

# MULTIPLE DIRECTORSHIPS AND CORPORATE REPUTATION

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## Abstract

The previous literature suggests that firms may use the characteristics of the board members as a signal for building their own image. The objective of this paper is to analyze whether the number of appointments of directors influences corporate reputation. For that, we focus on a sample of US firms listed on the New York Stock Exchange (NYSE) for the period 2007-2010 and we examine a total of 30,813 directors. Our results indicate that there is a curvilinear relationship between the number of directorships of board members and corporate reputation. These findings shed some light on the value of boards of directors and also have implications for companies in the selection of board members.

**Keywords:** Corporate Reputation, Board of Directors

## 1. INTRODUCTION

Directors' characteristics have been linked to several firm outcomes, but the evidence of their effect on corporate reputation remains scarce. The definitions of corporate reputation indicate that it is based on the aggregate perceptions of all the stakeholders of a firm (Fombrun, 2002; Walker, 2010). Therefore, an improvement in the stakeholders' perceptions about a firm leads to an improvement in corporate reputation. In addition, corporate governance mechanisms, such as the board of directors, can affect the stakeholders' expectations (Brammer et al., 2009). Firms may use the characteristics of the board members as a signal for building their own image.

In particular, there is an ongoing debate concerning the costs and benefits for companies of multiple directorships, and therefore the number of appointments of directors on boards might affect a company's image. Both practitioners and academics have suggested that multiple appointments of directors can be beneficial only up to certain levels. Organisms all over the world have highlighted the relevance of this issue and the existing literature indicates that whereas the value of advising is enriched by multiple directorships, the role of monitoring is damaged, and this can therefore have an effect on a firm's image.

The objective of this paper is to analyze whether the number of appointments of directors influences corporate reputation. In relation with our research question, several authors have pointed out that the ultimate responsibility for achieving and maintaining a good reputation lies with the board of directors (Mintzberg, 1983; Dowling, 2004; Tonello, 2007). However, previous research fails to provide evidence of the effect that multiple directorships may have on a firm's image. We focus on a sample of US firms listed on the New York Stock Exchange (NYSE) for the period 2007-2010 and we examine a total of 30,813 directors. In order to measure corporate reputation, we incorporate the multidimensional nature of this concept by using the ranking provided by Fortune magazine. This is generally accepted as a reference

for large companies in the United States in the assessment and management of their reputation. We find that, at lower levels, there is a positive relationship between the number of directorships and corporate reputation. Nevertheless, corporate reputation is negatively affected if the directors have too many appointments. Our findings indicate that a firm's reputation is harmed when the directors sit, on average, on three different boards.

This paper contributes to the previous literature in several ways. First, our study extends previous evidence about the relevance of boards of directors for the creation of corporate reputation. Our results confirm that as stakeholders are concerned by corporate scandals, the interest in good governance has increased, the board of directors being a mechanism that determines a firm's image. Second, we contribute towards the debate about the advantages and disadvantages of having board members with multiple directorships. More specifically, we point out the optimal level of directorships in order to enhance corporate reputation.

The remainder of the paper is organized as follows. The literature review and the hypothesis development are provided in the next section. Section 3 describes the data collection process and the sample, and explains the research method. Section 4 discusses the results of the empirical analysis and Section 5 summarizes the study's main contributions.

## 2. PREVIOUS LITERATURE

The literature has provided several definitions of corporate reputation. Fombrun (2002) proposed that "corporate reputation is the collective representation of a company's past actions and future prospects that describes how key resource providers interpret a company's initiatives and assess its ability to deliver valued outcomes." According to Walker (2010) corporate reputation can be defined as "a relatively stable, issue specific aggregate perceptual representation of a company's past actions and future prospects compared against some standard".

This author highlights that corporate reputation is based on perceptions and that it is the aggregated perception of all the stakeholders. Reputation contributes towards an enhancement of competitive advantage (Weigelt and Camerer, 1988; Fombrun and Shanley, 1990) and improves financial performance (Roberts and Dowling, 2002; Fernández and Luna, 2007).

