Pacific-Basin Finance Journal 35 (2015) 444–469

Contents lists available at ScienceDirect

Pacific-Basin Finance Journal

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

Monitoring capabilities of busy and overlap directors: Evidence from Australia☆

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ARTICLE INFO

Article history:
Received 7 July 2014
Accepted 20 May 2015
Available online 22 June 2015

JEL classification:
G30
G32
G34
G38

Keywords:
Board
Executive remuneration
Busy directors
Overlap directors
Audit fees
Audit opinion
Pay-performance sensitivity
CEO turnover

ABSTRACT

We analyze the effects of multiple board directorships (busy directors) and multiple committee memberships of a board (overlap directors) on four board supervisory outcomes: CEO remuneration, external auditor opinion, audit fees and CEO turnover. Using a panel of 684 Australian listed firms from 2001 to 2011, we find that firms with busy directors pay high remunerations to their CEOs, and experience low CEO pay-performance and low CEO turnover-performance sensitivities. Our results also suggest that firms with overlap directors have a lower probability of receiving a qualified audit opinion and are able to negotiate lower payments, both to their CEOs and to the external auditors. These results hold for alternative specifications and proxies. Our results suggest that busy (overlap) directors are detrimental (beneficial) to the monitoring capability of the board and its committees. Finally, our findings suggest that the negative monitoring effect of busy directors are predominantly observed in large firms where over-commitment problems are severe, while the positive monitoring effects of overlap directors are observed in small firms where directorial positions are less time demanding.

☆ Acknowledgment: This research was supported by Ministerio de Economía y Competitividad under project ECO2012-31772. Shams Pathan kindly acknowledges the support received from the Australian Research Council Discovery Early Career Researcher Award (Project ID # DE140100253). The authors wish to thank Francisco Gonzalez, Susana Menendez, Barry Oliver, Julie Walker. As usual, the authors take responsibility for any remaining errors of the paper.

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http://dx.doi.org/10.1016/j.pacfin.2015.05.006
0927-538X/

1. Introduction

The tightening of the regulatory frameworks of many countries during the last decade could discourage prospective directors from accepting directorships on the fear of potential personal risk involved. The concern about fulfilling their duties diligently as board directors sets the focus on "over-boarded" directors. Not only do additional directorships bring extra workload to board members, but board committees' memberships also imply extended duties to be fulfilled. Consequently, directors' commitments both within and outside the firm could affect their supervisory capabilities. Are directors with multiple board seats (termed as "busy" directors) and multiple committee memberships on a board (termed as "overlap" directors) able to perform their supervisory duties, or are they overcommitted?

Contrary to the view of the board of directors as a "managerial rubberstamp", board members have evolved by becoming active and independent monitors (MacAvoy and Millstein, 1999) who spend most of their time monitoring management (Schwartz-Ziv and Weisbach, 2013). The supervisory duties of board directors include designing and approving top managers' remunerations, hiring and firing managers, certifying the quality of financial reports and consulting with the external auditor. Given the diversity of these tasks, the board has delegated them mainly to three specific committees: audit, remuneration and nomination. The recent local and international regulations have stressed the need to form independent boards and independent committees. For instance, according to ASX corporate governance principles and recommendations (2010), an Australian listed company should have a majority of independent directors in its board, an audit committee entirely composed of non-executive directors and remuneration and nomination committees dominated and chaired by independent directors.

With these new regulatory and listing requirements and given the limited supply of directors, the demand for board directors is greater than ever before. As a result, independent directors are now more likely to serve on multiple boards and also on multiple committees in a board.[1] Moreover, directors are spending more time performing their increased duties due to new regulations, intense public scrutiny and the possibility of being sued. According to the 2012 survey by the National Association of Corporate Directors (NACD), a director of a US public company spends an average of 227.5 h on board-related matters, which is greater than the 210 h devoted to the same tasks in 2006. Consistent with this increase in dedication requirements, both national codes of good governance[2] and the board standards of individual companies[3] are constraining the number of external directorships. However, there are conflicting theoretical approaches that predict opposite relations between directors' multiple board memberships ("busyness") and their attitudes towards their monitoring duties (Levit and Malenko, 2013); in addition, empirical evidence on this matter remains inconclusive. For instance, Ferris et al. (2003) report that busy directors are value enhancing, while Fich and Shivdasani (2006) identify that the presence of busy directors is detrimental to the firm value. Kiel and Nicholson (2006) find no influence of busy directors on firms' performance.

Besides, the incentives of board directors acting as strong managerial monitors can be affected by their memberships in multiple board committees. As noted by Hoitash and Hoitash (2009) and Laux and Laux (2009), directors' responsibilities derived from their committee memberships can generate conflicts of interest which may affect their monitoring performance. Empirical evidence regarding the effect of an overlap director on the monitoring performance of the board is scarce and mixed.

To this end, we analyze how and to what extent multiple board directorships and multiple committee memberships in a board relate to four board supervisory decision outcomes: CEO remuneration, external auditor opinions, fees paid to external auditors and CEO turnover-performance sensitivity. We justify below our ex ante choices of each of these four outcomes.

The board, and by delegation, the remuneration committee are responsible for offering the CEO a compensation level that is high enough to attract and retain talented executives and is partly based on performance, to encourage the CEO's effort to create wealth for the shareholders. There is a well established stream of research

[1] See Cashman et al. (2012) and Kiel and Nicholson (2006) for information about the presence of busy directors in US and Australian listed firms respectively.

[2] For instance, limitations established by the codes of good governance and governmental recommendations in the UK, Belgium, France, Denmark, The Netherlands, China, Pakistan and India, among others.

[3] According to the 2011 Spencer Stuart US Board Index, 74% of S&P 500 companies limit other corporate directorships for their board members.