

17. Corporate Governance: Asian Boards of Directors

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Project Summary

This project is directed at collecting data on Asian firm governance structures and analysing the determinants of Asian firm board size and board composition. The Asian focus of the study is important because little is known about how Asian firms choose their board and how these boards change over time.

Recent theoretical modelling suggests that board size and composition decisions are endogenous to the firm but there are few empirical tests of this question reported in the literature. This project addresses this gap in the literature, with a focus on Asian companies.

The project will involve updating an existing data set of Asian firm director and shareholder information to span the period 1999 to 2004. The data set currently covers 1999 to 2002 and this project will add the years 2003 and 2004.

Literature in the area

Our understanding of corporate governance in Asian companies is limited at present and this project will extend our understanding of the determinants of Asian firm board size and composition. Perhaps the lack of information may go some way to explain the strong the home bias (French and Poterba, 1991) that is evident in Australian superannuation investment policies at present.

The corporate governance literature has generally focused on the relationship that might exist between firm performance and either board size or the level of board independence (Denis 2001; Hermalin and Weisbach 2003). It is often stated that better boards lead to better performance but it has proven quite difficult to identify what a better board is and to determine the best measure of performance for these comparisons. More recent research suggests that decisions concerning the board of directors is endogenous to the company. The board is but one part of the governance system that exists in the company and so it is possible that there will be no direct relationship between performance and board independence in a cross-sectional sense.

There is little research dealing with board size and composition. Strong statements have been made supporting smaller boards and greater levels of independent directors on the board. For example, it is suggested that the directors on smaller boards are more willing to discuss issues and that smaller boards are less risk averse and can react more quickly to changing market conditions (Yermack 1996). But if the board is truly endogenous to the firm then it is unlikely that there is one optimal board size for all firms or that there is an optimal board composition that applies to all firms (Hermalin and Weisbach 2003).

The theory underlying the board size and composition consists of some early work noting the importance of small boards (Yermack, 1996) and two recent papers, Raheja (2005) and Harris and Raviv (2005). Both of the more recent models rely on the existence of equity agency costs and costly monitoring and the authors show that that the choice of board size and board composition is endogenous to the firm. Essentially, there is a trade-off between the monitoring cost of adding extra outside

directors and the agency costs that are associated with inside directors who run the firm. In the empirical analysis that is a key part of the research, the proportion of executives that are directors (EXECS) is used to capture variation in the composition of the board. The regression model used in this analysis takes the form:

$$EXECS_i = \begin{cases} \alpha_0 + \alpha_1 LARDIR_i + \alpha_2 LDRSHP_i + \alpha_3 BM_i + \alpha_4 S20SHPC_i \\ + \alpha_5 NBLKHLDER_i + \alpha_6 TLA_i + \alpha_7 FIRM_SIZE_i \\ + \alpha_8 DIVERS_i + \sum_{i=1}^I \alpha_{8+i} IND + \varepsilon_i \end{cases}$$

Where EXECS is the percentage of directors that are clearly defined in the annual reports as executives holding a position on the board, LDRSHP is dummy variables with a value of one where the Chairman is also the chief executive officer and zero otherwise, BM is the book to market ratio, S20SHPC is the ratio of the shares held by the top 20 shareholders to total available shares, NBLKHLDER is the number of block holders who hold at least 5% of the firm's equity, TLA is the ratio of total liabilities to total assets ratio, FIRM_SIZE is the natural log of the market value of the firm's shares, DIVERS is a dummy variable with a value of one if the firm's core industry, primary industry or secondary industry as identified by OSIRIS differ and zero otherwise and IND are industry dummy variables. ARDIR is the number of directors on the board. The number of directors on the board (ARDIR) is a measure of the size of the board and this characteristic of the board is modelled as follows:

$$ARDIR_i = \begin{cases} \alpha_0 + \alpha_1 EXECS_i + \alpha_2 LDRSHP_i + \alpha_3 BM_i + \alpha_4 S20SHPC_i \\ + \alpha_5 NBLKHLDER_i + \alpha_6 TLA_i + \alpha_7 FIRM_SIZE_i \\ + \alpha_8 DIVERS_i + \sum_{i=1}^I \alpha_{8+i} IND + \varepsilon_i \end{cases}$$

Separate cross-sectional OLS and two stage least squares regression will be run using the annual data for 1999 through 2004 in the estimation of these models. Panel data analysis will also be used to get maximum use of the data set. White's adjusted standard errors will be used in statistical tests where appropriate. For some of the countries it may not be possible to obtain accurate data on the board split between insiders and outsiders and so in this case the analysis will focus on board size.

This analysis will provide insight into the importance of monitoring and agency costs in determination of the Asian firm board size and composition. The estimated models will provide a sense of what is expected in Asian firms and this could be treated as a benchmark. If agency costs are very high it is quite possible that there will be high levels of executive ownership while at lower agency costs levels there may be a greater proportion of outside directors employed to monitor the management team.

Data set updated as part of the project

An existing RMIT funded data set includes information on the board of directors and shareholders for the largest 150 companies listed on the stock exchanges of Hong Kong, Indonesia, Japan, South Korea, Malaysia, Philippines, Singapore and Thailand over the years 1999, 2000, 2001 and 2002. It includes the name, position and shareholding of directors, details on the top twenty shareholders and various

accounting data that are used for control purposes. At present there is no commercial electronic data set known to the author available that provides similar coverage and similar levels of information. The current one-year MCFS project will expand the data set to include 2003 and 2004. Research assistants will be paid to gather the data over the next 6 months as director and shareholder information must be entered into an excel spreadsheet manually from each firm's annual reports (PDF files obtained from the *Global Report on OSIRIS* service). Accounting data is presently obtained from *OSIRIS Standard Financials*.

References

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