Are independent directors good monitors in the public utilities? Evidence from Europe

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Motivation

- Corporate governance codes emphasize the importance of independent directors in the boardroom
  - Independent directors particularly effective in controlling CEO
- Most of the studies focus on manufacturing industries, excluding public utilities
- Controversial and relevant issue for the listed energy utilities
  - Regulated market
  - Maximization of both shareholders' wealth and social welfare
  - Politically connected directors
- No studies on independent directors in European public utilities

Research questions

In the energy public utilities…

- Do independent directors affect firm performance?
- Do independent directors affect firm growth?

Main goal:

To analyze the effective monitoring exerted by the independent directors in the public utility in Europe.

Main Results

① Effect on firm performance

Contrary to the conventional wisdom of corporate governance codes, we find the relationship between independent directors and firm performance is not statistically significant.

② Effect on firm growth

No statistically significant relation between independent directors and on firm growth.

Related literature

- No relationship between independent directors and firm performance in US unregulated companies

  (Mock et al. 1988; Hermalin and Weisbach, 1991; Klein 1998)

- Negative relationship in US firms and in Portuguese firms

  (Yermack 1996; Cole et al 1999; Bhagat and Black, 2000; Fernandez 2008)

- Positive relationship in Spanish firms, Chilean firms and continental European firms listed in US

  (Garcia-Meca and Sanchez-Ballesta 2006; Lefort and Urzùa 2008; Krivogorsky 2006)

Within the boardroom: some definitions

- Executive directors:

  Current officers in the company

- Outside directors:

  - Grey directors:

    Not current employees but likely to have business relationships with the company, such as lawyers; officers in the recent past; relatives of employees

  - **Independent directors**:

    Directors without such affiliations

Hypotheses

1. *H1:* Positive relationship between independent directors and firm performance

2. *H2:* Positive relationship between independent directors and firm growth

Data

- 43 listed public utilities of the energy industry

  (Italy, Spain, France and United Kingdom)

- 344 firm year-observations from 2002 to 2009

- Data collected from different sources:

  1) Worldscope and COMPUSTAT database (financial data)
  2) Annual Corporate Governance Reports (board composition are hand-collected)

Model (1): The effect on present firm performance

$$Performance_{it} = b_1 Independent_{it} + b_2 Executive_{it} + b_3 Bsize_{it} + b_4 CEOduality_{it} + b_5 X_{it} + e_{it}$$

Where:

$Performance_{it} = Tobin'sQ;\ MarketCap;\ Ebit;\ ROA$

$Independent_{it} = number\ of\ independent\ directors$

$Executive_{it} = number\ of\ executive\ directors$

$Bsize_{it} = number\ of\ directors\ in\ the\ board$

$CEOduality_{it} = dummy\ whether\ CEO\ is\ also\ chairman$

$X_{it} =$ control variables

Model (1): The effect on future firm performance

$$Performance_{it} = b_1 Independent_{it-1} + b_2 Executive_{it-1} + b_3 Bsize_{it-1} + b_4 CEOduality_{it-1} + b_5 X_{it} + e_{it}$$

Where:

$Performance_{it-1} = Tobin'sQ;\ Ebit;\ ROA;\ MarketCap$

$Independent_{it-1} = number\ of\ independent\ directors$

$Executive_{it-1} = number\ of\ executive\ directors$

$Bsize_{it-1} = number\ of\ directors\ in\ the\ board$

$CEOduality_{it-1} = dummy\ whether\ CEO\ is\ also\ chairman$

$X_{it} =$ control variables

Results: The effect on present firm performance

Effects of board composition on present firm performance in the public utilities in Europe (years 2000-2009)

