



Corporate Governance

Boardroom's independence and corporate performance: the ever-elusive conundrum

Karim S. Rebeiz

Article information:

To cite this document:

Karim S. Rebeiz , (2015), "Boardroom's independence and corporate performance: the ever-elusive conundrum", Corporate Governance, Vol. 15 Iss 5 pp. 747 - 758

Permanent link to this document:

<http://dx.doi.org/10.1108/CG-07-2015-0096>

Downloaded on: 14 November 2016, At: 21:07 (PT)

References: this document contains references to 76 other documents.

To copy this document: permissions@emeraldinsight.com

The fulltext of this document has been downloaded 334 times since 2015*

Users who downloaded this article also downloaded:

(2015), "Corporate governance and performance of UK listed small and medium enterprises", Corporate Governance: The international journal of business in society, Vol. 15 Iss 5 pp. 719-733 <http://dx.doi.org/10.1108/CG-03-2015-0029>

(2015), "Multiple directorships, industry relatedness, and corporate governance effectiveness", Corporate Governance: The international journal of business in society, Vol. 15 Iss 5 pp. 590-606 <http://dx.doi.org/10.1108/CG-05-2014-0060>

Access to this document was granted through an Emerald subscription provided by emerald-srm:563821 []

For Authors

If you would like to write for this, or any other Emerald publication, then please use our Emerald for Authors service information about how to choose which publication to write for and submission guidelines are available for all. Please visit www.emeraldinsight.com/authors for more information.

About Emerald www.emeraldinsight.com

Emerald is a global publisher linking research and practice to the benefit of society. The company manages a portfolio of more than 290 journals and over 2,350 books and book series volumes, as well as providing an extensive range of online products and additional customer resources and services.

Emerald is both COUNTER 4 and TRANSFER compliant. The organization is a partner of the Committee on Publication Ethics (COPE) and also works with Portico and the LOCKSS initiative for digital archive preservation.

*Related content and download information correct at time of download.

Boardroom's independence and corporate performance: the ever-elusive conundrum

Karim S. Rebeiz

Karim S. Rebeiz is Associate Professor at Olayan School of Business, American University of Beirut, Beirut, Lebanon.

Abstract

Purpose – *The purpose of this paper is to unravel the root causes as to why the boardroom independence–corporate performance linkage remains an elusive conundrum in the academic literature, and to propose practical recommendations for future research endeavors.*

Design/methodology/approach – *The probing of the underlying issues is made via an extensive review of the existing literature. A thoughtful analysis is conducted from a multi-disciplinary perspective by soliciting feedback from academics with corporate governance expertise in finance, accounting, economy, strategy, management and organizational behavior.*

Findings – *The lack of consensus on the economic value of an independent boardroom is attributed to three reasons. The first reason is ontological complexities inherent to the very nature of the corporation. The second reason is methodological complexities intrinsic to normative research with large archival data. The third reason is self-serving behavioral motive that cannot be factored in archival data.*

Research limitations/implications – *The infusion of complementary methodologies to the existing empirical dogmatism would provide the framework for a better understanding of corporate governance challenges and opportunities, particularly as it relates to making causal inferences on boardroom independence and corporate performance.*

Practical implications – *New insights on boardroom independence would directly influence corporate practices.*

Social implications – *The determination as to what constitutes optimum boardroom configuration has emerged as an issue of considerable importance to shareholders, policymakers and other stakeholders.*

Originality/value – *Virtually no studies have been conducted in a comprehensive and systematic manner addressing the fundamental question as to why research pertaining to boardroom independence–corporate performance has not yielded unequivocal results in the relevant academic literature, thus the originality and value of this research.*

Keywords *Organizational performance, Corporate governance, Financial performance, Board of directors, Boardroom effectiveness, Corporate strategy*

Paper type *Conceptual paper*

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.

Prior to plunging into an analysis on boardroom independence–corporate performance, it is worth to, a priori, define the independent directorship position. Just a few decades ago,

Received 10 July 2015
Revised 10 July 2015
Accepted 10 August 2015

a director would be considered as independent if such a 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 gray director) enjoys significant economic ties with the organization and/or personal ties with the management team. The Securities and Exchange Commission (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.

The Darwinian 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 and MacAvoy, 1998).

