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Multiple directorships in KSA

Augments effective management or promotes conflict of interest?

Research Highlights:
Studying Multiple Directorships in KSA in terms of composition and effect on firm profitability

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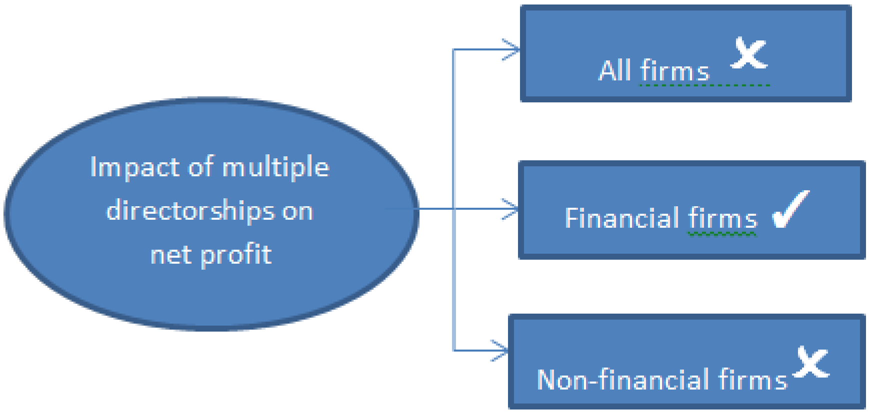
Multiple directorships are a common phenomenon observed across the globe. "Multiple directorships" refers to the practice of a member of the company's Board of Directors serving on the boards of multiple companies. The terms "Multiple directorships" and "Director interlocking" are interchangeably used. Albeit the practice is lawful, these overlapping linkages give rise to ethical dilemmas. This has triggered us to study the impact of multiple directorships on profitability in the Kingdom of Saudi Arabia. Our study reveals a high degree of inter-connectedness amongst the listed companies in the KSA. About 83% of listed companies in the KSA are interlinked through a shared board member. We infer from our study that multiple directorships significantly impact the net profits of financial institutions in the KSA while it has negligible impact on non-financial firms.

Chart 1: Summary of results: KSA firms, 2010



Source: Markaz Research

We have summarized the key findings of our study in the table below:

Table 1: Summary of key findings, 2010

Parameter	KSA
Number of listed companies	149
Number of directors	1,210
Sector with maximum directors	Insurance
Average Board size	8.1
% of companies interlocked	83%
% of directors with single board membership	65%
Impact of interlocks on net income	
All firms	No
Financial firms	Yes
Non-financial firms	No

Source: Markaz Research

Overview about Interlocks

We observed that multiple directorships have both benefits and limitations. Nevertheless, we believe that the threshold point beyond which director interlocks could erode value is a debatable question. While this exercise does not aim to determine the optimal number of directorships, it is interesting to set board limits based on such studies.

Defining multiple directorships

Multiple directorships occur when an individual sits on the board of more than one company. In our analysis, when a director is seated on the boards of two companies, it is counted as one instance of a member interlock. If a director is seated on three companies, it is counted as one instance of 2 member interlocks for each of the three companies. Summing the number of member interlocks for each company, gives us the number of company interlocks. If a particular company has zero company interlocks, it implies that none of its directors hold board positions in other companies.

Pros and Cons

‘Reputation Hypothesis’ says that multiple board appointments constitutes a reward from the labor market

Table 2: Pros and Cons of multiple directorships

Pros	Cons
Effective channel of communication	Existence of multiple directorships is often not transparent even to players in the industry
Increased prestige for small firms that manage to interlock with large firms	Key control groups can exercise control over a wide range of sectors and businesses
Can take a holistic view of the industry environment rather than the individual corporation’s alone	Can influence government and public policy
Efficient transfer of knowledge and experience	Large companies tend to interlock with each other which can be detrimental to smaller firms
Diffusion of new ideas and innovation	Possibility of collusion and improper business practices

Multiple directorships act as communication channels, enabling flow of information between companies through multiple board representations. These interlocks then form a kind of Social Network with the largest firms in the center (as they tend to have the most interlocks not to mention the most interlocks with *one another*). Major banks, due to the nature of their business, tend to occupy the center of such networks[1].