Any characteristic of the firm that has been perceived as a determinant of firm strategy and/or performance can be a signal which affects corporate reputation (Delgado-García et al., 2010), including corporate governance characteristics. Companies that have better governance practices have a better image and are more valued in terms of reputation (Bravo et al., 2015). A number of studies have discussed the concept of good corporate governance and codes across the world have claimed for the need of improving corporate governance practices. In particular, the board of directors has received a great deal of attention in the literature and has been considered a key factor in the determination of firm strategy (Hillman and Dalziel, 2003; Pugliese et al., 2009; Johnson et al., 2013). Nevertheless, the definition of "the right board" is still an open question. In corporate governance research, this question has traditionally been answered using agency and resource dependence theories. From an agency point of view, a board of directors is an internal control mechanism to protect shareholders' interests (Fama and Jensen, 1983). Boards' monitoring functions include a variety of activities regarding the supervision of company strategies. According to the resource dependence theory, directors use their resources to enhance the firm's external legitimacy (Pfeffer and Salancik, 1978). Directors are expected to contribute towards an improvement in strategic decision-making by providing the firm with advice and counsel (Zahra and Pearce, 1990). However, the role of directors goes beyond monitoring and advising the management. Several authors have also indicated that the board of directors has the ultimate responsibility for the achievement and maintenance of a good reputation (Kitchen and Laurence, 2003; Dowling, 2004). The board should have an oversight function in protecting and enhancing reputation (Mintzberg, 1983; Tonello, 2007). Therefore, a company's reputation can be affected by who serves on the board of directors (Bazerman and Schoorman, 1983; Hillman and Dalziel, 2003).

The configuration of the board of directors can determine its quality and its ability to develop its functions, and may have an influence on how stakeholders value a firm in terms of reputation. Directors can therefore improve the status and credibility of their firms (Daily and Schwenk 1996). Previous research suggests that directors' characteristics have an effect on corporate reputation. Delgado-García et al. (2010) focus on the ownership structure and also suggest that board independence positively affects corporate reputation. Vélez-Castrillón (2012) shows that board expertise, social capital and demographic diversity can influence the reputation of a firm. Bravo et al. (2015) highlights that corporate reputation is positively affected by board independence and gender diversity. Nevertheless, there is a lack of evidence which examines the specific relationship between the number of external directorships and a firm's reputation. Although there are a few studies that examine the relationship between multiple

directorships and firm performance, the previous literature fails to provide the influence of external directorships on other firm outcomes, such as corporate reputation - one of the drivers of performance. While many researchers have argued in favour of the benefits of interlock, others have questioned its importance (Harris and Shimizu, 2004). The value of advising is enriched by multiple directorships, but the role of monitoring is harmed.

First, directors with multiple appointments contribute towards an improvement of the quality of the board (Fama and Jensen, 1983). Directors with multiple appointments are likely to have good reputations since being a director is a prestigious job. These directors may have richer experiences, connections and/or expertise (Ferris et al., 2003; Lei and Deng, 2014; Perry and Peyer, 2005; Sarkar and Sarkar, 2009). They can provide valuable strategic advice to cope with a variety of problems and enhance firm growth (Carpenter and Westphal, 2001; Kor and Sundaramurthy, 2009). Through these connections, directors can better connect with the demands of various stakeholders (Hillman et al., 2008).

Therefore, they can increase corporate reputation as they are seen as providers of key resources for the firm. However, multiple directorships can worsen a firm's performance due to the directors' lack of proper functions (Kor and Sundaramurthy, 2009). A large number of appointments can make directors over-committed and consequently compromise their ability to monitor company management effectively on behalf of shareholders and adversely affect the firm's value (Fich and Shivdasani, 2006; Lei and Deng, 2014). Multiple directorships result in inefficiency in directors tasks and therefore reduce shareholder wealth (Jiraporn et al., 2008). The number of appointments that directors can accept on boards has become a controversial issue in society. In the US, as in the majority of developed countries, there is still an ongoing debate about whether the number of directorships of board members should be limited. In this line, the Principles of Corporate Governance (2012) states that service on too many boards can interfere with an individual's ability to satisfy his or her responsibilities. Taking into consideration previous theoretical arguments and recommendations, one could consider that stakeholders may negatively value the composition of a board whose members have too many directorships.

