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The Symbolic Management of Stockholders: Corporate Governance Reforms and Shareholder Reactions

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This paper examines the consequences of symbolic action in corporate governance. Specifically, we examine (1) whether the stock market reacts favorably to specific governance mechanisms that convey the alignment of CEO and shareholder interests, such as the adoption of long-term incentive plans (LTIPs), even if such plans are not actually implemented, (2) whether providing agency-related explanations for LTIPs affects the stock market response, and (3) whether the symbolic adoption of LTIPs deters other governance reforms that would reduce CEOs' control over their boards. Analysis of data from over 400 corporations over a ten-year period suggests that symbolic corporate actions can engender significant positive stockholder reactions and deter other, more substantive governance reforms, thus perpetuating power imbalances in organizations. We discuss implications for institutional and agency-based perspectives on organizations.•

In recent years, scholarly and popular concern about corporate governance arrangements in large corporations has increased in intensity. Institutional investors and the popular business press have decried the apparent absence in many corporations of strong governance mechanisms that adequately promote managerial accountability to stockholders (e.g., Charan, 1993; *Economist,* 1994; Pozen, 1994). This concern has been reinforced by extensive academic research on the effectiveness of existing governance structures in protecting shareholders. Thus, while agency theory suggests that managerial incentives and boards of directors represent the primary mechanisms by which differences between managerial and shareholder interests are minimized (Jensen and Meckling, 1976; Fama and Jensen, 1983), a large body of empirical research suggests that neither mechanism is used sufficiently to represent shareholders. For example, research on executive compensation has led many observers to conclude that traditional management incentive practices are inadequate to reduce agency costs significantly (Finkelstein and Hambrick, 1988).[1] Large-scale empirical research on corporate boards suggests that boards have traditionally lacked the structural power needed to monitor effectively (e.g., Wade, O'Reilly, and Chandratat, 1990), and extensive qualitative evidence also indicates that boards have often been minimally involved in monitoring and controlling management decision making (e.g., Mace, 1971; Vance, 1968; Lorsch and MacIver, 1989).

This stream of research has bolstered claims by dissatisfied shareholders, and institutional investors in particular, that significant changes in governance structure are needed to enhance managerial accountability to shareholders. Several changes have gained currency as legitimate improvements in corporate governance, such as the adoption of new long-term incentive plans that align management compensation more closely with stock performance, or changes in board structure that increase the board's monitoring and control capacity. These changes are seen as increasing top management's attention to shareholders' interests and have been advocated by increasingly active investors, represented by groups such as the Council of Institutional Investors and the

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1 Jensen and Meckling (1976) defined agency costs as the sum of (1) monitoring expenditures to assure that an agent is acting in the principal's interests, (2) bonding expenditures made by the agent to reassure the principal, and (3) the remaining costs due to unresolved conflicts between agent and principal (see also Barney and Ouchi, 1986: 209–210).

United Shareholders Association, both of which were founded in the 1980s (Kim and Ocasio, 1995). Advocates for such reforms have also pointed to the extensive empirical literature in financial economics that shows positive stock market reactions to the adoption of new governance mechanisms, such as long-term incentive plans.

Other behaviorally oriented studies, however, have emphasized that while there may be organization-wide benefits to such reforms, top managers would prefer to avoid or even resist them (Harrison, Torres, and Kukalis, 1988; Tosi and Gomez-Mejia, 1989; Hill and Phan, 1991). Both the economic and behavioral literatures on executive compensation suggest that, ceteris paribus, chief executive officers will prefer a pay package with a small pay-for-performance component (Zajac and Westphal, 1994). From a normative agency theory perspective, CEOs, as risk-averse agents, prefer less risk in their compensation contracts (Harris and Raviv, 1979), and incentives add uncertainty to a CEO's compensation (Beatty and Zajac, 1994). Research from the managerialist perspective (Williamson, 1964) suggests that CEOs prefer self-aggrandizing, growth-maximizing goals over profit-maximizing goals for their firms and would be reluctant to accept incentive plans tied closely to profit maximization or to give up decision-making autonomy vis-à-vis the board of directors.

While prior research has tended to emphasize the overtly political nature of top executive behavior, Westphal and Zajac (1994) and Zajac and Westphal (1995) have recently introduced a symbolic management perspective on corporate governance (see also Wade, Porac, and Pollock, 1997). They suggest that top managers can satisfy external demands for increased accountability to shareholders while avoiding unwanted compensation risk and loss of autonomy by adopting but not implementing governance structures that address shareholder interests and by bolstering such actions with socially legitimate language. Their research focused on the antecedents of symbolic action, however, and thus did not examine either the targeted audience or the likely consequences of such alleged symbolic actions. An unanswered question is: Do symbolic actions in the corporate governance domain have any real and measurable impact, and who are the stakeholders whose opinions are to be considered?

The present study makes several contributions. First, we extend the corporate governance literature by identifying the audience for two forms of symbolic actions relating to corporate governance and by measuring two important consequences. We examine how and why the stock market is likely to react positively to the adoption of new long-term incentive plans for top management, even if the plans are not implemented, and how and why socially legitimate verbal explanations may also favorably affect the stock market response. We then consider whether such symbolic actions also have internal consequences by diminishing the likelihood of other internal governance reforms advocated by institutional investors. Such a study, we believe, is unique to both the corporate governance area and the more general symbolic management and institutional literatures (e.g., Brown, 1994: 861).[2] For example, while some symbolic management studies have examined how language is used sym-

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Staw, McKechnie, and Puffer (1983), Marcus and Goodman (1991), and Elsbach (1994) are exceptions, in part.

bolically, they typically have not examined organizational "decoupling," in which formal structures are adopted in response to the demands of external stakeholders, but actual practices are tailored to the needs or demands of internal organization members (Meyer and Rowan, 1977; Scott, 1995). As a result, such studies have not been able to rule out the possibility that language enhancements may actually fit the facts of the situation (Clapham and Schwenk, 1991). In our study, we analyze the decoupling of formal structure and the use of symbolic language, as well as their consequences, which allows us both to assess when symbolic language does not actually fit the situation and to assess its effect. Furthermore, we examine not only how and why decoupling and symbolic language can enhance organizational legitimacy, as reflected in stock market reactions, but also how they affect organizational power relationships by allowing powerful organizational actors to exploit and reinforce myths about the effectiveness and appropriateness of organizational control mechanisms.

Finally, our study extends agency perspectives in organizational research by offering a social interpretation of the agency problem. While conventional economic perspectives focus on the cost reduction resulting from introducing substantive control mechanisms to resolve the conflicting interests of agents and principals, we conceive the agency problem as one of reducing social uncertainty about the alignment of managerial and shareholder interests through the introduction of symbolic rather than substantive control mechanisms. We test our hypotheses using extensive archival data from over 400 corporations over a ten-year period.

