Corporate Governance

Is director independence merely a box ticking exercise? A study of independence determinations in Irish listed companies

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Abstract

Purpose – *The purpose of this study is to establish whether Irish listed firms comply with the substance of corporate governance guidance rather than the letter of the rule in the determination of director independence. The paper examines non-executive director independence from three perspectives: the first is from the viewpoint of the sample firms, the second from that given in corporate governance guidance when applied to the sample firms, and the third based on extensive financial statement analysis, prior research and prior literature. By exploring multiple perspectives of director independence, disparities in the interpretation of non-executive director independence can be identified.*

Design/methodology/approach – *Descriptive statistics and non-parametric statistical analysis are used to examine for differences between multiple perspectives of non-executive director independence.*

Findings – *The study identified significant disparities in the interpretation of independence by Irish listed firms. This may be explained by a misunderstanding of what director independence means, a deliberate choice to ignore pre-existing norms regarding NED independence or the desire to exceed such norms. The findings suggest Irish financial institutions exhibit higher levels of NED independence than the remaining sample firms explained in part by linkages with the institutions themselves. Findings suggest a lack of adequate oversight in the sample firms, which could ultimately lead to greater agency costs for shareholders.*

Practical implications – *Policymakers and other stakeholders valuing director independence may need to reassess guidelines for interpreting director independence and related reporting, policies regarding adherence to such guidelines and associated director training requirements.*

Originality/value – *This study is timely, topical and the first of its kind in relation to Irish listed firms and provides evidence into the lack of compliance within Irish listed companies with best practice guidance. The findings clearly identify a notable lack in a consistent means of interpretation in the sample firms as to what non-executive independence is and why it is an important part of good corporate governance. The paper provides a basis for future research. Such research may include studies of firm motivation in interpretation choice and comparative studies with other jurisdictions.*

Keywords *Corporate governance, Independence, Non-executive director*

Paper type *Research paper*

Introduction

It has been recently suggested that a failure to adhere to the principles of good corporate governance was a major contributor to the credit crunch and that for the process of corporate governance to function effectively, it is not simply about complying with the letter of the law, but rather about embracing the broader spirit of good corporate governance (Moxey and Berendt, 2008). This echoes the view taken in the Hampel Report (1998, p. 11) which specifically addresses the threat and failings of box-ticking. While this report cautions that box-ticking does not take into account the diversity of circumstances and experience among companies, it also highlights a more fundamental problem with box-ticking in that ''It can be seized on as an easier option than the diligent pursuit of corporate governance objectives''. The Hampel Report (1998, p. 11) further warns that box-ticking provides an

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opportunity for those in the firm ''to arrange matters so that the letter of every governance rule was complied with but not the substance''. The issue of box-ticking also poses a notable threat to director independence, which has been consistently identified as one of the primary safeguards for effective corporate governance.

Considerable prior research has documented that simply deciphering between executive directors and non-executive directors (NEDs) ignores potential conflicts of interest between the NEDs and their employers (Hermalin and Weisbach, 1988; Lee *et al.*, 1992; Shivdasani, 1993). Fama and Jensen's (1980, 1983) theory on board composition would suggest that director independence is positively related to the monitoring effectiveness of the board. Consequently, a central tenet upon which this paper is based is that board effectiveness, and indeed corporate governance effectiveness, are largely influenced by the objectivity and independence of those leading the firm.

For nearly two decades, it has been widely accepted that NEDs can play a significant role in the corporate governance of publically listed companies (Cadbury Report, 1992; United States Congress, 2002; Higgs Report, 2003; Financial Reporting Council, 2008; Financial Reporting Council, 2010). Proponents argue that independent NEDs provide a variety of benefits including the possible prevention or impairment of managerial opportunism which may otherwise occur without independent oversight (Jensen and Meckling, 1976). Notwithstanding this, there seems to be significant variation in the determination of director independence (Brennan and McDermott, 2004; Mulgrew and Forker, 2006). More recently, the financial crisis has revived the debate on director independence with commentators arguing that the ''comply or explain'' approach may be reducing certain aspects of corporate governance, including those related to director independence, to a ''box-ticking'' exercise (Moxey and Berendt, 2008).

The objective of this study is to examine the extent of NED independence within Irish listed firms when viewed from multiple perspectives and to thereby ascertain if a gap exists in the determination of independence applied by Irish listed companies and best practice guidance. The paper examines whether or not director independence in Ireland could be considered a mere box-ticking exercise. NED independence is examined from three perspectives: Firstly, from the viewpoint of the sample firms, second, from that given in corporate governance guidance when applied to the sample firms, and third, based on extensive financial statement analysis, prior research and prior literature. By exploring multiple perspectives of director independence, disparities in the interpretation of non-executive director independence can be identified. The paper contributes to corporate governance literature by providing empirical evidence of the difference in perspectives as regards defining and measuring NED independence. A notable disparity between all views of NED independence is reported, suggesting that Irish firms are not engaging with this particular aspect of corporate governance in a meaningful manner. This failure to provide oversight may give rise to additional agency problems within the firm which may ultimately prove more costly for shareholders.

Related literature

Typically ''director independence'' has come to mean having no direct or indirect connection with the firm, the interpretation and impact of the degree of connectedness being central to narrow and broad definitions of ''independence.'' This lack of clarity has resulted in a noted lack of consistency as to what constitutes NED independence (Brennan and McDermott, 2004; Mulgrew and Forker, 2006).

In the academic literature, Lipton and Lorsch (1992) and Bedard *et al.* (2004) define an independent NED as one that has no affiliation with the firm other than being on its board. Klein (2002, p. 375) defines independent NEDs as directors that have ''no relationship to the company that may interfere with the exercise of their independence from management and the company''. Van den Berghe and Baeldon (2005) note the formality of definitions of NED independence provided by the regulatory environment and instead suggest that it essential that directors conduct their work with the appropriate attitude. Specifically Van den Berghe and Baeldon (2005) argue that NEDs need to be both critical thinkers and be of independent mind. Further, they stress that the firm must provide the appropriate resources to contribute to an environment that will engender such an attitude within the directors.

The UK Corporate Governance Code (Financial Reporting Council, 2010), which replaces the Combined Code (Financial Reporting Council, 2006, 2008), is the primary reference point for corporate governance conduct in Ireland. The UK Corporate Governance Code (Financial Reporting Council, 2010, p. 12) requires the board to determine whether a director is independent in character and judgment and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgment.

