $_{t+1}$ on firms having nominating committees composed of more than 50% of non-executive directors and (b) the number of new mandates obtained by each director on firms having nominating committees composed of less than 50% of non-executive directors. Data on gains of appointments to boards for each director and for each year were collected from annual reports and reference documents filed with the French financial markets authority (AMF). As our three hypotheses assert a causal effect of directors' reputations on the number of their subsequent appointments, we created a one-year lag between independent variables (measured from 2001 through 2004) and dependent variables (measured from 2002 through 2005) in all regression models. Over the period 2002-2005, directors included in our sample obtained a total of 1166 new appointments distributed as follows: 263 in year 2002, 345 in year 2003, 307 in year 2004 and finally, 251 in year 2005.

Independent Variables

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Directors' reputations. Directors' reputations for being active or passive in exercising control over management have been measured in several ways in the literature. On the one hand, a number of studies relied on a single signal to proxy directors' reputations. For instance, Agrawal, Jaffe and Karpoff (1999) and Fich and Shivdasani (2007) captured directors' reputations by examining whether firms on which they serve were suspected or charged with fraud. Similarly, Helland (2006) measured directors' reputations by investigating whether directors served on firms facing class action lawsuits. Coles and Hoi (2003) used rejection or acceptance of antitakeover provisions as a proxy of their inclination to exercise control over management. Shivdasani and Yermack, (1999) inferred directors' propensity to accomplish their monitoring duty by considering whether they were insiders (under the influence of the CEO), gray outsiders (who have conflicts of interests) and independent outsiders. On the other hand, several studies adopted a multi-criteria approach to proxy directors' reputations. For example, Zajac and Westphal (1996) measured directors' reputations through the number of actions their undertook to increase the ratio of outside directors, to separate CEO-board chair functions, to reduce firm diversification and to design CEO compensation packages closely linked to firm performance in boards they served. In line with this stream of research, we measured directors' reputations using five indicators which have been linked, in both the academic literature and codes of corporate governance (Bouton, 2002; The Combined Code, 2000; Vienot, 1995; Vienot, 1999), to the extent to which a board exercises strong control over management. These five indicators captured the involvement of the focal director in increasing the (1) ratio of the number of non-executive directors relative to the total number of directors, (2) in putting in place a nominating committee or (3) a compensation committee, (4) in separating the roles of CEO and Chairman of the board or (5) adopting a two-tier board structure (Boyd, 1995; Aste, 1999). More specifically, for each director i and for each year t we counted the number of actions the focal director implemented

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in the board in which he/she served along these five indicators. If the board in which the director served increased the ratio of the number of non-executive directors relative to the total number of directors by more than one standard deviation between year $_{t-1}$ and year $_{t.}$ this was counted as one action. If the board in which the director served put in place a nominating committee between year $_{t-1}$ and year $_{t.}$ this was counted as another action. The same counting rule was applied when the board in which the director served implemented a compensation committee, separated the roles of CEO and Chairman of the board or adopted a two-tier board structure between year $_{t-1}$ and year $_{t.}$ Hence, if director *i* implemented all five actions between year $_{t-1}$ and year $_{t.}$ he/she received a maximum score of 5. If no such actions were implemented, he/she received a score of 0. If the focal director *i* served on many boards in year $_{t.,}$ then we took the sum of actions he/she performed in all boards. Accordingly, a director's reputation score varies from 0, if the director did not implement any action in all his/her mandates between year $_{t-1}$ and year $_t$ to a maximum of (5 x number of mandates) if the director implemented the five actions in all his/her mandates between year $_{t-1}$ and year $_t$. As each additional action is likely to be perceived as a further signal for director's propensity to increase control, we decided to use a count variable instead of a ratio. The larger a director's score, the more he/she will be perceived in the labour market for directors as an active director. Data on the ratio of non-executive directors relative to the total number of directors, on nominating committees, on compensation committee, on CEO duality and on two-tier board structure were collected from annual reports and reference documents filed with the French financial markets authority (AMF).

Control Variables.

Corporate governance literature suggests that the role of directors is not only to control and monitor executive managers, but it is also to provide the firm with needed resources. More specifically, the resource dependence perspective suggests that directors are appointed

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in order to provide the firm with legitimacy, advice, counsel, and links to other organizations (Hillman & Dalziel, 2003, Pfeffer & Salancik, 1978). Accordingly, we controlled for possible confounding effects of this additional directors' role using a total of four variables. These four control variables capture resources related to human capital and relational capital which may explain the recruitment of the focal director (Hillman & Dalziel, 2003; Kim & Cannella, 2008; Zahra & Pierce, 1989).

