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Sydney Southeast Asia Centre

Exploring cross-industry connectedness in corporate governance networks

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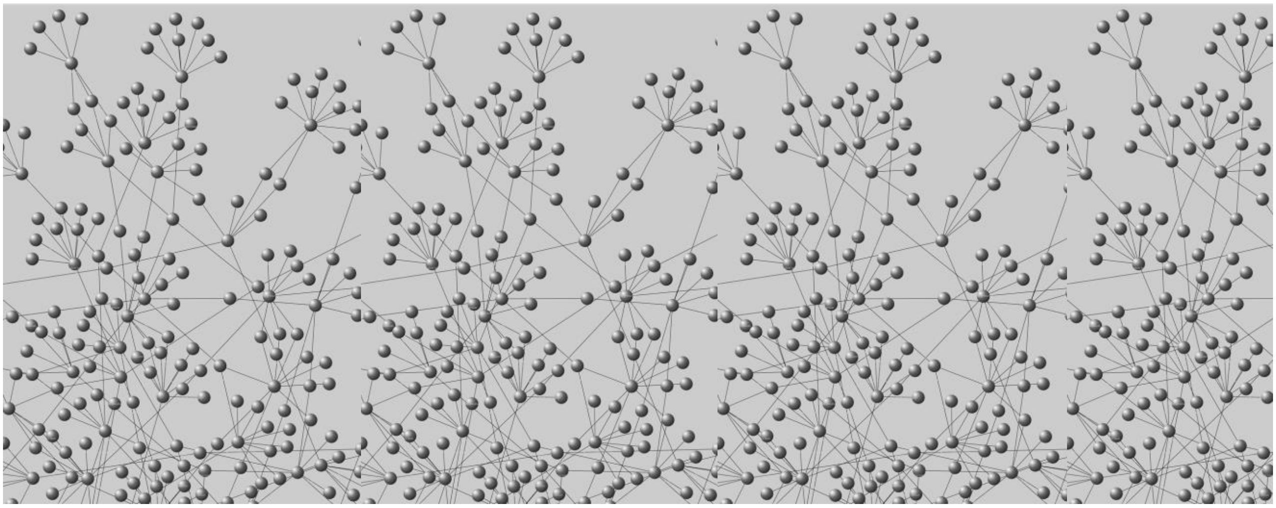

Board interlocks occur when individual directors occupy seats on one or more corporate boards, resulting in a situation where several companies share common directors. Interlocking directorates have been observed since the turn of the 20th century, and have been the subject of academic as well as policy debate in the field of corporate governance.

Origin and significance of interlocks

Corporate governance research focused on developed countries shows that interlocks in corporate governance networks mainly reflect existing social networks among corporate directors.

The membership of individuals on several boards has been found to be largely explained by friendship ties, family connections, and 'old boys' networks'. This has been remarkably consistent across a broad range of countries such as the United States, Norway, Sweden, Denmark and Japan.

Studies elsewhere have also shown that the structure of board interlocks tends to remain stable over time. This indicates that these socially-determined networks are generally resilient to changes in the business environment, including structural change arising from mergers, acquisitions, and regulatory reform.

While anti-trust legislation has virtually eliminated board interlocks among competing companies, interlocking directorates have been found to exist among companies with business relationships: that is, there are companies that share common directors with their key suppliers, major buyers, or both. This reflects motivations associated with exercising greater control over the quality of inputs and outputs across the supply chain. Banks have also been found to occupy corporate directorships, stemming from their financial or investing relationships with companies. These interlocks are motivated by the desire for closer monitoring and oversight of financial interests.

Interlocking directorates serve as conduits for the flow of information and knowledge among companies, and can thus significantly influence corporate decision-making and strategy formulation. As information networks, they create a medium for the diffusion of organisational practices, corporate structures, and strategic management approaches. They have also been found to be employed as a strategy for corporate takeovers, or – conversely – for the defence against takeovers.

Overlapping board memberships, therefore, serve as important drivers not just of corporate and organisational change but also industry evolution.

The case of Vietnam

To characterise the interlocking boards in the country, data from Vietnam's top 100 companies was analysed. The companies represent the largest publicly-traded corporations ranked according to 2015 market capitalisation.

Each company was classified according to the Bloomberg standard industry classification, and the data shows that there are 21 industries represented among the top 100 corporations. The largest industry groups are real estate (14 companies), capital goods (12 companies), food, beverage and tobacco (10 companies), transportation (10 companies), and materials (10 companies). A company typically appoints seven directors to its board, with the smallest board composed of three directors and the largest composed of 12 directors.

