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Is prior director experience valuable?
Evidence from new director appointments

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Is prior director experience valuable?

Evidence from new director appointments

Abstract

Prior studies have investigated numerous director characteristics (e.g. professional expertise, qualifications and independence), yet they have failed to examine the prior experience of directors as directors. Using a hand-collected dataset, this paper examines the market reaction at appointment of new non-executive directors to determine whether shareholders value the prior directorial experience of appointees. We find that both the depth (number of prior years) and breadth (number of current directorships) of the appointee's director experience is valued by shareholders at the time of appointment. In particular, the market reaction is strongest: (1) for appointees with the most prior director experience, i.e. those with two or more other current directorships in listed companies and four or more years of director experience, and (2) when experienced appointees join less experienced boards. Further analysis indicates that experienced directors are valued for their general experience and not specialist experience related to board committees or specific industries.

Keywords: board of directors, director appointments, director experience.

1. Introduction

Corporate directors are required to perform numerous complex tasks, e.g. monitor firm operations and management, analyse merger and acquisition opportunities, evaluate capital raising options, and hire and set the remuneration of top executives. Prior studies show that executive experience and specialist legal, financial or industry-specific skills assist directors in performing these tasks (Dass et al., 2010; Defond et al., 2005; Fich, 2005; Guner et al., 2008; Krishnan et al., 2011). In this study, we propose that prior experience as a director (i.e. experience performing the tasks required of directors) is the most relevant expertise directors can possess.

In specific settings, previous research shows that directors with prior experience make better acquisition decisions (Kroll et al., 2008; McDonald et al., 2008) and have more influence on the board (Westphal and Milton, 2000). Other studies that have examined a potential measure of the experience of individual directors, the number of current directorships in other listed companies, have focused on the constructs of “busyness” or “connectedness” and not director experience (Ferris et al., 2003; Fich and Shivdasani, 2006; Field et al., 2011; Larcker et al., 2010).

In this study we examine whether the prior directorial experience of appointees is valued by shareholders at the time of appointment. We focus on the appointment of new directors to firms, as this is a cleaner setting to examine the prior director experience the appointee brings to the hiring firm. Using panel analysis to relate director experience to firm performance would mix the experience of directors within the firm with their experience from outside the firm. Examining the market reaction to the appointment of new directors also allows us to determine whether prior director experience is a characteristic that is valued by shareholders.

We measure the prior director experience of appointees in a number of ways – the number of years of experience the appointee has as a director of other listed companies, the number of current directorships the appointee has in other listed companies and combinations of these two variables. These measures allow us to investigate the relative importance of both the breadth (number of current directorships) and depth (number of prior years) of the appointee’s experience as a director. Our methodology also allows us to isolate the incremental effect of director experience by controlling for other director and hiring firm characteristics. We specifically control for the appointee’s independence, professional expertise and qualifications, and also control for other hiring board and firm characteristics.

We find that both the depth and breadth of the appointee’s prior director experience is valued by the market at the time of appointment. The market reaction is strongest for appointees with the most director experience, i.e. those with two or more other current directorships in listed companies and four or more years of director experience. This indicates that a mix of depth and breadth of experience as a director is the most valuable combination. We also relate the director experience of the appointee to the existing director experience on the hiring board. Using a number of measures of hiring board experience, we find that the incremental value of the appointee’s experience as a director is only significant to hiring boards with less experience and is insignificant to hiring boards with more experience. This suggests that experienced directors are not valuable additions to all firms.

The remainder of the paper is organized as follows. The next section provides details of prior research and develops hypotheses. Section 3 explains the data and variables. Section 4 outlines the methodology and discusses the results. Conclusions are provided in section 5.

2. Hypothesis Development

The board of director literature can be separated into two areas. The first area examines properties of the board as a whole. Recent reviews are provided by Adams et al. (2010) and Hermalin and Weisbach (2003). The second area examines the characteristics of individual directors. Studies in this area generally relate the market reaction at the appointment of new directors to various director characteristics (Yermack, 2006). This study is primarily related to the second area of the literature that examines the characteristics of individual directors.

Prior studies have found that the appointment of outside directors with certain characteristics are viewed favourably by investors. Fich (2005) shows that the market reaction at appointment is higher for outside directors that have extensive executive experience, i.e. are CEOs of other listed companies. Defond et al. (2005) find that outside directors with financial expertise relevant to the hiring firm's audit committee are viewed favourably by investors. Other similar studies show that the market reaction at the appointment of new directors is related to independence, CEO involvement, interlocking directorships and firm size (Rosenstein and Wyatt, 1990; Shivdasani and Yermack, 1999). More recent studies also provide further evidence that the expertise of directors (e.g. industry knowledge, banking expertise and legal expertise) has an effect on board actions (Dass et al., 2010; Guner et al., 2008; Krishnan et al., 2011).

While prior studies have provided valuable insights, it is somewhat surprising that researchers have not fully investigated the experience of directors as directors. This is unusual as the management literature has provided evidence that the effectiveness of directors is related to their past experience as a director. Westphal and

Milton (2000) find that experienced directors are able to interpret business situations more effectively and Hillman and Dalziel (2003) contend that greater experience can enhance a director's ability to monitor firm performance and provide advice to the firm. Westphal (1999) find that experienced directors develop ties with other directors and executives more easily. In addition, Kroll et al. (2008) and McDonald et al. (2008) both show that directors with more relevant experience make better corporate acquisition decisions.

One reason why director experience has not been investigated in the finance literature is the lack of disclosure of such experience in the annual reports of firms in the United States. Another possible reason is that studies that have examined a possible measure of director experience, the number of current directorships in other listed companies, have focused on the constructs of "busyness" or "connectedness" and not director experience (Ferris et al., 2003; Fich and Shivdasani, 2006; Field et al., 2011; Larcker et al., 2010). The results of these studies have also been mixed, with Ferris et al. (2003) finding an insignificant market reaction to the appointment of busy directors (those with two or more other directorships), while Fich and Shivdasani (2006) find a positive market reaction to the departure of busy outside directors.

