### LOGO

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*24 July 2015*

Dear Editor:

I am attaching the manuscript entitled “The Uncertain Economic Benefit of Boardroom’s Independence: A Review of the Literature and Diagnosis” for review and potential publication in *Advances in Management and Applied Economics*. This paper has not been published, nor is considered for publication in another outlet.

Regards,

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Brief Biographical Sketch of Karim Rebeiz

Karim Rebeiz received his Ph.D. from the University of Texas at Austin, his MBA from Harvard Business School, his M.S. from the University of Texas at Austin, and his B.E. from the American University of Beirut. He is currently an Associate Professor in the Olayan School of Business at the American University of Beirut. Prior to his current position, he was a Financial Manager at Ford Motor Company in Dearborn, Michigan. He also assumed managerial position at JP Morgan Chase / First USA Bank in New York and Delaware. His area of expertise is corporate governance, corporate performance and the board of directors.

**Title Page**

**The Uncertain Economic Benefit of Boardroom’s Independence:**

**A Review of the Literature and Diagnosis**

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**Abstract**

How important is boardroom’s independence?What are the determinants of boardroom’s independence?Why is research linking boardroom’s independence to corporate performance inconclusive? What are the implications for future research agendas? These aforementioned questions have lingered in the minds of academics for the past decades. Until today, we do not have clear answers to these dilemmas because aggregate studies to date have failed to produce definitive results. In this paper, I review the major research studies attempt to shed new lights on the elusive dilemma pertaining to the economic benefit of boardroom’s independence. Specifically, I conduct a diagnosis as to why it is difficult to establish a robust relationship between boardroom’s independence and corporate performance. I conclude by providing some guidance as to future research endeavors.

**Keywords:** Board of directors; independence; corporate governance; corporate performance

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**Abstract**

How important is boardroom’s independence?What are the determinants of boardroom’s independence?Why is research linking boardroom’s independence to corporate performance inconclusive? What are the implications for future research agendas? These aforementioned questions have lingered in the minds of academics for the past decades. Until today, we do not have clear answers to these dilemmas because aggregate studies to date have failed to produce definitive results. In this paper, I review the major research studies attempt to shed new lights on the elusive dilemma pertaining to the economic benefit of boardroom’s independence. Specifically, I conduct a diagnosis as to why it is difficult to establish a robust relationship between boardroom’s independence and corporate performance. I conclude by providing some guidance as to future research endeavors.

**Introduction**

The importance of an independent boardroom is underscored by the fact that an inside directorship position implies that management is overseeing management. The egregious conflict of interest associated with the inside directorship position would certainly stifle the ability of the directors to maneuver in all objectivity and autonomy and to make value-added decisions for the supreme interest of the shareholders and other stakeholders. For instance, it would be awkward (if not impossible) for inside directors to evaluate the CEO (their boss) with equanimity (Lorsch, 1995). Their judgments are consciously or subconsciously impaired by self-serving career considerations such as compensation and promotion. Despite the apparent economic value of an independent boardroom composition, the empirical literature has yet to provide unequivocal evidence on the significance and directional superiority of boardroom’s independence, particularly as it pertains to corporate performance (Bhagat and Bolton, 2008; Linck, Netter & Yang, 2008; Nicholson and Kiel, 2007; Bhagat & Black, 2002; Coles, McWilliams & Sen, 2001; Dalton et al., 1998).

The purpose of this paper is to unravel the root causes as to why the linkage boardroom independence - corporate performance remains an elusive conundrum in the academic literature. I first review the research findings available to date on boardroom’s independence and corporate performance. I elaborate as to why it is a daunting challenge to establish an unequivocal linkage between corporate governance and corporate performance. The lack of consensus on the economic value of an independent boardroom is attributed to input-output factors in normative research using archival data, notably ontological complexities inherent to the very nature of the corporation and methodological complexities intrinsic to corporate performance metrics. I conclude by advocating the infusion of complementary methodologies to the existing empirical dogmatism.

