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Some empirical literature evidence on the effects of independent directors on firm performance

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This work is a review of existing literature on the effectiveness of independent directors at ensuring superior firm performance. The study finds that the evidence in this regard are not only mixed, but may also be culture-bound because while some studies, especially most of those structured and conducted in the US, find no positive relationship between the presence of independence directors on the board and the performance of those firms, some others, especially those structured and conducted in the orient find a positive relationship. Can this be on account of differences in culture, resulting from environmental and unique behavioral reasons? However, most findings agree that the presence of independent directors on boards of firms actually improves governance of those firms, although the quality of governance may not necessarily translate to high firm performance. It is argued that although research evidence has not conclusively fingered independent directors to have positive effects on corporate performance, the study still believes in the conventional wisdom that they really do affect corporate performance positively. But supermajority independent director boards may so excessively check management flexibility, in the bid to produce good corporate governance, that the activities of executive directors to raise performance may become stifled.

Key words: Independent directors, firm performance, quality of governance, corporate performance, firm value, culture-bound, good corporate governance, non-executive directors.

INTRODUCTION

The concept of independent director is an important subject within the broad concept of corporate governance. So, any discussion or review of literature on the subject matter will take its bearing from a brief introduction of corporate governance. In this respect, The Guardian (2010) explains that "... the simple idea of corporate governance is about building confidence in your product erected on the foundation of transparency and accountability; good corporate governance flowed from practises that involved fairness, accountability, responsibility and transparency on a foundation of intellectual honesty..." In its simplest definition, corporate governance is a system by which corporations are governed and controlled with a view to increasing shareholder value and meeting the expectations of other stakeholders. As expected, poor corporate governance is a major factor in almost all known cases of distress of financial institutions. But O'Donovan (2003) in her paper

titled "Change Management - A Board Culture of Corporate Governance" defines corporate governance as 'an internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity, accountability and integrity. She further posits that sound corporate governance is reliant on external marketplace commitment and legislation, plus a healthy board culture which safeguards policies and processes. Furthermore, O'Donovan argues that 'the perceived quality of a company's corporate governance can influence its share price as well as the cost of raising capital. Accountability and accounting are both instruments that promote high quality of good governance.

Sheng (2000) admits that an important theme of corporate governance is to ensure the accountability of certain individuals in an organization through mechanisms

that try to reduce or eliminate the principal-agent problem. This accountability is presumed to be more properly and adequately rendered by a board comprising a majority or supermajority independent directors.

The concept of independent director is however difficult to define. Presently, there is paucity of a universally accepted definition of independent directors. What are available are definitional principles by sovereigns which tend to explain the criteria for defining the subject to meet their peculiar need. From the definitional criteria provided by each country or region, a compact definition can be derived. However, my definition of independent director in this work is that an independent director is a director who is independent in character and judgment and not having any material relationship with the company beyond his/her directorship (directly or as a partner, shareholder, or officer of an organization that has a "material" relationship with the company).

Character is very important in defining who an independent director truly should be because character is the set of qualities that make somebody or something distinctive, especially somebody's qualities of the mind and feeling (Encarta dictionaries, 2008). If a person is to become an independent director therefore, it is this quality that should make him/her interesting or attractive to the selectors or appointers. Ultimately, what is being canvassed here is that to be independent, a director must be rightly known to have an acknowledged reputation of being of sound character and of independent judgments. This should form part of the minimum criteria for defining an independent director.

Regulatory authorities of capital markets now require that a certain minimum number of independent directors be identified to comprise boards of publicly quoted companies. In fact, they now make it a requirement for listing any firm on the stock exchange. The NASDAQ and the NYSE have gone a step further to require publicly quoted companies to identify and bring on board a supermajority of independent directors of companies that are either quoted or contemplate being quoted on their stock exchange. The same requirement now cuts across Securities and Exchange Commissions across the world. They all canvass that 'the purpose of identifying and appointing independent directors is to ensure that the board includes directors who can effectively exercise their best judgment for the exclusive benefit of the company by making sure that their judgment is not clouded by real or perceived conflicts of interest'. So, the term "independent directors" includes only those directors who are not officers or employees of the company or of any entity controlling, controlled by, or under common control with such a company'. What is worrisome however is the growing concern that this reawakened movement for the hiring of increased number of independent directors for boards of firms may tragically tow the line of earlier movements for corporate

governance codes which have achieved little or no success. In this regard, the study hastens to warn that the presence of independent directors on the boards of business firms should not be seen as an automatic assurance for firm performance. This warning is underscored by a host of mixed research evidence on the relationship between independent boards and the much sought firm performance for which the clamor for hiring independent directors has increased.