We overcome these obstacles by examining the experience of directors in Australia, where the reporting requirements provide greater detail on the current and past experience of directors in listed companies. In particular, Section 300 of the Corporations Act 2001 in Australia and Australian Stock Exchange listing rules require firms to disclose the skills, experience and expertise relevant to the position of director held by each director in office. These disclosures include all directorships held by directors in the past three years, with firms generally also reporting the period

of each directorship.¹ We hand collect this data from annual reports to construct numerous measures of director experience – the number of years of experience a director has as a director of other listed companies, the number of current directorships a director has in other listed companies and combinations of these two variables.

Thus, this study is the first to relate the market reaction at the appointment of new outside directors to the prior experience the appointee has as a director. This is a direct test as to whether the experience the appointees have acquired as directors of other listed companies is deemed to be beneficial to their new directorships. Since directors are required to perform a range of complex tasks (e.g. monitor firm operations, analyse merger and acquisition opportunities, evaluate capital raising options, and hire and set the remuneration of top executives) and directors come from a range of different backgrounds that may or may not equip them with the skills to perform these tasks, we propose that appointees with prior experience performing these tasks as directors of listed companies are likely to be perceived as more effective directors by shareholders. Our first hypothesis is stated as:

H1: The market reaction to the appointment of non-executive directors is positively related to the appointee's prior experience as a director.

We also examine the effect the experience of the hiring board has on the market reaction to the prior director experience of the appointee. While not specifically examining this relationship, Ferris et al. (2003) provide some evidence

¹ When firms do not specifically report the period of each directorship, we track the director's tenure in that directorship from the specific company. In a small number of cases where this information is not available, we assume the directorships have tenures of 3 years. This assumption does not influence our reported results.

that a relationship exists between the experience of the appointee and the experience of the hiring board. They find a positive market reaction when appointees with multiple directorships join hiring boards that do not contain directors with multiple directorships. When appointees with multiple directorships join hiring boards that already contain directors with multiple directorships the market reaction is insignificant. Similar analysis has also been conducted by Defond et al. (2005) to identify the effect of the first versus subsequent financial expert joining audit committees. As we expect the usefulness of the appointee's prior experience as a director to be most valuable to hiring boards with less experience, our second hypotheses is stated as:

H2: The appointee's prior experience as a director is most valuable to hiring boards with less experience.

3. Data and Variables

3.1 Sample

Our sample of non-executive director appointments is obtained from the Boardroom database from Connect4. This database analyses company announcements and records the date of all director appointments to Australian Stock Exchange (ASX) listed companies. Our preliminary sample started with 3,157 outside director appointments to ASX-listed companies between January 1, 2004 and June 30, 2006. We then undertook stringent measures to ensure the non-executive director appointment announcements are indeed new appointments and are not contaminated by other news announcements. We removed appointments where we could not confirm the announcement date of the appointment on the ASX Company Announcement database (741), where the director is not new to the company (718), where other news

was announced during the period from the day before to the day after the appointment announcement (704), where there were multiple appointment announcements on the same day (211) and where insufficient share price and financial data is available (360). These restrictions limit our sample to interim appointments, i.e. those not voted on at annual general meetings, which reduce the likelihood that the appointments were anticipated by the market.² After these restrictions, our final sample comprises 423 non-executive director appointments made by 332 companies.

Figure 1 shows the distribution of the appointment announcements across months of the year. The greatest number of observations is in May (50) and the least in November (19). The appointment announcements are spread across the year, which indicates that they are not clustered around any particular reporting dates. In total, there are 149 observations from 2004, 183 observations from 2005 and 91 observations from 2006.

3.2 Variables

Appointee director and hiring board characteristics are hand-collected from company annual reports on the Connect4 Annual Report database and appointment announcements. Hiring company financial and share price data are obtained from Aspect and Sirca databases. Table 1 provides definitions of the variables used in this study. Our main variables of interest are *Years* (number of years experience the appointee has as a director of other listed companies) and *Directorships* (number of current directorships the appointee has in other listed companies). In our analysis, we also identify directors with specific types of director experience. *Dir2+* is a dummy

² As interim appointments are made by the board there is less chance for the market to anticipate this news. In contrast, appointments conducted at the annual general meeting of shareholders require the company to circulate the list of director candidates in advance, which provides the market with information about potential new appointments before voting to elect the candidates takes place.

variable equal to one when the appointee has two or more current directorships in other listed companies.³ *Dir2+Yr1-3* is a dummy variable equal to one when the appointee has two or more current directorships in other listed companies and 1-3 years experience as a director of listed companies. *Dir2+Yr4+* is a dummy variable equal to one when the appointee has two or more current directorships in other listed companies and 4 or more years experience as a director of listed companies.

An advantage of our study is that we examine the incremental effect of the appointee's experience as a director while controlling for other director characteristics highlighted by the previous literature. A number of studies have examined the professional expertise of new directors. For example, Rosenstein and Wyatt (1990) find a higher stock market reaction when directors come from banks or other financial corporations. DeFond et al. (2005) find that the market reaction to new director appointments is higher if the director has financial expertise that is relevant to the company's audit committee. Similarly, Fich (2005) shows that announcement returns are higher if the director has expertise as a CEO of another listed company. Consistent with these studies, we categorize appointee directors into the following professional expertise groups: academic, banker, consultant, executive, financial/accounting expert, lawyer, politician and current CEO of another listed company. As Australia has an abundance of mining and health-related companies, we also introduce the additional occupation groups of engineer, scientist and medical doctor.⁴

Since directors in Australia are required by section 300 of the Corporations Act 2001 to disclose their level of education and other relevant qualifications in annual reports, we are able to distinguish between directors that have obtained

³ Some prior studies have labelled these directors as "busy" directors (Ferris et al., 2003; Fich and Shivdasani, 2006).