**The Evolution of Corporate Governance Theories**

In the early 20th century, relatively large U.S. firms (such Standard Oil, Ford, U.S. Steel, and Du Pont) were predominantly owned by a select group of wealthy entrepreneurs. These business owners, being also the controlling managers, used the venture resources in a parsimonious manner. They took calculated risks and invested in attractive investment opportunities. In the process, they exerted tremendous efforts in not carelessly squandering the organizational resources. Subsequently, the firms grew significantly in size and complexity thanks to the increased demand of an increasingly urbanized marketplace. The separation of ownership and control was further facilitated by the establishment of autonomous, limited liability and self-regulated corporations that enjoy the status of separate and artificial entities. In parallel, the capitalistic system evolved significantly and organized exchanges for the equity market were developed in New York and Philadelphia.

During the midst of the Great Depression, Berle and Means (1932) wrote their landmark book The Modern Corporation and Private Property. The book set the foundation for research examining the problems of separation of ownership and control, particularly as it relates to probing the trustworthiness of executives in carrying their fiduciary duties to the corporation and the shareholders in all diligence and conscientiousness. According to the proponents of the stewardship theory, the control should be centralized in the hand of the managers because of their intimate knowledge of the organization, its culture and its transacting environment (Davis et al. 1997; Mizruchi, 1983). The stewardship theory dwells on managerial trust as a central concept to reduce the transaction costs of elaborate control mechanisms (Donaldson & Davis, 1991). However, the trust assumption behind the stewardship theory may not always hold true. It would indeed be unwise to assume that all executives would readily forego their own personal well-being for the sake of the supreme interests of the shareholders and other stakeholders. From a moral-seduction perspective, one does not necessarily need to be sociopathic in nature to succumb to the traps of greed, euphoria, hidden motivations, and irrational exuberance (Simon, 1947; 1985).

The agency cost has gained prominence in the corporate governance literature because of the shortcoming of the stewardship theory. The agency cost is the additional layer of cost above and beyond non-agency relationship borne by the principal (the supplier of finance and the residual claimant of firm’s value) consequent to the unwarranted behavior of the agent (the agent). The agency cost is particularly significant in the case of highly diffused and heterogeneous shareholders because of the increased dilution of the managerial control mechanisms, the increased asymmetry in information and power between the shareholders (principals) and the managers (agents), and the further reduction in managerial incentives (Jensen and Meckling, 1976; Fama and Jensen, 1983; Jensen, 1986; Agrawal & Knoeber, 1996).

Sound corporate governance implies that a corporation ought to be run under the direction of a board of directors (Lorsch, 1995). The operative word “under the direction” is highly pertinent. It means that the board of directors delegates the daily operations of the firm to the managers. The roles of the managers are to plan, organize, direct and control the activities of the business effectively and efficiently. The roles of the directors are to continuously control, monitor, incentivize and advise management in all diligence and vigilance, but without infringing on management ability to run its daily business activities. The delimitation of the roles of management (corporate management) and the functions of the board of directors (corporate oversight) is an important consideration for the proper functioning of the internal corporate governance system.

In the process of fulfilling its oversight functions, the board of directors is expected to select, evaluate, compensate and, if necessary, terminate the CEO and other key executives. The board is also expected to review major organizational initiatives, to approve major financial and other corporate disclosures, to declare and issue dividends, and to oversee the organizational compliance systems and processes. In addition, the board is supposed to assist the firm in setting up a smooth and effective leadership succession plan. In times of emergencies, the board assumes a transitory pseudo managerial role until a new senior management team is in place. Finally, the board is expected to enhance the organization’s reputation and project a sense of corporate credibility and legitimacy.

**The Trend in the Direction of Boardroom’s Independence**

Just a few decades ago, a director would be considered as independent if such director does not belong to the management team. As such, the relationship for boardroom independence was confined to the sole employment status. With the passage of time, a two-level distinction emerged for directors’ independence, namely management versus non-management director, and affiliated versus non-affiliated director. An affiliated director (also called grey director) enjoys significant economic ties with the organization and/or personal ties with the management team. The SEC, the organized exchanges and other authoritative organizations have adopted various definitions of what constitutes a structurally independent director. A consensual definition considers a structurally independent director as a person who is not significantly involved in the strategic and operational conduct of the firm through professional affiliations that span well beyond the directorship position (e.g., suppliers, financiers, consultants, customers and other business partners). Likewise, a structurally independent director does not have parental and personal affiliations with the senior management team or other influential members of the organization. In addition, a structurally independent director does not receive compensation fees for services that span beyond the directorship duties to the firm.