Performance of firms on whose boards a director sits. This is a key factor that can significantly affect the number of his/her subsequent appointments. Indeed, directors who sit on the boards of profitable firms are more likely to signal to the labor market for directors a higher advice and counseling expertise than directors sitting on the boards of underperforming firms (Fama, 1980). Therefore, we included the average return on assets of firms on whose board the director sits as a control variable. Data on firm return on assets were obtained from Thomson one banker database.

Size of firms on whose boards a director sits. Serving on the boards of large firms might lend great prestige since it may signals that such directors are exposed to, and deal successfully with higher levels of complexity than do directors who sit on the boards of small firms (Fombrun & Shanley, 1990; Markarian & Parbonetti, 2007). Consequently, we included the average size of firms on whose boards the director sits, measured by total annual sales in billion dollars, as a second control variable. Data on firm annual sales were obtained from Thomson one banker database.

Director's age. Director's age can have an effect on his/ her reputation for providing legitimacy and advice to firms (Zajac & Westphal, 1996). For example, young directors could be considered more open to reforms. Young directors, however, might be considered too inexperienced to be effective. Therefore, director's age, in years, constituted our third control variable. Data on director's age were obtained from annual reports, reference documents filed

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with the French financial markets authority (AMF), Who's Who in France, Bloomberg, Thomson one banker, Factiva and the *Guide des Etats majors* annual publication.

Director's relational capital. Director's network of ties constitutes an important relational resource valued by the labor market for directors (Palmer, 1983; Pfeffer & Salancik, 1978). Indeed, this network of ties may facilitate the acquisition of information in firm markets, and hence, may decrease firm scanning costs and increase the diffusion of innovation (Hillman & Dalziel, 2003). We measured a director relational capital, for each year, using the ratio of closeness centrality (Brass & Burkhardt, 1993; Freeman, 1979; Geletkanycz, Boyd & Finkelstein, 2001; Rowley, 1997). This ratio measures the ability of a director in a network to gather information from, or transmit information to, all the members of the network, in an efficient manner. This efficiency is inversely proportional to the number of intermediaries who must be reached in order to contact or be contacted by the other members of the network (Wasserman & Faust, 1994). A high measure of closeness centrality indicates that a director can know or be known by the other network members more easily, as well as benefit from better recruitment opportunities (Freeman, 1979). Furthermore, a director with a high measure of closeness centrality will depend less on intermediary directors who might turn out to be unwilling to transmit information concerning him/her, or concerning a recruitment opportunity (Wasserman & Faust, 1994). As closeness centrality, which measures a director's social capital, is strongly correlated with the number of mandates he/she occupies it also controls for two important aspects. Indeed, closeness centrality controls for the greater opportunity offered to directors who occupy a large number of mandates to adopt reforms in many boards, and hence, to send numerous reputational signals to the labor market. In addition, as the number of mandates held by directors on the board of French listed firms has been limited by the law number 2002/1303 of October 29th 2002 to a maximum of five, closeness centrality controls for the reduced opportunity offered to directors who occupy a

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large number of seats to obtain new ones without resigning from held mandates. To measure closeness centrality of each director and for each year, we relied on adjacency matrices depicting links between all directors sitting on boards of firms included in our sample. We used the network analysis software Ucinet 6 (Borgatti, Everett & Freeman, 2002) to compute closeness centrality measures for each director and for each year. More specifically, a director's network centrality is defined as: $C_c(ni) = [\sum_{j=1}^{g} d(ni, nj)]^{-1}$; where d (*ni,nj*) is equal to the geodesic distance between directors *i* and *j* while *g* is equal to the total number of directors in the network. Data on board membership were obtained from annual reports and reference documents filed with the French financial markets authority (AMF).

Descriptive statistics and Pearson correlation coefficients for all variables included in our model are presented in table 2. In total, our sample consisted of 1742, 1776, 1798 and 1819 directors sitting on the boards of the 200 largest French firms in years 2001, 2002, 2003 and 2004 respectively. Accordingly, we tested our hypotheses using a sample of 7135 director-year observations.