⁴ Directors are allocated to professional expertise groups based on their descriptions in appointment announcements and annual reports. If a director has experience in two or more expertise groups, then we use the classification in which the director has the most experience.

bachelor, master or PhD degrees. This is consistent with prior studies, such as Fich (2005), who highlights directors with MBA or law degrees. Our qualification variables are therefore coded as no degree, law degree, other bachelor degrees, MBA, other master degrees and PhD.⁵

Director independence has been the subject of numerous studies. We therefore distinguish between independent and non-independent directors. As an additional measure of independence, we also include a dummy variable if the appointee holds shares in the hiring company (Equity). To ensure we are measuring the director experience the appointee brings to the hiring board and not other characteristics of the appointee, we also include dummy variables to highlight when the appointee is bringing new expertise and a new qualification to the hiring board. We also include a dummy variable to distinguish between the creation of a new board seat and an appointment that replaces a departing director.

CEO power and the CEO's ability to influence the appointment process have also been found to result in appointments that are viewed less favourably by the market. Directors who serve on boards with interlocking directors are also viewed less favourably. Therefore, following Shivdasani and Yermack (1999), we include dummy variables to indicate when the CEO is involved in the appointment process, when the CEO also holds the position of Chairman and when there are interlocking directorships. We also include the tenure of the CEO as another measure of CEO power. The market reaction to new director appointments has also been found to be related to company size, performance, growth prospects and existing board independence (Rosenstein and Wyatt, 1990; Fich, 2005). We therefore include control variables to isolate the effect of these influences.

⁵ Qualification dummy variables are for the highest degree only. The order is PhD, MBA, other master degrees, LLB and other bachelor degrees.

3.3 Descriptive Statistics

Table 2 displays summary statistics for appointee and hiring firm characteristics. Appointee directors have a range of prior director experience. Years of experience in other listed companies ranges from 0 to 21 years with an average of 2.37 years. Number of other directorships in listed companies ranges from 0 to 6 with an average of 0.70. In the professional expertise classifications, 35 percent of appointees are general business executives, 17 percent are bankers, 14 percent are financial experts, 9 percent are engineers, 6 percent are lawyers, 6 percent are scientists, 5 percent are CEOs, 4 percent are consultants, 2 percent are academics, and 1 percent are medical doctors or politicians.

With respect to qualifications, 11 percent have law degrees, 31 percent have other bachelor degrees, 9 percent have MBAs, 9 percent have other master degrees, 10 percent have PhDs and the remaining 30 percent have no degree. A total of 80 percent of appointees are classified as independent and 14 percent have an equity interest in the hiring company. Of the new appointees, 46 percent bring new professional expertise to the hiring board and 29 percent bring a new qualification to the hiring board. In addition, 32 percent of the appointments are new seats on the board rather than replacing a departing director.

As the appointing firms come from the complete range of ASX-listed companies there is variation in size from a minimum of less than \$10 million in total assets to a maximum of \$411.31 billion. The mean (median) sample firm has total assets of \$2.94 billion (\$50 million), return on assets of -11.18 percent (0.46 percent), a market-to-book ratio of 3.07 (2.12), debt-to-total-assets ratio of 0.35 (0.33), board size of 4.53 directors (4.00 directors) and board independence of 46 percent (50

percent). The average hiring firm CEO has tenure of 5.03 years and is involved in the appointment of new directors in 83 percent of the observations. There is a 5 percent incidence of interlocking directorships with the appointee and 14 percent incidence of Chairman-CEO duality. The average tenure of the hiring board directors is 4.82 years. The average total director experience of the hiring board is 31.79 years and 3.58 other current directorships in listed companies. A total of 42 percent of hiring boards have one or more directors with two or more current directorships in other listed companies and 4 or more years experience as a director of listed companies.

4. Empirical Results

Our main empirical analysis is divided into two sections. The first section relates the market reaction to the appointment of non-executive directors to the prior director experience of the appointee. The second section examines the effect hiring board experience has on the market reaction to the appointee's prior director experience. In our analysis, cumulative abnormal returns (CARs) around the appointment announcement are calculated following the standard event study methodology of Dodd and Warner (1983). Market model parameters are estimated from 250 trading days to 20 trading days prior to the announcement date. Results are presented for 3-day CARs (-1,+1). However, all analysis is also conducted using 2-day and 5-day event periods, using average returns over the estimation period and excess returns instead of abnormal returns during the event windows, with results consistent with those presented.

4.1 Director Experience

In this section, we test Hypothesis 1 by relating the market reaction at the appointment of non-executive directors to the prior directorial experience of the appointee. The director experience of the appointee is measured from two dimensions – the number of years of experience the appointee has as a director of other listed companies (*Years*) and the number of current directorships the appointee has in other listed companies (*Directorships*).

In Table 3 we separate each measure of the appointee’s director experience into three sub-groups and present the market reaction at appointment for each group. Panel A shows that 150 appointees have no prior experience as a listed company director, 176 appointees have 1-3 years of prior experience and 97 appointees have 4 or more years of prior experience. For *Directorships*, 248 appointees have no other current directorships in listed companies, 99 appointees have one directorship and 76 appointees have two or more directorships.

We find the market reaction is significantly positive for the most experienced appointees, i.e. those with four or more years of prior director experience and those with two or more current directorships in other listed companies. These results are consistent across the three different methodologies used to calculate abnormal and excess returns and provide some initial evidence that the appointee’s prior experience as a director is valued by shareholder at the time of appointment. However, we also find positive excess returns for appointees with no other current directorships, which reminds us that other director characteristics (unrelated to prior director experience) are also related to the market reaction at appointment.

In Panel B, we recognize that the two measures of the appointee’s prior director experience need not be independent, so we construct a 3x3 table of the two measures. Each cell reports the market reaction, t-statistic and number of appointees

(in square brackets). The analysis shows that the market reaction is only significantly positive for the 36 appointees with two or more directorships and 1-3 years of experience, and the 39 appointees with two more directorships and 4 or more years of experience. These results show that it is the combination of years of experience as a director and other current directorships that is valued highest by shareholders at the time of appointment.

