THE BEHAVIORAL THEORY OF THE PRIVATE FIRM – GOVERNANCE INFLUENCES ON RESPONSES TO PERFORMANCE SHORTFALLS (SUMMARY)

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THE BEHAVIORAL THEORY OF THE PRIVATE FIRM – GOVERNANCE INFLUENCES ON RESPONSES TO PERFORMANCE SHORTFALLS

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Principal Topic
Research on performance feedback, growing out of the behavioral theory of the firm, argues that organizations are more likely to undertake organizational change when firm performance declines below aspirations – or satisfactory levels for performance. Despite the substantial growth of research in this area, few studies consider how cognitive limitations and personal preferences of decision makers might influence this process. A potential reason is that the majority of studies investigated responses to performance feedback in the context of large public organizations where, as we argue, large managerial structures and external oversight may reduce the influence of personal preferences and behavioral biases on organizational-level decisions.

Focusing on private firms, our theoretical development suggests how governance structures can prohibit that self-enhancing cognitions of decision makers bias strategic decision making. Specifically, we contend that governance characteristics such as management team size, independence and turnover can limit the extent to which decision makers feel personally responsible for poor performance and subjectively assess low performance as satisfactory. This leads to theoretical predictions about how governance influences the likelihood that decision makers implement strategic change in response to poor performance.

Methods
We test our hypotheses using data on 8,543 Belgian private firms over a 19-year period using fixed effects specifications and controlling for alternative risk based explanations.

Results and Implications
In line with our theoretical predictions, results show that governance characteristics significantly influence responses to low performance in private firms. An increase in management team size, independence and turnover stimulates organizational change following low performance. Identification with the firm in contrast suppresses change.

Our study turns attention to the role of governance in guiding responses to performance feedback. Specifically, our theoretical framework and empirical results suggest that an important role of governance is to limit individual level behavioral issues from biasing performance assessments; and hence firm-level responses to performance shortfalls. This paper specifies boundaries on performance feedback theory's critical prediction that low performance induces organizational change and increases understanding about the differences between governance in privately and publicly held firms.

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