

# [Board busyness: target, deviation, and firm performance](https://assignbuster.com/board-busyness-target-deviation-and-firm-performance/)

Abstract

I investigate how firm’s demand for board services, agency issues, and labor market frictions are associated with board busyness, and reexamine the relation between board busyness and firm performance. My theoretical model predicts the existence of heterogeneous target levels of board busyness, which increase with firms’ demand for board advisory services and decrease with demand for monitoring services. However, frictions arising from agency issues and director labor market could prevent firms from reaching these target levels. My empirical results suggest that the variation in board busyness explained by firm’s demand for board services is positively associated with firm performance while the variation predicted by agency issues and labor market frictions is negatively related to firm performance. I also find that firm performance is positively associated with the busyness of audit committee, and negatively with that of nominating committee. Collectively, my results do not support the call for setting one size fit all limits of multiple directorships for all firms.

Introduction

The composition and effectiveness of the board of directors have been the focus of corporate governance literature for decades. While prior studies primarily focus on monitoring function and board independence, a growing literature investigates the advisory function and other board composition dimensions, such as board busyness, size, and diversity. Due to the increased time commitment needed for directors of public companies in recent years, the overboard concern has gained more attention increasingly. Activists and proxy advisors call for limits on multiple directorships with the belief that overboarded directors can harm firm performance. Firms have been increasingly adopting restrictive policies of multiple directorships. A growing literature has emerged to investigate multiple directorships as well. However, theoretical predictions and empirical findings are still ambiguous as to the impact of multiple directorships on firm performance.

Multiple directorships are endogenously determined in the director labor market, in which directors work as the suppliers of board services while the firms play as the consumers (demanders). The director labor market plays an essential role in corporate governance by providing managerial talents with reputational incentives through board seats. It is established in the literature how the supplier side works. Specifically, the labor market recognizes the ability difference of managerial talents through various firm performance metrics and provides different numbers of board seats accordingly. However, our understanding of the consumer (demander) side is relatively limited. The previous literature assumes that firms have homogenous demand. Therefore, it is not clear how firms’ different preferences for director services and other characteristics play a role when firms provide director positions to the market. My study aims to fill this gap.

My primary research question asks how firm’s preference for advisory services and monitoring services, agency issues, and labor market frictions are associated with the multiple directorships on the firm level. The answer to this question is fundamental to appreciate the relation between multiple directorships and firm performance. I posit that different firms have different target levels of board busyness, which maximize the value added by their boards. However, agency issues and labor market frictions could lead firms to deviate from the target levels. Therefore, the association between the observed levels of board busyness and firm performance depends on the composition of different components of board busyness.

To examine this argument, I provide a model in which a firm considers its particular preference for advising services and monitoring services and trades off the different effects of multiple directors on advising quality and monitoring quality in determining the target level of multiple directorships held by its board members. The model shows that there exist heterogeneous and time-varying target levels of multiple directorships, which are positively related to the firm’s advisory need and negatively with its monitoring need.

To empirically test the model, I decompose the level of firm’s multiple directorships into demand related component, friction related component, and unexplained residual component by regressing multiple directorships on a list of factors driving firm’s demand for board advisory services, demand for monitoring services, agency issues and labor market frictions. Then I examine the relation between these components and various performance metrics. I find consistent evidence of a positive association between firm performance and the demand related component, and a negative association with the friction related component. My committee level analysis shows that firm performance is positively associated with the multiple directorships of the audit committee, and negatively with the multiple directorships of the nominating committee. Given that audit committees are heavily scrutinized during my sample period, and nominating committees are in charge of nominating directors, this finding could be related with agency issues and director labor market frictions, which I will investigate further.