The preceding analysis, while informative, suffers from two limitations. It does not control for other director and hiring firm characteristics that may be related to the market reaction at appointment. It also does not show that the market reaction for appointees with more director experience is significantly higher than that for appointees with less director experience. These limitations are overcome in our multivariate analysis.

Table 4 presents the results of our model relating the CARs (-1,+1) at the announcement of our sample of non-executive director appointments to the director experience of the appointees, while controlling for other director and hiring firm characteristics. In the first regression, we find the coefficient on *Years* is insignificant but the coefficient on *Directorships* is positive. This indicates that the market reaction at appointment is higher for appointees with more directorships in other listed companies but is unrelated to the number of years of prior experience the appointee has as a director. As our prior analysis suggests the market reaction is strongest for appointees with two or more other directorships, we replace the continuous variable, *Directorships*, with the dummy variable, *Dir2+*, in the second regression. We find a positive coefficient on *Dir2+*, which indicates that the market reaction is significantly higher for appointees with two or more other directorships than for all other appointees.

Since our prior analysis also indicates that the market reaction is highest for appointees with a combination of two or more other directorships and 1-3 years of director experience, or two or more other directorships and 4 or more years of director experience, we include the dummy variables, *Dir2+Yr1-3* and *Dir2+Yr4+*, in the third and fourth regressions. We find the coefficients on the two variables are of a similar magnitude but only the coefficient on *Dir2+Yr4+* is significantly positive in the fourth regression. This indicates that the market reaction at appointment is only significantly higher for appointees with the most prior directorial experience, i.e. those with two or more other current directorships in listed companies and four or more years of prior director experience. The magnitude of the coefficient on *Dir2+Yr4+* indicates that the market reaction is on average 1.78 percent higher for appointees with the most prior director experience.

This analysis was conducted while controlling for the professional expertise, qualifications and independence of the appointee, as well as a range of hiring board and hiring firm characteristics. Within these control variables we find the market reaction at appointment is significantly lower for appointees with expertise as medical doctors and politicians, when there are interlocking directorships between the appointee and the hiring board, and when the hiring CEO has longer tenure. The expertise results suggest that medical doctors and politicians are value-decreasing appointments in Australia, possibly because these skills can be accessed when needed and do not need to be on the board in full-time roles. The remaining results are consistent with prior literature (e.g. Shivdasani and Yermack, 1999).

4.2 Hiring Board Experience

In this section, we test Hypothesis 2 by examining the effect the experience of the hiring board has on the market reaction to the appointee's director experience. We hypothesise that the director experience of the appointee is most valuable to hiring boards with less experience. We use a number of variables to measure the experience of the hiring board – average tenure of the directors on the hiring board, tenure of the CEO, total years of director experience of the hiring board directors, total number of outside directorships of the hiring board directors and a dummy variable to indicate the presence of at least one very experienced director (*Dir2+Yr4+*) on the hiring board.⁶ We split our sample into two sub-samples above the median and equal to or below the median for each continuous variable. We then repeat the regression analysis presented in Table 4 on the two sub-samples.⁷

Table 5 presents the results of this analysis. For each measure of hiring board experience we report the regression coefficients for *Directorships*, *Dir2+* and *Dir2+Yr4+*. These coefficients come from the same models presented in specifications 1, 2 and 4 of Table 4. For brevity, the coefficients on the control variables are not displayed but are consistent with those reported in Table 4.⁸ In Panel A, we find that the coefficients on the three measures of the appointee's director experience are only significant in the sub-sample where the average tenure of the hiring board directors is equal to or less than the median of 4 years. In Panel B, we find similar results with the coefficients on the three variables only significant when

⁶ We focus on direct measures of the experience of the hiring board rather than using more general firm characteristics, such as firm age or size, as proxies for firms' need for director experience (Field et al., 2011).

⁷ This analysis shows us in which sub-samples the market reaction to the appointment of experienced directors is significantly higher than the market reaction to other appointees. This is a direct test of our research question – when is prior director experience valuable. We do not interact the appointee experience measures with the hiring board experience variables as we are not specifically interested in when appointee experience is more (or less) valuable than average.

⁸ The number of experienced appointees in each sub-sample is quite similar. For example, the ratio of *Dir2+Yr4+* observations in each sub-sample is 19:20, 26:13, 18:21, 18:21 and 22:17 for the five hiring board experience variables presented in Table 5.

the tenure of the hiring firm CEO is equal to or less than the median of 3 years. These results indicate that the incremental value of the appointee's experience as a director is only significant in firms where the hiring board and CEO are less experienced (shorter tenure).

However, while these two measures of tenure account for the experience of the hiring board (and CEO) inside the hiring firm they do not take into account the director experience of the hiring board outside of the hiring firm. In Panels C and D we report the results for the total years of director experience and total number of outside directorships of the hiring board directors. In Panel C, we again find that the coefficients on the three measures of the appointee's director experience are only significant in the sub-sample with less hiring board experience. In Panel D, we find the coefficients are insignificant in both sub-samples. These results suggest that the incremental value of the appointee's experience as a director is significant in firms where the hiring board has less years of director experience, but is unrelated to the number of outside directorships.

In Panel E, we use our combined measure of director experience (Dir2+Yr4+) and a dummy variable to indicate which hiring boards already have at least one director that has both two or more outside directorships and four or more years of director experience. We find the coefficients on the three measures of the appointee's director experience are only significant in the sub-sample where the hiring board does not already contain a very experienced director (Dir2+Yr4+). These results confirm that the incremental value of the appointee's experience as a director is related to the existing experience of the hiring board. In fact, we find that the incremental value of the appointee's experience as a director is only significant to hiring boards with less experience and is insignificant to hiring boards with more experience.