Insert Table 2 about here

ANALYSIS AND RESULTS

The six dependent variables used in this paper measure the number of appointments gained by a focal director on boards of directors with distinct characteristics (presence of a nominating committee, CEO membership in the nominating committee and the proportion of non-executive directors on the nominating committee). As all these variables are count measures (i.e., integers truncated at zero), standard OLS regressions should not be used to test our hypotheses since count variables violate several assumptions associated with such regressions (normal distribution, negative values, independence of errors). Instead, Poisson

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regressions and negative binomial regressions are particularly suitable to estimate models involving count dependant variables. Compared to Poisson models, negative binomial processes present the advantage of correcting for overdispersion, that is, when data variance exceeds the mean (Barron, 1992). A preliminary examination of the distribution of our count measures revealed that the overdispersion parameters were significantly different from zero ($p<.05$). Moreover, as our dataset exhibited an excess of observations where no new board appointment were gained, we used zero-inflated negative binomial regressions to test our three hypotheses. A test for multicollinearity showed that the variance inflation factor for all main effects are lower than 1.18, which is significantly below the acceptance level of 10 (Bowerman and O'Connell, 1990; Myers, 1990).

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Table 3 presents the results of the zero-inflated negative binomial models examining the moderating impact of the presence of nominating committees on the relationship between director participation in increased control over management and the likelihood of subsequent appointments[1]. Model 1 which includes only the control variables indicates that the average size of firms in which the focal individual is a director, director age and director closeness centrality have a statistically significant impact on the likelihood of gaining new appointments to boards with a nominating committee. More specifically, the average size of firms in which the focal individual is a director as well as the centrality of the director in the social network impact positively the likelihood of subsequent appointments to boards with a nominating committee. On the other hand, as director's age increases the likelihood of new mandates on boards with a nominating committee decreases. Findings presented in Model 3 which considers gains of appointments to boards without a nominating committee show that only the centrality of the director in the social network impact positively the likelihood of subsequent appointments.

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The impact of director participation in increased control on the likelihood of gaining new appointments to boards with a nominating committee and to boards without a nominating committee are presented in Model 2 and Model 4 respectively. Model 2 suggests that the more directors engage in reforms increasing control over management the more likely they will gain new appointments to boards with a nominating committee (beta = .20; $p < .05$). In contrast, Model 4 shows that increasing control over management does not significantly impact the likelihood of gaining new appointments to boards without a nominating committee. These results indicate that the strength of the relationship between a director's reputation and the number of his/her subsequent depends upon the presence or not of a nominating committee. That is, the stronger a director 's reputation for being active in adopting reforms increasing control over management the larger the reward he/she is likely to receive from firms having a nominating committee. In contrast, increases in a director's reputation for being a reformer are not rewarded by firms without a nominating committee. These results which illustrate the moderating effect of the presence of nominating committees provide strong support for hypothesis 1.

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Insert Table 3 about here

Table 4 shows the results of the zero-inflated negative binomial models investigating the moderating impact of CEOs membership in nominating committees on the relationship between director participation in increased control over management and the likelihood of subsequent appointments. Model 5 indicates that average size of firms in which the focal individual is a director and director closeness centrality have an positive impact on the likelihood of gaining new appointments to boards with a nominating committee which excludes the CEO. Similarly, Model 7 suggests that the likelihood of gaining new

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appointments to boards with a nominating committee which includes the CEO is positively related to average size of firms in which the focal individual is a director. However, Model 7 indicates also that director's age is negatively associated with the likelihood of gaining new appointments to boards with a nominating committee which includes the CEO.

The effect of director participation in increased control on the likelihood of gaining new appointments to boards with a nominating committee which includes the CEO and to boards with a nominating committee which excludes the CEO are presented in Model 6 and Model 8 respectively. Model 6 indicates that the more directors adopts reforms increasing control over management the more likely they are going to gain new appointments to boards with a nominating committee which excludes the CEO (beta = .18; $p < .05$). On the other hand, Model 8 suggests that adopting reforms which increase control over management does not impact the likelihood of gaining new appointments to boards with a nominating committee which includes the CEO. These results show that the strength of the relationship between a director's reputation and the number of his/her subsequent mandates depends upon CEOs membership in nominating committees. The higher director 's reputation for being a reformer the larger the reward he/she is likely to receive from firms having a nominating committee which excludes the CEO. In contrast, a stronger director's reputation for being a reformer is not rewarded by firms which include the CEO in the nominating committee. These findings depicting the moderating role of CEO membership in nominating committees provide strong support for hypothesis 2.

