THE UNIVERSITY OF SYDNEY

Sydney Southeast Asia Centre

Exploring cross-industry connectedness in corporate governance networks

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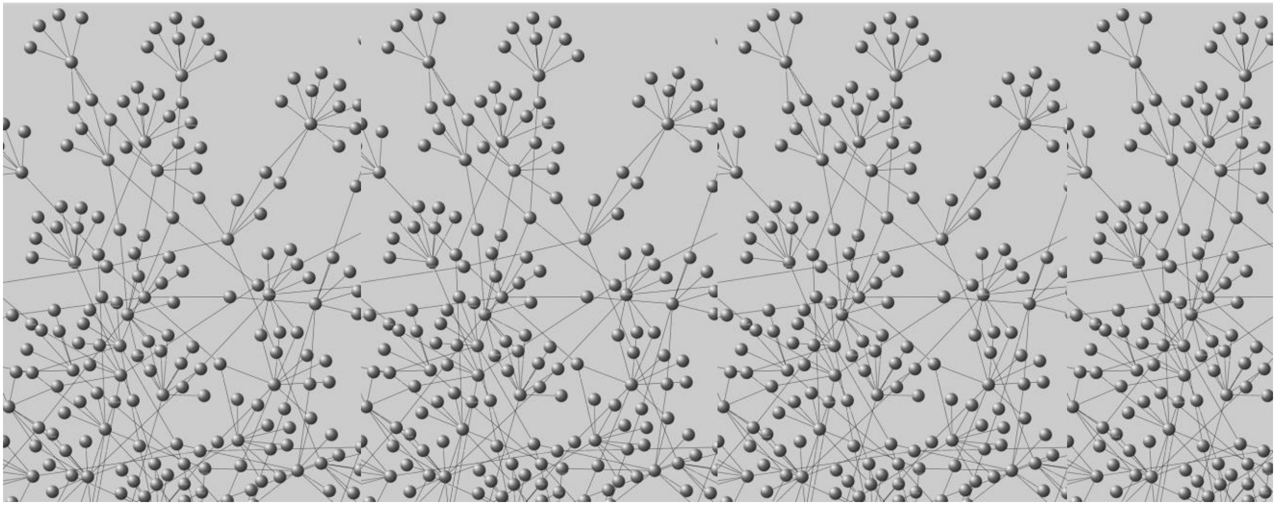

Board interlocks occur when individual commissioners occupy seats on one or more corporate boards, resulting in a situation where several companies share common commissioners. Interlocking boards of commissioners have been observed since the turn of the 20th century, and have been the subject of academic 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 commissioners. 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 boards of commissioners have been found to exist among companies with business relationships: that is, there are companies that share common commissioners 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 commissionerships, 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 boards of commissioners 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 Indonesia

Data from Indonesia's top 100 companies was analysed to characterise the interlocking boards in the country. 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 19 industries represented among the top 100 corporations. The three largest industry groups are food, beverage and tobacco (16 companies), banks (15 companies), and real estate (13 companies). A company typically appoints six commissioners to its board, with the smallest board composed of two commissioners and the largest composed of 22 commissioners.

Corporate boards in the country continue to be dominated by men, who comprise 90% of commissioners in the country.

Network connectors

Data further shows that a total of 508 individual commissioners serve on the 582 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 53 of the 508 individual commissioners of the major corporations in the country (or 10%) sit on multiple board seats. The gender composition of these connectors is skewed in favour of men. Around 94% of the connectors (or 50 commissioners) in the network are men, while only 6% (or 3 commissioners) are women.

Among all network the connectors, 36 individuals (or 68% of connectors) occupy 2 board seats, and 13 individuals (or 25%) occupy 3 board seats. A further 4 individuals (or 8%) hold 4 board seats, thus putting them in the category of network '**superconnectors**'.

Among the 4 superconnectors in the network, only 1 is a woman. This indicates that network power and influence in the country is overwhelmingly concentrated among the men.

Corporate connectedness

Connectors and superconnectors play a significant role in defining the overall structure of a network. The data shows that in Indonesia, the corporate governance network of the top 100 corporations is relatively fragmented: there are 49 individual companies whose boards are completely disconnected from any other board, while the remaining 51 companies form eight separate clusters of interlocked boards.

Four of the eight clusters are small, each composed of only two companies connected by one common commissioner. Three of the clusters each connect between three and five companies, with companies typically sharing one common commissioner.

Industry connectedness

When the interlocking boards are analysed by industry, however, the data shows a surprising degree of interconnectedness. Commissioners in 18 of the 19 industries represented in the sample form a large network of interlocked relationships (see accompanying Figure). Only one industry – Pharmaceuticals, Biotechnology & Life Sciences – is disconnected from all the other major industries.

This 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. Data shows that the 2 to 3 board seats held by the connectors in the network represent corporate governance participation in 2 industries on average. The 4 board seats held by the superconnectors in the network represent participation in 3 industries on average. The top superconnector in the network (who holds 4 board seats) effectively participates in the governance of 4 different industries, representing around 20% of the major industries in the country.

The women connectors in the network typically hold 3 board seats, representing governance participation in 2 industries on average. The top woman superconnector (who holds 4 board seats) participates in the governance of 3 different industries.

