

## **Too Busy To Serve? An Examination of the Influence of Overboarded Directors**

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**ABSTRACT** Overboarded directors (i.e., those serving on too many boards) have come under recent attack. The accusation is that such directors are 'stretched' by several directorships and therefore cannot fulfil their governance responsibility. This study investigates the impact of overboarded directors upon key strategic decisions such as corporate acquisitions. Based on our examination of acquisition outcomes, we found that such directors are important sources of knowledge and enhance acquisition performance. Moreover, they represent an important complement to inside and non-overboarded outside directors.

### **INTRODUCTION**

Most scholars (Fama and Jensen, 1983; Mace, 1971; Pearce and Zahra, 1991; Vance, 1964) agree that corporate boards have a fiduciary duty to shareholders to assist and monitor management in their effort to maximize shareholder wealth. In pursuit of enhanced board effectiveness, board reform advocates have called for such changes as reduced board size, more independent directors, separation of CEO and chairman and larger equity holdings by directors (Kesner and Johnson, 1990). This interest in board reform has increased among both researchers (Davis and Thompson, 1994) and practitioners (*Business Week*, 1997; *New York Times*, 1996). Emblematic of the concern regarding ineffective directors is a report recently issued by the National Association of Corporate Directors' Blue Ribbon Commission on Director Professionalism (NACD, 1996). The publication was intended to provide guidance to companies facing director selection decisions and board members seeking advice on how best to fulfil their board duties. NACD recommended that board members become more active decision making participants in the boardroom and increase their ability to read financial statements. Two

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recommendations that have attracted the most controversy and created the strongest reaction from directors (Levy, 1997) concern the potential problem of directors becoming 'overboarded' (i.e., serving on too many boards). First, the NACD recommended that directors budget at least four full 40-hour weeks of service for every board on which they serve. Second, they recommended that executives limit their board memberships.

The prospect of directors becoming overly burdened by directorships may be a corollary to board interlocks. That is, membership of its directors on other boards – thus the hazard that directors become busier – provides companies with indirect connections to other companies. This confluence of board interconnections begs the question of whether these 'nodes' of information might become overloaded. While aggressively interconnected boards are arguably beneficial in terms of co-opting resources and injecting new ideas, are such board members too busy to engage effectively in strategic decisions? The visceral reaction has been a deep concern that such directors are too plentiful and cannot adequately attend to all of his/her board duties. The popular press has become particularly focused on the topic of overboarded directors. Journalists (*Business Week*, 1996, 1997; *New York Times*, 1996) present a woeful picture of directors that sit on multiple boards and commonly miss board meetings. In sum, they suggest that these directors fail to fulfil their responsibility in properly governing the corporation. The underlying implication is that directors cannot properly serve when they are 'stretched' by several directorships. However, no systematic studies have examined this question. The purpose of this study is to examine the impact of overboarded directors upon key strategic decisions.

## THEORY AND HYPOTHESES

### **Risk of Overboarded Directors Being Stretched Thin**

Contributing to decision making is certainly an important director role, but concerns about contributions presuppose that directors are present at the board meetings. Boards meet, on average, seven times a year (Monks and Minow, 1996); therefore the probability of schedule conflicts can increase quickly when directors take on multiple directorships. Boards vary in terms of time demands (e.g., number of meetings, readings distributed in advance of meetings) and level of expected involvement (Forbes and Milliken, 1999), but simple attendance seems to be a universal expectation.

Scholars (Lorsch and MacIver, 1989; Mace, 1971) have discussed the personal demands of board membership, but little is known about the consequences of sitting on several boards. In an apparent acknowledgement of potentially becoming spread too thin, some executives have implemented self-imposed restrictions on their personal board memberships (*Wall Street Journal*, 1997). We therefore pre-

dicted that the increasing demands of multiple meeting schedules will lead to a higher incidence of missed meetings.

*Hypothesis 1:* Overboarded directors are more likely to miss board meetings.

### **Impact of Overboarded Directors**

Director experience is important in the market for directors (Zajac and Westphal, 1996). Knowledge and experience may come, in part, through prior managerial duties, but it is most commonly viewed as coming from directors' membership on other boards (Haunschild, 1993; Haunschild and Beckman, 1998). Scholars have argued that such interlocking directors may bring access to important resources (Mizruchi and Stearns, 1994; Pfeffer and Salancik, 1978), opportunities to cooperate with other firms (Koenig et al., 1979), legitimacy (DiMaggio and Powell, 1983) and information on business practices (Davis, 1991). While many have argued the virtues of interlocks (Burt, 1983; Pfeffer and Salancik, 1978; Useem, 1984), others have argued against their importance (Fligstein, 1995; Fligstein and Brantley, 1992; Palmer et al., 1995). Irrespective of the determinants or consequences of such board interconnections, all agree that interlocks are a widespread phenomenon.

Most important to our argument, individual directors reside at the nexus of these ties. These individuals may deliver information on such issues as poison pill adoption (Davis, 1991), M-form adoption (Palmer et al., 1993), propensity to acquire (Haunschild, 1993) and acquisition premiums (Haunschild, 1994). However, these directors are subject to the same human limitations as others.

Membership on multiple boards is likely to threaten available preparation time for board meetings. Lipton and Lorsch (1992) boldly stated that: 'Based on our experience, the most widely shared problem directors have is lack of time to carry out their duties.' They argued that directors' ability to perform their duties is further undermined by their willingness to serve on multiple boards. Such time demand concerns regarding directors are consistent with analyses on cognitive or attentional resource limitations (Kahneman, 1973; Kanfer and Ackerman, 1989; Kanfer et al., 1994; Norman and Bobrow, 1975). Kanfer and Ackerman (1989, p. 663) defined attentional resources as an 'undifferentiated pool representing the limited capacity of the human information-processing system'. Because individuals have a limited attentional capacity, competing demands can compromise decision making quality (Shalley, 1991). The competing demands associated with membership on several boards may compromise the director's ability to adequately prepare for meetings. Therefore, time constraints may limit these directors' ability to provide useful advice.