This Darwinian viewpoint seems to be supported by scattered evidences in the literature, particularly as it relates to boardroom discrete tasks, such as the balancing of power between the directors and the senior management team (Deutsch, 2005; Rebeiz, 2001; Johnson *et al.*, 1996). Many studies confirm that an independent boardroom has an impact on the boardroom's *modus operandi* (Gabrielsson and 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 that an outside-dominated boardroom is more likely to replace a poorly performing CEO than an insider-dominated one. In addition, Weisbach (1988) reports that CEO turnover is more sensitive to performance when the board is more independent.

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 independence, particularly as it pertains to corporate performance (Bhagat and Bolton, 2008; Linck *et al.*, 2008; Nicholson and Kiel, 2007; Bhagat and Black, 2002; Coles *et al.*, 2001; Dalton *et al.*, 1998). In this paper, I first review the research findings available to date on boardroom independence and corporate performance. Subsequently, I elaborate as to why it is a daunting challenge to establish an unequivocal linkage between corporate governance and corporate performance. I conclude by advocating different research approaches that offer different insights while complementing the existing literature.

A brief review of corporate governance theories

During the first part of the twentieth century, 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; Mizuchi, 1983). The stewardship theory dwells on managerial trust as a central concept to reduce the transaction costs of elaborate control mechanisms (Donaldson and 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 owner) 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 and Knoeber, 1996).

Literature review on boardroom independence–corporate performance linkage

Despite the apparent economic primacy of independent boardroom 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 independence (Bennedsen *et al.*, 2008; Lefort and Urzúa, 2008; Gompers *et al.*, 2003; Denis and 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:

- H1.* Positive correlation between per cent of outside directors and corporate performance.
- H2.* Positive correlation between per cent of inside directors and corporate performance.
- H3.* No correlation between compositional independence and corporate performance.
- H4.* Non-linear relation between per cent of independent directors and corporate performance.

H1. Positive correlation between per cent of 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 (Baysinger and 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 *et al.* (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 per cent 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, as 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. 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.

H2. Positive correlation between per cent of inside directors and corporate performance

Scores of research ([Baysinger et al., 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 provide 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 hinders 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.

H3. No correlation between compositional independence and corporate performance

Streams of research have found no evidence of a 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 ([Pearce, 1983](#); [Rechner and Dalton, 1986](#); [Molz, 1988](#); [Zahra and Stanton, 1988](#); [Baysinger and Hoskisson, 1990](#); [Burton, 2000](#); [Hermalin and Weisbach, 1988, 1991](#); [Mehran, 1995](#); [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. Nonetheless, one cannot automatically expect that the directors are going to 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 eighteenth-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.

H4. Non-linear relation between per cent of 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 non-linear, suggesting that it is possible to have too many independent outside directors. In the same vein, Rebeiz and Salameh (2006) report that the relationship between the per cent 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 to erode. The implication is that there is a limitation to the model consisting of a 100 per cent independent director boardroom. 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 per cent 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.

Diagnosing why research is inconclusive

Ontological complexities

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. Consequently, the determinants of corporate performance could be broken down, at the micro level, into literally thousands of dynamic variables, some of which are directly observable, and some of which are hidden in the fabrics of the organization (Dalton *et al.*, 1998; McAvoy and Millstein, 2004). In addition, the determinants of corporate performance constitute a complex web of interlinked and intertwined variables belonging to vastly different disciplines as further elaborated below:

- *The risk variables:* In finance, there is a distinguished tradition of using the risk factors as the determinants of *ex ante* returns. The risk factors include systematic risk (or market risk) and idiosyncratic risks (such as operating risks, financial risks, firm's size and firm's age).
- *The resource variables:* In strategic management, the distinctive resources (human resources and other tangible/intangible resources) that the firm is able to acquire would provide it with economic value, which is defined as the difference between a customer's willingness to pay for a product/service and the firm's total cost of producing it.

- *The work environment variables:* In management science, the determinants of corporate performance are the social and physical conditions related to the work environment, including job design, organizational climate and human resource management.
- *The human factor variables:* In organizational behavior, the complex human interaction patterns and motivational theories (e.g. needs theory, equity theory, reinforcement theory and expectancy theory) are believed to stimulate personal satisfaction, a necessary stopover in the quest for enhanced organizational performance.
- *The leadership variables:* 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.
- *The corporate governance variables:* In corporate governance, the internal governance mechanisms (such as the board of directors, the ownership type and concentration and the executives' compensation) and the external governance mechanisms (e.g. regulations, legal systems and market disciplinary forces) are believed to impact on corporate performance.
- *The macro-economic variables:* Many of the determinants of corporate performance belong to the transacting environment of the firm, as well as the overall macro-economic environment under which the firm operates. Porter (2008, 1979) 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. 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).