However, much excitement as much as controversy still attends the subject called independent directors. The extent of this controversy is reflected in the literature on this subject. While it appears settled that independent directors play important roles in the governance of modern organizations, how and whether these roles translate into higher performance of the firm or not remains a controversy hence the mixed research findings that adorn peer reviewed journals on the subject. This review captures the mixed nature of research evidence on this subject, and this suggests that nothing is decided yet on whether, and how, independent directors influence the performance of the firms on whose board they sit. And although more research still goes on to determine the impact of independent directors on firm performance, the nature of results and findings across international sovereign divides tend to point to the direction that the determination of whether independent directors confer higher performance or value to organizations may be culture-bound after all. For example, a great number of studies executed in Asia tend to confirm the traditional wisdom that independent directors actually assure higher performance of organizations while much of such studies conducted in the United States have found less veracity to that claim. Such dichotomy of findings can also be noticed in studies executed in Australia, Europe and elsewhere in the world. Presented here in three parts are studies that establish positive relationship, those that establish negative relationship, and those that establish a tangential relationship or a mix of both positive and negative.

Objectives of the study

It is now a preponderant view of regulatory authorities of business firms across corporate sovereignties that the "virtue" of majority independent director boards should guide appointments or selection of board members. Consequently, there is a growing trend towards appointing majority or supermajority independent boards. However, problems exist in determining who is a truly independent director. More than this, there also appears not to be any significant contribution made by the so called independent directors to firm performance so far, even in the United States where stock market regulatory authorities have made it a listing requirement for publicly quoted firms. This realization led this author to undertake

a review of empirical literature to find out what has been done in respect to whether independent directors actually contribute to firm performance or not and the outcome of such studies thereof.

METHODOLOGY

The work is essentially a review of empirical literature on the effects of independent directors on firm performance with a view to making contributions to knowledge. In this sense, the desktop or secondary research approach is used with the tool of analysis being deductive reasoning. The writer has been a corporate strategy and governance consultant for about 24 years in which case he has done several works on corporate governance and firm performance, presented well-researched papers on these subject areas and has collaborated with a preponderance of industry executives on this subject matter; and this has a semblance of primary data. In other words, the paper relies on two methodological approaches: secondary and quasi-primary research methods. The secondary data were mainly sourced from peer reviewed studies and articles in the worldwide web. These articles were subjected to critical review and analysis, and the main planks were summarized to embody the presentations and conclusions arrived hereto. For the purpose of clarity and sequence the empirical literature evidence reviewed here are classified and presented under the following:

Studies that Establish Positive Relationship

An Analysis of the association between firms' investment opportunities, board composition and firm performance is the subject of a study by Hutchinson (2002) in which 229 Australian firms were surveyed. Results of the study showed that the investment opportunities of the firms surveyed are strongly associated with a higher proportion of executive directors on the board. That is to say that firms that have a higher proportion of executive directors on their board tend to have more investment opportunities than firms with a greater proportion of non-executive directors. The result of the study also suggests that a higher proportion of non-executive directors on the board of growth firms monitor managers' actions to ensure that such actions are value adding. Again, the author reports that the interaction of investment opportunities and the proportion of non-executive directors on the board shows that firms perform better with increased number of non-executive directors on the board. This suggests that the negative relationship between firm performance and investment opportunities is weakened when the proportion of non-executive directors on the board is higher. Thus, it does appear that the monitoring role of non-executive directors overcomes the agency problem of high investment opportunities such that these firms become more profitable.

