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INTERLOCKING BOARD MEMBERSHIP AND FINANCIAL PERFORMANCE OF LISTED FIRMS IN NIGERIA

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Abstract

This study examined interlocking board membership and financial performance of listed firms in Nigeria. A sample of fifty (50) listed non-financial firms was selected from the population using the systematic random sampling technique. The data for the period, 2007 to 2018 was analyzed using the descriptive statistics, correlation matrix and the general method of moment (GMM). Findings revealed that the one lag value of the returns on equity is statistically significant and positively correlated with the firms' financial performance. Interlocking board membership (IBM) exerted a negative and significant impact on the firms' financial performance. Board size exerted a positive impact on the performance of the firms, suggesting that a relatively large board size engenders conflicts in decision making and may hamper financial performance of firms. Firm size was positive and significant on the firm performance in the reference period. Implicitly, board interlocks under the upper echelon theory, irrespective of the size of the board is yet a key driver of corporate financial performance in Nigeria. The study recommends that managerial interlocking board membership should be examined in the context of agency relationship on firm performance. There is need for regulators to design a framework on the proportion of board interlocks inclusion in firm board. Firm should be mandated to disclose proportion of board interlock as it will guide researchers in carrying out critical analysis for policy recommendations.

Key words: Interlocking Board Membership, Board Size, Firm Size and Financial Performance.

JEL CLASSIFICATION: G32, L14, L22

1. Introduction

A board of director may be at liberty to hold several positions in different firms in as much as the opportunity exists and the corporate governance code of best practices allows it. The tiers of board interlocks, viz-a viz, the executive and non-executive membership are imperative for a firm operation and performance. In a large board size with little number of executive board members, inclusion of higher proportion of board independence, regardless of their connection to other firms, tends to engender the practices of multiple directorship. So, the practice of board interlocks seeks to enhance links and network among firms. This practice enables firms to coopt, monitor each other and provide information on business models (see Dooley, 1969; Davis, 1991; Mizruchi & Stearns, 1994).

One of the influencing variables of board interlocks in firms is net worth and integrity (Okpamen & Ogbeide, 2020). Board directors with high integrity are in high demand in multinational firms globally. This easily places them with multiple directorships in various firms. Multiple directorship rises to interlocking board membership. Interlocking board membership involves directors who may be from other countries, race, ethnic and religion having multiple seats in different firms. Beyond the multiplicity of directorship role, interlocking refers to the phenomena where a director in a parent firm occupies more seats in subsidiary firm' board or in another firm in other industries. The financial expertise, accounting professionalism, managerial wizardry and experiences and social network worth are some drivers of interlocking board membership in firms globally. Hence, Westphal, Seidel and Stewart (2001) identified board interlock as a principal conduit for dissemination of innovations and business practices in the ever dynamic corporate world.

In the emerging markets such as Nigeria, the corporate governance code of best practices has not explicitly stated the prerequisite for interlocking board members inclusivity in firms. This may be one of the factors which seem to limit researchers over the years in analyzing the impact of board interlocks on firms' operation and financial performances in developing countries in the Nigerian corporate environment. Similarly, the constant corporate board room squabbles and unhealthy politicking among existing directors in boards' appointment and managerial positions in the corporate world may be a contributing factor for the low encouragement of board interlocks in developing countries such a Nigeria. This poor encouragement of boards interlock diversity culture in Nigerian firm, requires timely policy thrust by the government through regulators to enhance corporate governance best practice towards promoting firms' operations, financial performance and maximization of shareholder's wealth.

