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BUSY DIRECTORS AND THE OCCURRENCE OF CORPORATE ENVIRONMENTAL MISCONDUCT

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INTRODUCTION

Corporate misconduct is a significant organizational phenomenon that has the potential to adversely affect various stakeholders (Greve, Palmer, & Pozner, 2010). In the wake of a disclosure of major organizational misconduct (e.g., fraud, financial restatements, environmental violations), research shows that there is often a backlash from multiple stakeholders (Karpoff, Lott, & Wehrly, 2005; Carberry, Engelen, & Van Essen, 2018). Organizational leaders are expected to play a critical role in preventing the occurrence of such events in the first place and mitigating their adverse impact once they do occur (Kassinis & Vafeas, 2002; Hersel et al., 2019). Given their fiduciary duties of monitoring and oversight, boards of directors are often expected to play a key role in the prevention and management of corporate misconduct (Neville et al., 2019). However, notwithstanding boards’ grave responsibility and expectations in this area, corporate boards are not always effective in averting and effectively managing corporate misconduct. In this study, we focus on the phenomenon of “overboarded or busy” directors (Harris & Shimizu, 2004) - directors serving on multiple corporate boards. We argue that boards with busy directors (those serving on three or more corporate boards) are in a particularly weak position to effectively perform their monitoring and oversight duties that reduce the occurrence of organizational misconduct. Furthermore, we introduce three boundary conditions that enhance (mitigate) the positive relationship between the presence of busy directors and the occurrence of environmental misconduct. Specifically, we propose that firms with busy directors on their boards are more likely to have major environmental violations under the following conditions: 1) if the CEO is powerful; 2) the firm is experiencing financial distress; and 3) the firm does not have a superior ethical reputation. In the next section, we begin with providing a brief overview of the relationship between board oversight duties and organizational misconduct with a particular emphasis on busy directors. We then present and empirically test our theoretically derived hypotheses and conclude with a discussion and implications of our findings.

Busy Directors, Board Oversight and Organizational Misconduct
Corporate directors, as the senior leaders and trustees of the firm, play a critical role in the prevention and management of organizational misconduct. Perhaps most notably, directors have a crucial fiduciary responsibility in monitoring the decisions and actions of the firm’s senior executives including the CEO (Fama & Jensen, 1983). In the context of corporate misconduct, such responsibility often takes the form of proactively monitoring executive actions and decisions to ensure compliance with all applicable laws and regulations (Nguyen et al., 2016). Due to their over commitment, directors experience greater cognitive limitations. As a result it becomes difficult for busy directors to comprehend and synthesize large volumes of information pertaining to a focal firm’s business and make informed decisions. Furthermore, given their bounded rationality, busy directors are more likely to resort to ‘cognitive oversimplification’ and rules of thumbs in making decisions (Schwenk, 1988). They are less likely to have sufficient ‘cognitive bandwidth’ and attention that they can dedicate to each firm they serve. These responsibilities may curtail their ability to proactively detect abnormalities and discrepancies in the activities of the focal firm, that may ultimately lead to unethical or illegal corporate practices.

Environmental Violations as Forms of Corporate Misconduct

Environmental violations, regulatory standards and social norms have the ability to negatively influence a corporation’s reputation. Public perception of the violation may span the gamut from public condemnation to escaping public attention all together (Reuber & Fischer, 2010). The wide span of potential attribution results in a wide range of impact on corporate reputation. The increase of company failures and its resultant impact on society has motivated the demand for corporations to provide greater transparency regarding their financial and mandatory obligations (Sikka, 2009). Disclosures have the potential to provide a corporation’s private information, thereby potentially reducing investor uncertainty and market expectations (Luo, Courtenay, & Hossain, 2006). The potential for directors to consider their own interests and the resultant impact of disclosure will determine whether voluntary disclosure may take place. Since the corporation represents a body of people who are pursuing their own interests (Cyert & March, 1992), voluntary disclosure will take place based on the decision makers’ determination whether there is a personal benefit for disclosure.

