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EX ANTE GOVERNANCE CONTROLS ON NON-EXECUTIVE DIRECTOR SELF-INTEREST: EMPIRICAL EVIDENCE ON MULTIPLE DIRECTORSHIPS 2006-2010 IN THE UNITED KINGDOM

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ABSTRACT

Formal independence of non-executive directors should not be used as a mask for a potential problem of self-interest, as it can occur in many forms. While laws regulate more severe forms of self-interest, little attention is given to subtle governance controls that can seek to align a non-executive's interests with the company's. The increased role non-executives have on a board of directors exacerbates this problem with little consideration or evidence to support improved governance. This article is an empirical analysis seeking to identify if self-interest is a problem for non-executive directors and whether there are any available governance controls or if regulation is required. It also endeavours to inform a larger empirical study that seeks to hone in on the problem of self-interest for non-executives. This article provides evidence that self-interest is a potential problem if left unchecked.

Keywords: Corporate Governance; Directors; Non-Executives; Remuneration; Agency Problems

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1. SELF-INTERESTED NON-EXECUTIVE DIRECTORS

Corporate law has developed rules that govern some of the most severe form of self-serving behaviour.[1] Corporate governance, however, offers subtle ex ante interest alignment between controllers and owners. This interest alignment has received substantial attention in the literature in respect of executive directors, yet little attention is given to non-executive directors and their potential for self-serving behaviour. “Independence” is a formative means of denying possible conflict but this can be highly misleading in modern corporate governance as non-executives take on a more substantive role, caused by corporate scandals and an increased ability for companies to diversify. There are many reasons non-executive directors might be self-interested and it should not be taken for granted that increased involvement will lead to better corporate governance. The purpose of this study is to provide provisional empirical data on non-executive director self-interest from an initial sample. This will facilitate a larger empirical study that will identify and analyse matters such as the nature of the conflict as well as the impact this can have on corporate performance. Given the relatively sparse amount of literature on non-executive self-interest it is important to start with a smaller data sample to help identify the basic nature of that self-interest before it can be honed in on and refined. This preliminary evidence does that and provides some useful empirical evidence in the process. The preliminary study uses multiple directorships as a proxy for self-interest. Measuring these against elements of corporate governance the analysis will offer evidence on whether non-executives are self-interested and identifying potential governance controls on that self-interest.

2. WHY IS SELF-INTEREST A PROBLEM?

Non-executive directors are meant to monitor and constructively challenge executive management[2] meaning non-executive liability is often based on negligence for failure to

[1] See, for example, Companies Act 2006, ss.175-177

[2] UK Corporate Governance Code, Para A.4

perform this task reasonably.[3] Therefore, Cheffins and Black argued that private enforcement of directors' duties against non-executive directors are more likely to be that of duty of care rather than conflict of interest.[4] Yet, after corporate failures or scandals, non-executives are often pointed to as a means of improving governance to reduce the risk of such events occurring.[5] The result of these reports is often to make policy suggestions on increased involvement i.e. through Corporate Governance Codes. So much so that non-executive directorships in the United Kingdom went from practically non-existent at the time of the Cohen Report in 1945,[6] when it was identified that there was no internal monitoring body responsible for supervision; to a "job for the boys";[7] to 1985 where only 6% of companies lacked non-executives and on 20% of companies they were in the majority;[8] to 2014 where 92% of FTSE 350 companies had a majority of non-executives on their board, up from 89% in 2013.[9]

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[3] See, for example, *Dovey v Cory* [1901] AC 477; *Re Westmid Packing Services* [1998] 2 All ER 124; Equitable Life Assurance v Bowley [2003] EWHC 2263

[4] B Cheffins and B Black, 'Outside Director Liability Across Countries' (2006) 84 *Texas Law Review* 1385, 1405

[5] The Hampel Report, *Final Report: of the committee on corporate governance*, (January, 1998), para 3.8; The Higgs Report, Review *of the role and effectiveness of non-executive directors*, (January, 2003) para 1.6; The Walker Review, *A review of corporate governance in UK banks and other financial industry entities*, (November, 2009), para 2.7

[6] The Cohen Report, *The report of the committee on company law amendment*, (1945) Cmd 6659 (hereinafter Cohen Report)

[7] S Aris, 'Non-Executive Directors: Their changing role on UK boards' (1986) *Economist Intelligence Unit* Special Report no 244, 6-8

[8] ibid

[9] See, Grant Thornton Corporate Governance Review, 'Plotting a new course to improved governance' (2014) <http://www.grant-thornton.co.uk/Global/Publication_pdf/Corporate-Governance-Review-2014.pdf> accessed 13th May 2015

It is not just corporate scandals that increased the need for non-executive involvement and it is unlikely that this was the catalyst for their increasing numbers. It was noted by the Higgs Report that the increased complexities of business made it more difficult for shareholders to hold management to account, facilitating the need for non-executives.[10] Perhaps more importantly, reduction in trade barriers that culminated in the single market in the EU in 1992, and the demise of the *ultra vires*[11] rule facilitated business expansion and diversification. In uncertain market conditions, particularly where a company is looking to grow in to new markets, the hiring of a non-executive director who is familiar with the market reduces dependencies on external resources by reducing contractual costs and uncertainty.[12] Therefore, non-executive directors became more useful to the company as they could facilitate company expansion. Whether the non-executive would actually do this though is just one example of the potential for self-interest.

With increased responsibility comes with it the increased risk of using that influence for self-interested means. Whilst the majority of cases against non-executives will be for duty of care, recent cases have been faced with such circumstances of self-interest.[13] However, private enforcement of duties is rare,[14] particularly against non-executive directors.[15] Whether

[10] The Higgs Report, Review *of the role and effectiveness of non-executive directors*, (January, 2003)

[11] See, for example, Companies Act 2006, s. 31; *cf. Johns v Balfour* (1889) 5 T.L.R. 389; *Re Introductions Ltd* (No. 1) [1970] Ch. 199; *Re Horsely & Weight* [1982] Ch. 442, 448; *Rolled Steel Products (Holdings) Ltd v British Steel Corp* [1986] Ch. 246, 288-9;

[12] See, for example, J Pfeffer, 'Organization Theory and Structural Perspectives on Management (1991) 17(4) *Journal of Management* 789; K Eisenhardt and C Schoonhoven, 'Resource-Based View of Strategic Alliance Formation: Strategic and Social Effects in Entrepreneurial Firms' (1996) 7(2) *Organization Science* 136

[13] *Mission Capital Plc v Sinclair* [2008] EWHC 1339 (Ch); *Cambridge v Makin* [2011] EWHC 12 (QB); [2008] B.C.C. 866; *Burns v Financial Conduct Authority* [2014] UKUT 0509 (TCC)

[14] S Deakin and A Hughes, *Directors' Duties: Empirical Findings – Report to the Law Commissions* (ESRC Centre for Business Research, University of Cambridge 1999) (hereinafter ESRC Report); J

the threat of litigation is enough to deter self-interest is not the focus of this article but it is considered that the lack of legal deterrent can lead to bad governance.[16] Therefore, ex ante governance incentives may provide a viable solution to reduce the risk of self-interest amongst non-executive directors.