As a historical perspective, the concept of an independent boardroom was first given sufficient scrutiny in the 1940’s when Accounting Series Release No. 19 requested the establishment of independent audit committees in reaction to one of the most notorious business fraud issue at that time known as the McKesson-Robbins case (Vinten and Lee, 1993). The rationale behind the release was to have the board appoint an audit committee of outside and independent directors who, in turn, appoint external auditors and discuss any issues of material importance pertaining to the company’s financial statements.

The call for independence remained unheard until 1973 when the NYSE recommended (in a White Paper entitled “Comments on Financial Reporting to Shareholders and related Matters”) that all listed companies form an audit committee consisting entirely of outside independent directors. This demand was partly implemented in 1978 as the SEC made it a requirement for all companies with common stock listed in the NYSE to establish and maintain an audit committee. This transformation occurred in the aftermath of the monumental and unexpected failure of Penn Central, followed by the failures of other firms such as LTV, Ampex and Memorex.

The drive for overall boardroom independence (and not just the audit committee of the board of directors) gained significant momentum due to the phenomenal rise of shareholder activists during the 1990’s. The shareholder activists influenced the publication of the groundbreaking Cadbury report in the U.K. The Cadbury report identified three key elements in the preferred independent governance mechanism, namely the separation of the CEO and Chairmanship positions, the representation of at least three non-executive directors in the boardroom, and the establishment of key committees to the board of directors (mainly the audit and the remuneration committees).

In the aftermath of the publication of the Cadbury Report, a flurry of international codes of governance proliferated all over the world pushing the boardrooms in the direction of greater accountability and transparency. It is also noteworthy that some corporations took it upon themselves to develop best guidelines promoting greater boardroom autonomy. This self-initiative was probably being motivated by ethical or reputational needs. For instance, the GM 1994 “Corporate Governance Guidelines” became a bellwether of boardroom best practices. One innovation of the GM guideline is the concept of executive sessions in which outside directors meet under the guidance of a lead / outside directors and without the presence of the senior management team. The executive session takes place during the regularly scheduled board meetings for at least three times a year. It gives the opportunity for the outside directors to discuss corporate / management performance without the inhibitory presence of the CEO and other senior management members.

An independent boardroom is believed to be an important consideration in reducing agency costs because it is believed to effectively uphold managerial accountability on behalf of shareholders and stakeholders. The Darwinian’s logic has often been advanced to rationalize the economic primacy of independent boardrooms: “Even in large-scale, highly bureaucratic corporations, Darwin’s logic carries. If one organism has even a tiny advantage over the others, the advantage can be a grain in the balance that determines which organism survives over time. We can easily accept the notion that, at the least, an independent board of directors is such a grain in the balance” (Millstein & MacAvoy, 1998).

This Darwinian viewpoint seems to be supported by scattered evidences in the literature, particularly as it relates to boardroom’s discrete tasks, such as the balancing of power between the directors and the senior management team (Deutsch, 2005; Rebeiz, 2001; Johnson, Daily & Ellstrand 1996). Many studies confirm that an independent boardroom has an impact on the boardroom’s modus operandi (Gabrielsson & Winlund, 2000), its adopted processes (Cornforth, 2001) and other factors related to individual directors behavior and attitude with management (Kesner, 1988; Vance, 1978). Specifically, Weisbach (1988) and Borokhovich et al. (1996) report than an outside-dominated boardroom is more likely to replace a poorly-performing CEO than an insider dominated one. In addition, Weisbach’s (1988) reports that CEO turnover is more sensitive to performance when the board is more independent.