In yet another study titled "The Optimum Boardroom Composition and the Limitations of the Agency Theory", Rebeiz (2008) examines the extent of the linkage between the percentage of independent directors in the boardroom measured by the ratio of independent directors over total directors, and the market returns of firms belonging to the technology, engineering and communication industries. A major part of his findings is an empirical endorsement of the conventional wisdom that a board comprising more independent directors positively impacts on the financial performance of firms. He however asserts that this relationship of more independent directors on the board leading to positive financial performance of the firm is not linear in nature but curvilinear with a negative concavity. This implies that "there is a limitation of the agency theory of the firm as the optimum boardroom

configuration does not consist of 100% independent directors; instead it comprises a minority of inside directors to compensate for the information deficit inherent in a 100% independent boardroom configuration." The inside directors provide valuable information on the products, processes, and culture of the firm as well as its external surroundings. The author also confirms the results of other studies that affirm that the presence of inside directors with intimate knowledge of the firm on the board helps in expeditiously and effectively accessing key information from the right sources.

Still dwelling on whether independent directors produce superior performance for firms, and value for shareholders, Choi et al. (2007) report that the effects of independent outside directors on firm performance are strongly positive. Reporting under a study titled "Do outside Directors Enhance Firm Performance: Evidence from an Emerging Market", the authors comment that the results of their study "support a notion that board independence is critical in post-crisis emerging market environments that lack sufficient liquidity and infrastructure, and which are subject to economic instability and external shocks." So, for South Korea, an emerging market country, this study provides evidence that there is a positive relationship between board independence and higher firm performance, especially in the aftermath of the Asian crisis of 1997 which was seen to have occurred as a result of the poor governance system of that region. The authors thus report that the basic empirical result of their study is that board independence, measured by the proportion of outside directors on the board, has significant and positive effects on firm performance in the post-economic-crisis Korea. They note that this positive relationship with firm performance is stronger in firms with true independent directors than with those whose non-executive directors have professional ties with their firm (grey directors). Comparing their findings with earlier findings in the US, the authors contrast their results from those obtained in the US that affirm no positive relationship between board composition and firm performance.

The results obtained by Choi et al. (2007), is seen by them as significant because it suggests that board independence is critical to an emerging market that is subject to external shocks and may lack sufficient liquidity as well as indigenous industrial infrastructure. They note further that in such market environments firms with insider-dominant boards and entrenched inside ownerships can improve performance by adding independent directors and by actively involving them in major activities of the firm, with additional assistance from outside institutional shareholders, foreign investors in particular.

The results obtained by Choi et al. (2007) should be an eye-opener to researchers who tend to generalize results obtained in dominant markets that may have a different industrial, commercial and behavioral culture from those of emerging markets. The results of the present study thus tend to suggest that emerging markets may still be brittle and sensitive, in so many significant ways, to issues and developments to which dominant markets may appear immune. The results also suggest that there may be a possibility that the effect of independent directors on firm performance is culture and situation bound. That no relationship has been established between independent board directors and firm performance in the US for example, does not necessarily mean that such a relationship does not exist elsewhere on the corporate globe. The present practice whereby the definitional criteria for independent directors vary among corporate sovereigns gives support for the culture-bound approach for research in this area. I therefore suggest that differences in culture, situations, past experience, stage of corporate development and a lot more country or region-specific issues may be considered in structuring future studies.

Another study predicated on "Corporate Governance, Independent Directors, and Supervisors' Characteristics, and Corporate Performance: Evidence from GTSM Listed Companies in Taiwan", also show that the presence of independent directors and supervisors on the board, especially in audit committees, of firms

can significantly bring immense market and accounting performance benefits to the firm. This study by Cheng (2008) partly examines whether the characteristics of independent directors and independent supervisors in Taiwan are related to the performance of firms in Taiwan. For this study, the samples consist of all listed companies in Gre Tai Securities Market (GTSM). A suggestion is made by the author to the effect that companies should consider appointing highly educated females in their selection of independent directors or in the alternative increase the board seat ratio of independent directors to enhance their independence. I could not identify the foundations for this suggestion in the main research report because only the abstract of the study was accessed. However, with respect to what the author identified as independent supervisors of companies, he reports that his results reveal that females with high education levels could promote corporate performance. He concludes that demands for independent directors and independent supervisors with work experience or expertise in commerce, law, accounting and finance are not found significant in enhancing firm performance.