To analyse this, multiple directorships are used as a proxy for self-interest. Agency theory would contend that the taking of multiple directorships by non-executives is a form of perquisite consumption[17] that, in excess, can be detrimental to the companies involved for a number of reasons and can generate agency costs. For example, appointments may be based on contacts and networks rather than merit or signals from the managerial labour market.[18] This may lead to excessive executive compensation[19] due to the non-executives being

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Armour *et al*, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and United States' (2009) 6(4) *Journal of Empirical Legal Studies* 687

[15] B Cheffins and B Black, 'Outside Director Liability Across Countries' (2006) 84 *Texas Law Review* 1385; see also, H Hirt, 'The review of the role and effectiveness of non-executive directors: a critical assessment with particular reference to the German two-tier board system: Part 2' (2003) 14(8) *International Company and Commercial Law Review* 261, 266-7; The Higgs Report, Review *of the role and effectiveness of non-executive directors*, (January, 2003) para 14; *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch. 204; *Mission Capital Plc v Sinclair* [2008] EWHC 1339 (Ch); [2008] B.C.C. 866

[16] Z Zhang 'Legal Deterrence: the foundation of corporate governance – evidence from China' (2007) 15(5) *Corporate Governance: An International Review* 741

[17] S Ferris, M Jagannathan and A Pritchard, 'Too Busy to Mind the Business? Monitoring by Directors with Multiple Board Appointments' (2003) 58(3) *The Journal of Finance* 1087

[18] E Fama and M Jensen, 'Separation of Ownership and Control' (1983) 26(2) *Journal of Law and Economics* 301; L Bebchuk and J Fried, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation*, (Harvard University Press, 2006); Qianru Qi, 'How Does the Director's Social Network Matter? Evidence From Structure Estimation' (2010) <http://ssrn.com/abstract=1786555> accessed 14th April 2011

[19] L Renneboog and Y Zhao, 'Us knows us in the UK: On director networks and CEO compensation' (2011) 17(4) *Journal of Corporate Finance* 1132

unwilling to challenge the executives who supported their appointment. Non-executives may also be unable to fulfil all their duties for each one of their undertakings at the different companies.[20] However, it is not advocated that companies should prevent non-executives from taking any external appointments, as there are often many benefits in doing so. Benefits include reducing uncertainties in the market[21] and improvements in company performance.[22] The point is to highlight how companies might control an excess of external appointments and this may serve as a partial answer as to how a company can create an alignment of interests to prevent or guard against self-interested opportunism.

3. HYPOTHESES

The hypotheses are intended to look at different corporate governance mechanisms to see if this has a relationship with external appointments. This will allow for some inferences to be drawn from the data to consider how non-executives might be controlled beyond formal independence. The hypotheses will also aim to look at the pre and post financial time periods to see if there are any significant changes in behaviour.

H1: *Non-executives will hold more appointments where remuneration is higher*

Clearly, non-executives need to be remunerated; however, as Fama identified, if you pay an individual up front, what is to stop the individual consuming more perquisites to the

[20] S Ferris, M Jagannathan and A Pritchard, 'Too Busy to Mind the Business? Monitoring by Directors with Multiple Board Appointments' (2003) 58(3) *The Journal of Finance* 1087, 1088; citing M Lipton and J Lorsch, 'A modest proposal for improved corporate governance' (1992) 48 *Business Lawyer* 59

[21] See, for example, J Pfeffer, 'Organization Theory and Structural Perspectives on Management (1991) 17(4) *Journal of Management* 789; K Eisenhardt and C Schoonhoven, 'Resource-Based View of Strategic Alliance Formation: Strategic and Social Effects in Entrepreneurial Firms' (1996) 7(2) *Organization Science* 136

[22] J Cotter, A Shivdasani, M Zenner, 'Do independent directors enhance target shareholder wealth during tender offers?' (1997) 43(2) *Journal of Financial Economics* 195

detriment of his principal?[23] Since there are rarely wage revision processes or long-term incentive schemes for non-executives, for reasons of independence, it is hypothesised that as remuneration increases non-executive multiple directorships will also increase. This suggests that additional appointments are perquisite consumption for the non-executive.[24] If evidence is found to the contrary then it can be argued that higher remuneration is accompanied by greater responsibilities, therefore they are unable to take on more appointments. Renneboog and Zhao hypothesised that non-executives who are more locally constrained earn a higher fee since their isolation may be perceived as an indication of their independence and superior monitoring capabilities.[25]

H2: *Non-executives with more equity will hold fewer appointments*

Equity is tied to the value of the company. As such non-executives with a lower equity holding will have greater incentives to prefer short-term personal interests to those long-term interests of the company. For example, Baghat *et al*[26] showed that directors who have a higher equity ownership in the company are more likely to remove an under-performing CEO. As a consequence, as Ferris *et al* evidenced, non-executives with greater equity ownership will hold fewer additional appointments.[27] Their personal wealth is tied to the value of the company and so non-executives will be less willing to shirk their responsibilities and will provide better oversight of management. If data shows that non-

[23] E Fama, 'Agency Problems and the Theory of the Firm' (1980) 88(2) *Journal of Political Economy* 288, 306

[24] S Ferris, M Jagannathan and A Pritchard, 'Too Busy to Mind the Business? Monitoring by Directors with Multiple Board Appointments' (2003) 58(3) *The Journal of Finance* 1087, 1097

[25] L Renneboog and Y Zhao, 'Us knows us in the UK: On director networks and CEO compensation' (2011) 17(4) *Journal of Corporate Finance* 1132, 1135

[26] S Baghat, D Carey and C Elson, 'Director Ownership, Corporate Performance and Management Turnover' (1999) 54 *Business Lawyer* 885

[27] S Ferris, M Jagannathan and A Pritchard, 'Too Busy to Mind the Business? Monitoring by Directors with Multiple Board Appointments' (2003) 58(3) *The Journal of Finance* 1087, 1097

executives continue to be influenced by their equity holdings, then this may serve as a realistic alternative to limits or restrictions on appointments that are used in other jurisdictions.[28] However, equity may be questioned as a viable governance mechanism, by itself, given its previous shortcomings in corporate scandals[29] and might not improve governance.

