BOARDS AND DIVERSIFICATION STRATEGY: EVIDENCE FROM THE SPANISH SAVINGS BANKS SECTOR

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Abstract

When executives seek to satisfy their need for prestige and status through long-term strategic decisions that increase the size of the company -such as corporate diversification- but do not improve the firm's performance, agency costs might appear. Thus, the current work aims to responding the following question: *does the corporate governance of an organization influence its diversification strategy?* Considering that most research to date has focused on the governance structure of large public limited companies, we considered it would be useful to centre our study on organizations lacking alienable property rights and with an allocation of decision rights decided by law -this is the case of the Spanish savings banks. The results obtained show that board size, number of meetings, and ROE are positively associated with diversification.

Keywords: board of directors, Spain, savings banks

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Introduction

The current research is construed within the framework of moves in recent years urging the reform of corporate governance. There is one constant motive driving these reforms (Olivencia, 1998): the separation of ownership and management. After the first contributions of the classical economists (*e.g.*, Adam Smith, 1776) the problems caused by the divorce between ownership and control were not the object of study until the publication of the work of Berle and Means (1932) and, the one of Coase (1937). For these authors, while the managers are conceptualised as people seeking power, prestige and money, who try to impose on the company objectives more in accordance with their own and consistent with their motivations, the shareholders are only interested in profits.

Under this theoretical approach, the general objective of this research is to answer the following question: *does the firm's corporate governance influence its diversification strategy?* Guided by this question, in the following paragraphs we present a theoretical framework on the governance structure as an internal control mechanism and on the firm's diversification strategy, allowing us to look at the capacity of the board of directors to avoid opportunistic behaviours in the management. Subsequently, we describe the context of the fieldwork -the Spanish savings banks- and we present the methodology of the research as well as the findings of the empirical analysis. Finally we conclude the paper with our main conclusions, the limitations of the empirical work and implications for academics and practitioners, as well as suggestions for future research.

Corporate Governance and Diversification Strategy: An Agency Approach

The managerial theory of the firm is seen as one of the first explanations for the inefficiency resulting from the separation of ownership and control (Williamson, 1964; Jensen and Meckling, 1976). Starting from the basic premises of this, agency theory emerged, a theory which shares many hypotheses with organization theory, organizational behaviour and strategic management (Eisenhardt, 1989). This theory postulates that an agency relationship arises every time an individual depends on the action of another (Pratt and Zeckhauser, 1991). Thus, the main challenge posed by the divorce between ownership and control seen in the modern firm is to avoid the potential opportunistic behaviours of the managers that tend to destroy value (Gedajlovic and Shapiro, 1998). This leads to the concept of *corporate governance*, which has been described by Baysinger and Hoskisson (1990) as the integration of external and internal controls harmonising the conflict of interests between shareholders and executives that results from the separation of ownership and control. These mechanisms for controlling management discretion have been analysed by a large number of researchers (Finkelstein, 1992), with two basic types

of instrument of control being recognised (Jensen, 1993): *external control mechanisms*, consisting of the control market, the goods and services market, the labour market, the legal and jurisprudential system and external auditing (Fama, 1980; Fama and Jensen, 1983; Demsetz, 1983; Shivdasani, 1993; Hart, 1983); and *internal control mechanisms*, based on the shareholders' meeting and the board of directors (Jensen and Meckling, 1976; Shleifer and Vishny, 1986; Weisbach, 1988; Hermalin and Weisbach, 1991; Yermarck, 1996).

In this sense, the divorce between ownership and management of the firm, along with the former's lack of effective control over the latter, may favour a diversification strategy that is not justified from the point of view of the shareholder (Cuervo, 1991; Chatterjee *et al.*, 2003). Specifically, the diversification strategy has been recognised in the literature as one of the strategies providing least value to the shareholder (Goodstein *et al.*, 1994; Kochhar and David, 1996), and yet the most beneficial to the executives themselves (Hoskisson and Turk, 1990; Shleifer and Vishny, 1990ab). In other words, diversification may be motivated by the management's desire to appropriate or maintain the private privileges and benefits that they obtain as a consequence of the diversification processes, regardless of the net effect on the value-creation objective of the firm (Shleifer and Vishny, 1988). Particularly, diversification and firm size are highly correlated, as are firm size and executive compensation (Tosi and Gómez-Mejía, 1989; Hoskisson and Turk, 1990; Jensen and Murphy, 1990), firm size and executive power and prestige (Jensen, 1986), and firm size and volume of resources under managers' personal control (Jensen and Murphy, 1990).