The multiplicity, interdisciplinary and interdependency of intervening variables make it utterly difficult (if not virtually impossible) to isolate few specific boardroom attributes and associated control variables, and then link them with corporate performance. The complexity is further exacerbated by the endogenous nature of the input factors (Hermalin and Weisbach, 2003). 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. 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 using more exotic regression models, such as a

two-stage or three-stage regression analysis. Often, however, the instrumental variables are chosen arbitrarily with questionable validity and reliability (Wang, 2014; French and Popovici, 2011).

Methodological complexities

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. In addition, many of the determinants of market returns are beyond the preview and control of the managers, thus blurring the boardroom independence–corporate performance relationship.

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 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 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 debacle utterly surprised and shocked the entire marketplace.

An additional layer of complexity relates to the selected lag of time between boardroom attributes and corporate performance. Specifically, the boardroom independence – corporate performance relation 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 and Montgomery, 1995; Boyd, 1990).

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 and 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 independence would remain moot points.

Behavioral complexities

The definition of boardroom 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 in actuality. The Enron 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, Enron's board has utterly failed in its oversight role, particularly as it relates to averting disingenuous managerial maneuverings (Rebeiz, 2002).

The seemingly independent directors may not exercise independent judgment due to the prevailing culture in the boardroom and the control of the information by the CEO (Rebeiz, 2005). Specifically, the emotional affinity of the directors with the CEO (due to gratification, courtesy and recognition) 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).

The emotional dependency of the directors on the CEO is exacerbated by the CEO's social stature and positional power acquired via networking and mingling with other prominent organizational leaders. In addition, many CEOs are highly persuasive and charismatic individuals. They have mastered the art of leveraging their referent power to influence boardroom decisions. As a matter of fact, their self-confidence may have helped them reach the helm of organizations. Furthermore, the ambiguity and uncertainty inherent to the CEO performance provide ample opportunities for sustaining interpersonal influence.

Conclusions

The relationship between boardroom 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 ontological and methodological complexities. The uncertainties related to what constitutes directorship independent judgment further blur the boardroom independence–corporate performance linkage.

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 *et al.*, 2003; Huse *et al.*, 2011). 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 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 approaches in an attempt to unravel the boardroom independence – corporate performance conundrum, albeit such studies remain a relatively small fraction of the total research output (McNulty *et al.*, 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.

References

- Agrawal, A. and Knoeber, C. (1996), “Firm performance and mechanisms to control agency problems between managers and shareholders”, *Journal of Financial and Quantitative Analysis*, Vol. 31 No. 3, pp. 377-397.
- Baysinger, B. and Butler, H. (1985), “Corporate governance and the board of directors: performance effects of changes in board composition”, *Journal of Law, Economics and Organization*, Vol. 1 No. 1, pp. 101-124.
- Baysinger, B. and Hoskisson, R. (1990), “The composition of boards of directors and strategic control: effects on corporate strategy”, *Academy of Management Review*, Vol. 15 No. 1, pp. 72-87.
- Baysinger, B., Kosnik, R. and Turk, T. (1991), “Effects of board and ownership structure on corporate R&D strategy”, *Academy of Management Journal*, Vol. 34 No. 1, pp. 205-214.
- Bennedsen, M., Kongsted, H. and Nielsen, K. (2008), “The causal effect of board size in the performance of small and medium-sized firms”, *Journal of Banking & Finance*, Vol. 32 No. 6, pp. 1098-1109.
- Berle, A. and Means, G. (1932), *The Modern Corporation and Private Property*, Macmillan, New York, NY.
- Bhagat, S. and Black, B. (2002), “The non-correlation between board independence and long-term firm performance”, *Journal of Corporation Law*, Vol. 27 No. 2, pp. 231-273.
- Bhagat, S. and Bolton, B. (2008), “Corporate governance and firm performance”, *Journal of Corporate Finance*, Vol. 14, pp. 257-273.
- Borokhovich, K., Parrino, R. and Trapani, T. (1996), “Outside directors and CEO selection”, *Journal of Financial and Quantitative Analysis*, Vol. 31 No. 3, pp. 337-355.