The presence of multiple directorships has produced two factions, one of which follows the ‘Reputation Hypothesis’ which states that multiple board appointments constitutes a reward from the labor market and signals recognition for a particular manager’s superior talent.

[1] Devine (1997), Glasberg (1989)

Busyness Hypothesis': serving on multiple boards over-commits the individual which would be a stress on their time and may cause them to shirk responsibilities

The other argument is the so-called 'Busyness Hypothesis' which states that serving on multiple boards over-commits the individual to the functions of those boards which would be a stress on their time and may cause them to shirk their responsibilities at some point[2].

Multiple directorships are considered beneficial to a company in the sense that it allows for a greater exchange of knowledge in addition to being an avenue for the diffusion of new ideas and innovative management practices. Further, a small firm would be able to enhance its recognition and image by associating itself with a larger and well-established firm.

Additionally, studies have shown (Burt 1983) that firms will employ interlocking directorships in turbulent times in order to achieve better coordination between firms and to reduce uncertainty.

However, on the flip side multiple directorships can often be opaque and difficult to track; consequently, authority could rest with a handful of elite business people who can exercise a great deal of control over different sectors. Also, these same directors can, at times, sit on the boards of government agencies or as policy directors and can therefore influence public policy decisions which may benefit their firm rather than the economy or sector as a whole. There is also a greater possibility for collusion amongst the directors and unethical management practices in the firms they influence.

[2] Multiple Directorships, Chia-Wei Chen, University of South Florida

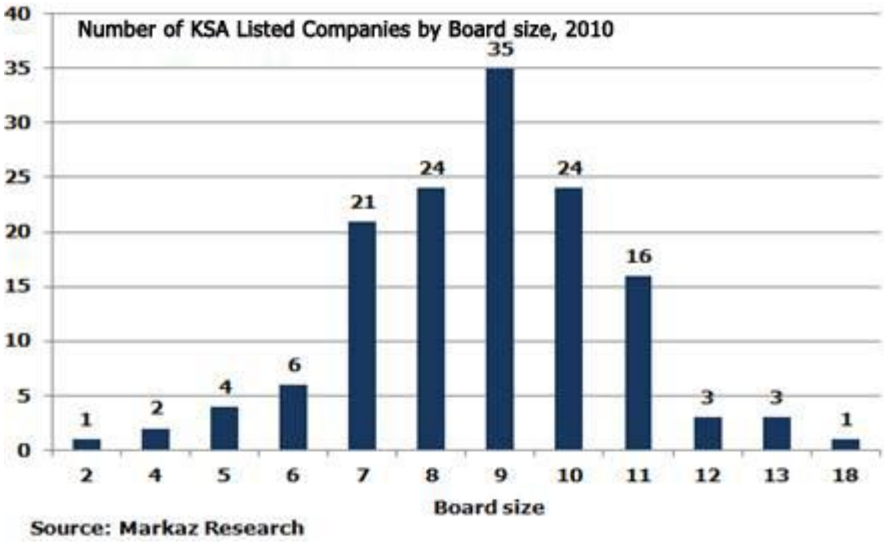
KSA Findings

There were 1,210 directors sitting on the boards of 149 Saudi firms yielding an average board size of 8, as of 2010

From our study about the KSA firms, we found that there were 1,210 directors sitting on the boards of 149 Saudi firms yielding an average board size of 8, as of 2010. (Table 3)

Board size compositions showed wide variation starting from 2 going all the way to 18. However, about 23.5% of companies have a board size of 9 while 16.1% of the companies had a 10-member board (Chart 2). The majority of directors (23%) were in the insurance sector, spread across 31 companies (Table 4) representing 20% of the company population. This was followed by Petrochemicals and Construction. Together these three sectors accounted for ---% of companies and ---% of board of director population.

Chart 2: Number of KSA Listed Companies by Board size, 2010



Overall, 83% of Saudi firms, numbering 124, had multiple directorships while 17% didn't. Sectors like Energy, Real Estate, Media and Hotel enjoyed 100% interlocks meaning companies in these sectors were connected to other companies through common board members. However, together they accounted for ---% of companies and ----% of directors. On the other hand, we notice that there were 25 companies with zero interlocks i.e., no linkages with other boards through common directorship.