Boards have a fiduciary duty to shareholders actively monitor and aid management's decision making. The aforementioned influences and time constraints

of busy directors should most clearly manifest themselves during major strategic decisions. Such decisions mark discrete junctures in which board awareness, analyses and involvement are heightened. Major corporate acquisitions are an example of such pivotal strategic decisions. An acquirer's ability to create value is a function of many factors (e.g., fit of target, price, timing). Complacent and/or uninvolved directors can undermine decision making and board effectiveness. Consequently, we examined the influences of overboarded directors in the M&A context.

*Hypothesis 2:* Proportion of overboarded acquirer directors will be negatively associated with acquirer abnormal returns.

### **Balance of Overboarded Outside Directors and Inside Directors**

Corporate governance scholars have a long history of interest in board composition (e.g., Baysinger and Butler, 1985; Baysinger and Hoskisson, 1990; Baysinger et al., 1991; Hill and Snell, 1988; Westphal, 1999). Central to this literature is the distinction between inside and outside directors.<sup>[1]</sup> One is not superior to the other, rather inside and outside directors serve different but complementary roles on the board. The two types bring different skill sets and outlooks to decision making. This cooperative tandem of roles should make overall board effectiveness stronger than that offered by either of the individual types of directors.

Inside directors can provide internal monitoring due to their access to information on managerial performance (Baysinger and Hoskisson, 1990; Fama and Jensen, 1983). Such directors can also enhance board decision making because of their knowledge of day-to-day operations (Baysinger and Hoskisson, 1990) and ability to integrate intra-firm functions (Hill and Snell, 1988). However, the reality of these directors' employee status and accompanying conflicts of interest may limit these benefits (Baysinger and Hoskisson, 1990; Weisbach, 1988). In particular, these directors may (as employees) feel unprotected and obligated to agree with the CEO, and thus nullify their valuable contribution to the governance process. In contrast, outside directors are viewed as a means of independent monitoring (Byrd and Hickman, 1992; Fama and Jensen, 1983; Jensen and Meckling, 1976; Kosnik, 1990), conduits for trends and business practices (Boeker, 1992; Davis, 1991; Haunschild, 1993) and advisors on strategic decision making (Baysinger and Hoskisson, 1990; Johnson et al., 1993).

Scholars have concluded that a complementary balance of inside and outside directors is important (Baysinger and Butler, 1985; Baysinger and Hoskisson, 1990; Byrd and Hickman, 1992; Fama and Jensen, 1983; Pfeffer, 1972). Among the above mentioned director roles, the advisory and strategic decision making roles of inside directors appear to be a key counterbalance to concerns (e.g., lack of preparation, poor participation in decisions) about overboarded directors. Insid-

ers serve as facilitators or interpreters of information (Baysinger and Butler, 1985), and integrators of information on internal functions (Hill and Snell, 1988). Therefore, insiders may aid in assuring continuity of discussions between meetings and in offering detailed explanations of the operations during discussions. The availability of such 'real time' expertise may be especially vital to unprepared directors. In short, insider directors may contextualize the rich external perspectives of outsider directors. This suggests that higher levels of insiders will attenuate any negative decision making consequences of overly busy, and presumably unprepared, directors. Therefore, we predicted that insider ratio will have a negative moderating effect on the relationship between proportion of overboarded directors and acquisition outcome.

*Hypothesis 3:* Insider ratio will have a negative moderating effect on the relationship between proportion of overboarded directors on the acquirer's board and acquirer abnormal returns.

## METHODS

### Sample Data

Our sample was drawn from the annual Top 100 Deals as reported by *Mergers & Acquisitions* magazine. The transactions all met the following criteria: non-private acquirer (necessary due to the market-based outcome variable), full-interest purchase (in order to examine acquirers possessing full control over the purchased target), whole-company purchases (asset purchases such as selected plants are markedly different from the purchase of businesses), use of external investment bankers ('in-house' transactions tend to be less complex and do not demand the same level of board scrutiny), non-leveraged buyouts (public status following the transaction was vital) and domestic acquirer (in order to facilitate examination of market performance). The set of useable transactions was further reduced to 143 due to randomly distributed missing data. The study period of our investigation was 1981–89. Though change comes slowly, attitudes about director responsibility and selection criteria are beginning to change. This study is aimed to provide a benchmark for tracking future change.

### Acquisition Setting as a Governance Test

Corporate boards are not simply monitoring devices (Fama and Jensen, 1983) or resource access vehicles (Boyd, 1990; Pfeffer and Salancik, 1978), but important sources of expertise and suggestions on strategy (Baysinger and Hoskisson, 1990; Charan, 1998; Judge and Zeithaml, 1992; Westphal, 1999). In examining boards as a group, Forbes and Milliken (1999) illuminate the challenges of measuring

board effectiveness by stressing the importance of task performance and cohesiveness. Zald (1969) argues that board power is most likely to be asserted during the handling of major phase problems or strategic decision points. While no perfect measure exists, we elected to use the outcome of a 'stand-alone' strategic decision – a corporate acquisition. Boards have the explicit duty to participate in acquisition decisions to assure that shareholder interests are served – though their diligence in carrying out this duty is often challenged in the courts. Davison and Weller (1997, p. 39) argue that 'there are few events where boards can add more value than in advising management through all stages of a merger'.

Among impactful corporate activities, mergers and acquisitions are arguably the greatest opportunity to quickly create or destroy value. Though acquisitions, on average, yield near zero returns (Healy et al., 1992; Jarrell et al., 1988; Jensen and Ruback, 1983; Kitching, 1967, 1974; Schwert, 1996), the diversity of returns is high with 47 per cent of bidders earning positive returns (You et al., 1986). This means that positive returns are possible – though hard. To become one of the winners in the acquisition market, these strategic decisions demand the attention of both the board and management. Shareholder expectations regarding the important role of board guidance during acquisitions are highlighted in the common occurrence of shareholder lawsuits against boards and public lobbying surrounding acquisition transactions (e.g., Vivendi's purchase of U.S. Filter, Mellon's proposed purchase of Bank of New York, Merck's purchase of Medco, MGM/UA's purchase of United Artists).

