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**THE SHAREHOLDER WEALTH EFFECTS OF AN EXECUTIVE
JOINING ANOTHER COMPANY'S BOARD**

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The shareholder wealth effects of an executive joining another company's board

Abstract

Using a sample of 134 announcements of an executive joining the board of another company from 1985 through 1997, we find a negative announcement date stock response of about one-half of one percent for the home firm. Our initial regression analysis shows that the prior performance of the home firm, how close the executive is to retirement, and the number of other boards the executive already sits on, help explain the cross-sectional variation in the announcement date stock returns. The stock price response we report is larger (more negative) than that found by Rosenstein and Wyatt (1994) during an earlier sample period. We attribute the difference in our findings to investors being much more attuned to corporate governance issues during our sample period.

Introduction

A company's chief executive officer is the single person most responsible for a company's success or failure. The CEO directly affects the company's strategic direction as well as its major financial, marketing and operating decisions. Through the choice of subordinates and articulation of corporate policy and culture, the CEO is indirectly involved in almost all aspects of corporate activity. Because these tasks require a broad set of talents and enormous energy, the CEOs of large companies are highly compensated. Not infrequently, however, corporate CEOs join the boards of other publicly-traded companies. CEOs and other high-level corporate officers make ideal director candidates because of their management experience and awareness of economic conditions. Lorsch and MacIver (1989) report that 69% of outside directors are active CEOs at other firms. A more recent survey by the management recruiting agency Spencer Stuart (2001) found that in 2000 47% of outside directors are active CEOs, corporation presidents or COOs. The Spencer Stuart survey also reports that on average a corporate CEO holds 1.2 other corporate directorships. Booth and Deli (1996) found that CEOs of S&P 500 firms in 1990 held 1.87 other directorships on average. S&P 500 companies average eight board meetings per year, though for individual firms the number of meetings ranges from to over 20 (Spencer Stuart, 2001). In accepting a board seat, an executive commits an average of 8 to 10 days per year to help oversee the affairs of another company. The time commitment can be much larger depending on required preparation and travel time and the particular board-level events of the company. This commitment reduces the time the executive can devote to the company they manage and

that pays their salary. Commentators have begun questioning whether CEOs should join other boards (Dobrzynski, 1996).

Sitting on another company's board obviously takes time that could be expended on the affairs of the home firm. Presumably a CEO would explain to the home firm board how these extra duties help create value for shareholders. Various hypotheses have been suggested for the value of an active CEO sitting on other boards. Bacon and Brown (1974) argue that serving on the board of another firm may help CEOs become more effective managers within their own firms. Watching other experienced managers, seeing different management styles in action, gathering information about economic trends, and having other CEOs with whom to confer, are some of the examples of how sitting on a board might make a CEO more effective and thereby create value for home firm shareholders.

Agency theory suggests that managers may not always act to maximize shareholder wealth (Jensen and Meckling, 1976). If so, the decision to join another board could be pursued so the executive increases the value of his/her human capital or prestige (Mace, 1986). In this case the benefits of sitting on another company's board accrue primarily to the executive. If these board duties reduce the executive's efforts on behalf of the shareholders of the home firm, then joining another board could be value decreasing for those shareholders. Booth and Deli (1996) argue that companies with many growth opportunities have the greatest need for the investment decision expertise of the CEO. If

the CEO expends effort elsewhere, for example as a member of another company's board, he or she has less time to devote to the concerns of the home firm.

Previous research

As detailed empirical studies of board of director activities are relatively new, few have examined the effect of an officer joining another company's board. The most relevant study, Rosenstein and Wyatt (1994), provides the pattern for this research. Rosenstein and Wyatt examine the stock price response at the announcement of an officer of a firm is joining the board of another company. Using data from 1981 through 1985 they report an average negative stock price response of 0.11% for the executive's home firm at the announcement of the appointment. This announcement date abnormal return is not statistically significant (Z-statistic of -0.69) but the average 4-day return just prior to the announcement is significantly negative. In cross-sectional tests, they find that the prior performance of the home firm, labeled 'sending firm' in their paper, is positively correlated with the abnormal return from five days prior to through the announcement date. They interpret this result as implying that companies with poorer performance need their executive officers to devote their efforts to home firm activities, not to other companies whereas better performing firms may not be hurt by their executives joining other boards. They also find that the abnormal return is negative for non-financial corporations but positive for financial companies. This positive stock price response may be due to officers from financial firms being able to generate new business when they join another company's board.