Insert Table 4 about here

Table 5 presents the findings of the zero-inflated negative binomial models which examine the moderating impact of non-executive director proportion in nominating

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committees on the relationship between director participation in increased control over management and the likelihood of subsequent appointments. Model 9 indicates that the average size of firms in which the focal individual is a director and director closeness centrality have a significant positive effect on the likelihood of gaining new appointments to boards with a nominating committee which includes a majority of non-executive directors while director's age is negatively associated with such likelihood. On the other hand, Model 11 indicates that all control variables do not have a significant impact on the likelihood of gaining new appointments to boards with a nominating committee which includes a minority of non-executive directors.

With regards to the focal independent variable, Model 10 indicates that the more directors adopt reforms which increase control over management the more likely they are going to gain new appointments to boards with a nominating committee which includes a majority of non-executive directors (beta = .20; $p < .01$). Conversely, Model 12 shows that implementing reforms which increase control over management does not influence the likelihood of gaining new appointments to boards with a nominating committee which includes a minority of non-executive directors. These findings indicate that the relationship between a director's reputation and the number of his/her subsequent mandates is moderated by non-executive directors' control of nominating committees. The stronger a director 's reputation for being a reformer the larger the reward he/she is likely to receive from firms having a nominating committee dominated by non-executive directors. Alternatively, a stronger director's reputation for being a reformer is not rewarded by firms having a nominating committee dominated by executive directors. These results provide strong support for hypothesis 3.

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To further assess the robustness of our results, we performed a series of logistic regressions in which the dependent variables were dummy variables taking a value of 1 if the director did gain at least one new appointment in year $_{t+1}$ and 0 otherwise. The results of logistic regression models were substantively consistent with the results of zero-inflated negative binomial analysis (i.e., the test of statistical significance supported the same set of hypotheses).

CONCLUSION

By examining data drawn from a sample of directors serving on the boards of the 200 largest firms in France over the period 2001-2004, this study shows that the existence and independence of nominating committees determines the profile of directors likely to be appointed to a firm's board. More specifically, the more directors implement corporate governance reforms which increase control over management, the more likely they will be rewarded by obtaining new mandates on boards with nominating committees. Moreover, the higher the directors' inclination to implement such reforms, the higher the likelihood that they will obtain new appointments on boards with nominating committees which exclude the CEO or which are dominated by non executive directors. In contrast, our findings suggest that directors' proclivity to put in place corporate governance reforms which increase control over management is disconnected from their chances of obtaining new mandates on boards without nominating committees or on boards with nominating committees dominated by executive directors or which include the CEO. These results indicate that, under these conditions, powerful CEOs are able to influence the director selection process to their advantage.

These findings, which highlight the role of nominating committees and directors' reputations in the functioning of the labour market for directors should be, however, interpreted in light of some specific characteristics of the French corporate governance

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context. These characteristics may influence the extent to which our results can be generalized to other countries.

First, French listed firms exhibit higher ownership concentration structures than U.S. or U.K. firms (La Porta et al.,1999). In our sample including the 200 major French listed firms on the Euronext stock Exchange, the largest shareholder controlled in 2004, on average, 36.5 percent of total equity. Such concentration reflects a strong presence of family firms among large French companies (e.g. L'Oreal, LVMH and Michelin). This relatively high concentration of ownership structure may have two alternative effects on the profile of appointed directors. On the one hand, high ownership concentration reduces agency problems arising between principals (shareholders) and agents (managers) because large shareholders have both the incentive and power to monitor managers, which in turn, decreases the benefits of appointing active directors (Rediker & Seth, 1995). On the other hand, high ownership concentration may exacerbate the principal-principal agency costs generated by the misalignment of interests between the largest shareholder and other minority shareholders (Claessens et al., 2002). More specifically, a firm's controlling shareholder may have risk aversion levels and time horizon perspectives that are quite different from those of other minority shareholders. These differences may result in the firm making decisions regarding both its size and scope that are not in line with minority shareholders' interests. In this situation, high ownership concentration increases the necessity to appoint active directors likely to protect the interests of minority shareholders, particularly in countries governed by French civil law which provide low levels of protection for minority shareholders (La Porta et al., 1998). Our findings suggest that the presence and independence of nominating committees increase the likelihood of appointing active directors which are more inclined to protect the interest of all shareholders. Further studies should investigate the role of nominating committees in shaping the labor market for directors in other contexts characterized by

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similarly high ownership concentration structures such as in many European and Asian countries (e.g. Italy, Spain and Singapore) and in countries showing fragmented ownership structures such as the U.S.A. and the U.K (La Porta et al.,1999).