As Grant (2002) points out, over the past 20 years the study of the lines and areas of research on corporate strategy, and specifically on diversification, have been the outcome of theoretical contributions ranging from transaction cost economics to the resource-based view of the firm, along with the significant contributions of agency theory and modern financial theory. Focussing on the approach that concerns us here, agency theory examines the motives that executives have for supporting a strategy of this type -*i.e.*, it centres on the analysis of executive discretion. In this sense, Lane *et al.* (1998, 1999) consider that in some cases the principles of the theory cannot be applied to diversification, since these strategic decisions may not be in conflict with shareholder interests. However, a substantial body of work has based its analysis of diversification on agency theory (*e.g.*, Amihud and Lev, 1981; Ramanujam and Varadarajan, 1989; Hoskisson and Hitt, 1990; Datta *et al.*, 1991; Montgomery, 1994; Palich *et al.*, 2000). Among these authors Hoskisson and Hitt (1990), in their review on the relation between agency theory and diversification, point out that the research in the area of executive motives for driving diversification has been very limited, since the management do not readily admit that they are seeking to maximise their personal utility through diversification; it is difficult to isolate the effects of governance mechanisms on strategic behaviour. The firm should have an effective corporate governance to avoid these agency problems (Baysinger and Hoskisson, 1990; Walsh and Seward, 1990); *i.e.*, the firm needs to design governance mechanisms that allow it to control the management efficiently (Shleifer and Vishny, 1996) and limit their tendency to overdiversify (Hoskisson and Hitt, 1990, 1994). Thus, governance mechanisms should play an important role in moderating the firm diversification strategy (Chatterjee *et al.*, 2003).

However, deciding which mechanisms to apply in each case depends to a great extent on the institutional and corporate characteristics in which the firm finds itself framed (Cuervo-Cazurra, 1998; Cabrera and Santana, 2002). Since the research that we present here centres on a study of the board of directors as mechanism of internal control and its influence on diversification in firms, we shall undertake a review of the extant literature relating to the facilitating and inhibiting effects that each control mechanism of the board of directors may exert on the potential growth of the firm (*i.e.*, its diversification strategy). In this line, Mizruchi (1983) argues that the board should fix the parameters within which the strategic decision-making process of the firm will operate.

The Board of Directors as Internal Control Mechanism

The board of directors is situated at the top of the firm's system of internal control (Jensen, 1993); it is a key element in the study of corporate governance since it monitors and validates important corporate decisions (Fama, 1980; Zahra and Pearce, 1989; Bainbridge, 1993; Johnson *et al.*, 1996), likewise controlling the activities of the top management team (Baysinger and Bulter, 1985; Hermalin and Weisbach, 1991). In recent years, the scientific literature has reflected the growing importance of the board of directors, not only because of its significance as a part of the governing structure, but also for the fact that it constitutes a determining element in corporate decision-making. McNulty and Pettigrew (1999:62) affirm that «[...] board members influence, not only the content of strategy, by taking and shaping strategic decisions, but also the processes and methodologies through which those ideas evolve». In many countries, the presumed crisis of governance that firms have suffered, reflected in poor results for their shareholders, has been attributed precisely to the defective operation of the board of directors, a diagnosis that has encouraged initiatives to reinforce the role of this governance body as a mechanism to safeguard the shareholders' interest by exercising a strict supervision of the management team (Salas, 2002). In this line, the codes of ethical conduct

designed for the board of directors constitute a subject for current debate, with documents being emitted that refer mainly to the distinct factors that may influence in the supervisory function of the board of directors, in an attempt to prevent boards from being dominated by executives and thereby failing in their role of efficient control mechanism (Leech and Manjón, 2002). The importance conceded to the board of directors as the organism charged with resolving agency conflicts is reinforced in the particular context of organizations lacking an ownership structure, such as in the case of savings banks. Here, the controlling role played by this governing body is even more significant in view of the absence of a shareholders' meeting *per se* -the interests in the organization may come from different stakeholders and not just those of an economic/financial type. For all this, we propose the following specific objective for the current research: *to study the relation between the board of directors -as mechanism of internal control- and the firm's diversification strategy in the context of organizations without ownership structures*. Specifically, studies focused on the board of directors -and that maintain that the factors influencing the efficiency of this supervisory body are critical for the governance of the firm- point towards four groups of factors: its composition, characteristics, structure and processes (Zahra and Pearce, 1989; Maassen, 1999). We now look at each of these factors in turn and establish hypotheses relating them to the diversification degree of the firm.

Board composition and characteristics

The literature on the board of directors, which is basically empirical, considers that the effectiveness of this governance body depends on its size (Jensen, 1993; Yermarck, 1996; Eisenberg *et al.*, 1998), as well as on its composition and independence (Baysinger and Butler, 1985; Weisbach, 1988; Hermalin and Weisbach, 1988, 1991; Rosenstein and Wyatt, 1990, 1997; Bhagat and Black, 2000). *Board size* -measured by the number of directors- may influence supervisory effiectiveness, as a large board can prove an obstacle to quick and efficient decision-making, since problems of coordination and information may arise (Lipton and Lorsch, 1992; Jensen, 1993). With regards this variable, Yermarck (1996) finds that large boards of directors are less effective at controlling, and also that large boards in diversified companies are associated with an agency motive for diversification. This result is reinforced by the findings of Anderson *et al.* (2000), who found out that the board of directors in diversified firms tends to be larger than in non-diversified firms. In consequence, we propose the following hypothesis:

H1. The size of the board is positively related to the diversification degree of the firm.