Table 3: Characteristics of Boards of Directors, KSA, 2010

Sector	No. of Companies	Percentage (%)	No. of Board Directors	Percentage (%)	Ave. Board Members per Co.	Interlocked companies	Company Interlocks Concentration (%)
	A	B	C	D	E = (C/A)	F	G=(F/A)
Banks & Fin. Serv.	11	7.38	98	8.10	8.91	10	91
Petrochem. Ind.	14	9.40	117	9.67	8.36	12	86
Cement	10	6.71	84	6.94	8.40	8	80
Retail	9	6.04	65	5.37	7.22	8	89
Energy and Utilities	2	1.34	18	1.49	9.00	2	100
Agriculture & Food	15	10.07	104	8.60	6.93	11	73
Telecom & IT	5	3.36	44	3.64	8.80	4	80
Insurance	31	20.81	274	22.64	8.84	25	81
Multi investment	7	4.70	48	3.97	6.86	6	86
Industrial Investment	13	8.72	96	7.93	7.38	12	92
Building construction	15	10.07	114	9.42	7.60	11	73
Real Estate	8	5.37	82	6.78	10.25	8	100
Transport	4	2.68	24	1.98	6.00	2	50
Media and Publishing	3	2.01	25	2.07	8.33	3	100
Hotel and Tourism	2	1.34	17	1.40	8.50	2	100
Total	**149**	**100.0**	**1,210**	**100.0**	**8.12**	**124**	**83**

Source: Markaz Research

Interlock by Sector

The insurance, industrial and construction sectors have most interlocks that range between 0 and 5

Table 4 shows how companies across different sectors are distributed at various interlock categories. For instance, the first cell denotes that 1 bank in Saudi has zero interlocks (no multiple directorships). The insurance, industrial and construction sectors have most interlocks that range between 0 and 5, while about half of the banks have as many interlocks.

Table 4: Company Interlocks by Sector

Sector	0	1	2	3	4	5	6	7	8	9	10	11	12	17	19	21	22	Total
Banks & Fin. Serv.	1	0	1	1	1	1	0	0	1	2	0	2	1	0	0	0	0	**11**
Petrochemical Ind.	2	0	3	1	2	0	2	1	1	0	1	0	0	0	1	0	0	**14**
Cement	2	0	0	1	2	2	0	1	0	0	1	0	1	0	0	0	0	**10**
Retail	1	1	2	0	1	3	0	1	0	0	0	0	0	0	0	0	0	**9**
Energy and Utilities	0	0	0	0	0	1	0	0	0	0	0	0	0	1	0	0	0	**2**
Agriculture & Food	4	3	0	0	2	2	0	1	0	0	0	0	1	0	1	0	1	**15**
Telecom & IT	1	0	1	1	1	0	0	0	0	0	1	0	0	0	0	0	0	**5**
Insurance	6	6	6	1	5	1	2	0	2	2	0	0	0	0	0	0	0	**31**
Multi investment	1	0	1	0	2	1	0	1	0	0	0	0	1	0	0	0	0	**7**
Industrial Investment	1	2	4	1	1	2	1	0	0	1	0	0	0	0	0	0	0	**13**
Building Construction	4	2	1	1	0	2	0	2	1	0	2	0	0	0	0	0	0	**15**
Real Estate	0	2	0	0	0	1	2	0	1	1	0	1	0	0	0	0	0	**8**
Transport	2	1	0	0	0	1	0	0	0	0	0	0	0	0	0	0	0	**4**
Media and Publishing	0	1	0	0	0	0	0	0	1	0	0	0	0	0	0	1	0	**3**
Hotel and Tourism	0	0	1	0	0	0	0	1	0	0	0	0	0	0	0	0	0	**2**
Total	25	18	20	7	17	17	**7**	**8**	**7**	**6**	**5**	**3**	**4**	**1**	**2**	**1**	**1**	**149**

