How board network affects firm performance and innovation incentives in transition economics

SUMMARY

Objectives

This thesis explores board member networks and their influence on firm performance and innovation and presents a conceptual framework for understanding and ultimately predicting the impact of board network features on firms in both established and transitional economies. A board member networks refers to the connectedness between firms in an economy resulting from individual board members who have membership of more than one firm boards. The study considers these networks as having an intrinsic business value for firms, known in the literature as "social capital". The thesis proposes that "structural" and "content" attributes of board member networks are the key levers underlying the social capital of these networks and their value for firms. Applying insights from social capital theory, the structural aspect of the social capital emphasizes the role of the firm's position in the board network, while network content suggests that attributes of partner firms are also significant factors toward firm performance and innovation.

Approach

We have collected panel data of 200 Armenian firms (Open joint stock companies) for the period 2000-2010, which include data on board members, firm's financial, industry, profit and other relevant variables. In addition we have conducted the first firm's innovation survey among selected firms.

We have constructed board network for four years and have generated various social capital variables using tools from social network analysis. The first part of the empirical analysis focuses on impact of social capital on firm financial performance as measured by the return on assets (ROA) and return on equity (ROE). In the second part we estimate the impact of social capital on firm innovation in Armenia.

Findings and Conclusion

Our empirical evidence shows that social capital embodied in firm connectedness has a significant impact on firm performance. The literature argues that shared board members serve as channels for transmission of information and knowledge, exchange of resources and assets across firms, which positively impact both their innovativeness and financial performance, and our results support this argument. It is not always true, though, that more connectedness is always better: under some circumstances, gaps in connectedness can actually be beneficial for firm performance.

The study finds that network diversity, partners' assets and export volume are important for improving financial performance and innovativeness (including the degree of novelty of innovativeness). For example, if a firms is embedded in a rich network, where its partners possess higher financial resources, it is more likely that the firm will benefit from the borrowing from its partners if the network is more closed, as cohesive network endure higher level trust among its member, they provide monitoring and sanctioning opportunities, especially when the legal infrastructure of the country will not protect the firms. In support of measuring and utilizing social

capital, we contribute to the literature with new measures for assessing network content and provide empirical evidence how those measure explain the firm performance.

Further research could investigate the joint effects of board network and board members characteristics on firm's learning and innovative outcomes. Our approach can be applied also to other country context, and findings can provide important insight for policymakers in the field of corporate governance, firm's growth and innovation.