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Impact of Multiple Directorships on Performance for Companies Listed on the Johannesburg Stock Exchange (JSE)

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The study investigates 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 better or worse than non over-boarded companies. The incidence of multiple directorship on JSE is low, therefore the hypothesis is rejected at 5%. Over-boarded company directors attend significantly less board meetings. The Pearson correlation between connectedness and log-transformed financial ratios is not significant between all the six financial ratios. The study finds no difference in performance between over-boarded and non over-boarded companies, and no association between multiple directorships and company performance.

Keywords: corporate governance, multiple directorships, board of directors, board effectiveness, company performance

Introduction

There is a global debate on appointing directors who already hold directorships in other companies which is a good or bad corporate governance practice (Ferris, Jagannathan, & Pritchard, 2003; Jiraporn, Kim &, Davidson, 2007; J. Sarker & S. Sarker, 2008; Fich & Shivdasani, 2006). Multiple directorships are a common practice worldwide, where executives serve as directors in other outside companies. The study looks at the extent of multiple directorships in South Africa's JSE and its effects on company performance, offering an emerging markets perspective on this behavioral aspect of corporate governance.

The authority of the agency theory has been central in the development of corporate governance standards and principles (Fama & Jensen, 1983; Vafeas, 1999). The composition and structure of boards and their functioning are governed by the principal and agent, a view which seeks to reduce agency costs and ensure that managers are maximizing shareholder wealth (Conger, Finegold, & Lawler, 2003; Schnake & Williams, 2008). The structure incorporates the principles of, among other issues, board independence and separation of an independent chairman and Chief Executive Officer (CEO) roles.

The role of a board of directors has to be clearly defined to understand the expectations of an effective board. Furthermore, the effectiveness of a board and how it links to company performance are important

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relationships to ascertain whether a quality board produces quality results

Board of directors is a difficult institution to study, the question of the structure of a board of directors and the behavior of a board is fundamentally intertwined. This presents a problem of endogenous factors, which generally bring complexity of studying the causes and effects (Goff, Lendisky, & Lile, 2009). The structure of a board determines the behavior of a board and subsequently the makeup of a board is influenced by what a board does. The joint endogeneity is an important aspect to consider when studying boards (Adams, Hermalin & Weisbach, 2008).

In this study, a theoretical model is developed on a simplistic basis that proposes a relationship between board effectiveness and multiple directorships, built on the presupposition that an effectively functioning board is a necessary condition for a company to produce quality results. If multi-directorship has a positive or negative effect on the effective functioning of a board, then it is expected to replica a positive or negative link with company performance. The literature review starts with looking at the role of a board and the ingredients that determine its effectiveness, circumspectly building up on whether multiple directorships impact the effectiveness of a board which will affect company performance.

Literature Review

Goldman, Rocholl, and So (2006) showed that countries with a weak legal system especially emerging markets, politically connected boards are valuable to a company. Government officials with the power to make and influence decisions have an economic impact on the private sector as they may choose to give preferential treatment to companies due to their political association.

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) found 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).

However, there is a prevailing argument that the benefits accrued from multiple directorships held by board members may be negated when directors hold too many directorships to the extent of failing to entirely discharge and appropriately attend to board functions. The quality of the board functions, such as the monitoring and supervisory functions is generally undermined by multiple directorships (Jiraporn et al., 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) proved 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.

Research Hypotheses

The four pairs of hypotheses to be tested in this study are given below.

Hypothesis 1: Incidence of multiple directorships on the JSE is high.

A busy director is defined as a director who holds three or more directorships (Ferris et al., 2003) and in studying the incidence of multiple directorships, an overboarded board is defined as a board that has the

majority of directors being overboarded. This hypothesis states that the incidence of multiple directorships in South Africa is more prevalent relative to other countries in the world.

Hypothesis 2: Directors who hold multiple directorships score low on the board effectiveness measure.

This hypothesis is predicated by the view that an executive's time is a finite resource (Jiraporn, Singh, & Lee, 2008). A director who seats on multiple boards may fail to effectively attend to his/her board functions. This hypothesis is based on the fact that multiple directorships over-commits a director and impedes his/her ability to execute important directorial obligations such as attending board meetings and internal committee involvement.

Hypothesis 3: Directors with multiple directorships impair company performance.

Using the authority of the principal agency theory, it is sensible to assume that directors holding multiple directorships are too busy to monitor management. Hence, the busyness hypothesis postulates that all directors have a universal problem of limited time and thus multiple board involvement will render them too busy to execute their fiduciary duties and subsequently negatively impact company performance.

Hypothesis 4: There is a negative correlation between multiple directorships and company performance.