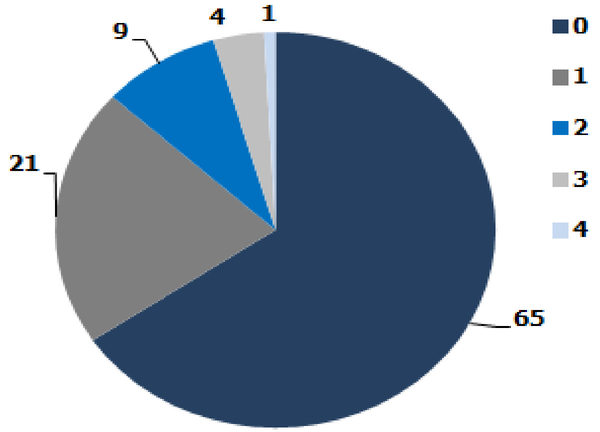
Source: Markaz Research

Director Interlocks

Of 1,210 directors, we found that (65%) were seated on only one board

Analyzing a total of 1,210 directors, we found that the majority (65%) have zero director interlocks, implying they sit on only one board whilst 21% of directors sit on two boards (Chart 3).

Chart 3: Director Interlocks in Saudi Firms



Source: Zawya, Markaz Research

Breaking it down sector wise, majority of the directors are in the Insurance and Petrochemical industries; within these, most of the directors have one board membership. This is illustrated in Table 5 below,

Table 5: Number of board memberships

	One	Two	Three	Four	Five	Six	Total
Banks & Fin. Services	54	25	11	6	1	1	**98**
Petrochemical Ind.	69	30	13	4	0	1	**117**
Cement	52	20	7	4	1	0	**84**
Retail	43	17	2	2	1	0	**65**
Energy and Utilities	7	5	3	2	0	1	**18**
Agriculture & Food	63	19	10	8	2	2	**104**
Telecom & IT	34	4	3	3	0	0	**44**
Insurance	209	43	17	5	0	0	**274**
Multi investment	25	16	4	2	1	0	**48**
Industrial Investment	66	19	10	1	0	0	**96**
Building construction	77	20	14	2	0	1	**114**
Real Estate	52	19	7	2	2	0	**82**
Transport	18	6	0	0	0	0	**24**
Media and Publishing	11	5	4	3	2	0	**25**
Hotel and Tourism	10	6	0	1	0	0	**17**
Total	**790**	**254**	**105**	**45**	**10**	**6**	**1,210**

Source: Markaz Research

Regulations on multiple directorships

Like most of the developed economies, in the KSA multiple directorships are governed by the Capital Market Authority Corporate Governance Regulations (Article 12, h).

KSA law: A member of the Board of Directors shall not act as a member of the Board of Directors of more than five Joint-Stock Companies at a time

According to the Article 12, h, "A member of the Board of Directors shall not act as a member of the Board of Directors of more than five Joint-Stock Companies (JSCs) at the same time". KSA recognizes the importance of interlocks; it merely limits the number for joint-stock companies. Essentially, a director can have 5 directorships in JSCs and additional board seats on non-JSCs.

Furthermore, in terms of Fund Managers and members of a Fund's Board of Directors; the Investment Funds regulations state, in Article 27:

a) Personnel and/or officers of a fund manager may not serve as directors or take up any other office in a company or other entity the securities of which form part of the assets of an investment fund managed by the fund manager. Independent directors for an investment fund may not serve as directors or take up any other office in a company or other entity the securities of which form part of the assets of the investment fund.

