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## Board members' contribution to strategy: The mediating role of board internal processes<sup>☆</sup>

Carmen Barroso-Castro<sup>\*</sup>, M<sup>a</sup> Mar Villegas-Periñan, Marta Dominguez

University of Sevilla, Department of Business Administration and Marketing, Faculty of Business Management and Economics, Avda. Ramón y Cajal, 1, 41018 Sevilla, Spain

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### ABSTRACT

This study aims to explore what directors do on the board, to what extent the processes occurring in the board allow the sharing and integrating of the existing knowledge, thus facilitating the board members' contributions to strategy. We adopt the view that the internal board processes increase the impact of the cognitive resources on board performance. Using survey data from 200 large Spanish companies we demonstrate that directors' level of knowledge of the firm and board job-related diversity positively influence the degree of the board's strategic involvement. Additionally, the internal processes that take place within the board – particularly *Cognitive Conflict*, *the Critical and Independent Approach* and *the Comprehensive Discussion Process* – influence the board's strategic involvement and play a partial mediating role on the aforementioned relationships. However, our results show no evidence for a positive relationship between *Board Meeting Dynamics* and the board's strategic involvement.

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### 1. Introduction

Boards are regarded as a valuable source of knowledge and expertise that can contribute to strategy decision-making actively initiating, implementing and evaluating strategic decisions (Johnson, Daily, & Ellstrand, 1996; Sellevoll, Huse, & Hansen, 2007). Previous studies into the antecedents of the board strategic involvement have paid attention to structural characteristics of boards, adopting an “input-output” focus. However, their results present mixed evidence. This has led many scholars to suggest other lines of research that posit boards as decision-making groups, whose internal processes should be better understood (Forbes & Milliken, 1999; Pugliese et al., 2009).

Board of directors are typically elite, large groups, with episodic functioning and part-time responsibility. The majority of board members are outside directors, whose primary affiliation is to another organization. Because of these distinctive characteristics, boards – more than other groups – face interaction difficulties and their effectiveness is likely to depend profoundly on the social and psychological processes arising from the participation, interaction and exchanges that originate from within the board (Zattoni, Gnan,

& Huse, 2015), these internal processes are critical determinants successfully fulfill its different tasks among which are boards' strategy task.

We propose that the board's degree of involvement in the firm's strategy depends on the set of knowledge and abilities of its directors (Hillman & Dalziel, 2003), and that board internal processes explain how this relation is generated (Ato & Vallejo, 2011). Clark and Maggitti (2012) conclude that the processes taking place in the top management team let effectively integrate organizational resources as knowledge and experience of the executives to formulate a well-developed strategy. Like top managers, boards face complex and non-routine problems in the fulfillment of their strategic tasks. In line with this argument, we adopt the view that the board's process mediating the relationship between resources on which the board bases its prospects of success, and board strategy involvement (Roberts, McNulty, & Stiles, 2005; McNulty, Roberts, & Stiles, 2005). Directors' knowledge and skills have been recognized as an important attribute in the board's strategic task (Minichilli & Hansen, 2007).

Although these ideas have begun to take shape in recent articles on the subject, they still need to be studied more thoroughly (Zattoni et al., 2015). Focusing on board team processes, we investigate the following question: *How do the board's internal processes affect the relation between director's knowledge and abilities and their strategic involvement?* This study aims to explore what directors do on the board, to what extent the processes occurring in the board mediate in the relationship between board job-related diversity,

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<sup>\*</sup> Corresponding author.  
E-mail address: [barroso@us.es](mailto:barroso@us.es) (C. Barroso-Castro).

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board members' in-depth knowledge of the firm and board's strategic involvement. Our main contribution lies in highlighting the importance of board processes as a means through which board members contribute to strategic decision making, helping to open the 'black box' of corporate boards (Zona & Zattoni, 2007), all of which takes into account the arguments of the Behavioral Theory of the Firm (Cyert & March, 1963) and the Team Production Theory (Blair & Stout, 2001), and studying them in a specific context, as is the Spanish case. The literature points out the importance of the board's resources in creating value in the firm (Hillman & Dalziel, 2003; Kor & Sundaramurthy, 2009), but the knowledge and experiences of the board, must be expressed in the boardroom to contribute to the decision making (Samra-Fredericks, 2000). Therefore, it is also necessary to know how the board members behave within the board – if they express different points of view (Cognitive Conflict), if they challenge the proposals from management (Critical and Independent Approach), if board meetings are dominated by certain board members (Board Meeting Dynamics) or if they spend time on productive discussions (Comprehensive Discussion Process). Our results show that the processes that take place within the board play a partial mediating role between board's resources and the board's strategic involvement. Therefore, our research makes a new contribution to this field of study by deepening in the analysis of the functioning of the board as a group of interacting individuals. Our theoretical contribution is the proposal that the board's processes are the mechanisms by which the "complementarity" of the board members should be promoted and the processes should be used to encourage the board to make use of the knowledge and capabilities of all of its members. As a result, this would reduce the problem of bounded rationality and enable the board to function effectively as a collaborative team. The article is structured as follows. First, there is a brief introduction to the literature. Then we outline our theoretical approach and derive hypotheses. After the presentation of our results, we discuss their implications for research and practice before concluding with areas for further research.

