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Multiple Directorships , Advantages and Disadvantages

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Abstract

The purpose of this study is to, investigate advantages and disadvantages of multiple directorships.The issue of the multiple directorships attracted the attention of researchers and practitioners. A large literature focused on the concept of multiple directorship by directors and its relationships with internal and external characteristics of the firm. There is a global debate on whether appointing directors who already hold directorships in other companies is a good or bad on firm performance. In this study we collected the literature about the advantages and disadvantages of multiple directorships and compared them.

Keywords: Multiple directorships, Firm performance, Advantages and disadvantages of multiple directorships

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Introduction

The issue of the multiple directorships attracted the attention of researchers and practitioners. A large literature focused on the concept of multiple directorship by directors and its relationships with internal and external characteristics of the firm (Jackling and Johl, 2009; Sarkar and Sarkar, 2009; Jiraporn, et al. 2009; Ahn et al. 2010). There is a global debate on whether appointing directors who already hold directorships in other companies is a good or bad corporate governance practice (Ferris, Jagnathan & Pritchard, 2003; Jiraporn, Kim & Davidson, 2007; Sarker & Sarker, 2008; Fich & Shivdasani, 2006). There is a common tradition of supporting multiple directorships as an instrument for the company to engage external skills in fortifying its existing proficiency in improving effectiveness of board activities " the quality hypothesis" (Beasley, 1996; Kiel & Nicholson, 2005). The resource dependency hypothesis also pronounces that this class of directors is well networked and hence assists companies to better exploit the external environment (Zahra & Pearce, 2004). Loderer and Peyer (2002) find a positive association between a firm's value and the number of directorships that a director holds, and that directors who sit on multiple boards are a good source of knowledge during acquisitions (Harris & Shimizu, 2004). The quality of the board functions, such as the monitoring and supervisory functions are generally undermined by multiple directorships (Jiraporn, Kim & Davidson, 2007) subsequently increasing agency costs through an affinity for corporate diversification, which has an effect of lowering company value (Fich & Shivdasani, 2006). Furthermore, Fich and Shivdasani (2006) prove that companies with a majority of directors, holding three or more directorships, flaunt inferior market to book ratios, worse profitability, and lower sensitivity of CEO turnover to firm performance. Some studies (Sarkar and Sarkar, 2009; Frye and Wang, 2010) highlighted the benefits of increasing the number of directorships held by directors (e.g., additional experience; firm legitimacy). In this study we speak about advantages and disadvantages of multiple directorships on performance of firms.

Advantages and disadvantages of multiple directorships

There are two different views of the role of directors. One party claims the directors having multiple directorships shows many negative managerial behaviors. Because they have not only time restriction but also a role as a vector, such as earning managements, financial frauds, etc. Through their overlapping directorships (Chiu et al. (2010)). However, the other party argues that their multiple directorships are the signal of quality; they can serve on firm better advices and monitoring because of

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more experiences (Fama and Jensen (1983), Brown and Maloney (1999), and Certo et al. (2001)). In terms of directors' information linkage role, many papers recently report several types of managerial behaviors spread through the social networks and shared directors, such as investment choices, M&A, compensation, and IPO etc, (Davis 1991; Haunschild 1993; Rao, Davis, and Ward. 2000; Cohen, Frazzini, and Malloy 2008; Bizjak, Lemmon, and Whitby 2009; Cai and Sevilir 2009; Fracassi 2009; Stuart and Yim 2010; Ishii and Xuan 2010). According to Bouwman (2010), the directors' influences on firm decision making is called 'familiarity effect' (or 'influence effect'). The research has shown board members have several roles in the boardroom and they carry some information through their social networks, regardless of their perception and their information quality, good or bad. These firm level decisions could have serious consequences for an individual firm. Thus, the quality of directors' information might make a significant difference.

Baccouche and et al (2013) examine the relationship between Audit Committee Multiple-Directorships and earnings management and show that audit committee can't provide effective monitoring of earnings management when its members held many additional outside directorships. Chiranga and Chiwira(2013) investigate the plausible link between multiple directorships and company performance for Johannesburg Stock Exchange (JSE) listed companies in South Africa. This study also interrogates whether companies with busy boards perform any better or worse than non over-boarded companies. The study finds no difference in performance between over-boarded and non over-boarded companies and no association between multiple directorships and company performance (Chiranga and Chiwira,2013).

Wai Leea and Leeb(2014) posit that the benefits and costs of multiple directorships are conditional on firm characteristics. They find firm valuation is positively associated with multiple directorships in (i) firms with high advising needs and (ii) firms with high external financing needs. As multiple directorships increases, cash holdings (capital expenditures) contribute less to shareholder value. The negative association between value of cash (capital expenditure) and busy boards is mitigated in firms with (i) high advising needs, (ii) high external financing needs and (iii) less entrenched ownership structures.