**Literature Review: Linkage Boardroom Independence – Corporate Performance**

Despite the apparent economic primacy of independent boardrooms’ configurations, the aggregate research findings are inconclusive. The majority of the prevailing empirical studies have adopted deductive methodologies using normative statistical analysis with large sets of archival data. The normative research uses hypothesis testing and deductive reasoning using dependent and independent variables. The dependent variable is usually a measure of corporate performance and the independent variable is a corporate governance attribute such as boardroom’s independence (e.g., Bennedsen, Kongsted, & Nielsen, 2008; Lefort & Urzúa, 2008; Gompers, Ishii & Metrick, 2003; Denis & Sarin, 1999; Yermack, 1996). The control variables are incorporated in the regression equation to assess the robustness of the observed relationship and to determine whether the results are data driven or model dependent. The model is processed in a normative input-output sense ranging from simple to multi-stage regression analyses. The major research findings could be grouped into four hypotheses:

* Hypothesis 1: Positive correlation between percent outside directors and corporate performance
* Hypothesis 2: Positive correlation between percent inside directors and corporate performance
* Hypothesis 3: No correlation between compositional independence and corporate performance
* Hypothesis 4: Non-linear relation between percent independent directors and corporate performance

*Hypothesis 1: Positive correlation between percent outside directors and corporate performance*

Streams of research have found a positive correlation between boardroom independence (as measured primarily by the mix percentage of outside directors) and financial performance (Liu et al., 2015; Baysinger & Butler, 1985; Schellenger et al., 1989; Pearce and Zahra, 1992; Ezzamel and Watson, 1993). In one specific study, Kosnik (1987) reports that boards of directors that effectively resisted paying greenmails include more outside directors than board of companies that paid greenmails. In another study, Johnson, Hoskisson & Hitt (1993) posit that outsider representation on the board is positively related to board involvement in restructuring when managerial strategy implementation appears to be deficient. In cases of mergers and acquisitions, Byrd and Hickman (1992) argue that bidding firms on which independent outside directors hold at least 50% of the seats have significantly higher announcement-date abnormal returns than other bidders. In the same vein, Rosenstein and Wyatt (1997 and 1990) report that the investors react positively to the appointment of outside directors since such an event is usually followed by a higher share price for the firm, notwithstanding the fact that the market return is measured over a relatively short period of time. The implication from the aforementioned studies is that, by virtue of their detached statuses from the organization, the outside directors are in large part immune to self-interested behaviors and other political maneuverings, biases and predispositions that may exist within the organization. There are also other benefits inherent to the outside directorship position: The outside directors are expected to bring with them a fresh and different perspective. Through their own experiences in their respective industries, they would stimulate the discussion during the boardroom meetings and induce the directors to seek out different and, perhaps, more creative solutions to organizational challenges. The outside directors are also potential sources of valuable external resources via a network of contacts and connections that would complement the board’s social capital of the corporation in which they assume the directorship position. For instance, they may have access to key stakeholders (customers, suppliers, financiers and others) and may help forge unique alliances with other organizations.

*Hypothesis 2: Positive correlation between percent inside directors and corporate performance*

Scores of research (e.g., Baysinger, Kosnik and Turk, 1991; Hill and Snell, 1988; Kesner, 1987) highlight the fact that inside directors (being the organizational experts) are more inclined to understand the business and make value-added decisions on a range of issues (such as R&D spending) than outside directors. The indirect implication from the aforementioned studies is that there are limitations to the outside directorship position. The outside directors are part-timers to the firm in which they assume their directorship positions. Unlike the inside directors, they are not organizational experts. More often than not, they do not possess sufficient knowledge about the internal and external environments of the organization to digest large and complex information and to make informed decisions. In addition, the bulk of time and energy of the outside directors are directed to their full-time job, and not to their directorship position. The episodic involvement of the outside directors in corporate affairs does not give them sufficient time to secure independent information, let alone to engage in due diligence. Moreover, the flow of information provided to the directors is basically exclusively channeled via the CEO main office. The outside directors will only receive complete, relevant and timely information to the extent the CEO is ready to share this information with them. The framing, filtering and screening of information by the CEO provides ample opportunities for information deficit and information bias. Furthermore, the outside directors mingle together a few times a year. The episodic interaction of the independent directors hinder on their ability to forge meaningful (effective) and long-lasting (intense) strong interpersonal bonds with each other. The cohesiveness of the board, which serves as an important counterbalance to excessive CEO power, may never fully develop.