ASSESSING THE SYMBOLIC REDUCTION OF AGENCY COSTS

Symbolic Decoupling and Market Reactions

While studies that examine the effects of symbolic actions on stock market reactions are rare, a substantial body of research in the financial economics literature has examined market reactions to a firm's adopting an organizational innovation; positive market reactions are seen as evidence that the adoption of that innovation should result in a performance benefit. In the domain of corporate governance, one innovation that has spawned a number of market-reaction studies is the adoption of new long-term incentive plans (LTIPs) for top executives (e.g., Tehranian, Travlos, and Waegelein, 1987; Gaver, Gaver, and Battistel, 1992). LTIPs are defined as new incentive programs that introduce a so-called performance plan for top managers (Larcker, 1983).[3]

In the financial economics literature, LTIPs are seen as minimizing the extent to which the interests of agents (top management) diverge from those of principals (shareholders) (Jensen and Meckling, 1976). LTIPs are expected to lengthen executives' time horizons and focus their attention on creating shareholder value. A primary difference between LTIPs and traditional stock option plans is that LTIP awards are contingent on meeting specific performance goals for profitability over a three-to-six-year period, whereas stock options can be exercised over an extended time regardless

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Grants under a performance plan, which confer the right to receive shares of common stock or cash at a particular date in the future to the extent that specific performance objectives are met, are typically made in either shares of common stock or stock units, referred to as performance shares and performance units, respectively. The final value of each share is the market price at the end of the award period, while each unit is assigned a fixed dollar value, unrelated to share price, at the beginning of the award period (Crystal, 1984).

of performance (Larcker, 1983). Compensation consultants have touted LTIPs as an important innovation in executive pay administration (Crystal, 1984), and *Business Week's* (1996) "Report Card on Corporate Governance" evaluates boards on the degree to which they link the CEO's pay to specific performance targets, which is precisely what LTIPs are supposed to accomplish. Scholars have enumerated a variety of other, presumed advantages of LTIPs over stock option plans (e.g., Larcker, 1983; Brozovsky and Sopariwala, 1995). Kumar and Sopariwala (1992: 563) noted that "the payoff from stock options is often an imprecise indicator of managerial performance because stock prices also depend on factors beyond a manager's control." As a result, managers concentrate on achieving short-term performance goals that are more controllable. In contrast, compensation from performance plans, which depends on profitability over a multiyear period as well as on stock price, is more directly linked to managerial performance than stock option plans, encouraging managers to redirect their attention toward long-term profitability.

Given the presumed advantages of LTIPs, it is not surprising that most research studies investigating the consequences of LTIP adoption have found a positive market reaction to the announced adoption of LTIPs (Larcker, 1983; Brickley, Bhagat, and Lease, 1985; Tehranian, Travlos, and Waegelein, 1987; Kumar and Sopariwala, 1992).[4] According to Kumar and Sopariwala (1992: 562), "this positive reaction is consistent with the view that there will be a lower degree of agency problems and lower agency costs subsequent to the adoption of these plans." In the organizational literature, however, Westphal and Zajac (1994) found that many firms announce new LTIPs and then make no grants at all or trivially small grants under the plan. One predictor of such decoupling of LTIP adoption and implementation was greater CEO influence, relative to the board, over compensation policy. Westphal and Zajac (1994) interpreted this as suggesting that CEOs give in, but only symbolically, to external pressure for greater incentive alignment, while minimizing the actual compensation risk in their pay packages.

Thus, while conventional agency perspectives assume that stock market reactions to LTIP adoption reflect economic benefits from reduced agency costs, a social perspective on agency suggests a different interpretation: market reactions may instead reflect social benefits resulting from symbolic actions that reduce uncertainty about managerial motives. Symbolic management scholars and institutional theorists have long argued that symbolic actions are most effective under conditions of ambiguity or uncertainty (Meyer and Rowan, 1977; Pfeffer, 1981; DiMaggio and Powell, 1983; Scott, 1995). Uncertainty in the stock market about managerial accountability makes it susceptible to the effects of symbolic action.

While stock market reactions are viewed in the financial economics literature as providing hard numbers that reflect the true underlying value of a firm, from a symbolic perspective, firms can also influence market reactions and thus change their underlying market value through the use of symbolic action. Market reactions thus should perhaps be viewed

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An empirical study by Gaver, Gaver, and Battistel (1992) is an exception; they did not find evidence for a significant stock market reaction to LTIP adoption. Kumar and Sopariwala (1992: 567) attributed this finding, in part, to the smaller size of companies in that sample, some portion of which appears to include firms outside the population of *Fortune* 1000 companies.

more in terms of "soft" numbers that reflect the subjective perceptions of a heterogeneous audience, neatly quantified and aggregated (Beatty and Zajac, 1987), reacting to changes in formal policy that may be independent of substantive practices. Symbolic actions such as the adoption (and decoupling) of legitimate formal practices and the use of socially accepted language can play a role in the social construction of market value.

Certain features of the stock market make it particularly receptive to symbolic action. It is a relatively complex "audience" composed of actors ranging from small individual investors to immense institutions, with varying levels of interest, ranging from passive to active, and with varying levels of expertise and access to information. Despite the fact that such circumstances are not conducive to extensive communication and coordination among the disparate subgroups (Baker, 1984), significant collective reactions to actions such as LTIP adoption are quantified almost immediately. To cope with the quick response times and imperfect communication that characterize market reactions to announced events, audience members can be expected to estimate how others are likely to respond in determining their own response to the current action. Such estimations are influenced, in turn, by prior market responses to similar events, providing the basis for institutional effects in the construction of market value.

While we do not assume strong-form market efficiency, we also do not assume that markets are irrational. Rather, we assume that investors are intendedly but boundedly rational information processors who are interested in reducing uncertainty and therefore value socially legitimate indications that agency problems are being addressed. This perspective helps explain recent survey evidence that "stockholders were willing to pay 11% more on average for companies considered well-governed" and that companies seek to make governance changes that can "reassure—or at least placate—restive investors" (*Business Week,* 1997: 34).

The adoption of formal governance reforms may be particularly effective in enhancing organizational legitimacy by helping to allay concerns about managerial loyalties, irrespective of whether such reforms are actually implemented in the organization. As Oliver (1991: 155) noted, "from an institutional perspective . . . the appearance rather than the fact of conformity is often presumed to be sufficient for the attainment of legitimacy." Similarly, Meyer and Rowan (1977: 349) suggested that "by designing a formal structure that adheres to the prescriptions of myths in the institutional environment, an organization demonstrates that it is acting on collectively valued purposes in a proper and adequate manner." The formal adoption of LTIPs serves to promote and reinforce the specific notion that a pay-for-performance linkage exists for CEOs, while appealing more generally to social beliefs about the existence of meritocratic reward structures. Thus, the announced introduction of LTIPs for CEOs might engender a favorable stock market reaction, regardless of whether the plans are actually implemented, because they appear to address the specific goals of external constituents while also exploiting more general social beliefs.[5] Analyzing

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We do not assume, as a strong-form efficiency approach might, that during the period covered in this study, investors would know (1) that adopted LTIPs were often not implemented, (2) that if LTIPs were not implemented at the same time they were adopted, they were never implemented, or (3) that LTIPs that were described as addressing agency problems were financially no different from LTIPs with no agency explanation (Westphal and Zajac, 1994; Zajac and Westphal, 1995).

decoupling in the adoption and implementation of LTIPs and its effect on stock market reactions offers a unique opportunity to assess quantitatively the consequences of an important form of symbolic management. This suggests the following:

Hypothesis 1 (H1): LTIP adoption will engender positive stock market reactions, whether or not the plan is implemented.

Symbolic Explanations and Market Reactions

While the adoption of formal mechanisms such as LTIPs can represent an important form of symbolic action, additional communication may also reinforce the symbolic message. Corporate leaders use language to emphasize the connection between formal structure such as LTIPs and collectively valued purposes such as reducing agency costs (Meyer and Rowan, 1977: 349). Such supplemental symbolic communication may be particularly valuable for actions such as LTIP adoption, given that recent popular discourse on executive compensation has sometimes viewed LTIPs more cynically as an effort to enrich management at shareholder expense, rather than to align pay with performance (Crystal, 1991; *Business Week,* 1992). The use of justifying language may encourage more favorable interpretations of organizational actions and preempt negative interpretations (Goffman, 1971; Pfeffer, 1981; Elsbach and Sutton, 1992). Zajac and Westphal (1995: 285) showed that firms commonly provide lengthy verbal explanations, like the following, for new LTIPs when announcing them in proxy statements:

> Alcoa's Board of Directors has decided to place an increasing share of management's overall compensation at risk rather than in fixed salaries. The new approach to compensation was recommended by the Board's compensation committee, which is composed solely of outside directors. The board believes that granting stock options, performance shares and [bonuses] will create a more appropriate relationship between compensation and the financial performance of the company in order to increase key employees' personal financial identification with interests of the Company's stockholders. (Aluminum Company of America, 1988)

This example illustrates what Zajac and Westphal (1995: 288) called the "agency explanation," which they suggested is the most frequently used explanation for LTIPs adopted in the 1980s. The agency logic emphasizes explicitly how LTIPs promote shareholder interests by tying CEO compensation more closely to shareholder wealth. Several authors have noted the growing prominence and acceptance of agency theoretic perspectives in the academic and managerial literatures on corporate governance (Davis and Thompson, 1994; Zajac and Westphal, 1995). This institutionalization of the agency logic can reinforce the tendency for boundedly rational external constituents to respond favorably to the adoption of LTIPs when it is accompanied by an agency explanation. LTIP explanations invoking an agency logic can be characterized as enhancements (Tedeschi and Melburg, 1984) that build the perceived desirability of LTIP adoption by invoking notions of managerial incentive alignment, compensation risk, and shareholder identification as legitimate rationales for long-term incentive compensation. We examine whether such symbolic language enhancements affect the stock market reactions to LTIP adoption.

