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ISSUES IN MULTIPLE DIRECTORSHIP AND FIRM'S CASH HOLDING: A CONCEPTUAL PAPER

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ABSTRACT

This paper aims to explain the issues in board practices in corporate governance. The board practices that this paper wants to uncover are multiple positions by the director in a company. This paper specifically wants to discuss multiple positions held by the commissioners and directors in a public company in Indonesia. The method used for this conceptual paper is based on a literature review, journal articles, previous studies, online news related to the topic, and regulation related to the multiple directorships in Indonesia. Multiple directorships are when a director of a firm hold two or more position on another firm's board. The practice of multiple directorships has two points of view; the first point of view told that multiple directorships are one of the elements in board practice that is important to create good corporate governance in reducing agency problems. But another point of view said that multiple directorships create a busy board, which results in an "over-committed" board. Although there is a lot of research on multiple directorship topics, such as the effect of multiple directorships on firm performance and firm value, further research is needed to uncover the effect of multiple directorships in reducing agency problems in a firm, such as an agency problem in a firm's cash holding.

Keywords: *Agency Problem, Cash Holding, Corporate Governance, Multiple Directorship*

1. Introduction

In general, each company has a significant proportion of cash in the company's total assets (Alghadi et al., 2019). In developing countries, companies store large amounts of cash to use when economic conditions are bad. The main purpose of the company to store cash or have a cash holding is to allow the company to make useful investments and also provide security for the company both when in a good or bad economic situation (Alghadi et al., 2019). Company resources in the form of cash can contribute to the company when the company has financing problems that are when funding from outside the company is very expensive; however, cash can also trigger company managers to take opportunistic actions to spend the company's cash for personal gain rather than maximizing shareholder wealth such as using cash for excessive compensation, using cash for projects that have no profit, and to over-consume so that it can trigger agency problems or agency conflicts in the company (Chou and Feng, 2018). Agency conflicts that occur in the company can be mitigated by good corporate governance practices.

One of the important elements in corporate governance is the practice of the board within the company. The existence of board members is very important in making decisions for the company. One of the important issues in board practices is in multiple positions held by the director of a company. Multiple directorships are a phenomenon in which individuals occupy two or more positions. Fama and Jensen (1983) suggest that agency theory explains the role of company directors in controlling and monitoring company policies to mitigate conflicts of interest among stakeholders. Agency conflict occurs when there is a difference in objectives that occur between the principal or shareholders of the company and the company manager as an agent in the company, namely a conflict that occurs when the manager takes actions that prioritize his personal interests over the interests of the company's shareholders. Some previous studies explain that multiple positions by a director could have both positive and negative effects on the company. This paper wants to discuss the role of multiple directorships in reducing the agency problem, especially the agency problem that could happen when a company is hoarding cash.

2. Multiple Directorships in Indonesia

When implementing a board system in corporate governance, Indonesia adopts a two-tier board system, in which the supervision functions and managerial functions are two different bodies. The condition of Indonesia, which consist of a two-tier board system, is different from the country with a unitary board system, where the system owned by Indonesia is more likely to cause the practice of multiple positions by board members (Santoso, 2016). The supervisory function of the company is carried out by the company's board of commissioners, and regulating the day-to-day operations of the company is carried out by the company's executives, namely the company's directors.

Multiple directorships in Indonesia are regulated by the Financial Services Authority (OJK) through the Financial Services Authority Regulation No. 33/POJK. 04/2014 concerning directors and boards of commissioners in public companies. Based on this regulation, The Board of Commissioners in a public company has the function of supervising the company and providing advice to the company's Directors. The company's commissioners members consist of at least 2 (two) members of the Board of Commissioners, whereas if it consists of 2 (two) members, one of them is an independent commissioner. If the company's Board of Commissioners consists of 2 (two) members of the Board of Commissioners, the number of Independent Commissioners in the company must be at least 30% of the total number of members of the company's Board of Commissioners. In the case of concurrent positions by a commissioner of a company, a member of the Board of Commissioners may hold concurrent positions as members of the Board of Directors for a maximum 2 (two) in other public companies and may have concurrent positions as a Board of commissioners for a maximum 2 (two) in other public companies. However, in the case that a commissioner does not hold a concurrent position as a member of the Board of Directors in another company, the member of the Board of Commissioners may concurrently serve as a member of the Board of Commissioners for a maximum 4 (four) in other public companies. So it can be concluded that a Board of Commissioners can have 5 (five) concurrent positions. The practice of concurrent positions by the board of commissioners is important to analyze its effectiveness considering that the board of commissioners in the company must have to supervise and be responsible for overseeing the company's management policies, including overseeing the company's financial policies.

Meanwhile, Based on the Financial Services Authority (OJK) Regulation No. 33/POJK.04/2014, the Board of Directors has the function of running the company's operations. The Board of Directors is a company's organ that is responsible and authorized for the management of the company. There are at least 2 (two) members of the Board of Directors in the company, where 1 (one) person among the directors can be appointed as president director. In terms of concurrent positions by the board of directors, the regulation stipulates that members of the Board of Directors of a company can hold concurrent positions as members of the Board of Directors for a maximum 1 (one) in other public companies, in addition, members of the Board of Directors can hold concurrent positions as members of the Board of Commissioners for a maximum 3 (three) in other public company. In line with the board of commissioners, the practice of concurrent positions by the board of directors is important to analyze as well as its effectiveness considering that the board of directors and commissioners have the same goal of improving good corporate governance to provide value for the company's shareholders.