In Mulgrew and Forker (2006), it was recognised that considerable disparity exists as to the understanding of and application of the term ''NED independence'' within a company. Similar to Clifford and Evans (1997) who measure NED non-independence by identifying whether NEDs are involved in transactions beyond those required to fulfil the role of a director, whether they are a significant shareholder in their firm and if they are a previous employee of the firm, Mulgrew and Forker (2006) suggest that if one is to have an independent NED serving on the board, certain affiliations between the director and their employer firm should not exist. Based on financial statement analysis, a review of the relevant academic and regulatory literature, a detailed checklist' was developed in Mulgrew and Forker (2006) as a means of measuring NED independence. In particular, this checklist identified a whole series of potential relationships which, if found to exist, would automatically suggest a NED is no longer independent. Mulgrew and Forker (2006) summarise these 28 potential relationships into three categories of NED affiliation with the form other than being on its board of directors:

1. business;
2. personal; or
3. financial.

The current global financial crisis refocused attention on the adequacy of corporate governance and specifically the role of directors. It has been suggested that corporate governance is now ''broken'' and that elements of the Combined Code should perhaps be enshrined into law (AccountancyAge, 2009). Irish corporate governance is not immune from such criticism. The directors of Anglo Irish Bank, now being referred to as ''Ireland's Enron'', have been criticised for their actions, and indeed inaction, in relation to the transfer of undisclosed loans to its Chairman and other members of the Board (Forelle, 2009).

Consequently, the central research objective of this study is to examine levels of NED independence within companies listed on the Irish Stock Exchange from varying perspectives and thereby identify whether or not a gap exists between how NED independence is defined and measured by Irish listed firms and best practice regulatory guidance. By investigating the various viewpoints that may be taken with regard to defining and measuring NED independence, the study is able yield evidence regarding the degree to which the sample firms are incorrectly classifying their NEDs and are engaging in a ''box-ticking'' process with regards to their determination of director independence, rather than adhering to the spirit of good corporate governance.

It is important to emphasise that the process of box-ticking defeats the very purpose of corporate governance. Should a firm engage in box-ticking, the value of its corporate governance systems are instantly diminished with the focus moving from proving valuable oversight and accountability for stakeholders, particularly shareholders, to simply paying ''lip service'' to such issues. Said differently, box-ticking leads to corporate governance systems with no real substance. Moreover, a continued failure to implement and apply corporate governance systems with any real meaning may have far- reaching consequences in countries, such as Ireland, where these issues are becoming increasing apparent. The recent corporate scandals within the UK and Ireland have led to calls for radical changes to be made including calls for mandatory disclosure of corporate governance information (The Central Bank of Ireland, 2010) and suggestions that the solution to the current crisis in corporate governance may be due to the fact that the principles based systems employed in Ireland and the UK are simply inadequate to contend with the plethora of governance issues plaguing listed firms (Black, 2010). In contrast mandatory disclosure of corporate governance information can be seen to essentially place a ''straight-jacket'' on insightful and meaningful corporate reporting and that voluntary disclosure of corporate governance information by the firm has the benefit of providing a broader, more tailored set of information which satisfies the specific needs of the stakeholders which can instil a strong degree of confidence that the firm and its board take into consideration the needs of stakeholders when providing assurance on the activities of those charged with running the firm. Additionally, principles based corporate governance is argued to work for firms listed in the UK and Ireland by offering flexibility, being less costly and providing a stronger focus on the needs of the investor (Solomon, 2010).

As regards the board of directors, there is clearly a compelling case for firms to correctly classify their NEDs as either being, or not being, independent. A continued failure by companies to pay any attention to this issue would only serve to undermine a firm's credibility, both in the eyes of investors and indeed the business media, should such issues later be exposed. Differences in such views over time would prove costly for the firm and could eventually strengthen the case for rules-based corporate governance regimes to be implemented in the UK and in Ireland. Furthermore, by incorrectly classifying and reporting the independence of NEDs on the board and its sub-committees, all stakeholders are essentially being lied to which only serves to widen the information asymmetry gap between the principal and the agent (Jensen and Meckling, 1976). Finally, it is critical that those charged with corporate oversight within the firm are themselves free from bias and conflicts of interest which could impair their independence. If the firm fails to understand this point and what exactly constitutes director ''independence'', those being tasked with ensuring stakeholder interests are protected will not be able to do so to the best of their ability as their objectivity and independence will be, to an extent, impaired.

This investigation will examine NED independence within the firm by measuring levels of independence within the main corporate governance mechanisms within the firm – the board of directors, the audit committee, the remuneration committee and the nomination committee.

Fama and Jensen (1983, p. 311) recognise that the board of directors as the primary mechanism by which decision management may be separated from decision control and the oversight function of the board as the most vital of directors' roles (Chtourou *et al.*, 2001, p. 11). Fama and Jensen (1980, 1983) assert that the effectiveness of the board at monitoring management is largely determined by its composition.

The audit committee is the most common board sub-committee, and is widely recognised as an essential facet of effective corporate governance. Weidenbaum (2003) claims that a well-functioning audit committee is the conscience of the corporation and that an arm's length relationship between the audit committee and company management is essential to establish and maintain the independence required from the audit committee. The audit committee is generally considered as a more efficient mechanism than the full board for focusing on particular issues (Lumsden, 2004). An audit committee provides the board with a direct link with the auditors and an assurance that the right questions are being asked about the adequacy of management control systems, and the degree to which they are being adhered to (Cadbury, 1990). In particular, the audit committee is responsible for ensuring and monitoring the integrity of the financial statements and the internal controls of the firms (Laux and Laux, 2009).

The remuneration committee is an essential committee with regard to the control of the remuneration of executive directors. It determines the most effective remuneration for executive directors based on performance-related pay. NEDs are a vital contribution to this committee. Similar to the audit committee, the NEDs are required to effectively monitor the activities and performance of management and ensure that they are compensated in such a way that is reflective of their performance.

The Higgs Report (2003, p. 39) recognises that the nomination and appointment committee are crucial to strong corporate governance as well as effective accountability and that all listed firms should have a nomination committee. The Combined Code (Financial Reporting Council, 2006) recognises that the nomination committee should comprise of a majority of independent NEDs who make recommendations to the board for board appointments. The nomination committee should throw its net out as wide as possible in the search for suitable candidates to ensure that it identifies the best candidates for the individual firm (Mallin, 2007, p. 129).

Sample, data and method

This paper measures NED independence from three perspectives, which are now fully explained.

Perspective 1: the company perspective

Perspective 1 examines NED independence, as measured by the sample firms themselves. More specifically, under perspective 1, NED independence is gauged in the sample firms according to disclosures the firms make about their NEDs in their annual reports and is thus a reflection of the sample firms' interpretation of NED independence based on the appropriate regulatory guidance, in this case the Combined Code (Financial Reporting Council, 2006).