Second, the highly dense social network of ties among the French elite institutionally maintained through the "grandes écoles", "grands corps" and exclusive club membership facilitates the diffusion and increases the visibility of directors' reputations (Burt, Hogarth & Michaud, 2000; Kadushin, 1995; Maclean, Harvey & Press, 2006). In other networks with loosely connected individuals, boards and nominating committees are less likely to be exposed to information on candidate directors' inclinations to control management through social networks and may rely on other means to collect such information. We conducted our empirical investigation in a favorable context likely to strengthen the link between directors' reputations and subsequent appointments. Further studies are needed to explore such links in other countries with social contexts less conducive to the spread of directors' reputations. More generally, research is needed to examine the moderating role of social networks on the relationships between directors' reputations, nominating committees and subsequent appointments.

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Third, as directors' reputations are embedded in symbolic spatial and temporal environments shaped by a set of shared norms and beliefs, the definition of the dimensions with which we captured directors' reputations were strongly linked to the country and time specific contexts (DiMaggio, 1991; Feldman & March, 1981; Rao, 1994). In France over the period under study, directors' reputations for being active or passive in protecting shareholders' interests has been considerably shaped by their inclination to implement reforms advocated by the Vienot I (1995), Vienot II (1999) and Bouton (2002) reports. This was primarily the consequence of three factors. First, French corporate governance reports have been elaborated under the leadership of two highly influential CEOs of *Société Générale*

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bank. Second, reports have been strongly supported by the French business confederation (MEDEF) and Anglo-American institutional investors operating in France. Third, as reforms recommended by reports are not compulsory, their voluntary implementation represents a strong signal portraying the extent to which directors' are disposed to control and monitor management. Accordingly, we measured directors' reputations using their propensity to adopt reforms which increase control over management in past mandates. Future studies may proxy directors' reputations using other measures in contexts in which reforms advocated by codes and reports are not elaborated and supported by influential actors or in contexts in which the implementation of corporate governance reforms are compulsory. For instance, several reforms recommended by the French corporate governance reports are necessary prerequisites for a firm's listing on the Nasdaq and NYSE stock exchanges (Christiansen & Koldertsova, 2009), and hence, directors' reputations for being active or passive cannot be portrayed using their inclination to implement such reforms. Past studies have measured directors' reputations for exercising control over management using measures such as charges of fraud, class action lawsuits, acceptance of antitakeover provisions, the design of CEO compensation packages and firm diversification (Agrawal et al., 1999; Coles and Hoi 2003; Fich & Shivdasani, 2007; Helland 2006; Zajac & Westphal, 1996). More measures are needed to explore the multi-dimensionality and complexity of directors' reputation concept as long as such measures are strongly linked to the country and time specific contexts examined (DiMaggio, 1991; Feldman & March, 1981; Rao, 1994).

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In sum, our results indicate that, in the French context, the presence of independent nominating committees within boards of directors affects the extent of rewards and sanctions provided by the labor market to directors. However, these results may not hold outside of France. The impact of nominating committees and reputation on directors' subsequent appointment is likely to be different in countries where the density of ties among directors, the

structure of ownership and the components shaping directors' reputation diverge from the ones observed in the French specific context. Accordingly, future studies are needed to explore the extent to which our findings can be generalized to other countries.

Moreover, this study assumes that structural arrangements within boards (i.e, presence and independence of nominating committees) reliably capture board room dynamics. To better seize the adequacy of this assumption, future studies should adopt qualitative research methods. A deeper study of the nomination decision process always comes up against observational difficulties. The lack of access to data makes the possibility of observing candidates from their initial consideration through the entire selection process highly unlikely (Leblanc & Schwartz, 2007). This study demonstrates that a change in the recruitment process has a significant effect on its outcomes, although further studies are needed to identify at what level of the process, and in what way, nominating committees come to have an impact. Results of such studies would enable us to better understand the functioning of nominating committees.

Bearing in mind these limits, our results may suggest several theoretical and policy implications. First, our findings show that the implementation of practices recommended by corporate governance reports (e.g., increasing the percentage of outside directors, the creation of nominating and remuneration committees, adoption of the two-tiered board structures and separation of the CEO and board Chair functions) have enabled directors who participate in such implementations to acquire a reputation for being active on the market for directors. This seems to indicate that, during the period under consideration, these codes of corporate governance have acted as a kind of benchmark for corporate governance actors, and that their adoption or rejection served as one criterion by which directors or potential directors could be judged. Directors' reputations were, therefore, likely to be built around these criteria, and

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influenced whether they would be offered new board mandates. That is, the adoption of reforms seems to be a relevant signal on which the labor market for directors relies.