A few studies in the institutional and impression management literatures have found evidence for reputational benefits from the use of enhancements or related communications (e.g., Marcus and Goodman, 1991; Bielby and Bielby, 1994; Elsbach, 1994).[6] Nevertheless, while the business press occasionally provides vivid accounts of how top managers may influence stock prices via symbolic management (e.g., *Wall Street Journal,* 1994, 1995), systematic empirical examination of this phenomenon is relatively rare in the organizational literature. Furthermore, prior symbolic management studies have typically not explored whether verbal enhancements or justifications fit the facts of the situation. Clapham and Schwenk (1991: 221) noted that verbal enhancements may generate favorable stock market reactions simply because they "accurately reflect causal relationships." We test whether market reactions to verbal accounts reflect actual organizational practices by examining reactions when LTIPs are announced and implemented and when they are announced but not implemented. Observing a positive market reaction to agency explanations even when LTIP adoption is decoupled from actual implementation would provide stronger evidence that verbal enhancement in proxy statements represents symbolic management and not merely rational communication or persuasion (cf. Porter, Allen, and Angle, 1981). Thus, we hypothesize:

Hypothesis 2 (H2): LTIP adoption with an agency explanation will engender more positive stock market reactions than LTIP adoption without an agency explanation, whether or not the plan is implemented.

Substituting Symbolic Incentives for Substantive Board Structure Changes

While the two hypotheses offered above address an important possible consequence of the symbolic use of LTIPs, such consequences may not be limited to a positive stock market reaction. The decoupling of LTIP adoption from implementation and the use of socially legitimate explanations can relieve pressures that firms face from shareholder groups to enact other governance reforms. By using symbolic action to reduce the social uncertainty regarding the divergence of managerial and shareholder interests, such symbolic action substitutes for other governance mechanisms. Recent empirical research has provided evidence of a substitution effect between the substantive use of top management incentives (including LTIPs) and the use of board monitoring mechanisms (Beatty and Zajac, 1994; Zajac and Westphal, 1994). Drawing from normative agency theory (Holmstrom, 1979), Zajac and colleagues suggested that managerial incentive alignment and board monitoring represent alternative solutions to the agency problem, such that shareholders' concerns for greater board monitoring capacity decline as managerial incentive alignment increases. The substitution effect between incentives and monitoring should also exist in the domain of symbolic control, because it would reduce social uncertainty about the agency problem. By formally adopting "institutionally 'correct' procedures" (Walsh and Seward, 1990: 431) indicative of CEO accountability, top managers may effectively preempt or forestall alternative changes in board structure that are less easily

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Schlenker (1980: 6) defined impression management as "the conscious or unconscious attempt to control images that are projected in real or imagined social interactions."

decoupled from substantive arrangements. In effect, symbolic CEO incentive alignment may represent an important and subtle entrenchment device, perpetuating the CEO's dominance over the board.

We examine whether symbolic LTIP adoption alleviates shareholder pressures for two specific changes in board structure thought to increase board control: separation of the CEO and board chair positions and increases in the ratio of outside to inside directors. Institutional investors and advocates of board reform have pressured firms to separate the CEO and board chair positions as a means of improving board monitoring and control of management decisions (*Fortune,* 1984; Pozen, 1994). In general, governance researchers and the business press have agreed that allocating the two positions to separate individuals enhances the board's ability to monitor and control management independently (Crystal, 1991; Mallette and Fowler, 1992; Beatty and Zajac, 1994; Finkelstein and D'Aveni, 1994). CEOs holding both positions are viewed as able to suppress open challenges to their decision making in board meetings more easily (Westphal and Zajac, 1994). Given that the board chair is nominally responsible for monitoring and evaluating CEO decision making, uniting both roles in one person represents a formalized conflict of interest.

With respect to outside directors, stockholder groups such as the California Public Employee Retirement System (CALPERS) and other large pension funds have consistently advocated increases in the ratio of outsiders to insiders as a source of increased board control over top management (*New York Times,* 1992; Useem, 1993; Pozen, 1994). While both inside and outside directors are responsible for overseeing corporate strategy, governance scholars and advocates of board reform have long argued that outsiders are better able to evaluate strategic decision making objectively (Vance, 1968; Brudney, 1982; Fama and Jensen, 1983). Insiders are subordinate to the CEO and are therefore typically viewed as unwilling or unable to present a serious challenge to the CEO's opinion on strategic issues in board meetings (Kesner and Johnson, 1990). In addition, to the extent that manager-directors hold certain preferences in common with the CEO, such as a desire to minimize employment risk (Amihud and Lev, 1981), they may be more likely to agree with the CEO's position. By symbolically reducing the perceived divergence between managerial and shareholder interests (e.g., adopting LTIPs without implementing them), however, CEOs can alleviate pressure from shareholders either to separate the CEO and board chair positions or to increase the outsider ratio. This suggests the following hypothesis:

Hypothesis 3 (H3): LTIP adoption will be negatively related to (1) subsequent separation of the CEO and board chair positions and (2) increases in the ratio of outside to inside directors, whether or not the plan is implemented.

Similarly, the use of socially legitimate explanations should also help alleviate shareholder pressure to make changes in board structure that increase control over management. Explanations that present LTIPs as a control mechanism designed to align management and shareholder interests con-

veys the sense that the board has acted to exercise control over management on behalf of shareholders, thus reducing the perceived need for specific changes in board structure that serve the same purpose. Accordingly, an agency explanation for LTIP adoptions should diminish external pressure for separation of the CEO and board chair positions or increases in the outsider ratio, irrespective of whether the plans are actually implemented:

Hypothesis 4 (H4): LTIP adoption with an agency explanation will amplify the negative relationship between adoption and (1) subsequent separation of the CEO and board chair positions, and (2) increases in the ratio of outside to inside directors, whether or not the plan is implemented.

Symbolic Substitution and Institutional Investors

While our discussion thus far has treated shareholders as having homogeneous preferences, institutional investors represent an important subgroup of owners who typically hold significantly larger equity stakes in corporations than do individual shareholders. One important implication of holding such large equity stakes is that for dissatisfied institutional investors, the option of "exit" (i.e., selling the stock) is somewhat more difficult and costly, hence leading to the greater exercise of "voice" (Hirschman, 1970; Jensen, 1989; Kim and Ocasio, 1995). Since institutional investors are virtually always explicit about not wanting to manage the large U.S. companies in which they invest, their voice is often expressed in terms of seeking governance changes to ensure that managerial interests do not dominate shareholder interests. Given that constrained exit options make changes in corporate governance practices more salient to institutional investors, it is not surprising that much of the recent pressure for governance reform, such as separating the CEO and board chair positions and increasing the outsider ratio, has been generated by institutional investors (Pozen, 1994). While this suggests that firms with greater institutional ownership would thus be more likely to push for such governance reforms, this tendency should be diminished to the extent that symbolic actions, such as the adoption of LTIPs without implementation and the use of agency explanations, are provided as symbolic substitutes. This suggests the following additional hypotheses related to H3 and H4:

Hypothesis 3a (H3a): LTIP adoption will interact with ownership by institutional investors to diminish the likelihood of (1) subsequent separation of the CEO and board chair positions and (2) increases in the ratio of outside to inside directors, whether or not the plan is implemented.