In this study, we address the effect of multiple directorships on corporate reputation. On the one hand, we expect board members who have multiple directorships to be seen as advisors or providers of knowledge to management. Stakeholders can also perceive that these directors will share their experience or business connections, which can be helpful for the board and increase the likelihood of firm success. Therefore, the following hypothesis is formulated:

Hypothesis 1: There is a positive relationship between the number of directorships and corporate reputation.

On the other hand, stakeholders can perceive that directors with too many appointments may not effectively contribute to a company's performance. Then, the number of directorships would positively impact corporate reputation only up to a certain level. This leads to the next hypothesis:

Hypothesis 2: There is a curvilinear relationship between the number of directorships and corporate reputation.

### 3. RESEARCH DESIGN

#### 3.1. Sample and data

Our final sample is composed of 2,733 firm-year observations for firms listed on the NYSE for the period 2007-2010. The NYSE is, by its market capitalization, the world's largest stock exchange and is made up of the big companies that are most visible in the capital markets. The board of directors of these companies is more likely to play an important role in determining corporate reputation. Data about directors were obtained from the Investor Responsibility Research Center (IRRC). The IRRC gathers most of the data from proxy statements and it is considered by Wharton Research Data Services (WRDS) as the world's leading source of information on corporate governance. 30,813 directors were examined. The information about corporate reputation was obtained by means of the survey performed by Fortune magazine. On the other hand, financial data were extracted from Compustat. The description of all the variables included in the study is presented in the following sections.

#### 3.2. Variables

*The dependent variable: corporate reputation*

Reputation is an intangible concept based on perceptions and therefore it is difficult to measure. The previous literature in the U.S. context has been largely based on the survey of the America's Most Admired Companies performed by Fortune magazine in order to design a measure of corporate reputation. In this survey, executives, directors and analysts are asked to rate a company according to the different dimensions that determine a company's reputation, from investment value to social responsibility. This survey results in a reputation ranking which is generally accepted as a reference for large companies in the United States in the assessment and management of their reputation.

In this paper, the ranking including the "World's Most Admired"<sup>71</sup> companies is used in order to measure corporate reputation. Therefore, corporate reputation (REPUTATION) was a dummy variable that

took a value of 1 if a firm was included in the Fortune ranking and 0 otherwise. This type of measure is commonly used in academic journals (Black et al., 2000; Roberts and Dowling, 2002; Chung et al., 2003; Martínez-Ferrero, 2014).

*The explanatory variable: multiple directorships*

Multiple directorships is used as the main explanatory variable in the statistical models. Consistent with previous studies (Perry and Peyer, 2005; López and Morros, 2014), the average number of appointments that directors have on external boards is considered to calculate this variable.

*Control variables*

Several control variables are also considered due to their potential influence on corporate reputation. First, two board-related variables are included: board size and board independence. Previous studies suggest that stakeholders perceive that larger boards have more resources at their disposal (Forbes and Milliken, 1999; Delgado-García et al., 2010), and that independent directors are more likely to protect the stakeholders' interests and that they are more valued in terms of reputation (Zahra, 1989; Delgado-García et al., 2010; Bravo et al., 2015). Board size (BSIZE) is measured by the total number of members on the board (Lückerath-Rovers, 2011; Adams and Ferreira, 2009). Board independence (BINDEP) is calculated as the proportion of independent directors on the board (Volonté, 2015; Zhang, 2012; Baghat and Black, 2002). In addition, in line with the previous literature, some financial variables are also added: firm size, firm performance, and industry reputation. The size of the firm is calculated as the log of market value (SIZE), firm performance is defined as the return on equity (ROE), and industry reputation (IND\_REP) is measured by the average reputation score in the Fortune's Most Admired Companies ranking of firms within a specific industry, considering 4-digit SIC codes for the classification of industries. In addition, time effect was also tested through a set year's dummy variables. The definition and the expected sign of the all the variables are indicated in Table 1.

