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Finance-oriented directors and crisis management: Blissful ignorance in the hospitality industry?

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ABSTRACT

The primary purpose of this study was to examine the demographic characteristics of Boards of Directors in the hospitality industry, and how those characteristics can impact a firm's performance during a major crisis. More specifically, using the upper echelons perspective, this study examined the impact of finance-oriented directors, and directors who were outsiders, on a company's stock price during the great recession. Results using companies from the hospitality industry indicate that companies that had the highest percentage of finance-orientated directors tended to fall further and recover less quickly. Yet, in the aftermath of the crisis, companies that performed worse during the crisis tended to increase the percentage of finance-oriented directors. The authors of the study assert that extending the application of the blissful ignorance effect is a logical explanation for the behavior found in the results.

1. Introduction

How an organization performs during changes in its external environment can be critical to its success (Cho & Hambrick, 2006; Hambrick, 2007; Ocasio, 1997). This can be particularly true when companies experience a crisis (Goldberg & Petasnick, 2010). In the hospitality sector, for example, potential crises include: outbreaks of food-borne illnesses, rodent infestations, equipment breakdowns and supply disruptions. Perhaps most calamitous is when whole industries, or whole economies, are hit with a wide-spread crisis, such as a natural disaster or an economic collapse, that is defined as a high-impact event that threatens the organization's viability and is characterized by ambiguity of cause and effect (Brandstrum, Bynander, & Hart, 2004; Pearson & Clair, 1998). Though wide-spread crises occur somewhat infrequently, they do present opportunities to examine how differing organizations perform while facing a similar scenario. As such, research on these larger events could shed light on how organizations perform during more local disasters.

Inspired by a framework for crisis management by Smits and Ezzat (2003), which was itself influenced by the upper echelons perspective (Hambrick & Mason, 1984), the primary purpose of this paper was to examine the impact of finance-oriented directors on a company's ability to successfully manage a major crisis. Post hoc tests were then used to explore any significant changes in the percentage of finance-oriented individuals on the BODs during a major crisis. Finally, the author(s) of this study assert that the combination of the results from the primary, and ad hoc analysis, are best explained by extending the managerial application of the concept called “blissful ignorance”.

2. Literature and hypotheses

In 2003, Stanley Smits and Niveen Ezzat presented a framework for crisis management that argues that firm performance during a crisis event is the responsibility of organizational leadership; that a firm's response to a major change in their environment is shaped by the ability of organizational leadership to adequately process information in a timely manner (Ocasio, 1997; Smits & Ezzat, 2003). And while many actors within an organization may play a role in environmental scanning, much of the data gathering and interpretive work is assumed to be done by the organization's leadership (Cho & Hambrick, 2006). In turn, the ability of an organization's leadership to effectively and efficiently respond to information is dependent, at least in part, by the characteristics of that team—the upper echelon perspective (Hambrick & Mason,

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1984; Hambrick, 2007).

Significant evidence exists to support purported links between the demographic characteristics of the organization's leadership and organizational actions (Hambrick, 2007; Nielsen, 2010a; Adams et al., 2015). For example, studies have found significant relationships between the demographic makeup of an organization's leadership and a company's proclivity to discuss entrepreneurial issues (Tuggle, Schnatterly, & Johnson, 2010), its inclination to internationalize (Rivas, 2012; Hsu, Chen, & Cheng, 2013), and their bent to focus on innovation (Talkea, Salomob, & Rost, 2010). Further studies have successfully linked demographic characteristics to a firm's voluntary financial disclosure choices (Bamber, Jiang, & Wang, 2010), the comprehensiveness of a firm's strategic decision-making process (Fredrickson & Iaquinto, 1989) and the makeup of an organization's strategy (e.g., Geletkanycz & Hambrick, 1997; Alexiev, Jansen, Van den Bosch, & Volberda, 2010).

However, as for a direct link between the demographic characteristics of a firm's leadership and firm performance, there is mostly conflicting evidence (Nielsen, 2010b; Adams et al., 2015). As such, there remains a need for further tests of the link between demographic characteristics and firm performance.

Since the publication of the seminal paper on the Upper Echelon perspective (Hambrick & Mason, 1984) the demographic characteristic that appears to have garnered the most attention is diversity, this includes several reviews, at least one meta-analysis and numerous papers (Adams et al., 2015; Homberg & Hong, 2013; Nielsen & Nielsen, 2013; Nielsen, 2010a; Talkea et al., 2010). Emulating the general links between leadership characteristics and firm performance, there is a lack of consensus among studies that have examined the specific link between leadership diversity and firm performance.