*Hypothesis 3: No correlation between compositional independence and corporate performance*

Streams of research have found no evidence of robust relationship between boardroom composition (typically measured by the fraction of outside directors on the board) and financial performance, measured either by market or accounting returns (Volonté, 2015; De Andres et al., 2005; Dalton et al., 1998; Pearce, 1983; Rechner and Dalton, 1986; Molz, 1988; Zahra and Stanton, 1988; Baysinger and Hoskisson, 1990; Burton, 2000, Hermalin and Weisbach, 1988, 1991; Klein, 1998). The analysis synthesis suggests that there are motivational constraints inherent to the directorship position: The directors, in their roles as representatives of the shareholders, are supposed to work rigorously and diligently for the supreme interest of the corporation by digesting large and complex information provided to them by management in a relatively short period of time. Nonetheless, one cannot automatically expect the directors are going exert the same level of effort and the same degree of vigilance as the owners of the enterprise themselves. After all, the outside directors are disinterested part-timers to the firm in which they assume directorship position, whereas the inside directors are just the agents of the shareholders. The 18th century economist Adam Smith was the first to recognize this motivational problem. In his famous book “An Inquiry into the Nature and Causes of the Wealth of Nations” (Smith, 1776), he made the following comment:

“The directors of such companies, being the managers rather of other people’s money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company”.

*Hypothesis 4: Non-linear relation between percent independent directors and corporate performance*

A small, yet noteworthy, body of literature suggests that the relationship “boardroom independent configuration - financial performance” is not linear in nature, but rather curvilinear with a negative concavity. Byrd and Hickman (1992) argue that the relationship between bidding firms' abnormal stock returns and the proportion of board seats held by independent outside directors is nonlinear, suggesting it is possible to have too many independent outside directors. In the same vein, Rebeiz and Salameh (2006) report that the relationship between the percent of outside independent directors and the returns of construction firms is not linear, thus implying an optimum mass of outside directors beyond which returns would start erode. In a different, yet somewhat related concept, Hsu and Wu (2014) indicate that the probability of corporate failure in the UK context is lower both when firms have a higher proportion of grey directors relative to executive directors and when they have a higher proportion of grey directors relative to independent directors. The implication is that there is a limitation to the model consisting of having a boardroom with 100% independent director. In other words, a critical mass of inside directors is needed in the boardroom because they are the organizational experts. They compensate for the information deficit inherent with a 100% independent boardroom configuration. However, the contribution of the inside directors should be restricted to an advising role. The control-related decisions in the board of directors (such as audit, nominating, compensating and other key control committees) should be under the sole jurisdiction of the outside and independent directors.

**Results and Discussion: Why is Research Inconclusive?**

*Issue 1: The Complex Nature of Corporations*

The corporation is a complex economic, legal and social system that influences the external environment and is influenced by the external environment. Its operation is regulated by an elaborate network of explicit and implicit contracts. Its stakeholders are numerous and often motivated by conflicting goals (Dalton et al., 1998; McAvoy & Millstein, 2004). Table 1 summarizes the determinants of corporate performance as perceived by various functional disciplines. In finance, there is a distinguished tradition of using the risk factors as the determinants of ex-ante returns. The capital asset pricing model has emerged as one of the most influential corporate finance theories. In strategic management, the resource-based view of the firm and the industry attractiveness are perceived to be main determinants of corporate performance. In organizational behavior, the complex human interaction patterns and the resulting organizational culture and norms are believed to influence personal satisfaction and personal dissatisfaction, a necessary stopover in the quest for enhanced organizational performance. In leadership theory, the leader’s personal traits (such as drive, self-confidence and charisma), the leader’s behaviors (task oriented versus relationship oriented), and the congruence between the leader’s behaviors and the situational contexts are believed to have a significant impact on organizational results. In a nutshell, each discipline has its own conception of what constitutes corporate performance. Consequently, the determinants of corporate performance constitute a complex web of interlinked and intertwined variables. The multiplicity, interdisciplinary and interdependency of intervening variables make it utterly difficult (if not virtually impossible) to isolate few specific boardroom’s attributes and associated control variables, and then link them with corporate performance.