HYPOTHESIS DEVELOPMENT

In this study, we argue that the presence of busy directors on corporate boards has important repercussions when it comes to firm misconduct. Busy directors experience overcommitment due to the demand for their time and attention. Specifically, we contend that director “busyness” severely hampers their sense of alertness to various signs and symptoms of corporate misconduct (Kress, 2018). Busy directors, by virtue of their overcommitment, are more likely to focus on the firm’s “surface level” (basic) compliance pertaining to environmental laws. Furthermore, they are less likely to pay attention to emerging (perhaps subtle) signs of corporate environmental misconduct often associated with seemingly mundane and routine firm activities and decisions. Additionally, given their overcommitment, busy directors are also more likely to take a more reactive posture with regards to the occurrence of environmental misconduct. We argue that these directors, given their overcommitment, are more likely to assume a “fire-fighting” role in mitigating the impact of corporate environmental violations once they occur instead of proactively scrutinizing the firm’s culture and decision-making processes that may
lead to the occurrence of such violations in the first place (Kassinis & Vafeas, 2002). The above arguments lead us to the following hypotheses:

*H1a*: The presence of busy directors on corporate boards is positively related to the likelihood of environmental misconduct.

*H1b*: The presence of busy directors on corporate boards is positively related to the frequency of environmental misconduct.

CEO preferences have the ability to moderate the relationship between the board and firm outcomes, especially when the CEO is powerful vis-a-vis the board. Powerful CEOs can threaten the independent judgement of the board (Dalton & Kessner, 1987), by dampening the effect of the board (Haynes & Hillman, 2010). We focus on the influence of CEO power as it is a dominate characteristic used to interpret and respond to environmental issues (Sharma, 2000). CEO power may manifest in various forms. We rely on Finkelstein’s definition of CEO power, as “the capacity of individual actors to exert their will” (Finkelstein, 1992: 506). The characteristics of the CEO will likely have a significant influence on how the firm responds to institutional pressures (Lewis, Walls, & Dowell, 2014). Powerful CEOs have the ability to enact their own interests, thereby shaping how corporations respond (Cyert & March, 1992). Further, powerful CEOs in the context of busy directors have the ability to pursue activities that benefit themselves. The relationship between busy directors and environmental misconduct will be strengthened in the context of a powerful CEO. CEOs with power have the ability to leverage entrenchment (via any one of the sources of power) to influence decisions that support their continued control (Finkelstein, Hambrick, & Cannella, 2009). Our arguments for CEO power result in the following hypotheses:

*H2a*: The degree of CEO power positively moderates the relationship between the presence of busy directors and the likelihood of environmental misconduct such that the relationship is stronger for firms led by powerful CEOs.

*H2b*: The degree of CEO power positively moderates the relationship between the presence of busy directors and the frequency of environmental misconduct such that the relationship is stronger for firms led by powerful CEOs.

Firm ethical reputation can be defined as “a general organizational attribute that reflects the extent to which external stakeholders see the firm as *good* and not *bad*” (Roberts & Dowling, 2002: 1078). In this study, we argue that firm ethical reputation is likely to weaken the relationship between director busyness and environmental violations for a number of reasons. First, ethical reputation creates an intangible asset that reduces uncertainty concerning a firm’s actions in a given ethical situation (Bear et al., 2010; Baselga-Pascual et al., 2018). Firms with superior ethical reputation are more likely to follow established ethical safeguards and standards of practice. Second, firms with superior ethical reputation are not only expected to engage in ethical behavior, but also are expected to prevent unethical behavior and comply with rules and regulations (Lin-Hi & Blumberg, 2018). As such, even if board members pay less attention to environmental issues, top executives will feel psychological pressure to maintain the firm’s superior ethical reputation and will take initiatives to avoid incidents of environmental
misconduct. Finally, board members will tend to identify more intensively with firms having superior ethical reputations (Mael & Ashforth 1992). As a result, they will spend more time in monitoring activities and pay more attention to the environmental issues of firms with high ethical reputation as compared to the firms with low ethical reputation. Based on the above arguments, we propose the following hypotheses:

**H3a:** Firm ethical reputation negatively moderates the relationship between the presence of busy directors and the likelihood of environmental misconduct such that the relationship is weaker for firms with superior ethical reputation.