In yet a different study, titled "Separation of Powers: Active, Independent Boards Enhance Credibility", Deli et al. (2005) report that firms in which the CEO is a separate position from chairman of the board are given greater credence by the markets. Results of the study also show a correlation between informative earnings and greater independence of the board. In fact, among other findings of the study summarized by the authors are the followings:

- a. Earnings response coefficients increase as corporate boards become more independent
- b. Active boards are associated with higher earnings coefficients.
- c. The effects of board independence and activity are contingent upon one another. Thus, increasing independence will increase the credibility of the earnings numbers the most when board activity is low.
- d. Firms which have separate CEO and chair positions have more informative earnings.

The authors reiterate that the more independent the board is, the more credible and meaningful are the accounting numbers to the market.

Some studies that establish no or negative relationship

In another work by Kumar and Sivaramakrishnan (2007), the authors' show that the belief that board independence and equity-based director incentives unambiguously improve board performance and, therefore enhance shareholder value may sometimes be misplaced as more independent boards may actually perform worse. The authors' work is necessitated by the belief in regulatory bodies like United States Securities and Exchange Commission (SEC), the NYSE and the NASDAQ that to address the apparent ineffectiveness of corporate boards, certain reforms to promote board independence must be made. They report that in this regard, NYSE and NASDAQ have gone ahead to require that a majority of directors on corporate boards should be independent and that the audit and compensation sub-committees should entirely comprise independent directors. This is in addition to the increasing emphasis that directors be awarded equity ownership (equity-based incentive) in order to better align their interests with shareholder welfare.

Kumar and Sivaramakrishnan (2007) used an agency model of the firm to analyze how the board-CEO relationship affects shareholder value. They measured board dependence on the CEO by the extent to which the board's interests are intrinsically aligned with the CEO's interests, and came to the finding that, other things held constant, a more dependent board exhibits a greater alignment

with the CEO. They were thus able to examine the effects of bringing to the board more independent directors or less of them on the firm's investment, managerial compensation, board equity compensation and shareholder value. The main finding in this study is that shareholder value can increase as board dependence (not independence) increases. In other words, when a board is more independent it performs worse. The reason for this, the authors note, may be because when directors get equity awards, tension is created between the board's monitoring and contracting (supervision) roles. They argue that the reason that explains this finding is that 'a more dependent director benefits less from superior information about the firm's economic prospects generated by monitoring than a less dependent director. Thus, as more dependent directors sit on the board; there is a substitution effect that lowers its optimal monitoring effort. On the other hand, from the viewpoint of shareholder value maximization, such a board is also more inclined to award less efficient contracts to the manager'. This tendency however imposes a negative wealth effect on the board if it has an equity stake. In equilibrium, this negative wealth effect motivates a dependent board to increase its monitoring effect ex ante so that it is able to award a more informed (or efficient) managerial compensation contract ex post. Thus, the net effect of increased (or decreased) board dependence and shareholder value is ambiguous.

The conclusion of the authors is that shareholder value or corporate performance can actually improve when board directors are more dependent on the CEO or management team but decreases when more independent directors comprise the board. They note that the view that board independence unambiguously enhances corporate performance or shareholder value does not take into account the fact that there are conflicting effects of including the board's independence.

Researching on the topic "Corporate Governance – Independent Directors and Financial Performance: An Empirical Analysis", Krishna (2006) investigates whether board independence has any influence in the maximization of firm value. She concludes that the empirical analysis of her study produces no evidence to confirm any relationship between the independent board and the maximization of firm value or performance. She however adds that the lack of confirmatory evidence in her work may be attributable to the short period of time her study spanned as well as the fact that in India where the study was structured and conducted companies were still in the early period of implementing the regulatory authority inspired corporate governance reforms. In laying the foundation for her work, the author notes that corporate excellence and good governance are so intertwined that achieving one without the other is unimaginable. Short of explaining what corporate excellence means, she further asserts that well governed companies produce distinctively excellent performance, and that good corporate governance is a source of competitive advantage and critical to economic and social progress. She further agrees that "adherence to good governance practice provides stability and growth to the companies, builds confidence, reduces perceived risks, and thus the cost of capital; promotes stability and long term sustenance of stakeholders' relationship, adds to the position and status of the corporate and finally facilitates relationship with other companies whose governance credentials are exemplary."