*Issue 2: The Endogenous Nature of the Variables*

The endogenous phenomenon is a reverse casualty between corporate governance variables (the independent / control variables – the input factors) and corporate performance (the dependent variable – the input factors). This complexity requires a scrutiny of the board’s activation process, its behavioral implications and its situational contexts (Hermalin & Weisbach, 2003). As an example, boardroom attributes may impact on corporate performance, and corporate performance may impact on boardroom attributes (i.e., the interaction is a simultaneous two-directional phenomenon). Using a tangible evidence, Hermalin and Weisbach (1988) report that firms that perform poorly tend to slightly increase the proportion of their independent directors in the boardroom, either through self-initiative, or due to pressure of influential groups such as the shareholder activists. In other words, the independent variables are correlated with the residual of the ordinary least squares (OLS) regression model, thereby making the OLS model (coefficients) biased and inconsistent. The problem is further compounded with “unobserved heterogeneity”, whereby the identified relationships are symptoms of some unobservable factors that drive both the dependent variable (corporate performance) and the explanatory variables (boardroom attributes). A typical method of cleaning the endogenous data is via the use of carefully selected instrumental variables via a two-stage or three-stage regression analysis. However, more exotic regression models may be warranted to circumvent the endogenous complexity.

*Issue 3: The Unobserved Variables*

Some of the variables of corporate performance are directly observable. However, the majority of variables associated with personal and group behavior are hidden in the fabrics of the organization. Specifically, the subtle behavioral patterns and motives inside the boardroom have been outside the preview of public scrutiny. For that reason, the boardroom has often been referred to as “the black box fortress” (Daily, Dalton & Cannella, 2003; Huse et al., 2011). For instance, the definition of boardroom’s independence has so far been confined to the structural dimension. It is often assumed that if a director is structurally independent, then such a situation would automatically translate into directors’ independent judgment. However, this assumption may not necessarily be valid. The Enron’s fiasco provides a pertinent illustration on the limitation of the assumption that an independent director automatically equates to independent judgment. Enron had an exemplary board of directors with a preponderance of outside directors (there were only two inside directors out of its 17 board members). Likewise, the Enron audit committee was composed entirely of independent directors. The committee also adopted avant-garde practices; its charter would permit the committee to retain the services of accountants, legal counselors and consultants on demand as it deemed appropriate. Nonetheless, the Enron’s board has utterly failed in its oversight role, particularly as it relates to averting disingenuous managerial maneuverings (Rebeiz, 2002). It is noteworthy that many CEOs are highly persuasive and charismatic individuals. They have mastered the art of leveraging their referent power via high level networking and alliances to influence boardroom’s decisions. Furthermore, the ambiguity and uncertainty inherent to the CEO performance provides ample opportunities for sustaining interpersonal influence.

The seemingly independent directors may not exercise independent judgment due to hidden organizational factors. There are three levels of boardroom’s independence, namely structural independence, psychological independence and empowerment:

* *Structural independence*: The structural factors that impact independence are the personal and professional detachment of the directors with the management team and the corporation. For instance, a board that is under the jurisdiction of an independent lead director translates into a structurally independent leadership configuration.
* *Psychological independence*: The psychological factors that impact on independence often emanate from the prevailing culture and norms in the boardroom (Rebeiz, 2005). For instance, the emotional affinity of the directors with the CEO arises due to gratification, courtesy and recognition. Such a situation limits the freedom of the directors to exercise independent judgment because they seek (consciously or subconsciously) the CEO’s acquiescence before making a decision. It is noteworthy that the emotional dependency is nurtured over time due to frequent interactions. One research suggests that partisan’s interest and common identity could even take place in superficial affiliation situations (Thompson, 1995).
* *Boardroom’s empowerment*: The extent of boardroom’s empowerment impacts on independent judgment. One determinant of boardroom’s empowerment includes the nurturing of boardroom’s competency, particularly as it relates to acquiring knowledge about the corporation and its environment. A second determinant of boardroom’s empowerment relates to the ability of the directors to secure valuable information from independent sources outside the regular corporate channels. A third determinant of boardroom’s empowerment relates to the tangible resources at the disposition of the board. For instance, an empowered board is provided with a dedicated budget to select new board members or to appoint external consultants free from CEO interference.