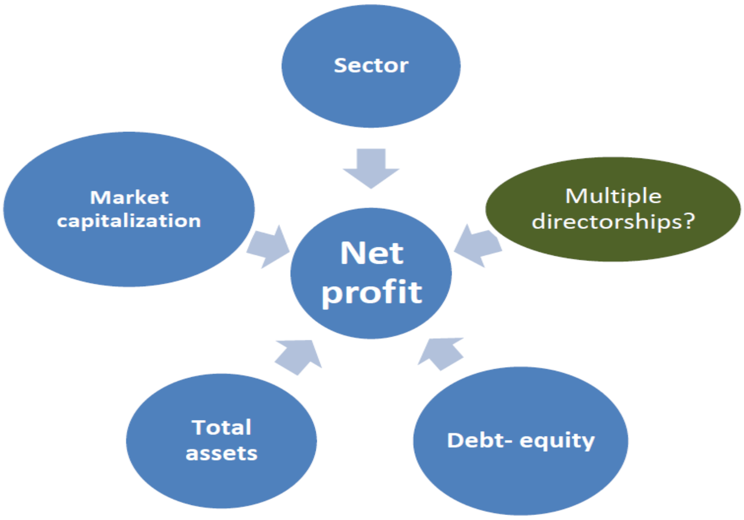
b) If a director or an officer of a company or other entity described in paragraph (a) of this Article is employed by a fund manager or is appointed as an independent member of a fund board, that person must resign from such entity.

Do multiple directorships affect a firm's profitability?

To ascertain whether multiple directorships had a significant influence on a firm's profitability we carried out the Ordinary Least Squares (OLS) regression analysis on the KSA firms.

As shown in Chart 4, generally it is expected that net profits would be influenced among other things by sector, size and capital structure. But, do multiple directorships also affect a firm's profitability?

Chart 4: Factors that influence net profit



Multiple directorships have a statistically significant impact on net income of financial firms of KSA in 2010

Our regression analysis indicates that multiple directorships have a statistically significant impact on net income of financial firms, but not on that of non-financial firms. Neither did we notice any significant impact on net income when all firms were considered together.

Table 6 presents regression results for the analysis of member/director interlocks. We observe that for all firms and non-financial firms, interlocks were not statistically significant in explaining net profit. However, for financial firms, we see that the presence of directors who are on four other boards has a positive impact on net profit; while the presence of directors who are on five other boards has a negative impact on net profit. Market capitalization was found to be significant in explaining net profit in all three cases.

Table 6: Regression Results for Member Interlocks, Saudi Firms

Impact on net income	All firms	Financial firms	Non-financial firms
Zero	No	No	No
One	No	No	No
Two	No	No	No
Three	No	No	No
Four	No	Yes**(+)	No
Five	No	Yes*(-)	No
Total assets	No	Yes***(+)	Yes***(-)
Market cap	Yes***(+)	Yes***(+)	Yes***(+)

Source: Markaz Research

Findings on International Interlocks

There has been a lot of debate on director interlocking worldwide. According to a study published in the International Journal of Business and Social Science, interlocked directorships can have a positive influence on earnings; it indicates that the presence of interlocked board members can be a powerful incentive for more diligent monitoring due to a deeper well of knowledge. However, the relationship appears non-linear, i.e. too many interlocks have proven to be detrimental to earnings[3]. The study showed that as the interlocks increased, earnings quality increased; nevertheless, once the figure crossed the 75% threshold (i.e. more than 75% of directors in a firm are interlocked), a negative association begins to emerge. Another study in the Asia Pacific region concluded that 17% of Directors in Hong Kong held multiple positions versus 18% in the US and 11% in the UK at the end of 1996; however, that being said, the majority (86%) had no more than three outside positions. The proportion was slightly higher in the US at 88% holding two or three positions while it stood at 90% in the UK[4].

18% of directors in the US held multiple positions at the end of 1996 as against 11% in Great Britain

Table 7: International Study on Interlocks

	Hong Kong	Great Britain	US
Total # of directors	1,628	2,682	3,108
Total # of director seats	2,105	3,091	3,976
Total number of multiple directors	276	282	564
Proportion of multiple directors	17%	11%	18%
Mean number of positions	1.29	1.15	1.28
Number of Director seats held by a multiple director			
2	61%	69%	64%
3	25%	21%	24%
4	6%	6%	8%
5	5%	3%	3%
More than 5	3%	1%	1%

Source: Asia Pacific Journal of Management
Note: Study is conducted on the Top 200 firms in Hong Kong and the Top 250 firms in the US and Great Britain

[3] Multiple Board Appointments: Are Directors Effective?, International Journal of Business and Social Science, Vol. 2 - No. 17
[4] Interlocking Directorates, Firm strategies & Performance in Hong Kong, Asia Pacific Journal of Management

Appendix

Regional Regulations on Interlocks

It would be prudent to enforce transparency measures such as requiring firms to show their various corporate relationships and linkages

There has been much discussion internationally as to the optimum number of interlocks for board members; studies differ on whether there is an optimum level and what that level might be.