Multiple board appointments effectively mean that a director has to spread themselves across the board. Thus as a director picks up more directorships, the time dedicated to other directorships would continuously decrease and therefore as board connectedness increases, the board becomes busier (J. Sarker & S. Sarker, 2008). This may mean that the board devotes less time to the board activities affecting company performance negatively with every increase in board busyness (Jiraporn et al., 2008). Various countries have placed different limits with regards to the number of directorships that executives can have. If multiple directorships have a negative effect on company performance, the consequence could be measured to ascertain the threshold by assessing whether performance becomes cumulatively worse.

Sample Selection and Data Description

This study utilizes data for all companies listed on the JSE during the period from 2006 to 2012. The data was collected from circulars, annual reports, and Mcgregor's publication (*Who Owns Whom*). The individual directors of each company listed on the JSE were identified and directors who held multiple directorships across these companies were listed. Board connectedness was used to group companies into overboarded and non-overboarded companies. Overboarded companies were then matched (by industry and size) with companies that were not overboarded (control companies). Any company that failed to meet the matching criteria was discarded and so did companies whose complete financial data were not available. The matching process resulted with 21 overboarded companies and 21 control companies.

Board performance was measured by board attendance and internal committee involvement. Company performance was measured by liquidity and solvency (current account and debt-to-equity ratio), profitability (return-on-assets and return-on-equity ratios), and shareholder wealth (earnings-per-share and price-to-earnings ratio).

Statistical Methods

To test hypothesis 1, the number of directors who hold multiple directorships was tabulated and a frequency count was used to determine the extent of multiple directorships in South Africa compared to other developed and developing countries. The tabulation process then led to the identification of companies that had

an over-boarded board as measured by board connectedness, where a board connectedness of three or more meant that the company was over-boarded. The extent of multiple directorships in South Africa is compared to other countries.

To test hypothesis 2, board attendance and internal committee involvement were compared between over-boarded and control companies using the matched-pairs *t*-test.

To test hypothesis 3, company performance was compared between over-boarded and control companies using the matched-pairs *t*-test (Mangena & Chamisa, 2008).

To test hypothesis 4, Pearson's correlation between multiple directorships (as measured by connectedness) and company performance (as measured by performance metrics given above) was computed. This analysis was done irrespective of whether a company was over-boarded or not, that is, all the companies in the sample were pooled in this correlation analysis.

All variables with skewed distribution were log-transformed. Throughout the analysis, two-sided statistical tests were used at $\alpha = 0.05$. STATA 11.0 for Windows (STATA Corporation, College Station, TX, USA) was used in the statistical analysis of data.

Results

Hypothesis 1

Table 1 below shows the extent of multiple directorships for companies listed on the JSE in 2007.

Table 1

Distribution of Multiple Directorships

Number of outside directorships	Frequency	Percent (%)	Cumulative percent (%)
0	2,083	57.94	57.94
1	1,137	31.63	89.57
2	297	8.26	97.83
3	38	1.06	98.89
4	18	0.50	99.39
5	15	0.42	99.81
6	2	0.06	99.86
7	3	0.08	99.94
8	1	0.03	99.97
9	0	0	99.97
10	0	0	99.97
11	0	0	99.97
12	1	0.03	100

From Table 1, it is observed that the incidence of multiple directorships in South Africa amongst listed companies on the JSE is low. Almost 60% of directors in South Africa have no outside directorships, about 30% have only one outside directorships, and less than 10% have two outside directorships. Only 2% hold more than two outside directorships with a single director holding 12 outside directorships. The median number of outside directorships from Table 1 is 0.

Table 2 below shows a comparison of directorships among South Africa, Australia, and India.

Table 2 shows that multiple directorships in South Africa's JSE when compared to Australian's Stock Exchange (ASE) are relatively similar, 42.06 % of directors in South Africa hold at least one outside

directorships compared to 41.2% in Australia. Australia is considered as a developed country under the Organization for Economic Co-operation and Development (OECD) while South Africa is still considered as a developing country.

When compared to India, a country classified as developing, the results indicate that the incidence of multiple directorships in South Africa is very low, 42.06% of directors in South Africa hold at least one outside directorships compared to 71.63% in India. The levels of multiple directorships are quite rampant in India ranging up to 25 directorships for a director with the most number of directorships.

Table 2

Distribution of Multiple Directorships in South Africa, Australia, and India

Number of outside directorships	Percent (%)		
	South Africa	Australia	India
0	57.94	58.8	28.37
1	31.63	20	15.75
2	8.26	9.6	11.67
3	1.06	6.2	8.97
4	0.50	2.2	6.12
5	0.42	1.6	5.99
6	0.06	1.3	4.29
7	0.08	0	3.8
8	0.03	0.1	3.16
9	0	0	2.65
10	0	0.1	2.06
11	0	0.1	1.64
12	0.02	0	1.57
13	0	0	1.41
14	0	0	1.03
15+	0	0	1.52
Totals	100	100	100

Hypothesis 2

Table 3 summarizes the results of board attendance and internal committee involvement for directors of over-boarded companies and the control group.