With regard to the nature of the directors, two main types can be distinguished among board members: the inside directors -those that have an executive post at the same time; and the outside directors -those that are not linked to the firm's management *(*Dalton *et al.,* 1998). There are also different categories of outside directors in the board (Daily *et al.,* 1999): (a) the independents -who are not linked in any way with the firm's ownership; and (b) the affiliated -who have a personal and/or professional tie with the firm. The board of directors would be expected to be more effective in its supervisory role if most of its members were independent outsiders, since inside directors will tend to be reluctant to monitor managers who are not maximising value for the firm, although they can bring valuable knowledge and experience (Weisbach, 1988; Rosenstein and Wyatt, 1990; Hermalin and Weisbach, 1998). Moreover, affiliated outsiders find it difficult to comply with their functions of evaluation and control in an objective manner (Kesner *et al.,* 1986; Mallete and Fowler, 1992; Rechner *et al.,* 1993). McNulty and Pettigrew (1999) examine the contribution to strategy by «part-time board members» (non-executive directors) in large UK companies, and they find out that the involvement of those directors in strategy is consistent with agency perspectives which treat boards as important mechanisms of corporate control. In this line, the more independent the board, the more control it will exercise on the firm's strategies (Chatterjee *et al.*, 2003). This may be due to the fact that outsiders are frequently concerned to evaluate the relation between firm diversification and performance (Hoskisson and Hitt, 1990), which leads us to propose the following hypothesis:

H2. The board independence is negatively related to the diversification degree of the firm.

The characteristics of the board that have been studied are those aspects relating to the *background of the directors* -age, length of service, educational level, skills and experience- (Zahra and Pearce, 1989). Among the authors who have analysed the demographic characteristics of director, Vance (1978), Pearce (1983) and Norburn (1986) could be highlighted. These works postulate that the different skills and knowledge of the directors constitute their backgrounds and experiences, and the use they make of these influences the results of the board (Gabrielsson and Winlund, 2000), and consequently the diversification degree of the firm.

For Jackson (1992), the importance of the board of directors in the firm in terms of its participation in strategic decision-making is similar to that of the top management team. In this sense, Hambrick and Mason (1984) point out that managerial demographic and personal aspects could influence strategic decisions. According to the analogy we have just set, directors' backgrounds will also be influential. More specifically, manager's age is related to corporate growth (Hart and Mellons, 1970). This is due to several reasons (Hambrick and Mason, 1984): (a) age reduces physical and mental vitality, and therefore for older managers it will be more difficult to integrate information in decision-making; (b) they also

maintain a stronger commitment to organizational *statu quo*; and (c) they are likely to elude any action that could endanger their financial or professional safety. In the same line, Grimm and Smith (1991) and Wiersema and Bantel (1992) find out that age is negatively associated with strategic change; Vroom and Pahl (1971) and Hitt and Tyler (1991) affirm that older managers generally avoid risky actions. This leads us to propose the following hypothesis:

H3. The age of the director is negatively related to the diversification degree of the firm.

Board structure and process

Research on the structure and the decision-making processes of the board has been largely neglected (Gabrielsson and Winlund, 2000), despite the fact that in studies such as Zahra and Pearce (1989), Pearce and Zahra (1991), Huse (1998) and Forbes and Milliken (1999) it is argued that these topics should be a central theme in research on corporate governance. Board structure refers to how these governance body is organized into different committees (John and Senbet, 1998), with the aim to help in its activities (Zahra, 1990), each specialising in specific tasks (Kesner, 1988; Klein, 1996), thus improving board's effectiveness. The variables studied include the number and type of committees, the number of members on them, the flow of information among committees, the leadership of the board and the composition of the committees (Zahra and Pearce, 1989; Maassen, 1999). Therefore, an increase in the number of committees indicates an increasing number of aspects delegated by the board (Vafeas, 1999), although one must not forget that the creation of committees increases the board's task of coordination and supervision (Kose and Lemma, 1998). In the other words, as far as the structure of the board is concerned, it needs to have a committee framework and effective procedures allowing it to actively participate in the strategy (Zahra, 1990). All these arguments let us to advance the following hypothesis:

H4. The number of board's committees is negatively related to the diversification degree of the firm.

It is noteworthy that among the variables associated with the structure of the board, an aspect of great importance is whether there is duality of power (Shivdasani and Yermarck, 1999), that is, the same person is in charge of the responsibilities of chairman of the board and chief executive of the firm. This coincidence has been criticised in the literature (e.g., Jensen, 1993), since this situation leads to a concentration of power in a single person who can take decisions on his or her own interest rather than on the interests of the owners (Coles et al., 2001). A firm with active shareholders seeks to separate the roles of CEO and Chairman of the board, thereby ensuring that the CEO does not have direct control over board members (Vafeas, 1999). In this sense, CEO-chairman duality may ensure that the leadership of the firm is unitary, but it also favours an excessive centralisation and limits information processing capacity, which may impede the development of new business (Zahra et al., 2000)[6].