H3: *Non-executives will hold fewer appointments where there are more agency problems in the company*

Perry and Peyer found that executive directors would be less willing to take on additional appointments where agency problems in the company are greater.[30] This study used two proxies only to determine agency problems. The agency problems they identified and tested were the number of independent directors and percentage of executive ownership.[31] This study uses nine agency problems[32] and makes a similar hypothesis for non-executive directors. This will make the test more robust. As well as examining the impact of the extent of agency problems collectively, individual agency problems such as the ratio of independent directors to executives, the duality of CEO and chair positions, board meetings missed/held and board size can be explored. This is justified by the argument that where there are greater

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[28] Capital Requirements Directive IV 2013/36/EU, Art 91(1)-(6); Dutch Corporate Governance Code: Principles of good corporate governance and best practice provisions (2008) para 39; The French Recommendation of Corporate Governance 2011, Part II Para D.2; The German Stock Corporation Act (AtkG), s. 100

[29] See, for example, B Holmstrom and S Kaplan, 'The State of U.S. Corporate Governance: What's right and what's wrong?' 15(3) *Journal of Applied Corporate Finance* 8

[30] T Perry and U Peyer, 'Board Seat Accumulation by Executives: A Shareholder's Perspective' (2005) 60(4) *The Journal of Finance* 2083

[31] ibid, 2096

[32] LTIS to fixed remuneration; executive ownership; executive multiple directorships; ratio of independent directors to executives; board size; number of board meetings; number of remuneration committee meetings; number of board meetings missed; and CEO-Chair duality

agency problems in the company, the non-executives will recognise the need to monitor senior management more closely. As a consequence they will be less able to take on other appointments. Another reason may be that executive management may be able to impose higher agency costs on the company where non-executives have fewer external appointments based on Masulis and Mobbs' observation that non-executives may become more reliant on the company when they hold fewer appointments and thus less willing to challenge.[33] Conversely, if non-executive multiple directorships increase with the volume of agency problems this may be a result of what Ferris *et al* stated that 'reduced monitoring by such directors allows managers to impose greater agency costs on the firm'.[34]

H4: *After 2008 non-executives will hold fewer appointments*

In 2008 the economy suffered a significant contraction. This event may have significantly altered the way directors behave in regard to accepting multiple directorships and monitoring executive management.

Eisenhardt and Schoonhoven observed additional appointments can be beneficial in difficult market conditions. This is supported by Erkens *et al*[35] study that showed higher performance levels in companies with access to expertise compared with those boards with more independent directors. For executive directors, Booth and Deli found that the CEO was more likely to hold fewer appointments where growth opportunities were greater.[36] In a recession,

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[33] R Masulis and S Mobbs, 'Are all Inside Directors the Same? Evidence from the External Directorship Market' (2011) 66(3) *The Journal of Finance* 823

[34] S Ferris, M Jagannathan and A Pritchard, 'Too Busy to Mind the Business? Monitoring by Directors with Multiple Board Appointments' (2003) 58(3) *The Journal of Finance* 1087, 1096

[35] D Erkens, M Hung and P Matos, 'Corporate Governance in the 2007-2008 Financial Crisis: Evidence from Financial Institutions Worldwide' (2010) <http://ssrn.com/abstract=1397685> date accessed 1st Nov 2010

[36] J Booth and D Deli, 'Factors affecting the number of outside directorships held by CEOs' (1996) 40(1) *Journal of Financial Economics* 81

growth opportunities are likely to be lower therefore leading to a larger number of external positions.

However, Fich and Schivdasani found that directors were more likely to depart underperforming companies. Linking this with Lorsch and MacIver's[37] qualitative study that a primary reason behind accepting an appointment is the reputation of the company it would be expected that companies' reputation would decrease in a recession leading to fewer appointments. As well as a decrease in reputation, it is likely that the non-executives' reputation and worth in the managerial labour market may also be diminished after a financial crisis, especially those with more external appointments, which would be contrary to what was reported by Eisenhardt and Schoonhoven. Gilson reported, for example, that non-executives who left a company that had difficulties with its finances held fewer external appointments after departure than those who left in other circumstances.[38] Therefore non-executives with more external appointments will have less worth in the managerial labour market resulting in a decline in additional appointments held after 2008.

As well as identifying whether non-executives hold more or fewer appointments after the financial crisis, the other hypotheses will also be tested pre and post crisis to see whether there are any changes in behaviour. Whilst the hypotheses will remain the same any changes in the results may indicate changing behaviour in different market conditions.

4. METHODOLOGY

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[37] M Conyon and L Read, 'A model of the supply of executives for outside directorships' (2006) 12 *Journal of Corporate Finance* 645, 651; citing J Lorsch and E MacIver, *Pawns or Potentates: The Reality of America's Corporate Boards*, (Harvard Business School Press, 1989)

[38] S Gilson, 'Bankruptcy, boards, banks and blockholders: Evidence on changes in corporate ownership and control when firms default' (1990) 27(2) *Journal of Financial Economics* 355

The dataset was from 150 cases – thirty FTSE 100 companies selected at random from the London Stock Exchange website[39] over a five year period, 2006-2010. The time series[40] will add to the observations about controlling self-interest to see if there are any significant changes over time, particularly in different market conditions before and after 2008. The relevant data was collected from the annual reports, which are required to be made available for the last five years.[41] The data was collected at company level, rather than for individual directors. This was done as the study is interested in regulating self-interest generally. Essentially the study aims to identify reasons why some companies have non-executives with higher levels of external appointments in order to identify conditions that facilitate increased external appointments, rather than why individuals take more appointments. This will identify ways governance mechanisms could be used to reduce the potential for self-interest in external appointments.

For most companies the annual report relates to the period of 1st January to 31st December. However, some companies' data in their annual reports ran for different periods. Where a financial year did not coincide with the calendar year the data collected was attributed to the year where the most months had been covered.

