Cliques and clones in the board room

PROFILE

Freek Vermeulen obtained a PhD in business administration (cum laude) from Tilburg University and a PhD in Organisation Studies from Utrecht University. He is an Associate Professor of Strategic and International Management at the London Business School, where he teaches on the MBA and Executive levels. He has received the School's "Best Teacher Award" and, in 2008, was announced as the first ever recipient of London Business School's "Excellence in Teaching Award". Freek has acted as an advisor for major companies, is a much sought-after keynote speaker and has been published extensively in highly reputed international academic journals. He currently serves on five Editorial Boards, is a member of the Strategic Management Society and the Academy of Management and served on the Advisory Council of the Academy of Management Journal.

FREEK VERMEULEN REVEALS TO ALAN HOSKING WHAT GOES ON BEHIND CLOSED DOORS AT BOARD MEETINGS.

WHY ARE BOARDS CONSIDERED ELITIST?

Professor James Westphal – currently at the University of Michigan – conducted an elaborate study in which he collected data on 417 firms, interviewed scores of top managers and directors, obtained surveys from no less than 1,098 directors and 197 CEOs at multiple points in time, and came up with an intriguing answer.

He found that the top managers and board members of the US's biggest companies together form an "elite", which acts very much like "the clique of popular kids in high-school". Let me explain.

Specifically, Jim tracked directors' voting behaviour when any of the following four measures were being proposed in the company (which each limit top managers' power):

1. CEOs can not concurrently also hold the seat of chairman of the board (so that the board can operate independently);
2. The company should have a nominating committee to appoint new board members, rather than that the company's CEO controls this process;
3. The director at some point had voted to dismiss the (underperforming) company's CEO (a measure clearly not in the interest of the CEO!); and
4. The company should revoke a so-called poison pill construction – a mechanism that makes it difficult for a firm to be acquired against top management's will (so that even when top management is doing a poor job, and the company is underperforming, they still can't be ousted by new owners)

Jim examined what had happened to the directors that had voted in favour of adopting one or more of these ("controversial") measures …

First, what you have to realise, is that people who hold board memberships more often than not also are members of the boards of other companies. If a particular board member, at some point in time, had voted for one of the above measures, which remove privileges from top managers (that is, members of the elite) and gives it to investors (who are not considered part of the elite), their fellow directors at other boards would subsequently start to give them the cold shoulder. The board member would become unpopular with the rest of the in-crowd, and get treated as "a traitor".

HOW DID THIS MANIFEST?

The questionnaires and interviews (conducted with both the "unpopular board members" themselves as well as with their former "friends") clearly indicated that the other boards' members would start to engage in subtle behaviour intended to punish the deviant person, such as neglecting to invite him to an informal meeting, not asking his opinion or advice in formal meetings, not acknowledging or building on his comments in discussion, engaging in exclusionary gossip whereby they would talk about other people and events with which the director was not familiar, and so on. Basically the good old pretend-you're-not-there kind of stuff.

Board members said that the deviant persons "can expect to be ostracised", and that "people are less interested in working with them". One director said, "The directors (who had voted for one of the four changes) get treated differently – I think they get put on notice a bit", while another commented, "It will hurt you. You won't get thrown off the board, but you definitely won't get treated the same. In a way you get treated like the enemy – or at least as suspect". One director, who had once voted in favour of one of the measures, related his own experience: "After we fired the CEO I got the cold shoulder from colleagues at another board… I didn't get invited to an important meeting".

ISN'T THIS A BIT JUVENILE?

It certainly does remind one of one's high school days ... Water in your locker, a "Kick me" sign on your back, your school books thrown in the bin, your clothes missing when you returned from the gymnasium shower. That's the reality of a deviant board member who went against the wishes of the elite.

And, guess what, it worked. Jim, in his statistical analysis, also examined what the subsequent voting behaviour was of the directors who had been subject to such treatment. Whenever, in the ensuing years, there would be another vote about one of the four aforementioned measures, the directors would cave in, and vote against it. They didn't dare do it again.

DO CEOS AND DIRECTORS THEN MERELY LOOK TO APPOINT CLONES OF THEMSELVES?

Let me answer this by posing and answering a few pertinent questions. Who do CEOs think should succeed them? Well, someone like them, of course.

But then, who do their boards think should succeed the CEO? Well, someone who is much more like the members of the board, of course.

Then what does the CEO think should the next board member ideally look like? Well, someone quite like him, of course.

Does the current board agree with this? No, usually not; they think the new board member should be much more like them.

This sort of sums up the research that professors James Westphal and Ed Zajac (at the time both at Northwestern University) did in the mid-1990s on CEO successors and the background characteristics of newly appointed board members. Surprising it is not – we all like people who are like us, and think that they are so much more competent than the next guy – but I still find it quite striking (if not shocking) how Jim and Ed could so easily uncover evidence of these tendencies using a few simple statistics.