Second, our findings suggest that the impact of a director's reputation for being active on the number of his/her subsequent appointments does depend upon the existence and composition of nominating committees. A director who has a reputation for being a reformer is increasingly rewarded by the market for directors as the number of firms with nominating committees, dominated by non-executive directors and which exclude the CEO, grows. These results suggest that conditions exist that would permit the market for directors to function optimally and facilitate the recruitment of directors who would protect shareholders' interests. The market mechanism, which would benefit active directors and penalize others, works only if the recruitment process takes place without the influence of management (Zajac & Westphal, 1996). The assessment of candidate directors' reputations differs according to whether the firm wishes to hire a new director who has implemented codes of governance in the past or a new director who has blocked such implementation. Our study provides further evidence indicating that CEOs successfully influence director selection process in their advantage in particular cases. Accordingly, our results imply that efficient labor market mechanisms described by agency theory (Fama, 1980) function only under specific conditions. These conditions include (1) the creation of a nominating committee; (2) exclusion of the CEO from this committee and (3) domination of this committee by outside directors.

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Our results also shed light on the important role of institutions in the functioning of the labor market for directors and in corporate governance (Fiss, 2008). Recruitment practices, and the way that the board of directors functions, are not only a result of market interactions but also contingent on the institutional environment of firms. In this study, corporate governance reports seem to have encouraged the adoption of best practices, and made such

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practices normalized behavior on company boards. Even though such practices are widespread, resistance to their adoption still exists. This does not, however, undermine the fact that they are considered as norms even by those who do not comply with them. What matters is that these reports are now considered benchmarks when considering the roles and interests of the various actors. It is this role as a point of reference that is important, since it identifies those individuals who resist the adoption of reform practices in the struggle between shareholders and managers, and in the struggle to establish professional norms among directors themselves.

In addition, the results presented in this study provide clear indications on the appropriateness of institutional norms advocating for the creation of independent nominating committees within boards. Indeed, most codes and reports on corporate governance best practices, in France and all over the world, recommend the creation of nominating committees which exclude executive directors and CEOs and our empirical results confirm that such committees successfully resist to the influence of CEOs during the selection process.

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By calling for changes in the recruitment process and by taking previous proposals into account, reports have made the prospect of change credible, and above all have managed to translate proposals into practices. They have also reinforced the idea that directors who press for these reforms will be able to benefit because of these actions later on. If a director believes that changes in the recruitment process will benefit reformers, then that director has an interest in pushing for reforms. This provides an additional insight to research interested in understanding why codes of good governance are adopted (Zatoni & Cuomo, 2008). In a larger sense, this suggests that the market is an institution (North, 1991; Roe, 1994) created by the application of rules that do not appear out of nowhere. These rules must be respected by market actors to at least a minimal degree to guarantee that the market will function efficiently.

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Finally, our study provides a further step toward uncovering the role of nominating committees and directors' reputations in shaping the labor market for directors in three ways. First, it extends previous research which has overlooked the importance of the balance of power between incumbent CEOs and directors, implied by the presence of independent nominating committees, in determining candidate selection outcomes (Agrawal et al., 1999; Coles and Hoi 2003; Fich & Shivdasani, 2007; Helland 2006; Zajac & Westphal, 1996). Second, this study adopts a multi-criteria approach to measure directors' reputations in contrast with most previous research examining the role of directors' reputations in the operation of the labor market for directors which relied on single measures (Agrawal et al., 1999; Coles and Hoi, 2003; Fich & Shivdasani, 2007; Helland 2006). Finally, this paper extends the few studies which investigated the role of nominating committees in determining the profile of recruited directors by considering the individual director as the unit of analysis in contrast to the firm level of analysis (e.g. Shivdasani and Yermack, 1999).

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NOTE

1. Following the methodology adopted by Zajac and Westphal (1996), we estimated a negative binomial regression for each sub-sample (presence of nominating committee vs. no nominating committee; CEO member of the nominating committee vs. CEO excluded from the nominating committee; nominating committee dominated by non executive directors vs. nominating committee dominated by outsiders). The standard way to examine a moderating impact is to estimate the effect of the interaction term. However, this is not possible in our case since reputation is measured at the individual level of analysis while the presence and composition of nominating committee is measured at the mandate (firm) level of analysis.