4.1 Descriptive Data

4.1.1 Director and Multiple Directorships data

For any director serving for the whole year and any external appointments held for the whole year are given a value of 1 otherwise the value was 0.5. These were then converted in to full time equivalents (FTE). FTEs were used for multiple directorships, directors serving, independent directors and chairs. A multiple directorship was classified as one that attracts

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[39] <http://www.londonstockexchange.com>

[40] Data collected is also a panel which would allow for control of firm and organisation type in future studies

[41] Transparency Directive 2004/109/EC Ch 2 Art 4

fiduciary accountability in a private, for profit role. Therefore membership of professional bodies, non-profit firms etc. were excluded. Multiple directorship data for directors not listed in the annual report due to retirement were collected using the previous year's annual report and cross-referenced with a company they served on.

Table A reports the descriptive statistics on directorships levels and multiple directorships in companies. There seems to be no obvious pattern between the number of appointments and external directorships. However, there is a noticeable drop of 17% in the number of external appointments held by executives from 2008 to 2010. This relates to Hypothesis 4, that market conditions can impact on director behaviour in how many appointments they take. The number of non-executive external appointments has also been in decline after 2007 but is still just above the lowest levels reported in 2006.

Despite a slight decrease in the number of non-executives serving, 7.73 to 7.67, an interesting observation from the data is that whilst the maximum number of multiple directorships on a board has been in decline, from 45 to 38, the minimum has been rising, 3 to 7. This suggests that smaller boards are now allowing for more external appointments, whilst bigger boards have scaled back external appointments. This may be related to market conditions that directors of larger companies tried to focus attention on a particular business to aid survival in difficult market conditions. The shift in public perception relating to directors who subsequently resigned or were removed from positions may also have had an influence, perhaps, prompting resignations in larger companies to improve public perception of commitment. Conversely, smaller FTSE 100 companies may have appointed directors with more external appointments to help reduce uncertainties in the market, which would account for the increase in the minimum number of external appointments. This is consistent with Eisenhardt and Schoonhoven thesis in Hypothesis 4. Reputational influences may have also played a part with larger companies losing reputation and prestige thus attracting fewer talented individuals, whilst existing directors with high volumes of additional appointments lost worth in the managerial labour market and became less desirable to appoint.

Table A: Board External Appointments

Variable (n = 150)	Min	Max	Mean	SD
Executive Directorships	**1.5**	**8**	**4.09**	**1.32**
2006	1.5	6.5	4.22	1.31
2007	1.5	7	4.20	1.34
2008	2	7.5	4.18	1.20
2009	2	8	4.02	1.32
2010	1.5	8	3.85	1.45
Non-Executive Directorships	**3.5**	**14.5**	**7.83**	**2.41**
2006	3.5	14.5	7.73	2.53
2007	4	14	7.78	2.39
2008	4	14	8.07	2.61
2009	4.5	14.5	7.90	2.36
2010	5	13.5	7.67	2.26
Executive Multiple Directorships	**0**	**10**	**3.04**	**2.30**
2006	0	9.5	3	2.54
2007	0	8	3.07	2.25
2008	0	10	3.40	2.44
2009	0	9	2.93	2.27
2010	0	7	2.82	2.07
Non-Executive Multiple Directorships	**3**	**45**	**18.38**	**8.05**
2006	3	40.5	17.40	8.01
2007	4	40.5	19.15	8.32
2008	4	45	18.73	8.20
2009	8	41	18.55	8.61
2010	7	38	18.07	7.50

4.1.2 Remuneration data

Executive remuneration has been divided into three different categories: (1) fixed remuneration of salary and benefits; (2) Annual bonus of shares and cash including any deferred; and (3) Long Term Incentive Schemes (LTIS). These categories and what is included is mainly based on the Listing Rules (LR) definitions as opposed to the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008/410. The only relevant distinction between the two definitions of these categories is in regard to deferred annual bonuses. Whilst the 2008 Regulations class deferred bonuses as a LTIS[42] the Listing Rules do not.[43] This definition from the LR is used to carve out LTIS from deferred bonuses, but the two are merged back together when calculating the ratio of LTIS to fixed remuneration for the purposes of analysing this specific agency problem.

To calculate the value of the LTIS the amount of shares awarded is multiplied by the value of the company's shares at the time of award and not how much of the award vested. This is done to judge how the director is incentivised. As for the calculation of share options, since share options are paid for by directors through a right to acquire at an agreed exercised price, the value of awards is taken at the value of those exercised in that year.

Figure 1 give a break down of executive remuneration. The biggest portion of executive compensation is LTIS making up 46% of their overall package. Despite a sharp fall in bonus and LTIS after the 2008 crash, these awards reached new highs in 2010 as measured by the mean. However the percentage of performance related pay that made up the total was 47% in 2007 and 2010 and 39% in 2006 and 2009. In terms of fixed remuneration for executive directors' salary and benefits, despite a continual growth in the mean paid to executives, the median has decreased for two consecutive years in 2009-10. This is suggestive of outliers, which is supported by the increase in the standard deviation. Annual bonuses and share options were also squeezed in 2008, which was to be expected as executives forfeited their bonuses and share prices dwindled with the recession.

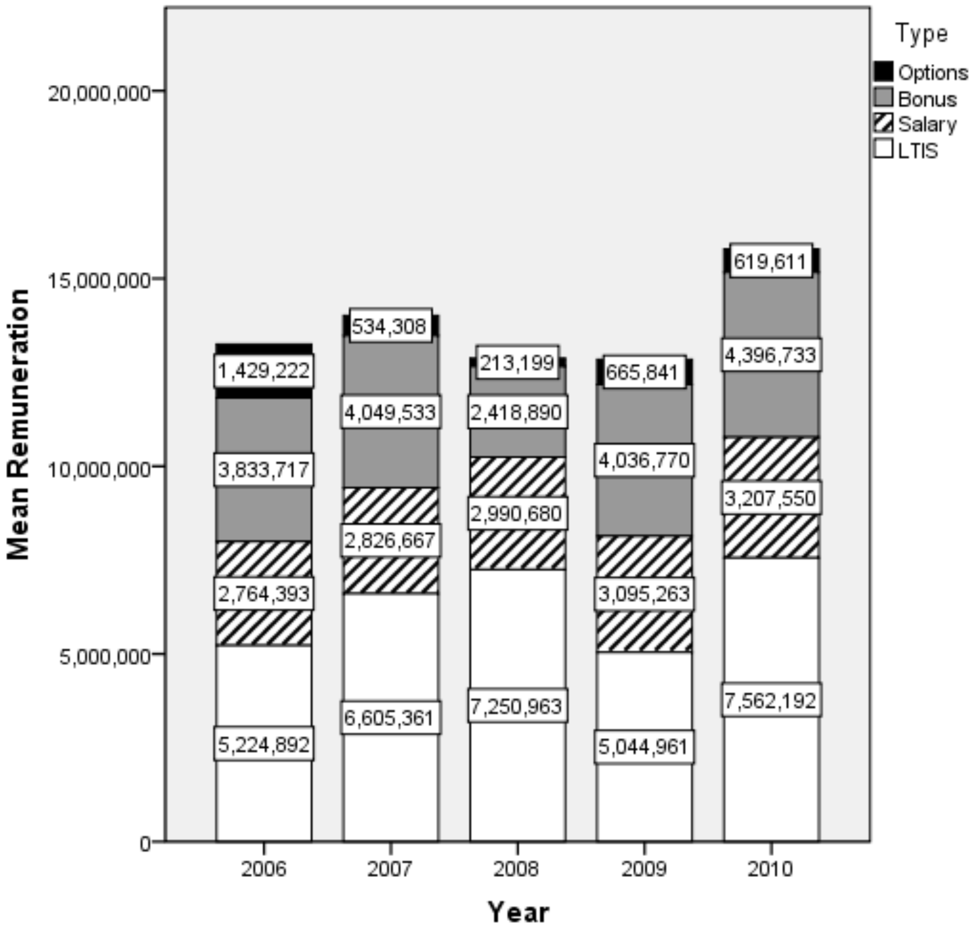
Whilst looking at individual sectors may not be reliable due to the size of the dataset, some observations can still be drawn from the descriptive statistics. Companies in the banking, oil and gas producers, utilities and financial services were the sectors to pay