For Vance (1983), Zahra and Pearce (1989) and Pettigrew (1992) board process refers to the approach that this governing body follows in its decision-making. This has been the subject of debate by many authors (*e.g.*, Pettigrew, 1992; Huse and Eide, 1996; Huse, 1998; Forbes and Milliken, 1999), although the empirical tradition of observing this process is very limited (Huse, 2000). An inadequate access to boards has resulted in little knowledge about their behavioural dynamics (McNulty and Pettigrew, 1999). Specifically, the variables considered include (Mueller, 1979, Vance, 1983): the frequency and duration of meetings, the form of communication between CEO and board, the level of consensus among directors facing a problem, the formality of the procedures of the board and to what extent the board evaluates itself. For Zahra and Pearce (1989) and Lorsch (1995) the attitude of the directors in the board meetings predicts the process of the board; and as they are part of committees, in order to be involved in the business and strategic objectives, directors should also be prepared before the meetings in the areas that will be dealt within them (Demb and Neubauer, 1992).This allows us to propose two hypotheses:

H5. A better attitude of directors in boardroom sessions is negatively related to the diversification degree of the firm.

H6. The access to information by board members is negatively related to the diversification degree of the firm.

A widely analysed aspect is the frequency of meetings celebrated by the board. In this regard, Conger *et al.* (1998) point out that the frequency can be considered a measure of the board's effectiveness in its control role, and they conclude that boards that meet frequently will be in better position to comply with their obligations in accordance with shareholder interests. This reasoning can also be used for the meetings of the various board's committees, since the functions of this governing organism are delegated in them. In this sense, as Reyes Recio (2000) points out, the more meetings, the more time directors spend consulting, developing strategies, and controlling the management. Consequently, we advance the following hypothesis:

H7. The frequency of meetings of board is negatively related to the diversification degree of the firm.

H8. The frequency of meetings of board's committees is negatively related to the diversification degree of the firm.

[6] In this study we do not go ahead with a hyphotesis proposal because in the context of Spanish savings banks only one out of the 46 fims exhibits this coincidence of power (executive chairman of the board).

Framework of Application and Methodological Design

Taking into account that most research has centred its discussion on the governance structures of large public limited companies, this paper will focus on organizations lacking alienable property rights and with an allocation of decision rights decided by law, as is the case of the Spanish savings banks - institutions in which, moreover, dysfunctions can arise as a result of the conflict of power between executives, directors and other stakeholders. The importance of savings banks in Spanish society can be understood in financial terms: these institutions have become key players, currently capturing more than half the deposits of the Spanish banking system. But these organizations are also distinguished by their contribution to society through the so-called social funds. In practice, as Melle and Maroto (1999), Salas (2001) and Azofra and Santamaría (2002) point out, the governance of savings banks is specific for this context for various reasons: (a) external control mechanisms are totally unworkable due to the banks' legal structure; (b) the CEO or executive chairman constitutes the first executive with the role of agents looking after the interests of the social groups represented; (c) the social groups that make up the governing structure of the savings banks pursue diverging interests, more if we consider that the decision rights are not equitably allocated among the various groups; (d) the independence of the board will be determined by the existence of a non-executive chairman along with the board's model of control; this is a function of the degree of concentration and type of control possessed, on the one hand, by the public administrations, and on the other, the depositors and employees. As García-Cestona and Surroca (2002) point out, when the former possess more than 50 per cent of the votes, the savings bank is controlled by the Administration, while when the latter possess more than 50 per cent, the savings bank is controlled by the management, resulting in less independence. This last aspect occurs due to the limited capacity of the depositors to influence the operation of the institution and also to the condition as employees of the bank of the representatives of the personnel.

The information necessary to carry out the current research work was obtained from primary sources -a structured questionnaire- and secondary sources -the 2001 individual company reports of the institutions and the *Anuario Estadístico de las Cajas de Ahorros 2001* (Savings Banks Statistical Yearbook 2001). For the structure of the board of directors we used various sources of information, in order to determine its composition, characteristics, structure and process in decision-making. In this sense, the variables analysed for each of the board attributes were the following: (a) for board size: the number of directors; (b) for board independence: the model of control, the percentage of members by representative group (autonomous region, town corporations, town halls or provincial councils, founders, personnel or institutions) and the nature of chairman's post - executive or non-executive; (c) for characteristics of the board: the average age of directors in the board (six intervals); (d) for board structure: the number of committees; and finally, (e) for board process: the degree of importance conceded to each of the attributes related with attitude of directors and access to information (a six-variable questionnaire answered by the board chairman, according to a 5-point Likert-type scale), and the number of ordinary and extraordinary meetings celebrated by the board as well as by the various committees.