**Table 1.** Variables definition

Abbreviation	Variable	Definition	Expected sign
REPUTATION	Corporate reputation	Dummy variable: 1 if the company appears in the Fortune ranking; 0 otherwise	
DIRECTORSHIPS	Multiple directorships	Average number of external directorships of board members	+/-
BSIZE	Board size	Number of directors in the board	+
BINDEP	Board independence	Percentage of independent directors on a board	+
SIZE	Firm size	Market value (logarithm)	+
ROE	Firm performance	Net income /Shareholder's Equity	+
IND_REP	Industry reputation	Average reputation by four-digit SIC code	+

### 3. METHOD

A panel data study for 2007-2010 was performed through a logistic regression analysis in order to

determine the association between the number of directorships of board members and the likelihood of being included in the reputation ranking. The general model employed in order to test our hypothesis is:

<sup>71</sup> For detailed information, see <http://money.cnn.com/magazines/fortune/most-admired/>

$$REPUTATION_{i,t} = \beta_0 + \beta_1 DIRECTORSHIPS_{i,t} + \beta_2 BSIZE_{i,t} + \beta_3 BINDEP_{i,t} + \beta_4 LN TAB_{i,t} + \beta_5 ROE_{i,t} + \beta_6 INDUSTRY_{i,t} + \sum_{j=1}^5 \beta_7 DUM\_YEAR_{jt} + \mu_i + \varepsilon_{it} \quad (1)$$

where  $\beta_0$  is the intercept and  $\beta_i$  is the coefficient of each independent variable. The sub-index  $i$  identifies the individual and the sub-index  $t$  the time:  $\mu_i$  represents the fixed individual effect, and  $\varepsilon_{it}$ , the stochastic error. The stochastic error term combines both the measurement errors of any independent variable and the omission of explanatory variables.

Our database combines time series with cross-sectional data enabling the formation of panel data. The panel data approach allows the unobservable constant heterogeneity or fixed effects term to be controlled (Arellano 2003). This term is intended to reflect the firm-level characteristics, and it thereby avoids the omission bias and renders more efficient estimates. Thus, we employ logistic panel data. This methodology is a popular and widely used statistical technique to solve classification binary problems. We apply a cross validation or multiple subsets estimation to validate the results obtained with the logistic panel data method and then focus on assessing the predictive ability of the discriminant functions. That is, the discriminant functions for each

element  $ij$  is estimated by excluding it from the analysis and then performing the prediction, which treats each object as if it were a new item for which group membership must be predicted.

#### 4. RESULTS

Table 2 displays the descriptive statistics for the variables included in the statistical analyses. The table shows that 22% of the companies from our sample appear in the Fortune's ranking. The average number of external appointments of directors on external boards is almost one. This value is consistent with other studies in the US context (Ferris et al., 2003; Hillman et al., 2011; Perry and Peyer, 2005), and indicates that the boards analyzed are not particularly busy since their directors do not serve on many external boards. The dispersion of most variables is at an acceptable level. Specific outliers and influential observations were not found.

**Table 2.** Descriptive statistics of the main variables

Mean, standard deviation, quartile one, median and quartile three of the variables. REPUTATION is a dummy variable with a value of 1 if a company is included in FORTUNE's ranking and 0 otherwise; DIRECTORSHIPS is the Average number of external directorships of board members; BSIZE is the number of directors on the board; BINDEP is the percentage of independent directors on a board; SIZE refers to the firm's market value; ROE is the return on equity; IND\_REP is an industry's average reputation in four-digit SIC codes.