4.3 Further Analysis

In our analysis we have documented a higher market reaction for appointees with more prior experience as a director. However, it is also possible that appointees with more prior experience as directors also have more business or life experience in general, which is driving the results. To overcome this concern we collect the age of the appointees at the time of appointment. As the age of directors is disclosed voluntarily we are only able to collect this for 281 out of 423 appointees. We find that the average age of 55.25 years of the most experienced appointees (*Dir2+Yr4+*) is insignificantly different to the age of all other appointees (54.27) and the age of other appointees with at least one other directorship (54.71). When we include the age variable in our models presented in Table 4, we find the coefficients on *Directorships* (0.0063, $t=2.09$), *Dir2+* (0.0211, $t=2.59$) and *Dir2+Yr4+* (0.0213, $t=2.02$) are consistent with those previously reported. Therefore we are confident that we are measuring the incremental value of the appointee's experience as a director and not their general business or life experience.

As there is an increasing literature on gender differences in the boardroom, we also repeat our analysis including a dummy variable identifying the gender of the appointee. In Table 4, we find the coefficients on *Directorships* (0.0059, $t=1.88$), *Dir2+* (0.0202, $t=2.24$) and *Dir2+Yr4+* (0.0182, $t=1.81$) are consistent with those previously reported. This is not surprising since only 3 of 76 *Dir2+* observations and 1 of 39 *Dir2+Yr4+* observations are female appointees.

We also examine whether the incremental value of the appointee's experience as a director is driven by general or specific director experience. For example, it may be the case that the market reaction is highest for the most experienced appointees

(Dir2+Yr4+) as they bring a range of director experience to the hiring firm. Alternatively, the market reaction may be higher as these appointees have experience related to a specific board committee (e.g. audit committee specialists). We therefore trace the board committee assignments of the appointees in the 12-month period after their appointment. We exclude hiring firms that do not have board committees, which reduces our sample to 341 appointments. We find that the most experienced appointees (Dir2+Yr4+) have an average of 1.14 committee assignments, which is insignificantly different to the 1.34 committee assignments of all other appointees and 1.16 committee assignments of other appointees with at least one other directorship. We also examine specific committees and find no significant differences. The most experienced appointees (Dir2+Yr4+) are assigned to audit committees 71 percent of the time, compared to 64 percent for all other appointees and 72 percent for other appointees with at least one other directorship. For remuneration and nomination committees the percentages are 20:27:23 and 9:16:13 respectively.

As a last step we also examine the profiles and other directorships of the most experienced appointees (Dir2+Yr4+) to see if there are any common traits that have not been identified by other variables in our analysis. For example, the appointees may be experts in mergers and acquisitions, turnarounds or industry specialists. We find there is considerable variation across the appointees. Few of the appointees highlight specific expertise in mergers and acquisitions or turnarounds. The other directorships of the appointees are also not clustered in particular industries, with only one-third having two directorships in the same industry. Most in fact have directorships across a diversified range of industries. For example, one appointee has directorships in the telecommunications, real estate, healthcare, commercial services and capital goods industries. Another has directorships in the biotechnology, banking,

health care, food and beverage, and commercial services industries. This analysis confirms that the most experienced appointees are valued for their general experience as directors and not any particular specialist experience.

Finally, we acknowledge the possibility that our measures of director experience overlap with variables used in other studies to measure the connectedness or network centrality of directors (e.g. Larcker et al., 2010). However, we are confident that our results are due to director experience for two reasons. First, in our analysis we use a combined measure of director experience which includes years of experience and number of other directorships. Studies of the connectedness of directors focus on connections through other directorships. Second, if director connectedness is the primary driver of our results then our results should be strongest when connected directors join boards that do not have strong connections, i.e. boards with few outside directorships. However, in Panel D of Table 5 we find that this is not the case.

5. Conclusion

Prior studies investigating the characteristics of individual directors have not specifically examined the importance of prior director experience. This is unusual as the management literature has provided evidence that the effectiveness of directors is related to their past experience as a director. One reason why the prior directorial experience of directors has not been explored is the lack of disclosure of such experience in the annual reports of U.S. firms. We overcome this obstacle by examining the prior experience of directors in Australia, where the reporting requirements provide greater detail on the current and past experience of directors in listed companies.

We find that both the depth and breadth of the appointee's prior director experience is valued by the market at the time of appointment. The market reaction is strongest for new appointees with the most director experience, i.e. those with two or more other current directorships in listed companies and four or more years of director experience, and when experienced appointees join less experienced boards. These results show that director experience is an important characteristic, but that it must be considered in the context of the experience of the hiring board.

Our results have a number of implications. First, while prior studies have documented a number of desirable characteristics of corporate directors, this study shows that prior experience as a director is a vitally important director characteristic that should be considered in future studies concerning individual directors and the diversity of the board of directors. Second, our analysis indicates that holding multiple outside directorships can contribute in a positive way through director experience to corporate boards and need not be viewed through the "busyness" construct of prior studies. Third, our results provide evidence that relationships exist between the characteristics of appointees and characteristics of hiring boards. Therefore, it is no longer prudent to examine the characteristics of individual directors without contemplating how they relate to the existing board of directors as a group. Finally, our additional analysis indicates that our results are not driven by any specific director experience. Therefore our analysis complements other studies examining specific expertise (e.g. financial expertise) to show that general experience as a director is valuable in its own right.

From a practical perspective, our results show that shareholders value new directors with the most prior director experience. This indicates that there is an incentive for directors, particularly those with some experience (e.g. 1-3 years and/or

1 other directorship) to continue to seek additional directorships to increase their level of experience. We acknowledge, however, that directors have limited time, so this conclusion is likely to only be true if directors have the capacity to take on the workload of additional directorships. Our results also indicate that there is an incentive for experienced directors to seek directorships in firms with the least experienced boards as this is where shareholders believe they will have the greatest impact.