While plethora of researches such as Richardson (1987); Geletkanycz and Boyd (2011); Pye, Kaczmarek and Kimino (2015) critically examined the implication of interlocking board membership in firm performance in developed nations of the world, the same cannot be said in developing countries such as Nigeria. This gap may be adduced to differences in regulation among varying climes. Another main reason for such challenge in the developing countries, is variable measurement problem and data constraint. Still, the researches on the association between interlocking board membership and firm financial performance in the developed countries are inconclusive (see, Zona & Gomez-Mejia, 2015; Horton, Millo, & Serafeim, 2012; Pombo & Gutierrez, 2011; Devos, Prevost, & Puthenpurackal, 2009; Fich & Shivdasani, 2006; Phan, Lee, & Lau, 2003; Fligstein & Brantley, 1992; Meeusen & Cuyvers, 1985). This study therefore seeks to examine the subject in a developing clime, specifically in the Nigeria context with a view to building on the findings of prior studies.

Interlocking board membership could be vertical or horizontal in firms. Vertical interlocking board membership is where the directors sitting in a parent firm also sit in group affiliated firm and this often occur because of intra-group resources sharing. This type of interlocking is more useful in diversified business. Horizontal interlocking board membership is where a director in the board of a subsidiary also becomes a board member in another subsidiary in a parent company. Horizontal interlocks commonly occur in an undiversified firm.

Irrespective of the types of interlocking board membership, board interlock in firm is undoubtedly a double – edged sword. The positive side of interlocking board members includes obtaining needed resources and access to information for performance, promoting quality of the board, financial expertise, accounting and managerial wizardry, wealth of long standing industry work experiences and social network worth (Lamb, 2017; Ferris, Jagannathan, & Pritchard, 2003).

In addition, the negative implication of interlocking board membership encompasses, too busy to be committed to organization's set goals, less engagement in strategic decision making towards ensuring optimal performance, lack of independent critical thinking, creation of reputational penalty on firms, weak intellectual commitment towards promoting dominance and growth of firms in the industry and stock market (Kang, 2008; Armstrong & Larcker, 2009; Bizjak, Lemmon, & Whitby, 2009).

The negative side of interlocking board membership is associated with ignoring policy favoring board interlocks. Ferris, Jagannathan and Pritchard (2013); Tany and Smith (2015); Fredriksson et al. (2018) posit that if serving on multiple boards enhances directors' expertise and their professionalism, being involved with many firms may make them too 'busy', thus reducing the quality of work. Congruently, Non* and Franses (2007) argued that one of the negative implications of board interlocks is that such directors get short of time and the performance of their firms deteriorates. Nonetheless, balancing these two opposing implications of interlocking board membership in firms is possible through a systematic approach (Oehmichen, Braun, Wolf & Yoshikawu, 2017; Kemp, Viviers & Collins, 2018). Fligstein and Brantley (1992) in a research argued for the abandonment of researches related to board interlocks and firm financial performance because it is dependent on a lot of other observable and non- observable variables. Davis and Greve (1997) canvassed for the use of board interlock variables to examine operational and financial performance with assertive theoretical supports.

It is against this background this research is undertaken with a view to contributing to literature on corporate governance in Nigeria as an emerging market. Following this introduction, section two engages in a critical review of the outstanding literature review; section three explains the prevailing methodology that works for an emerging market such as Nigeria; section four presents and discusses the results of the empirical analysis, while section five is conclusion and recommendations.

2. Literature Review and Theories

Interlocking board membership as a corporate governance indicator has no defined proportion for inclusion in corporate governance code of best practices in developing countries unlike in developed nations of the world. For instance, the research of Yatim et al. (2014) state that the recommended limits of multiple directorship in several emerging economies are significantly higher than the best practices suggested in many developed countries. In the United States for instance, few multiple directorships is considered as a best practice while in other countries such as India, the limits are higher; ranging from ten to twenty five. Sarkar and Sarkar (2009) stress that multiple directorship are quite pervasive in India with 72 percent of directors holding more than one directorial position. The author stress that the higher limit of multiple directorships often reported in emerging markets may be due to the supply constraints in the market for

corporate directors. Mizruchi and Galaskiewicz (1994) had posited that if interlocking is a successful method of cooptation, all things being equal, heavily interlocked companies should perform more profitable than less interlocked firms.