Variable	Mean	Std. Dev.	Q1	Median	Q3
REPUTATION	0.220	0.414	0	0	0
DIRECTORSHIPS	0.944	0.503	0.571	0.917	1.3
BSIZE	9.899	2.287	8	10	11
BINDEP	0.793	0.110	0.727	0.818	0.889
SIZE	8.090	1.490	7.078	7.975	9.049
ROE	0.305	9.362	0.053	0.112	0.185
IND_REP	0.335	0.808	0.151	0.198	0.25

Table 3 reports the correlation matrix between the model's main variables. Multiple directorships is correlated with corporate reputation. Furthermore, all the control variables show the expected association with the reputation of firms. Although the rest of the correlation coefficients are not high, we compute the variance inflation factor (VIF) to test the lack of multicollinearity in our estimates. Given that the VIF values presented are less than two (1.5), multicollinearity does not seem to be an issue with our sample; potential multicollinearity problems can exist for values over 10 (Hair et al., 2008).

In order to confirm our research hypotheses, the association between corporate reputation and multiple directorships is examined by using a logistic panel data approach and the results are presented in Table 4. The assumptions underlying the regression model are verified for all the models, and no problems about multicollinearity and heteroscedasticity<sup>72</sup> are present.

Model 1 includes the number of directorships as an explanatory variable. A positive and significant relationship, at a 1% level, between this variable and corporate reputation is observed. The results from Model 1 are consistent with the theoretical arguments, and we confirm our first research hypothesis (H1). In Model 2, the quadratic variable of DIRECTORSHIPS is also added to the previous model in order to analyze the potential curvilinear relationship between this variable and corporate reputation. Our results with directors who sit on multiple boards provide value resources that can be helpful for the board and increase the likelihood of firm success and enhance corporate reputation. However, since directors need to carefully study every single decision for each firm to fulfil their duties effectively, a high number of directorships can negatively affect the perception of stakeholders concerning the quality of a board, which may harm corporate reputation. Consequently, this evidence

<sup>72</sup>To test the lack of multicollinearity in our estimates we have used the variance inflation factor (VIF). The results are shown in Table 3. Meanwhile,

the lack of heteroscedasticity has been tested with the Breusch-Pagan/ Cook-Weisberg test.

leads us to support Hypothesis H2. According to our results, we can conclude that belonging to more than two external boards causes a negative perception about the quality of the board and therefore a reduction in corporate reputation. Our results are in line with previous research in the US context, which

has considered that a board member who holds around two external directorships is a busy director (Ferris et al., 2003; Fich and Shivdasani, 2006). Busy directors are more likely to decrease the likelihood of firm success and this can negatively affect corporate reputation.

**Table 3.** Correlation matrix and variance inflation factors

Pearson's correlations between variables and variance inflation factor (VIF). REPUTATION is a dummy variable with a value of 1 if a company is included in FORTUNE's ranking and 0 otherwise; DIRECTORSHIPS is the Average number of external directorships of board members; BSIZE is the number of directors on the board; BINDEP is the percentage of independent directors on a board; SIZE refers to the firm's market value; ROE is the return on equity; IND\_REP is an industry's average reputation in four-digit SIC codes.

	<i>DIRECTORSHIPS</i>	<i>BSIZE</i>	<i>BINDEP</i>	<i>SIZE</i>	<i>ROE</i>	<i>IND_REP</i>
<i>REPUTATION</i>	0.253 (0.000)	0.259 (0.000)	0.123 (0.000)	0.445 (0.000)	0.038 (0.0047)	0.022 (0.000)
<i>DIRECTORSHIPS</i>		0.178 (0.000)	0.328 (0.000)	0.409 (0.000)	0.016 (0.395)	-0.006 (0.770)
<i>BSIZE</i>			0.157 (0.000)	0.475 (0.000)	0.020 (0.287)	-0.044 (0.021)
<i>BINDEP</i>				0.228 (0.000)	-0.004 (0.831)	-0.035 (0.069)
<i>SIZE</i>					0.015 (0.434)	-0.102 (0.000)
<i>ROE</i>						-0.001 (0.966)
<i>VIF</i>	1.29	1.30	1.14	1.52	1.00	1.01