To adequately assess business combinations and contribute to these decisions, board members typically must have a thorough understanding of the organization that they govern along with a good understanding of how the proposed target benefits the company. Such decisions may require special board meetings and further tax overboarded directors. Therefore, the acquisition setting is an ideal juncture to test the diligence of the board. If overboarded directors hamper board effectiveness in any way, it is most likely to occur during this key strategic decision. However, our selection of the acquisition setting may limit the generalizability of our findings because of the type of high-profile directors sought by active acquirers.

### **Analytical Method**

We employed the event study methodology to compute abnormal returns using standard cumulative abnormal return techniques (Brown and Warner, 1985). These returns were regressed on the variables of interest in order to assess the acquisition outcome as a value creating activity. While integration is important (Haspeslagh and Jemison, 1991), ultimate success turns on the price paid (Sirower, 1997). Failure can occur for many reasons, but an excessive price purchase (i.e.,

beyond justifiable synergies) will always dictate failure. Accordingly, we focused upon the market's judgement of the reasonable of purchase price paid. Sirower (1997) found that price paid dictates short and long run success, at least, up to four years following the transaction.

We elected to use a market measure in order to parse out performance effects attributable to the transaction in question. Haleblan and Finkelstein (1999) found a strong consistency between accounting and market measures. Also, financial economists (Healy et al., 1992; Kaplan and Weisbach, 1992; Mitchell and Lehn, 1990) have conducted comprehensive studies comparing accounting, efficiency, divestiture and market measures and found that abnormal returns are a good predictor of long term acquisition outcome.

Our prediction in Hypothesis 1 on the association between overboarded directors and meeting attendance demanded that we examine proxy statements for mention of director attendance. The Securities and Exchange Commission requires disclosure of directors who fail to attend 75 per cent of all required meetings. Consequently, directors that miss 25 per cent or more of the board meetings during the year are singled out in these documents as exceptions. We examined these attendance records using three categories: NACD's definition for overboarded executives, for overboarded retirees and all others. We then conducted a chi-squared analysis to assess whether director attendance is associated with being overboarded.

## Dependent Variable

*Abnormal returns.* Because of the scrutiny and immediate feedback offered by the capital markets, we used cumulative abnormal returns as a measure of acquisition outcome. This approach assumes that the market, on balance, can accurately discern the announced transaction's worth. Utilizing the Center for Research in Security Prices (CRSP) daily return data, we used the market model to estimate the parameters for each bidding firm over a 'hold-out' period prior to the announced acquisition transaction. The purpose of the hold-out period is to establish the 'base case' or the normal fluctuations of the company's share price. The base case patterns allow the detection of unusual or abnormal price movements surrounding the event (in our study, this is the acquisition announcement). To avoid any rumour effects, hold-out periods are commonly defined as the 12-month period ending six months before the event. Accordingly, we defined this period as beginning 375 days prior to the event date (i.e.,  $t_{-375}$ ) through 125 days prior to the event (i.e.,  $t_{-125}$ ). McWilliams and Siegel (1997) stress that the event period should not extend beyond two days, unless done so for a specific reason. We examined the daily returns and concluded that leakage of information prior to the acquisition announcement had occurred in many cases. Accordingly, the event

period was designated as the period beginning five days prior to the event in order to account for possible leakage of the announcement, and ending with two days following the acquisition announcement.

Daily returns were used which represent the percentage change in the day's ( $t_i$ ) share price over the previous trading day ( $t_{i-1}$ ). Because general return levels vary over time, intertemporal comparisons require a reference point. In our design, this point of reference was the returns for the S&P 500 Index or the NASDAQ Composite Index, depending on how the company was listed. Firm performance in both the hold-out and event periods was computed relative to the market returns – thus market-adjusted.

The model used to estimate the parameters for the hold-out period is as follows:

$$R_{it} = \alpha_i + \beta_i R_{m_{it}} + \varepsilon_{it}$$

where:

- $R_{it}$  = daily stock return for stock  $i$  on day  $t$ ;
- $R_{m_{it}}$  = daily return on market portfolio  $m_i$  (equally weighted) on day  $t$ ;
- $\alpha_i, \beta_i$  = parameter values for stock  $i$ ;
- $\varepsilon_{it}$  = disturbance term in the model for security  $i$  at time  $t$  – this is assumed to be normally distributed with mean 0 and variance  $\sigma^2$ .

We computed performance differences for the firms by estimating abnormal (i.e., expected versus realized) returns for the 'event period'. The purpose of this procedure was to measure the performance impact of the event (i.e., the acquisition) against the base case period (i.e., assuming that no event occurred). The abnormal return of firm  $i$  at time  $t$  was computed as follows:

$$AR_{it} = R_{it} - (\hat{\alpha}_i + \hat{\beta}_i R_{m_{it}})$$

where:

- $AR_{it}$  = abnormal return for security  $i$  on day  $t$ ;
- $R_{it}$  = realized return for security  $i$  on day  $t$ ;
- $R_{m_{it}}$  = daily return on market portfolio  $m_i$  (equally weighted) on day  $t$ ;
- $\hat{\alpha}_i, \hat{\beta}_i$  = estimated parameters in the model for stock  $i$ .

$AR_i$  is cumulative in that it represents the sum of the daily abnormal returns across the entire *event period* for each firm.

$$AR_i = \sum AR_{i,t}$$

## Independent Variables

*Overboarded directors.* This variable is concerned with directors that sit on too many boards, thus becoming faced with time constraints and conflicts between board activities. In contemplating how exactly to define overboarded directors, we struggled with how best to operationalize this concept that has been loosely discussed in the business press and unstudied in the academic literature. No clear definition or membership threshold has been established, though the NACD, a not-for-profit trade group that offers guidance to boards and directors, has issued guidelines (NACD, 1996). Accordingly, we used two definitional approaches.