Perspective 2: the corporate governance guidance perspective

Perspective 2 refers to NED independence measured in the sample firms according to what is defined and explained as constituting NED independence in the Combined Code (Financial Reporting Council, 2006), the appropriate regulatory guidance for the sample firms in 2007. It should be noted that there has been no change in the criteria for the evaluation of NED independence from the Combined Code (Financial Reporting Council, 2006) to the UK Corporate Governance Code (Financial Reporting Council, 2010), meaning that the findings from this study may be argued to bear relevance to Irish and UK corporate governance in 2012. Perspective 2 is operationalised in the sample firms by assessing the extent to which the sample firms comply with the key provision of the Combined Code (Financial Reporting Council, 2006) which requires the firm to identify the non-executives considered to be independent each year in the annual report and identifies a number of criteria by which the independence of a non-executive director can be assessed.

Perspective 3: the author's perspective

Perspective 3 is derived from Mulgrew and Forker's (2006) checklist for NED independence. These sources are used to derive a checklist used to classify the business affiliations (a relationship the NED has had with the firm through business transactions), financial affiliations (a known financial association the NED has or had with the firm), or personal affiliations (known personal relationships) which the NED may have with the firm which, if present, may impair independence. The authors have updated and extended the checklist in light of more recent research studies examining director independence as well as any subsequent revisions or amendments to the Combined Code, the relevant benchmark used in Mulgrew and Forker (2006). The criteria used by the authors for defining and measuring NED independence under perspective 3 is presented in the Appendix. It should be noted that perspective 3 builds on perspective 2 in that it essentially goes beyond those areas where the Combined Code (Financial Reporting Council, 2006) identifies NED independence to be impaired or negated. Consequently, perspective 3 may be seen as the strictest view of NED independence where any possible suggestion or likelihood of NED independence is impaired will result in that NED being deemed non-independent or ''grey'' as is often referred to in the literature (Beasley, 1996).

Having established the three perspectives, the study employs non-parametric statistical analysis to compare how they differ. Should no difference be detected, one might argue that the sample firms examined apply a high degree of rigour and scrutiny in their application of best practice corporate governance and exceed the requirements as defined in Combined Code (Financial Reporting Council, 2006). This would also help to instil investor confidence in financial statements, as regards corporate governance disclosure, the source of all data used in this investigation. However, should a difference be found to exist, this may raise questions over the extent to which the sample firms engage in meaningful corporate governance practice as regards NED independence. Examining the extent to which firms in the sample define and measure NED independence in a manner which differs from that of regulation (the Combined Code, (Financial Reporting Council, 2008)) provides contemporary evidence on the degree to which such firms are/are not adhering to best practice corporate governance guidance. In addition, and as will be explored later, this study identifies and discusses the primary drivers that lead to differences in the perspectives of NED independence employed in the study. This is not to be confused however with what may motivate firms to incorrectly classify independence of their NEDs, which is beyond the scope of this paper and may be an avenue for further research.

Evidence of the difference in perspectives may suggest that users of financial statements, particularly those with a staked investment, should be more sceptical of the firm's governance procedures and may corroborate Moxey and Berendt's (2008) claims that a more questioning and challenging attitude by investors is now required in these times of economic and financial hardship. Thus, the value of this research is primarily for users of financial statements and shareholders.

Table I provides a description of the variables employed in this investigation. Data for each of these variables is extracted from annual financial statements of the sample firms.

The investigation period was the financial year 2007, just prior to the global financial crisis. The sample consists of firms listed on both the Irish Stock Exchange (ISE) and the Irish Enterprise Exchange (IEX). The IEX is similar to the Alternative Investment Market (AIM) in the UK in that it has less onerous corporate governance requirements than firms listed on the main ISE. IEX listed firms do not have to adhere or state their compliance (or not) with the Combined Code (Financial Reporting Council, 2006, 2008) or the UK Corporate Governance Code (Financial Reporting Council, 2010), but may choose to do so.

Table I Description of variables

Variable	*Definition*
$\%INED_n$	$\frac{\text{Number of independent NEDs on board}}{\text{Board size}} \times 100$
$HALF_n$	Equals 1 if at least Half the Board, excluding the Chairman, consists of Independent NEDs; 0 if otherwise
$\%INEDAC_n$	$\frac{\text{Number of independent NEDs on audit committee}}{\text{Total number of audit committee members}} \times 100$
$THAC_n$	Equals 1 if the audit committee consists of at least three independent NEDs; 0 if otherwise
$\%INEDRC_n$	$\frac{\text{Number of independent NEDs on remuneration committee}}{\text{Total number of remuneration committee members}} \times 100$
$THRC_n$	Equals 1 if the remuneration committee consists of at least three independent NEDs; 0 if otherwise
$\%INEDNC_n$	$\frac{\text{Number of independent NEDs on nomination committee}}{\text{Total number of nomination committee members}} \times 100$
$MAJNC_n$	Equals 1 if the nomination committee consists of a majority of independent NEDs; 0 if otherwise

Notes: ''Perspective 1'' refers to the sample firm's interpretation of NED independence as identified in their annual reports; ''Perspective 2'' refers to the NED independence as measured by reference to the Combined Code (Financial Reporting Council, 2006) on corporate governance when applied to the annual reports of the sample firms; ''Perspective 3'' refers to the author's interpretation of NED independence, based on extensive financial statement analysis, prior corporate governance reports and prior research. The criteria used to measure NED independence under Perspective 3 is shown in the Appendix; Subscript n for each variable denotes that each variable will be collected three times (Perspectives 1 to 3) for analysis

PricewaterhouseCoopers (2008, p. 2) suggest that for firms listed on such markets, reasons to comply with the Combined Code (Financial Reporting Council, 2008) may be to allow the firm to ''differentiate themselves in terms of the quality of their business practices'' and that voluntary compliance with a globally recognised benchmark of governance can provide the firm with a means of ''getting ahead of its competition''.

Firms from both markets are included in the study for two reasons. First, to increase the sample size of the study and thus the generalisability of findings. Second, to facilitate analysis of the state of corporate governance procedures in Irish companies at a period immediately prior to the global financial crisis and when the Irish Stock Exchange achieved its peak valuation i.e. February 2007 (Lynn *et al.*, 2010). The analysis of corporate governance procedures as regards NED independence allows the authors to generate empirical evidence which can either contradict or support the claims of Moxey and Berendt (2008) that many modern corporate governance practices by corporations is mere a box-ticking exercise with no real substance. Furthermore, findings generated in the paper shed insight into the corporate governance practices of Irish listed companies at a time when increasing attention has been focused on the corporate governance practices of one of the globe's most severely affected nations in the global financial crisis

A stipulation for a firm to be included in the sample was that an adequate discussion of director independence was included in the director's report or the relevant corporate governance report. Thus, if the independence of NEDs was not discussed or stated by the firm, no assessment could be regarding the potential existence/non-existence of the gap between perspectives being tested. Table II provides a summary of the final sample.

Empirical results and discussion

Table III provides descriptive statistics for the research sample. To attain a fuller picture of the sample under consideration, data for a number of additional variables which measure board size and the size of the audit, remuneration and nomination committees are also reported within Table III. Interestingly, as shown in Panel A of Table III, 15 of the sample firms (26.32 per cent) did not have a nomination committee in place in 2007.