[42] Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations (SI 2008/410) Schedule 5 Regulation 8 Part 3 Article 11

[43] Financial Conduct Authority Listing Rules 9.8.8

executives the most. The highest paid executives were those at Barclays in 2007 to its six executives who served that year. Barclays also paid the most per executive in 2010 where it awarded £36,950,000 (£12,317,000 per executive) to its three executives. The lowest was paid in 2006 to the two executives of Autonomy Corporation who awarded £768,600.

Figure 1: Executive Remuneration



Non-executive remuneration is paid in fees based on their role on the board. Table B offers some descriptive statistics on how non-executive fees have changed over the five-year period. Since it was rare for a non-executive to receive bonuses or equity based compensation the figures below only consider the fees paid to non-executives. Generally, the average paid to non-executives has increased. The overall increase in the average paid to a company's non-executives has been around £150,000 or 17%. This is despite a slight decrease in the average number of non-executives serving. Despite the increase in the mean, the standard deviation is observed to have increased with the amount paid to non-executives, based on the median, having levelled off. This again suggests the presence of outliers. Sectors where fees paid to non-executives were the highest included banking, oil and gas producers, pharmaceuticals, tobacco and food producers. However, when taking into account the amount paid per director the highest paid non-executives were those in banking, oil and gas producers, pharmaceuticals and general mining. It appears these sectors are the ones pulling the mean up.

Table B: Non-executive Remuneration Breakdown

Variable (n = 150)	Min	Max	Mean	SD	Median
Remuneration	**£98000**	**£2603000**	**£958152**	**594747.24**	**£808500**
2006	£102000	£2603000	£897233	747308.63	£696500
2007	£98000	£1831000	£846133	419648.52	£771500
2008	£124000	£2154000	£950600	506061.64	£855500
2009	£267000	£2408000	£1043500	619674.98	£830000
2010	£377870	£2351000	£1053296	639501.04	£849500

4.1.3 Equity holdings

How much time an individual will dedicate to their role and whether they take on additional appointments may be affected by how much equity they hold in the company. This data was collected using the disclosed equity holdings of directors in the annual report and the percentage of ownership was calculated against the called up share capital. On October 1st 2009 section 10 of the Companies Act 2006 came into force that removed the requirement for companies to have an authorised share capital. For consistency across all years the percentage of ownership was always calculated against the called up share capital. Table C gives a breakdown of insider ownership. This data offers support to Renneboog and Zhao's findings of a general trend of increasing insider ownership.[44] The mean and median have both increased over the five years for executives with notable increases in the mean despite a significant drop in the maximum ownership by executive directors. Non-executive ownership

[44] L Renneboog and Y Zhao, 'Us knows us in the UK: On director networks and CEO compensation' (2011) 17(4) *Journal of Corporate Finance* 1132, 1146

saw a fluctuation in 2008 and 2009 but returned to pre-crash levels by 2010. Thus, for non-executives the incidence of inside ownership by non-executives appears to have levelled off, which is unsurprising since non-executives rarely hold much, if any, equity. The mean and median are also considerably lower than that of Renneboog and Zhao's study. Although the sample size of this study is smaller and the sample is taken only from the FTSE 100 rather than the full listings on the market, it may actually represent a drop in insider ownership for non-executives suggesting greater conformity with governance standards. However, smaller companies outside the FTSE 100 may have directors with a higher equitable percentage due to a smaller called up share capital or founders sitting as directors on the board, which may account for the difference.

Three sectors can be identified as ones where the directors owned higher amounts of equity in the company and these may explain the differences in the mean and median, which are highly skewed. General mining (mean executive/non-executive - 49.8%/1.9%), oil and equipments services (27.6%/0.7%) and financial services (11.0%/4.4%) all had insiders who owned a significant portion of the company's share capital. Kazakhmys had the highest executive ownership whilst Schroders NV had the highest non-executive ownership. Due to the distribution, as with remuneration, it would be more accurate to rely on the median figures to make generalisations about insider ownership.

Table C: Equity Ownership Breakdown

Variable (n = 150)	Min	Max	Mean	SD	Median
Executive Ownership (%)	**0.00**	**59.92**	**3.80**	**10.69**	**0.08**
2006	0.00	59.92	3.92	12.25	0.07
2007	0.00	52.84	3.59	11.07	0.09
2008	0.00	45.43	3.20	9.54	0.08
2009	0.00	45.43	4.11	10.49	0.08
2010	0.01	45.43	4.16	10.61	0.10
Non-Executive Ownership (%)	**0.00**	**8.10**	**0.29**	**0.97**	**0.01**
2006	0.00	2.50	0.25	0.64	0.01
2007	0.00	2.54	0.24	0.63	0.01
2008	0.00	8.10	0.43	1.52	0.01
2009	0.00	4.83	0.31	0.96	0.01
2010	0.00	4.80	0.23	0.88	0.01

4.1.4 Agency Problems

This study uses nine proxies to see if there is a relationship between agency problems and multiple directorships for non-executives. These nine proxies are the ratio of LTIS to fixed remuneration; executive ownership; executive multiple directorships; ratio of independent directors to executives; board size; number of board meetings; number of remuneration committee meetings; number of board meetings missed; and CEO-Chair duality.