They measured some straightforward background characteristics of all of these guys (sorry… yes, usually guys), such as their age, their functional background, education and so forth, in 413 Fortune 500 companies. Using these measures, they computed how dissimilar newly appointed CEOs and board members were from the prior CEO and from existing board members.

If the incumbent CEO was in a powerful position (because he was both CEO and chairman of the board, had long tenure, the firm had been performing relatively well, and because there were few outside directors on the board, who owned little stock), incoming CEOs and board members would be much more like the previous CEO – obviously this guy used his powerful position to make sure someone was selected who could be mistaken for his clone. Yet, the reverse was true too; if the board members had more power, they would select someone quite unlike the CEO and much more similar to themselves.

IS THIS A GOOD THING?

Not at all. The tricky thing is, of course, when the CEO succeeds in selecting more and more board members who are just like him. Then the process escalates because board members and CEO start liking the same people! Eventually, everyone in The Firm starts to look alike, talk alike, has the same background, education, taste in cars, dress, entertainment, and so on and so on. Sounds familiar? Know any companies like that? Perhaps you're employed by a firm just like that (and good chance that you fit in nicely …), or perhaps it reminds you of this phenomenon called "the success trap", or perhaps – and even worse – both!

Interestingly, Jim and Ed also analysed what happened to the compensation packages that firms offered to their CEO, if the CEO succeeded in selecting more and more people like them. Guess what, the percentage of his pay that was

performance related went down, while the total amount of his compensation went up …!

SHOULD DIRECTORS BE FRIENDS?

Lately, boards of directors in various countries and systems have been subject to considerable frowning, loathing, smirking and indecent hand gestures. Comments made include, "They're all part of the same elite", "corporate amateurs", "never really objective", "not really independent", "an old-boys-network", and so on. Surely, it is said, those directors that are pretty much personal friends of the CEO will be most useless; they will just protect him and never really be critical, asking the nasty and awkward questions they should be asking.

Yet, is this necessarily so? Do "friends" make for bad directors? Professor James Westphal, of the University of Michigan (yes, him again), became sceptical of the sceptics. He investigated whether social relations between board members and CEOs really are as harmful as assumed. He extensively surveyed 243 CEOs and 564 of their outside directors and examined whether personal friendships and acquaintances made for less effective board members.

First of all, he found that the boardroom friends hardly ever engaged in less "monitoring" of the CEO (that is, checking strategic decisions, formal performance evaluation and so on) – the traditional stuff that directors are supposed to do. They were still quite active in that sense, despite being the CEOs personal friend.

In addition, Jim found that boardroom friends engaged a lot in another type of behaviour towards the CEO: ongoing advice and counselling. They gave their CEO informal feedback about the formulation of the firm's strategy: they acted as a 'sounding board', continuously provided general feedback and suggestions, etcetera. All this happened outside the company's formal board meetings. Directors who were not personal friends hardly engaged in this type of behaviour.

> "Psychologically, it is just a bit more secure to listen to criticism from someone you know and trust than from a formal stranger."

Usually CEOs don't easily do this; accept or even ask for ongoing counselling and opinion. It is well-known from research that a primary inhibitor to seeking advice is the perceived effect it could have on the advice seeker's status. People often believe that others will view their need for assistance as an admission of uncertainty or dependency and as an indication that they are less than fully competent or self-reliant.

Little doubt that CEOs – who are expected to be confident, proud and self-assured – have these tendencies too! Fierce, testosterone-driven CEOs may not take criticism or even advice easily, but if the director is a personal friend, it might just be a bit easier to swallow. Psychologically, it is just a bit more secure to listen to criticism from someone you know and trust than from a formal stranger. Hence, having your friends in the boardroom may not be such a bad thing after all. *(HR)*

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BRAND IMAGE

Brand associations are the determinants of brand image. Keller defines brand image as an amalgamation of the perceptions related to the product related/non-product related attributes and the functional/symbolic benefits that are encompassed in the brand associations that reside in consumer memory.

Marketing literature supports the concept that product brand equity is strengthened when the brand image resonates with the consumer. As brand awareness heightens, consumers begin to develop positive identification with the brand. The more positive the brand is perceived to be, the more highly identified the consumer becomes with the product. As social identity theory suggests, in the end, the consumer purchases the brand because of the positive self-concept that results from feeling membership with the brand. In a similar manner, as potential employees find positive aspects of the employer image, they are more likely to identify with the brand, and will more likely choose to seek membership with the organisation for the sense of heightened self-image that membership promises.

BRAND EQUITY

The concept of brand equity provides a complementary theoretical perspective for understanding employer branding. In brand guru David Aaker's book, Managing Brand Equity, he defines brand equity as the brand assets (or liabilities) linked to a brand's name and symbol that add to (or subtract from) a product or service. These assets can be grouped into four dimensions: brand awareness, perceived quality, brand associations and brand loyalty. Applying this thinking to employer branding, I have developed a Model of Employer Brand Equity™.

MODEL OF EMPLOYER BRAND EQUITY™