Hypothesis 4a (H4a): The use of agency explanations for LTIP adoption will interact with ownership by institutional investors to diminish the likelihood of (1) subsequent separation of the CEO and board chair positions and (2) increases in the ratio of outside to inside directors, whether or not the plan is implemented.

METHOD

Sample and Data Collection

The initial sample frame for this study included large and medium-sized U.S. industrial and service firms listed in the 1982 *Forbes* and *Fortune* 500 indexes. The final sample in-

cluded all companies for which complete data on board structure, CEO compensation, and stock market reactions were available. This criterion yielded 408 companies. *T*-tests revealed that companies in this sample were not significantly different in sales or profitability (return on assets) from companies in the larger population. Data were collected for the years 1982 to 1992, and LTIP adoptions are observed from 1985 to 1991, inclusive, because the lag structure requires collecting data for the earlier and later time periods. We chose this time frame because institutional investors have exerted increased pressure for greater management accountability to shareholders during this period (Davis and Thompson, 1994).

We collected data on LTIP adoption and implementation from corporate proxy statements and information on board structure from both proxies and *Standard & Poor's Register of Corporations, Directors, and Executives*. Data on institutional ownership came from the *Compact Disclosure* data base, supplemented by data from a large management consulting firm. Finally, data on stock market reactions, firm size, and profitability were provided by COMPUSTAT and the Center for Research in Security Prices (CRSP).

Independent Variables

LTIP adoption. We defined LTIP adoption as the addition of a new performance plan that aimed at providing multiyear performance incentives, such as performance shares or performance units, to a CEO's compensation contract. Thus, amendments or updates to existing performance plans were excluded. We carefully analyzed proxies before and after the LTIP adoption date to confirm the newness and uniqueness of coded LTIP adoptions. A substantive LTIP adoption is one in which firms adopted and also announced grants under the plan, and a symbolic LTIP adoption is one in which firms adopted an LTIP in a particular year but did not announce grants of any of the incentive vehicles included under the plan, consistent with Westphal and Zajac (1994). Given that payouts of restricted stock are not contingent on firm performance (Crystal, 1991), stand-alone restricted stock plans were not considered LTIPs. A new LTIP and any initial grants from the plan are typically announced at the same time, in the same proxy statement. This is to be expected, since firms intending to use the plan have no obvious reason to delay implementation until later years. We checked for grants from the year of adoption to the end of the time period studied and found that all firms in our sample that made grants under their plans did so at the same time the LTIP was adopted. Also, one of our analyses measures stock market reactions over the subsequent 390-day period (as discussed below), and that analysis would capture reactions to any grants announced in the following year's proxy statement. LTIP grants ranged from 2 percent of total compensation to 93 percent, with a mean of 26 percent.

We used the two categories of adoption (symbolic or substantive) to create subgroups in the stock market analyses (H1) and to create two dummy variables in the analyses to isolate the effects of symbolic and substantive LTIP adop-

tions (the base case is no LTIP adoption) on other governance changes (H3).

Agency explanations. To determine the presence or absence of agency explanations for new LTIPs, we conducted a basic content analysis of proxy statements in the year of adoption (Holsti, 1968; Weber, 1985; Zajac and Westphal, 1995). New LTIPs are typically announced to shareholders in a separate section of the proxy statement. In addition to describing the plan, these announcements may include an introductory section outlining the rationale for adopting it. Although explanations are nearly always confined to this portion of the proxy statement, we nevertheless carefully checked the entire compensation section of each proxy for any references to the new plan.

We decided not to furnish coders with an exhaustive rule book dictating the categorization of every possible phrase or combination of phrases; Holsti (1968) noted that such coding strategies can artificially inflate reliabilities while sacrificing the content validity of the coding scheme. Accordingly, we simply provided coders with a summary description of the agency perspective, including a short list of key concepts characterizing the theory, and specific coding instructions, consistent with Zajac and Westphal (1995). The coders included an undergraduate student and two doctoral students in business. We asked coders to determine whether an agency explanation was present anywhere in the proxy. Thus, the ''recording unit'' (i.e., the unit of analysis) is the entire proxy statement. Pre-negotiation intercoder reliabilities were very high, with Pearson correlation coefficients ranging from .903 to .972 and an intercoder agreement rate of 95 percent, suggesting minimal ambiguity in the coding scheme. Forty-nine percent of the proxy statements included an agency explanation. Zajac and Westphal's (1995) analysis showed that ''human resource explanations,'' which emphasize how LTIPs help to retain scarce leadership talent, were most prevalent earlier in the time period. They found that over 90 percent of adopting firms providing an explanation for new LTIPs used one or both of these explanations exclusively. They also found that the agency explanation did not reflect any difference in the actual incentive compensation plans, which lends credence to their contention that the language chosen was largely symbolic.

We used the categorization of agency explanation or no agency explanation to create subgroups in the stock market analyses (H2) and to create dummy variables in the analyses that predicted governance changes (H4). In effect, H4 predicts an interaction effect between symbolic or substantive adoption and the use of agency explanations on the likelihood of board changes. The product-term approach cannot be used to test the interaction between dichotomous variables (Jaccard, Turrisi, and Wan, 1990). Thus, to test whether LTIP adoption has stronger effects on board changes when an agency explanation is used, whether or not the plans were implemented, we created separate dichotomous variables for the four different categories of adoption: (1) *substantive LTIP adoption with agency explanation;* (2) *substantive LTIP adoption without agency explanation;* (3) *symbolic LTIP adoption with agency explanation;* and

(4) *symbolic LTIP adoption without agency explanation.* The base case is no adoption, as there can be no agency explanation without adoption. H4 is thus supported if variables (1) and (3) are stronger predictors of board changes than variables (2) and (4).

Other independent variables. *Institutional ownership* was measured as equity held by pension funds, banks and trust companies, savings and loans, mutual fund managers, and labor union funds divided by total common stock (Hansen and Hill, 1991). We used this variable in interaction terms with the LTIP adoption and LTIP explanation variables to test H3a and H4a, respectively.

Control variables. Given some evidence linking poor firm performance to changes in governance structure, including separation of the CEO and board chair positions (Harrison, Torres, and Kukalis, 1988) and the likelihood of appointing outsiders to the board (Hermalin and Weisbach, 1988), we included a measure of operating profits *(return on assets)* in models predicting increased structural board control over management. Moreover, although the evidence is mixed, several studies have shown relationships between firm size and board monitoring or control capacity (e.g., Beatty and Zajac, 1994; Finkelstein and D'Aveni, 1994). Thus, we also included *log of sales* in models predicting greater structural board control.

Given that prior levels of board control might influence subsequent changes in board structure, as well as the stock market reaction to LTIP adoption, we controlled for *prior board control* in all models. We used the following commonly used indicators of board control (cf. Zajac and Westphal, 1995): (1) relative stock ownership by outsiders, calculated as the percentage of total common stock owned by outside directors (Hoskisson, Johnson, and Moesel, 1994); (2) the portion of the board appointed after the CEO; (3) the ratio of outside to inside directors; and (4) CEO/board-chair separation, which we excluded from models predicting separation of the CEO and board chair position, since only firms with combined CEO/board chair positions are at risk of separation. We combined these variables into a single measure using principal components analysis (Jackson, 1991). The results of this analysis yielded only one eigenvalue greater than one, and the scree plot also suggested that only this first component should be retained. We also estimated separate models of change in the outsider ratio, in which the prior ratio of outside to inside directors was included in the model separately from the other measures of prior board control, and the results were substantively unchanged.