In light of the specific guidelines on membership limits issued by the NACD, we decided to start by testing its recommended limits. The guidelines implicitly assume that membership on several boards will compromise the director's ability to govern. These limits were specified as: no more than three directorships (including their own) for CEOs and senior executives, and no more than six directorships for all others. We operationalized these NACD directives by designating board members sitting on corporate boards in excess of the specified limits as 'overboarded'. We aggregated these data to the board level by summing the total number of overboarded directors and dividing by the total board size.

Directors differ in regard to responsibilities beyond their board tasks. Some directors are active executives, and must protect against their board responsibilities impeding on their primary occupation. Other directors are retired and therefore have more time available for board duties. Ideally, an investigation of overextended directors would focus on board duties relative to the individual director's occupation. Though the NACD schema separates between executives and retirees, such a designation downplays the benefits that accrue to the director's 'home' company. Participation on other boards is often an important means of gaining new insights and exposure to best practices. Because of the varying motivations and time commitments of directors, we used a second measure that collapsed NACD's categories, but examined multiple membership levels. We examined the impact of overboarded directors upon strategic decisions using number of directors that sit on more than 4, 5 and 6 boards. A separate model was formulated for each of these three definitions. We examined the proportion of overboarded directors in each model, therefore this was a continuous variable.

In spite of an absence of empirical precedence on defining 'overboarded', we selected the lower level of greater-than-4 because of Lipton and Lorsch's (1992) recommendation that directors spend at least 100 hours annually for board activities. This suggestion is conservative relative to NACD's recommendation of 160 hours. Bacon (1993) found that directors spend between 2 and 180 hours on these tasks. Though having four or more directorships is common (nearly 40 per cent of our sample), it seems that spending a quarter or a third of one's time on board activities is taxing for any director. Accordingly, we constructed our initial model

using a lower limit of 4. We chose not to examine definitions beyond greater-than-6 because of their rarity (only 3.7 per cent occurrence) and redundancy with other models (i.e., lower limits include directors in all upper limits). We examined the acquirer's proxy statement for the year prior to the acquisition announcement, and counted the number of corporate boards for each director by examining his/her bio-sketch. The number of directors meeting the criteria for each definition (i.e., greater than 4, 5 and 6 boards) was divided by total board size. This resulted in a board size-adjusted level or proportion of overboarded directors sitting on the acquirers' board.

The study of board composition is oftentimes threatened by reverse causality concerns. That is, did the predicted effect (e.g., board diversity, high profile directors) lead to firm performance or vice versa? The present study of overboarded directors and resulting acquisition performance is not affected by such a threat because it examines the performance associated with a discrete event.

*Insider ratio.* Inside directors typically serve a different purpose from outside directors. Baysinger and colleagues found that insider ratio has important implications for strategic decision making and direction (Baysinger and Butler, 1985; Baysinger and Hoskisson, 1990; Baysinger et al., 1991). This study is designed to go beyond the effects of insider/outsider board composition. We therefore used a variable that accounted for variance attributable to insider ratio. It was computed as the number of employee directors divided by the total number of board members.

### **Control Variables**

*Deal volume.* This variable was intended to account for effects due to the widely varying acquisition activity observed during the 1980s. Differences in acquisition levels tend to create contrasts in general acquisition climate. Such variance in climate could pose a threat to our ability to examine the effects of overboarded directors upon strategic decisions. We follow Haleblan and Finkelstein (1999) and Haunschild (1993) in controlling for such period effects. As a proxy for the acquisition climate, we used total annual acquisition activity (in excess of \$1 million), defined as number of deals, as reported by *Mergers & Acquisitions* magazine.

*Deal size.* The sample included acquisitions across a wide spectrum of sizes. This variable was included because large transactions are more complex. Such size-related differences (e.g., economic impact, antitrust concerns, level of market scrutiny, tax implications, number of employees to be integrated) influence how the transaction is handled (cf. Haunschild, 1994; Kesner et al., 1994; Servaes and Zenner, 1996) and how the competitive environment is changed (Sharma, 1998). These issues threatened our central relationships of interest. To capture these size

and complexity effects, we used the log transformation of total dollar value of the merger transaction. We obtained these data from *Mergers & Acquisitions* magazine.

*Relative bidder-target size.* Asquith et al. (1983) and Jarrell (1983) found that bidder returns tend to be distributed according to the relative size differential between the bidder and target firms. That is, targets that were relatively small were associated with smaller abnormal returns to the acquiring firm. Moreover, Kitching (1973) argues that mismatches in size can lead to a lack of management attention. We defined size as total assets in the year immediately preceding the year of the acquisition announcement, and used the natural log of the quotient of target and bidder size. We obtained these data from the Standard & Poor's COMPUSTAT database.

*Bidder debt level.* Bruner (1988) demonstrated that bidder firm capital structure influenced choice of target firm to be acquired, market value of the acquisition and returns accruing to the bidder. We controlled for these effects with a continuous measure of the bidder's debt-to-equity ratio immediately before the acquisition announcement. We obtained these data from the Standard & Poor's COMPUSTAT database.

*Prior bidder performance.* Hermalin and Weisbach (1988, p. 602) report an interplay between governance and prior performance in their investigation of board composition. Moreover, research by Morck et al. (1989) and Meindl et al. (1985) suggests that boards take performance into consideration when evaluating managerial decisions. Morck et al. (1990) found that firms with better financial performance tend to be better acquirers. Therefore, board scrutiny and participation in strategic decisions such as acquisitions may be influenced by overall financial condition. We controlled for the variance attributable to performance factors by including acquirer average return on assets for the three years prior to the acquisition announcement. We obtained these data from the Standard & Poor's COMPUSTAT database.

