Going overboard? Investors prefer directors who serve on fewer corporate boards

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Corporate directors, like most businesspeople, are busy—but according to investors, they can, in fact, be too busy.

New research from the University at Buffalo School of Management shows that when directors who serve on multiple boards resign, investors react positively at both the company they left and those that keep them on board.

"On one hand, sitting on several boards shows these directors are in high demand because of their reputation, experience and expertise," says study co-author Feng Gu, Ph.D., professor and chair of accounting and law in the UB School of Management. "But over the past 20 years, a director's responsibilities have increased significantly, and investors may assume that 'busy' directors will be distracted and devote less time to their company."

While the bulk of previous research focuses on director appointments, Gu's study is the first to examine the stock market impact of a director's resignation on the companies that retain them. The study appeared online this winter ahead of publication in the Journal of Financial and Quantitative Analysis in May.

First, the researchers compiled data from 1996 to 2016 on an average of more than 1,500 companies a year. They discovered that while the average board of directors has shrunk, the percentage of individuals who hold two or more board seats has increased from 26.8% to 40% of all directors.

From there, they zeroed in on a sample of 314 directors who resigned from a board position between 2004-07, a period before the recession when various regulations were increasing director responsibilities and investor scrutiny.

When news broke of these directors' resignation from one board, the companies that retained them saw positive cumulative abnormal returns over the next three days, the study found. The market reaction was stronger when a director's guidance was needed more, either because the director had specialized expertise or because the company was smaller or in a risky sector, like tech.

"Clearly, investors expected that by resigning these directors would be freed up to devote more time and attention to corporate governance—and our results indicate they were right," Gu says.

The study showed the resigning directors increased their involvement and leadership at the retaining firms, and did not seek additional board positions.

So, how many board seats should one leader hold? It's complicated, Gu says.

"Despite the critical importance of strong corporate governance, there is no regulatory limit, or even exchange guideline, on the number of directorships an individual can hold," Gu says. "But investors have spoken and generally prefer directors hold fewer board seats—no more than three, we estimate."

Provided by University at Buffalo

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