The ratio of independent directors to executives and board size was determined using the FTEs. Under the Code companies are advised to have at least half the board represented by independent directors.[45] In most companies the ratio was at least 1:1 or higher. On the rare occasion that it fell below 1 this was normally due to board rotation or unexpected retirement.

As for board meetings missed it was only possible to measure this for directors who had served for the full year. This was due to a lack of available data on meeting attendance for those joining and leaving the board during the year. When testing for agency problems and board meetings missed both non-executive and executive non-attendance were included. When identifying board size agency problems it was determined that a board that was too big or too small would be deemed to present an agency problem.

To determine whether there was an agency problem in a company a subjective scale approach was adopted. Agency problems were scaled between 0-5 except in the case of CEO-Chairman duality where it was scored 0-1. The greater the agency concern the higher the score was awarded depending on pre-determined thresholds. For example, fewer independent directors to executives was considered an agency problem. Therefore as the ratio of independent directors to executives decreased the higher the score awarded. The 0-5 scale

[45] UK Corporate Governance Code 2010, para B.1.2

was used where it was possible for it to be considered no agency problem i.e. where no meetings were missed or there were no executive multiple directorships, otherwise the scale was 1-5. For board size a similar approach was adopted to that of the first method. Where the board sized moved away from the centre, the bigger the agency concern.

Table D details the descriptive statistics of these different agency problems. Executive directorship and ownership details are outlined in Tables A and C and are not repeated here. For duality of CEO-Chair there were twelve incidences of executive chairs serving a full year over the five year period and three incidences of an executive chair stepping down showing a move towards all companies separating the role, in order to comply with the code.[47] Over all the company years the incidence of an executive chairing the board was 11.3% and 8% for those serving the whole year.

From the data it is observed that executives on average can potentially earn £3 in performance pay for every £1 of fixed remuneration. Therefore, potentially, three quarters of a director's overall compensation package is performance related. The biggest ratio of LTIS to fixed remuneration was in the banking and financial services sectors. The median ratio across all company years from the dataset was 3.10. There is also one and three quarter independent non-executives to every executive with the highest average over the five year period in the food producers sector with Unilever. Petrofac in the oil equipment and services sector had the lowest average ratio for independent directors.

It is the Code's requirement that directors have enough time to fulfil their duties but it is noted that in one instance the board of directors between them missed a total of 35 meetings despite the average number of meetings held a year being between 8 and 9. This suggests that companies with more appointments may be unable to fulfil all their commitments and are

[47] UK Corporate Governance Code 2010, para A.2.1

taken as perquisite consumption evidenced by the increase in the agency problem. For board size it was seen in Table B that the median was a ratio of 4:7.5 executives to non-executives.

Overall Table D shows the highest level of agency problems was 29 out of 41, which three companies scored. These scores were attributed to Kazakhmys in 2006; Arm Holdings in 2009; and HSBC Holdings in 2010.

While Table D details the scores of individual company's agency problems it was considered that it is natural for most companies to have agency problems. For example, companies are likely to pay directors a fixed fee and LTIS awards. Ultimately, there is no escaping some forms of agency problems where there is dispersed ownership. With this in mind, indicator variables were created to identify whether companies had an agency problem beyond what may be considered "normal". To identify whether a company had an agency problem for each individual variable in this regard, the frequency of agency problems were analysed to see how many companies scored each result between 0-5 or 1-5. The category where the top 25% of results fell and above was used as the indicator of whether the company did or did not have an agency problem. It was presumed that those scoring low on the agency scale were representative of normal company behaviour. Those with an agency problem were given a value of 1 and those that did not were given the value 0. As well as indicating whether a company had a specific agency problem, these individual indicator variables were tallied up to identify the total number of agency problems a company had.

Table D: Agency Problems Breakdown

Variable (n = 150)	Min	Max	Mean	SD
Board Meetings	4	25	8.59	2.61
Remuneration Committee Meetings	0	14	5.50	2.32
Board Meetings Missed	0	35	3.81	4.31
Ratio Independent:Executives	0.63	6.67	1.75	0.90
Ratio LTIS:Fixed Remuneration	0.35	14.84	3.65	2.54
Board Size	6.00	20.50	11.9	2.89
Agency Problems	**11**	**29.00**	**20.43**	**3.73**
2006	16	29	21.80	3.50

2007	13	26	20.37	3.30
2008	11	27	20.47	3.79
2009	14	29	20.17	3.67
2010	12	29	19.33	4.14

This gave data for both a total indicator agency problem variable and the individual indicator agency problems. The latter allowed the tests to be taken one step further. The regression model for the individual agency problems will identify any significant relationships between these agency problems and multiple directorships. Those agency problems that had a significant relationship with multiple appointments were used to create dummy variables. The dummy variables were created based on how many significant agency problems a company had. Thus, for example, if a company had one agency problem from those identified as significant from the individual analysis then they would be given the value of one under the variable “one significant agency problem”. Depending on how many significant agency problems there are, all the other dummy variables, i.e. “two significant agency problems”, would be given the value of 0. These dummy variables could then be used to test Hypothesis 3 and see if multiple appointments relate to these significant agency problems.

4.2 Regression models

4.2.1 Non-executive influences

Non-executive remuneration and non-executive equity holdings were built in to the model using the average totals of both variables to predict the FTE of non-executive multiple directorships as the dependent variable. The reason behind using the FTE for the outcome is that the study is at company level and thus a measure of company rather than individual behaviour *per se*. The results will help illustrate why companies have non-executives who have more external appointments. A larger board is likely to have more multiple directorships and higher remuneration due to the volume of directors. The averages of these predictors therefore provide a more accurate reflection of the conditions that facilitate multiple appointments.

Building agency problems into the regression model was done using the total agency problems indicator variable as opposed to the subjective scale. As well as including the total indicator variable in to the regression model to determine whether there is a relationship between agency problems and multiple directorships, each individual indicator variable agency problem was included in a separate model. This helped identify individual agency problems that had a significant relationship with external appointments. Four significant agency problems were identified: total board meetings missed, the presence of an executive chairman, executive equity ownership and the ratio of independent directors to executive directors. After identifying the individual agency problems, dummy variables were created showing whether companies have one, two, three, or four agency problems. The variable "four significant agency problems" was omitted from the analysis because no company was identified as having these. These variables were used in a regression model to test whether the significance of predicting non-executive multiple directorships increased as companies had more of these agency problems.[50]

4.2.2 *Multi-level regression analysis*

To further understand the factors that impact on external directorships for non-executives the regression analysis will be run for individual years to investigate whether economic conditions can impact on the decisions to take external appointments.