Table 3

Summary of the Results for the Board Effectiveness Measures for the Over-boarded Companies and Companies in the Control Group: Mean (SD)

	Over-boarded	Control	*p*-value
Board attendance (%)	75.71 (5.9)	93.05 (3.9)	0.0000
Internal committee involvement	1.49 (0.29)	2.13 (0.30)	0.0000

The results clearly show that over-boarded company directors attend significantly less board meetings than control company directors (76% and 93% respectively, p-value < 0.0001). Once more, over-boarded company directors are significantly less involved in internal committees when compared to the companies that are part of control group (1.49 and 2.13 respectively, p-value < 0.0001). It is therefore concluded that directors who hold multiple directorship score lower on board performance measure compared to non-over-boarded companies.

Hypothesis 3

Six financial ratios were used to assess whether there was a statistically significant difference in company performance between the over-boarded and control companies for the years from 2006 to 2012. The distribution of all the six financial ratios is skewed and therefore log-transformed ratios were used in a matched-pairs *t*-test. The results of the matched-pairs *t*-test of the log-transformed values are given in Table 4 below.

Table 4

Summary Statistics for Company Performance: Geometric Mean (SD)

Financial year	Measure	Over-boarded	Control	*p*-value
	CA:CL	0.60 (1.46)	0.33 (0.69)	0.382
	D:E	-0.30 (2.07)	-0.06 (1.01)	0.682
	EPS	4.54 (1.75)	5.02 (1.88)	0.326
2006-2008	P:B	1.20 (1.17)	1.01 (0.63)	0.545
	P:E	2.67 (0.48)	2.75 (1.00)	0.778
	ROA	3.00 (0.50)	2.80 (1.49)	0.619
	ROE	3.10 (0.77)	3.24 (0.49)	0.518
	CA:CL	0.51 (1.58)	0.32 (0.80)	0.618
	D:E	-0.31 (1.80)	-0.22 (1.13)	0.872
	EPS	4.57 (1.52)	5.38 (1.43)	0.088
2009-2010	P:B	0.88 (1.18)	0.88 (0.65)	0.995
	P:E	2.56 (0.55)	2.45 (0.50)	0.611
	ROA	2.75 (0.70)	2.98 (0.97)	0.445
	ROE	2.79 (0.86)	3.15 (0.84)	0.243
	CA:CL	0.41 (1.14)	0.21 (0.86)	0.455
	D:E	-0.48 (1.80)	-0.22 (1.19)	0.638
	EPS	4.39 (1.33)	4.20 (2.00)	0.678
2010-2012	P:B	0.76 (1.13)	0.68 (0.58)	0.796
	P:E	2.20 (0.77)	2.55 (0.98)	0.226
	ROA	3.02 (0.46)	2.85 (1.06)	0.557
	ROE	2.90 (0.78)	3.00 (1.10)	0.752

In this table, CA:CL is the current ratio, D:E is the debt-to-equity ratio, EPS is earnings-per-share, P:B is the price-to-book ratio, P:E is price-to-earnings ratio, ROA is return-on-assets, and ROE is return-on-equity.

Inspection of the *p*-value column shows that all the *p*-values are greater than the level of significance $\alpha = 0.05$ meaning that there is no statistically significant difference in company performance between over-boarded and control companies with respect to all the six financial ratios. This major result of no difference translates to the fact that the findings in this study support hypothesis 3 that states that directors with multiple directorships impair company performance

Hypothesis 4

Table 5 below shows the Pearson's correlation between connectedness and log-transformed financial ratios together with the corresponding *p*-values.

The results show no significant correlation between connectedness and company performance with respect to all the six financial ratios for the years from 2006 to 2012. This means that hypothesis 4 is not supported by the data in this study.

Table 5

Correlations Between Company Performance and Multiple Directorships

Financial year	Measure	Pearson's correlation	*p*-value
2006-2008	CA:CL	0.2992	0.0543
	D:E	-0.1431	0.3785
	EPS	0.0171	0.9186
	P:B	0.2352	0.1337
	P:E	-0.0723	0.6662
	ROA	0.2149	0.1950
	ROE	-0.0587	0.7261
2009-2010	CA:CL	0.2407	0.1247
	D:E	-0.0861	0.5974
	EPS	-0.0385	0.8261
	P:B	0.1372	0.3924
	P:E	0. 0342	0.8455
	ROA	0.0789	0.6379
	ROE	-0.1515	0.3779
2011-2012	CA:CL	0.2227	0.1563
	D:E	-0.1641	0.3054
	EPS	0.1967	0.2300
	P:B	0.1221	0.4469
	P:E	-0.2491	0.1262
	ROA	0.1725	0.2935
	ROE	-0.0395	0.8164

Findings

Multiple directorships occur regularly in South Africa and companies involved have often justified the practice as mobilizing quality and scarce resources on the basis of the expertise and skills of this class of directors. On the other hand, investors and corporate governance activists have dismissed and labeled this phenomenon to be bad corporate governance practice. This study devoted attention to the possible implication of multiple directorships on company performance.

