INSEAD Insights: July 2024 Research Picks

By Lily Fang , INSEAD

Recent findings on productive misunderstandings, corporate good deeds that hurt, the effectiveness of governance practices, the human dimension of climate change, and when short selling doesn’t lead to pricing efficiency.

This month’s selection of new research by INSEAD faculty offers some counterintuitive insights, from how misunderstandings can be productive to the possible negative effects of corporate social responsibility under certain conditions.

Other studies reveal the significance of understanding the actions and interactions of human actors to achieve ideal outcomes. They include how traders’ strategic response to short selling can harm price efficiency, why the right structures can shift the needle in tackling the climate crisis, and why board members need the appropriate governance practices to improve firm performance.

1. When misunderstandings can be productive

Misunderstandings often lead to accidents, delays, missed opportunities, waste and conflict in organisations. However, on occasion, they can also lead to beneficial outcomes – at least for one of the parties involved – in what is known as productive misunderstanding and strategic ambiguity.

Under what conditions can misunderstandings be beneficial?

Emory University's **Özgecan Koçak** and INSEAD's **Phanish Puranam** elucidate three mechanisms through which misunderstandings can create positive outcomes: establishing truce, encouraging search and creating resonance. They also define the different boundary conditions for each mechanism.

Read the full paper

2. Why strategic trading in response to short sellers could hurt

Short sellers tend to improve pricing efficiency in the markets thanks to their skill in unearthing private information and their competitive advantage in interpreting public news. However, the reaction of other market participants to their presence can affect price informativeness. INSEAD's **Massimo Massa** and his co-authors* examine if the strategic response to short selling by other informed investors decelerates the incorporation of positive information.

They found that the anticipation of a price decline induced by short sales leads positively informed investors to delay and conceal their trades. This strategic behaviour can reduce price informativeness, potentially harming price efficiency and offsetting the beneficial impact of short sales.

Marco Di Maggio*, Harvard Business School and National Bureau of Economic Research; ***Francesco Franzoni*, USI Lugano and the Swiss Finance Institute; and ***Roberto Tubaldi***, BI Norwegian Business School.*

Read the full paper

3. When corporate good deeds may become a burden

Many firms may find themselves, often unexpectedly, involved in negative events related to ESG (environmental, social and governance) issues during their business operations. Corporate social responsibility (CSR) is believed to have insurance effects against such negative events by building goodwill. However, existing literature raises doubts about the insurance effect, suggesting that under certain conditions, CSR might become a burden rather than a buffer against negative events.

The study by INSEAD's **Kate Niu** and her co-authors* examines how a company's CSR efforts can either help or hurt its reputation depending on the nature of the negative event (associated with morality vs. capability) and the type of stakeholders, namely primary or secondary stakeholders.

Chang Hyun Kim*, China Europe International Business School; and ***Zang Yoonseok* and ***Wang Heli***, Singapore Management University.*

Read the full paper

4. The impact of governance practices on corporate outcomes

Board independence and an alignment of incentives are widely believed to improve firm outcomes, according to agency theory. However, the evidence so far has led to proposals that board members' motivations and capabilities are important factors as well. Yet, it is difficult to assess which governance practices are effective.

To understand the effectiveness of different board governance practices on firm performance, INSEAD's **Andrew Shipilov** and **Henrich Greve**, along with their co-authors*, used machine-learning methods to analyse data of Canadian firms between 2001 and 2010, complemented with interviews with board members. Their findings show that the independence of directors and the alignment of their interests with those of shareholders must be accompanied by practices that result in motivated and capable board members.

Yeonsin Ahn*, HEC Paris; and ***Timothy Rowley*, University of Toronto.*

Read the full paper

5. The human dimension of climate change

At a time when climate adaptation was not given the same weight as mitigation in multilateral negotiations, the government of Sweden launched the international Commission on Climate Change and Development (CCCD) in 2007. The purpose was to promote adaptation as an integral part of the international development agenda and to evoke the “human dimension” of climate change, focusing on strengthening the local capacities of vulnerable communities.

A recent independent evaluation found that Sweden’s climate change initiative contributed to significant and sustained progress in integrating climate, disaster-risk reduction and mainstream development practices at different levels of governance. INSEAD’s **Katell Le Goulven** and her co-authors* explore how the achievements of the CCCD were due in part to its proximity to government decision-making, and in part to new climate finance mechanisms and the Swedish European Union presidency. They argue that the increasing intensity and complexity of climate impacts, in a context of polycrisis, calls for the creation of an international body that would mirror the work of the CCCD on a permanent basis.

*****Johan Schaar****, Stockholm International Peace Research Institute; and* ***Richard J. T. Klein****, Stockholm Environment Institute.*

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