Booth and Deli (1996) examine factors that determine the number of other boards a CEO joins. They find that CEOs of companies with more growth opportunities (measured as market-to-book ratio and whether the company is regulated) sit on fewer boards than do other CEOs. They also find that the longer a CEO has held the position, the more outside directorships the CEO holds. They interpret this as being consistent with the suggestion that after a certain tenure in the position a CEO begins to hand decision authority to a successor. However, joining additional boards could also represent opportunistic end-game behavior on the part of a CEO (Dechow and Sloan, 1991).

The current study extends the work of Rosenstein and Wyatt (1994) in two ways. We use data from 1986 through 1997. This period saw a tremendous change in the role of the board in corporate governance as well as outside scrutiny of the board by institutional investors. Thus, the reaction to active CEOs joining other boards may be different than during the earlier, and presumably more benign, period. Second, we examine several variables Rosenstein and Wyatt (1994) did not include that could potentially explain the extent to which accepting an outside board position affects an executive's effectiveness within the home firm. These variables include the number of other board seats the executive holds at the time of the announcement, whether the executive is near retirement, and the executive's position in the home firm (vice-president, president, CEO, or chairman of the board).

Sample selection

We follow the sample selection process of Rosenstein and Wyatt (1994). We examine all of the weekly ‘Who’s News’ announcements in the *Wall Street Journal* from January 1986 through December 1997. All announcements of director appointments of a corporate officer are collected. If the home firm of the newly appointed director is a publicly-traded corporation and there are no potentially confounding announcements in the *Wall Street Journal Index* for the three trading days surrounding the announcement date, the observation is eligible for our sample. To be included in the final sample, the company must have returns data on the CRSP file for 250 days prior to the announcement date and a proxy statement must be available that lists variables for the executive, such as age and other board seats held. Our final sample consists of 134 announcements by 119 different companies. Nine firms appear twice and three firms appear three times. The time distribution of observations is shown in Table 1.

Insert Table 1 here

Over a five year period Rosenstein and Wyatt (1994) developed a sample of 124 observations. Although we include NASDAQ firms, which Rosenstein and Wyatt did not, our final is about the same size sample as theirs, despite being collected over a longer sample period (13 years in our study compared to just 5 years in their study). This difference in sample sizes can be attributed in part to our additional screen of requiring a proxy statement be available for each sample firm. The smaller sample might also be

explained by fewer director appointments being made in the late-1980s and 1990s than in earlier periods (Spencer Stuart, 2001).

Univariate results

Panel A of Table 2 presents the summary statistics for the 2-day abnormal announcement date returns for our sample of announcements of executives joining the board of another corporation. Almost 60% of the announcement date abnormal returns are negative. A sign test shows that this proportion is significantly different that a 50% probability of obtaining a negative return at a significance level of 4%. The average abnormal return is -0.37% and the median is -0.43%. Neither of these measures of central tendency are statistically significant at standard levels using a two-tailed test. These results, though not statistically significant, differ from those presented by Rosenstein and Wyatt (1994). They found a 2-day abnormal return of just -0.11% during their sample period of 1981 through 1985. The larger stock price response reported here may be due to more investor interest in corporate governance issues since the late 1980s.

