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Sydney Southeast Asia Centre

Exploring cross-industry connectedness in corporate governance networks

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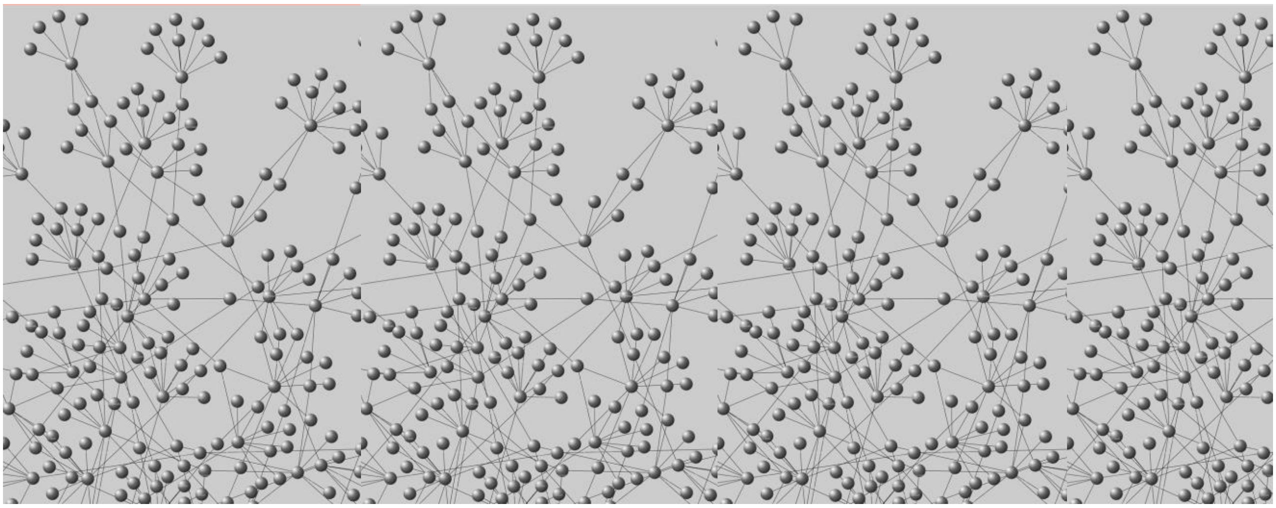

Board interlocks occur when individual directors occupy seats on one or more corporate boards, resulting in a situation where several companies share common directors. Interlocking directorates have been observed since the turn of the 20th century, and have been the subject of academic as well as policy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

Data from the Philippines' top 100 companies was analysed to characterise the interlocking directorates 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 17 industries represented among the top 100 corporations. The three largest industry groups are real estate (15 companies), banks (13 companies), and capital goods (10 companies). Banks tend to have the largest boards, with an average of around 11 directors, followed by real estate companies, with an average of 9 directors.

Corporate boards in the country continue to be dominated by men, who comprise 85% of directorships in the country.

Network connectors

Data further shows that a total of 690 individual directors serve on the 992 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. As gateways and gatekeepers to information, they occupy very important and influential positions in the network.

Analysis shows that 165 of the 690 individual directors of the major corporations in the country (or 24%) sit on multiple board seats. The gender composition of these connectors generally reflects the overall gender composition of corporate governance in the country, but with a further slight increase in the dominance of men. Around 89% of the connectors in the network are men, while only 11% are women.

Among all network the connectors, 99 individuals (or 60% of connectors) occupy 2 board seats, and 33 individuals (or 20%) occupy 3 board seats. A further 33 individuals (or 20%) hold 4 or more directorships, thus putting them in the category of network '**superconnectors**'.

Most of the superconnectors (14 individuals or 42%) occupy 4 board seats, while 18 individuals (or 55%) hold between 5 and 7 directorships. The single most connected individual in the network sits on 11 different boards. Among the 33 superconnectors in the network, only 1 is a woman, who holds 4 directorships. 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. Data shows that the Philippine corporate governance network is highly clustered and connected. There are only five companies whose boards are completely disconnected from all the other boards of the major corporations in the country.

There are two small clusters of two companies each, sharing one or two common directors. However, the data shows that more than 90% of the top corporations in the country form a very large network of interconnected boards.

Industry connectedness

When the interlocking directorates are analysed by industry, the data shows an even greater degree of interconnectedness. Directors in 16 of the 17 industries represented in the sample form a large network of interlocked relationships (see accompanying Figure). Only one industry – retailing – 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 to 7 board seats held by the superconnectors in the network represent participation in 4 industries on average. The top superconnector in the network (who holds 11 directorships) effectively participates in the governance of 9 different industries – more than half the major industries in the country.