Existing incentive arrangements might also influence market reactions to LTIP adoption or the likelihood of subsequent changes in board structure. Thus, given that stock options were the principal form of long-term incentive compensation used at most companies prior to the adoption of LTIPs (Ellig, 1984), we controlled for *prior stock option grants,* measured as the average total value of stock options granted over the prior two-year period divided by average total compensation over that period. We measured option grants over a two-year period because grants are sometimes made on a bi-

annual basis. Options were valued using the Black-Scholes method. We also ran three sets of supplementary analyses in which we controlled for the adoption of another long-term incentive plan and change in board control (using the four measures discussed above), with these variables measured for one of the following three time periods: (1) year t (the year of LTIP adoption), (2) year t+1, or (3) year t through year t+1. These analyses assess whether any effects of symbolic LTIP adoption result from the simultaneous or subsequent adoption of other changes in board composition or incentive compensation. The results were substantively unchanged from the results presented below. Moreover, these control variables were negatively correlated with symbolic LTIP adoption. We also ran separate analyses including dummy variables for primary, two-digit Standard Industrial Classification codes and found that controlling for industry differences had essentially no effect on the results.

We controlled for time effects by including dummy variables for each year in the event history analyses (given the large number of year dummies, coefficients for these variables are not reported in the tables). Descriptive statistics are provided in table 1.

Dependent Variables

Stock market reaction. We followed standard event study methodology (Patell, 1976; Kumar and Sopariwala, 1992) in measuring stock market reactions to LTIP adoption with excess stock returns, or the cumulative difference between a firm's observed return and its expected return during a specified period surrounding adoption. As Lubatkin et al. (1989) noted, excess returns provided by CRSP are superior to simple abnormal returns in at least two respects: (1) they are corrected for biases resulting from nonsynchronous trading (Brown and Warner, 1985), and (2) they compare the firm's returns to a market portfolio of firms with similar betas, rather than an overall market-wide average, thus controlling for various extraneous influences on market returns that may be correlated with systematic risk.

As many authors have noted, a general limitation to event study methodology is the difficulty in defining precisely the time window during which information about an event be-

Table 1

Descriptive Statistics

Variable	Mean	S.D.
Symbolic LTIP adoption	.52	.50
Substantive LTIP adoption	.48	.50
Symbolic adoption with an agency explanation	.27	.44
Symbolic adoption without an agency explanation	.25	.43
Substantive adoption with an agency explanation	.22	.42
Substantive adoption without an agency explanation	.26	.44
Institutional ownership	.34	.22
Prior CEO/board power	.00	1.06
Prior stock option grants	.25	.37
Return on assets	.06	.06
Log of sales	7.91	1.22
CEO/board chair separation	.05	.22
Increased outsider ratio	.03	.08

comes known to the market. In general, long observation windows take into account the potential for information leakage prior to the event date or the possibility of gradual diffusion of information after the event date. Short observation windows, in contrast, reduce the likelihood of contamination from extraneous organizational events during the time period. We used multiple observation windows in this study to ensure that results were not dependent on a particular set of assumptions about information disclosure to the market. We cumulated returns over four different time intervals, three of which are commonly used in the event study literature (Brickley, Bhagat, and Lease, 1985; Kumar and Sopariwala, 1992; Worrell, Davidson, and Glascock, 1993): 2 days (t_{-1} to t_0), 11 days (t_{-5} to t_{+5}), and 31 days ($t_{-5,}$ to t_{+25}). We also recognize that some studies have examined cumulative abnormal returns over a much longer period (e.g., 12 months) to assess whether positive returns dissipate over time or whether they constitute relatively permanent, long-lasting reevaluations of the company and its stock (cf. Dodd and Ruback, 1977; Bradley, 1980; Bradley, Desai, and Kim, 1983). Thus, in the interest of thoroughness, we also examined cumulative excess returns over the subsequent year (t_{-5} to t_{+385}).

Following Kumar and Sopariwala (1992), we observed excess returns from the proxy mailing date, or the date on which the LTIP announcement was sent to shareholders. While some researchers have observed returns from the date of the annual board meeting (e.g., Gaver, Gaver, and Battistel, 1992), Brickley (1986) found evidence for an annual meeting effect that could contaminate results of an event study: for a random sample of firms, he found a positive stock market reaction over the two-day period following the annual meeting, but no such effect for the proxy mailing date. Moreover, the proxy mailing date is the most commonly chosen date for this kind of study (Brickley, 1986: 346). Nevertheless, we also conducted separate analyses using the stamp date, or the date on which the proxy is registered as having been received by the Securities and Exchange Commission (Gaver, Gaver, and Battistel, 1992). The results were substantively unchanged from the findings presented below.

Increased board control structure. To analyze the likelihood of separating the CEO and board chair positions *(CEO/board chair separation),* we created a dichotomous variable for each year, coded as 1 if the positions were separate in the subsequent year, t_{+1}, but not in the current year, and 0 otherwise.[7] We measured increases in the ratio of outside to inside directors *(increased outsider ratio)* by subtracting the ratio in the current year from the ratio in the subsequent year.

Analysis

Analyzing stock market reactions. To test whether symbolic LTIP adoption and verbal enhancement in proxy statements generate favorable stock market responses, we calculated average cumulative excess returns over the time intervals discussed above for all adopting firms, as well as for the following subgroups: substantive adopters, symbolic

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Anecdotal evidence suggests that some firms retain departing CEOs as board chairs for a period of time after succession to smooth the transition between regimes (Vancil, 1987). In such cases, external pressure from shareholders may be less directly relevant to separation of the CEO and board chair positions. The results reported below, however, remained unchanged when we removed these cases from the analysis.

adopters (those adopting but not implementing new plans), substantive adopters providing an agency explanation, symbolic adopters providing an agency explanation, substantive adopters not providing an agency explanation, and symbolic adopters not providing an agency explanation. To assess the significance of excess returns for each group, we used the following test statistic suggested by Brown and Warner (1985: 7):

$$A_t / S(A_t),$$

where A_t is the average cumulated excess return over the relevant observation period, and $S(A_t)$ is the time-series standard deviation of excess returns over a 238-day estimation period. When average excess returns are independent, identically distributed, and normal, this statistic has a student-*t* distribution under the null hypothesis. Moreover, simulation studies suggest that this test statistic is well-specified for samples of 50 or more and for observation periods of various lengths (Dodd and Warner, 1983; Brown and Warner, 1985). This estimation approach is used in most of the prior event studies of LTIP adoption and has become a standard event methodology in the financial economics literature (Brickley, 1986; Kumar and Sopariwala, 1992).

Analyzing increased board control structure. We assessed the effects of symbolic LTIP adoption on the likelihood of CEO/board chair separation and increases in the outsider ratio with discrete-time event history analysis (Allison, 1982; Yamaguchi, 1991) and pooled cross-sectional time series regression analysis, respectively (Sayrs, 1989). In these models, the independent variables are measured over the prior three-year period. Thus, for instance, the models assess the increased likelihood of change in board structure in a given year (t) if firms adopted an LTIP (of various kinds) sometime during the prior three years (t_{-3} to t_{-1}). We used a multiyear period because employment contracts for directors limit the ability of firms to change board composition immediately, for example, in response to greater or lesser pressure from investors. For instance, if directors have employment contracts that expire between one and three years into the future, a board planning to make significant alterations in board composition that involve changing multiple positions may have to implement this change over several years. Given this data structure, we observed changes in board structure from 1985 to 1992, yielding 3,264 firm-years of data. In separate analyses, we examined whether the results were sensitive to this particular lag structure by examining the effect of LTIP adoption over a more recent, two-year period (t_{-2} to t_{-1}) and over a four-year period (t_{-4} to t_{-1}). The results presented below were substantively unchanged, suggesting that our findings are not sensitive to the particular lag structure used in the models.

