# Lead Independent Directors: Good Governance or Window Dressing

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Hypotheses:

H1: Firms with an LID perform better relative to firms without an LID and as a consequence have higher firm value.

H2: Firms with an LID have higher CEO turnover following poor performance relative to firms without an LID.

H3: CEOs of firms with an LID have stronger risk taking incentives and lower excess compensation, as compared to firms without an LID.

TABLE 2
TRENDS IN THE ADOPTION OF THE LID POSITION

Table 2 shows the prevalence of the LID position among ExecuComp firms with available relevant data from BoardEx and Compustat during 1999-2009.

| | (1) | (2) | (3) | (4) | (5) |
|---|---|---|---|---|---|
| Year | # of firms with an initial LID appointment | Cumulative firms starting LID position | # of firms discontinuing LID position | Cumulative # firms ending LID position | Total # LID firms |
| 1999 | 8 | 8 | 0 | 0 | 8 |
| 2000 | 67 | 75 | 0 | 0 | 75 |
| 2001 | 23 | 98 | 1 | 1 | 96[a] |
| 2002 | 67 | 165 | 0 | 1 | 161[a] |
| 2003 | 202 | 367 | 1 | 2 | 361[a] |
| 2004 | 201 | 568 | 7 | 9 | 547[a] |
| 2005 | 152 | 720 | 14 | 23 | 646[a] |
| 2006 | 192 | 912 | 22 | 45 | 781[a] |
| 2007 | 153 | 1065 | 23 | 68 | 882[a] |
| 2008 | 101 | 1166 | 32 | 100 | 925[a] |
| 2009 | 78 | 1244 | 39 | 139 | 815[a] |

[a] This number does not equal the cumulative firms starting LID-cumulative firms ending LID because 76 firm-years have a gap between years in which the LID position is reported.

| Dependent Variable: | MTB | | | ROA | | |
|---|---|---|---|---|---|---|
| | *2SLS* | *Heckman* | *MLE Treatment* | *2SLS* | *Heckman* | *MLE Treatment* |
| Variables: | (1) | (2) | (3) | (4) | (5) | (6) |
| $LID_{(t-1)}$ | 0.308*** | 0.173*** | 0.209*** | 0.011*** | 0.006** | 0.005** |
| | (5.51) | (3.89) | (4.51) | (4.52) | (2.55) | (2.30) |


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| | CEO Delta | | | CEO Vega | | | CEO MRI | | |
|---|---|---|---|---|---|---|---|---|---|
| | *2SLS* | *Heckman* | *MLE Treatment* | *2SLS* | *Heckman* | *MLE Treatment* | *2SLS* | *Heckman* | *MLE Treatment* |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) |
| $LID_{(t-1)}$ | -215.86*** | -153.43*** | -151.71*** | 77.737*** | 47.114*** | 51.526*** | 0.054*** | 0.037*** | 0.029*** |
| | (3.70) | (3.11) | (3.03) | (8.09) | (10.86) | (11.19) | (3.36) | (3.73) | (2.76) |

Summary of Results:

Overall, we find evidence that an LID represents an effective governance mechanism rather than governance window dressing. Specifically, firms with an LID have higher corporate profitability, higher market valuation, higher excess stock returns, higher likelihood of turnover of underperforming CEOs and stronger risk taking incentives to the CEO (i.e., higher *CEO Vega* and lower *CEO Delta*).

Implications:

This study contributes to the corporate governance literature on board structure and independent directors by showing that the LID board role has an important and prominent impact on firm value, CEO incentives and CEO turnover. Importantly, this role is unexamined in prior empirical studies of corporate governance and our findings support the view that the LID board role increases firm value.

Current Status:

We are in the process of revising for journal submission.

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