- Boyd, B. (1990), "Corporate linkages and organizational environment: a test of the resource dependence model", *Strategic Management Journal*, Vol. 11 No. 6, pp. 419-430.
- Burton, P. (2000), "Antecedents and consequences of corporate governance structures", *Corporate Governance: An International Review*, Vol. 8 No. 3, pp. 194-203.
- Byrd, J. and Hickman, K. (1992), "Do outside directors monitor managers? Evidence from tender offer bids", *Journal of Financial Economics*, Vol. 32 No. 2, pp. 195-221.
- Coles, J., McWilliams, V. and Sen, N. (2001), "An examination of the relationship of governance mechanisms to performance", *Journal of Management*, Vol. 27 No. 1, pp. 23-50.
- Collis, D. and Montgomery, C. (1995), "Competing on resources: strategy in the 1990s", *Harvard Business Review*, Vol. 73 No. 4, pp. 118-128.
- Cornforth, C. (2001), "What makes boards effective? An examination of the relationships between board inputs, structures, processes and effectiveness in non-profit organizations", *Corporate Governance: An International Review*, Vol. 9 No. 3, pp. 217-227.
- Daily, C., Dalton, D. and Cannella, A. (2003), "Corporate governance: decades of dialogue and data", *Academy of Management Review*, Vol. 28 No. 3, pp. 371-382.
- Dalton, D., Daily, C., Ellstrand, A. and Johnson, J. (1998), "Meta-analytic reviews of board composition, leadership structure, and financial performance", *Strategic Management Journal*, Vol. 19 No. 3, pp. 269-290.
- Davis, J., Schoorman, F. and Donaldson, L. (1997), "Toward a stewardship theory of management", *Academy of Management Review*, Vol. 22 No. 1, pp. 20-47.
- Denis, D. and Sarin, A. (1999), "Ownership and board structures in publicly traded corporations", *Journal of Financial Economics*, Vol. 52 No. 2, pp. 187-223.
- Deutsch, Y. (2005), "The impact of board composition on firms' critical decisions: a meta-analytic review", *Journal of Management*, Vol. 31 No. 3, pp. 424-444.
- Donaldson, L. and Davis, J. (1991), "Stewardship theory or agency theory: CEO governance and shareholder returns", *Australian Journal of Management*, Vol. 16 No. 1, pp. 49-64.
- Donaldson, T. and Preston, L. (1995), "The stakeholders theory of the corporation: concepts, evidence, and implications", *Academy of Management Review*, Vol. 20 No. 1, pp. 65-91.
- Ezzamel, M. and Watson, R. (1993), "Organizational form, ownership structure, and corporate performance: a contextual empirical analysis of UK companies", *British Journal of Management*, Vol. 4 No. 3, pp. 161-176.
- Fama, E. and Jensen, M. (1983), "Separation of ownership and control", *Journal of Law and Economics*, Vol. 26 No. 2, pp. 301-325.
- French, M. and Popovici, I. (2011), "That instrument is Lousy! In search of agreement when using instrumental variables estimation in substance use research", *Health Economics*, Vol. 20 No. 2, pp. 127-146.
- Gabrielsson, J. and Winlund, H. (2000), "Boards of directors in small and medium-sized industrial firms: examining the effects of the board's working style on board task performance", *Entrepreneurship & Regional Development*, Vol. 12 No. 4, pp. 311-330.
- Gompers, P., Ishii, J. and Metrick, A. (2003), "Corporate governance and equity prices", *Quarterly Journal of Economics*, Vol. 118 No. 1, pp. 107-155.
- Hermalin, B. and Weisbach, M. (1988), "The determinants of board composition", *Rand Journal of Economics*, Vol. 19 No. 4, pp. 589-606.
- Hermalin, B. and Weisbach, M. (1991), "The effects of board composition and direct incentives on firm performance", *Financial Management*, Vol. 20 No. 4, pp. 101-112.
- Hermalin, B. and Weisbach, M. (2003), "Boards of directors as an endogenously-determined institution: a survey of the economic evidence", *Economic Policy Review*, Vol. 9 No. 1, pp. 7-26.
- Hill, C. and Snell, S. (1988), "External control, corporate strategy, and firm performance in research-intensive industries", *Strategic Management Journal*, Vol. 9 No. 6, pp. 577-590.
- Huse, M., Hoskisson, R., Zattoni, A. and Vigano, R. (2011), "New perspectives on board research: changing the research agenda", *Journal of Management and Governance*, Vol. 15 No. 1, pp. 5-28.
- Jensen, M. (1986), "Agency costs of free cash flow, corporate finance, and takeovers", *American Economic Review*, Vol. 76 No. 2, pp. 323-329.

