

Busy Boards: The Effect of Multiple Directorships on Corporate
Governance, Firm Monitoring and Performance in Australia

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I. Aims and Background

Aims

This project will focus on the instances of multiple directorships for Australian directors. The study will relate the existence of busy boards on the quality of corporate governance, firm value, and firm operating performance. More specifically, the project will aim to answer the following research questions:

- What is the rate of turnover and of renewal of Australian directors since ASX Corporate Governance guidelines of 2003? What is the extent of multiple directorships in ASX 200 companies?
- Do firms served by busy boards exhibit different levels of value and profitability when compared with other firms whose directors are less busy?
- How do the capital markets perceive the appointment of well-connected (but inevitably busy) directors?

Background

In a recent report commissioned by Australian Council of Super Investors (ACSI), ISS Australia reports that a significant number of directors in ASX 100 companies now hold multiple directorships. In 2006, 123 directors collectively held more than 45% of all board seats in ASX 100 companies. This trend has in fact been growing - in 2001 (first year such a report was produced) 72 directors held about 31% of all board seats, but by 2005, 117 individual accounted for 43% of all ASX 100 company board seats.¹ In another, but related, ISS reports that in 2004 existing ASX 200 directors were 4.4 times more likely to be chosen to fill a vacant board position in another ASX 200 company.² The implications of these analyses are that one, the speed of renewal of Australian boards is slow, and two that the gene pool of Australian company directors is essentially static.

Multiple directorships are thought to signal director quality. Fama and Jensen (1983) argue that the market for multiple appointments creates incentives for directors to develop their reputation as good monitors. Studies by Gilson (1990), Coles and Hoi (2003), and Harford (2003) provide support for the notion that directors undertake decisions that are consistent with both the directors' creating reputational capital and provide them with additional appointments, increase their visibility, and provide lucrative commercial opportunities. Additionally, Booth and Deli (1995) suggest that multiple directorships permit firms to maintain advantageous relationships with their suppliers and

¹ "Board Composition and Non-Executive Director Pay in the Top 100 Companies: 2006", and "Director Talent Pool Keeps on Narrowing", August 2007, available from www.acsi.org.au

² "Analysis Shines Light on the Pace of Change in the Director's Club", The Age, 5th April, 2005.

customers, and further, the larger the firm, the more important these directorships become both to the firms and to the individuals.

However, other studies also suggest that too many directorships *lower* directorial effectiveness. Core et al (1999) report that busy directors provide excessive compensation for their CEOs, which results in lower firm performance. Shivdasani and Yermack (1999) provide evidence that suggests that busy directors cater to the CEO, thus compromising their monitoring role. If this indeed is the case, busy directors may not fully represent shareholder interests. In a recent study Fich and Shivdasani (2006) show that firms with busy directors exhibit lower book-to-market ratios as well as weaker operating profitability. They also present results that suggest that if directors are busy, the rate of CEO turnover (in response to performance) is significantly lower than otherwise. Finally, if busy directors take on another appointment, the firms where they already serve exhibit negative abnormal returns.

In the U.S., professional bodies have also recognized the possible detrimental effects of multiple directorships. Ferris et al (2003) cite reports by Council of International Investors (1998) and National Association of Corporate Directors (1996) that suggest that directors should not serve on more than two or three boards. The Business Roundtable (1997) by contrast believes that it is not necessary to impose limits on number of directorships. Finally in a survey of directors of Fortune 500 companies, although the directors indicated that they turned down appointments due to lack of time, they did not support placing mandatory limits on the number of boards they could serve on.

Significance & Innovation

The preceding literature review indicates the relevance of multiple directorships on shareholder interests and on firm value. We are not aware of any published evidence on consequences of multiple directorships on quality of corporate governance and on firm value for Australian firms. Our empirical evidence on “busyness” and value will provide implications of the recent trends both for shareholders (in short- and long-run) and for proponents of good corporate governance.

We expect the project output to also result in a thought-leadership article that will directly address issues that are currently being canvassed by professional bodies representing institutional investors. For instance, in a recent article Phil Spathis, Executive Officer, ACSI noted that “...investors needed to pay more attention to how boards were selected given the increasing prevalence of appointments from within”, and “It’s an open question whether these people are being selected because they are the best, most experienced directors”³. A continuation of this trend suggests that these directors are increasingly becoming more busy and perhaps less likely to efficiently perform their monitoring functions. The results of the paper will have several implications regarding the current evolution of board structures and corporate governance guidelines in Australia. By highlighting the value consequences of multiple directorships, it will allow companies (and their directors and shareholders) to make more informed, and perhaps optimal,

³ “Director Talent Pool Keeps on Narrowing”, August 2007, available from www.acsi.org.au.

choices regarding their board design. It will also inform the policy debate on the pace of renewal of Australian boards. Finally our results will also directly contribute to the discussion that questions whether the benefits of increasingly fewer numbers of unique directors (namely establishing reputation), are balanced by the costs such as decreasing ability to monitor management and reduced firm values.

Our study should be of great interest to professional bodies such as ACSI, Australian Institute of Company Directors (AICD), and Investment and Financial Services Association Limited (IFSA). We aim to interact with these professional bodies to solicit their suggestions that may allow for a well-designed experiment. Further, our results will also inform the continuing debate about the provisions in the ASX Corporate Governance Guidelines. Our results can be easily incorporated in a (say) one-day corporate governance symposium at MCFS or be presented at other sponsored conferences and seminars. We expect these presentations to garner significant interest amongst professional bodies (including fund managers) that are continually concerned with the quality and level of corporate governance of the firms they invest their clients moneys in.

Taken together, our results will utilize a unique and hitherto unexplored experimental design to provide insights that will inform the continuing debate about the role played by directors and corporate governance.

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