**H3b:** Firm ethical reputation negatively moderates the relationship between the presence of busy directors and the frequency of environmental misconduct such that the relationship is weaker for firms with superior ethical reputation.

The degree of financial distress a firm experiences is an important contingency factor that may exacerbates the extent to which the presence of busy directors increases the occurrence of environmental misconduct. Scholars have used the arguments from General Strain Theory (Agnew et al., 2009) to provide some explanations. According to the core tenets of this theory, individuals and organizations often resort to unethical and/or illegal behavior when they perceive that they are unable to achieve their goals through established social and institutional channels. Such a “goal blockage” (Agnew et al., 2009), or the gap between the desired and actual level of performance may lead to desperate or extreme measures from organizational leaders in order to close such a gap (Simpson, 2002). Firms in financial distress often face existential crisis with their viability, as a going concern is seriously challenged. Financial distress not only adversely affects the short-term liquidity of the firm, but also hampers long-term solvency and the firm’s ability to honor its financial commitments to its stakeholders (Hambrick & D’Aveni, 1988). Financially distressed firms, therefore, are more likely to seek cost-cutting measures, including possibly significantly reducing their sustainability investments (Singal, 2014) and even resort to pursuing illegal environmental practices that violate established federal and state level environmental statutes. The above arguments lead us to the following hypotheses:

**H4a:** Financial distress negatively moderates the relationship between the presence of busy directors and the likelihood of environmental misconduct such that the relationship is weaker for firms that are financially less distressed.

**H4b:** Financial distress negatively moderates the relationship between the presence of busy directors and the frequency of environmental misconduct such that the relationship is weaker for firms that are financially less distressed.

**METHODS**

**Sample and Data Sources**

To test our predictions, we used data from U.S.-based, publicly traded firms listed in the Standard & Poor’s (S&P 500) composite index. After removing firms that are privately held and those with missing data, our final sample comprised of 492 U.S.-based, publicly traded firms.
We used a 10-year sampling window (2007-2016) to ensure that we observe patterns of environmental misconduct among S&P 500 firms across the economic cycle. The final panel dataset consisted of 4920 firm-year observations (492 firms over ten years). Our primary source of data on environmental misconduct (violations) was Violation Tracker (https://www.goodjobsfirst.org/violation-tracker), an online database maintained by Corporate Research Project. The database reports extensive data on each firm including instances of environmental violations along with primary offense, description of offense, and Agency initiating the complaint, penalty year, and penalty amount. Data on busy directors was obtained from BoardEx and Institutional Shareholder Services (ISS)/Risk Metrics databases. These databases provide extensive information on individual directors’ demographic and professional profiles along with the number of corporate boards they serve on. Data on our executive and organizational controls were obtained from ExecuComp and Compustat databases.

**Measures**

We measured the *Likelihood of Environmental Misconduct* as the binary variable taking the value of “1” if a sample firm had at least one environmental violation during the sampling window (2007-2016), “0” otherwise. The *Frequency of Environmental Misconduct* was operationalized as a count variable representing the number of environmental violations for each firm in the sample during the sampling window (2007-2016). We operationalized *busy directors* as those outside directors that serve on three or more corporate boards. We aggregated individual director data to the board level by using a dummy coding of “1” for firms with at least one “busy” director (serving on three or more other corporate boards) on their boards and “0” otherwise. Following other works (Finkelstein, 1992; Haynes & Hillman, 2010), we measured *CEO Power* as a multidimensional construct consisting of ownership (CEO percent of equity ownership and CEO founder status), structural (CEO duality), expert (CEO tenure) and prestige power (number of other boards served). These variables were standardized and summed to create a composite measure of CEO power. *Financial Distress* was operationalized using Altman (1983)’s bankruptcy Z-score (Barker & Mone, 1994; Abebe, Angriawan, & Liu, 2010). A Z-score of 3 or above usually indicates that the firm is in sound financial condition, while a score below 3 suggests financial distress with lower values indicating a higher likelihood of bankruptcy. *Firm Ethical Reputation* was operationalized using data from the annual “World’s Most Ethical Companies” rankings compiled by the Ethisphere Institute. We reviewed this annual rankings data and coded each sample firm as “1” if it was included in the rankings and “0” otherwise for each year of the sampling period (2007-2016). We controlled for several governance (Board Size, Board Independence, Presence of Lone CEO Director) and organizational (Firm Age and Firm Size) indicators that are likely to influence our outcome variable (corporate environmental violations).

