

Board Independence and Corporate Misconduct

Research published in *Journal of Management* studied the effectiveness of board independence in reducing corporate misconduct. The researchers observe that board independence has increasingly been hailed as a vital governance mechanism, especially in the wake of the financial crisis and many other high-profile corporate scandals. They also note, however, that evidence of the effectiveness of board independence is relatively mixed and seek to provide a more definitive look at this relationship by examining the results of a large number of studies on the topic.

Key Takeaways:

- Board independence, audit committee independence, and CEO-board chair separation reduce the likelihood of corporate misconduct.
- Audit committee independence is twice as effective as overall board independence in reducing misconduct.
- Board independence and CEO-board chair separation are more effective where corruption is less common but less effective in more corrupt countries.

The researchers analyzed 142 samples of data comprising thousands of companies across 24 countries from the late 1960s through present-day. They found that firms with more independent boards and separate CEOs and board chairs are slightly less likely to engage in corporate misconduct (e.g., financial fraud, regulatory violations, insider trading). They also found that

audit committee independence, specifically, is over twice as effective in deterring corporate misconduct compared to overall board independence and CEO-board chair separation. Finally, the researchers found that the effects of board independence and CEO-board chair separation on misconduct are weaker in countries where corruption is more common but stronger in countries with less corruption, whereas the effectiveness of audit committee independence was unaffected by country-level corruption.

The authors conclude that their findings suggest that board independence is, in fact, a deterrent to corporate misconduct but, given the particular effectiveness of audit committee independence, more attention should be paid to the composition and influence of each board committee in addition to the board as a whole. They also note that individual firms that operate under systemic conditions that promote corruption may continue to struggle to curtail misconduct even when they employ conventionally-effective governance mechanisms.

Source: Neville, F., Byron, K., Post, C., & Ward, A. (In press). Board Independence and Corporate Misconduct: A Cross-National Meta-Analysis. *Journal of Management*.

