Explorations in Economic History 62 (2016) 108–123

Contents lists available at ScienceDirect

Explorations in Economic History

journal homepage: www.elsevier.com/locate/eeh

The value of corporate boards during the Great Depression in Belgium

Marc Deloof*, Veronique Vermoesen

University of Antwerp, Department of Accountancy and Finance, Prinsstraat 13 2000, Antwerp, Belgium

A R T I C L E I N F O

Article history:
Received 22 July 2015
Received in revised form
1 July 2016
Accepted 4 July 2016
Available online 5 July 2016

JEL Classification:
G21
G30
G34

Keywords:
Board busyness
Board size
Bank affiliation
Director interlocks
Firm value
Great Depression
Belgium

A B S T R A C T

We investigate how board characteristics were related to the value of listed Belgian firms in the 1928–1931 period, when investor protection was weak and firms were hit by the largest financial crisis of the 20th century. We find that firms typically had a large board and many directors held multiple directorships. Most boards included bank directors. While large, busy boards and bankers on the board were positively related to firm value before the crisis, their value significantly decreased from 1929 onwards, suggesting that these boards were less suited to face a crisis. Board busyness seems to be the main driver of negative board effects during the crisis. We also find that riskier firms which had busier and larger boards experienced a larger drop in value.

1. Introduction

Do corporate boards matter? A large number of studies has investigated the relation between board composition and firm value, but these studies typically focus on steady-state economic conditions (e.g. Jensen, 1993; Petersen and Rajan, 1994; Yermack, 1996; Weinstein and Yafeh, 1998; Ferris et al., 2003; Fich and Shivdasani, 2006; Coles et al., 2008). Few studies have considered the value of the board during a crisis, when the board of directors is likely to matter most (Francis et al., 2012). In this paper, we take a unique historical perspective by investigating the relation between board composition and firm value in Belgium during the Great Depression. Belgium in this period provides a very interesting environment to study the value of corporate boards. Despite weak investor protection, Belgium combined an active stock market (Rajan and Zingales, 2003) with a powerful financial industry (e.g. van der Valk, 1932; Chlepner, 1943; Durviaux, 1947; Vanthemsche, 1991; Rajan and Zingales, 2003), which was dominated by a limited number of banks with close ties to the Belgian industry via director interlocks and equity stakes (e.g. Chlepner, 1943). Furthermore, the Great Depression had a strong negative effect on the value of Belgian firms. Fig. 1 shows an index of the cumulative stock returns of all firms listed on the Brussels

* Corresponding author.
E-mail address: marc.deloof@uantwerpen.be (M. Deloof).

http://dx.doi.org/10.1016/j.eeh.2016.07.002

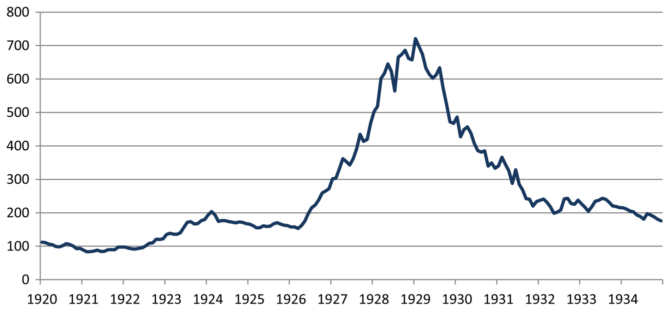

Fig. 1. Cumulative stock return of Belgian firms on the Brussels Stock Exchange with December 1919 as basis (index value of 100).
Source: Own calculations based on SCOB database.

Stock Exchange in the period 1920–1934.[1] The index rose from 100 to 721 in January 1929, after which it fell back to 176 in December 1934.