In order to explore the likelihood of a relationship between independent boards and company performance, the author hypothesized that "the companies that have independent boards exhibit better performance than other companies." Value creation was isolated as the dependent variable. Testing this proposition involved multiple regression analysis. Book value ratio, as canvassed by Marakon Associates, was used as the model to. The measure the value author explains that the book value ratio model requires that "shareholders' wealth is measured as the difference between the market value and the book value of a firm's equity." In this model, "market to book value ratio is a function of the return on

equity, growth rate of the dividends as well as earnings. She proceeded to examine the relationship between the independent variables (such as composition of independent directors in the board, participation on board meetings, AGM, audit committee meetings, and chairmanship of governance committees); and the dependent variables, which is value creation measured by market value to book value ratio. The findings are that:

- a) There is no evidence to confirm that independent directors do really lead to or cause the maximization of firm performance or corporate value.
- b. Independent directors are boardroom intruders to be tolerated for the sake of compliance with corporate governance regulation.

Fernandes and ECGI (2005) focus their study on board compensation and firm performance: the role of “independent” board members. They find that non-executive board members are not very successful in aligning shareholders’ and managers’ interests. They also find that firms with zero non-executive board members actually have a stronger relationship between executive remuneration and firm performance. The authors conclude by noting that the results suggest that to foster the board of directors’ effective monitoring role, special attention needs to be paid to the role, quality and integrity of their non-executive directors; in particular, real independence should be guaranteed.

In another study that focuses on the role played by independent directors in private equity investments in Italy, Caselli and Giatti (2007) found that independent directors are not a means of boosting the performance of firms but are instead tools used by venture capitalists to control and monitor their investments. Results of empirical test in the study also show that independent directors can make greater contribution to project performance when very specific skills are required as in buy-out or turnaround operations. The authors further assert that as far as deals showing positive results are concerned, the subjective characteristics of independent directors do not help explain the performance of private equity deals. However, it is shown that in the case of negative performance of the capital venture firm, independent directors tend to make maximum effort in the fund if they do not have commitments in other “external” bodies in some way linked to the management company. Therefore, the commitment of independent directors seems to be determined by their visibility outside the fund, and the incentive to achieve positive performance. Oddly, the study finds that a high turnover of independent directors seems to lead to improved performance in private equity investment firms (venture capital firms) or alternatively, when there is little turnover of independent directors, performance of these firms is lower. Finally, the authors assert that a targeted use of independent directors can bring benefits if the skills of the individuals are evaluated bearing in mind the type of deal to be implemented. The conclusion therefore is that independent directors certainly do not improve performance in these firms, although the skills of individual directors can be useful in board activities, especially with respect to deals on the front burner (Caselli et al., 2008).

One of the groups of researchers who have consistently found no association between independent directors and corporate performance is the duo of Bhagat and Black (2001). In a study predicated on “The non-correlation between board independence and long-term firm performance”, Bhagat and Black (2001) note that the boards of American public companies are dominated by independent directors. The underlying belief for this dominance is that a “monitoring board” comprising almost entirely of independent directors is of inestimable value to corporate governance. However, the empirical evidence of this study challenges the wisdom behind that belief. Findings in this study show that although low profitability firms tend to increase the independence of their boards, there is however no evidence that such increase is helpful in enhancing the performance of such firms. In other words, firms with more

independent boards have nothing to show that they perform better than other firms. In fact, Bhagat and Black’s findings in this study hint not only that the firms with more independent boards do not achieve improved profitability; they also perform worse than other firms. According to the authors, this evidence clearly suggests that the conventional wisdom on the importance of board independence lacks empirical support. They also report that board size does not show any consistent correlation with firm performance. The authors advise that if their results are correct, the current focus on board independence as a core measure of board quality could detract from other likely and more effective strategies for addressing poor firm performance.

Another survey by Bhagat and Black (1999) titled “The Uncertain Relation between Board Composition and Firm Performance” still found no convincing evidence that greater board independence positively correlates with greater firm financial performance or faster growth. They therefore find no empirical support for the growing demand that firms should have a very high majority of their board members as independent directors with a dilution of only one or two inside directors. The authors also find evidence that firms with supermajority independent boards are less profitable than other firms. They suggest therefore that with this evidence, it may be useful for firms to have a moderate number of inside directors (say 3 – 5 on an average board of 11 members).