Rosenstein and Wyatt (1994) find a positive stock price response for financial firms whose executives join the boards of other companies. Eliminating financial firms from the sample we find that the average abnormal return is negative and statistically significant (p -value = 7.1%). These results are reported in Panel B of Table 2. The results in Panel B of Table 2 are consistent with an executive joining the board of another company being seen as reducing the value of the home firm. Investors appear to value

the loss of managerial effort or expertise more highly than any benefits the executive might derive from observing the workings of another corporation.

Insert Table 2 here

Other univariate tests compared the abnormal returns by job title. We find no statistical difference in the abnormal returns between executive positions. That is, there was no significant difference in the abnormal returns for CEOs joining another company's board versus non-CEOs, and similarly for vice-presidents, presidents and board chairs.

Multivariate results

We use cross-sectional regression models to more closely examine the factors that might affect the response of investors to the announcement that an executive is joining the board of another company. The dependent variable is the two-day announcement date abnormal return for each sample firm. Rosenstein and Wyatt (1994) find that prior performance is a significant explanatory variable in regressions of the six-day announcement date abnormal return. As a measure of prior performance we used the market-adjusted returns (Firm return minus the CRSP equally weighted index return) for the pre-announcement estimation period of day -250 through day -10 relative to the *Wall Street Journal* announcement date. Booth and Deli (1996) suggest that CEO succession can free an executive to be on other boards as they transfer authority to their successor. To capture this notion we include a variable that is assigned the value 1 if the executive is 60 years old or older. One of our concerns in the present study is whether the growing

investor interest in corporate governance issues, particularly related to the CEO and board of directors, applies to executives joining the boards of other companies. One aspect of investor concern is that key executives are spreading themselves too thin when they join other boards (Dobrzynski, 1996). We use an indicator variable assigned the value one if the executive sits on three or more boards (corporate or not-for-profit) at the time of the announcement about joining another board. We include variables for the position the executive holds in the home company. These are indicator variables for CEO, chairman of the board, president or vice-president. We also include an indicator variable to designate situations in which a single executive is both CEO and chairman of the board. The coefficient estimates from regressions using all or some of these variables are reported in Table 3. The t-statistics are based on consistent standard errors using the methods of Huber (1967) and White (1980).

Insert Table 3 here

The regression results presented in Table 3 show that there is a significant negative relationship between the announcement date abnormal return and prior performance (measured over the 250 days before the announcement). This result is opposite of that found by Rosenstein and Wyatt (1994). Our result implies that poor performing firms will have a more positive announcement day effect than will firms performing well; that is, investors seeing executives joining other boards as better news for firms that have had poor stock market performance immediately prior to the announcement date. This result is counter-intuitive. Rosenstein and Wyatt (1994) suggest that the positive association

they find implies that shareholders of poor performing firms do not want their executives dissipating their efforts outside of the firm. Our contradictory result could be explained as investors in poor performing firms seeing value in executives gaining expertise by observing the workings of another company (Bacon and Brown, 1974). The negative relationship could also arise if investors interpret the selection as an indication of executive quality. Robustness tests find no outliers or influential observations driving the result.

The remaining statistically significant coefficients lend themselves to more standard interpretations. The positive coefficient on the 'Near Retirement' variable is consistent with older executives beginning to prepare for succession with shareholders interpreting the additional board positions as having future benefits to the home firm. The negative coefficient on the '3 or More Boards' variables implies that investors view an executive with too many outside duties as reducing the value of the home firm. This result is consistent with the 'being spread too thin' criticism leveled at executives who sit on many boards.

Models 4, 5 and 6 suggest that there might be some complex interactions between the three key explanatory variables. Initial regression diagnostics identified one potential influential observation. Re-estimating the models in Table 3 with this observation excluded changed the significance level of the '3 or More Boards' from roughly 10% (Models 1, 2 and 3) to 24%.

Remaining Work

Booth and Deli (1996) find that firm growth opportunities explain how many boards a CEO sits on. We will collect similar data to determine if the investor reaction to an executive joining another firm is also affected by the nature of a company's assets. We plan to update the sample into 2000 or 2001 and collect more governance data such as the proportion of independent outside directors on the home firm's board (Byrd and Hickman, 1992).

