

Corporate Governance, Board of Directors, and the Firm: A Maturing Field

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Corporate governance scholars are intensely interested in the relation of corporate governance (CG) and firm performance, broadly defined. The role and effectiveness of the board of directors (or “boards”) continue to be at the center of CG research and inquiry because, in most countries, boards serve as the representatives of shareholders and have the fiduciary responsibility to monitor management and improve performance (Van Den Berghe & Levrau, 2004; Kumar & Sivaramakrishnan, 2008). Of course, the performance of boards has attracted special scrutiny in recent years following a wave of corporate scandals that raised serious doubts on their effectiveness. Indeed, board composition and structure remain at the center of policy debates as different countries attempt to develop legal and institutional frameworks to improve board performance and diversity.

There has been active research on boards by CG scholars for over three decades. As is typical with fields of scientific inquiry, the focus of the literature has evolved over time. The initial focus of board research was on defining basic issues and developing the conceptual frameworks to address these issues. What is the role of boards? How do they influence corporate governance — theoretically and empirically? By utilizing agency-theoretic, institutional, and social-norm based perspectives the initial literature made enormous strides in defining the role of boards and understanding the determinants of their composition and performance (see, e.g., Adams et al., 2010; Huse et al., 2011; Pugliese et al., 2009). However, having addressed the basic questions and generated some broad empirical results with respect to the effects of boards on firm performance, the research agenda has evolved to examine the role and effectiveness of boards in detail. In other words, the recent board literature has started exposing the *granularity* that attends

board composition, task formulation, decision making, and ultimately board influence on the myriad activities of the firm.

CGIR has been in the forefront of publishing high quality research that has moved forward the literature on boards. For example, in the past year papers published in CGIR have examined the effects of ownership structure on board composition (Sur et al., 2013); studied the task formulation and strategic decision making of boards (Machold and Farquhar, 2013; Bailey and Peck, 2013) ; and, analyzed the relation of boards to auditor choice, earnings management, and financial risk taking (Johansen and Petterson, 2013; Chan et al., 2013; McNulty et al., 2013). This evolution of research on boards is consistent with a maturing field of scientific study that moves from setting up a basic research agenda to continually refining providing conceptual frameworks and developing stylized facts.

In this issue, we have four high quality research studies that further sharpen our understanding of the effects of boards in various aspects of firm performance. Chakrabarty and Bass examine corporate governance and board performance in microfinance institutions (MFIs). This is among the first CG studies relating to MFIs and is thus of substantial interest. MFIs are having a major impact on the bottom of the economic pyramid (BOP) in the developing world and have tremendous potential to aid the economic uplift of literally hundreds of millions of people. But because of their BOP settings, MFIs also typically face “institutional voids.” Chakrabarty and Bass provide a number of interesting findings that are novel to the CG literature. They find that boards that have more socio-economic expertise and female representation are more effective in terms of lowering the MFI’s costs of operating at the BOP. These results are of independent interest to the literature. But their analysis also points to the importance of the effectiveness of agrarian institutions. In particular, they note that when agrarian institutions are ineffective the

boards may have difficulty in helping MFIs reduce costs of operating at the BOP. Since this is one of the first papers to examine CG in agrarian and impoverished settings, the emphasis on the quality of agrarian institutions in ameliorating or exacerbating the institutional voids is thought provoking. We are hopeful that this paper will set a new research agenda for CG scholars across the world.

The study by Da Maere et al. focuses on the relation of board incentives and capital to bankruptcy in unlisted firms. Their study is of interest for a variety reasons. First, empirical studies typically measure board performance through effects on accounting or financial returns. But bankruptcy is a watershed and a major performance-related event for the firm but its relation to board structure is relatively underexplored. Second, their data relate to unlisted firms, which typically are not considered in the literature because of data limitations. However, the number of unlisted firms far exceeds the number of listed firms. Hence, shedding light on board performance in unlisted firms is particularly welcome. Third, their results highlight the “reputation” hypothesis, namely, that directors tend to flee from firms in downward spiral, thereby aggravating the performance of firms in distress towards bankruptcy. Finally, their analysis supports an eclectic mix of theoretical frameworks, integrating elements of agency, resource-dependency, and group decision-making models. This is a good example of the power of interdisciplinary CG research.

Meanwhile, Sun and Shin study an aspect of board behavior that has received significant negative public attention recently. The financial press and some recent academic studies have highlighted the tendency of some boards to issue new stock options to top management when their existing stock options “go underwater,” that is, the stock price falls below the exercise price of the previously awarded stock options. Clearly, this behavior is of concern since it appears to

award bad CEO performance. Their study is also interdisciplinary because, while it draws on agency and attribution theories, it explores social and psychological mechanisms. Their empirical findings emphasize the role of contextual factors, such as recent aggregate and industry performance, in the willingness of boards to grant new options to top management. In particular, they find that boards give greater number of new options in response to CEOs' underwater options during recessionary periods, but fewer new options when the recent industry performance was high. The Sun and Shin study is a useful contribution to the literature and indicates that understanding the contextual factors is especially important in studying executive compensation policies of boards.

The paper by Chen relates board capital — specifically directors' educational level, industry experience, and interlocking ties — to R&D investment. Since innovation and R&D are a primary engine of economic growth, the effects of corporate governance on R&D investment behavior of firms is an important issue. Chen finds not only a positive relation of board capital on R&D investment but also highlights the positive moderating role of CEO power. While CEO power has a variety of implications, which have been studied in the CG literature, the positive interaction effects of board capital and CEO power on R&D investment is an especially interesting finding.

We believe and hope that the papers in this issue will give further impetus to international CG research on boards by providing new conceptual insights and empirical findings. As we noted at the outset, the study of boards is now maturing as a field of scientific inquiry and we look forward to reading (and hopefully editing) new studies that extend the frontiers of this vibrant literature, as is done by the papers in this issue.

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