Some international associations and institutions have placed a limit on the amount of directorships board members can hold:

- In the United States: The Clayton Act (1914) legally prohibits interlocking among firms that compete in the same industry, if the combination of those firms into a single entity would constitute a violation of Antitrust Laws. Moreover, the Council of Institutional Investors recommends that a board member sit on no more than two other boards. Meanwhile, the National Association of Corporate Directors advocates that senior executives not hold more than three directorships,
- The Australian Shareholders' Association places the limit at five,

Bursa Malaysia allows up to twenty-five directorships, of which only ten can be on publicly listed firms

- Bursa Malaysia allows up to twenty-five directorships, of which ten can be on publicly listed firms.

UAE

According to the Commercial Companies Law (Article 98):

A Board member may not be a) director of more than five public joint companies, b) a chairman or vice-chairman of more than two companies, or c) an executive managing director of more than one company whose head offices are in the UAE.

With regard to Fund Managers and members of a Fund's Board of Directors, the Emirates Securities & Commodities Authority (SCA) states in Article 27 of its Investment Funds regulations that:

- Investment Fund manager may not be a member in the boards of companies where it invests part of its funds in their shares, nor shall the employees or officials under the Investment Manager or any member of the Board of Directors or the members of Sharia Board be represented in their personal capacity on the boards of companies which the Fund invests part of its funds in their shares.

- If any party referred to in the first paragraph of this Article appoints any member of the boards of companies which the Fund invests part of its funds in their shares, then that member shall resign from the membership of that board / boards.

However, the SCA does provide some wiggle room in this rule by adding that:

- The Authority may exclude some of the Funds that have special nature from the rulings of [the aforementioned] paragraphs of this article.

Policy makers should be aware of clusters of interlocks among certain sectors, such as Investment, whereby they may be able to exercise a significant amount of control over a broad segment of the market. Consequently, regulatory bodies ought to be aware of key players in the market who are linked with each other[5].

It would be prudent to enforce transparency measures such as requiring firms to show their various corporate relationships and linkages.

Kuwait

Capital Market Authority regulations prohibit interlocking among Fund Managers and persons serving on the Fund's Board of Directors

According to the Kuwait Commercial Law (Article 140), a board member cannot hold more than three outside directorships or act as Managing Director or Chairman of the Board of more than one publicly-listed firm.
Additionally, the Capital Market Authority regulations prohibit interlocking among Fund Managers and persons serving on the Fund's Board of Directors:

Box 1: Article (317)

The staff and officers of the fund manager may not serve on the Board of Directors or hold any position in a company or other entity where its securities form a part of the assets of any investment fund managed by the firm.

And the independent members of the fund's Board of Directors may not serve as Board members or hold any position in a company or other entity whose securities form part of the assets of the investment fund.

Consequently, Fund Managers, their staff and the independent Board members of a fund's Board of Directors may not serve on the boards or hold any position within a company that constitutes a holding or investment of the fund.

Limits on multiple directorships

Given the caveats and possibility for misuse, most countries have enacted laws limiting multiple directorships.

Table 8: Limits on Multiple Positions in Publicly-listed Firms

Country	Directors	Chairman	Managing Director
Saudi Arabia	5	NA	NA
Kuwait	3	1	1
UAE	5	2	1
USA*	2	NA	NA

* The USA does not prohibit multiple directorships, but it is recommended that members do not sit on more than two boards
Source: Capital Market Authorities

The regional regulations on multiple directorships are identical for the Saudi Capital Market Authority and the UAE Securities & Commodities Authority (SCA), both in terms of corporate board membership and investment fund boards. While an individual is permitted to serve on three corporate boards in Kuwait, the UAE and Saudi Arabia permit five board positions. Chairman and Managing Directors in Kuwait can hold only one such position (Table 8).

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