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Figure 1 - Distribution of sample observations

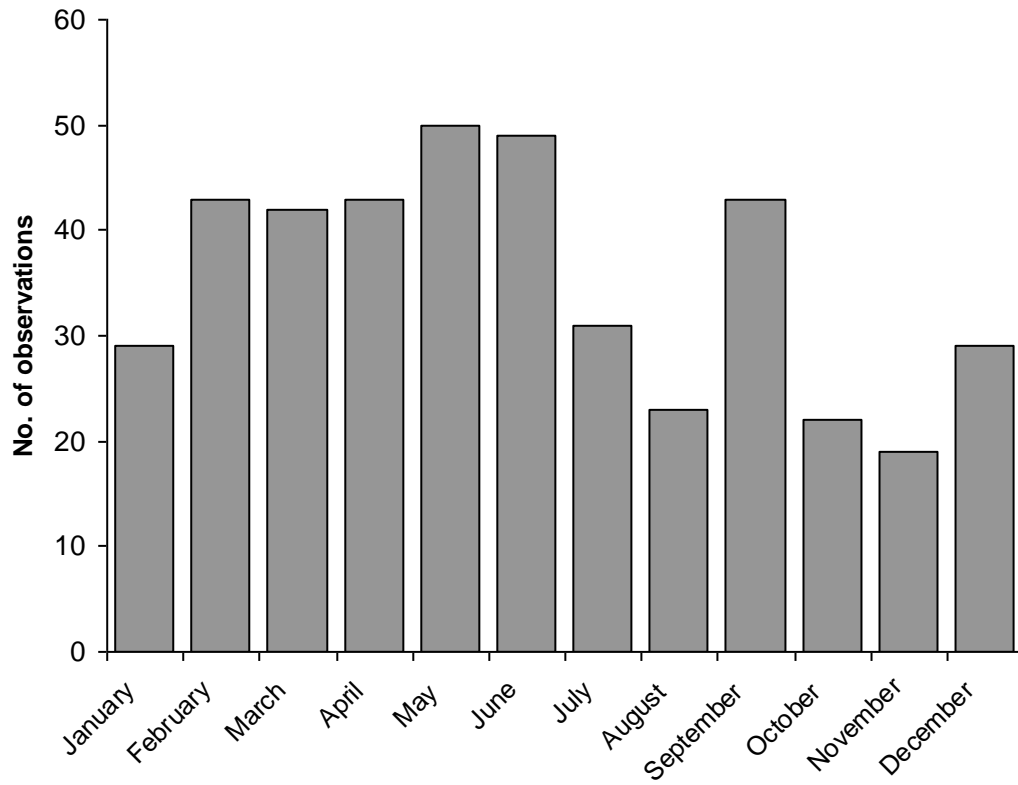


Table 1 – Variable Definitions

Variable	Definition
Years	Number of years experience the appointee has as a director of other listed companies.
Directorships	Number of current directorships the appointee has in other listed companies.
Dir2+	Dummy variable equal to one if the appointee has 2 or more other directorships in addition to the new appointment.
Dir2+Yr1-3	Dummy variable equal to one if the appointee has 2 or more other directorships in addition to the new appointment and 1-3 years of experience as a director of other listed companies.
Dir2+Yr4+	Dummy variable equal to one if the appointee has 2 or more other directorships in addition to the new appointment and 4 or more years of experience as a director of other listed companies.
Academic	Dummy variable equal to one if the appointee's occupation is classified as an academic (current professorship).
Banker	Dummy variable equal to one if the appointee's occupation is classified as a banker (e.g. experience as an investment banker, commercial banker, funds manager).
CEO	Dummy variable equal to one if the appointee is currently the CEO of another listed company.
Consultant	Dummy variable equal to one if the appointee's occupation is classified as a consultant (e.g. management, IT or marketing).
Doctor	Dummy variable equal to one if the appointee's occupation is classified as medical doctor.
Engineer	Dummy variable equal to one if the appointee's occupation is classified as an engineer.
Executive	Dummy variable equal to one if the appointee's occupation is classified as a general executive/businessperson (not classified into another occupation group).
Financial	Dummy variable equal to one if the appointee's occupation is classified as a financial/accounting expert (e.g. experience as a CA, CPA, CFO).
Lawyer	Dummy variable equal to one if the appointee's occupation is classified as a lawyer (e.g. experience as a practicing lawyer).
Politician	Dummy variable equal to one if the appointee's occupation is classified as a politician (e.g. recent political office)
Scientist	Dummy variable equal to one if the appointee's occupation is classified as a scientist.
BA	Dummy variable equal to one if the appointee's highest degree is a bachelor degree.
LLB	Dummy variable equal to one if the appointee's highest degree is a law degree.
MA	Dummy variable equal to one if the appointee's highest degree is another Master degree.
MBA	Dummy variable equal to one if the appointee's highest degree is an MBA.
PHD	Dummy variable equal to one if the appointee's highest degree is a PhD.
Independent	Dummy variable equal to one if the appointee is classified as an independent director in the appointing company.
Equity	Dummy variable equal to one if the appointee holds shares in the appointing company.

New Expertise	Dummy variable equal to one if the appointee's expertise (Academic to Scientist) is not already present on the hiring board.
New Qualification	Dummy variable equal to one if the appointee's qualification (BA to PHD) is not already present on the hiring board.
New Seat	Dummy variable equal to one if the appointment is a new board seat (not replacing a resigning director).
Interlock	Dummy variable equal to one if there is an interlocking directorship between the appointing company and the other companies with which the appointee has directorships.
CEO involved	Dummy variable equal to one if the appointing company CEO is involved in the appointment process (no nomination committee or CEO is on nomination committee).
Chair-CEO duality	Dummy variable equal to one if the appointing company CEO is also the Chairman of the board of directors.
CEO tenure	Number of years the appointing company CEO has been in position.
Independent board	Dummy variable equal to one if the appointing board is majority independent.
Firm size	Natural logarithm of total assets of appointing company.
Return on Assets	Return on assets of appointing company (winsorized at 1 st percentile).
Market-to-Book	Market to book ratio of appointing company (winsorized at 99 th percentile).
Board tenure	Average tenure of directors on the hiring board.
Board years	Sum of all years of directorial experience of directors on the hiring board.
Board directorships	Sum of all current outside directorships of directors on the hiring board.
Board Dir2+Yr4+	Dummy variable equal to one if the hiring board has one or more directors with experience categorized as D2+Y4+.
Board size	The number of directors on the hiring board.