Panel B of Table III reports the variables under Perspective 1, the viewpoint of the firm. In the sample considered, the average percentage of board members considered by the firm to be independent (per centINED1) is 55.18 per cent. In contrast Panel C of Table III presents the results of an assessment of NED independence in the sample firms when measuring compliance with the Combined Code (Financial Reporting Council, 2006). Interestingly, in all instances, levels of NED independence fall notably, particularly with regard to the

Table II Details of final sample

	Number
Panel A: summary detail of final sample	
Initial search for firms listed on Irish markets in 2007 financial year	68
Less firms whose data is unavailable	(7)
Less firms where director independence is not addressed	(4)
Final sample of firms	57
Panel B: breakdown analysis of final sample	
Firms listed on the Irish Stock Exchange (ISE)	36
Firms listed on the Irish Enterprise Exchange (IEX)	21
Final sample of firms	57
Panel C: breakdown of final sample by industry type	
Transport and communication firms	5
Financial services firms	10
Energy and technology firms	16
Consumer goods and retail firms	14
Construction, manufacturing and exploration firms	12
Final sample of firms	57

Table III Descriptive statistics

Variable	*Board*	*Audit committee*	*Remuneration committee*	*Nomination committee*
Panel A: board and sub-committee sizes				
Number of firms	57	57	56	42
Average	9.40	3.36	3.44	4.10
Standard deviation	4.00	1.30	1.29	1.68
Panel B: independence measures (perspective 1)				
Continuous variables	$\%INED_1$	$\%INEDAC_1$	$\%INEDRC_1$	$\%INEDNC_1$
Average (%)	55.18	90.08	85.00	80.92
Standard deviation	0.18	0.22	0.27	0.22
Discrete variables	$HALF_1$	$THAC_1$	$THRC_1$	$MAJNC_1$
Percentages of results:				
Yes (1)	49.1	64.9	64.9	66.7
No (0)	50.9	35.1	35.1	33.3
Panel C: independence measures (perspective 2)				
Continuous variables	$\%INED_2$	$\%INEDAC_2$	$\%INEDRC_2$	$\%INEDNC_2$
Average (%)	29.10	57.51	46.90	51.67
Standard deviation	0.23	0.40	0.40	0.34
Discrete variables	$HALF_2$	$THAC_2$	$THRC_2$	$MAJNC_2$
Percentages of results:				
Yes (1)	17.5	33.3	33.3	42.1
No (0)	82.5	66.7	66.7	57.9
Panel D: independence measures (perspective 3)				
Continuous variables	$\%INED_3$	$\%INEDAC_3$	$\%INEDRC_3$	$\%INEDNC_3$
Average (%)	24.31	42.33	15.53	38.27
Standard deviation	0.22	0.41	0.18	0.31
Discrete variables	$HALF_3$	$THAC_3$	$THRC_3$	$MAJNC_3$
Percentages of results:				
Yes (1)	12.3	24.6	24.6	31.6
No (0)	87.7	75.4	75.4	68.4

Notes: Panel A presents descriptive statistics regarding the size of the board and its sub-committees. Panel B presents the descriptive statistics for those variables concerned with measuring NED independence under Perspective 1 (the firm's interpretation of what constitutes NED independence) while Panel C presents the descriptive statistics for the same variables under Perspective 2 (NED independence as measured by the 2006 Combined Code (Financial Reporting Council, 2006)). Finally, Panel D presents descriptive statistics for the below variables according to Perspective 3 (the author's interpretation of what constitutes NED independence). All variable definitions are given in Table II

percentage of independent NEDs on the board of directors which decreases by over 25 per cent. Similar notable reductions are observed for all sub committees of the board. As shown in Panel D of Table III, all of the above statistics once again are reduced even further when one moves to perspective 3 where NED independence is measured by the authors using the definition explained in the Appendix.

Thus, the above findings provide evidence of a notably lower representation of independent NEDs and its sub-committees than the views of the sample firms, as stated in their publicly available annual reports. This presents an alarming picture of corporate governance in Ireland and may suggest evidence that the sample firms were in effect paying little attention to the issue of director independence during this period. Given the apparent high levels of disagreements between each of the three perspectives, particularly between perspectives 1 and 2, this may suggest evidence of a difference in perspectives as to how this important element of corporate governance is defined and indeed measured. This difference is confirmed by statistical testing Panels A and B of Table IV shows that for all variables measuring NED independence in the sample firms there is a statistically significant difference (at the 1 per cent level) between perspective 1 and perspective 2 and between perspective 1 and perspective 3. This again supports the above findings and provides compelling evidence that the sample firms appear to be giving little credence to NED independence as part of their corporate governance processes. This finding supports the views of Brennan and McDermott (2004) who find that there is a noted lack of consistency as to what constitutes NED independence in Irish listed companies. When one compares

Table IV Test results for statistically significant differences in data

Variable	*Board*	*Audit committee*	*Remuneration committee*	*Nomination committee*
Panel A: Perspective 1 vs Perspective 2				
Continuous variables				
Wilcoxon signed ranks test	$\%INED_n$	$\%INEDAC_n$	$\%INEDRC_n$	$\%INEDNC_n$
p-value	0.000***	0.000***	0.000***	0.000***
Discrete variables				
McNemar test	$HALF_n$	$THAC_n$	$THRC_n$	$MAJNC_n$
p-value	0.000***	0.000***	0.000***	0.000***
Panel B: Perspective 1 vs Perspective 3				
Continuous variables				
Paired samples *t*-test	$\%INED_n$			
p-value	0.000***			
Wilcoxon signed ranks test		$\%INEDAC_n$	$\%INEDRC_n$	$\%INEDNC_n$
p-value		0.000***	0.000***	0.000***
Discrete variables				
McNemar Test	$HALF_n$	$THAC_n$	$THRC_n$	$MAJNC_n$
p-value	0.000***	0.000***	0.000***	0.000***
Panel C: Perspective 2 vs Perspective 3				
Continuous variables				
Wilcoxon signed ranks test	$\%INED_n$	$\%INEDAC_n$	$\%INEDRC_n$	$\%INEDNC_n$
p-value	0.001***	0.000***	0.000***	0.001***
Discrete variables				
McNemar Test	$HALF_n$	$THAC_n$	$THRC_n$	$MAJNC_n$
p-value	0.250	0.063*	0.063*	0.031**

Notes: * Significant at the 10 per cent level; ** Significant at the 5 per cent level; *** Significant at the 1 per cent level; Presented above are comparisons of the variables used in the study to measure NED independence within the board of directors and its sub-committees within the sample companies; With the exception of $\%INED_1$ and $\%INED_3$, all variables are found to be non-normally distributed. Hence, when comparing $\%INED_1$ and $\%INED_3$ a paired samples *t*-test is applied. For all remaining tests, non-parametric statistical analysis is appropriate. For continuous variables, a Wilcoxon matched-pairs test is applied, while for discrete variables, a McNemar test is applied. For each test conducted the probability of a statistically significant difference (*p*-value) is reported; Panel A presents the results when comparing Perspectives 1 and 2. Panel B presents the results when comparing Perspectives 1 and 3. Finally, panel B presents the results when comparing Perspectives 2 and 3

perspective 2 against perspective 3, continued evidence of a statistically significant difference (for the most part) is present. This finding provides further evidence that there are certain areas where a NED may be clearly non-independent but may still be deemed independent by the Combined Code (Financial Reporting Council, 2006).