**Analytical Approach**

To estimate the likelihood of environmental violations, we employed a panel logistic regression analysis given the binary nature of the variable (Zorn et al., 2017). Our second dependent variable is the frequency of environmental violations. Since a large portion of our sample firms (82.48%) did not have any environmental violations during the sampling window (2007-2016), this variable is truncated with several zero values. Accordingly, to account for such
truncation in the data, we employed a panel tobit regression analysis which uses a maximum likelihood estimation method. To address endogeneity concerns, we followed a two-step approach (Koch-Bayram & Wernicke, 2018). In the first step, we used a probit model to regress a binary busy directors variable on firm age, firm size, average director age and firm performance. In the second stage, we used the residuals from the first stage probit analysis as our revised presence of busy director measure in the main analyses.

RESULTS

Our findings indicate that the presence of busy directors on corporate boards is positively related to the likelihood ($\beta = 2.019$, $p < 0.05$) and frequency ($\beta = 5.645$, $p < 0.05$) of environmental misconduct lending empirical support to hypothesis 1a and 1b. Results show that the interaction term between the presence of busy directors and CEO power, contrary to our prediction, is not statistically significant for both the likelihood ($\beta = 0.154$, n.s.) and frequency ($\beta = 0.123$, n.s.) of environmental misconduct. Accordingly, hypothesis 2a and 2b did not receive empirical support. Similarly, the coefficient of the presence of busy directors was not statistically significant predictor of both the likelihood ($\beta = 1.972$, n.s.) and frequency ($\beta = 0.813$, n.s.) of environmental misconduct for the firms that are included in ethical ranking. However, in case of firms that are not included in ethical ranking, the presence of busy directors is positive and statistically significant predictor of the likelihood ($\beta = 2.052$, $p < 0.05$) and frequency ($\beta = 2.023$, $p < 0.01$) of environmental misconduct. Based on these analyses, hypothesis 3a and 3b received empirical support. Finally, the coefficient for the interaction term between presence of busy directors and financial distress was positive and statistically significant for both the likelihood ($\beta = 0.409$, $p < 0.01$) and frequency ($\beta = 0.842$, $p < 0.05$) of environmental misconduct. Accordingly, hypothesis 4a and 4b received empirical support.

DISCUSSION AND CONCLUSION

This study explored the relationship between the presence of busy directors on corporate boards and the likelihood and frequency of environmental misconduct. The findings indicate that, consistent with our predictions, the likelihood and frequency of environmental misconduct is higher among firms with busy directors on their boards. Furthermore, we demonstrated that the presence of busy directors on corporate boards may lead to a higher likelihood and frequency of environmental misconduct among firms that experience high financial distress. Environmental compliance and sustainability initiatives can be costly (Sprinkle & Maines, 2010), and are more likely to be compromised when the firm experiences financial distress (Singal, 2014). Additionally, we found that the relationship between the presence of busy directors on corporate boards and the likelihood and frequency of environmental misconduct tends to be stronger among firms that did not have a superior ethical reputation. This finding further underscores the importance of robust organizational ethical climate as a defensive mechanism against the occurrence of corporate misconduct. Overall, this study sheds light on the organizational consequences of overboarded directors as it relates to environmental misconduct.

REFERENCES AVAILABLE FROM THE AUTHORS