Table 2 – Descriptive Statistics

This table displays mean, median, minimum, maximum and standard deviation of appointee and hiring firm characteristics. The sample comprises 423 non-executive director appointments to Australian Stock Exchange listed companies between 1 January 2004 and 30 June 2006. Director and hiring board data is sourced from company annual reports on the Connect4 Annual Report database. Hiring firm financial data is from Aspect. See Table 1 for variable definitions.

	Mean	Median	Min	Max	Std
<i><u>Appointee Characteristics</u></i>					
Years	2.37	1.00	0.00	21.00	3.37
Directorships	0.70	0.00	0.00	6.00	1.07
Academic	0.02	0.00	0.00	1.00	0.14
Banker	0.17	0.00	0.00	1.00	0.38
CEO	0.05	0.00	0.00	1.00	0.21
Consultant	0.04	0.00	0.00	1.00	0.20
Doctor	0.01	0.00	0.00	1.00	0.10
Engineer	0.09	0.00	0.00	1.00	0.28
Executive	0.35	0.00	0.00	1.00	0.48
Financial	0.14	0.00	0.00	1.00	0.35
Lawyer	0.06	0.00	0.00	1.00	0.25
Politician	0.01	0.00	0.00	1.00	0.12
Scientist	0.06	0.00	0.00	1.00	0.25
BA	0.31	0.00	0.00	1.00	0.46
LLB	0.11	0.00	0.00	1.00	0.31
MA	0.09	0.00	0.00	1.00	0.29
MBA	0.09	0.00	0.00	1.00	0.29
PHD	0.10	0.00	0.00	1.00	0.30
Independent	0.80	1.00	0.00	1.00	0.40
Equity	0.14	0.00	0.00	1.00	0.34
New Expertise	0.46	0.00	0.00	1.00	0.50
New Qualification	0.29	0.00	0.00	1.00	0.45
New Seat	0.32	0.00	0.00	1.00	0.47
<i><u>Hiring Firm Characteristics</u></i>					
Total Assets (billions)	2.94	0.05	0.01	411.31	23.93
Return on Assets (%)	-11.18	0.46	-100	42.66	30.97
Market-to-Book ratio	3.07	2.12	0.10	10.00	2.60
Debt to Total Assets	0.35	0.33	0.01	1.00	0.26
Board Size	4.53	4.00	2.00	14.00	1.91
Board Independence	0.46	0.50	0.00	1.00	0.26
CEO tenure	5.03	3.00	0.00	26.00	5.19
CEO involved	0.83	1.00	0.00	1.00	0.38
Interlock	0.05	0.00	0.00	1.00	0.22
Chair-CEO duality	0.14	0.00	0.00	1.00	0.35
Board tenure	4.82	4.00	0.33	25.67	3.46
Board years	31.79	26.00	1.00	191.00	24.84
Board directorships	3.58	3.00	0.00	17.00	3.39
Board Dir2+Yr4+	0.42	0.00	0.00	1.00	0.49

Table 3 – Director Experience

This table displays average cumulative abnormal returns based on the market model CARs (-1,+1), the mean return model Avg (-1,+1) and the excess return model Excess (-1,+1), and the significance of these returns from zero. The sample comprises 423 non-executive director appointments to Australian Stock Exchange listed companies between 1 January 2004 and 30 June 2006. Director and hiring board data is sourced from company annual reports on the Connect4 Annual Report database. Share price data is sourced from Sirca. See Table 1 for variable definitions. T-statistics are in parentheses. Significance at * 10%, ** 5% and *** 1%.

Panel A – Market Reaction at Announcement

	n	CARs (-1,+1)	Avg (-1,+1)	Excess (-1,+1)
<u>Years</u>				
0	150	0.0033 (0.48)	0.0037 (0.51)	0.0097 (1.41)
1-3	176	0.0064 (1.00)	0.0068 (1.06)	0.0100 (1.49)
4+	97	0.0108 (1.94)*	0.0109 (1.96)*	0.0133 (2.42)**
<u>Directorships</u>				
0	248	0.0057 (1.10)	0.0058 (1.08)	0.0114 (2.12)**
1	99	-0.0039 (-0.49)	-0.0029 (-0.36)	-0.0007 (-0.08)
2+	76	0.0214 (3.01)***	0.0218 (2.99)***	0.0228 (3.15)***

Panel B – Years versus Directorships CARs (-1,+1)

Directorships	Years		
	0	1-3	4+
0	0.0032 (0.44) [144]	0.0078 (0.82) [77]	0.0135 (1.23) [27]
1	0.0118 (0.46) [5]	-0.0038 (-0.32) [63]	-0.0067 (-0.76) [31]
2+	-0.0218 (n/a) [1]	0.0212 (1.82)* [36]	0.0228 (2.56)** [39]

Table 4 – CARs and Director Experience

Regressions relate CARs (-1,+1) to director experience and control variables. The sample comprises 423 non-executive director appointments to Australian Stock Exchange listed companies between 1 January 2004 and 30 June 2006. Director and hiring board data is sourced from company annual reports on the Connect4 Annual Report database. Hiring firm financial data is from Aspect. Share price data is sourced from Sirca. See Table 1 for variable definitions. Models include robust standard errors. T-statistics are in parentheses. Significance at * 10%, ** 5% and *** 1%.