The discrete-time event history model can be expressed in the following, logistic regression form (Allison, 1984):

$$\log\{P_i(t) / [1-P_i(t)]\} = a + b_k X_{ik}(t),$$

where $P_i(t)$ is the probability of CEO/board chair separation or an increase in the outsider ratio in year t, X_{ik}s are time-varying covariates hypothesized to influence the "risk" or likeli-

hood of change, and b_ks are the estimated coefficients. Moreover, P_i is defined as:

$$\exp[b_k X_{ik}(t)] / (1 + \exp[b_k X_{ik}(t)],$$

such that $P_i(t)$ increases monotonically with $b_k X_{ik}(t)$ and can assume any value between zero and one. With time-varying covariates, a firm's likelihood of change is updated over time as the values of independent and control variables change. All independent and control variables were lagged by one year. The year dummy variables included in all models controlled for unspecified, time-specific factors (Allison, 1982, 1984). Clogg and Eliason (1987) have shown that discrete-time models provide an adequate approximation of continuous-time models, which estimate instantaneous rates of change, when the conditional probability of event occurrence is 0.1 or less. Conditional probabilities are less than 0.1 for both CEO/board chair separation and increases in the outsider ratio.

We modeled only the likelihood of the first event during the time period, removing the firm from the risk set following change, because we assume that increasing board control through structural change reflects a relatively fundamental and long-lasting change in shareholders' expectations about the board's role in controlling management (Useem, 1993). Consistent with this assumption, there were only 17 reversals in board structure during the period of study, representing less than 5 percent of all changes. In effect, this model examines the role of symbolic LTIP adoption in forestalling a lasting shift in the board's orientation toward management.

To correct for heteroskedasticity and autocorrelation in modeling change in the ratio of outside to inside directors, we used GLS pooled cross-sectional time series regression analysis. This model can be expressed in the following equation:

$$B = (X'S^{-1}X)^{-1}X'S^{-1}Y,$$
given
$$Y = X_{nt}B_k + u_{nt}, \text{ with } u_{nt} = v_t + = u_n + e_{nt},$$

where B equals the vector of regression coefficients, X is the vector of exogenous variables, and u_{nt} is the error term, divided into serial, cross-sectional, and combined serial and cross-sectional components: v_t are random over time, u_n are random over cross sections (i.e., companies), e_{nt} are random over space and time. S is the sum of the variances of the three error components (Sayrs, 1989).

RESULTS

Results of the event study are presented in table 2. The results in column 1 indicate significantly positive excess returns for all adopting firms across all four time intervals, providing consistent evidence for a favorable stock market reaction to LTIP adoption, but the results reported in columns two and three of table 2 support H1, which predicted that firms would experience a positive stock market reaction to LTIP adoption, whether or not the plans were implemented. Excess returns are significantly positive for substantive adopters and for symbolic adopters across all four intervals examined.

H2 predicted that when an LTIP adoption is accompanied by an agency explanation emphasizing the role of LTIPs in aligning CEO compensation with shareholder interests, it would engender a more favorable stock market response, irrespective of whether the adoption was substantive or symbolic. Results in table 2 on excess returns for cases of LTIP adoption with and without an agency explanation provide strong and consistent evidence for H2: LTIP adoptions providing an agency explanation elicit more positive stock market reactions than LTIP adoptions without an agency explanation, and this holds true for both symbolic and substantive adoptions. *T*-tests indicated highly significant differences between symbolic adoption with an agency explanation and symbolic adoption without an agency explanation for each of the four time windows; values ranged from 8.69 to 11.98.[8] The fact that LTIP adoptions without an agency explanation show weaker positive excess returns should not be interpreted as suggesting that verbal explanations are more important than LTIP adoption. LTIP adoption, whether substantive or symbolic, is a prerequisite to providing an agency explanation, since such explanations point specifically to the LTIP adoption event in claiming that the firm has reduced the divergence in managerial and shareholder interests through increased incentive alignment. Also, as Jaccard, Turrisi, and Wan (1990: 14–15) noted in their discussion of main effects and interaction effects, knowing that a positive relationship between X and Y (i.e., LTIP adoption and stock market reactions) is greater in the presence of Z (i.e., agency explanations) does not "diminish the utility of the information" that there is an average main effect. The results in table 2 show that symbolic LTIP adoption leads to positive excess returns (H1) and that the presence of the agency explanation is a powerful moderator of that positive relationship.

Although our hypotheses were limited to symbolic action, this pattern of results also applies to substantive LTIP adoption, which is also as we would expect. Our prediction is not that symbolic actions will have a larger impact on stock price than substantive ones but, rather, that they too can have a significant effect on stock price. While the results show that

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This analysis does not rule out the possibility that firms might experience a favorable stock market reaction when providing *any* type of explanation for the LTIPs, but results of separate analyses indicated that excess returns were not significant for the subset of adopting firms that provided another, non-agency explanation for LTIP adoption.

Table 2

Mean Cumulative Excess Returns Surrounding LTIP Adoption: Substantive and Symbolic Adoptions with and without Agency Explanations*

				With Agency Explanations		Without Agency Explanations	
Interval (days)	All adoptions	Substantive adoptions	Symbolic adoptions	Substantive adoptions	Symbolic adoptions	Substantive adoptions	Symbolic adoptions
−1 to 0	2.00••	1.85••	2.13••	2.15••	2.83•••	1.44•	1.37
	(.78)	(.71)	(.84)	(.78)	(.80)	(.81)	(.89)
−5 to +5	1.96••	2.12•••	1.79•	2.31•••	2.44•••	1.22•	1.16
	(.65)	(.59)	(.99)	(.63)	(.67)	(.69)	(.70)
−5 to +25	.96••	.86•	1.15••	2.19•••	2.04•••	.73	.79
	(.46)	(.45)	(.52)	(.55)	(.49)	(.48)	(.54)
−5 to +385	1.99•	1.59•	1.96•	2.31••	2.53••	.98	.91
	(.84)	(.77)	(.90)	(.87)	(.87)	(.88)	(.97)
N	197	95	102	44	53	51	49

• $p \leq .05$; •• $p \leq .01$; ••• $p \leq .001$.
* Excess returns are expressed as a percentage; standard deviations are in parentheses.

agency explanations also accentuate the market's response to substantive adoption, the significant hypothesized effect of agency explanations for decoupled LTIPs—adopted but not implemented—provides a particularly strong test of the consequences of symbolic management.

To control for other variables that might affect these results, we also conducted supplementary multiple regression analyses of excess stock returns (Lubatkin et al., 1989) for those firms that adopted LTIPs. In these analyses we controlled for prior levels of board control, prior levels of incentive compensation, and time of adoption. Results, given in the Appendix, show that the inclusion of these control variables does not affect our hypothesized results: the positive effects of symbolic LTIP adoption established in table 2 were not different from the effects of substantive adoption, and the presence of an agency explanation again provided for greater positive effects, even after controlling for symbolic versus substantive adoptions.[9]

Results of tests for hypotheses 3, 4, 3a, and 4a, on the governance consequences of symbolic actions, are shown in tables 3 and 4. Table 3 includes models of CEO/board chair separation, and table 4 includes models of increases in the outsider ratio. Both tables report a chi-square for these models rather than an F statistic because only the asymptotic properties of the random-effects estimator are known (Greene, 1993). H3 predicted that LTIP adoption, even without implementation, would diminish the likelihood of separating the CEO and board chair positions and increasing the outsider ratio. The results support this hypothesis: model 1 in table 3 shows that the likelihood of subsequent CEO/board chair separation is significantly lower for firms that have symbolically adopted LTIPs, and model 1 of table 4 shows that symbolic LTIP adoption is also negatively related to subsequent increases in the outsider ratio. Taken together, these results suggest that there is not only a substantive substitution effect between the use of incentives and monitoring, but also a symbolic substitution effect, whereby even a decoupled LTIP adoption can forestall changes in governance.