Therefore two further regression models are analysed. This analysis is conducted by looking at pre and post financial crisis. Therefore the years 2006-2007 are compared against

[50] The final regression model is: (1) NED Multiple Directorships$_i$ = β_0 + β_1NED remuneration$_i$

+ β_2NED equity$_i$

+ β_3 one sig. agency problem$_i$

+ β_4 two sig. agency problems$_i$

+ β_5 three sig. agency problems$_i$

the years 2008-2010. However in business change can take time. Thus any impact of the financial crisis on company behaviour may not be immediately apparent. This may bias results as changes take place. Therefore the analysis compares 2006-2007 to 2009-2010 and omits the year 2008. The same tests are run again this time omitting both 2008 and 2009 and comparing 2006-2007 against 2010.

5. RESULTS

5.1 Non-executive appointments and corporate governance influences

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Initially a correlation analysis was conducted to observe relationships between non-executive multiple directorships, equity, and remuneration and the company's agency problems, using the indicator variable. From the analysis it was observed that there is a significant positive correlation between non-executive appointments and their remuneration and negative with equity holdings. This correlation analysis shows early indication that whilst increased remuneration may create additional perquisite consumption by non-executives, equity holdings may serve as a check on over consumption. There was a non-significant negative relationship between non-executive multiple directorships and the agency problem indicator. Therefore, those with more appointments may not necessarily shirk their responsibilities. Whilst there is no significant relationship between these variables, there was one between equity holdings and agency problems. The relationship suggests that whilst equity may serve as a check on over consumption of additional appointments, it is also associated with more agency problems and bad corporate governance. Thus, where equity ownership of non-executives increases they may become more dependent on the company, which results in increased agency problems. This supports Masulis and Mobbs' study that non-executives who are reliant on the company become less effective monitors as well as

Renneboog and Zhao's study which saw non-executive owners as less effective monitors.[52] As such, increased equity ownership may not be a sufficient resolution to curbing excessive consumption of additional appointments for non-executives.

Table E: Non-Executive Multiple Directorship Predictors

	B	SE B	β	Sig.	t
Constant	11.70	2.39			4.91
Remuneration	4.283E-5***	.000013	.27	.001	3.30
Equity	-16.69***	4.34	-.31	.000	-3.85
Agency Problem (Indicator)	.81	.44	.16	.066	1.85

$R^2 = .15$; $F = 8.47$. *** $p < .001$
Dependent Variable: Non-Executive Multiple Directorships

From Table E it is observed that both remuneration and equity significantly contribute to predicting the number of non-executive external appointments, whilst agency problems do not significantly contribute to the model. The model offers evidence that non-executives do view additional appointments as a form of perquisite, supporting Hypothesis 1. It seems that a company offering higher remuneration does not deter non-executives from taking additional appointments. This could be countered by rewarding non-executives in equity, which provides support for Hypothesis 2, that when the non-executive's wealth is tied to the value of the company they will accept fewer appointments. However, a company would have to be mindful of any trade off this may have with increased agency problems for the company. Hypothesis 3, that non-executives will hold fewer appointments where agency problems are higher, is not substantiated by this model.

To continue the analysis the indicator agency problem variable was replaced by the individual agency problems in the regression model in order to identify any individual agency problems that significantly predict the outcome of non-executive external appointments. These were identified as those situations where there was a duality of chairman-CEO; low

[52] L Renneboog and Y Zhao, 'Us knows us in the UK: On director networks and CEO compensation' (2011) 17(4) *Journal of Corporate Finance* 1132, 1150

executive equity ownership; the ratio of independent directors to executives and the number of board meetings missed. With the exception of the ratio of independent to executive directors all agency problems demonstrated a positive correlation with non-executive multiple directorships. Therefore non-executives are more likely to take more external directorships where there is a duality of chairman-CEO and where directors collectively miss more meetings. Where executives hold less equity the results show that non-executives hold more external positions when the agency problem of reduced equitable ownership for executives arises. Coupled with situations where more meetings are missed and the control of the board is with one individual it is suggestive that monitoring may be weaker in companies with a larger number of non-executive appointments. This is similar to what Booth and Deli observed in regard to a CEO's decision to take additional appointments where there was a lack of growth opportunities in the home company. The control of the board may reduce the influence non-executives can have thus they choose to exert their influence and commit their time elsewhere. The evidence here is suggestive that where there is less need for non-executives, or they have less influence, they will hold more appointments.

Where the ratio of independent directors to executives is lower and thus creating generating greater agency problems, the number of non-executive appointments fall. This offers some support for Hypothesis 3 that non-executives will need to dedicate more time to the company as there is potentially more work to be done as there are fewer individuals to monitor the executives. However, this finding may also reflect that boards with a lower ratio are smaller in general, and thus non-executives will have a smaller number of external appointments.

These findings also reject what Ferris *et al* found regarding meetings attendance.[53] Whilst no significant relationship was found with the amount of meetings held and external

[53] S Ferris, M Jagannathan and A Pritchard, 'Too Busy to Mind the Business? Monitoring by Directors with Multiple Board Appointments' (2003) 58(3) *The Journal of Finance* 1087, 1096

appointments, it was observed that more meetings are missed where there are a higher number of external appointments. Thus the "busyness hypothesis" is supported and supports the notion that additional appointments are a form of perquisite consumption resulting in less effective monitoring.

Table F outlines the results for these four individual agency problems using dummy variables. The interesting observation is that it is not the existence of agency problems that matter, rather it is the concentration of a large number that makes a difference. The results demonstrate a positive relationship between the presence of a wide range of significant agency problems and multiple directorships. Therefore the results do not support Hypothesis 3. Rather it appears where a company has increased agency problems their non-executives have additional directorships. In consequence having directors with additional appointments may not result in better monitoring as submitted by Masulis and Mobbs since the results demonstrate agency problems increasing with external appointments. This offers more support for the notion that additional appointments for non-executives are perquisite consumption and without sufficient controls this could lead to increased self-interest.