The above findings of Bhagat and Black agree with those of Klein (1998) who in her study titled “Firm Performance and Board Committee Structure” asserts that the three monitoring committees of a board (audit, nomination and compensation committees) traditionally dominated by independent directors do not have any meaningful effect on firm performance, notwithstanding how they are staffed. In fact, Klein instead found a positive correlation between firm performance and the presence of inside directors on boards’ finance, and investment committees.

In a sample that covered nearly 700 directors holding about 900 board seats, Lawrence and Stapledon (1999), under the research heading “Do Independent Directors Add Value?” surveyed the top 100 Australian firms listed on the Australian Stock Exchange to measure the relationship between board composition and corporate performance. In doing this, two broad types of corporate performance measures are used. These are share price performance and accounting performance. Data on these performance measures within a span of 10 years, starting from 1985 and ending in 1995 was used. The share price variables measure the change in the sample company’s share price or cumulative stock return within a particular time period; while raw accounting variable as well as growth, ratio and ratio of growth variables are the four types of accounting variables used. All tests involve ordinary least squares regression. Findings in the study show that:

- i. Improved corporate governance in terms of board composition would not, on average, lead to improved performance in large listed Australian companies.
- ii. Share price data offers little firm evidence that board composition matters.
- iii. There is no evidence that the proportion of independent directors has any influence on a company’s management resources.
- iv. There was also no evidence that manager-dominant board could produce superior returns to shareholders.

The authors explain the reasons that may account for their findings on the non-relationship between independent directors and firm performance as follows:

- a. Timing of the study: Independent directors may not have been performing their monitoring role efficiently or effectively at the time of the studies. For example, board composition and structure

became a major issue in Australia from the early to mid 1990s while the collection of data for this study started in 1985.

b. Different types of board composition may be appropriate for different companies since there is no best fit board structure for all companies.

c. An optimal board may contain a varying mix of independent directors, affiliated non-executive directors and executive directors.

d. The critical factor may well be boardroom behavior rather than any particular board composition.

e. Some types of independent directors may add value while others may not.

f. While monitoring by independent directors may improve the quality of management decisions, it may also complicate and lengthen the decision process. Consequently, monitoring by independent directors may be advantageous in some situations but a hindrance in other situations.

g. Non-executive directors who satisfy all of the independent criteria may, nevertheless, be relatively ineffective monitors of the CEO and executive management for reasons of a range of other factors that include the followings:

- A personal or social friendship between the independent director and the CEO;
- In the case of an independent director who is an executive director of another listed company their propensity to engage in effective monitoring may reflect the (low) level of monitoring that they would like to see from non-executives on their own board;
- The fact that an independent director has been on the board for many years can result in diminishing performance;
- The fact that some independent directors have insufficient time to devote to the company's affairs due to other commitments;
- Independent directors' relative lack of knowledge about the company's business, compared to the executive directors.

Studies that establish middle-of-the-road relationship

In their study, Duchin et al. (2008) examined the effects of board independence on performance that are largely free from endogeneity problems. Their main finding is that the effectiveness of outside directors depends on the cost of acquiring information about the firm because when the cost is low, performance increases when outside directors are added to the board but if the cost of information is high performance worsens when outside directors are added to the board. The identification strategy adopted by the authors in arriving at their result was to use the "exogenous" changes in board composition (brought about by the regulation that firms should increase the number of independent (outside) directors on their boards) to generate estimates of the effectiveness of board independence that are largely free from endogeneity concerns. The authors claim to have used this approach to shed light not only on the broad question of whether independence matters for boards, but when it is likely to matter also. Noting that the two primary roles of boards are monitoring and advising, the authors seek to prove or disprove a nascent stream of theoretical research that shows that the effectiveness of independent (outside) directors in both functions depends on the information environment. Thus, when the outside director's cost of acquiring information about the firm is high, outside directors are less effective at monitoring and providing advice, than when the cost of information is low.

The authors further state that the reasons for constituting a board should really be a primary determinant of whether the number of independent directors should be large or small. In this regard, they state that for firms that constitute their boards to maximize value, an

increase in the number of independent directors on such boards would be harmful. On the other hand, if firm managers constitute their boards with too few independent directors for the reason of minimizing oversight, an increase in the number of independent directors will be helpful in enhancing oversight in such firms. Thus, it is unlikely that an increase in independent directors would have a uniform impact on performance across firms. What is likely to happen is that there will be different performance effects among different sub-samples of firms. So, when organizations are forced by legislation to put more independent directors on their board, mixed (as opposed to uniform) performance should be expected across firms. In other words, there is no consistency in the performance of independent directors that can be guaranteed across firms.