However, empirical evidence on this proposition around the world is ambiguous.

The nexus between interlocking board membership and firm performance is mixed on the empirical fronts. Richardson (1987) report that interlocked companies perform better than firms without the presence of interlocked membership. Shropshire (2010) through the use of diffusion model reported that interlocking board membership diversity is a key variable that can effectively influence firm performance with a view to deeply reconciling the competing views of resource dependency and agency theory. The author concluded that the level of board interlock is likely to create favourable conditions for the reception of ideas available through the interlocking ties and positively impacts on firm performance. Peng, Mutu, Sauerwald and Wang (2015) investigated board interlocks and corporate performance among Chinese firms listed in Hong Kong between 1990 and 2012. The findings indicate that network centrality and interlocks help to improve performance in varying degrees. Ahmad (2018) investigated interlocking directorates and financial performance in Pakistani Business Groups from 2011 to 2015 for a sample of 55 public limited companies. Panel regression method was used to analyze the data. The finding indicates that vertical interlocking directors increase the performance of group firm by supporting in coordination and promotion of transactions between group members firm and holding firm. Pombo and Gutierrez (2010) investigated the impact of outside directors, board interlocks and non- financial firm performance in Colombia. A sample of 335 firms per year for the 1996-2006 period was examined. The study established a positive relation between the levels of board interlocks with firm return-on-assets.

Fligstein and Brantley (1992) empirical study revealed a negative relationship between interlocking directors and profitability for large sample of US firms. In the view of Devos, Prevost and Puthenpurackai (2009), interlocking board membership is negatively correlated with performance of firms; the poorly performing firms are more likely to interlock directors on their board and market reacts on the announcement of appointment of directors that create interlocks. The researches of Fligstein and Brantley (1992); Devos, et al. (2009) favorably supported the study of Peyre, et al (2012) conducted a study on a sample of Swiss firms. Danoshana and Ravivathani (2013) conducted a research using data collected from 145 Italian manufacturing firms for the period 2001 to 2006. The study specifically examined impact of interlocking board members on the return on assets of the sampled firms in the period. The finding indicates that board members who serve on multiple boards exert a negative effect on firm performance; but the effect is dependent relatively on its resources. The research outcome also indicates that firm with fewer resources perform better when their board members also serve on boards of firms with more resources. In contrast, the research stress further that firm with greater resources performs worse when their board members also serve on boards with more resources constraints.

Contrary to these findings, Kiel and Nicholson (2006) and Geletkanyez (2011) established no direct nexus between interlocking board members and firm financial performance. The author supported the evidence that the effect of interlocking board membership on firm performance is contextual and concentrated on the firms' externalities such as industry growth, concentration and firm diversification. Hashim (2018) suggests that the number of inter directors should be

moderate to avoid non-linear relationship with firm operation and financial performances. They asserted that interlock directors have the knowledge, expertise, skills and stronger incentives to actively monitor the actions of management and improve quality of financial reporting. From all the literature examined, it can be observed that empirical studies on the association between interlocking board membership and firm financial performance in the context of Nigeria are not available, thus prompting the reason to fill the research gap through this study. Zona and Gomez-Mejia (2015) in study on board interlocks and firm performance in the context of agency–resource dependence perspective on a sample of 145 Italian companies, established that interlocking directorates may exert either a positive or a negative effect on firm performance. Lamb (2017) in a study sought to investigate if the number of interlocking directors influence firm financial performance in an exploratory meta-analysis. The finding indicates little evidence of a systematic impact of interlocking board directors on financial performance of firms. The finding is suggestive that interlocking directors may not have an influence on firm financial performance.

