TIME IS MONEY

The Link Between Over-Boarded Directors and Portfolio Value

SBA FLORIDA
STATE BOARD OF ADMINISTRATION

GOVERNANCE BRIEF

JANUARY 2018

TIME IS MONEY

The Link Between Over-Boarded Directors and Portfolio Value

KEY TAKEAWAYS

-1.4%

HIGH DIRECTORSHIPS LINKED TO LOWER STOCK PERFORMANCE

Corporate boards with above average levels of directorships exhibited lower average 5-year stock performance of approximately 140 basis points (1.4%). For companies with the highest level of multiple directorships, those firms underperformed by 102 basis points (1.02%) when compared to the full stock universe. A near inverse relationship between the level of directorships and TSR was found in the data across the 1, 3, and 5 year time periods.

77%

MOST LARGE COMPANIES LIMIT OUTSIDE BOARD MEMBERSHIP

A strong majority of S&P 500 boards place limits on directors' acceptance of corporate directorships, up sharply over the last decade.

<4

SBA POLICY ENCOURAGES LESS THAN 4 DIRECTORSHIPS

SBA corporate governance principles advocate for each board member to limit the maximum number of simultaneous directorships to less than four boards. Numerous academic and industry studies point to the likelihood of both higher costs and lower performance when directors are "over-boarded."

26.2

AVERAGE SUM OF DIRECTORSHIPS ACROSS THE BOARD AT TOP 50 HIGHEST DIRECTORSHIP COMPANIES

At those companies with the highest sum of directorships among all board members, the level of full board directorships was 76 percent higher than the average firm, and their 1, 3, and 5-year stock performance is lower than other companies with lower average board directorships.

TIME IS MONEY

Are distracted directors lowering share-owner returns?

For the last two decades, the SBA has advocated limiting the number of simultaneous directorships held by U.S. board members. The SBA's Corporate Governance Principles & Proxy Voting Guidelines espouse non-CEO directors who are also employed full time to hold less than four simultaneous directorships. In line with this policy, SBA staff have routinely cast commensurate proxy votes based on this numerical threshold and applied the policy on a global basis, regardless of any home country bias or local market norms.

As part of the review of individual director service, we qualitatively examine other types of board membership including non-public entities (e.g., private companies), boards of trustees (e.g. for mutual funds), philanthropies, and foundations. So the analysis extends well beyond merely counting the number of public board seats an individual director maintains.

Over the last few years, numerous studies have found a negative link between "busy" directors and the financial and stock performance of companies.

One study found poor oversight and subsequent risks to investors from over-boarded individual directors, particularly at large financial institutions such as JPMorgan, Wells Fargo, and PNC. The study states, "...busy directors generally detract from firm performance and that the drawbacks of director busyness are more severe for larger firms." The authors stipulated that busy directors were less able to provide oversight of management and, thereby, increased the risk of firm failure of a regulatory or financial nature.

