

Listen to the non-experts

Expert advice? Research shows banks are more likely to fail *if* their boards were dominated by directors who were experts in banking. Risky decisions are for non-experts.



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Boards need some expert advice to help guide management decisions. For example, a bank's board of directors should probably have at least a couple of high-level executive bankers with deep knowledge of the industry.

Common sense might then suggest that packing *more* experts on a board would make a good thing better. But [research published in the *Academy of Management Journal*](#) says this is

not so: Too many experts on a board can be downright dangerous and lead to business failure.

IESE's [John Almandoz](#) and co-author András Tilcsik analyze data from more than 1,300 U.S. community banks over 17 years and show a clear link between the proportion of experts on boards and the banks' chances of failure during times of uncertainty. They also interview scores of bank CEOs and directors to pinpoint three contributing factors — with implications that resonate beyond the world of banking.

The recipe for failure?

The co-authors conclude that expert-dominated boards make failure more probable when businesses are engaging in uncertain or unfamiliar activities. For community banks, these types of activities include pursuing rapid growth, high-risk lending (especially in real estate or construction) and competing in saturated local markets. Meanwhile, keeping to a steady course with low-risk endeavors is generally unaffected by board composition, they observe.

Understanding why expert-dominated boards might fail in risky situations can help managers and shareholders build better governance structures. The study identifies three main dangers: experts' (1) cognitive entrenchment, (2) overconfidence and (3) suppression of alternative views.

1. Thinking inside the box

Cognitive entrenchment describes what psychologists observe when we gain deeper expertise in an area but also become less flexible in our thinking. On the one hand, we know more details and are more accurate. Yet, on the other hand, we have a harder time changing course or responding to new circumstances as experts. In short, expertise can come at the expense of thinking outside the box.

So, while experts have deep knowledge of their field, they can be rigid or reluctant to adapt to unfamiliar situations. In the interviews with CEOs and other directors on boards, it is noted that experts may bring "baggage" or "habits" from previous roles to the table and may not look at a situation "with fresh eyes."

This means experts may fail to anticipate new threats from competitors or adapt to changing conditions.

2. Daredevil behavior

The co-authors' interviews also show how experts may view risk in overly optimistic terms. They can become overconfident, buoyed by faith in their abilities and their experiences of past success. Almandoz recalls a banker's boast: "Every deal is doable; you just have to know how to structure it."

At board meetings, non-banker directors (often high-status professionals from other fields) may require more thorough explanations than the domain experts to make a decision. Meanwhile, a seasoned banker may, for example, push to offer loans for construction based on positive past experiences rather than on current risk analyses as market conditions change.

There is another point to consider: experts are often granted especially strong authority on boards. Pressure to live up to high expectations may encourage experts to conceal any gaps in their knowledge, rather than to admit uncertainty or lack of confidence in their abilities. This can result in rushed decisions, taken with a poor sense of the real risks involved.

3. Suppressing disagreement

If domain experts are more likely to be rigid or overconfident at risky times, why don't the non-expert board members point this out? Interviewees suggest that conflict avoidance happens where experts dominate. One CEO observes, "[where] everybody respects each other's ego at that table... at the end of the day, they won't really call each other out."

To make effective and responsible choices at uncertain moments, boards need a healthy level of disagreement and members who play the devil's advocate role. More non-expert directors at the table can better challenge the entrenched experts' views. A bank CEO with only a few experts on the board says, "When we see something we don't like, no one is afraid to bring it up because we are not stepping on anybody's toes because of their massive banking experience in the past."

In sum, the co-authors offer both empirical evidence and interviewees' insights to support the idea that boards shouldn't be dominated by experts. A counterbalance of non-experts, from different fields, is important for good governance — especially at challenging times, when a company's future is at stake.

Methodology, briefly

The co-authors interpret data from 1,307 U.S. community banks between the years 1996 and 2012, a time period covering two U.S. recessions. They use a longitudinal dataset — a set that tracks the same type of information on the same subjects at different points in time — on bank failures and the professional background of both expert and non-expert bank directors. They also draw on interviews with 73 community bank CEOs, directors, regulators and consultants.

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