This study employs the upper echelon theory to explain the link between interlocking board membership and firm financial performance. The upper echelon theory developed by Hambrick and Mason (1984) states that organization's outcome; strategic choices and performance level are partially predicted by managerial background and characteristics. The theory describes how board directors' behavior towards firm performance is a function of personal experiences and values (Hambrick & Masson, 1984). Conventionally, board director prior long standing work experiences are imperative (Hambrick, 2007). Terjesen et al. (2016), in explaining further the upper echelon theory, emphasized that a board consisting of interlocking directors, nationality and reputation, vast and diverse set of knowledge and skills is likely to influence the company financial performance. Marimuthu and Kolandaisamy (2009) in a research, contributed that one of the most effective theories that can be used to underpin studies on board heterogeneity is the upper echelon theory. In the context of the upper echelon theory, it is likely that in a relatively stable environment, team homogeneity and specifically board interlocks will positively promote firm profitability; but in a turbulent environment, especially discontinuous environment; team heterogeneity and board interlocks may negatively affect a firm profitability (Marimuthu & Kolandaisamy, 2009). The quoted firms in Nigeria have operated under a harsh corporate environment occasioned by macro-economic challenges over the years. Researches that have examined the association between interlocking board membership and firm financial performance in the context of the upper echelon theory on the empirical fronts in the emerging economy of Nigeria are scarce, hence this study is undertaken.

3. Methodology and Model Specification

This study examines the effect of interlocking board membership on firm financial performance using causal-research design. The study population consists of listed non-financial firms in Nigeria. Fifty (50) listed non-financial firms were selected using the simple random sampling technique in the period 2007 to 2018. This represents about six hundred firm-annual observations. The descriptive statistics, correlation statistics and general method of moment (GMM) were employed to analyze the data. The robustness tests were also carried out using E-view 8.0 software. The model used in the study is adapted from the studies of Pombo and Gutierrez (2010); Zona and Gomez-Mejia (2015); and Lamb (2017). The models were modified, stated in a stochastic form as follow:

$$ROE_{it} = \beta_0 + \beta_1 ROE_{it-1} + \beta_2 Ibm_{it} + \beta_3 Bsize_{it} + \beta_4 \sum_{it} control\ variable + \varepsilon_{it} \dots$$

Where, ROE_{it} = return on equity of i firm in t period;; Ibm_{it} = Interlocking board membership of i firm in t period; $Bsize_{it}$ = Board size of i firm in t period and $\sum Control\ variables_{it}$ = consists of firm size; i = Individual firm in the sample size; t = Period the study covers; ε = Error term acting as a surrogate in the models and β_0 = Intercept.

Table 1: Measurement of the Variables

s/n	Variables	Type of variable	Measurement	Source
1	Financial performance	Dependent variable	Measured using return on equity (ROE)	Rossi, Nerino and Capasso (2015)
2	Return on equity	Dependent variable	Computed with the formula: profit after tax/ equity.	Rossi, Nerino and Capasso (2015)
3	Interlocking board membership	Independent variable	Total number of busy directors. A busy director is a dummy variable equal to 1 if the number of directorships held by a board member within firms affiliated with the business group or other businesses groups is more than one, and 0 otherwise. Restricted only to firms in the sample	Haynes and Hillman (2010); Pombo and Gutierrez (2011)
4	Board size	Independent variable	Z	Barroso, Villegas and Pérez-Calero. (2011)
5	Firm size	Independent variable	Using the total Assets of the firms	Gu, Lee and Rosset (2005)

Source: Compiled by the author

4. Results and Discussion

The analysis in this subsection is carried out using descriptive statistics, correlation matrix, robustness tests and general method of moment (GMM) on the variables of the study. The analysis is contained in tables 1, 2, 3 and 4.

