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Power, Politics and Crisis Response on the Board

It's not the individual directors – it's the competing coalitions they form that determine what boards will do.

When crisis kicks in, we tend to rely on instinct. Familiar solutions and well-honed responses will occur most naturally to us – regardless of their relevance to the problem at hand. If you want to know how someone will cope with adversity, then, in most cases their established strengths will give you more than a clue. This is especially true for top business leaders, who tend to believe devoutly in the wider significance of their personal successes.

Complications arise, however, when decisions must be taken by democratic vote, as happens on corporate boards. Provided the board is diverse, directors with strong opinions based on long experience will need to compete for the support of peers who are more neutral. This process of winning allies through coalition building has enormous implications for firm activity in a crisis, as I describe in a recent ***Academy of Management Journal*** paper (co-authored with Cyndi Man Zhang of Singapore Management University).

Contrasting imperatives in China

China supplies an ideal example of a split on the board that may precipitate coalition building. As part of a raft of market reforms in the early 2000s, boards of Chinese companies were mandated to have one-third independent director representation. Ever since, boards of both state-owned and private companies in China have largely included directors drawn from government agencies as well as the market economy.

We reasoned that, broadly speaking, these two groups have very different instincts. In challenging times, directors steeped in the ways of government will tend to rely upon moves designed to consolidate political capital and curry favour with officials, such as loans from state-owned banks, internal acquisitions (which mirror the operations of state socialism by transferring assets between firms with at least one leading shareholder in common) or state-brokered acquisitions.

For their part, market-oriented directors will aim towards acquiring companies with underrecognised or dormant performance potential. They will also be far more comfortable with efficiency-minded steps such as retrenchments, which may offend the civic-minded sensibilities of their state-oriented peers.

For our study, we made use of the China Stock Market & Accounting Research (CSMAR) database, which contains leadership and financial details of all Chinese listed firms since 1992. We cross-referenced CSMAR entries for the years 2000-2012 with a complete set of loan and acquisition information from data provider **Wind**.

These resources allowed us to trace correlations between the composition of Chinese corporate boards (specifically, the backgrounds of the directors concerned) and firm behaviour. In doing so, we could intuit the political manoeuvring that went on behind the scenes amongst the board directors.

The coalitions in action

Our interest was in finding out more about the coalitions that likely existed on each board, as opposed to how the individual board members were naturally inclined to vote. Not every director fell solidly into one camp or another. The neutrals or those with muddled leanings were also an important factor for us – indeed, they were the reason coalition building was necessary in the first place.

We classified each director as market-experienced, state-experienced, both or no experience. By aggregating the individual director scores, we could measure where the board as a whole stood on the state-to-market spectrum of orientation. Also, we could guess at the size of each coalition, and how ensconced the coalition members were in their experience (judging from the lopsidedness of their CVs *in toto*).

Ranking each firm's performance compared to its own past outcomes and to current competitors, we found that firms with a strong state-oriented coalition were far less responsive *in either direction* to relative performance. (A board's true colours emerge most vividly when performance is on the upswing.) In times of crisis, strategic change may be more urgent, but it is not always undertaken. Still, coalition-building behaviour will look much the same for a given firm no matter whether it is thriving or declining relative to the past. The difference is one of degree.

Low-stateness boards were much more likely to engage in market-targeted acquisitions at moments when performance had dropped below or soared above past benchmarks. But when state-heavy boards *did* act, it was more often in a state-oriented direction than a profit-seeking one.

We would guess that the apparent inactivity of the state-slanted boards was partly related to our use of ROA – a highly meaningful metric for market-attentive leaders, less so for the public sector – as a performance index.

Loans from state-owned banks seemed to contradict the above pattern. For the strongly state-oriented boards in our sample, there was no perceived interaction between relative performance and receipt of loans. On the one hand, this probably partly stems from the banks' reluctance to extend loans to underperforming firms in some cases. On the other hand, we could not detect that the strong-state boards sought out loans from different sources due to changes in performance.

The components of coalitions

To be sure, professional background is not the only stuff of which coalitions are made. It may not even be your trump card: A weak or ill-advised deal may encounter resistance from your inner circle as much as from the opposite camp. To an accomplished bridge-builder, almost any similarity between people can serve as mortar: educational affiliation, geographical or cultural ties, etc. Therefore, in the absence of a background-based link, it helps to know as much as possible about your intended ally.

Our research reinforces the intuition that too much uniformity on the board can generate groupthink and reflex responses that may not be well adapted to the situation. By contrast, duelling perspectives create the need for coalition building, which may be better for decision making. The competition of opposing groups to win over the undecideds may surface a truer sense of each proposal's strengths and weaknesses. For chairs of boards dominated by one coalition, it may be a good idea to play devil's advocate, or at least ensure that otherwise drowned-out voices get a chance to be heard.

Henrich R. Greve *is a Professor of Entrepreneurship at INSEAD and the Rudolf and Valeria Maag Chaired Professor in Entrepreneurship. He is also the editor of* **Administrative Science Quarterly** *and a co-author of* **Network Advantage: How to Unlock Value from Your Alliances and Partnerships**. *You can read his* ***blog*** *here.*