Explaining the difference in perspectives

Having identified the existence of a statistically significant difference between how NED independence is determined under each of the three perspectives, one must next examine how this difference can be explained. This requires a vigorous assessment of the raw data used in the above analysis. It should be noted that from the initial sample, a total of 348 NEDs were identified for the financial year 2007. Of this number, 45 non-executive chairmen (12.94 per cent) were identified, leaving 303 NEDs (87.06 per cent).

Table V reports an analysis of non-independence within the sample firms from the viewpoint of Perspective 1. More specifically, Panel A of Table V provides a breakdown of how the sample firms themselves classified their NEDs and non-executive chairmen as being independent or not. Within the sample, eight of the 45 non-executive chairmen studied were reported by the firms as being non-independent. Panel B of Table V reports the various reasons given by the sample firms for deeming their chairmen non-independent, with both an excessive tenure and having been either a previous employee or having served in a previous executive capacity as the primary reasons for non-independence. It is interesting to note that the sample firms identify just 42 NEDs (12.07 per cent of the total sample of NEDs) as being non-independent. Panel C of Table V provides a breakdown of the various

Table V Analysis of non-independence in sample firms: perspective 1

Panel A: breakdown of sample classifications				
Total number of non-executive chairmen in sample:	45			
Total number of NEDs (excluding chairs) in sample:	303			
Total	348			
	Independent		Non-independent	
	Number	Percentage of sample	Number	Percentage of sample
Non-executive chairmen	37	10.63	8	2.30
Non-executive directors (excluding chairmen)	261	75.00	42	12.07
	298	85.63	50	14.37
Panel B: reasons for non-independence of non-executive chairmen				
Affiliation type	Reason for non-independence		Number of directors	Sub totals
Business	Affiliated with subsidiary company		1	
	Served on board for over nine years		3	
	Former employee/executive of firm		2	6
Financial	Represents significant shareholder		1	1
Personal	Founder of firm		1	1
	Total			8
Panel C: reasons for non-independence of non-executive directors				
Affiliation type	Reason for non-independence		Number of directors	Sub totals
Business	Involved in related party transactions		4	
	Served on board for over nine years		4	
	Former employee of firm		4	
	Joined board on acquisition		1	
	Cross directorship		1	
	Affiliated with firm subsidiary		1	
	Affiliated with company engaged in business with firm		2	
	Provides additional services to firm		1	18
Financial	Represents significant shareholder		19	19
Personal	Founder of firm		2	
	Family relationship with fellow board member(s)		2	4
	Reasons for non-independence not disclosed			1
	Total			42

reasons why the sample companies deem these 42 NEDs as being non-independent. Noteworthy reasons here include the NED being involved in related party transactions within the firm, the NED serving on the board for an excessive time period, the NED being a former employee of the firm and the NED representing a large shareholding in the firm

Table VI presents an analysis of non-independence within the sample firms when NED independence is determined according to Perspective 2. As before, Panel A of Table VI provides a summary of the number of NEDs classified as independent or non-independent under this perspective. Panel A of Table VI reports that of the 45 non-executive chairmen examined, only 12 are found to be independent, while of the 303 NEDs examined, only 153 (43.07 per cent) are reported to be independent. Both findings are notably different to that reported in Table V, where according to the firms studied, non-independence among their non-executive chairmen and NEDs is over 85 per cent compared to just over 46 per cent in Table VI. These findings yield interesting insight into the extent to which the sample firms are evidently not complying with the Combined Code (Financial Reporting Council, 2006)

Table VI Analysis of non-independence in sample firms: perspective 2

Panel A: breakdown of sample classifications

Total number of non-executive chairmen in sample:	45			
Total number of NEDs (excluding chairs) in sample:	303			
Total	348			
	Independent		Non-independent	
	No.	Percentage of sample	No.	Percentage of sample
Non-executive chairmen	12	3.45	33	9.48
Non-executive directors (excluding chairmen)	150	43.10	153	43.97
	162	46.55	186	53.45

Panel B: reasons for non-independence of non-executive chairmen

Affiliation type	Reason for non-independence	Number of directors	Sub totals
Business	Affiliated with subsidiary company	1	
	Served on board for over nine years	14	
	Former employee of firm	4	
	Affiliated with company engaged in business with firm	1	
	Provides additional services to firm	1	21
Financial	Represents significant shareholder	2	
	In receipt of share options from firm	8	10
Personal	Founder of firm	1	
	Family relationship with fellow board member(s)	1	2
Total			33

Panel C: reasons for non-independence of non-executive directors

Business	Involved in related party transactions	6	
	Served on board for over nine years	42	
	Former employee of firm	4	
	Joined board on acquisition	1	
	Cross directorship	1	
	Affiliated with firm subsidiary	1	
	Affiliated with company engaged in business with firm	2	
	Provides additional services to firm	2	59
Financial	Represents significant shareholder	38	
	In receipt of share options from firm	47	85
Personal	Founder of firm	6	
	Family relationship with fellow board member(s)	2	8
	Reasons for non-independence not disclosed		1
	Total		153

guidance regarding NED independence. Panel B of Table VI provides a breakdown of the reasons why 38 of the 46 non-executive chairmen examined were deemed to be non-independent under Perspective 2. As before, the major drivers of non-independence among chairmen were due to having served on the board for over 9 years and being a former employee of the firm. In addition, 8 non-executive chairmen in the sample examined were found to be non-independence due to their receipt of share options. Notably, none of the sample firms (as measured under perspective 1) regarded this as a reason to deem their non-executive chairmen as being non-independent. Panel C of Table VI reports the main reasons for non-independence among NEDs when independence is determined under Perspective 2. For all three affiliation types which may lead to an impairment in NED independence, an increase is observed. In Table V, 18 NEDs (5.17 per cent of the total NEDs studied) were reported to have had a business affiliation which resulted in their firm deeming them to be non-independent. In contrast, under Perspective 2, 59 NEDs (16.95 per cent of the total NEDs studied) were found to have had a business affiliation with their firm which resulted in their classification of non-independence. A further notable finding as reported in Panel C of Table VI is that 85 NEDs (24.4 per cent) were found to have a financial affiliation with the firm in that they represent major shareholders or are in receipt of share options in the company. This compares notably against just 19 NEDs according to the firm (see Table V). Finally Panel C of Table VI reports that the number of NEDs with personal relationships (being the firm founder/co-founder or having a fellow family member on the board) has doubled from that reported in Table V.