In line with the previous literature and theoretical arguments, we also find a positive relationship between corporate reputation and several control variables, such as board size, firm size, and the industry's reputation. Firms with larger boards can have a better reputation since stakeholders perceive that these boards have better knowledge, skills and connections to contribute towards firm success. Firm size also appears as a decisive factor for corporate reputation. Larger companies are more exposed to the market and better known to the public, and visibility can be associated with reliability and trustworthiness (Rose and Thomsen, 2004; Bravo et al., 2015). Finally, the industry's reputation also influences the perception

of the firms within the industry and determines their corporate reputation (Velez-Castrillón, 2012).

As a robustness test, we replicate the previous analysis, but we also consider that corporate reputation can be influenced by past reputations. Therefore, the lagged variable for corporate reputation is also included in Models 3 and 4. The inclusion of this lagged variable means the loss of one year, and the sample size is therefore reduced. The results show that the variable corporate reputation in the previous year is not statistically significant. However, the results for the multiple directorships variable remain constant. Our results confirm that corporate reputation depends on firm characteristics and board characteristics, but not necessarily on previous corporate reputation.

**Table 4.** Influence of multiple directorships on corporate reputation

REPUTATION is a dummy variable with a value of 1 if a company is included in FORTUNE's ranking and 0 otherwise; DIRECTORSHIPS is the Average number of external directorships of board members; BSIZE is the number of directors on the board; BINDEP is the percentage of independent directors on a board; SIZE refers to the firm's market value ; ROE is the return on equity; IND\_REP is an industry's average reputation in four-digit SIC codes.\*\*\*for 99% confidence level, \*\*for a 95%, and \*for a 90% confidence level.

<i>Variables</i>	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>	<i>Model 4</i>
	<i>Marginal effect</i>	<i>Marginal effect</i>	<i>Marginal effect</i>	<i>Marginal effect</i>
REPUTATION <sub>t-1</sub>			0.015	0.110
DIRECTORSHIPS	0.059***	0.221***	0.038**	1.575**
DIRECTORSHIPS <sup>2</sup>		-0.071**		-0.555**
BSIZE	0.011**	0.011**	0.008**	0.052*
BINDEP	0.049	0.018	0.112	0.630
SIZE	0.100***	0.096***	0.098***	0.728***
ROE	0.01	0.001	-0.009	-0.082
IND_REP	0.037***	0.034***	0.795***	5.786***
Year dummies	Yes	Yes	Yes	Yes
No. observations	2,733	2,733	2,024	2,024
Wald	339.17***	340.22***	335.63***	335.77***

## 5. CONCLUSIONS

Our research has analyzed the influence of board members who have multiple directorships on a firm's reputation. Our results show that the number of appointments of directors has an impact on the perceptions of stakeholders about a board and therefore affects corporate reputation. Our evidence extends previous findings in this research area by highlighting the role of directors in determining corporate reputation. In particular, our results suggest that boards whose directors have on average up to two external directorships are perceived as high quality boards, since these directors will provide valuable resources to the firm and contribute to its success. However, if these directors have more external appointments, a negative effect on corporate reputation is expected. The most reputable companies are more likely to have larger boards, a greater size and belong to industries which have a better reputation.

These findings shed some light on the value of boards of directors. Companies may have incentives to improve the composition of their boards of directors since corporate reputation is a key resource associated with many potential benefits for firms. These results have direct implications for shareholders who must consider that an adequate selection of board members will help in the creation and maintenance of corporate reputation and as a result increase the value of their investments.

This paper extends the previous literature on corporate governance and corporate reputation. Future research could study other personal characteristics of board members, and/or analyze the effect of board composition in different contexts.

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