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Article

It is useful to consider the interlocks according to the type of board member (executive or non-executive) who posseses them? Their effect on firm performance

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ABSTRACT

Taking the assumptions of the resource dependency theory as our starting point, the main objective of this investigation is to gain an understanding of how and in what way board members who serve on multiple boards (interlocks) can affect a firm's profitability, and whether it is useful to consider the derivation of these interlocks according to the type of board member (executive or non-executive) who possesses them. Using dynamic panel data analysis (GMM) and a sample of 88 firms quoted on the Spanish Continuous Market for the period 2005–2008, our results confirm the existence of a curvilinear (inverted-U) relation between interlocks and firm performance. The results demonstrate that this relation is only significant if we include the total number of external ties rather than just the number of links generated by non-executive directors. We can also confirm that the degree of familiarity and shared knowledge between board members (measured by average board tenure) affects this relationship.

¿Es útil diferenciar a los interlocks de acuerdo con el tipo de consejero (ejecutivo o no ejecutivo) que los posee? Su influencia sobre el rendimiento de la empresa

Palabras clave:
Consejos de administración
Interlocks
Permanencia del consejo
Rendimiento de la empresa

RESUMEN

Partiendo de los supuestos de la teoría de dependencia de recursos, el principal objetivo de esta investigación pasa por conocer cómo y de qué forma la pertenencia de los consejeros a múltiples consejos (interlocks) podría afectar a la rentabilidad de la empresa y si es importante considerar en esta relación la procedencia de los interlocks según la tipología del consejero que lo ostente (consejeros ejecutivos y no ejecutivos). Mediante un análisis de datos de panel dinámico (GMM), y a través de una muestra de 88 empresas cotizadas en el Mercado Continuo español para el periodo 2005–2008, los resultados obtenidos confirman que existe una relación curvilínea (en forma de U invertida) entre los interlocks y el rendimiento de la empresa, y que esta relación es sólo significativa si tenemos en cuenta el número total de vínculos externos, y no sólo cuando tomamos en número de vínculos generados por los consejeros no-ejecutivos. Asimismo, podemos afirman que el grado de familiaridad y conocimiento mutuo entre los miembros del consejo (medido por la permanencia media del consejo) influye sobre esta relación.

Introduction

The board of directors can be viewed as a source of competitive advantage for an organisation, since it provides access to valuable external resources and allows the firm to respond to

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outside events (Pfeffer & Salancik, 1978; Wincent, Anokhin, & Boter, 2009). Studies based on the resource provision role of the board have generally focused on the external connections brought by the directors; the ties to other firms created by their joint board membership, known as interlocking directorates, are the most commonly used in the literature (Beckman & Haunschild, 2002; Gulati, Nohria, & Zaheer, 2000; Hillman & Dalziel, 2003; Kor & Sundaramurthy, 2009; Nahapiet & Ghoshal, 1998; Ortiz, Aragón, Delgado, & Ferrón, 2012).

Prior studies have sought to understand how the resources brought by board members via their interlocks affect a firm's performance and have proposed both positive (Kim & Cannella, 2008) and negative (Goerzen & Beamish, 2005) relations, and reached a variety of conclusions. These inconsistent results are due to, in the majority of cases, the existence of different types of interlocks, and the different effects these have on the firms' performance and strategies. For example, Davis (1991) examine how a firm's interlocks formed with other companies that have adopted *poison pill* strategies in the past, increasing the likelihood of the firm adopting similar tactics; Shipilov, Greve, and Rowley, (2010) analyse how the adoption of a practice by one organisation is positively influenced by the accumulated adoption of the same practice by its interlocking firm; and finally, Diestre, Rajagopalan, and Dutta (2014) examine how board members' experience in a specific market increases the likelihood of an interlocking firm entering that new market.

However, despite attempts in the literature to classify the various types of interlocks, the majority of studies ignore any distinction according to origin (from executive or non-executive directors); they are examined implicitly, with little awareness of the importance of the ties brought by non-executive directors (Certo, 2003; Filatotchev, 2006; Johansen & Pettersson, 2013; Kor & Sundaramurthy, 2009; Tian, Haleblian, & Rajagopalan, 2011), and ignoring the rich potential of the links formed by executive directors. Firms need to appoint non-executive board members who will bring new resources and knowledge to the top management team (TMT) (Kor & Misanyi, 2008). This is not to say, however, that the resources brought by executive directors should be ignored, especially when they also contribute new resources and knowledge derived from their external ties, and in particular through their interlocks.