Conclusions

Using a sample of 134 announcements of an executive joining the board of another company from 1985 through 1997, we find a negative announcement date stock response of about one-half of one percent for the home firm. This announcement date response is more negative when financial firms are excluded from the sample. Our initial regression analysis shows that the prior performance of the home firm, how close the executive is to retirement, and the number of other boards the executive already sits on, help explain the cross-sectional variation in the announcement date stock returns. The stock price response we report is larger (more negative) than that found by Rosenstein and Wyatt (1994) during an earlier sample period. We attribute the difference in our findings to investors being much more attuned to corporate governance issues during our sample period.

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Table 1
Time distribution of the sample

Year	Frequency	% of Total
1985	2	1.49
1986	7	5.22
1987	2	1.49
1988	10	7.46
1989	5	3.73
1990	7	5.22
1991	12	8.96
1992	24	17.91
1993	16	11.94
1994	13	9.70
1995	14	10.45
1996	14	10.45
1997	8	5.97
Total	134	100.00

Table 2: Summary statistics of the 2-day abnormal announcement date return**Panel A: Entire sample of 134 observations**

Measure	Abnormal Return	Statistic for hypothesis that abnormal return = 0	p-value
Mean	-0.369%	t-statistic = 1.607	11.04%
Median	-0.434%	t-statistic = 1.51	13.34%
Std. Dev.	2.66%		
Minimum	-8.99%		
Maximum	8.26%		
Number negative	79 (59%)	t-statistic = 2.073	4.00%

Panel B: Financial firms eliminated. Sample size is 127.

Measure	Abnormal Return	Statistic for hypothesis that abnormal return = 0	p-value
Mean	-0.423%	t-statistic = 1.82	7.1%
Median	-0.468%	t-statistic = 1.61	11.1%
Std. Dev.	2.62%		
Minimum	-8.99%		
Maximum	8.26%		
Number negative	76 (60%)	t-statistic = 2.22	2.82%

Table 3: Cross-section regression coefficient estimates of the two-day announcement date abnormal return on performance, age, position and other board commitment variables for 134 announcements that an executive of the sample company will be joining the board of another corporation. The t-statistics are based on consistent standard errors using the methods of Huber (1967) and White (1980) and p-values are in parentheses.

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Intercept	-0.414	-0.420	-0.545	-0.636	-0.426	-0.400
t-statistic	-1.152	-1.237	-1.973	-2.384	-1.720	-1.412
p-value	(0.251)	(0.218)	(0.051)	(0.019)	(0.088)	(0.160)
Prior Performance	-1.333	-1.332	-1.265	-1.084	-1.288	
t-statistic	-2.177	-2.172	-2.093	-1.713	-2.141	
p-value	(0.031)	(0.032)	(0.038)	(0.089)	(0.034)	
Near Retirement						
Age (60 or over)	0.819	0.819	0.738	0.533		0.771
t-statistic	1.896	1.909	1.717	1.266		1.846
p-value	(0.060)	(0.058)	(0.088)	(0.208)		(0.067)
On 3 or more						
Other Boards	-0.937	-0.934	-1.115		-0.930	-0.883
t-statistic	-1.373	-1.401	-1.685		-1.432	-1.312
p-value	(0.172)	(0.164)	(0.094)		(0.155)	(0.192)
CEO	-0.047	-0.020				
t-statistic	-0.072	-0.038				
p-value	(0.942)	(0.969)				
Chair	-0.503	-0.472				
t-statistic	-0.768	-0.952				
p-value	(0.444)	(0.343)				
CEO and Chairman of Board	0.068					
t-statistic	0.071					
p-value	(0.943)					
Number of obs=	134	134	134	134	134	134
F-statistic	2.01	2.43	3.80	2.89	3.79	2.17
F-statistic p-value	0.069	0.039	0.012	0.059	0.025	0.118
R-squared=	0.057	0.057	0.050	0.030	0.038	0.021