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

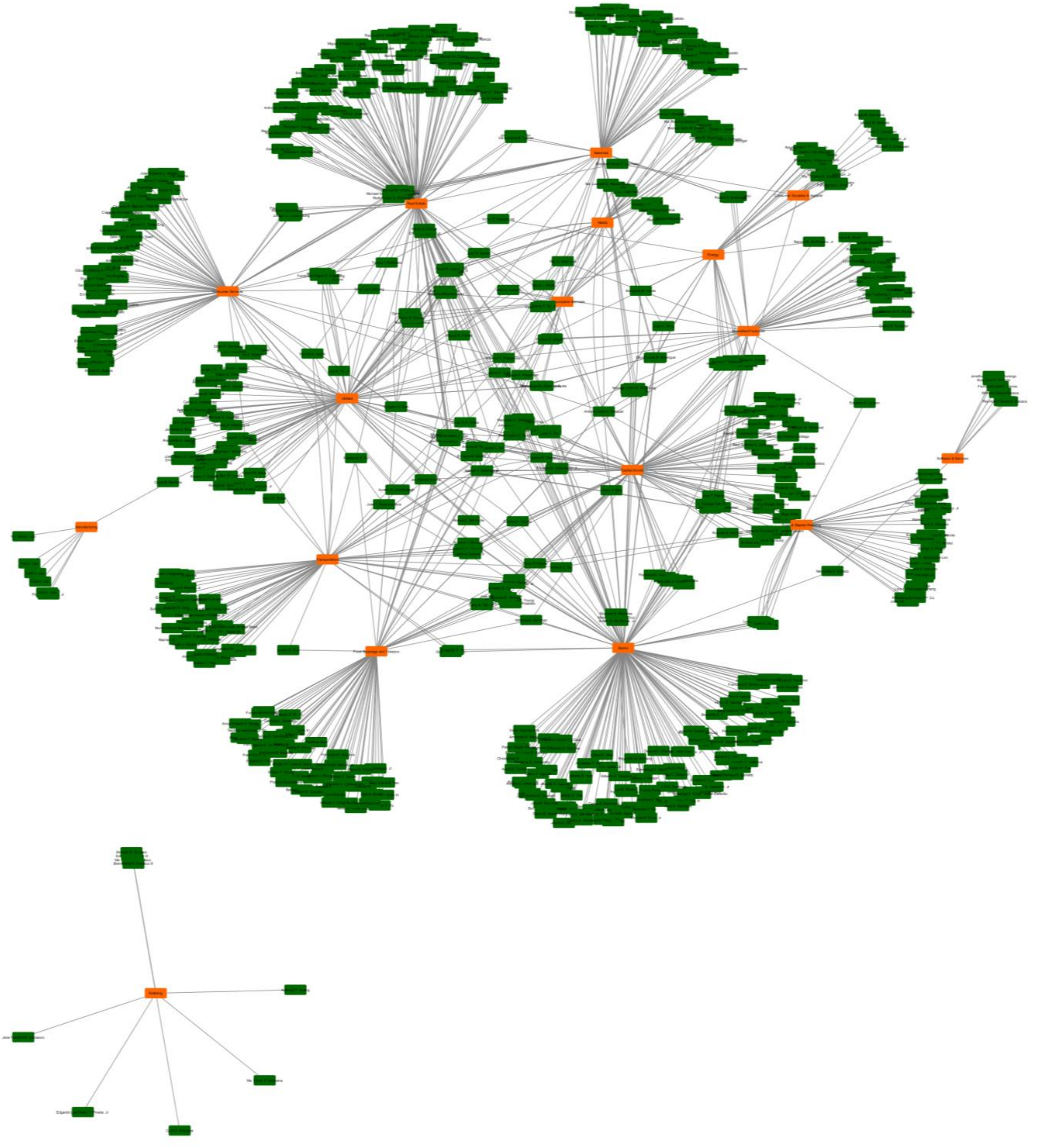

Image: 2015 industry interlocks in the Philippines (where orange boxes are industries, and green boxes are directors)

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 most concentrated are media, real estate, and utilities.

The media industry has 10 individual directors who each occupy board seats in 2 different media companies. The real estate industry has 12 individual directors who each sit on the boards of 2 different companies, and a further 2 directors who each have directorships in 3 companies in the industry. In the utilities industry, there are 5 individual directors who each have 2 directorships, and 5 other directors who each have 3 directorships in the industry. There is 1 individual director who holds a seat in 4 different utilities companies. This data points to the conclusion that the utilities industry has the most significant concentration of governance network power and control among the major industries in the country.

By contrast, consumer services and food, beverage and tobacco are among the major industries where governance network power and influence are least concentrated.

Implications

The highly connected nature of the Philippines's corporate governance structure has important implications on the vulnerability of the corporate sector to crises. The data suggests that the control and management of capital may be concentrated in the hands of a few highly connected and influential directors. The connectors and superconnectors in the network have been found to bridge not only individual companies, but extend influence across several industries as well.

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. The finding regarding the high degree of interconnection between industries signals that contagion can very quickly spread across industries and sectors in the whole economy. 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.

While the participation of women in corporate boards is higher in the Philippines compared to other key countries in Southeast Asia (including Singapore and Indonesia), there continue to be significant opportunities 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

THE UNIVERSITY OF SYDNEY

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