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Table 1
Number of firms adopting main corporate governance reforms

Variables	**2001**	**2002**	**2003**	**2004**
Number of firms having a nominating committee *(count)*	37	49	70	83
Number of firms having a compensation committee *(count)*	76	90	107	126
Mean ratio of non-executive directors *(ratio)*	0.59	0.60	0.64	0.67
Number of firms separating the roles of CEO and chairman *(count)*	8	10	19	24
Number of firms having a two-tier board structure *(count)*	64	66	65	64

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Table 2
Descriptive statistics and correlations.

Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11
1. **Average return on assets** *(ratio, control variable)*	2.56	9.20	1.00										
2. **Average total sales** *(billion dollars, control variable)*	7.86	14.48	-0.03	1.00									
3. **Director age** *(years, control variable)*	55.72	8.27	0.01	**0.11**	1.00								
4. **Closeness centrality** *(ratio, control variable)*	0.06	0.01	0.03	**0.34**	**0.11**	1.00							
5. **Participation in increased control** *(count, main independent variable)*	0.70	0.83	**-0.05**	**0.07**	**0.05**	**0.21**	1.00						
6. **Additional appointments to board with a nominating committee** *(count, dependent variable)*	0.03	0.17	0.01	**0.07**	-0.01	**0.08**	**0.05**	1.00					
7. **Additional appointments to board without a nominating committee** *(count, dependent variable)*	0.01	0.12	0.01	0.02	-0.01	**0.05**	0.01	**0.08**	1.00				
8. **Additional appointments to board with a nominating committee which does include the CEO** *(count, dependent variable)*	0.01	0.06	0.01	**0.04**	-0.02	0.03	0.03	**0.38**	**0.07**	1.00			
9. **Additional appointments to board with a nominating committee which does not include the CEO** *(count, dependent variable)*	0.02	0.16	0.01	**0.06**	-0.01	**0.07**	0.04	**0.93**	**0.06**	0.02	1.00		
10. **Additional appointments to board with a nominating committee dominated by non-executive directors** *(count, dependent variable)*	0.02	0.17	0.01	**0.07**	-0.01	**0.07**	**0.05**	**0.98**	**0.09**	**0.33**	**0.93**	1.00	
11. **Additional appointments to board with a nominating committee dominated by executive directors** *(count, dependent variable)*	0.01	0.03	0.01	0.02	-0.01	0.02	0.01	**0.19**	0.03	**0.27**	**0.10**	0.01	1.00

N = 7135 director-year observations.
Correlations significant at $p < 0.01$ (two-tailed test) are in bold.

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Table 3
Zero inflated negative binomial models testing the moderating effect of nominating committee on the relationship between participation in increased control over management and the likelihood of additional appointments (hypothesis 1).

	Additional appointments to board with a nominating committee *(count)*				**Additional appointments to board without a nominating committee** *(count)*			
	Model 1		**Model 2**		**Model 3**		**Model 4**	
Independent variables	**Coeff.**	**Z**	**Coeff.**	**Z**	**Coeff.**	**Z**	**Coeff.**	**Z**
Intercept	-5.44*** (0.75)	-7.23	-5.33*** (0.74)	-7.11	-3.49*** (1.05)	-3.29	-3.47*** (1.06)	-3.28
Average return on assets *(ratio)*	-0.01 (0.01)	-0.56	-0.01 (0.01)	-0.46	0.01 (0.02)	0.47	0.01 (0.02)	0.49
Average total sales *(billion dollars)*	0.02*** (0.01)	4.00	0.02*** (0.01)	4.06	0.01 (0.01)	0.43	0.01 (0.01)	0.43
Director age *(years)*	-0.02*** (0.01)	-2.19	-0.02* (0.01)	-2.21	-0.02 (0.01)	-1.80	-0.02 (0.01)	-1.81
Closeness centrality *(ratio)*	46.68*** (8.84)	5.28	42.04*** (8.96)	4.69	42.67*** (11.22)	3.80	41.97*** (11.44)	3.67
Participation in increased control *(count)*			0.20* (0.08)	2.36			0.04 (0.13)	0.31
N (director-year observations)	7135		7135		7135		7135	
Degrees of freedom	7130		7129		7130		7129	
Likelihood ratio chi^2	62.54***		67.85***		20.56***		20.66***	
Log likelihood	-779.88		-777.22		-461.00		-460.96	

*** $p \leq 0.001$; ** $p \leq 0.01$; * $p \leq 0.05$;
Unstandardized coefficients are reported. Standard errors are in parentheses. Inflation model: logit.

