The influence of board leadership and board roles on frequency of board meetings and firm performance in two-tier boards.

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Abstract

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Increased corporate scandals due to the wrong-doings of unscrupulous CEOs or directors around the world such as Enron and Worldcom in the US, Parmalat in Italy, Transmile Group in Malaysia, Cipaganti Citra Graha in Indonesia, and Volkswagen in Germany have prompted the need for better governance through increased number of independent directors (Aguilera, 2005; Bezemer, Peij, de Kruijfs, & Maassen, 2014; Crespi-Cladera & Pascual-Fuster, 2014) and greater emphasis on the efficacy of directors’ monitoring and advising roles (Adams & Ferreira, 2007; Adams, Hermalin, & Weisbach, 2010; Armstrong, Core, & Guay, 2014; Hahn & Lasfer, 2016). Despite the different board structure composition adopted by different countries, where some countries such as US and UK subscribing to the one-tier board structure while others such as Germany and Indonesia subscribing to the two-tier board structure, the presence of independent directors and the efficacy of the directors’ monitoring and advising roles remain critical in achieving proper management and better governance of corporations (Adams & Ferreira, 2007; Armstrong et al., 2014; Hahn & Lasfer, 2016; Schwartz-Ziv & Weisbach, 2013). Extant literature has shown that directors’ board meetings serve as a platform to obtain and exchange information between non-independent (inside) and independent (outside) directors (Brick & Chidambaran, 2010; Hahn & Lasfer, 2016; Jensen, 1993; Vafeas, 1999). Thus, the effectiveness of directors’ monitoring and advising roles are dependent on such information procurement and exchanges during board meetings (Brick & Chidambaran, 2010; Hahn & Lasfer, 2016; Schwartz-Ziv & Weisbach, 2013).

Past studies has suggested that one-tier board structures can better facilitate communication and information exchange between non-independent (inside) directors and independent (outside) directors through board meetings because both inside and outside directors are placed within the same board (Adams & Ferreira, 2007; IFC, 2015). However, at the same time, the one-tier board structure may be a deterrent for independent directors to perform their monitoring functions because of their potential biasness arising from the close interaction between the non-independent and independent directors within the same board structure (Adams & Ferreira, 2007; IFC, 2015; Volonté, 2015). Therefore, two-tier board structures have been suggested to be more effective for directors to monitor management because of the clear separation between the supervisory board, which only consists of independent (outside) directors who focuses on monitoring and advising functions; and the management board, which consists of non-independent (insiders) who focuses on managing the operations of the firm (Bezemer et al., 2014; Peij, Bezemer, & Maassen, 2012; Schwartz-Ziv & Weisbach, 2013). However, the clear separation of supervisory and management board in two-tier board structures, gives rise to two weaknesses. First, the absence of insiders in supervisory boards may hinder the flow of information to supervisory boards, thereby affecting the efficacy of the supervisory boards’ monitoring and advisory roles (Harris & Raviv, 2008; Raheja, 2009). Second, information procurement and exchange during board meetings between non-independent (inside) directors and independent (outside) directors may be a challenge, thereby resulting in information deficit which could impair the effectiveness of directors’ monitoring and advising roles (Bezemer et al., 2014). Armstrong et al. (2014) found that although independent directors, who are outsiders to the firm, must acquire and process substantial amount of firm-specific information in order to effectively perform their monitoring and advising roles, inside directors can withhold such information from independent directors, thus limiting the monitoring effectiveness of independent directors. Independent (outside) directors depend on the information provided by inside directors through agendas of board meetings. Therefore, frequent board meetings is critical in facilitating adequate information procurement and exchange between the outside and inside directors (Bezemer et al., 2014; Peij et al., 2012; Schwartz-Ziv & Weisbach, 2013). In
addition, Andres & Valvelado (2008) suggest that higher frequency of board meetings leads to more monitoring through closer control over inside directors and greater advisory roles by independent directors.

Extant research has shown that the leadership of boards – chairman of the board and the CEO – may influence the frequency of board meetings (Baccouche, Hadriche, & Omri, 2014; Cook & Burress, 2013; IFC, 2015). In particular, the CEO provides firm-specific information to the board by preparing board meeting agendas and may also influence the frequency of board meetings (Baccouche et al., 2014; Baldenius, Melumad, & Meng, 2014; Cook & Burress, 2013; Jiraporn, Davidson, DaDalt, & Ning, 2009). Whilst the chairman of the board may influence the frequency of board meetings by managing the board meeting agendas (Baccouche et al., 2014; Masulis & Mobbs, 2014). However, these past studies are conducted within the context of one-tier boards, hence the influence of CEO and Chairman on the frequency of board meetings within two-tier boards remains ambiguous. As mentioned earlier, past studies has suggested that inside directors can provide the necessary firm-specific information and can ensure the proper flow of information to the board of directors (Harris & Raviv, 2008; Raheja, 2009). Therefore, affiliated independent directors, who were previously inside directors of the focal firm by virtue of their previous professional or their family-related relationship with the focal firm, may have more firm-specific information than strictly independent directors. As such, affiliated independent directors are more likely to be able to provide more effective monitoring roles compared to strictly independent directors (Cavaco, Crifo, Rebérioux, & Roudaut, 2017). In turn, more monitoring roles by affiliated independent directors may influence greater frequency of board meetings (Brick & Chidambaran, 2010). As such, the above issues motivates us to ask our first research questions within two-tier boards: How do the CEO, Chairman and affiliated independent directors influence the frequency of board meetings?

Some past studies have found that frequent board meetings lead to better firm performance, especially when the board increases their monitoring roles more than advisory roles (Baccouche et al., 2014; Brick & Chidambaran, 2010; Chou, Hamill, & Yeh, 2018; Hahn & Lasfer, 2016; Kim, Mauldin, & Patro, 2014), while other studies have found the opposite, whereby increases in advisory roles rather than monitoring roles lead to better firm performance (Baldenius et al., 2014). Such inconclusive results warrants further empirical investigation on the relationship between the frequency of board meetings and firm performance. In addition, most past studies have investigated firms in countries adopting one-tier board structure while there is a paucity of research in countries adopting the two-tier board structure. This leads us to ask our second research question within two-tier boards: How do advisory and monitoring roles influence the frequency of board meetings and firm performance?

We investigate our research questions using a longitudinal dataset of 500 publicly listed companies from Germany and Indonesia, where both countries adopt the two-tier board structure. Our observation period spans across 10 years from 2006 to 2015. We utilize the content analysis method to quantify the advisory and monitoring roles obtained from board meeting agendas (Krippendorff, 2004; Lieblich, Tuval-Mashiach, & Zilber, 1998; Schwartz-Ziv & Weisbach, 2013). Our research offers three contributions. First, we integrate upper echelon theory and resource based theory to examine our hypotheses (Hambrick & Mason, 1984; Hillman & Dalziel, 2003) within a developed country (Germany) and a less developed country (Indonesia). Second, we are amongst the first study to utilize content analysis to capture the essence of advisory and monitoring roles within the context of two-tier boards. Third, our study provides a more nuanced overview as to the determinants of board meetings and the efficacy of advisory and monitoring roles in influencing firm performance.

**Keywords:** Two-tier board, advisory and monitoring board roles, board leadership, frequency of board meeting, affiliated independent director, CEO, Chairman.
References


