

On the Limits of Board Diversity: Impact of Network Effect on Director Appointments

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Abstract : Research on the effect of director's network connections on investor welfare is inconclusive. Some studies suggest that directors' connections are beneficial, in terms of, improving earnings information, firms valuation for new investors. On the other hand, adverse effects of directorial networks are also reported, in terms of higher earnings management, options back dating fraud, reduction in firm performance, lower board monitoring. From regulatory perspective, the role of directorial networks on corporate welfare is crucial. Cognizant of the possible ill effects associated with directorial networks, large investors, for better representation on the boards, are building their own database of prospective directors who are highly qualified, however, sourced from outside the highly connected directorial labor market. For instance, following Dodd-Frank Reform Act, California Public Employees' Retirement Systems (CalPERS) has initiated a database for registering aspiring and highly qualified directors to nominate them for board seats (proxy access). Our paper stems from this background and tries to explore the chances of outside directors getting directorships who lack established network connections. The paper is able to identify such aspiring directors' information by accessing a unique Indian data sourced from an online portal that aims to match the supply of registered aspirants with the growing demand for outside directors in India. The online portal's tie-up with stock exchanges ensures firms to access the new pool of directors. Such direct access to the background details of aspiring directors over a period of 10 years, allows us to examine the chances of aspiring directors without corporate network, to enter directorial network. Using this resume data of 16105 aspiring corporate directors in India, who have no prior board experience in the directorial labor market, the paper analyses the entry dynamics in corporate directors' labor market. The database also allows us to investigate the value of corporate network by comparing non-network new entrants with incumbent networked directors. The study develops measures of network centrality and network degree based on merit, i.e. network of individuals belonging to elite educational institutions, like Indian Institute of Management (IIM) or Indian Institute of Technology (IIT) and based on job or company, i.e. network of individuals serving in the same company. The paper then measures the impact of these networks on the appointment of first time directors and subsequent appointment of directors. The paper reports the following main results: 1. The likelihood of becoming a corporate director, without corporate network strength, is only 1 out of 100 aspirants. This is in spite of comparable educational background and similar duration of corporate experience; 2. Aspiring non-network directors' elite educational ties help them to secure directorships. However, for post-board appointments, their newly acquired corporate network strength overtakes as their main determinant for subsequent board appointments and compensation. The results thus highlight the limitations in increasing board diversity.

Keywords : aspiring corporate directors, board diversity, director labor market, director networks

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