Corporate boards in the country continue to be dominated by men, who comprise around 81% of directors in the country.

Network connectors

Data further shows that a total of 628 individual directors serve on the 689 board seats of the major corporations in the country. This provides evidence of individuals holding multiple board seats, who serve as '**connectors**' in the corporate governance network of the country. These connectors are responsible for bridging companies and industries, and act as the glue that binds the network together. Because they act as bridges between companies and industries, connectors effectively define the critical pathways through which information travels across the corporate sector. Therefore, as gateways and gatekeepers to information, they occupy very important and influential positions in the network.

Analysis shows that 54 of the 628 individual directors of the major corporations in the country (or around 9%) sit on multiple board seats. The gender composition of these connectors is skewed in favour of men. Around 83% of the connectors (or 45 directors) in the network are men, while only 17% (or 9 directors) are women.

Among all network the connectors, 49 individuals (or 91% of connectors) occupy 2 board seats, and 3 individuals (or 6%) occupy 3 board seats. A further 2 individuals (or 4%) hold 4 board seats, thus putting them in the category of network '**superconnectors**'.

Of the 2 superconnectors in the network, 1 is a woman. This indicates that network power and influence in the country is overwhelmingly concentrated among the men, although the most influential female superconnector is just as influential as the male superconnector.

Corporate connectedness

Connectors and superconnectors play a significant role in defining the overall structure of a network. The data shows that in Vietnam, the corporate governance network of the top 100 corporations is relatively fragmented: there are 43 individual companies whose boards are completely disconnected from any other board, while the remaining 57 companies form 17 separate clusters of interlocked boards.

Most of the sub-clusters are small, each composed of two or three companies connected by two or three common directors. However, there is one large cluster composed of 11 companies.

Industry connectedness

When the interlocking boards are analysed by industry, however, the data shows a surprising degree of interconnectedness. directors in 14 of the 21 industries represented in the sample form a large network of interlocked relationships (see accompanying Figure). Five industries – utilities, construction and real estate, retailing, properties, and consumer durables and apparel – are disconnected from all the other major industries.

This relatively high degree of industry connectedness indicates that the individual connectors in the network typically participate in the governance of companies that operate in different industries. The top woman superconnector holds 4 board seats across 2 industries, while the top male superconnector has 4 directorships across 4 different industries.
The directors that occupy 3 board seats are typically involved in supervising companies that operate across 3 industries, and more than half of the directors that hold 2 board positions (57%) are involved in companies operating in 2 different industries.

These common directorships points to some degree of concentration in the control of capital across economic sectors in the country, and also explain the extent of industry interconnectedness in the country.