In order to determine the degree of diversification of the savings banks we also used secondary sources, which allowed us to measure a number of variables to explain the diversification. First, the number of firms participated by the savings bank. Second, the volume of such partifcipation (million euros) compared to total assets -investment in another financial firms was not considered. Third, the dimensions established by Varadarajan (1986) based on counting the number of activities, which maintains the objectivity and simplicity of the SIC approximation and does not require that we have detailed information available about each business segment. These dimensions are: the Broad Spectrum Diversity (BSD) and the Narrow Spectrum Diversity (NSD). The BSD refers to the firm's expansion into a different industry defined by 2 SIC digits, definied as the total number of 2-digit SIC industries in which the firm currently operates. The NSD reflects expansion outside the industry measured by 4 SIC digits, definied as the total number of 4-digit SIC industries in which the firm is involved. The application of this methodology to savings banks was the result of a process of elaboration consisting of the following phases[7]: (a) noting down of the different activities carried out by each savings bank as detailed in their company reports and annual accounts; (b) selection of those businesses where investment was at least 50 per cent, in order to ensure that the savings bank exercised a majority control in the activity and it was not merely a portfolio investment; and (c) elimination of those businesses corresponding to typically banking activities, which, according to the legal regulations (Law 8/1987, 8 June, Regulation of Pension Plans and Funds; Law 24/1988, 28 July, On the stock market; Law 30/1995, 8 November, Regulation and Supervision of Private Insurance, modified by Law 14/2000, 29 December, and by Law 24/2001, 27 December; and Law 46/1984, 26 December, regulating Institutions of Collective Investment), have to have a corporate personality different from the deposit institutions. Fourth, with the four previous measures (the third measure is made up of two variables) we carried out a factor analysis.

[7] In the current work we opted to use CNAE (National Classification of Economic Activities) codes, the Spanish equivalent of the SIC codes.

Results

In order to fulfil the objectives we have set in this research -*i.e.*, to study the relation between the board of directors and the degree of diversification in the context of organizations lacking ownership structures- we proceeded to test the various hypotheses advanced. These postulate relations between certain attributes of the board -size (H1), independence (H2), characteristics (H3), structure (H4), and process (H5 to H8)- and the institution's diversification.

Board Composition and Characteristics

First, employing a *Kruskal-Wallis* analysis of variance (henceforth K-W) and Spearman's coefficient, we tested for the existence of significant relations between board composition -size and independence- and characteristics -age- and the degree of diversification. In Table 1, we can see that there is a significant relation between board size and savings bank diversification for each of the five diversification measures we used (number of non-financial firms, number of non-financial industries, number of non-financial activities, volume of participation and degree of diversification). Moreover, the bigger the board, the higher the mean rank, so that we can say that institutions with larger boards show a higher diversification, with the degree of dependence being stronger for the number of non-financial firms participated by the savings bank (eta^2=0.350) and the degree of diversification (eta^2=0.331). For this reason, we can confirm the hypothesis H1.

Table 1. Relation between board size and the degree of diversification

Diversification	Size	n	*K-W* test		*eta*	eta^2
			Mean rank	Mean rank		
Number of non-financial firms	Lower than mean	13	13.38	15.297***	0.592	0.350
	Equal to mean	21	23.60			
	Higher than mean	12	34.29			
Number of non-financial industries	Lower than mean	13	13.46	11.726**	0.491	0.241
	Equal to mean	21	25.45			
	Higher than mean	12	30.96			
Number of non-financial activities	Lower than mean	13	13.27	13.093***	0.524	0.275
	Equal to mean	21	24.86			
	Higher than mean	12	35.21			
Volume of participation	Lower than mean	13	13.69	12.712**	0.358	0.128
	Equal to mean	21	24.29			
	Higher than mean	12	32.75			
Degree of diversification	Lower than mean	13	13.00	14.688***	0.575	0.331
	Equal to mean	21	24.29			
	Higher than mean	12	33.50			

**p<0.01, ***p<0.001.

Second, with regards board independence, we can see (Table 2) that for the model of control there is a significant difference between the volume of participation and the percentage of Administration members in the board; in other words, the higher the board independence is, the higher the degree of diversification, so that the hypothesis H2 cannot be confirmed as it postulated a negative relation. In contrast, individually, the weight of participation of the representative groups shows the existence of significant relations between the degree of diversification and the group of representatives of the town halls (positive relation), founders (positive relation), employees (negative relation) and institutions (negative relation). These results indicate that, at least partially, H2 can be accepted when the model of control is considered only through the percentage of institutional members in the board. This would indicate that a stronger presence of this latter group in the board would negatively affect the diversification. Third, the executive nature or otherwise of the chairman -a variable that also indicates the degree of board independence- is related with the volume of participation (see Table 3). In this respect, the mean rank of the *Mann-Whitney* test (henceforth M-W) shows how this variable increases when we go from non-executive to executive chairman in the savings banks. Thus, this aspect confirms the postulate that greater board independence is associated with a lower diversification (H2).

Board structure and process

The structure and operation of the board is analysed in terms of the number of committees, the concern for the efficient operation of the board, and the frequency of board and committee meetings. With regards the committees in which this governance body is structured, we only study the meetings of the control and the executive committees, ignoring the other committees because they are much less frequent among Spanish savings banks. In the first place, the results of the analyses (see Table 5) show that there is a positive relation between the number of committees and the diversification of the savings banks, except when it is measured using the volume of participation. Thereby, these results do not allow us to accept hypotheses H4, where a negative-sign relation was considered.