*Issue 4: Corporate Performance Metrics Limitations*

The normative research uses either accounting metrics or market metrics to measure corporate performance. Both economic indicators have their merits and their shortcomings. The accounting returns are lagging performance indicators. They merely capture the historical aspects of firm performance. In addition, they rely on assets’ values that are recorded at historical value in the balance sheet, which may cause inconsistencies for intra and inter-industry analysis. The accounting returns (such as the return on equity and return on assets) are also sensitive to the level of financial leverage of the firm. Unless the returns are deleveraged (i.e., decoupling the financial risk from the business risk), then the inter-firm comparison would lack in reliability because the firm’s leverage would distort the picture. Moreover, the accounting returns could easily be manipulated by disingenuous managers. For instance, they may use opaque off-balance sheet transactions involving convoluted financial instruments and special purpose entities to distort the economic reality and materially mislead the market.

Conversely, the market returns are based on future expectations of the marketplace. It relies on the consensual and presumably objective assessment of the large number of market participants. Admittedly, market performance metrics are immune to accounting standards as they reflect the present value of future expected cash flows. Nevertheless, market returns are significantly impacted by macro-environmental variables (economic, political, regulatory and others) that are difficult to measure. As alluded previously, many of the determinants of market returns are beyond the preview and control of the managers. Specifically, Porter suggests that five forces influence the industry effectiveness, including the intensity of rivalry, the bargaining power of customers, the bargaining power of suppliers, the availability of substitutes, and the potential threats of new entrants (Porter, 2008; 1979). Other researchers also corroborate that industry performance is a strong and significant driver of performance (Coles et. al.; 2001). On a more global basis, Porter also asserts that there are inherent factors that render some nations, as well as industry clusters within nations, more profitable than others. Such factors include factor conditions, demand conditions, related and supporting industries, and firm strategy and structure at the macro level (Porter, 1998; 1990). Such external drivers of corporate performance blur and complicate the relationship boardroom’s independence – corporate performance.

Moreover, the use of market returns assumes that the marketplace is rationale and efficient. However, the market is not always efficient, at least not in the strong sense, even in well-developed capital markets (Macey, 2004). The limitations of the efficient market hypothesis have superbly been exposed in the emblematic Enron’s failure. The audit committee of Enron presumably ensured the integrity of the internal and external audit system. Arthur Andersen (the external auditor) presumably reviewed the integrity of the financial information and then issued a favorable opinion. The Securities and Exchange Commission (SEC) presumably checked the disclosed financial information for completeness, accuracy, and compliance with existing accounting standards. It then published the financial information in the EDGAR web site for the entire world to see. Finally, the marketplace, with its cohort of financial analysts, credit rating agencies, and other watchdogs scrutinized the Enron’s financial reporting and made positive recommendations on the stock price viability and credit worthiness of the firm. Nonetheless, and despite all the aforementioned checks and balances, the Enron’s debacle utterly surprised and shocked the entire marketplace.

An additional layer of complexity relates to the selected lag of time between boardroom’s attributes and corporate performance. Specifically, the relation boardroom’s independence – corporate performance is not an instantaneous phenomenon. For instance, a company with poor financial results may have a currently effective boardroom. Conversely, a company with good financial results may have a currently ineffective board of directors. Stated differently, the current financial performance indicators are not necessarily indicative of the quality of its corporate governance system because they are largely dependent on past endowment factors. It is noteworthy that valuable corporate resources, including corporate governance resources, accumulate slowly and incrementally over time (Collis & Montgomery, 1995; Boyd, 1990).