The regulation of multiple positions by the company's board is also regulated by The Indonesian Competition Supervisory Commission (KPPU) through *Pasal 26 Undang-Undang Nomor 5 Tahun 1999,* which is the regulation of the prohibition of monopoly practices and unfair business competition. The law stipulates that a person is prohibited from occupying the position of commissioner and board of directors at the same time concurrently as a commissioner or director of another company if the company is in the same relevant market, is closely related in the type of business, dominates certain markets so that it can lead to monopolistic practices or unfair business competition.

3. Issues in Multiple Directorships

According to the National Association of Corporate Directors (1996), directors who have multiple positions are not able to carry out adequate monitoring management and advise to limit the number of multiple directorships in other companies. While different opinions are expressed by some experts who like the presence of multiple directorships and argue that commissioners and directors who have multiple directorships can provide valuable experience and expertise for the company (Chou and Feng, 2018).

In Indonesia, the dual positional practices cause a debate between the Competition Supervisory Commission (KPPU) and the Ministry of State-Owned Enterprises (BUMN). The Indonesian Competition Supervisory Commission (KPPU) argues that the dual position rules contained in the Minister of State Own Enterprises Regulation (Permen) No. 10 of 2020 that allow commissioners of State-Owned Enterprises (SOEs) to have multiple positions in non-SOE companies can cause unhealthy business competition if these companies are in the same market. However, the influence of the existence of multiple directorships on the company can be described from two opposing points of view. From the first point of view, the reputation hypothesis is that the underlying hypothesis is when company board members hold several board positions in several other companies can contribute to the effectiveness of carrying out obligations and responsibilities because the board members can bring more experience to the company and have a stronger monitor function because board members have a high reputation capital (Chou et al., 2018). While the second perspective is the busyness hypothesis, where this hypothesis assumes when company board members have multiple positions (multiple directorships), then the board members will be "over-committed" thus, directors could give less time and contribution in carrying out their board's obligations.

4. Multiple Directorship and Cash Holding Company

Saleh et al. (2020) argue that the board members who have multiple positions (multiple directorships) will become too busy so that they can't monitor the company's management adequately, so they can produce high agency costs. Booth and Deli (1996) suggest multiple directorships allow executives to develop their expertise and learn about different strategies and various forms of management. Carpenter and Westphal (2001) stated that the existence of multiple directorships could trigger the development of directorship and experience. However, Jiraporn, P., Singh M., and Lee, C. I (2009) in Alghadi et al. (2019) stated that the more a company director is involved in some responsibilities, the more potentially risky the director is to miss the board meeting because it has the excessive commitment, which can negatively affect the company's cash holding. Based on this view, the presence of a "busy board" that is negatively associated with cash holding can be a signal that busy members of the board structure have a beneficial impact. For companies, which can prevent the misuse of "cash resources."

Alghadi et al. (2019) examine the relationship between corporate governance and cash holding company. The study analyzed the relationship between gender boards and multiple directorships, and corporate cash holdings. The results of the study found that multiple directorships positively affect cash holding, whereas the results of the study support agency theory. Furthermore, Chou et al. (2018) conducted a study of the influence of multiple directorships on things that can damage the "value" in cash associated with an increase in cash holdings where the results found that there is a positive influence between cash value and multiple directorships. Furthermore, the results of the analysis of the study found that multi-board limits companies in storing excess cash. Overall, the results of the study stated that multiple directorships could be associated with more efficient use of company cash, thus providing benefits directly to the shareholders.

Jensen & Meckling (1976) suggests that based on agency theory, an increased cash fund of companies can indicate an opportunistic behavior of management. Opportunistic behavior by management can occur by turning the company's assets into personal gain. For example, management can invest the company's assets in the form of cash reserves into projects that are more profitable for members of the company shareholder. Furthermore, based on the theory of free cash flow, which examines the relationship between agency costs and cash reserves of companies where the results indicate that the company with agency problems tends to have large amounts of cash (Dittmar & Mahrt-Smith, 2007). Based on the description, it can be suspected that the presence of multiple directorships, if it supports the reputational hypothesis (which is expected to limit the opportunistic actions of management) then can reduce the opportunistic managerial behavior that causes an agency problem by limiting the amount of firm's cash holding and not let the company have a high or big amount of cash. However, if the busyness hypothesis dominates, the effect of multiple positions by the commissioners and directors will not help to reduce the agency problem that is when firms have a large amount of cash holding.

5. Conclusion

Although several previous studies and publications focus on the effect of multiple directorships of a board of directors on a company's performance, the effect of multiple directorships of the board of a company in mitigating the agency problem in the company should be considered as well. Since the agency problem is one of the biggest issues in corporate governance practice in a company, especially how multiple directorships of a board can reduce or mitigate an agency problem that maybe rise when a company holds an amount of cash. There is also a limited study related to the effect of multiple directorships and whether it can reduce or mitigate the agency problem in a company's cash holding, especially in Indonesia's public companies. Some results showed that the multiple positions of the board could be associated with more efficient use of company cash, thus providing benefits directly to the shareholders. In this case, the multiple positions of the board could minimize the agency problems in the company so that the results support the "reputation hypothesis." However, the results could support the busyness hypothesis if the practice of multiple positions of the director results in a high company's cash holding, which could lead an opportunistic behavior by management and also raise the agency problem in a company. Since this paper is conceptual, further research, both empirical and non-empirical, must be done to uncover more issues related to the effect of multiple directorships in reducing agency problems in a company's cash holding, especially in a public company in Indonesia.

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