It is difficult to establish a link between board characteristics and firm value during normal economic conditions, because firms chose their boards endogenously to maximize firm value (e.g. Boone et al., 2007; Linck et al., 2008). If firms maximize their value and board composition can be promptly adjusted without costs, there would be no reason to observe an empirical relation between board composition and firm value (e.g. Coles et al., 2008). However, the Great Depression was an unexpected event for firms to which firms were unable to instantly react by altering the composition of their boards. By considering the effect of board characteristics *prior to* the start of the Great Depression on firm value *during* the Great Depression, we ascertain that board characteristics are not affected by our firm performance measure. A crisis such as the Great Depression is also an interesting period to investigate the role of corporate boards because it puts pressure on a board that is potentially not composed to face such an exceptional situation. Even if it is composed to deal with crisis situations, a crisis asks for the full potential of those directors, which might otherwise not be the case (Mace, 1986).

We focus on board characteristics that have been found to have an association with firm value: *board busyness*, i.e. the extent to which directors on the board held multiple directorships, and *board size*, i.e. the number of directors on the board. *Busy directors* may enhance the quality of the board's advice because they may be a source of valuable experience and they may enlarge a firm's network (e.g. Miwa and Ramseyer, 2000; Ferris et al., 2003). However, board busyness may also hinder the advising and monitoring quality because of time limitations if directors become overcommitted resulting in lower firm value (e.g. Loderer and Peyer, 2002; Fich and Shivdasani, 2006). As *board size* increases, communication and coordination problems (e.g. Lipton and Lorsch, 1992) can result in less effective advising and monitoring and lower firm value (e.g. Yermack, 1996; Eisenberg et al., 1998). On the other hand, a large board adds experience and knowledge to the board and reduces environmental uncertainty (e.g. Dalton et al., 1999). This may be beneficial for firm value especially when advising needs are large (e.g. Coles et al., 2008; Faleye et al., 2011). Since banks played a crucial role in Belgian business during the period considered in this study, we also take into account the presence of *bankers on the board*. Bank representatives on the board can provide important industry-specific financial expertise (e.g. Kroszner and Strahan, 2001) and they can mitigate information asymmetries between the bank and its client firm so that the availability of credit is increased and its cost reduced (e.g. Diamond, 1984; Ramirez, 1995; Becht and Ramírez, 2003; Van Overfelt et al., 2009). However, a bank that has a representative on the board can also abuse its private information to extract rents from the firm (e.g. Rajan, 1992). This cost has been found to offset the above-mentioned benefits of having a banker on the board (e.g. Fohlin, 1997; Fohlin, 1998; Guinnane, 2002).

Using a sample of 150 large Belgian firms listed on the Brussels Stock Exchange in 1928–1931, we find that these firms typically had a large board, with directors holding multiple directorships in other firms and in banks. Busy boards and larger boards were associated with a higher firm value. However, the positive relationship between board busyness and firm value significantly decreased in the 1929–1931 period. We also find a significant decrease in the association between firm value, board size and bankers on the board in 1929. When we include measures of board busyness, board size and bankers on the board in the same regression, the effects of bankers on the board disappear. This suggests that our findings are not driven by bank-firm relations. Our results also indicate that the negative crisis effects of busy and large boards are partially driven by firm risk. This is consistent the with resource dependence theory, which predicts that risky firms prefer large and busy boards to reduce environmental uncertainties.

Our paper provides a unique contribution to the literature by investigating the value of corporate boards during the most important crisis of the 20th century. It contributes to an extended literature that investigates the value of corporate governance mechanisms during a crisis (Johnson et al., 2000; Mitton, 2002; Lemmon and Lins, 2003; Baek et al., 2004; Barton and Waymire, 2004; Graham et al., 2011; Nguyen et al., 2015), but also to a small but growing literature that investigates the value of corporate boards in a historical context (Van Overfelt et al., 2009; Campbell and Turner, 2011; Graham et al., 2011;

[1] Indices are Laspeyres market cap weighted return indices (including dividend returns) calculated by linking monthly returns through a chain index. The weight of each firm's return is given by its relative market capitalization.