Table 2. Relation between board independence and the degree of diversification

Diversification	Spearman coefficients								
	Model of control (n=37)		Nature of members (%) (n=37)						
	% Adm.	% internals	Aut. Region	Town halls	Other local adm.	Depositors	Founders	Employees	Institutions
Number of non-financial firms	0.127	-0.021	-0.003	0.279†	-0.108	-0.043	0.340*	-0.126	-0.327*
Number of non-financial industries	0.056	0.009	0.024	0.387*	-0.127	0.026	0.261	-0.215	-0.287†
Number of non-financial activities	0.061	0.011	0.037	0.368*	-0.117	0.023	0.260	-0.192	-0.317†
Volume of participation	0.335*	-0.043	-0.002	0.238	-0.059	0.037	0.212	-0.330*	-0.286†
Degree of diversification	0.102	-0.012	0.026	0.354*	-0.117	0.011	0.289†	-0.197	-0.321†

†p<0.1, *p<0.05.

Table 3. Relation between post of chairman and the degree of diversification

Diversification	Post of chairman	n	M-W test		eta	eta^2
			Mean rank	Mean rank		
Number of non-financial firms	Non-executive Executive	22 7	13.80 18.79	50.500	---	---
Number of non-financial industries	Non-executive Executive	22 7	13.93 18.36	53.500	---	---
Number of non-financial activities	Non-executive Executive	22 7	13.80 18.79	50.500	---	---
Volume of participation	Non-executive Executive	22 7	13.14 20.86	36.000*	0.468	0.219
Degree of diversification	Non-executive Executive	22 7	13.68 19.14	48.000	---	---

*p<0.05.

For the age of the directors we did not found any significative relation between this variable and the different diversification measures employed in this research (see Table 4). Therefore, hypothesis H3, that established a negative relation between these variables, is not accepted.

Table 4. Relation between age and the degree of diversification

Diversification	K-W test
	Age of directors (n=29)
Number of non-financial firms	0.530
Number of non-financial industries	1.224
Number of non-financial activities	0.807
Volume of participation	1.200
Degree of diversification	0.535

Table 5. Relation between board structure and the degree of diversification

Diversification	Spearman coefficients
	Number committees (n=37)
Number of non-financial firms	0.362*
Number of non-financial industries	0.283†
Number of non-financial activities	0.299†
Volume of participation	0.084
Degree of diversification	0.312†

†p<0.1, *p<0.05.

In order to examine the operation of the board of directors, we used six items, each on a 5-point Likert-type scale, measuring the degree of importance conceded to each of the attributes related with board operation. In order to reduce the dimensionality of these variables, we used principal components analysis with varimax rotation. Previously, we had tested whether principal components analysis was in fact suitable for this data, making use of Bartlett's sphericity test and the Kaiser-Meyer-Olkin test of sampling adequacy, whose results were favourable.

The results of the factor analysis for the set of variables relating to concern for efficient board operation, which are shown in Table 6, indicate the existence of two factors explaining a satisfactory proportion of the total variance (68.5%). The first factor, labelled *information to members*, is made up of items concerning board members' access to information necessary for carrying out their functions. And the second factor, which includes items relating to participation in board decision-making, has been labelled *consensus in the decision-making*. With regards the analysis of reliability for the joint scale and for each of the factors, the Cronbach *alpha* indicates that the measurement instrument is moderately reliable, since the values lie between 0.5 and 0.75. Having reduced the measuring scale, correlation analysis allows us to deduce that diversification is independent from these aspects of board operation (see Table 7).

Table 6. Factor analysis for attributes of board operation

Tests of suitability of factor analysis			
KMO index = 0.631		Bartlett sphericity = 43.787***	
Results of factor analysis (Cronbach alpha = 0,6960)			
Factors	Items	Communality	Factor loading
Information to members Explained variance= 34.6% Cronbach alpha= 0.6848	Provision of detailed and precise information Ease of access to information Advice for functions	0.654 0.662 0.536	0.804 0.761 0.732
Consensus in decision-making Explained variance= 33.9% Cronbach alpha= 0.7281	Participative operation Intervention of all members Agreement by majority vote	0.832 0.759 0.668	0.901 0.860 0.627

***p<0.001.

Table 7. Relation between importance of attributes of board operation and the degree of diversification

Diversification	*Spearman coefficients* (n=26)	
	Information factor	Consensus factor
Number of non-financial firms	-0,180	-0,127
Number of non-financial industries	-0,084	0,011
Number of non-financial activities	-0,080	-0,053
Volume of participation	0,071	-0,292
Degree of diversification	-0,123	-0,070

Finally, with regards the frequency of board's and committees' meetings and organizational diversification, in Table 8 we can observe that total and ordinary meetings of control committee are positively related to the diversification of savings banks -with correlation coefficients close to 0.4-, for the number of non-financial firms, the number of non-financial industries, the number of non-financial activities and the overall degree of diversification. In conclusion, hypotheses H7 and H8 cannot be accepted.