The composition of the board is affected by the age and stability of the firms in its sector and thus the majority of the top management team of newly created firms (new ventures) tend to be board members. As a result, in order to verify that the firm's decisions are being taken in an appropriate manner, the literature on corporate governance is beginning to question whether board members possess and are contributing sufficient resources, and to ask whether non-executive directors should be appointed to make up for the possible failings of its executive directors (Dalziel, Gentry, & Bowerman, 2011; Knockaert & Ucbasaran, 2013; Knockaert, Bjornali, & Erikson, 2014). However, in established firms of a certain size, the literature takes for granted that it is appropriate to appoint non-executive directors. It considers that non-executive directors exert an important control over the management, provide support and advice thanks to their human capital or professional experience (many board members enjoy a high professional prestige) and are able to bring in resources from outside the firm through their network of contacts (Finegold, Benson, & Hecht, 2007; Kroll, Walters, & Son, 2007). On the other hand, influenced by agency theory, the literature presupposes that executive directors, members of the top management team (Dalziel et al., 2011), will pursue their own interests and rewards at the expense of the firm's shareholders. This means that little attention has been paid to the external resources brought by executive directors or the need to study the board as a group of individuals who contribute valuable and complementary resources.

We therefore consider it appropriate to examine the value that all board members contribute through their interlocks. In this investigation, we propose that the resources brought by the directors, regardless of type, enable the firm to take better decisions, thanks to their pooled knowledge and experience (Filatotchev, 2006), and that this ultimately affects firm performance.

Finally, by considering the complete set of resources brought by all of the board members, regardless of type, we are supporting an idea that has already been proposed in a number of studies (Forbes & Milliken, 1999; Gabrielsson & Huse, 2004; Stevenson & Radin, 2009; Van Ees, Gabrielsson, & Huse, 2009) that the board should be viewed in its entirety as a "group of individuals", whose effectiveness depends not only on the individual resources contributed by each member, but also on its ability to act as a team and to share and assimilate these resources. The aim of our investigation is to pursue this line of research in greater depth, introducing the moderator effect of board tenure on the relation between interlocks and firm performance. A board with high average board tenure encourages better relations and greater trust between its members (Le, Kroll, and Walters, 2013), encouraging a mutual and efficient exchange of the vision and strategic resources acquired from other firms. By looking at board tenure therefore, we can analyse the effect of the degree of familiarity and mutual understanding between board members and their essential role in the assimilation and application of the resources that can be gained through interlocks.

This work is structured as follows: in the first section we explain our choice of subject and set out our objectives. In the subsequent sections we carry out a literature review that allows us to propose a set of hypotheses. In the final section we explain our empirical study, followed by an analysis and interpretation of the results obtained.

Literature review and proposed hypotheses

The more traditional literature, based on agency theory (Fama & Jensen, 1983; Letza, Sun, & Kirkbride, 2004) identifies the control function as the board's principal activity, and assumes that non-executive board members are more effective than executive board members in controlling the senior management and protecting shareholder interests. This perspective reinforces the particular importance of the role of non-executive directors in board composition. To this can be added the recent financial scandals of high-profile firms (Enron, Tyco, WorldCom, Adelphia), which have reminded us of the importance of board independence, while bringing about a reduction in the number of executive board members and giving primacy to the board's control function. Recent studies (Hillman & Dalziel, 2003; Lynall, Golden, & Hillman, 2003; Stiles & Taylor, 2001) consider that new functions should be included, such as service, or resource provision, this latter being at the heart of our investigation. These new functions are founded on the use of knowledge, information, experience, capabilities, etc., namely, the set of resources that each board member brings to the board. This new viewpoint affects studies of board composition by altering the initial perspective: board composition should not only be viewed in quantitative terms (percentage of non-executive directors), but also in qualitative terms, since every board member, regardless of type, contributes complementary resources to the firm, which are required by the group as a whole for effective decision-making (Certo, 2003; Hillman & Dalziel, 2003; Westphal & Fredrickson, 2001).

The resource dependency theory considers that the board of directors is an effective mechanism for the firm, in that its members have outside contacts or external links with the environment (Kim, 2005). Of all the external connections, the relations that have been studied most frequently by researchers are the ties to other