On one hand greater diversity should make it more likely that leadership will become aware of new stimuli and to include it in relevant discussions, thus leading to better performance (Hambrick & Mason, 1984; Hambrick, 2007). And results of one recent study, Ferrero-Ferrero et al. (2015) showed that greater age diversity can lead to more effective visions and strategies, which in turn leads to a greater adoption of more effective corporate governance codes. In another study, Terjesen, Couto, and Francisco (2016) found that gender diversity directly leads to higher firm performance.

On the other hand, greater leadership diversity could increase social friction and discourage social integration, which could negatively impact the efficiency of the decision-making process, leading to larger hits on the bottom line (Adams et al., 2015; Ferrero-Ferrero et al., 2015; Li, 2013; Smith et al., 1994). In sum, past tests on the relationship between diversity and firm performance have found negative effects (Murray, 1989), no effects (Homberg & Hong, 2013; Michel & Hambrick, 1992; Nielsen, 2010a) and positive effects (Eisenhardt & Schoonhoven, 1990) Therefore, further studies are needed to establish which of the three scenarios is most valid.

Given the lack of concrete guidance from either the theoretical or the empirical realm, the author(s) of this study crafted a set of hypotheses using the assumption that there is a positive relationship between leadership diversity and firm performance during a crisis event. Support for such a perspective can be found in a paper from Talkea et al. (2010) and others, who convincingly argued that demographics characteristics of the Board of Directors, specifically diversity, can among other things, enhance firm performance by facilitating innovation, which in turn, generates new ideas that could help companies weather a widespread economic crisis (Chavan, 2005; Smart & Vertinsky, 1984; Zack, 1999). Therefore, the author(s) of this study argues that TMT diversity can have a strong positive impact on choices made, which in term leads to better firm performance.

This leads to two sets of hypotheses:

Hypothesis 1a. During a major economic crisis, firms having a higher percentage of outsiders on the BODs will fall less than firms having a lower percentage of outsiders on the BODs.

Hypothesis 1b. During a major economic crisis, firms having a lower percentage of individuals with a finance orientation on the BODs will fall less than firms having a higher percentage of individuals with a finance orientation.

Hypothesis 2a. During a major economic crisis, firms having a higher percentage of outsiders on the BODs will have a better recovery than firms having a lower percentage of outsiders on the BODs.

Hypothesis 2b. During a major economic crisis, firms having a lower percentage of individuals with a finance orientation on the BODs will have a better recovery than firms having a higher percentage of individuals with a finance orientation.

3. Method

3.1. Sample

The author(s) identified 81 hospitality companies listed on either the NYSE or the NASDAQ exchange. The author(s) of this study elected to use the hospitality industry because unlike industries such as manufacturing, the hospitality industry is crisis prone and vulnerable to numerous external pressures (Ritchie, 2004).

3.2. Data sources

All primary and post hoc data was gathered through the use of DEF 14As and 10Ks using the Edgar company filings website of the SEC; and Yahoo Finance.

3.3. Timeframe

This study explored the link between BOD diversity and firm performance during the Great Recession. The U.S. National Bureau of Economic Research declared that the ‘Great Recession’ started on December of 2007 and ended on June, 2009. Therefore, this study used December 1, 2007 as the starting point for this study and June 30, 2009 as the end point of this study.

3.4. Dependent variables

Given the relative paucity of empirical investigations on the determinants of firm performance during a crisis, widely accepted constructs for measuring performance during a major crisis do not exist. However, the work done by Smits and Ezzat (2003) suggests that the extent of a firm's fall and the extent of a company's recovery could be two reasonable metrics.

To determine the extent of a firm’s fall and the extent of a company’s recovery, the author(s) first utilized Yahoo Finance’s Interactive Stock Chart to tract the Dow Jones Index from December 1, 2007 to June 30, 2009. During the 18 months of the Great Recession, the Dow Jones composite hit its nadir on March, 9th of 2009. Not surprisingly, the movements of the individual stocks used in this study have similar V configurations, with 80% of the individual stocks used in this study hitting their nadir 30 days within the ninth of March of 2009.

Therefore, the author(s) used the stock price on the day each company hit its nadir to calculate both the extent of a company’s