Table 8. Relation between frequency of meetings and the degree of diversification

Diversification	*Spearman coefficients*						
	Number of meetings (board of directors)			Number of meetings (control committee)			Number of meetings (executive committee)
	Tot. (n=31)	Ord. (n=32)	Ext. (n=31)	Tot. (n=31)	Ord. (n=32)	Ext. (n=31)	Ord. (n=27)
Number of non-financial firms	0.100	0.117	0.133	0.414*	0.450**	0.102	0.292
Number of non-financial industries	0.061	0.062	0.033	0.388*	0.428*	0.093	0.316
Number of non-financial activities	0.075	0.105	0.011	0.411*	0.445*	0.074	0.289
Volume of participation	0.257	0.288	0.069	0.212	0.283	-0.223	0.316
Degree of diversification	0.080	0.111	0.054	0.406*	0.452**	0.056	0.312

*p<0.05, **p<0.01.

Board Control Mechanisms as Determinant Factors of Diversification: An Integrative Model

To capture the effects of boards on diversification strategy, in table 9 we present five regressions examining that association, the independent variables being the number of non-financial firms, the number of non-financial industries, the number of non-financial activities, the volume of participation and the degree of diversification. The dependent variables are those that turned out to be significant in the previous bivariate analyses: board size, percentage of Administration, percentage of employees, number of

committees and number of meetings held by control committee. For each regression analysis we have obtained two models, one without control variables (model 1) and another one (model 2) including ROE as an independent control variable, as diversification degree is positively related to firm return (Palich *et al*., 2000).

In order to determine the significance of the five multiple linear regressions, we carried out ANOVAs. These tests indicate that four regressions are significant, all except when the dependent variable is the volume of participation. Considering the remaining diversification variables, the most robust regressions are those in which diversification is measured through the number of non-financial activities or through diversification degree. That is because the inclusion of the control variable does not affect the significance of the dependent variables in those models.

Looking at the model built around the variable number of non-financial activities, the multiple correlation coefficients analysis allows us to say that out of the six variables introduced into the analysis, three proved to be significant, namely, in decreasing order of their relative contribution to explaining diversification: board size, number of meetings of control committee and ROE (adjusted R^2= 42.1%). A significant positive coefficient for both corporate governance variables indicates that firms with larger boards and a more intense activity of control committee -measured through the number of meetings- are more likely to diversify.

Table 9. Multiple regression for the degree of diversification

Regression Analyses										
Dependent variable	Independent variable									
	Number of non-financial firms (Durbin-Watson=2.262)		Number of non-financial industries (Durbin-Watson=2.168)		Number of non-financial activities (Durbin-Watson=2.004)		Volume of participation (Durbin-Watson=2.504)		Degree of diversification (Durbin-Watson=2.245)	
	Model 1 Beta (*t*)	Model 2 Beta (*t*)	Model 1 Beta (*t*)	Model 2 Beta (*t*)	Model 1 Beta (*t*)	Model 2 Beta (*t*)	Model 1 Beta (*t*)	Model 2 Beta (*t*)	Model 1 Beta (*t*)	Model 2 Beta (*t*)
Independent term	(-2.072*)	(-2.752*)	(-0.429)	(-1.382)	(-1.440)	(-2.334*)	--	--	(-2.569*)	(-3.550**)
Board size	0.400 (1.988†)	0.328 (1.712)	0.386 (1.771†)	0.282 (1.470)	0.514 (2.536*)	0.427 (2.311*)	--	--	0.444 (2.165*)	0.354 (1.904†)
Percentage of Administration	-0.075 (-0.363)	-0.057 (-0.293)	-0.206 (-0.922)	-0.180 (-0.927)	-0.293 (-1.409)	-0.271 (-1.452)	--	--	-0.168 (-0.800)	-0.145 (-0.774)
Percentage of employees	-0.028 (-0.177)	-0.074 (-0.484)	-0.222 (-1.277)	-0.287 (-1.882†)	-0.139 (-0.857)	-0.193 (-1.319)	--	--	-0.172 (-1.053)	-0.228 (-1.542)
Number of committees	0.285 (1.546)	0.311 (1.800†)	0.167 (0.840)	0.205 (1.183)	0.123 (0.666)	0.155 (0.931)	--	--	0.208 (1.108)	0.240 (1.428)
Number of meetings (control committee)	0.254 (1.374)	0.253 (1.464)	0.252 (1.261)	0.251 (1.447)	0.362 (1.946†)	0.361 (2.166*)	--	--	0.261 (1.388)	0.260 (1.547)
ROE		0.316 (2.135*)		0.451 (3.041**)		0.381 (2.673*)	--	--		0.388 (2.699*)
F	3.430*	4.025**	2.190†	3.969**	3.315*	4.632**	1.466	1.265	3.136*	4.485**
Adjusted R^2	0.288	0.377	0.165	0.373	0.278	0.421	--	--	0.263	0.411

†p<0,1, *p<0,05, **p<0,01.