Finally, when one moves to Table VII where NED independence is measured using perspective 3, the number of independent NEDs in the sample firm again decreases, with independent NEDs representing just over 39 per cent of the sample. As one would expect with perspective 3, by delving deeper into the backgrounds of NEDs employed in the sample firms, additional, more subtle and indirect relationships between the NEDs and their firms were identified. For example Panel C of Table VII reports that seven NEDs were found to have direct or indirect relationships with the firm's bank, five NEDs were associated with the firm's auditors or solicitors and a further eight were affiliated with the firm's subsidiaries and associated companies. In addition, a further four NEDs were identified as being non-independent due to indirectly representing major shareholdings in the firm.

In sum, these findings show that as one moves from perspectives 1 to 3 NED independence decreases each time due to a variety of reasons.

What is driving the reduction in NED independence?

An examination of the annual reports and accounts of the sample firms identifies the following as being primary causes of the increasing reduction in NED independence reported above:

NED tenure. The Combined Code (Financial Reporting Council, 2006) states that NED independence is impaired if the director in question has served more than nine years on the board. As reported in Tables VI and VII, 14 non-executive chairmen and 42 NEDs are deemed by their firms to be non-independent due to their serving on the board for over nine years. In contrast, Table V identifies that three non-executive chairmen and 4 NEDs can be regarded as non-independent for serving on the board for more than nine years. This notable difference is clearly a major contributory factor to the difference in perspectives reported above.

The tenure of NEDs has often been the focus of prior research. Kosnik (1987), Beasley (1996), Chtourou *et al.* (2001) and Xie *et al.* (2003) test whether NED tenure is a key indicator of board competence and effectiveness. Chtourou *et al.* (2001) argue that more senior NEDs are likely to have greater knowledge of the firm, its directors and its corporate governance systems and therefore may be more adept at monitoring management and overseeing the firm's financial reporting process. Furthermore, Beasley (1996) contends that more experienced NEDs may be less susceptible to conform to group pressures and may therefore be more independent.

In their annual review of Irish corporate governance, Grant Thornton (2010, p. 14) argue that once the NED's tenure exceeds nine years, he/she does not simply become non-independent overnight and in such instances, tenure should not be used as the only criteria for deeming a NED as non-independent. The authors would argue that precisely the opposite is called for if corporate governance is to reform and restore the confidence of investors. Rules such as deeming a NED non-independent once their tenure exceeds nine years should be upheld and should be enforced consistently. Were companies to adopt a

Table VII Analysis of non-independence in sample firms: perspective 3

Panel A: breakdown of sample classifications

Total number of non-executive chairmen in sample:	45			
Total number of NEDs (excluding chairs) in sample:	303			
Total	348			
	Independent		Non-independent	
	No.	Percentage of sample	No.	Percentage of sample
Non-executive chairmen	11	3.16	34	9.77
Non-executive directors (excluding chairmen)	125	35.92	178	51.15
	134	39.08	227	60.92

Panel B: reasons for non-independence of non-executive chairmen

Affiliation type	Reason for non-independence	Number of directors	Sub totals
Business	Affiliated with subsidiary company	1	
	Affiliated with firm's bank	1	
	Served on board for over nine years	14	
	Former employee of firm	4	
	Affiliated with company engaged in business with firm	1	
	Provides additional services to firm	1	22
Financial	Represents significant shareholder	2	
	In receipt of share options from firm	8	10
Personal	Founder of firm	1	
	Family relationship with fellow board member(s)	1	2
Total			34

Panel C: reasons for non-independence of non-executive directors

Business	Involved in related party transactions	6	
	Affiliated with firm's bank	7	
	Affiliated with firm's auditors/solicitors	5	
	Served on board for over nine years	42	
	Former employee of firm	4	
	Joined board on acquisition	1	
	Cross directorship	1	
	Affiliated with firm subsidiary/associate	8	
	Affiliated with company engaged in business (past or present) with firm	3	
	Provides additional services to firm	3	80
Financial	Represents significant shareholder (direct and indirect)	42	
	In receipt of share options from firm	47	89
Personal	Founder of firm	6	
	Family relationship with fellow board member(s)	2	8
	Reasons for non-independence not disclosed		1
	Total		178

zero tolerance code of corporate governance, with obvious exceptions for smaller companies, it is argued that a better, more robust standard of corporate governance will emerge which would avoid such pitfalls as that seen in more recent times. Such views were echoed in the recent Larosière Report (2009) and the resulting Green Paper by the European Commission (2010) where the lack of effective control within corporate governance mechanisms, the fundamental nature of the corporate governance regime in place and the implementation of such systems has been called into question within the context of financial institutions.

NEDs in receipt of stock options. One of the most persistent drivers of the reported differences in perspectives is due to NEDs in the sample firms receiving share options from their employer. As stated in the Appendix, these are regarded as a financial affiliation the NED may have, over and above being a paid director of a firm, which may compromise their independent status within the firm. As reported in Tables VI and VII, there are 47 NEDs and eight Chairmen identified in the sample as being in receipt of share options and thus, according to perspectives 2 and 3, are deemed to be non-independent. This notable finding is in stark contrast to that reported in Table V, where no NEDs are regarded as being non-independent as a result of the receipt of share options. This notable finding is clearly a major determinant of the differences in perspectives reported above and provides additional evidence of the lack of compliance within the sample firms with the Combined Code (Financial Reporting Council, 2006) provision as regards NED participation in share options. Admittedly, while only 11 of the 23 firms (47.8 per cent) that were found to have NEDs in receipt of stock options were fully listed and therefore should be adhering to these recommendations, this finding may be viewed as a cause for concern by shareholders seeking high standards of best practice corporate governance in their investments.

Chtourou *et al.* (2001, p. 7) argue that a NED with a financial interest in the firm may impair their independence and that NEDs, particularly those on the audit committee, should refrain from holding employee stock options, given their oversight duties. The issue is intensified for stock options that may be exercised in the short-term as financial statement manipulation or creative accounting may have an effect on share value at the time of exercise. Blair (2002) claims that one of the many lessons learnt from accounting scandals in the US is that providing directors with employee stock options as a means of aligning their interests with shareholders may in fact serve to encourage such directors to behave in a more opportunistic fashion.

Conflicts of interest. This phrase is used to describe the many relationships that the NED may have with the firm, over and above being a director on the board. These relationships may impair the NED's independent status on the board and its sub-committees. In the context of this analysis, ''conflict of interest'' refers to the director being a director of the firm's subsidiary/associated firm, being a former employee (Clifford and Evans, 1997) being affiliated with the firm's bank/solicitors/auditors/stock brokers and accountants, providing additional services to the firm, being involved in cross-directorships with the firm and engaging in related party transactions or business with the firm (Clifford and Evans, 1997).