*Bidder firm size.* Haunschild (1993) found that larger firms tend to undertake more acquisitions. She speculated that this may be due to superior information resources. More important, her study of how director interlocks affect acquisitions revealed that large firms are less influenced by the acquisitions of their interlock partners. This interaction between firm size and governance is consistent with Daily and Dalton's (1993) finding that higher proportions of outsiders are associated with higher performance in small firms. Castaldi and Wortman (1984) also found that small companies tend to underutilize their boards in regard to decision making and strategic direction. In examining the decision making dynamics of boards, Forbes and Milliken (1999) argued that firm size is important because of

its influence on director involvement levels. Similarly, Dalton and Kesner (1983) and Norburn and Birley (1988) argue that organizational systems and structure may influence the role of boards. We controlled for the variance attributable to firm size by using the natural log transformation of the acquirer's total revenue for the year immediately prior to the acquisition announcement. We obtained these data from the Standard & Poor's COMPUSTAT database. We accounted for board size through the overboarded director computation.

*Interlocking directorates.* Interlocking boards have been found to be an important means through which information is diffused through networks of firms (Davis, 1991; Haunschild, 1993, 1994). Though related to board interconnections, our study aims to capture board effects beyond mere interlocks. We obtained all directors and their directorships from the proxy statements of the acquirer. Network centrality, or degree of interlocks, was computed as the sum of all director interconnections, minus any duplicated ties.

*Institutional ownership.* Institutional owners have trumpeted the importance of board independence. Our thesis focuses relates importantly to board interconnections, which have the potential to undermine board independence. Such a possibility may attract the attention of institutions, therefore co-varying with our predictors of interest. To isolate these effects, we included a control for level of institutional investment. We followed prior studies (Bethel and Liebeskind, 1993; Daily, 1996) in using proportion of equity owned by institutional investors. These data are reported quarterly by *Moody's Industrial Manual*. Data were collected at the most recent quarter-end prior to the acquisition announcement date.

## RESULTS

Hypothesis 1 is concerned with whether overboarded directors tend to miss more board meetings than non-overboarded directors. We examined a total of 110 companies totalling 1691 directors. We found that overboarded directors do not miss a disproportionate number of meetings ( $\chi^2 = 2.61$ ,  $p < 0.30$ ). Thus, our prediction in Hypothesis 1 on the association between being overboarded and missing meetings is not supported.

Table I shows the descriptive statistics and Pearson correlation coefficients. The correlation table reveals a number of significant correlations among the predictors and control variables. We were concerned about multicollinearity, and thus examined the variance inflation factor for each of the models. Although some models had interaction terms, all the VIFs were within the acceptable range when evaluated against the conventional rule of thumb of 10.0 (Neter et al., 1996, p. 387). The correlations among the overboarded definitions were expected and not viewed as a concern because each model was examined independently.

Table I. Means, standard deviations, and correlations

Variable	Mean	s.d.	1	2	3	4	5	6	7	8	9	10	11	12	13
1. Abnormal return	-0.01	0.08													
2. Bidder debt	35.66	62.13	-0.12†												
3. Deal size (ln)	6.58	1.00	0.00	0.00											
4. Deal volume	3194.92	860.55	0.05	0.02	0.38***										
5. Relative size (ln)	-1.42	1.64	0.09	-0.05	0.31***	0.22**									
6. Bidder size (ln)	7.86	1.51	-0.04	0.01	0.39***	0.01	-0.55***								
7. Bidder prior perf	0.06	0.04	0.06	-0.22***	0.08	-0.11	-0.09	0.09							
8. Board interlocks	31.12	17.30	-0.02	-0.02	0.12†	0.01	-0.38***	0.46***	-0.11						
9. Insider ratio	0.29	0.15	0.14*	-0.17*	0.02	-0.02	-0.03	0.08	0.30***	-0.31***					
10. Inst'l owners	18.45	16.65	0.08	-0.01	0.50***	0.20**	0.19*	0.27***	0.12†	0.09	0.00				
11. NACD definition	0.30	0.20	0.08	0.04	0.13†	0.01	-0.14†	0.32***	-0.02	0.76***	-0.23***	0.03			
12. >4 definition	0.24	0.19	0.04	0.02	0.10	-0.05	-0.26**	0.40***	-0.01	0.77***	-0.22**	0.07	0.82***		
13. >5 definition	0.15	0.14	0.06	0.00	0.09	-0.06	-0.24**	0.34***	0.00	0.73***	-0.19**	0.09	0.75***	0.88***	
14. >6 definition	0.08	0.10	0.10	-0.04	-0.01	-0.06	-0.22**	0.29***	-0.01	0.65***	-0.09	0.06	0.66***	0.75***	0.83***

\*\*\* p < 0.001, \*\* p < 0.01, \* p < 0.05, † p < 0.10.

Consequently, we concluded that the results were not a function of multicollinearity.

To examine the effects attributable to the predictors of interest, we constructed hierarchical regression analyses (Aiken et al., 1991). Table II exhibits the regression results for the main effect of overboarded directors. These models test our central hypothesis that the proportion of overboarded directors present on the board has an important impact on strategic decisions such as corporate acquisitions. We predicted that level of overboarded directors would be negatively associated with acquisition outcome. Models 2–5 test the various definitions of overboarded directors. Model 1 reflects the results for the controls-only model. Model 2 reflects the results for the analysis conducted using the NACD definition of overboarded directors. Models 3–5 reflect our alternative definitions of overboarded directors. We found a significant effect only for the model that tests the more-than-6 definition (model 5). The change in  $R^2$  was significant at the  $p < 0.001$  level. Interestingly, the coefficient sign is positive, indicating that firms with more overboarded directors outperform those with fewer. Therefore, the data contradict the prediction made in Hypothesis 2.

Table III exhibits the regression results for the models that test for the moderating effect of insider ratio. We hypothesized that the balance between inside and outside directors can govern the impact of overboarded directors. For each definition of overboarded directors, we examined the variance attributable to the interaction term beyond that explained by the main effects models (i.e., models 2–5). These results are reported in models 6–9.