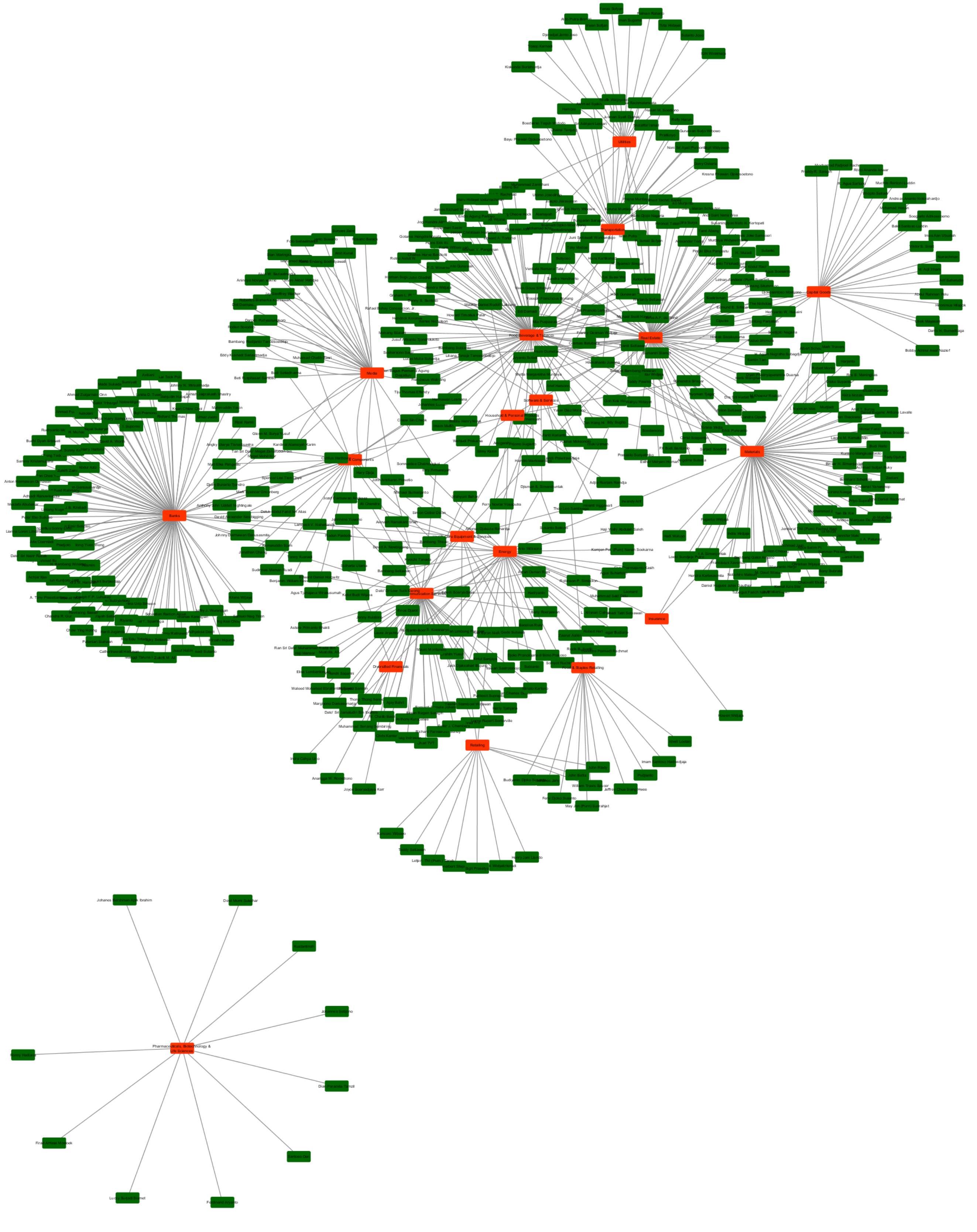

Image: 2015 industry interlocks in Indonesia (where orange boxes are industries, and green boxes are commissioners)

The presence of common commissioners 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 most concentrated are media, real estate, and food, beverage and tobacco.

The media industry has 6 individual commissioners who each occupy board seats in 2 different media companies. There is 1 further commissioner who holds a seat in 3 different media companies. The real estate industry has 7 individual commissioners who each sit on the boards of 2 different companies. In the food, beverage and tobacco industry, there are 2 individual commissioners who each hold 2 board seats. This data points to the conclusion that the media industry has the most significant concentration of governance network power and control among the major industries in the country.

By contrast, the materials, energy, and telecommunications services sectors are among the major industries where governance network power and influence are least concentrated.

Implications

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

While the fragmented nature of Indonesia'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 commissioners, 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.

Exploring the bases for network connectedness (i.e., company-based versus industry-based) 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 also a significant opportunity to harness the connectedness of the network for purposes of sectoral change and reform. Effecting change may be particularly effective by specifically eliciting the support of connectors and superconnectors in the network.

Finally, there is clearly a significant opportunity to further improve gender diversity in the management and control of capital in the country.

Dr Sandra Seno-Alday *is a researcher at the Sydney Southeast Asia Centre and a Lecturer of International Business at the University of Sydney Business School.*
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Sydney Southeast Asia Centre | Dr Sandra Seno-Alday
T +61 2 9351 4916 | **E** sandra.seno-alday@sydney.edu.au
W sydney.edu.au/southeast-asia-centre