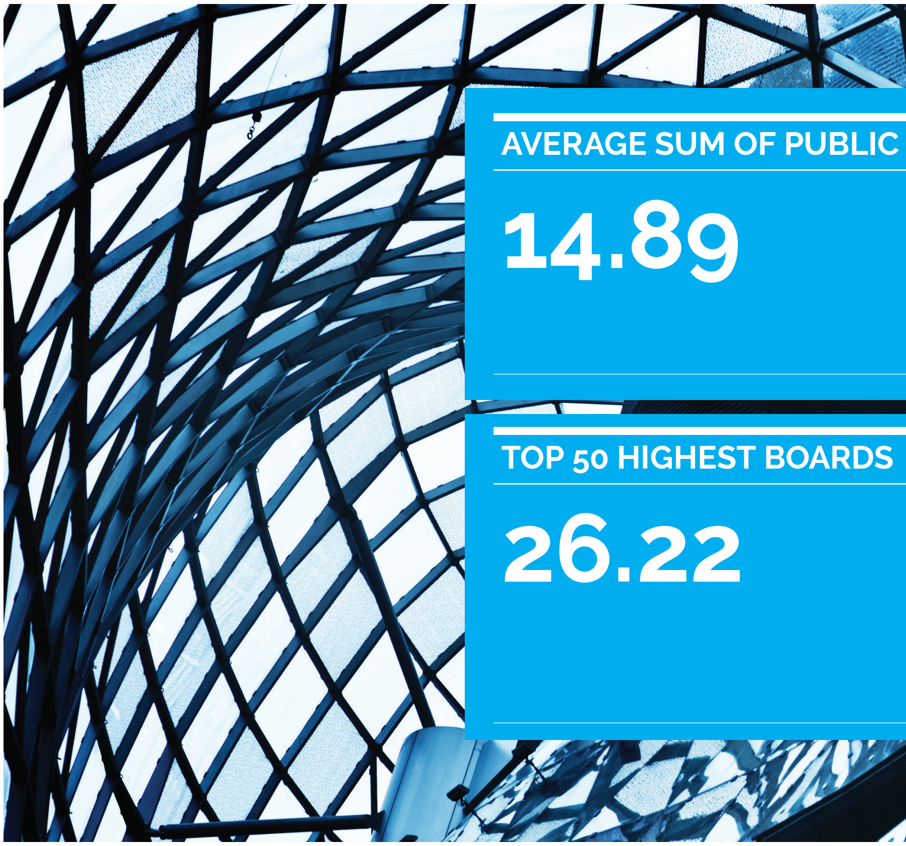
Equilar, a compensation consultant, recently analyzed director service levels for the Wall Street Journal and compared the figures to company performance. Equilar found that among the S&P 500 stock universe where Chief Executive Officers (CEOs) served on at least two outside boards, those CEOs earned median compensation 13 percent higher than those CEOs who served on zero outside boards. The average director compensation at large capitalization companies is approximately $290,000 a year. Equilar also found 1-year investor returns to be almost 50 percent lower at companies with over-boarded CEOs. This relationship also held for Chief Financial Officers, with CFO's serving on more than two outside boards exhibiting lower stock performance, lower revenue, and lower net income at their companies. Non-boarded CFOs with zero outside directorships had 1 and 3 year total stockholder return (TSR) of 15.6% and 10.4%, respectively, whereas companies with CFO's serving on 2 or more boards exhibited 1 and 3 year TSR of 9.3% and 3.3%, respectively.

According to a separate Equilar study, the percentage of director seats occupied by an individual that serves on multiple public boards increased from 48.6 percent to 53.6 percent over the past five years—with the percentage on four simultaneous boards almost doubling since 2012.

"BUSY" DIRECTORS

One study analyzed whether "busy directors", and in turn the busyness level of the entire board of directors, is either beneficial or harmful to share-owners. The authors hypothesized that busy directors may bring positive synergies across firms and potentially offer strategic interaction among all the directors on the board. Many critics of busy directors allege that such individuals don't have the time and resources to adequately monitor all the firms for which they serve. And as a result, they achieve poor levels of strategic management and oversight—that is, the corporate governance at those firms is less than what it would be if they were not over-boarded.

Because of this alleged deficiency, many investors oppose busy directors, either through direct engagement with



AVERAGE SUM OF PUBLIC BOARDS

14.89

Average sum of all directorships held by all board members at Russell 3000 stock index companies.

AVERAGE NUMBER OF BOARDS AMONG ALL INDIVIDUAL DIRECTORS IN THE INDEX EQUALS 1.65.

TOP 50 HIGHEST BOARDS

26.22

At those companies with the highest sum of directorships among all board members, the level of full board directorships was 76% higher than the average firm.

THESE COMPANIES EXHIBIT LOWER 1, 3, AND 5 YEAR TSR FIGURES.

the company or through proxy votes cast at owned companies. The researchers defined synergies as those that, "…arise when the information or expertise acquired in monitoring one firm is transferable across firms." They also noted that strategic interaction could arise from managerial misconduct or accounting fraud, fostering collaborative and increased effort to curb such management behaviors. The researchers found mixed results suggestive of busy directors only being harmful, "when the firms on whose boards she serves have so little in common informationally that tight time constraints result in negative monitoring synergies." Likewise, the authors found that firms may benefit when their common directors become busier on another of their boards.

Two other long-term studies published in the last year found that over-boarded directors impair share-owner value. One study developed a measure of director "distraction" and the other examined director and board-level busyness. Both studies found that over-boarded directors attended significantly fewer board meetings and were associated with lower performing companies (exhibiting lower market-to-book ratios and lower profitability). Researchers found these effects were reversed for younger companies, possibly due to positive effects of director networks for emerging and growing companies.