We found that insider ratio has a moderating effect for two of the four overboarded definitions. Model 8 indicates that the effect was strongest with the more-than-5 definition. The significant negative coefficient suggests that under conditions of a high proportion of inside directors, the value of having overboarded directors is significantly less. However, overboarded directors have a very valuable impact on decision making when few insiders are present on the board. Therefore, Hypothesis 3 in regard to the moderating effects of insider ratio is partially supported.

To better facilitate interpretation of the interaction effect, we graphed the moderating effect of insider ratio upon the relationship between proportion of overboarded directors (using the more-than-5 definition) and abnormal returns (see Figure 1). We standardized all the independent variables of the model, and calculated the effects of these variables on abnormal return when all other variables were constant (i.e., mean value) (Cannella and Rowe, 1995, p. 77).

## CONCLUSION AND IMPLICATIONS

The primary purpose of this study was to examine the impact of overboarded directors upon critical strategic decisions such as corporate acquisitions. Toward

Table II. Results of regression analyses for the effects of overboarded directors

<i>Variable</i> <sup>1</sup>	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>	<i>Model 4</i>	<i>Model 5</i>
<i>Predictors</i>					
PROPORTION OF OVERBOARDED DIRECTORS (defined per NACD guidelines)		0.0754 (1.58)			
PROPORTION OF OVERBOARDED DIRECTORS (defined as sitting on more than 4 boards)			0.0445 (0.841)		
PROPORTION OF OVERBOARDED DIRECTORS (defined as sitting on more than 5 boards)				0.0661 (1.01)	
PROPORTION OF OVERBOARDED DIRECTORS (defined as sitting on more than 6 boards)					0.1326 (1.77)†
<i>Control variables</i>					
Institutional owners	0.0005 (1.19)	0.0006 (1.40)	0.0005 (1.23)	0.0005 (1.19)	0.0005 (1.15)
Insider ratio	0.0731 (1.54)	0.0746 (1.60)	0.0711 (1.50)	0.0685 (1.44)	0.0561 (1.17)
Bidder debt	0.0001 (1.22)	0.0001 (1.14)	0.0001 (1.19)	0.0001 (1.21)	0.0001 (1.31)
Deal size (ln)	-0.0140 (-1.47)	-0.0128 (-1.35)	-0.0128 (-1.32)	-0.0130 (-1.36)	-0.0107 (-1.12)
Deal volume by year	0.0000 (2.25)*	0.0000 (2.18)*	0.0000 (2.24)*	0.0000 (2.31)*	0.0000 (2.34)*
Relative bidder-target size (ln)	0.0082 (1.31)	0.0061 (0.966)	0.0071 (1.13)	0.0072 (1.14)	0.0064 (1.02)
Bidder firm size (ln)	0.0079 (1.02)	0.0078 (1.02)	0.0072 (0.921)	0.0076 (0.977)	0.0072 (0.936)
Prior bidder performance	0.1480 (1.03)	0.1312 (0.924)	0.1434 (0.997)	0.1420 (0.989)	0.1565 (1.10)
Board interlocks	0.0006 (1.28)	-0.0002 (-0.263)	0.0001 (0.225)	0.0001 (0.183)	-0.0001 (-0.094)
R <sup>2</sup>	0.095	0.112	0.100	0.102	0.116
ΔR <sup>2</sup>		0.017	0.005	0.007	0.021
F-test for ΔR <sup>2</sup>		2.49*	0.71	1.01	3.09**
F	1.52	1.66†	1.44	1.47	1.70†

Notes: N = 143. t-statistics in parentheses.

<sup>1</sup> Outcome measured as bidder abnormal returns for the two-day time interval examined and includes a five-day prior period to account for leakage of information.

\*\*\*p < 0.001, \*\*p < 0.01, \*p < 0.05, †p < 0.10.

Table III. Results of regression analyses for the moderating effects of inside directors

<i>Variable</i> <sup>1</sup>	<i>Model 6</i>	<i>Model 7</i>	<i>Model 8</i>	<i>Model 9</i>
<i>Predictors</i>				
PROPORTION OF OVERBOARDED DIRECTORS (defined per NACD guidelines) × INSIDERS	-0.0004 (-0.256)			
PROPORTION OF OVERBOARDED DIRECTORS (defined as sitting on more than 4 boards) × INSIDERS		-0.3056 (-1.19)		
PROPORTION OF OVERBOARDED DIRECTORS (defined as sitting on more than 5 boards) × INSIDERS			-0.8401 (-2.24)*	
PROPORTION OF OVERBOARDED DIRECTORS (defined as sitting on more than 6 boards) × INSIDERS				-0.9238 (-1.81)†
<i>Main effects</i>				
PROPORTION OF OVERBOARDED DIRECTORS (defined per NACD guidelines)	0.0828 (1.48)			
PROPORTION OF OVERBOARDED DIRECTORS (defined as sitting on more than 4 boards)		0.1184 (1.45)		
PROPORTION OF OVERBOARDED DIRECTORS (defined as sitting on more than 5 boards)			0.2707 (2.42)*	
PROPORTION OF OVERBOARDED DIRECTORS (defined as sitting on more than 6 boards)				0.3830 (2.44)*
<i>Control variables</i>				
Institutional owners	0.0007 (1.20)	0.0005 (1.06)	0.0004 (0.946)	0.0004 (1.04)
Insider ratio	0.0727 (1.53)	0.1149 (1.91)†	0.1355 (2.44)*	0.0990 (1.86)†
Bidder debt	0.0001 (1.13)	0.0001 (1.15)	0.0001 (0.976)	0.0001 (1.08)
Deal size (ln)	-0.0125 (-1.32)	-0.0139 (-1.43)	-0.0142 (-1.50)	-0.0117 (-1.22)
Deal volume by year	0.0000 (2.19)*	0.0000 (2.24)*	0.0000 (2.41)*	0.0000 (2.60)*
Relative bidder-target size (ln)	0.0060 (0.938)	0.0076 (1.20)	0.0073 (1.18)	0.0065 (1.04)
Bidder firm size (ln)	0.0078 (1.01)	0.0077 (0.985)	0.0084 (1.10)	0.0074 (0.971)
Prior bidder performance	0.1345 (0.940)	0.1595 (1.11)	0.1489 (1.05)	0.1477 (1.05)
Board interlocks	-0.0002 (-0.252)	0.0002 (0.330)	0.0002 (0.300)	-0.0001 (-0.233)
R <sup>2</sup>	0.113	0.109	0.135	0.138
ΔR <sup>2</sup>	0.001	0.009	0.033	0.022
F-test for ΔR <sup>2</sup>	0.147	1.30	4.92***	3.14***
F	1.50	1.44	1.84*	1.87*

*Notes:* N = 143. t-statistics in parentheses.