The study brings in a unique controlled experimental design, going beyond just assessing the cumulative effect of multiple directorships on company performance. The study delves deeper into comparing the company performance of over boarded companies and the non-overboarded companies. This is more valuable in the sense that it not only controls for endogenous variables, but also brings out more objective and valid results in the process.

Moreover, the study also assesses the impact of multiple directorships on the effective functioning of a board of directors. The study uses board attendance and internal committee involvement as a proxy for board effectiveness. Finally, the cumulative effect of multiple directorships in line with other studies (J. Sarker & S. Sarker, 2008; Kiel & Nicholson, 2005) is also assessed.

Judging from the empirical evidence above, it appears that the results support the busyness hypothesis with regards to the fact that directors who are involved in multiple directorships are more likely to miss board meetings. Furthermore, these directors are probably less involved in terms of their committee meeting and it may be that the skills that they bring in are not at a technical level where internal committees tend to

operate.

However, the results are inconclusive with regard to the link between director's busyness and its effect on company performance. The results yield different results for multiple directorships and company performance contrary to studies by Shivdasani and Yermack (1999); Fich and Shivdasani (2006), stating that multiple directorships have a negative impact on company performance.

There is no consistent empirical evidence that companies with directors who hold multiple directorships have poorer performance. Thus companies who appoint directorships who hold other directorships may be faced with directors who miss meetings or are less involved in internal committees, but this does not translate into weaker company performance.

Applying a general restriction on the number of directorships either through the listing requirements or the application of the recommendations by King (2006) is subjective. Though limiting directorships may imply that a director will spend more time for each directorship, it does not necessarily indicate that these directors will actually do so. The critical component with respect to corporate governance is not the number of boards that a director sits on, but the effectiveness of board processes and ensuring that directors are equipped to do the job and give the right incentives and motivation for them to be actively engaged in board matters. Furthermore, other factors such as the ability of the individual, time availability, complexity of business, involvement in board committees, and possibly the size of the board, may affect the number of directorships that an individual can handle.

At the same time, the study does not find a positive relationship between multiple directorships and company performance in line with the reputation hypothesis (Zahra & Pearce, 2004), the resource dependency theory (Harris & Shimizu, 2004), or information advantage of such type of directors which leads to increased company performance. The advantages to be gained from multiple directorships and its links to the social capital theories do not have a substantial impact on company performance.

The information advantage or experience from other boards gained serial directors is offset by other sources of distinctive information that directors without multiple directorships have. This indicates that having directors who are involved in multiple directorships does not imply that the company will have better corporate governance or more importantly perform any better than a company that does not have these types of directors.

Thus the study, while not supporting the notion of limiting the number of directorships that a director should be allowed to hold, also questions the whole wisdom of appointing directors who are already involved in other directorships. It appears that this class of directors does not add any value to the board to the extent of performing any better than companies that do not have multiple directorships on their board. If this class of directors who hold multiple directorships were adding value to the companies that they were associated with, then this would translate into a better performance than the control group.

This is an important contribution to the corporate governance studies in South Africa, given the fact that multiple directorships have been a contentious issue in corporate governance practices. The results also play a significant role in the equity valuations of emerging markets companies. Other studies in South Africa establish that investors in certain emerging market countries, would pay a premium of 23% and 28% for shares in a company with good corporate governance, as opposed to a poorly governed company with similar financial performance (Abdo & Fischer, 2007). Hence the question of governance will have a material impact on the country's ability to attract foreign direct investments and foreign portfolio investments materially impacting

economic stability and growth prospects.

Consistent with results from Nicholson and Kiel (2004), the study gives evidence to support the notion that individual director appraisal and evaluations are the critical factors in the assessment of boards. The assessment and evaluations will ensure an effective functioning board which delivers quality financial performance.

Conclusions

The study investigated if there was any plausible link between multiple directorships and company performance for JSE listed companies in South Africa. This was tested using four pairs of hypotheses using data from 2006 to 2012. All variables with skewed distribution were log-transformed. Throughout the analysis, two-sided statistical tests were used at $\alpha = 0.05$ using STATA 11.0 for Windows. Judging from the empirical evidence above, it appears that the results support the busyness hypothesis with regards to the fact that directors who are involved in multiple directorships are more likely to miss board meetings. It can be further concluded that directors holding multiple directorships do not add any value to the board to the extent of performing any better than companies that do not have multiple directorships on their board.

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