SBA Proxy Voting Guideline on Multiple Directorships

The following language is from the SBA's proxy voting guidelines:

Serving on too many boards ("over-boarding"): generally a director who serves on more than 3 company boards and who is employed in a full-time position. Directors with significant outside responsibilities such as serving as CEO of a public company should not exceed one external board membership. Surveys of directors have indicated that the average board membership requires over 250 hours of active, committed work, making service on multiple boards difficult for executives, particularly CEOs, and leading to many investors embracing similar limits as the SBA.

WANT TO FIND OUT MORE
ABOUT SBA POLICIES AND GOVERNANCE
RESEARCH STUDIES?

https://www.sbafla.com/fsb/Governance.aspx

SELECTED RESEARCH ON "BUSY" BOARDS

Busy Directors and Shareholder Satisfaction
Kevin Chen & Wayne Guay, Wharton School, University of Pennsylvania, December 2017

Abstract excerpt: "...the negative relation between shareholder satisfaction and busyness is smaller for retired directors, and is larger for directors who are full-time executives and who sit on boards where fiscal-year ends cluster in the same month. We also find that the potential expertise benefit of busy directors is more pronounced in early-stage firms, firms with higher CEO ownership, and firms with lower book-to-market ratios. Our analyses shed new light on the heterogeneity of busy directors and, more broadly, highlight the useful role of shareholder voting in board composition research."

Busy Directors: Strategic Interaction and Monitoring Synergies
Alexander Ljungqvist, New York University, Konrad Raff, Norwegian School of Economics, September 2017

Abstract excerpt: "we find that busy directors increase monitoring at spillover firms when synergies are positive (which we show increases expected firm value) and reduce monitoring at spillover firms when synergies are negative (which we show reduces expected firm value)."

Better Directors or Distracted Directors? An International Analysis of Busy Boards
Stephen Ferris, Trulaske College of Business, University of Missouri, Narayanan Jayaraman, Scheller Colleg of Business, Georgia Institute of Technology, Min-Yu (Stella) Liao, Illinois State University, August 2017

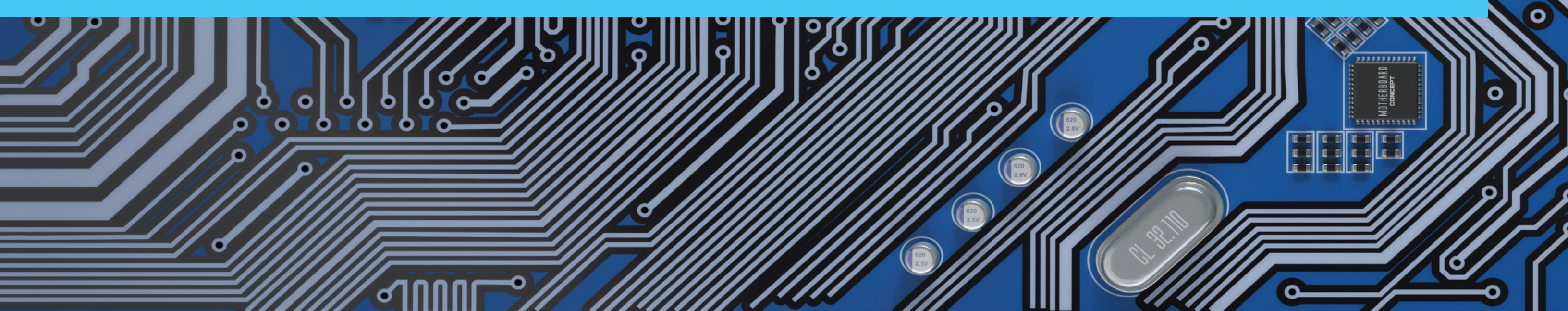
Abstract excerpt: "We find that busy directors and boards are a global phenomenon. We determine that firms with busy boards exhibit lower market-to-book ratios and reduced profitability. A demographic analysis shows that multiple directorships are positively associated with firm performance and education, but negatively associated with female directors."