The results in model 2 of tables 3 and 4 also support H4: model 2 of table 3 shows a strongly significant negative effect of LTIP adoption on CEO/board chair separation, for both symbolic and substantive adoptions, when firms provide an agency explanation. Similarly, model 2 of table 4 shows that symbolic LTIP adoption with an agency explanation and substantive LTIP adoption with an agency explanation are both strongly and negatively related to CEO/chair separation. In contrast, model 2 of tables 3 and 4 indicates that both symbolic and substantive LTIP adoptions without an agency explanation are generally not significantly related to increases in CEO/chair separation or increases in the outsider ratio. We also used the Wald test to confirm that coefficients for adoption with an agency explanation were significantly greater than coefficients for adoption without an explanation (e.g., chi-square = 5.09 and $p \leq .05$ for symbolic adoption with an explanation vs. symbolic adoption without an explanation in predicting CEO/chair separation; $F = 15.98$, $p \leq .001$, for the same comparison in models predicting in-

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Moreover, in a separate model we estimated the interaction between time of adoption and the use of an agency explanation on excess returns and found a positive but only marginally significant ($p \leq .10$) interaction, suggesting that agency explanations do not become much more (or less) effective in influencing the market's response to LTIP adoption over the period of this study. This is not surprising, because our prior research would suggest that agency explanations had already acquired considerable legitimacy by the mid-1980s (Zajac and Westphal , 1995).

Table 3

Event History Analyses of CEO/Board Chair Separations ($N = 2,569$)*

Independent variable†	Model 1	Model 2	Model 3	Model 4
Symbolic LTIP adoption	−.825•		−.825•	
	(.372)		(.376)	
Substantive LTIP adoption	−1.079••		−1.197••	
	(.398)		(.444)	
Symbolic LTIP adoption w/out agency expln.		−1.021		−1.591•
		(.728)		(.834)
Symbolic LTIP adoption w/agency expln.		−1.948••		−2.392••
		(.729)		(.909)
Substantive LTIP adoption w/out agency expln.		−1.534•		−2.175•
		(.875)		(1.029)
Substantive LTIP adoption w/agency expln.		−3.905•••		−4.689•••
		(1.215)		(1.449)
Institutional ownership × sym. adoption			−3.376•	
			(1.531)	
Institutional ownership × sub. adoption			−6.039••	
			(2.073)	
Institutional ownership × sym. adoption w/out agency expln.				−3.318
				(2.525)
Institutional ownership × sym. adoption w/agency expln.				−8.281••
				(3.369)
Institutional ownership × sub. adoption w/out agency expln.				−3.605
				(2.692)
Institutional ownership × sub. adoption w/agency expln.				−20.609•••
				(6.59)
Institutional ownership	.516	.217	.530	.227
	(.375)	(.180)	(.388)	(.183)
Prior board control	−.093•	−.098•	−.078	−.086
	(.043)	(.043)	(.043)	(.044)
Prior stock option grants	−.183	−.201	−.182	−.201
	(.178)	(.178)	(.178)	(.178)
Return on assets	−2.731••	−2.221••	−2.689••	−2.040••
	(1.055)	(.781)	(1.061)	(.781)
Log of sales	.095	.052	.093	.052
	(.056)	(.056)	(.067)	(.066)
Constant	1.946•••	2.387•••	1.961•••	2.367•••
	(.579)	(.563)	(.577)	(.584)
Chi-square	42.37•••	48.85•••	58.12•••	69.99•••

• $p \leq .05$; •• $p \leq .01$; ••• $p \leq .001$.

* Unstandardized coefficients are reported; standard errors are in parentheses; *t*-tests are one-tailed for hypothesized effects, two-tailed for control variables.

† Coefficients for industry and year dummy variables are not reported.

creased outsider ratio) (Judge and Yancey, 1986). Thus, use of an agency explanation for LTIPs decreased the likelihood of subsequent increases in board control, irrespective of whether the plans were implemented.

H3a predicted that while institutional ownership may increase the pressure for governance reforms, such as separating the CEO and board chair positions or increasing the outsider ratio, this tendency is dampened when firms symbolically adopt LTIPs. The results support this hypothesis, as evidenced by the significant negative interaction term (institutional ownership × symbolic adoption) in model 3 in tables 3 and 4. Additional results also supported H4a: as the significantly negative interaction terms in model 4 of tables 3 and 4 show, while institutional ownership can create a force for changes in governance structure, under certain conditions, LTIP adoptions with an agency explanation (whether implemented or not) decrease this force; moreover, this interaction effect is not observed for LTIP adoptions without an

Table 4

Event History Analyses of CEO/Board Chair Separations ($N = 4,488$)*

Independent variables†	Model 1	Model 2	Model 3	Model 4
Symbolic LTIP adoption	−.022•		−.021•	
	(.013)		(.012)	
Substantive LTIP adoption	−.022••		−.017••	
	(.009)		(.007)	
Symbolic LTIP adoption w/out agency expln.		−.017		−.024•
		(.013)		(.014)
Symbolic LTIP adoption w/agency expln.		−.040•••		−.040••
		(.013)		(.015)
Substantive LTIP adoption w/out agency expln.		−.033		−.050•
		(.021)		(.025)
Substantive LTIP adoption w/agency expln.		−.065•••		−.076•••
		(.021)		(.025)
Institutional ownership × sym. adoption			−.076•	
			(.040)	
Institutional ownership × sub. adoption			−.419•••	
			(.139)	
Institutional ownership × sym. adoption w/out agency expln.				−.061
				(.041)
Institutional ownership × sym. adoption w/agency expln.				−.092•
				(.041)
Institutional ownership × sub. adoption w/agency expln.				−.221
				(.140)
Institutional ownership × substantive adoption w/agency expln.				−.408••
				(.142)
Institutional ownership	.015	.013	.016	.014
	(.014)	(.014)	(.015)	(.015)
Prior board control	−.002•	−.002•	−.002	−.002
	(.001)	(.001)	(.001)	(.001)
Prior stock option grants	−.001	−.001	−.001	−.001
	(.002)	(.002)	(.002)	(.002)
Return on assets	−.006	−.005	−.006	−.005
	(.007)	(.007)	(.007)	(.007)
Log of sales	.001	.001	.001	.001
	(.001)	(.001)	(.001)	(.001)
Constant	.037•••	.037•••	.038•••	.037•••
	(.010)	(.010)	(.010)	(.010)
Chi-square	25.16•••	28.70•••	38.97•••	42.94•••

• $p \leq .05$; •• $p \leq .01$; ••• $p \leq .001$.

* Unstandardized coefficients are reported; standard errors are in parentheses; *t*-tests are one-tailed for hypothesized effects, two-tailed for control variables.

† Coefficients for industry and year dummy variables are not reported.

agency explanation. In addition, we conducted Wald tests to confirm that the interaction effect was stronger for symbolic adoption with an agency explanation than symbolic adoption without an explanation and found the expected significant differences for both changes in board structure (e.g., chi-square = 4.08, $p \leq .05$, for CEO/board chair separation, and $F = 4.14$, $p \leq .05$, for increased outsider ratio). Thus, the tendency for LTIPs to dampen the influence of institutional ownership on board changes is greater when LTIPs include an agency explanation, regardless of implementation. Overall, the results suggest that despite the widespread belief that institutional investors are driving substantive changes in board structure to increase the board's capacity to monitor and control top management, symbolic actions can forestall such pressures.

DISCUSSION

The findings of this study show that the adoption of incentive plans that symbolically align CEO compensation with

shareholder interests can have important external and internal organizational consequences. First, we found that the stock market reacts positively to LTIP adoption whether or not the plans are actually implemented. Second, we found that using agency language results in a more favorable stock market reaction to LTIP adoption, again, irrespective of whether the plans are implemented. With respect to internal consequences, we also found that appeasing shareholders through the symbolic adoption of LTIPs substitutes for other changes in board structure that are thought to decrease CEO autonomy and increase the board's monitoring capacity. Moreover, this effect exists even when the presumed pressures for such changes are particularly great due to high levels of institutional investor ownership.

