BRQ Business Research Quarterly (2018) xxx, xxx–xxx

BUSINESS RESEARCH QUARTERLY

www.elsevier.es/brq

REGULAR ARTICLE

Board composition and firm reputation: The role of business experts, support specialists and community influentials

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Received 23 March 2017; accepted 25 January 2018

JEL CLASSIFICATION
G30

KEYWORDS
Reputation;
Board;
Expertise;
Corporate governance;
Directors

Abstract The objective of this paper is to analyze the influence of board resource diversity on firm reputation. We classify board members as business experts, support specialists, political directors and other community influentials, in an effort to address whether business, technical expertise or political ties in the boardroom affect stakeholders' opinion and, therefore, firm reputation.

This study confirms that not all outside directors are equally effective in improving firm reputation, and that certain kinds of outside directors, especially business experts, help increase it. However, the findings note an inverted U-shaped non-linear relationship with these directors, which means that the effect of business experts on reputation is positive up to a point, after which the relationship becomes negative. The findings also evidence that, contrary to popular beliefs, directors with previous experience as politicians are not negatively viewed by stakeholders. Moreover, this type of community influential directors has positive effects on firm reputation in regulated firms as well as in those of the public work sector.

Introduction

Corporate reputation measures the collective judgment of an organization held by its stakeholders (Brammer and Millington, 2005). The relevance of corporate reputation as a valuable firm asset is shown in the increasing number of reputational rankings issued during the last years, such as *Fortune* or *Financial Times* rankings (Musteen et al., 2010).

Previous research has evidenced a high variety of benefits related to corporate reputation as employee retention,

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https://doi.org/10.1016/j.brq.2018.01.003

corporate branding, market price and firm performance (Bear et al., 2010). In this respect, the interest in corporate reputation is increasing worldwide among managers and scholars, and some papers have examined the effect on firm reputation of corporate governance variables like board gender (Brammer et al., 2009) and ownership concentration (Delgado-García et al., 2010). However, research on the role of board composition on firm reputation is still scarce, despite the board of directors' being at the center of the policy debate (Kim et al., 2014) and worldwide corporate governance codes are encouraging firms to comply with their good governance recommendations related to board composition and board diversity (Musteen et al., 2010).

In this regard, the interest in the issues related to board composition has increased after the financial crisis, as it was questioned to what extent the lack of qualifications, skills, and expertise of directors was responsible for the crash of corporate governance in many companies. In this respect the European Commission states that ''accurate assessment of skills and expertise is the most important factor in selecting new non-executive board members'' (European Commission, 2011, p. 7). Similarly, there is an increasing concern regarding the high presence of directors with political ties in Spanish boardrooms, which may affect stakeholder opinion and therefore company reputational levels.

Previous literature highlights two main roles of board of directors: monitoring and advising. Although most of the research has focused on the monitoring function, recent papers highlight the board advisory role and evidence that directors are sought when they can provide political influence, expertise or contacts (Dass et al., 2014). Therefore, according to van der Walt and Ingley (2003), the concept of board diversity should not look for representatives of particular interests (e.g. gender), but people with certain skills, knowledge and experiences that bring unique perspectives and valuable contributions to firm decisions. In this context board diversity should look for ''skill'' more that the traditional ''representation'' role of directors. Thus, and following to Bear et al. (2010) we understand diversity of board resources as the variety in resources (e.g. professional background) that directors bring to the boardroom. This board diversity combines a mix of competences and capabilities that represents a pool of social capital for the company (van der Walt and Ingley, 2003).

Despite the fact that the board of directors is an important governance mechanism to affect stakeholder perceptions, the literature on the effects of board resource diversity on reputation is scarce. As an exception, Bear et al. (2010) analyzed the effect of gender and background diversity on CSR ratings and firm reputation. They did not find a significant effect of the diversity of board resources, although they noted that their results may be influenced by sample criteria due to their only using a small sample of US health care companies in 2009. Musteen et al. (2010) also examined the role of board composition on firm reputation, but only examined the role of outside directors and not the specific effect of the different categories of outsiders according to their professional background.

In this paper we analyze the influence of board resource diversity on corporate reputation. Our analysis proceeds in two steps. First, we examine the global effect on board resource diversity on firm reputation. Reputation is measured by using the MERCO ranking provided for the 100 Spanish companies with the best reputations. This index has been previously used by Fernández Sánchez and Sotorrío Luna (2007) and Delgado-García et al. (2010, 2013).

Second, we examine the role of specific members of the board according to their professional background. In this respect, previous studies find that not all directors are equally effective monitors or valuable advisers, noting they have different problem-solving skills, professional experiences, business exposures and variability in their abilities (Baysinger and Zardkoohi, 1986). Then, while most studies have treated outside directors as a homogeneous group, in this paper we use the boardroom classification of Hillman et al. (2000) and classify board members as business experts, support specialists, and community influentials, examining whether business, technical expertise or political ties in the boardroom affect firm reputation. Other papers that have used the Hillman classification are Markarian and Parbonetti (2007), Bear et al. (2010), Haynes and Hillman (2010) or Jones et al. (2008), among others.

Although agency theory has dominated research about board of directors, other theoretical approaches such as the signaling theory, stewardship theory, and the resource dependency theory can provide interesting insights. We assume that the appointment of business experts and support specialist as directors can have a positive effect on firm reputation due to these members can signal a relevant attribute to the market regarding firm abilities and intentions. Similarly, the previous experience in the industry of business experts can also improve their monitoring role and therefore, affect to reputational assessments by stakeholders. The effect of support specialist directors on stakeholder perceptions is mainly understood by the stewardship theory, which considers important to have a board that complements the management with knowledge and skills. The effect on reputation of the appointment of community influential directors, mainly formed by ex politicians, is not so clear. According to the resource dependence theory, the aid that these directors provide comes in the form of preferential access to commitments or support from important elements outside the firm. Then, although these directors can facilitate ties with government, business elite, and non-profit companies, stakeholders may also penalize companies having a high proportion of community influentials on their boards, especially in a country as Spain, characterized by a high level of corruption and a low level of transparency.

We focus on Spain, an interesting setting for several reasons. First, Spain is a country characterized by the ''comply or explain'' principle in the enforcement of corporate governance regulations, a high concentration of dominant shareholders and low developed capital markets (Iturriaga and Rodríguez, 2017). Second, this research is related to the 14th recommendation of the Good Governance Code of Spanish Listed Companies (2015), according to which firms should have a diverse board in skills and background, and ''director selection policy should seek a balance of knowledge, experience and gender in the board's membership''. Spain is also valuable because of the high number of directors with political connections