Table 1: Descriptive Statistics

	ROE	IBM	BSIZE	FSIZE
Mean	9.678514	0.368243	9.092905	7.155946
Median	11.97500	0.000000	9.000000	7.090000
Maximum	2898.450	1.000000	19.00000	9.220000
Minimum	-2087.700	0.000000	4.000000	4.960000
Std. Dev.	174.0946	0.482736	2.840929	0.758573
Skewness	4.181965	0.546337	0.652986	0.244280
Kurtosis	169.9883	1.298484	3.202795	2.655715

Jarque-Bera	689557.6	100.8643	43.08493	8.811502
Probability	0.000000	0.000000	0.000000	0.012207
Sum	5729.680	218.0000	5383.000	4236.320
Sum Sq. Dev.	17912578	137.7230	4769.890	340.0809
Observations	592	592	592	592

Source: Researcher’s compilation from Eview-8

Table 1 points out that the return on equity (ROE) has a mean of 9.67% while the standard deviation is 174.09, suggesting that the firms experienced about 9% variability in the return on equity in the reference period. This percentage variability in ROE the period may not be unconnected with systematic and unsystematic risks across the industries. While return on equity was positively skewed at 4.181, implying the variable was symmetrical around its mean in the period observed, the kurtosis which indicates the peakedness or flatness of the distribution of the series stood at 169.98. It suggests that the distribution is peaked (leptokurtic). The Jarque-Bera statistics of 689557.6 with P- value of 0.00 is statistically significant at 5% level, an indication that the data was normally distributed.

Interlocking board membership has a low value of 0.36% among the companies in the period. This suggests that multiple directorship representation on board of listed firms in Nigeria is very scanty. This effect may undermine the benefits accruable from having these sought after strategists and experts in companies, consequently impact negatively on their operational and financial activities. The standard deviation which shows the variability from the mean is 0.48, an indication of low risk since the proportion of board interlocks was very low in the firms’ board. The skewness is positive (0.54) and the kurtosis platykurtic (1.29). The Jarque-Bera value of 100.86 is significant and distributed normally in the reference period. Board size has a mean of 9, suggesting at least there were nine members which made up the board membership across the sampled firms. It has a standard deviation of 2.84. Firm size mean value is 7.15910 billion and high mean value of 9.220000 billion naira in the reference period. The figures reported are a pointer that the sampled firms invested heavily in total assets perhaps to enable them optimize the benefit of economy of scale and capital allowance. The result obtained is quite similar to the empirical value obtained by Ilaboya et al. (2016) of N7.155946 billion. It is an indication that the sampled firms made huge investments fixed assets. The standard deviation is 0.76, the skewness and kurtosis are positive (0.24 and 2.66). The Jarque – Bera value of 8.811502 ($p < 5\%$) is statistically significant at 5% level.

Table 2: Descriptive Statistics

ROE	1	IBM	BFSIZE	FFSIZE
IBM	-0.0581	1		
BFSIZE	0.0122	0.1305	1	
FFSIZE	-0.0099	0.3443	0.5161	1

Source: Researcher’s compilation from Eview-8

Table 2 depicts the correlation between interlocking board membership and firms’ financial performance on corporate board diversity and return on asset (ROA). The result indicates absence of multicollinearity between return on equity (ROE) and the explanatory variables and the control variable also. The correlation between return on equity (ROE) and interlocking board membership is weak and negative ($r = 0.06$). This weak and negative relationship may not be

unconnected with the scantiness of interlocking board member in the sampled firms. The fewness of the board interlocks may also be adduced to non-inclusion of the mechanism as a corporate governance indicators firms are expected to give key attention to in the Nigeria clime. The correlation between return on equity (ROE) and board size is weak and positive ($r = 0.01$). The finding portends that though a large board size may be favourable perhaps due to size, it could result to conflict in decision making in firms.