*Issue 5: The Corporate Accountability Factor*

The problem is further exacerbated by the confusion as to what constitutes corporate value. In other words, who is the corporation ultimately accountable to? This complexity stems from the fact that the corporation could be viewed a nexus of contracts (Jensen and Meckling, 1976). It transacts with various stakeholders via explicit or implicit contractual agreements (Donaldson & Preston, 1995). The corporate value therefore depends on the relative importance the firm is willing to give the various stakeholders. Under the shareholders’ primacy model, the firm should first and foremost focus on the satisfaction of the residual claimants of the firm, typically epitomized by the maximization of corporate value and, thus, shareholders’ value. All other considerations are subordinate to shareholders’ value maximization. The firm that does not adhere to the shareholders’ primacy rule would be violating the fiduciary duty embedded in the core mission of the organization. Another perspective on corporate accountability is the stakeholder model. Under this paradigm, the objective of the firm is to maximize stakeholders’ wealth. However, the theoretical model defining stakeholders’ utility is obviously more complex and elaborate than the theoretical model defining shareholders’ utility because of the sheer number of interdependent constituencies. A third perspective is the social contract model. Under this paradigm, society allows the corporations to operate and engage in business transactions with the important precondition of growing the economy, enhancing the quality of life, safeguarding the environment, upholding human rights, and contributing to the development of a nation. However, the determination of what constitutes societal value cannot easily be ascertained, at least in quantifiable terms. In the final analysis, without a shared and clear consensus as to the role of the corporation, then all discussions about corporate value, corporate performance, and boardroom’s independence would remain moot points.

**Conclusions**

The relationship boardroom’s independence and corporate performance is puzzling because it is still unsettled in the academic literature. Empirical investigations on the subject have been dominated by positivists who postulate inferences based on normative hypothesis formulation using, predominantly, archival data. This form of research fails to establish robust and unequivocal evidences because of input-output factor complexities. The uncertainties related to what constitutes directorship independent judgment and the subtle behavioral patterns and motives inside the boardroom further blur the linkage boardroom’s independence – corporate performance. Some suggestions to dismantle the black box fortress include exploring new research avenues for data acquisition (e.g., mediations or multiplex networks), and integrating deductive analysis with interpretative reasoning. The issue of boardroom’s effectiveness could indeed be ascertained with more confidence if multiple and independent research methodologies are used to capture subtle social dynamics. At the very least, triangulation in research (such as mixing hermeneutic and quantitative methods) would mitigate methodological artifacts (Jick, 1979). However, one has to be pragmatic by recognizing that the adoption of heterogeneous methodologies in one single study is a rarity. Most publication outlets indeed favor methodological purity. The changes need to be initiated “within the system” and, invariably, such changes are notoriously slow to implement. Fortunately, however, there seems to be a trend in the direction of less conventional and more holistic approach in an attempt to unravel the conundrum boardroom’s independence and corporate performance, albeit such studies remain a relatively small fraction of the total research output (McNulty, Zattoni & Douglas, 2013). The call for a broader research agenda certainly does not imply that the past empirical investigations should be discarded in favor of new ones. It merely means that the corporate governance literature would greatly benefit from a more balanced and integrative research approach.

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**Table 1. Determinants of Corporate Performance from a Multi-Disciplinary Perspective**

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| --- | --- | --- |
| **Type of Variable** | **Discipline** | **Components** |
| *The risk variables* | Finance | Systematic risk (or market risk) and idiosyncratic risks (such as operating risks, financial risks, firm’s size and firm’s age). |
| *The resource-based view* | Strategy | Valuable, rare, inimitable, and organized resources. |
| *The organizational variables* | Management | Organizational structure, job design, and human resource practices. |
| *The individual and group behaviors* | Organizational behavior | Needs theory, equity theory, reinforcement theory, and expectancy theory. |
| *The leadership theory* | Leadership | Leader’s personal traits, leader’s behaviors, and congruence between leader’s behaviors and situational contexts. |
| *The corporate governance variables* | Corporate governance | Internal governance mechanisms (e.g., board of directors, ownership type and concentration, and executives’ incentives); External governance mechanisms (e.g., regulations, legal systems and market disciplinary forces). |
| *The macro-economic variables* | Economy | Transacting environment variables of the firm (e.g., industry attractiveness; market outlook); Macro-economic variables (e.g., political, social, technological, economic and legal variables). |