	CARs (-1,+1)			
	(1)	(2)	(3)	(4)
Intercept	0.0069 (0.35)	0.0083 (0.42)	0.0089 (0.46)	0.0084 (0.43)
Years	-0.0002 (-0.19)	-0.0002 (-0.16)		
Directorships	0.0058 (1.84)*			
Dir2+		0.0199 (2.22)**		
Dir2+Yr1-3			0.0184 (1.44)	
Dir2+Yr4+				0.0178 (1.78)*
Academic	0.0233 (0.59)	0.0242 (0.61)	0.0211 (0.53)	0.0236 (0.59)
Banker	-0.0080 (-0.71)	-0.0085 (-0.76)	-0.0093 (-0.83)	-0.0082 (-0.74)
CEO	-0.0157 (-1.03)	-0.0165 (-1.09)	-0.0152 (-0.96)	-0.0133 (-0.87)
Consultant	-0.0325 (-1.44)	-0.0325 (-1.46)	-0.0339 (-1.55)	-0.0330 (-1.49)
Doctor	-0.1429 (-2.30)**	-0.1429 (-2.28)**	-0.1438 (-2.31)**	-0.1424 (-2.28)**
Engineer	-0.0065 (-0.38)	-0.0062 (-0.36)	-0.0076 (-0.45)	-0.0070 (-0.41)
Financial	0.0101 (0.83)	0.0097 (0.80)	0.0105 (0.88)	0.0101 (0.84)
Lawyer	0.0127 (0.64)	0.0116 (0.59)	0.0132 (0.67)	0.0102 (0.52)
Politician	-0.0457 (-2.86)***	-0.0429 (-2.76)***	-0.0459 (-2.88)***	-0.0416 (-2.60)***
Scientist	0.0276 (1.31)	0.0274 (1.31)	0.0266 (1.29)	0.0313 (1.51)
BA	0.0061 (0.58)	0.0058 (0.55)	0.0054 (0.52)	0.0054 (0.51)
LLB	-0.0039 (-0.22)	-0.0031 (-0.17)	-0.0038 (-0.21)	-0.0037 (-0.21)
MA	0.0018 (0.14)	0.0025 (0.19)	0.0016 (0.12)	0.0019 (0.15)
MBA	0.0124 (0.73)	0.0135 (0.79)	0.0123 (0.73)	0.0133 (0.78)
PHD	-0.0014 (-0.10)	-0.0010 (-0.07)	-0.0009 (-0.07)	-0.0036 (-0.26)
Independent	-0.0040 (-0.40)	-0.0044 (-0.43)	-0.0041 (-0.41)	-0.0037 (-0.37)
Equity	0.0150 (1.06)	0.0155 (1.09)	0.0145 (1.02)	0.0149 (1.05)
New Expertise	-0.0065 (-0.69)	-0.0071 (-0.74)	-0.0061 (-0.65)	-0.0059 (-0.62)
New Qualification	0.0141 (1.41)	0.0135 (1.36)	0.0133 (1.33)	0.0136 (1.37)

New Seat	0.0085 (0.98)	0.0083 (0.96)	0.0095 (1.08)	0.0082 (0.94)
Interlock	-0.0170 (-1.97)*	-0.0163 (-1.85)*	-0.0114 (-1.28)	-0.0173 (-1.87)*
CEO involved	0.0011 (0.17)	0.0014 (0.20)	0.0014 (0.21)	0.0012 (0.17)
Chair-CEO duality	-0.0196 (-1.27)	-0.0192 (-1.24)	-0.0197 (-1.28)	-0.0197 (-1.28)
CEO tenure	-0.0011 (-1.63)	-0.0011 (-1.63)	-0.0011 (-1.73)*	-0.0010 (-1.48)
Independent Board	-0.0016 (-0.19)	-0.0015 (-0.17)	-0.0011 (-0.13)	-0.0018 (-0.21)
Firm Size	-0.0004 (-0.19)	-0.0005 (-0.24)	-0.0003 (-0.16)	-0.0004 (-0.17)
Return on Assets	-0.0085 (-0.49)	-0.0085 (-0.49)	-0.0091 (-0.52)	-0.0073 (-0.42)
Market-to-Book	0.0007 (0.47)	0.0006 (0.44)	0.0005 (0.37)	0.0069 (0.47)
Adj-R ²	0.021	0.025	0.023	0.023
n	423	423	423	423

Table 5 – Hiring Board Experience

Each panel displays six coefficients from six different regression specifications. The columns display the coefficients from specifications 1, 2 and 4 from Table 4 on subsamples with less than and greater than median levels of various measures of board experience. The sample comprises 423 non-executive director appointments to Australian Stock Exchange listed companies between 1 January 2004 and 30 June 2006. Director and hiring board data is sourced from company annual reports on the Connect4 Annual Report database. Hiring firm financial data is from Aspect. Share price data is sourced from Sirca. See Table 1 for variable definitions. Models include robust standard errors. T-statistics are in parentheses. Significance at * 10%, ** 5% and *** 1%.

Panel A – Board Tenure

	Board tenure ≤4 years (n=220)	Board tenure >4 years (n=203)
Directorships	0.0117 (2.33)**	0.0020 (0.46)
Dir2+	0.0310 (1.96)*	0.0149 (1.39)
Dir2+Yr4+	0.0301 (2.28)**	0.0017 (0.10)

Panel B – CEO Tenure

	CEO tenure ≤3 years (n=230)	CEO tenure >3 years (n=193)
Directorships	0.0158 (3.67)***	-0.0028 (-0.58)
Dir2+	0.0421 (3.31)***	0.0019 (0.15)
Dir2+Yr4+	0.0363 (3.19)***	-0.0045 (-0.24)

Panel C – Board Years

	Board years ≤26 (n=215)	Board years >26 (n=208)
Directorships	0.0132 (2.42)**	0.0021 (0.49)
Dir2+	0.0432 (2.63)***	0.0069 (0.64)
Dir2+Yr4+	0.0511 (3.70)***	-0.0081 (-0.65)

Panel D – Board Directorships

	Board directorships ≤3 (n=249)	Board directorships >3 (n=174)
Directorships	0.0075 (1.19)	0.0061 (1.55)
Dir2+	0.0283 (1.50)	0.0156 (1.49)
Dir2+Yr4+	0.0222 (1.31)	0.0162 (1.21)

Panel E – Board Dir2+Yr4+

	Board Dir2+Yr4+ = 0 (n=247)	Board Dir2+Yr4+ = 1 (n=176)
Directorships	0.0113 (2.06)**	0.0033 (0.76)
Dir2+	0.0320 (2.09)**	0.0135 (1.16)
Dir2+Yr4+	0.0255 (1.77)*	0.0111 (0.76)