The results are striking in their consistency across theoretical and empirical variations. Rather than focusing on a single issue, we identified and quantified two forms of symbolic action, the decoupling of formal mechanisms and the use of socially legitimate language to reinforce decoupling, and tested their impact on two important organizational consequences. Our predictions were supported for both outcomes, and the results also appear robust across different time windows for stock market reactions and alternative measures of board structure.

While prior empirical research has examined the presumed organizational benefits of conforming to institutional norms (Kraatz and Zajac, 1996; Westphal, Gulati, and Shortell, 1997), there is very little large-sample empirical research that has explored the phenomenon of organizational decoupling (Scott, 1995) and even less research examining the consequences of decoupling. This study is therefore distinctive in that we show not only how and why decoupling can enhance organizational legitimacy but also how it affects organizational power relationships. Meyer and Rowan's (1977) classic thesis on decoupling suggested not only that symbolic organizational structures could enhance organizational legitimacy but also that decoupling led to the persistence of organizational relationships (Orton and Weick, 1990). The findings of this study are unique in shedding light on the consequences of both kinds of decoupling.

We also contribute to research on symbolic management in several ways. First, while prior studies of symbolic management have focused primarily on the use of verbal communication to manage impressions (e.g., Salancik and Meindl, 1984; Brown, 1994; Elsbach, 1994), our study illustrates how structural or policy changes (whether decoupled or not) can provide a vehicle or opportunity for such communications. Kamoche (1995) has noted how organizational reality can be socially constructed through a combination of ritual and language. The symbolic adoption of new long-term incentive plans may be particularly effective in this regard, because it not only meets the specific demands of corporate stakeholders for greater managerial accountability but also reifies basic, meritocratic values and associates them with the CEO and his or her decision making. The research reported here

could be fruitfully complemented by qualitative research that explores how basic social values have driven long-standing debates on corporate governance reform.

In addition, while prior symbolic management research has examined how symbolic communications in response to a threat to an organization's image or credibility may affect subsequent firm performance (e.g., Salancik and Meindl, 1984; Marcus and Goodman, 1991; Elsbach, 1994), we examined how proactive symbolic actions and communications affect power and control relationships within the firm. The importance of symbolic management to the power differences and control relationships in the firm follows from a social theory of agency. Specifically, the presence of legitimate formal policies, together with verbal communications that advertise legitimate aspects of those policies, can lead to a symbolic resolution of the agency problem, rather than an economic or substantive solution, by reducing social uncertainty about the alignment of managerial and shareholder interests.

Our findings may shed some light on recent and somewhat surprising empirical evidence suggesting that institutional investors may have very little effect on actual board decision making (Harrison et al., 1994; Kim and Ocasio, 1995). Our results suggest that firms may engage in symbolic management as a means of responding to institutional investors' calls for visible corporate governance reforms. This interpretation is consistent with recent evidence that firms with more concentrated ownership are more likely to use agency explanations for their compensation arrangements (Wade, Porac, and Pollock, 1997). To the extent that firms comply with the wishes of institutional investors through symbolic action rather than substantive change, evidence that the real influence of institutional investors is less than expected should not be surprising. This is not to say that institutional investors have had no effect on corporate governance issues in large U.S. corporations, only that their substantive effect may be less than would be indicated by the intensive media coverage and general public attention. To assess whether the growing activism of sophisticated institutional investors might temper the market's reaction to symbolic management, we also examined in separate analyses the market reaction to symbolic adoption for firms with high versus low institutional ownership (split at the median). We observed significantly positive excess returns for symbolic LTIP adoption both for companies with high institutional ownership and those with low institutional ownership. Thus, the evidence suggests that institutional investors are also influenced by symbolic action.

While this interpretation assumes that institutional investors favor the separation of CEO and board chair positions when agency costs are a concern, a combined CEO/board chair position could also be said to have symbolic benefits, to the extent that combining the positions reinforces the illusion (or reality) of unified managerial control (Salancik and Meindl, 1984). We suggest, however, that today's shareholders are more concerned with the opposite problem: the CEO having too much control and not enough accountability to the board

and to shareholders. Separation of the CEO and board chair positions is the change in board structure/composition most commonly and strongly demanded by large institutional investors like CALPERS (Pozen, 1994) and the Council of Institutional Investors (*Business Week,* 1996). Moreover, these preferences are increasingly shared by other external constituents. In addition, while our theoretical framework explains the effect of LTIP adoption on the likelihood of separating the CEO and chair positions, it is not clear why LTIP adoption would increase or decrease concern about whether the CEO is fully in control. Thus, even if the CEO/board chair combination did have symbolic value for firms in our study, it would symbolize something different (e.g., the romance of leadership) that would neither contradict our theoretical perspective nor provide an alternative explanation for our results.

While this study focuses on the consequences of symbolic action for internal control mechanisms (Walsh and Seward, 1990), there may also be important consequences for external control mechanisms, such as the market for corporate control. Future research could extend our approach and findings to examine whether symbolic governance reforms could reduce the impact of sources of external control on management action. For instance, symbolic action might help explain recent empirical evidence that the market for corporate control does not necessarily lead to substantive improvement in managerial efficiency or reductions in managerial entrenchment (cf. Walsh and Kosnik, 1993; Philippatos and Baird, 1996).

Future research might also begin to examine the limits or the further benefits of symbolic management. For example, do firms that repeatedly engage in symbolic management across multiple domains or issues develop superior skills in this area, with more favorable consequences, or do they develop a negative reputation for such activities with their targeted audiences, resulting in less favorable consequences? Future research might also address whether symbolic governance structures lead stakeholders to view subsequent strategic decisions or other organizational outcomes in a more favorable light. For instance, one could design a study assessing whether symbolic information about governance arrangements affects stakeholders' evaluations of managerial motives for acquisition decisions, given uncertainty about whether an acquisition is motivated by perceived synergies or by the CEO's appetite for personal power, compensation, and stability (Marris, 1964; Hill and Snell, 1988). In this way, one could consider in greater detail the fundamental question raised in the present study: whether the symbolic management of corporate governance changes resolves the agency problem in the domain of social beliefs yet perpetuates existing control relationships, leaving unresolved the agency problem in the domain of substantive policy. The further development of a social theory of agency could stimulate a potentially valuable new stream of research on the economic, political, and social consequences of actions that provide a symbolic, rather than substantive, resolution of the uncertainty surrounding divergent interests in and between organizations.

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APPENDIX: Multiple Regression Analyses of Excess Stock Returns for Firms Adopting LTIPs ($N = 197$)*

Variables†	Interval			
	Day −1 to day 0	Day −5 to day +5	Day −5 to day +25	Day −5 to day +385
Symbolic (vs. substantive) LTIP adoption	−.004	.004	.002	.003
	(.007)	(.006)	(.003)	(.009)
Agency (vs. no agency) explanation	.018•••	.017•••	.009•••	.029•••
	(.006)	(.005)	(.003)	(.008)
Time of adoption	.001	.001	.001	.001
	(.001)	(.001)	(.001)	(.001)
Prior board power	−.001	−.001	−.001	−.004
	(.003)	(.002)	(.002)	(.001)
Prior stock option grants	−.021	−.014	−.004	−.024
	(.018)	(.015)	(.011)	(.004)
Institutional ownership	.038••	.026••	.011••	.036••
	(.014)	(.010)	(.004)	(.017)
Constant	.055	.136	.112	.196
	(.119)	(.123)	(.114)	(.206)
F	3.72•••	3.91•••	3.87•••	4.03•••
R^2	.13	.14	.14	.16

• $p \leq .05$; •• $p \leq .01$; ••• $p \leq .001$.

* Unstandardized coefficients are reported; standard errors are in parentheses; t-tests are one-tailed for hypothesized effects, two-tailed for control variables.

† Coefficients for industry and year dummy variables are not reported.