	Tobin'sQ	*Log(Mktcap)*	*L(Ebit)*	*ROA*
Independent directors$_{it}$	*-0.09*	*0.03*	*0.02*	*1.10*
	(-0.57)	*(0.93)*	*(0.72)*	*(1.02)*
Executive directors$_{it}$	*0.04**	*0.10****	*0.12****	*-1.42*
	(1.73)	*(2.94)*	*(2.80)*	*(-0.64)*
Board Size$_{it}$	*0.01*	*-0.01*	*0.19*	*-0.90*
	(0.89)	*(-0.67)*	*(0.67)*	*(-0.98)*
CEO duality$_{it}$	*0.16****	*0.33****	*0.32*	*0.21*
	(3.84)	*(3.02)*	*(1.36)*	*(0.06)*
_cons	*0.83****	*14.71****	*12.42****	*10.95*
	(3.05)	*(6.94)*	*(4.02)*	*(0.96)*
Years-dummy	*Yes*	*Yes*	*Yes*	*Yes*
Fixed Effect	*Yes*	*Yes*	*Yes*	*Yes*
R-squared	*0.19*	*0.56*	*0.32*	*0.05*
F-statistic	*17.87*	*16.38*	*13.56*	*0.74*
Prob>F	*0.00*	*0.00*	*0.00*	*0.69*

Results: The effect on future firm performance

Effects of board composition on future firm performance in the public utilities in Europe (years 2000-2009)

	Tobin'sQ	*Log(MarketCap)*	*L(Ebit)*	*ROA*
Independent directors $_{it-1}$	*-0.02*	*0.16*	*-0.01*	*0.03*
	(-1.21)	*(1.00)*	*-(0.61)*	*(0.15)*
Executive directors $_{it-1}$	*0.01*	*0.07****	*0.10*	*0.57*
	(0.67)	*(2.03)*	*(1.56)*	*(0.59)*
Board Size $_{it-1}$	*0.60*	*-0.03****	*0.01*	*-0.01*
	(0.89)	*(-2.05)*	*(0.62)*	*(-0.04)*
CEO duality $_{it-1}$	*0.02*	*0.30****	*0.22*	*0.03*
	(0.57)	*(3.50)*	*(1.33)*	*(0.05)*
_cons	*1.18****	*15.04****	*12.83****	*0.35*
	(14.77)	*(11.33)*	*(4.28)*	*(0.06)*
Years-dummy	*Yes*	*Yes*	*Yes*	*Yes*
Fixed Effect	*Yes*	*Yes*	*Yes*	*Yes*
R-squared	*0.30*	*0.61*	*0.36*	*0.04*
F-statistic	*17.76*	*16.82*	*14.24*	*2.49*
Prob>F	*0.00*	*0.00*	*0.00*	*0.02*

Model (2): the effect on firm growth

$$AnnualGrowthRate_{it} = b_1 Independent_{it-1} + b_2 Executive_{it-1} + b_3 Bsize_{it-1} + b_4 CEOduality_{it-1} + b_5 X_{it} + e_{it}$$

Where:

$$AnnualGrowthRate_{it} = Log(Tot\ Assets_{it}) - Log(Tot\ Assets_{it-1})$$

$Independent_{it}$ = number of independent directors

$Executive_{it}$ = number of executive directors

$Bsize_{it}$ = number of directors in the board

$CEOduality_{it}$ = dummy whether CEO is also chairman

X_{it} = control variables

Results: the effect on firm growth

Effects of board composition on firm growth in the public utilities in Europe (years 2000-2009)

	Annual Growth Rate	
Independent directors $_{t-1}$	*0.03*	*0.03*
	(0.58)	*(0.50)*
Executive directors $_{t-1}$	*-0.28****	*-0.30****
	(-2.79)	*(-3.31)*
Board Size $_{t-1}$	*-0.08*	*-0.09**
	(-1.52)	*(-1.82)*
CEO duality $_{t-1}$	*-0.60****	*-0.36*
	(-2.00)	*(-1-29)*
_cons	*1.66****	*1.70****
	(3.41)	*(3.18)*
State-owned		*0.08*
		(0.15)
Years-dummy	*Yes*	*Yes*
Fixed Effect	*Yes*	*Yes*
R-squared	*0.13*	*0.12*
F-statistic	*2.49*	*1.93*
Prob>F	*0.00*	*0.03*

Conclusions

1. The relationship between independent directors and firm performance is not statistically significant
2. The relationship between independent directors and firm growth is not statistically significant
3. Executive directors affect positively firm growth

- This lack of effectiveness of independent directors can depend on:
  - Not truly independent
  - Lack of info
  - Weak incentives

Thank you for your attention

For any questions

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