<sup>1</sup> Outcome measured as bidder abnormal returns for the two-day time interval examined and includes a five-day prior period to account for leakage of information.

\*\*\*p < 0.001, \*\*p < 0.01, \*p < 0.05, †p < 0.10.

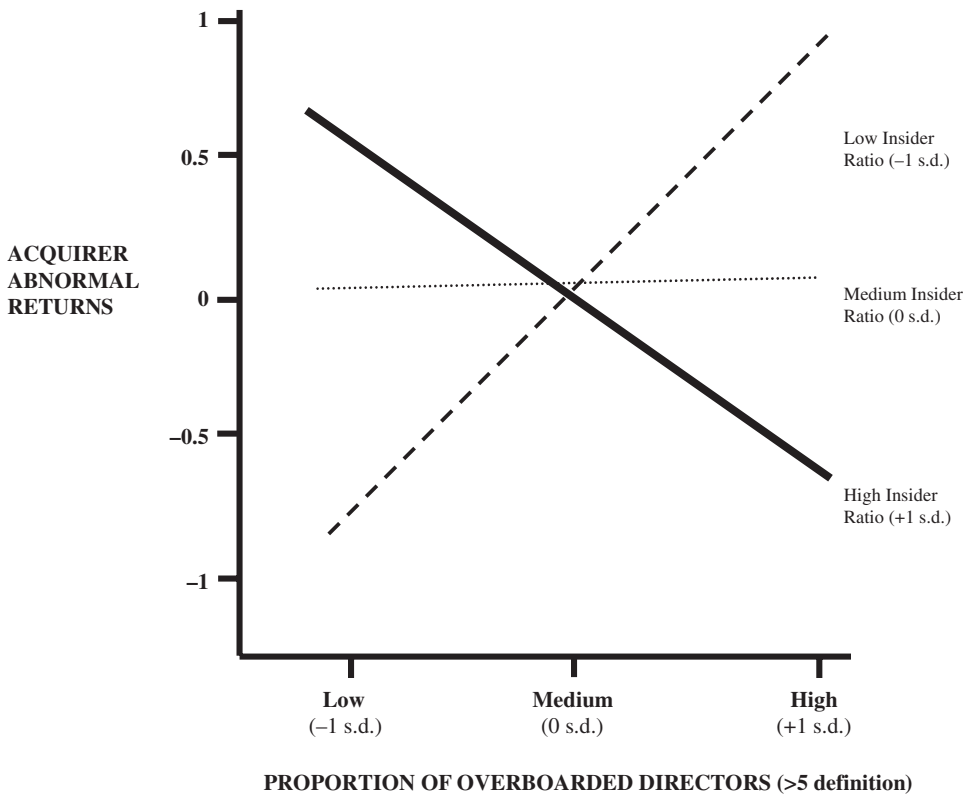


Figure 1. Interaction between insider ratio and overboarded directors (defined as >5)

answering this question, we used multiple operational definitions of ‘overboarded’. Based on the concern that such directors can become overextended and compromise their ability to actively participate, we predicted that the number of acquirer overboarded directors would be negatively associated with acquirer abnormal returns. To our surprise, we found a positive relation between proportion of overboarded directors and abnormal returns. This suggests that the criticisms levelled against these directors may be unfounded. Though anecdotal evidence can be found for busy directors that miss board meetings (*Business Week*, 1997), there is no systematic evidence that such directors’ disproportionately miss meetings. Perhaps these directors take into account the boards’ typical meeting schedule prior to accepting membership. Moreover, our findings suggest that these directors have, not a detrimental impact, but a favourable effect on key strategic decisions.

These results are interesting for two reasons. First, they contradict the conventional wisdom that multiple directorships threaten one’s ability to fulfil his/her board duties and have a resulting detrimental effect on the board. Intuitively, it makes sense that directors sitting on several boards may be forced to make trade-offs because of time constraints and activity conflicts (Kanfer and Ackerman,

1989). But, our sample on acquisition decisions suggests that these busy directors can somehow overcome this and govern as required. It may be that they draw upon their experiences from other boards and become more efficient decision makers. That is, they may recognize patterns and problems that have been encountered at other companies. Such accumulated knowledge can facilitate faster learning and minimize preparation time.

Second, the results are interesting in that they are consistent with theories on interlocking directors' ability to make informed contributions. Specifically, our results on the benefits of having directors that sit on several other boards is consistent with the argument that directors absorb environmental uncertainty by providing information (Pfeffer and Salancik, 1978; Schoorman et al., 1981; Zahra and Pearce, 1989).

We also detected a moderating effect for insider ratio. Our Hypothesis 3 predicted that the negatives of having overly busy directors would be mitigated by the presence of inside directors. However, the relationship seems to be much more complex. We found that when insider levels are low, higher proportions of overboarded directors have favourable effects on acquisition decisions. When few overboarded directors are present, the board likely lacks the market expertise to balance the operations knowledge of insiders and objectivity of non-overboarded outsiders. Thus, as predicted, these busy directors complement inside directors – and, no doubt, other outside directors as well – with knowledge on issues such as key M&A obstacles, typical decision biases and leads on advisors that can help guide management through the deal.