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Table 4
Zero inflated negative binomial models testing the moderating effect of CEO membership to nominating committee on the relationship between participation in increased control over management and the likelihood of additional appointments (hypothesis 2).

	Additional appointments to board with a nominating committee which does not include the CEO *(count)*				Additional appointments to board with a nominating committee which does include the CEO *(count)*			
	Model 5		Model 6		Model 7		Model 8	
Independent variables	**Coeff.**	**Z**	**Coeff.**	**Z**	**Coeff.**	**Z**	**Coeff.**	**Z**
Intercept	-5.93***	-7.10	-5.84***	7.01	-5.54***	-3.32	-5.42***	-3.26
	(0.83)		(0.83)		(1.67)		(1.66)	
Average return on assets *(ratio)*	-0.01	-0.61	-0.01	-0.54	-0.01	-0.01	0.01	0.07
	(0.01)		(0.01)		(0.02)		(0.03)	
Average total sales *(billion dollars)*	0.02***	3.39	0.02***	3.41	0.02*	2.44	0.02*	2.45
	(0.01)		(0.01)		(0.01)		(0.01)	
Director age *(years)*	-0.01	-1.57	-0.02	-1.58	-0.05*	-2.01	-0.05*	-2.01
	(0.01)		(0.01)		(0.02)		(0.02)	
Closeness centrality *(ratio)*	47.92***	4.91	43.85***	4.44	38.57	1.93	32.08	1.58
	(9.75)		(9.88)		(19.98)		(20.32)	
Participation in increased control *(count)*			0.18*	2.00			0.29	1.58
			(0.09)				(0.18)	
N (director-year observations)	7135		7135		7135		7135	
Degrees of freedom	7130		7129		7130		7129	
Likelihood ratio chi^2	50.61***		54.08***		13.87***		16.05***	
Log likelihood	-680.29		-678.55		-170.64		-169.55	

*** p ≤ 0.001; ** p ≤ 0.01; * p ≤ 0.05;
Unstandardized coefficients are reported. Standard errors are in parentheses. Inflation model: logit.

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Table 5
Zero inflated negative binomial models testing the moderating effect of NED proportion in nominating committee on the relationship between participation in increased control over management and the likelihood of additional appointments (hypothesis 3).

	Additional appointments to board with a nominating committee which includes a majority of NED *(count)*				**Additional appointments to board with a nominating committee which includes a minority of NED** *(count)*			
	Model 9		**Model 10**		**Model 11**		**Model 12**	
Independent variables	**Coeff.**	**Z**	**Coeff.**	**Z**	**Coeff.**	**Z**	**Coeff.**	**Z**
Intercept	-5.52*** (0.77)	-7.16	-5.40*** (0.77)	-7.05	-7.75* (3.28)	-2.36	-7.73* (3.25)	-2.38
Average return on assets *(ratio)*	-0.01 (0.01)	-0.61	-0.01 (0.01)	-0.51	0.02 (0.06)	0.37	0.02 (0.06)	0.36
Average total sales *(billion dollars)*	0.02*** (0.01)	3.89	0.02*** (0.01)	3.96	0.01 (0.01)	0.89	0.01 (0.01)	0.89
Director age *(years)*	-0.02* (0.01)	-2.02	-0.02* (0.01)	-2.03	-0.05 (0.04)	-1.08	-0.05 (0.04)	-1.08
Closeness centrality *(ratio)*	46.07*** (9.04)	5.10	41.31*** (9.16)	4.51	53.78 (39.25)	1.37	54.90 (40.04)	1.37
Participation in increased control *(count)*			0.20** (0.08)	2.34			-0.06 (0.42)	-0.14
N (director-year observations)	7135		7135		7135		7135	
Degrees of freedom	7130		7129		7130		7129	
Likelihood ratio chi^2	58.67***		63.92***		4.45		4.47	
Log likelihood	-754.46		-751.83		-60.12		-60.11	

*** $p \leq 0.001$; ** $p \leq 0.01$; * $p \leq 0.05$;
Unstandardized coefficients are reported. Standard errors are in parentheses. Inflation model: logit.

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