Table V reports that the sample firms themselves identify four non-executive chairmen and 17 NEDs involved in such relations which impairs their independence. In contrast, Table VI reports 24 NEDs involved in such relationships, while Table VII identifies 46 such affiliations. This is clearly cause for concern and a notable contributor to the reported differences in perspectives above.

It may be claimed that such a ruthless attitude towards NED independence is unrealistic and impracticable for the modern corporation to the extent that it may severely limit the scope for who can and cannot serve on a board as a NED. However, this investigation would argue that if a firm is to fully embrace the spirit of good corporate governance (Moxey and Berendt, 2008) and strive for higher standards of impartiality within the board where an appropriate forum for challenge exists, then the uncertainty and inconsistency surrounding NED independence needs to be addressed fully. Further, by establishing clearly defined boundaries for NEDs, stakeholders including shareholders, employees and suppliers, to name but a few, may have greater confidence in the corporate governance mechanisms within their firms to the extent that NEDs serving on such boards/committees have no associations which may call into question the effectiveness of their oversight role.

Significant shareholders. A key driver of the reported differences in perspectives was due to a notable number of NEDs representing, both directly and indirectly, large shareholders. Table V reports 20 NEDs with such affiliations, while Tables VI and VII identify 40 and 44 NEDs with such affiliations, respectively. A large shareholder is taken in this case to at least 5 per cent of the firm's total equity capital. Clifford and Evans (1997) argue that NED independence is impaired if the NED is a significant shareholder in the firm.

Implications of findings

The differences in the determination of director independence found to exist in this study highlights that there is a large degree of variability with regard to understanding, interpreting and applying the concept of NED independence by Irish companies that form the sample used in this investigation. There are a number of important implications of these findings which will now be considered.

Despite reporting by commentators to the contrary, such as Grant Thornton (2007–2010), it would seem that one cannot take the reporting of director independence by Irish listed companies at face value. The vast disparity between the perspectives analysed in this study, indicate the fundamental weakness in the determination of director independence; namely that it is, in fact, a ''box-ticking'' exercise. In other words, it encourages a culture of mere compliance with regulation. The attitude would seem to be that ''if this compliance with regulation is not possible, then explain such problems away.'' If the NED ''independence'' is taken at face value, it appears that the firms are represented by a vast majority of independent NEDs. However, when the relationships are scrutinised and examined, with no exceptions taken, many directors reported to be independent would appear to be in fact non-independent, and thus the findings illustrate a low representation of independent NEDs on the boards of Irish listed firms. Furthermore, the ''comply or explain'' approach may be used by firms as an ''escape route'', allowing them to avoid full compliance with the spirit of good corporate governance as called for by Moxey and Berendt (2008). In this case, the interests of shareholders are not being protected. The independent monitoring component is, at best, weakened and, at worst, is no longer present on the board. Thus the internal capability to challenge objectively and remain impartial to the decisions of executive management is impaired to the detriment of shareholders.

Consequently, it is the opinion of the authors that future corporate governance reports address these issues in and around NED independence. While, it is encouraging to see the Walker Report (2009) stress the importance of NED independence, particularly within the realm of risk management in financial institutions, one must remember that financial institutions already have a higher standard of director probity (Irish Financial Services Regulatory Authority, 2008). Nonetheless, one might argue that the directors of Irish financial institutions, and indeed financial institutions elsewhere, have been weighed and measured and have been found to be inadequate. Since 2007, not only have the membership of the boards of Irish institutions been radically overhauled; the level of shareholder oversight has been increased dramatically (Lynn *et al.*, 2010). It is, perhaps, time for greater probity in all firms which seek the benefits of investment from the public. While preclusion of experienced persons from directorships on the grounds of non-independence may be a step too far, mandatory determination and reporting of director independence against detailed criteria would neither seem to be a significant burden on neither companies nor the State.

Second, it is possible that management and directors are not sufficiently aware of the various items against which one might determine independence. Again it would not be a significant burden for State agencies or firms to provide training to those responsible for such determination. If corporate governance is to improve, it must begin by instilling a sense of what is fundamentally correct in the minds of those responsible for leading the firm.

The role of financial institutions

Given that a lack of compliance and adherence to fundamental principles of good corporate governance within financial institutions in particular has been argued to be a primary factor in the global financial crisis (Moxey and Berendt, 2008) a further insight may be garnered in the sample firms by assessing the extent to which measures of NED independence differ for the financial institutions from the rest of the sample firms.

Within the sample firms, there are four financial institutions. Panel A of Table VIII presents the descriptive statistics for the proportion of independent NEDs on the board for the financial institutions for each perspective. Given that there are only four firms in this subset of the sample, only the descriptive statistics for these three variables are presented and subjected to further analysis, as variables pertaining to the sub committees of the board do not provide any additional insight. Panel B of Table VIII presents the descriptive statistics for the remaining sample firms, while Panel C of Table VIII presents the results for non-parametric statistical analysis of differences between the two samples.

Despite the adverse publicity received by many financial institutions in the recent credit crisis, Table VIII reports that, when viewed under perspectives 1 and 2, the proportion of independent NEDs on the boards is notably higher in the financial institutions. This yields further support for the view that Irish financial institutions exhibit higher levels of director probity (Irish Financial Services Regulatory Authority, 2008).

Therefore it seems that while a NED's affiliation with a financial institution may be deemed to be a contributory factor to the increasing gap between perceptions 1, 2 and 3 as regards NED independence reported above, NED independence within the financial instructions themselves may actually be seen to be higher than the remaining sample from which the data was extracted. Hence, these findings when combined would lead one to infer that financial institutions in Ireland can report higher levels than the remaining sample as regards NED independence, but that it is the linkages that the remaining sample firms share with these very same financial institutions that leads to the increasing gap between the perceptions of NED independence examined above. In other words, when one assesses NED independence in Irish listed firms, Irish financial institutions actually exhibit satisfactory levels of NED independence and in fact it is the more subtle, less transparent linkages that exist between Irish listed companies and such financial institutions that ultimately impairs NED independence in the sample firms. Perhaps it may be argued that this issue is systemic

Table VIII Statistical analysis of financial institutions and remaining sample

Panel A: descriptive statistics for financial institutions in sample			
Variable	$\%INED_1$	$\%INED_2$	$\%INED_3$
Number of firms	4	4	
Average (%)	67.69	58.26	54.10
Standard deviation	0.56	0.13	0.12
Panel B: descriptive statistics for remaining firms in sample			
Variable	$\%INED_1$	$\%INED_2$	$\%INED_3$
Number of firms	53	53	53
Average (%)	54.23	26.90	22.06
Standard deviation	0.18	0.22	0.21
Panel C: comparison of measures of independence between samples			
Mann-Whitney U Test	$\%INED_1$	$\%INED_2$	$\%INED_3$
P-value	0.012**	0.087*	0.111

Notes: * Significant at the 10 per cent level; ** Significant at the 5 per cent level; Panel A presents descriptive statistics for the financial institutions in the sample. Panel B presents those same descriptive statistics for the remaining sample firms. Panel C presents a comparison of the two samples using the Mann-Whitney U Test. For this test, the probability of a statistically significant difference (*p*-value) is reported; For this analysis only three variables are presented: $\%INED_1$ (proportion of independent NEDs on the board according to perspective 1, that of the company), $\%INED_2$ (proportion of independent NEDs on the board according to perspective 2, that of corporate governance best practice) and $\%INED_3$ (proportion of independent NEDs on the board according to perspective 3, that of the authors) of a smaller nation like Ireland where the market for NEDs is smaller and where the chances of hiring a truly ''independent'' NED are less likely.