Table 3: Robustness Tests

Variance inflation factors (VIFs)		
	Coefficient variance	Centered VIF
IBM	250.85	1.138
BSIZE	8.702	1.367
FSIZE	138.123	1.525
Breusch – Godfrey – serial correlation LM test		
F-statistic = 0.633	Prob.F(2, 586)	0.531
Obs * R-squared = 1.276	Prob.Chi-Square (2)	Pro. Chi-square (2) 0.528
Heteroskedasticity test		
F-statistic 6.095	Prob. F(3,588)	0.001
Obs * R-squared 15.001	Prob. Chi-square (3)	0.001
Ramsey Reset Test		
t-statistic = 0.367	Df = 537	0.713
F-statistic = 0.135	Prob.F (1, 587)	0.713

Source: Researcher’s compilation from Eview-8

The diagnostic table above shows that the variance inflation factor (VIF) statistic is less than 10 (centered vif < 10) for each of the variables. This indicates absence of multicollinearity among the explanatory variables. The ARCH: Heteroskedasticity test shows the presence of homoscedasticity ($0.001 < 0.05$), thus confirming the constant variance assumption of the ordinary least square estimator. The Breusch-Godfrey serial correlation LM test result of $0.531 > 0.05$ points out the absence of higher order correlation. The Ramsey Reset Test result of ($0.713 > 0.05$) substantiate validity of the regression model.

Table 4: IBMand ROE

IBM	-163.08
	[0.00]*
BSIZE	19.07
	[0.00]*
FSIZE	59.29
	[0.00]*
ROE(-1)	0.01
	[0.00]
J-Statistics	0.640

Source: Output from Eview-8

Table 2 represents the variables in the model. ROE represents return on equity; IBM represents board director interlocks; BSIZE represents board size; FSIZE; represents firm size, while probability values are in parenthesis at different significance level with * $p < 0.1$ and *** $p < 0.01$. The result of the general system general method of moment (GMM) in table 4 indicates that the coefficient of the lag value of the returns on equity (ROE) is positive and statistically significant at 95% level. It is suggests that a period lag of return on equity (ROE) drives the financial performance of listed firms in Nigeria. The research finding is in tandem with Rossi et.al. (2015); Pye et al (2015); Watkins-Fassler, Fernander-Perez and Rodriquez-Arizo (2016).

Interlocking board membership (IBM) has a negative coefficient value (-163.08) and is statistically significant at 95% level. The finding implies that though interlocking board membership is significant, it is not a significant driver of financial performance of listed firms and by extension the wealth of shareholders in Nigeria. The non-significant effect of the board interlocks on the financial performance of the firms agrees with the position of the upper echelon theory. However, the not too significance of interlocking board membership on firm financial performance in our analysis is not unconnected with low encouragement of board interlocks in firms. The result affirms the research outcome of Shropshire (2010); Pombo and Gutierrez (2011); Peng, et al (2015); and Ahmad (2018). The finding fails to agree with the studies of Devos, et al. (2009); Peye, et al (2012); Danoshana and Ravivathani (2013); Lamb (2017); and Hashim (2018). Board size has positive coefficient value of 19.07 on return on equity (ROE) of the firms. The finding is suggestive that a relatively large board size engenders positive effect on the financial performance of firms. The finding did to agree with the research outcome of Igbiosa and Ogbeide (2015); Darmadi (2013) which reported a negative and insignificant impact of board size on financial performance in firms. Firm size is positive and significant on the firm performance in the reference period.

5. Conclusion and Recommendations

The effect of interlocking board membership on firms in the light of global economic challenges cannot be overemphasized. In the Nigeria clime, the assessment of the association between interlocking board membership on firm financial performance lacks much empirical evidence. The study concludes that board interlocks under the upper echelon theory, irrespective of the size of the board is not yet a key driver of corporate financial performance in Nigeria. The study is however constraint of the fact that managers who are opportunistically driven can employ board interlocks for private benefits to the detriments of the shareholder. The study suggests that managerial interlocking board membership be examined in the context of agency relationship on firm performance. There is need for regulators to design a framework on the proportion of board interlocks inclusion in firm board. Firm should be mandated to disclose this as it will guide researchers in carrying out critical analysis for policy recommendations. Future researches should examine the link between interlocking board membership and firm financial performance under the agency, social network and resource dependency theories through the use of advanced panel estimation methods on cross country basis in different jurisdictions.

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