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Busyness and advising at Borsa Istanbul firms☆

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Abstract

In this study, we investigate director busyness and advising for firms quoted at Borsa Istanbul. We show that firms prefer not to appoint directors with multiple directorships and superior advising skills to monitoring positions, potentially as a result of a trade-off between the monitoring and advising functions of directors. In addition, we find that busy boards have higher advising capacity compared to non-busy boards. Also, we show that firms that have busy boards or higher advising qualities do not perform better or worse than firms that have non-busy boards or lower advising quality. Lastly, multivariate tests suggest that there is no significant relationship between board busyness or board advising quality and firm performance.
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1. Introduction

One of the primary responsibilities of directors is to perform their monitoring functions effectively. A concept associated with director-effectiveness while performing this responsibility is director busyness. Directors that are considered busy are generally criticized for potentially not putting enough time and effort into performing their monitoring duties as a result of board appointments at other firms. On the other hand, these directors are praised for potentially providing focal boards and CEOs with improved advising, which is considered the other primary responsibility of directors, via valuable information and expertise gained through board directorships in other firms. The number of studies investigating these topics regarding public firms in the Turkish capital market is very limited. Studies such as Ararat and Cetin (2008), Kaymak and Bektas (2008), Ararat, Aksu, and Cetin (2010), Ararat, Orbay, and Yurtoglu (2010), and Ararat, Black, and Yurtoglu (2014) mainly focus on director independence, which is the main criteria that we employ in categorizing directors and boards as busy, and calculating the proxy for advising quality in this study. Keeping the findings of these studies in mind, we investigate director busyness and advising. Specifically, we attempt to provide insight into understanding whether firms consider the monitoring and advising of directors as separate functions and whether director busyness and advising have effects on the performance of public firms listed on Borsa Istanbul.

The terms “busy directors” and “busy boards” have become popular in corporate governance research in recent decades. Some of the early papers in literature investigating director busyness are Core, Holthausen, and Larcker (1999), Ferris, Jagannathan, and Pritchard (2003), Perry and Peyer (2005), and Fich and Shivdasani (2006). In these papers, the authors

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generally define a busy director as an independent director serving on three or more boards. In addition, they define a busy board as a board where more than 50% of its members are busy directors. Opponents of busy directors argue that board memberships in multiple firms would have negative effects, especially on directors' monitoring effectiveness. Since the monitoring duties performed by directors require significant time and effort, as directors receive additional board seats, time constraints could be expected to become a more serious issue, affecting a director's ability to monitor effectively. This could potentially lead them to avoid some of their responsibilities, such as attending board meetings and serving on board committees (Adams, Hermalin, & Weisbach, 2010; Ferris et al., 2003). In addition, additional seats in other boards could lead to interlocking relationships with other directors and CEOs, leading to compromised independence and poor monitoring (Fields & Keys, 2003; Stuart Yim, 2010), and in turn, decreased firm performance and value (Field, Lowry, & Mkrtchyan, 2013).

Empirical evidence on this topic is mixed. Ferris et al. (2003) and Field et al. (2013) are unable to provide evidence supportive of superior performance by firms with busy boards. On the other hand, Fich and Shivdasani (2006), and Falato, Kadyrzhanova, and Lel (2014) provide evidence that is not in favor of busy directors and boards in terms of monitoring quality and firm performance. In addition, studies such as Beasley (1996) and Core et al. (1999) provide evidence suggesting that director busyness has negative effects on issues such as fraud and CEO compensation. However, Ferris et al. (2003) and Field et al. (2013) provide evidence suggesting that director busyness has positive effects on CEO compensation and director committee servings and board meeting attendance. On the other hand, Ferris et al. (2003) provide evidence suggestive of positive returns when a firm announces the appointment of a director with multiple board directorships for the first time. However, this evidence contradicts the findings of Fich and Shivdasani (2006).

Lastly, it should be kept in mind that directors, especially independent ones, have reputational concerns, which is expected to lead them to be effective monitors. If they perform their duties more effectively, this would signal their worth to the market, leading them to be appointed as directors to other firms. However, every director might not necessarily perceive the reputational incentive at the same level, and might not distribute her effort equally. Her level of effort could change with relative prestige (Masulis & Mobbs, 2014).

Based on these arguments and findings, some reform advocates in U.S. markets call for limitations on the number of outside directorships that directors can hold. In Turkish capital markets, there are currently no such limitations. However, in the future, any potential proponents of such limitations should keep in mind that the issue of director busyness and the potential costs as a result of decreased monitoring should be considered without ignoring the potential benefits of director busyness in the form of increased advising.

The advisory function of members of boards of directors has attracted major attention in recent literature. Among studies that discuss the importance of the advisory function of boards of directors are Boone, Field, Karpoff, and Raheja (2007), Coles, Daniel, and Naveen (2008), Chen (2008), Faleye, Hoitash, and Hoitash (2013), Kim, Mauldin, and Patro (2014), and Coles, Daniel, and Naveen (2014). These studies argue that board members with more connections through outside directorships could be expected to have better access to valuable resources such as information. As directors' access to information increases, they could be expected to provide advice of a higher quality to both executives of the company and other board members. Naturally, high-quality advice from directors could contribute to company's success substantially (Adams, 2009). Knowledge and skills, as well as connections to outside resources, could lead directors to become more effective in performing their duties (Kor & Sundaramurthy, 2009). In addition, a director's exposure to diverse ideas and valuable political resources through external directorships could be beneficial to the sending firm as well (Oh, Labianca, & Chung, 2006). Also, the strategic advising by advisory directors could improve the firm's ability to create value in the long term (Faleye et al., 2013). Other studies such as Adams (2009), Kor and Sundaramurthy (2009), and Fahlenbrach, Low, and Stulz (2010) also provide arguments in support of the potential benefits that could be provided by directors with connections, in terms of increased advising skills.

However, while focusing on the potential benefits provided by advisory directors and boards, it should also be kept in mind that directors, who consider themselves to be monitors, could consider advisory directors to be free-riders, and consequently, reduce their own efforts in performing their monitoring functions (Faleye, Hoitash, & Hoitash; 2011, 2013). Also, it should be considered that not all firms might benefit from advisory boards to the same extent. Coles et al. (2008) argue that firms that are complex in nature would require greater advice from directors. Coles et al. (2014) argue that as the complexity level of the company increases, firm value would be expected to increase with advising quality and total advising.

In empirical studies, Adams (2009), Faleye et al. (2013), and Kim et al. (2014) provide evidence supporting the argument that directors with outside directorships would gain experience and perform as more effective advisors, leading to increased firm value. Field et al. (2013) provide evidence highlighting the importance of busy directors as valuable advisors, who could potentially play a vital role in IPO firms, since they lack experience with public firms. Faleye et al. (2013) and Coles et al. (2014) provide evidence highlighting the importance of the relationship between firm characteristics and advisory needs.

The research on the advisory role of directors has started a debate about the separation of the two main functions of directors. Studies such as Chen (2008), Adams (2009), Hwang and Kim (2009), Stuart and Yim (2010), and Faleye, Hoitash, and Hoitash (2011) argue that increased monitoring effectiveness by board members could come at the expense of forgone advising effectiveness, potentially as a consequence of

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