In summary, prior studies provide mixed evidence on the association between multiple external directorships and firm performance. A possible reason for this mixed evidence is that different firms have different optimal board structures (Adams et al., 2010). Recent governance literature emphasizes the importance of firm characteristics in the design of optimal board structures (Boone et al., 2007; Coles et al., 2008 and Linck et al., 2008).

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The Advantages of Multiple Directorships

Fama (1980) and Fama and Jensen (1983) argue that the market for outside directorships serves as an important source of incentives for outside directors to develop reputations as monitoring specialists. Mace (1986) suggests that outside, directorships are perceived to be valuable because they provide executives with prestige, visibility, and commercial contacts. Support for the reputational capital view of directorships comes from several studies which show that the number of boards that outside directors sit on is tied to the performance of the firms in which these directors are incumbents, either as CEOs or as outside directors. This pattern is documented for financially distressed companies (Gilson (1990)), for firms that cut dividends (Kaplan and Reishus (1990)) and opt out of stringent state antitakeover provisions (Coles and Hoi (2003)), for companies that fire their CEOs (Farrell and Whidbee (2000)), for firms that are sold (Harford (2003)), for CEOs following retirement (Brickley, Linck, and Coles (1999)), as well as for broad samples of firms (Yermack (2004)). Accordingly, several studies use the number of board seats held by an outside director as a proxy for the director's reputation in the external labor market (Shivdasani (1993), Vafeas (1999), Brown and Maloney (1999)). While the number of directorships appears to be closely linked to directors' reputational capital, other studies suggest that too many directorships may lower the effectiveness of outside directors as corporate monitors (see, e.g., Core et al. (1999), Shivdasani and Yermack (1999)). Core et al. (1999) find that busy outside directors provide CEOs with excessive compensation packages, which in turn leads to weaker firm performance. Consistent with such a view, the National Association of Corporate Directors and the Council for Institutional Investors have adopted resolutions calling for limits on the number of directorships held by directors of publicly traded companies.Perry and Peyer (2005) investigate firms with executives that accept an outside directorship and find negative announcement returns only when the executive's firm has greater agency problems.Their results suggest that outside directorships for executives can enhance firm value, which has important implications for firms employing executives nominated for outside boards and for policy recommendations restricting the number of directorships.On the other hand, the decision by an executive to accept a directorship can enhance shareholder value of the primary employer if the executive sitting on an outside board learns about different management styles or strategies used in other firms (Bacon and Brown (1974), Booth and Deli (1996), and Carpenter andWestphal (2001)). In addition, the sender firm could also benefit from its executive using the directorship to establish a network or to monitor business relationships (e.g.,

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Mace (1986), Rosenstein and Wyatt (1994), and Loderer and Peyer (2002)). Furthermore, Fama and Jensen (1983) suggest that the demand for the executive to serve as an outside director can be an independent certification or signal of the executive's ability. Kaplan and Reishus (1990), Gilson (1990), Shivdasani (1993), Brickley, Coles, and Linck (1999), and Ferris, Jagannathan, and Pritchard (2003) all report evidence consistent with a positive relation between the number of directorships held by an executive and director quality

The disadvantages of Multiple Directorships

Some researchers investigated disadvantages of multiple directorships (e.g., lack of time and efforts) and asked legislators to impose restrictions on the number of directorships held by a director to make it more effective (Devos et al., 2009; Jiraporn et al., 2009b; Sharma and Iselin, 2012).Firms with busy boards, those in which a majority of outside directors hold three or more directorships, are associated with weak corporate governance. These firms exhibit lower market-to-book ratios, weaker profitability, and lower sensitivity of CEO turnover to firm performance.When directors become busy as a result of acquiring an additional directorship, other companies in which they hold board seats experience negative ARs. Busy outside directors are more likely to depart boards following poor performance (Eliezer and et al, 2006).

Conclusion

The objective of this study is to investigate advantages and disadvantages of multiple directorships. Our investigations showed that multiple directorships have a lot of advantages and disadvantages. There are two different views of the role of directors. One party claims the directors having multiple directorships shows many negative managerial behaviors. Because they have not only time restriction but also a role as a vector, such as earning managements, financial frauds, etc. Through their overlapping directorships (Chiu et al. (2010)). However, the other party argues that their multiple directorships are the signal of quality; they can serve on firm better advices and monitoring because of more experiences (Fama and Jensen (1983), Brown and Maloney (1999), and Certo et al. (2001)).

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