Over all, the authors find that adding independent directors to the board does not help or hurt performance in the average but that such directors significantly improve performance, not because of their superior abilities or gifts but only when the cost of acquiring the information they use in working is low. Ultimately, such directors hurt the performance of the firm when their information cost is high. The authors assert that these findings are consistent with previous literature, and affirmed that such results appear even after controlling for endogeneity and whether performance is measured by earnings, Tobin's Q or stock return and for several different information cost measures.

In 2005, a study titled "Board Structures around the World: An Experimental Investigation", Gillette et al. (2008) investigated the board structure that performs best. Their findings show that the presence of outside directors on corporate boards leads to better decision making. They also find that the most efficient board structure is the single-tiered board with a majority of outside directors, and that the presence of outside directors improves the quality of corporate decision-making even when they are not in the majority.

RESULTS AND ANALYSIS

This paper investigates some empirical literature evidence on the effects of independent directors on firm performance. For the purpose of clarity and sequence the empirical literature evidence reviewed are classified and presented under the following sub-headings:

- i. Studies that establish positive relationship,
- ii. Studies that establish negative relationship, and
- iii. Studies that establish a tangential relationship or a mix of both positive and negative (i.e. middle-of-the-road relationship).

Among all the works reviewed, six establish a positive relationship between independent directors and firm performance thus affirming that the presence of independent directors on the board of an organization clearly enhances the performance of such organizations. On the other hand, 11 of such works find no positive relationship between the presence of independent directors on the job and high firm performance. Finally, a mixed relationship of positive-negative is the verdict of authors of six works on the relationship between the presence of independent directors on the board of business firms and firm performance. In all, 72 works were reviewed but only 23 proved relevant to the focus of

this paper. Ultimately, the number of works that find that the presence of independent directors may have value to firms but does not add to the performance of such firms outweighs the number of those that say it positively affects performance. However, there appears to be no argument in a preponderance of literature on this subject matter that the presence of majority or supermajority independent directors on boards of firms clearly improves the quality of governance in those firms.

Implications for practice

The implication of the findings hereto is that the notion that firm performance improves with the presence of a majority or supermajority independent directors on the board of firms is yet to have conclusive evidence. In fact, a good number of the studies point to the fact that the presence of more executive directors on the board positively affects firm performance than can ever be contemplated under a board with majority or supermajority independent directors. In the same vein some studies clearly point out that in some instances, the presence of independent directors makes positive firm performance impossible. What can possibly account for these findings? The answer can only be found with further research to find out why the presence of majority or supermajority independent directors on the board of firms diminishes firm performance on the one hand, while the presence of majority executive directors on the board of firms on the other hand improves firm performance significantly. Consequently, although there appears to be no argument that the presence of majority or supermajority independent directors on the boards of firms clearly improves the quality of governance, firms should for now remain circumspect on the impact of majority or supermajority independent boards on firm performance.

Contributions and limitations of this paper

The major contribution of this paper is that it affords regulatory authorities, corporate decision makers and some members of the academia a unique insight into whether the majority or supermajority board actually confers or yields positive firm performance. The shortcoming of the present work is the small number of empirical literature that comprises the relevant part of the review. This is primarily because of the difficulty in sourcing peer reviewed journals on account of the relative unavailability of the contents of most journals on the worldwide web, and the fact that it indeed costs a fortune to privately source these journals. The libraries in this part of the world do not also appear to stock recent and relevant journals on the subject matter since research on corporate governance is still nascent in my

country.

Conclusion

The above review captures the prevailing research evidence for and against the conventional wisdom that independent boards have positive effect on firm performance. Although the review undertaken here does not capture every literature on this subject matter, research evidence in most literature on the issue follow the pattern reported in this work.