Conclusion

The objective of this study is to establish whether or not firms listed on Irish stock markets embrace the principles and substance of effective corporate governance, rather than simply following the letter of the law regarding NED independence. The examination of multiple perspectives of NED independence allows for a comparison between the corporate governance mechanisms the firm actually has in place to address potential agency issues and what the firm should have or should be doing to ensure objectivity oversight and the protection of shareholders.

Notable disparities in interpretation of independence were identified and suggest that the companies are merely paying lip service to the provisions of the Combined Code (Financial Reporting Council, 2006), which applied in the sample period, as regards NED independence and not, complying with the broader spirit of good corporate governance. The sample period was selected as it represents a snapshot of corporate governance within the Irish economy when the Irish Stock Exchange was at its peak valuation and in a period prior to the current credit crunch (Lynn *et al.*, 2010). As such, the findings provide strong support for the calls of Moxey and Berendt (2008) in that they clearly show that firms were merely engaging in more of a box-ticking exercise as regards NED independence.

An investigation into the reasons behind the reported differences in perspectives indicate that a notable number of NEDs and non-executive chairmen had business and financial affiliations which led to their classification as non-independent by the authors when applying the research methodology. The findings in this regard were in stark contrast to the views of the sample firms themselves, many of which regarded their levels of NED independence as satisfactory or even surpassing expectations. It is argued that the findings of this investigation provide a compelling argument for revisiting the issue of NED independence, how it is determined and reported by boards and their advisors. The authors also briefly assessed levels of NED independence in Irish Financial Institutions contained within the sample and found that such companies exhibit higher levels of NED independence but that it is the more indirect and subtle linkages that the remaining sample firms have with such financial institutions which ultimately leads to the reported decoration of NED independence as one moves from perspective 1 through to perspective 3. Based on all of the above findings, the authors would support the calls for certain aspects of corporate governance to perhaps be made mandatory or to be enshrined into law (AccountancyAge, 2009); in this case the reporting of director independence including the basis of determination being applied. The authors also suggest that there is a possible need to explore director training and education relating to the determination of independence.

Finally, this study yields compelling evidence of a notable shortfall in NED independence within Irish listed companies, mainly due to issues such as NEDs in receipt of employee stock options, conflicts of interest and the representation of significant shareholders. This leads the authors to conclude that a widening gap exists between what Irish firms do regarding NED independence and what they should be doing. An avenue for further research would be to understand what motivates firms to define and measure NED independence differently. A misunderstanding of what director independence means, a deliberate choice to ignore pre-existing norms regarding NED independence or the desire to exceed such norms are all potential reasons which could be explored via a qualitative research project utilising surveys, interviews or perhaps a mixture of both.

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Further reading

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Appendix

An independent non-executive director (NED) is defined as having no business, financial or personal affiliation with the firm other than being on its board.

Presented below are a series of checks applied when appraising the independence of NEDs of the sample firms. Should any of the below relationships be found to exist between a NED and the firm, he/she is deemed non-independent:

1. Business affiliation checks:

   - NED is a director/partner/employee/owner of a company engaged in business with the firm.

- NED is a director/partner/employee/owner of a company that provides consultancy services to the firm.
- NED is a director/partner/employee/owner of one (or more) of the firm's subsidiaries/joint ventures/associated undertakings.
- NED is affiliated with one (or more) of firm's subsidiaries/joint ventures/associated undertakings.
- NED is a director/partner/employee/owner of one (or more) of the firm's business clients.
- NED is a director/partner/employee/owner of a company that receives or has received a loan from the firm.
- NED is a director/partner/employee/owner of a company that provides or has provided the firm with a loan.
- NED is a director/partner/employee/owner of a company that has a material interest in any contract or arrangement within the last five years that is significant in relation to the business of the firm or any of its subsidiaries/joint ventures/associated undertakings.
- NED is a director/partner/employee/owner of the firm's stockbrokers/solicitors/financial advisors/bankers/auditors.
- NED holds cross-directorships or has significant links with other directors through involvement in other firms/bodies.
- NED acts or has acted as an advisor/consultant to the firm.
- NED acts or has acted as an advisor / consultant to the firm's stockbrokers / solicitors /financial advisors / bankers / auditors.
- NED acts or has acted as an advisor / consultant to one (or more) of the firm's subsidiaries/joint ventures/associated undertakings / business clients.
- NED was appointed to the board on the acquisition of a company in which he/she was employed.
- NED was appointed to the board on a merger with a company in which he/she was employed.
- NED was appointed to the board on a demerger from a company in which he/she was employed.
- NED was employed by the firm prior to being appointed to the board
- NED is affiliated with a company/bank/solicitor/advisor/accountant/stock broker/auditor that is engaged in business with the firm.
- NED is affiliated with a firm that is a significant shareholder in the firm (significance in this case taken to be 5 per cent of the issued ordinary shares of the firm).
- NED has been an employee of the company or group.
- NED has served on the board for more than nine years from the date of their first election.
- NED is ex-chairman of the firm.
- NED is or used to be company secretary.
- NED is or has worked for the firm in an executive capacity (including on a temporary basis).
- NED is engaged in related party transactions.

2. Financial affiliation checks:
   - NED receives employee stock options from the firm.
   - NED receives a pension from the firm.
   - NED receives performance-related pay/bonuses from the firm.
   - NED is a direct significant shareholder (significance in this case taken to be 5 per cent of issued ordinary shares of the firm).

- NED is an indirect significant shareholder (significance in this case taken to be 5 per cent of issued ordinary shares of the firm).
- NED receives pay for work undertaken for the firm in a non-director capacity.
- NED is a member of the firm's long term incentive programme.

3. Personal affiliation checks:

- NED is a founder/co-founder of the firm.
- NED is a member of a family that owns/founded the firm.
- NED is related to any fellow board member through family.
- NED has close family ties with any of the company's advisors/senior employees.

Corresponding author

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