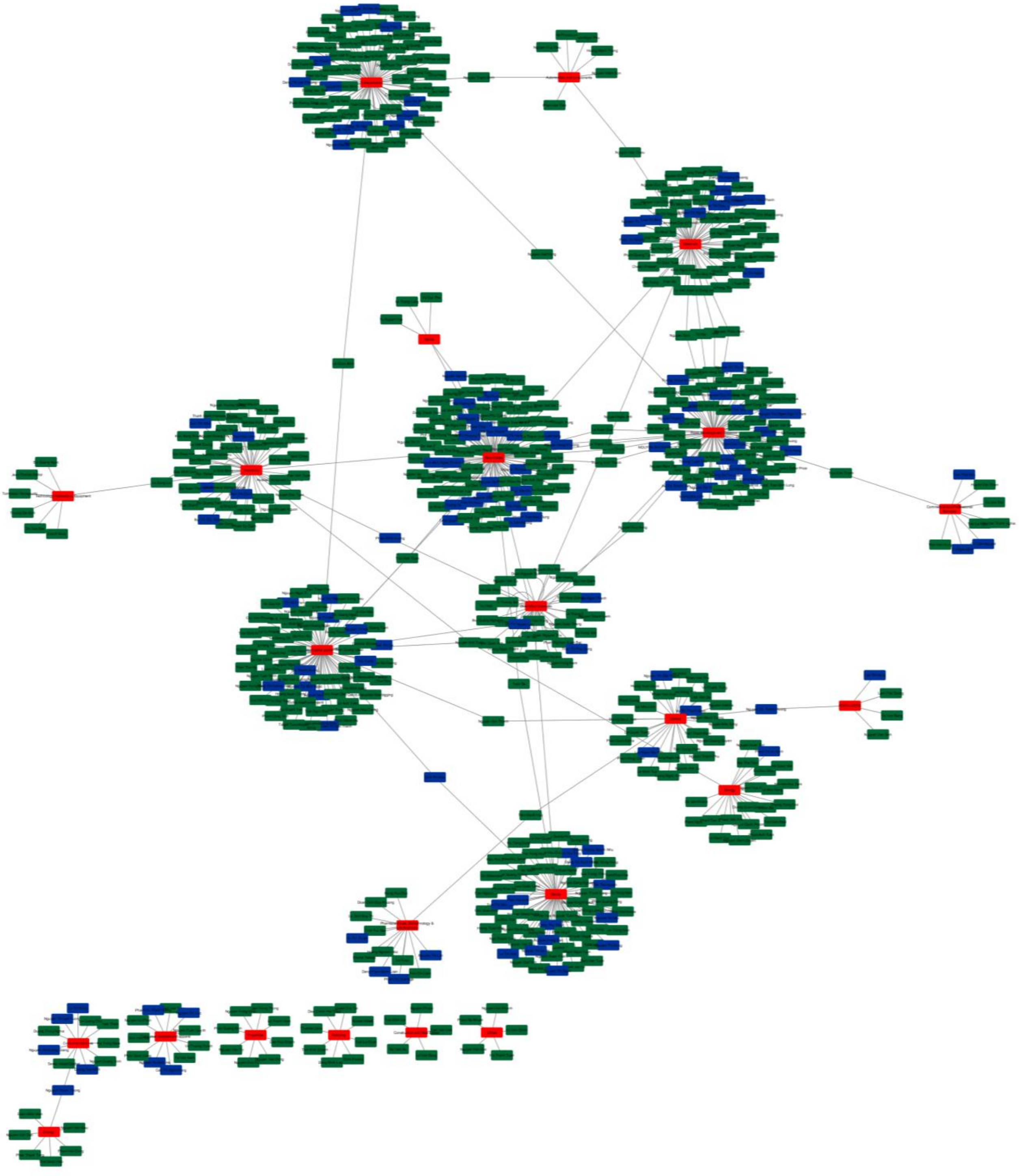

Figure 1: 2015 industry interlocks in Vietnam (where orange boxes are industries, blue boxes are women directors and green boxes are male directors)

The presence of common directors who occupy board seats in several companies within the same industry can be viewed as an indicator of the degree of concentration of control or influence within that industry. The data shows that the industries in which control is tends to be concentrated are diversified financials, materials, insurance, and real estate.

The diversified financials industry has 7 individual directors who each occupy board seats in 2 different companies, while the materials industry has 5 individual directors who each sit on the boards of 2 different companies.

In the insurance industry, there are 4 individuals who occupy board seats on 2 companies, while the real estate industry has 2 individuals who have seats in 2 companies. One female director in the real estate industry holds directorships in 3 different real estate companies. Among the directors in the sample, this represents the highest level of corporate governance influence held by an individual director in a single sector.

Implications

The contrasting nature of the governance network in Vietnam when viewed from the perspective of corporate connectedness versus industry connectedness has interesting and important implications.

While the fragmented nature of the country's corporate governance network points to the existence of a few connectors who link individual companies, this belies the underlying power of these network connectors whose influence in fact extends across industries. The data suggests that the control and management of capital in the country may be concentrated in the hands of a few highly connected and influential directors, and that the corporate sector in the country may be much more interconnected than it appears on the surface.

On the one hand, the disadvantages of a highly connected and clustered corporate governance network include the potential speed of crisis contagion throughout the network. This further signals that there may also be fairly limited opportunities for risk and portfolio diversification for investors, given the highly concentrated nature of capital control and management.

On the other hand, the advantages of having a highly connected corporate governance network are associated with the speed at which information is able to travel through the network. A tightly-knit network structure (within industries and between industries) is particularly helpful in the early detection of potential crises, and in developing proactive responses to risk and crisis management.

Investigating the nature of company-based versus industry-based connectedness points to an opportunity to further raise questions of other potential bases for connectedness. Examples of other types of linkages are family-based and profession-based connections, which also serve as alternative pathways of information dissemination.

There is a significant opportunity to harness the connectedness of the network for purposes of sectoral change and reform. Influencing change may be particularly effective by specifically eliciting the support of connectors and superconnectors in the network, who essentially serve as information superhighways within the corporate sector.

Finally, there is clearly a significant opportunity to further improve gender diversity in the management and control of capital in the country. While some women directors exercise the same degree of power and influence as male directors, women remain a minority in corporate governance in the country.

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