- Jensen, M. and Meckling, W. (1976), "Theory of the firm: managerial behavior, agency costs and ownership structure", *Journal of Financial Economics*, Vol. 3 No. 2, pp. 305-350.
- Jick, T. (1979), "Mixing qualitative and quantitative methods: triangulation in action", *Administrative Science Quarterly*, Vol. 24 No. 4, pp. 602-611.
- Johnson, J., Daily, C. and Ellstrand, A. (1996), "Board of directors: a review and research agenda", *Journal of Management*, Vol. 22 No. 3, pp. 409-438.
- Johnson, R., Hoskisson, R. and Hitt, M. (1993), "Board of director involvement in restructuring: the effects of board versus managerial controls and characteristics", *Strategic Management Journal*, Vol. 14, pp. 33-50.
- Kesner, I. (1987), "Directors' stock ownership and organizational performance: an investigation of Fortune 500 companies", *Journal of Management*, Vol. 13 No. 3, pp. 499-508.
- Kesner, I. (1988), "Directors' characteristics and committee membership: an investigation of type, occupation, tenure, and gender", *Academy of Management Journal*, Vol. 31 No. 1, pp. 66-84.
- Klein, A. (1998), "Firm performance and board committee structure", *Journal of Law and Economics*, Vol. 41 No. 1, pp. 275-303.
- Kosnik, R. (1987), "Greenmail: a study of board performance in corporate governance", *Administrative Science Quarterly*, Vol. 32 No. 2, pp. 163-185.
- Lefort, F. and Urzúa, F. (2008), "Board independence, firm performance and ownership concentration: evidence from Chile", *Journal of Business Research*, Vol. 61 No. 6, pp. 615-622.
- Linck, J., Netter, J. and Yang, T. (2008), "The determinants of board structure", *Journal of Financial Economics*, Vol. 87 No. 2, pp. 308-328.
- Lorsch, J. (1995), "Empowering the board", *Harvard Business Review*, Vol. 73 No. 1, pp. 107-117.
- McAvoy, P. and Millstein, I. (2004), *The Recurring Crisis in Corporate Governance*, Stanford University Press, Stanford, CA.
- McNulty, T., Zattoni, A. and Douglas, T. (2013), "Developing corporate governance research through qualitative methods: a review of previous studies", *Corporate Governance: An International Review (Special Issue: Qualitative Research)*, Vol. 21 No. 2, pp. 183-198.
- Macey, J. (2004), *Efficient Capital Markets, Corporate Disclosure and Enron*, Yale Law School Legal Scholarship Repository (Yale Law School), New Haven, CT.
- Mehran, H. (1995), "Executive compensation structure, ownership, and firm performance", *Journal of Financial Economics*, Vol. 38 No. 2, pp. 163-184.
- Millstein, I. and MacAvoy, P. (1998), "The active board of directors and performance of the large publicly traded corporation", *Columbia Law Review*, Vol. 98, pp. 1283-1321.
- Mizruchi, M. (1983), "Who controls whom? An examination of the relation between management and boards of directors in large American corporations", *Academy of Management Review*, Vol. 8 No. 3, pp. 426-435.
- Molz, R. (1988), "Managerial domination of boards of directors and financial performance", *Journal of Business Research*, Vol. 16 No. 3, pp. 235-249.
- Nicholson, G. and Kiel, G. (2007), "Can directors impact performance? A case-based test of three theories of corporate governance", *Corporate Governance: An International Review*, Vol. 15 No. 4, pp. 585-608.
- Pearce, J. (1983), "The relationship of internal vs external orientations to financial measures of strategic performance", *Strategic Management Journal*, Vol. 4 No. 4, pp. 297-306.
- Pearce, J. and Zahra, S. (1992), "Board composition from a strategic contingency perspective", *Journal of Management Studies*, Vol. 29 No. 4, pp. 411-438.
- Porter, M. (1979), "How competitive forces shape strategy", *Harvard Business Review*, Vol. 57 No. 2, pp. 137-145.
- Porter, M. (1990), "The competitive advantage of nations", *Harvard Business Review*, Vol. 68 No. 2, pp. 73-93.
- Porter, M. (1998), "Clusters and the new economics of competition", *Harvard Business Review*, Vol. 76 No. 6, pp. 77-90.