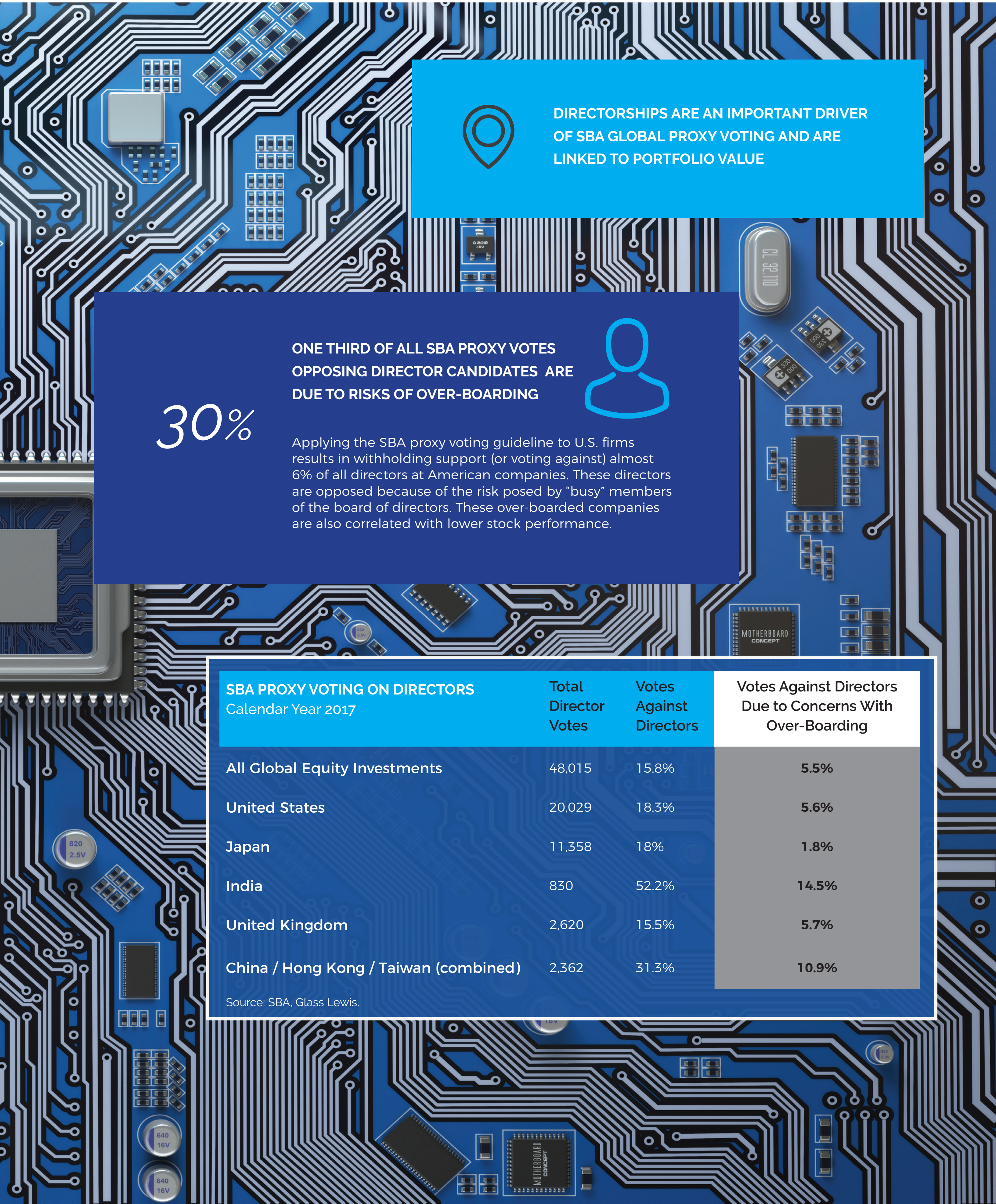
Director Attention and Firm Value
Rex Wang Rejie, Erasmus School of Economics, Patrick Verwijmeren, Erasmus School of Economics & Uniersity of Melbourne, June 2017

Abstract excerpt: "Directors attend significantly fewer board meetings when they are distracted. Firms with distracted board members tend to be inactive and experience a significant decline in rm value. Overall, this paper highlights the impact of limited director attention on the effectiveness of corporate governance."

Board to Death: How Busy Directors Could Cause the Next Financial Crisis
Jeremy Kress, Stephen M. Ross School of Business, University of Michigan, June 2017

Abstract excerpt: "This article argues that the directors of the United States' largest financial institutions are too busy to execute their governance roles effectively. These outside commitments provide important learning and networking opportunities that can enhance a director's effectiveness. Outside commitments, however, might also limit the time that a director spends assessing the firm's strategy and risk or contribute to cognitive overload. Over-committed directors, therefore, might consciously or subconsciously shirk their advising and monitoring responsibilities.