## 2. Theoretical background

### 2.1. What happens in the board?

Scholars in organization and strategy raised a number of theoretical perspectives to study the board's functioning (Huse, 2007; Hambrick, von Werder, & Zajac, 2008). In our study we suggest two important perspectives: the Behavioral Theory of the Firm (BTF) (Cyert & March, 1963) and the Team Production Theory (TPT) (Blair & Stout, 2001).

BTF helps to highlight the importance of the board's internal processes to examine more closely the interior of the boardroom and directors' behavior. From its general assumptions, our investigation focuses on bounded rationality (Greve, 2003). Exchanges between directors improves rationality in decision-making as it helps to overcome the limitation of directors' knowledge and skills (Hendry, 2005), increases the options and information sources available (Rindova, 1999) and contributes to a better understanding among all board members (McNulty et al., 2005). Internal board processes representing mechanism through which board members make decisions collectively sharing information through discussion and integration of the different points of view to reach board's strategic involvement. TPT sees the board as a collective body; the basic assumption is that through team production firms are able to achieve a level of productivity, which is higher than the sum of the individual productivities of the resources involved. In this respect, teamwork creates interpersonal ties that strengthen trust and may influence the ability to share knowledge (Nahapiet & Ghoshal, 1998). From this theoretical perspective, directors should

have the ability to share knowledge and generate new knowledge through their collaboration. As no board member is likely to possess the full complement of information and knowledge necessary to achieve the goals desired – due to his bounded rationality –, then working as a team permits greater productivity than that which can be achieved by individual efforts. Board members are expected to bring different backgrounds and perspectives into the boardroom and this will assist the strategic decision-making. However, a more diverse group of people in the boardroom is also more likely to bring different goals, values and norms (Milliken & Martins, 1996; Hambrick, Cho, & Chen, 1996). If not effectively managed this is something, which could lead to shirking and free-riding relationships among directors and reduce or completely diminish the board effectiveness. The TPT highlights the need of delve into the internal processes of the board as a variable that helps explain the degree of effectiveness in achieving the assigned roles (Gabrielsson, Huse, & Minichilli, 2007).

Both perspectives emphasize the role of knowledge for decision-making, showing that the processes taking place in the boards improve their effectiveness, they reduce the problems associated with the bounded rationality and facilitate the transmission of knowledge and the necessary cooperation for the board to function as a team. Taking into account these arguments, our model takes as a starting point the directors' knowledge of the firm and the knowledge derived from job-related diversity in the boardroom. Therefore, we argue that both theoretical perspectives support that directors' knowledge is essential in board's strategic task, and that internal processes that take place within the board mediate this relationship.

### 2.2. Board's strategic involvement

The literature traditionally describes two broad schools of thought regarding the board's involvement in strategy, referred to as active and passive (Castro, de la Concha, Gravel, & Periñán, 2009). The active school, in which our study is based, sees the board's directors as independent thinkers who shape their organization's strategic direction. From this perspective, strategy is the responsibility of both the TMT and the board. The board can bring differing perspectives to the planning of strategy, risk management and execution, potentially leading to better decision outcomes and improved company performance. In this context, "boards are legally responsible for the strategy and they are in an excellent position to contribute to strategy" (Pugliese et al., 2009).

### 2.3. Board members' in-depth knowledge of the firm as antecedent of their strategic involvement

An in-depth knowledge of the firm enhances the directors' involvement in the decisions and makes the board more active. Knowledge on the firm's industry, competitors, customers, and technology and is a sine qua non of board involvement in the strategic decision process (Hillman & Dalziel, 2003). Board members with a solid knowledge on how the industry operates and the firm's competitive environment will be in a prime position from which to advise the firm's management on strategic decisions (Kor & Sundaramurthy, 2009). Moreover, with firm-specific knowledge directors can speak a common language, enhancing strategy discussion in the board (Nahapiet & Ghoshal, 1998). TPT shows that board members must have knowledge of the firm to make decisions that create value (Kaufman & Englander, 2005); while BTF, in spite of noting that the board members' knowledge and resources are limited, recognizes their relevant role in strategic decision making (Wiseman & Gomez-Mejia, 1998). We therefore propose that:

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