To our surprise, we found the opposite for high levels of insiders. That is, insider-dominated boards fared better with fewer overboarded directors. It was difficult to ferret out the precise underlying reason with our data, but we speculate that such insider-dominated acquirers seek characteristically different M&A transactions. Such companies may seek out targets that they know well. For example, these deals may be more driven by operating synergies or may exhibit a stronger similarity of technology. In such a context, outside board expertise is less important than simple independence. The benefits of independence may be evident in the downward sloping high-insider ratio curve. These insider-dominated deals perform well with low proportions of overboarded directors, but the performance drops with higher levels of busy directors. This may be an indication that, for these deals, the expertise offered by overboarded directors is less important than objectivity/independence. Though they possess general M&A market knowledge, these virtues are squelched by the need for unbiased challenges to the status quo and/or checks against the threat of agency costs. In this particular context, the critics of overboarded directors may be right – these busy directors are too encumbered to govern properly.

This pattern of results may indicate the complementarities among the three types of directors – insiders, overboarded outsiders and non-overboarded out-

siders. This synergistic outcome is consistent with previous arguments (Baysinger and Butler, 1985; Baysinger and Hoskisson, 1990; Byrd and Hickman, 1992; Fama and Jensen, 1983; Pfeffer, 1972) that a balance of insiders and outsiders is preferable to exclusively having one or the other. Overboarded directors (average of 15 per cent for the more-than-5 definition) bring a wealth of knowledge to the boardroom and insiders (which make up, on average, 29 per cent of the board) assist in applying it to the particulars of the situation at hand, but dominance by either is unhealthy.

This study makes an important contribution to both the research and practitioner communities. It is difficult to precisely assess the underlying processes of this interaction effect, but these findings seem to highlight the importance of viewing the board as a complete unit. If one believes in a market for directors, then perhaps selection committees are already aware of these findings. Companies may pursue active directors because they are, in fact, the candidates best equipped to add value. In short, busy directors are busy for good reason – they are good contributors. Therefore, the selection of outside directors merely for sake of their independent views may not be as important as the accumulated knowledge represented by the director sitting on several boards. It seems that selection committees would arrive upon different selection decisions if they strove for a blend of complementary skill sets instead of the overly simplistic test of independence. Investors should not be alarmed by the presence of busy directors. The proper mix of contributors is far more important.

These findings, also, suggest that the guidelines offered by the NACD do not distinguish among types of directors as promised. Moreover, the results call into question the NACD's assertion that overboarded directors represent a threat to corporate America. Instead, our study provides evidence that overboarded directors may be an asset to the board. While such directors have been criticized for missing meetings and exhibiting poor preparation for meetings, their expert advice apparently offsets the accompanying negative aspects. This bears importantly upon board selection decisions because it suggests that accumulated board experience must be considered. These findings are consistent with Westphal and Zajac (1995) and Zajac and Westphal's (1996) findings on the importance of director experience.

Discussions of board reform have been dominated by concerns about director independence. Acquisitions would appear to be both a corporate event plagued by uncertainty and one that demands close scrutiny by the board. These findings on the benefits of busy directors in the challenging context of acquisitions are particularly impressive. Perhaps such board reform debates are better served by focusing less on board monitoring and more on board decision making. Though labels such as 'affiliated' and 'grey' have a pejorative bias (Byrd and Hickman's (1992) discussion of affiliated directors is a notable exception), we must not overlook the valuable resources available through these links.

These arguments on the virtues of overboarded directors are, in principle, the same as those argued by interlock and networking scholars. However, our study goes beyond overall board links. Instead, it captures the distribution of board links. It, therefore, lies at the nexus of board composition and interlock research. This intersection represents one of the areas from which we may learn the most about building effective boards.

We believe that caution should be exercised in condemning such boards as ineffective due to the presence of overboarded directors. We recommend that corporate governance discussions on multiple directorships should distinguish between outliers at the individual level (i.e., citing directors that meet the selected definition of an overboarded director) and pervasiveness of the general phenomenon (i.e., the frequency of such directors across all companies).

### **LIMITATIONS AND FUTURE DIRECTION**

This study has advanced our understanding of board composition and how it relates to board interlocks, but it does have limitations. Our intentions were to study a critical strategic decision that demanded the attention of the board. We selected major corporate acquisitions as such a decision, thus the generalizability of our findings to other key strategic decision is unclear. Further, our examination of consummated transactions overlooks the effects that such directors might have on rejected deals. Our examination of major acquisitions also introduces a potential bias of director type. That is, companies that are most active in the acquisition market tend to have busier directors. Extension of this investigation of overboarded directors to other settings will further enhance our understanding of such directors.

We controlled for the factors that typically contribute to acquisition outcomes and assessed the immediate market reaction to the acquisition. However, it can be argued that post-acquisition integration is vital to determining acquisition success (Haspelaugh and Jemison, 1991). We followed the conventional event study approach of relying upon the immediate market response, which avoids the introduction of subsequent contaminants unrelated to the acquisition. Nevertheless, as discussed in the methods section, many have found abnormal returns to be a good predictor of long run success.

As an initial investigation of overboarded directors, we examined their effect based on their presence on the board. There may be more subtle effects at work such as the degree to which board members' other directorships are related to the focal company. Our findings are consistent with the importance of director expertise, thus it is plausible that directors with a tightly-related portfolio of directorships (e.g., all high-tech software companies, all consumer goods companies) build a strong foundation of knowledge that aids in asking questions and making suggestions. The answers to these questions are beyond the scope of this study.

## NOTE

- [1] Johnson et al. (1996) point out the inconsistencies of defining outside directors. The operationalization challenges centre around accurately capturing director independence. That is, many outside directors are not truly 'outside' due to their business and family affiliations with the company. Our thesis on overboarded directors focuses on decision making impact upon acquisitions. This advisory role is far less affected by levels of independence.

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