- Porter, M. (2008), "The five competitive forces that shape strategy", *Harvard Business Review*, Vol. 86 No. 1, pp. 78-93.
- Rebeiz, K. (2001), "Corporate governance and the role of the CEO in engineering companies", *Journal of Management in Engineering*, Vol. 17 No. 1, pp. 14-23.
- Rebeiz, K. (2002), "Strategies for corporate governance in engineering corporations", *IEEE Transactions on Engineering Management*, Vol. 49 No. 4, pp. 398-408.
- Rebeiz, K. (2005), "The two dimension of corporate governance independence", *Advances in Financial Economics*, Vol. 11, pp. 209-230.
- Rebeiz, K. and Salameh, Z. (2006), "Relationship between governance structure and financial performance in construction", *Journal of Management in Engineering*, Vol. 22 No. 1, pp. 20-26.
- Rechner, P. and Dalton, D. (1986), "Board composition and shareholder wealth: an empirical assessment", *International Journal of Management*, Vol. 3, pp. 86-92.
- Rosenstein, S. and Wyatt, J. (1990), "Outside directors, board independence, and shareholder wealth", *Journal of Financial Economics*, Vol. 26 No. 2, pp. 175-191.
- Rosenstein, S. and Wyatt, J. (1997), "Inside directors, board effectiveness, and shareholder wealth", *Journal of Financial Economics*, Vol. 44 No. 2, pp. 229-250.
- Schellenger, M., Wood, D. and Tashakori, A. (1989), "Board of directors composition, shareholder wealth, and dividend policy", *Journal of Management*, Vol. 15 No. 3, pp. 457-467.
- Simon, H. (1947), *Administrative Behavior: A Study of Decision-Making Processes in Administrative Organizations*, 4th ed., The Free Press, New York, NY.
- Simon, H. (1985), "Human nature in politics: the dialogue of psychology with political science", *The American Political Science Review*, Vol. 79 No. 2, pp. 293-304.
- Smith, A. (1776), *An Inquiry into the Nature and Causes of the Wealth of Nations*, W. Strahan & T. Cadell, London.
- Thompson, L. (1995), "They saw a negotiation: partisanship and involvement", *Journal of Personality and Social Psychology*, Vol. 68 No. 5, pp. 839-853.
- Vance, S. (1978), "Corporate governance: assessing corporate performance by boardroom attributes", *Journal of Business Research*, Vol. 6 No. 3, pp. 203-220.
- Wang, C. (2014), "Instrumental variables approach to correct for endogeneity in finance", *Handbook of Financial Econometrics and Statistics*, Springer, New York, NY, pp. 2577-2600.
- Weisbach, S. (1988), "Outside directors and CEO turnover", *Journal of Financial Economics*, Vol. 20, pp. 431-460.
- Yermack, D. (1996), "Higher market valuation of companies with a small board of directors", *Journal of Financial Economics*, Vol. 40 No. 2, pp. 185-211.
- Zahra, S. and Stanton, W. (1988), "The implications of board of directors' composition for corporate strategy and performance", *International Journal of Management*, Vol. 5, pp. 229-236.

Further reading

Boyatzis, R. (1998), *Transforming Qualitative Information: Thematic Analysis and Code Development*, SAGE Publications, Thousand Oaks, CA, London, New Delhi.

About the author

Karim S. Rebeiz received his PhD from the University of Texas at Austin, his MBA from Harvard Business School, his MS 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. Karim S. Rebeiz can be contacted at: karim.rebeiz@gmail.com

For instructions on how to order reprints of this article, please visit our website:

www.emeraldgrouppublishing.com/licensing/reprints.htm

Or contact us for further details: permissions@emeraldinsight.com

This article has been cited by:

1. Rebeiz Karim S. Karim S. Rebeiz Karim S. Rebeiz is Associate Professor at the Olayan School of Business, American University of Beirut, Beirut, Lebanon. He received his PhD from the University of Texas at Austin, his MBA from Harvard Business School, his MS from the University of Texas at Austin and his BE 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. Olayan School of Business, American University of Beirut, Beirut, Lebanon . 2016. Design guidelines for boardroom's effectiveness: the case of Fortune 500 firms. *Corporate Governance: The international journal of business in society* 16:3, 490-506. [[Abstract](#)] [[Full Text](#)] [[PDF](#)]