Table F: Significant agency problems

	B	SE B	β	Sig.	t
Constant	13.05	2.10			6.23
Remuneration	3.584-E**	.000013	.22	.005	2.85
Equity	-16.15***	4.19	-.30	.000	-3.86
One sig. agency problem	1.91	1.58	.12	.227	1.21
Two sig. agency problems	2.45	1.81	.13	.177	1.36
Three sig. agency problems	7.05*	2.59	.23	.007	2.72

$R^2 = .17$; F = 5.99; *p <.01, **p <0.05, *** p <.001
Dependent Variable: Non-Executive Multiple Directorships

5.2 Multi-level analysis

There are certainly significant observations to be made from pre and post financial crisis. Eisenhardt and Schoonhoven predicted that external appointments would increase in difficult market conditions. However, it was hypothesised that their decline in worth in the managerial labour market would result in fewer additional appointments post-crisis. It is observed that pre financial crash the number of external non-executive appointments is higher when remuneration is higher, equity is lower and agency problems exist.

The influence of equity is certainly more pronounced pre crisis. For years 2006-2007 for every one standard deviation in equity non-executives owned (.13493) there would be -4.97 non-executive appointments. Therefore a one standard deviation increase in equity reduces external appointments by 27%. In comparison to remuneration for every one standard deviation increase this would raise external appointments by 16%. As a result equity can have a larger impact on external appointments than remuneration. Therefore before the crash if a company was to compensate its non-executives with £100,000 in total there would be 5.36 external appointments. If the company was to increase that to £200,000 there would be 10.72 external appointments. With equity though there is a much sharper impact with the increase in equity. Where non-executives owned 0.1% of the equity there would be 3.70 fewer external appointments and for 0.2% there would be 7.38 fewer. Thus, whilst increased equity may create more agency problems it may be easier to balance the trade-off since you may not have to award as much equity to prevent additional appointments resulting in excessive perquisite consumption and thus reducing the potential for agency problems.

After the crisis figures for 2008-2010 demonstrate that one standard deviation increase in equity (.15681) would result in only -1.69 external appointments. Therefore one standard deviation after the crisis only accounts for a 9% reduction in external appointments. That is almost half of what was the case in 2006-2007. 2009-2010 demonstrated only a -1.28 decrease in external appointments for every one increment in standard deviation (.13582) for equity. Comparing again to remuneration for non-executives one standard deviation increase would raise external appointments by 11%. After the financial crisis, remuneration has a bigger influence on the outcome than equity. Therefore, remuneration in comparison to equity was more important post crisis, but still had a smaller overall impact on the outcome when compared with 2006-2007. Using the example above, the model predicts that if non-executives are rewarded £100,000 there will be 4.52 external appointments and 9.04 for £200,000. Compared to equity, where non-executives hold 0.1% equity there would be 1.06 fewer appointments. If that increased to 0.2% there would be 2.13 fewer. As a consequence companies may have problems in curtailing excessive additional appointments with increased equitable ownership due to the potential for increases in agency problems it brings and the smaller effect it has. This may be a result of the decrease in opportunities in any one company so the non-executive spreads their risk by taking more appointments to increase their *ex ante* remuneration as they see *ex post* equitable incentives as unattainable.[54] As such whilst increased appointments may bring about an increase in resources in difficult market conditions the evidence suggests that it may result in perquisite consumption that is harder to control.

While equity appears to have less impact post-crisis, remuneration plays a similar role in predicting non-executive appointments pre and post crisis. This offers support for the need for regulation of multiple directorships when equity stops becoming an effective check on additional appointments. Thus this study does not support Renneboog and Zhao's findings that those who are more constrained will earn higher fees. If multiple directorships are capable of helping a company survive in difficult market conditions however, it would appear that higher compensation will help facilitate the creation of them.

Agency problems were also shown to have a significant positive relationship with non-executives' additional appointments pre-2008. Yet, after the financial crash that significant relationship disappeared. Before 2008 this supported the notion that those with fewer appointments are better monitors. However, post-crash boards do not necessarily have

[54] See, J Booth and D Deli, 'Factors affecting the number of outside directorships held by CEOs' (1996) 40(1) *Journal of Financial Economics* 81

more external appointments relative to agency problems. Therefore the hypothesis that non-executives will hold fewer appointments where there are more agency problems is rejected before the financial crisis and is not substantiated afterwards. This supports what Ferris *et al* argued that executives may be able to impose higher agency costs on the company where the non-executives hold more external appointments.

The reason behind this change may be a change in corporate culture as illustrated by the call for monitoring from non-executives as in the Walker Review. Non-executive board members may have been inclined to ensure governance in a company was improved and thus minimising the relationship between agency problems and external appointments. Companies may also wish to be perceived as aiming to improve corporate governance standards and thus minimising agency problems by moving more in line with the Code.

6. CONCLUSIONS

From the analysis, whilst the law might protect against the more severe forms of self-interest that a non-executive might engage in, there is little ex ante control. The relationship between the company's corporate governance systems and non-executives' external appointments is complex. While the existing arguments on regulating additional appointments seem to favour no regulation in the UK, the empirical evidence above provides an insight, and in many instances appears to support the call for tighter regulation of external appointments. It seems non-executives may be taking additional directorships as a form of perquisite consumption as well as increasing their external commitments allowing for executives to impose higher agency costs on the company. The concentration of agency problems having a positive relationship with additional appointments is evidence of this. While governance mechanisms, such as equity, may be able to reduce the amount of external appointments this may not be an adequate way of reducing self-interest *ex ante* amongst non-executives. Equity awards had a significant correlation with agency problems in the company and its significance in relation to how many external appointments the non-executives will hold since the economic recession in 2008 has reduced compared to its significance pre-2008.

The evidence that non-executives with more external appointments may be less effective monitors is supported by a positive relationship with board meetings missed and other key agency problems in the company. As well as these findings, despite the calls from reports such as the Walker Review for non-executives to become more involved and annual reports declaring that non-executives are required to be paid more due to their increased involvement,[55] that increase in remuneration appears to be resulting in non-executives taking additional appointments as perquisite consumption. The reduced significance that equity has on checking this consumption post-crisis may be particularly worrying in ensuring effective monitoring. Thus the provisional data collected here would urge caution on policy decisions that focus on increasing non-executive appointments without first considering the impact it may have on the company's governance and the non-executives' self-interest.

Where business and self-interest are endlessly diverse, it seems fundamentally flawed that independence is enough to deny self-interest. Governance models should be mindful that increased involvement from non-executives might not have the desired effects of improving corporate governance since the incentives for non-executive directors are not yet fully appreciated. This study offers evidence that non-executives are similarly incentivised compared to executives and without checks on that self-interest, problems can occur.

[55] Walker Review, (November, 2009) para 2.7