Discussion and Conclusions

In 1990, Baysinger and Hoskisson underlined the importance of studying the strategic implications of governance structure, for discussions of corporate governance have tended to be the special preserve of economists and lawyers. Our research responds to that insight and we believe we have contributed to a deeper understanding of the board of directors as a control mechanism of management discretion. This paper compares the structure of corporate governance across five diversification measures, within an agency theory framework. We can see that for board characteristics and composition, there is a positive relation between the degree of diversification and the size of this governance body, the percentage of Administration and the executive nature of the post of chairman. Likewise, we find a negative relation between the diversification strategy and the group of representatives of the employees. Among the hypotheses relating to board structure and operation, a positive relation has been found with the number of committees and the number of meetings of control committee.

Hence, the most diversified firms are those with a higher board size, percentage of group of representatives of Administration, number of committees, and number of meetings of control committee; executive nature of post of chairman; and less representatives of the employees. These results have not generally been interpreted as supporting an agency cost explanation for diversification, except for board size. Therefore, the diversification is not predominantly a performance-reducing strategy and the results cannot be atributed to the presence of agency issues (Singh *et al.*, 2004). According to stewardship theory (Davis *et al.*, 1997); it might happen that managers whose needs are based on growth, accomplishment and self-fulfilling, and are intrinsically motivated, could obtain a higher utility through the accomplishment of organizational -versus personal- goals, or similarly, managers that identify with their organizations and show a strong commitment towards organizational values are more likely to serve organizational purposes.

The results obtained may also be due, first, to the fact that investment by savings banks in other firms is a recent phenomenon due to the characteristics of this type of bank (Cals, 1998), an aspect that causes them to have a very different cycle of growth. Thus, while the current tendency in banks is to reduce their shareholdings in other organizations, the savings banks are doing exactly the reverse (Nieto and Serna, 2001). To this we should add the fact that the degree of diversification of these institutions is still not very high if we take into account the number of sectors in which they participate. The average number of sectors is 4, compared to 11 for the large US firms analysed by Varadarajan and Ramanujam (1987), although the empirical research frameworks are different for the two studies.

The multivariate results are, to some extent, similar to the bivariate results in that firms with a large board and more frequent control committee meetings are more likely to adopt diversification (measured through the number of non-financial activities). In this view, a significant positive coefficient for board size indicates that firms with larger boards are more likely to expand their corporate scope (Singh *et al.*, 2004). A large board is beneficial as more directors can provide a greater variety of opinions, which might raise the capacity of control of the board, or alternatively, superior corporate decisions (Pearce y Zahra, 1992). Anderson *et al.* (2000) found out that board size is higher in diversified firms when compared to non-diversified firms, though the difference is not very important. The positive relation between the number of meetings of control committee and diversification could suggest that the more meetings, the more time directors spend consulting, developing strategies and controlling the management (Reyes Recio, 2000). In sum, the results indicate that it may be difficult to explain the adoption of a diversification strategy through agency theory.

Considering the control role played by Administration in the savings banks, we especially appreciate the significantly positive coefficient for Administration percentage (outside directors), although this relation cannot be observed in the regression analyses. Our findings are consistent with Melle and Maroto's (1999) conclusions that the vote of the Public Administration can influence the organization's policies, making them more favourable to their own interests. Likewise, they are in line with García Cestona and Surroca (2002), who point out that this group of representatives neglects the fostering of competition although it does favour other objectives of the institutions, such as regional development (*e.g.*, investment on regional firms).

The current research has a series of implications, both for academics and for practitioners, which may prove useful for an improved understanding of how the control mechanisms function, both in financial organizations in general and in those that lack an ownership structure in particular, such as the Spanish savings banks. Moreover, we have studied the effects for credit institutions of their investment in the stock of other firms. This is an issue that has traditionally been analysed from the reverse perspective -*i.e.*, that of the firm in which the bank invests, with authors studying the consequences for a firm of having financial institutions participating in its capital. Furthermore, about methodology we should also highlight the use in one study of different sources of information to analyse a single business reality, on the one hand, and the inclusion of numerous measures of firm diversification, on the other, this latter responding to the recommendations of authors on the question of the unreliability of using a single measure. In this sense, it should also be underlined that we have been able to solve the substantial problems inherent in any analysis of the savings banks sector: the difficulty of determining the shareholdings of all the institutions, along with the lack of homogeneity of the data in their company reports.

As limitations of this study, we briefly outline the following: (a) our findings should be considered with due caution since they cannot be extrapolated beyond the sector concerned -the Spanish savings banks- so that future researchers would be advised to extend the focus to the financial sector as a whole; and (b) the static character of the study is a drawback: it would be of interest to carry out a longitudinal analysis, which would help to reveal the effects of the promulgation of the new Finance Law 2002 on Reform Measures of the Financial System.

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