DIRECTORSHIPS ARE AN IMPORTANT DRIVER OF SBA GLOBAL PROXY VOTING AND ARE LINKED TO PORTFOLIO VALUE

30%

ONE THIRD OF ALL SBA PROXY VOTES OPPOSING DIRECTOR CANDIDATES ARE DUE TO RISKS OF OVER-BOARDING

Applying the SBA proxy voting guideline to U.S. firms results in withholding support (or voting against) almost 6% of all directors at American companies. These directors are opposed because of the risk posed by "busy" members of the board of directors. These over-boarded companies are also correlated with lower stock performance.

SBA PROXY VOTING ON DIRECTORS Calendar Year 2017	Total Director Votes	Votes Against Directors	Votes Against Directors Due to Concerns With Over-Boarding
All Global Equity Investments	48,015	15.8%	**5.5%**
United States	20,029	18.3%	**5.6%**
Japan	11,358	18%	**1.8%**
India	830	52.2%	**14.5%**
United Kingdom	2,620	15.5%	**5.7%**
China / Hong Kong / Taiwan (combined)	2,362	31.3%	**10.9%**

Source: SBA, Glass Lewis.

OVER-BOARDING HURTS RETURNS

In its own review of directorships at companies within the Russell 3000 stock index, SBA staff found that boards exhibiting an above average level of over-boarded directors were associated with lower average annualized total-shareholder-return (TSR).

Using data from Institutional Shareholder Services' (ISS) DataDesk database, SBA staff analyzed both the level of multiple directorships exhibited by the full board of directors and the sum of individual directors' multiple directorships. Examining data through October 2017, staff found that corporate boards with above average levels of directorship exhibited lower average 5-year TSR performance of approximately 140 basis points (1.4%). For those companies where the deviation was the most extreme—the top 50 companies by level of multiple directorship—firms underperformed by 102 basis points (1.02%) when compared to the full stock universe. A near inverse relationship between the level of directorships and TSR was found in the data across the 1, 3, and 5-year time periods.

As of October 2017, 63 directors within the S&P 500 stock universe served on five or more public boards, down from 83 in 2012.

UNDER-PERFORMANCE OF OVER-BOARDED FIRMS

-1.02%

Average level of directorship for the full board is calculated by dividing the total number of directorships held by all board members by the number of board seats.

1 OR MORE OVER-BOARDED DIRECTORS

1.88

Average directorship level of the full board was 14% higher at companies with 1 director exceeding the SBA voting guideline of less than 4 directors.

THESE COMPANIES EXHIBIT LOWER 1, 3, AND 5 YEAR TSR FIGURES.

TOP 50 FIRMS WITH HIGHEST # OF DIRECTORSHIPS

3.14

Average directorship level of the full board at the top fifty firms was almost double that of all companies.

THESE COMPANIES EXHIBIT LOWER 1, 3, AND 5 YEAR TSR FIGURES.

A MAJORITY OF U.S. DIRECTORS AMONG S&P 500 COMPANIES FACE RESTRICTIONS ON ADDITIONAL BOARD SERVICE

» 77% of S&P 500 boards have limits on directors' acceptance of corporate directorships, up from only 27% in 2006.

» 64% of boards set a numerical limit for other board service applying to all directors; of those, 4% cap additional directorships at two, 36% at three, 49% at four, and 11% at five or six.

» 24% of boards set restrictions for directors who are public company CEOs or are otherwise fully employed; most often, these directors are limited to two other outside public company boards. No board allows directors who are employed executives (CEOs or CFOs) to serve on more than three additional boards.

» Most companies do not restrict their CEOs from serving on outside boards. Only 22% of S&P 500 boards set a specific limit in their corporate governance guidelines on the CEO's outside board service; 65% of those boards limit CEOs to two outside boards and 32% set the limit at one outside board. Only one company does not allow the company's CEO to serve on any outside corporate boards.

» Fewer CEOs serve on outside boards: 33% of S&P 500 CEOs serve on one outside corporate board in addition to their own board, with only 4% serving on more than two boards. In 2006, 55% of CEOs served on at least one outside board.

Source: Spencer Stuart, U.S. Board Index 2017

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