The idea that public companies should be governed by independent directors is of United States of America origin. Although the idea has always been there, its resurgence into becoming a dominant requirement of good corporate governance is a direct consequence of corporate malfeasance involving directors who are thought not to be independent enough to care about the wellbeing of the firm and shareholder interests or value. However, notwithstanding their presence on boards of quoted firms, corporate scandals, distress and failures have continued to adorn modern corporate landscapes across America and, indeed, the corporate world. The preponderance of these failures again gave rise to the Sarbanes-Oxley Act which, among many other provisions, also requires that audit committees be composed entirely of independent directors. The US Congress bought the entire notion that more independent directors on the board of firms and corporations will improve governance and performance. This idea has caught up with the courts and strong business groups who believe in its wisdom. Stock Exchanges like New York Stock Exchange (NYSE) and NASDAQ have also, along this wisdom, established rules that require firms listed on them to have majority independent directors on their boards. With this chain of happenings, the idea that a majority independent director board is "best practice" took hold. But that was the beginning, having established the existence of majority independent director board, the notion that 'if a majority independent board was good, then supermajority of independent boards would be better' became the new fad.

Consequently, the US Securities and Exchange Commission (US SEC) in 2004 adopted a rule requiring that to be well-governed, 75% of mutual fund directors should be independent of the investment adviser and that the mutual funds should have independent chairmen. These two requirements were pronounced necessary if the fund and the adviser wished to take advantage of some important exemptions from the investment company act, 1940. This requirement that well-managed companies should be governed by a board comprising supermajority independent directors has now been taken as a Corporate governance is led by research, and this research often emanate from the academia. However compelling conventional wisdom research evidence on

the effect of majority, as well as supermajority, independent director boards on corporate performance has not produced consistent and conclusive positive results. At best what we have seen are results that tend to suggest a bias along sovereign cultures. For example, most results from the US tend to find either no consistent relationship or no relationship at all between independent boards and firm performance.

But in the orient, the report on research that originated there tend to support the conventional wisdom that majority independent boards do actually produce positive performance for the firm. In this regard, writers like Peter J. Wallison have tried to differentiate between good governance and performance. Wallison notes that "requiring more independent directors on audit committees or boards was done in order to obtain better governance, not better performance, and that better governance could be considered a value in itself, irrespective of its effect on corporate performance." It is argued that the fact that independent directors have a limitation on their knowledge of the company on whose board they sit; the incentives to learn more or take risks, and the quality of information on which to base their monitoring decisions on the activities of the management of the company, should serve as a check on the relationship between their activities and positive firm performance. This is a major reason that so far, the empirical data associated with the performance effects of independent directors is at best ambiguous. The reason for this ambiguity may well be for reason canvassed by Thomas H. Noe and Michael J. Rebellato that "empirical studies relating to board structure and firm performance rely on firm data. The main drawback of this approach is the difficulty of distinguishing the effects of the board structure from other institutional, economic and social factors that also affect firm performance."

However, in the study's view, if we aggregate everything that could have effects on the activities of the independent director, it will be argued that notwithstanding the fact that research evidence has not universally and conclusively fingered independent directors to have positive effects on corporate performance, the study still believes in the conventional wisdom that they really do affect corporate performance positively. In my mind, a simple majority of independent directors over the other directors may do the magic. The supermajority independent directors may so excessively check board flexibility, in the bid to produce good corporate governance, that the activities of executive directors to raise performance may become stifled. So, the presence of supermajority independent directors on the board may produce good corporate governance but not necessarily good or better firm performance.

On the other hand, the study suggests that researchers also advert their mind to the possibility that corporate performance in relation to independent boards may be culture-bound that is what works in one culture like the

US may not work in another culture like the orient hence research results on the same subject matter may substantially differ even to the level following extreme parallel tracks. The fact that some results in the orient appear to be consistent on the positive relationship between independent directors and firm performance, while those from the US appear not to endorse such a relationship should necessitate another round of research to find out if culture, the environment or corporate history may be responsible for the disparity in research findings. So, the obvious conclusion here is that we must apply a high degree of caution when it comes to the relationship between majority/supermajority independent boards and the (financial) performance of their firms. This caution is particularly important because empirical evidence is quite mixed, given that some studies confirm a positive relationship while others either do not confirm such a relationship or tread the middle path.

Finally, further research is needed to conclusively determine why majority executive directors on the board bring about more firm performance than independent directors do, and why it appears that in many cases majority or supermajority independent boards are actually associated with negative firm performance. Similarly, we need to know why studies on this subject matter appears to be culture-bound whereby results obtained in some continents like North America differ substantially from those obtained from some other continents like the orient.

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