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New Sheriff in Town: Antecedents and Consequences of Effective Lead Independent Directors

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New Sheriff in Town: Antecedents and Consequences of Effective Lead Independent Directors

A dissertation submitted in partial fulfillment
of the requirements for the degree of
Doctor of Philosophy in Business Administration

by

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Abstract

This paper examines a relatively new form of board leadership structure, the Lead Independent Director (LID), that has not received much attention in the corporate governance literature. This role was adopted in 2003 by most large US firms as a result of stock exchange mandates and pressure from institutional investors. From an agency theory perspective, this new form of leadership structure was designed to give additional control to independent directors, thus enhancing the monitoring function of the board. However, according to symbolic management theory, firms may adopt such a structure merely as a response to institutional pressures, thus making no significant changes to boards' monitoring mechanism. This paper examines whether efficiencies and monitoring within boards have increased after the adoption of the LID. This paper contributes to the limited understanding of LIDs and studies the antecedents and consequences of having an effective LID. I predict that underperforming firms, firms with high strategic complexity, as well as firms with a large number of dedicated institutional investors are more likely to select an effective lead independent director. In addition to that, I suggest that an effective LID can influence board monitoring functions such as board meeting effectiveness, CEO compensation structure, and dismissal of problem directors. Using sample of S&P 500 firms, I found that underperforming firms were more likely to select an effective LID, whereas the level of strategic complexity of the firm had no effect on the selection of an effective LID. Surprisingly, I found that firms with a higher ratio of dedicated investors were more likely to select a less effective LID. For the consequences, I found that when firms adopted effective LIDs, the following year the board meetings had higher attendance, and problem directors on boards were more likely to be dismissed. However, the effectiveness of a LID had no influence in changing the CEO's pay structure. Results from this dissertation provide valuable insights about the adoption of LIDs.

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I. Introduction

In the early 2000s, executives of large US firms including Enron, WorldCom, and Tyco engaged in corrupt practices which resulted in bankruptcies (Ackman, 2002). Due to these corporate scandals, shareholders lost billions of dollars in shareholder value, and many lives were affected (Bragg, 2002). In the aftermath of these events, it was found that one of the main reasons these events occurred was because independent directors failed to effectively do their job of monitoring the CEO and their top-management teams (Stanford Business, 2003).

As a result, investors and regulating bodies started to push for more stringent laws and policies and emphasized additional monitoring by bringing greater independence to board leadership structures (Kim, Burns, and Prescott, 2009). For instance, the US Congress passed the Sarbanes-Oxley Act, which required executives and financial officers to certify the company's annual and quarterly reports, verifying that such reports are accurate and complete, and stipulating that defrauding shareholders by providing false information would be subject to fines or up to 20 years of imprisonment (SEC, 2003). Similarly, the New York Stock Exchange (NYSE) mandated new structural reforms with the hope of improving the overall governance process (e.g., the majority of directors must be independent; boards must have independent audit and compensation committees) (NYSE, 2003). It has been over 15 years since the implementation of these major reforms, and it still not clear whether these new policy changes and mandates have improved governance standards for firms.

This dissertation explores the legitimacy of one of the many important policies implemented by the NYSE. In 2003, the NYSE mandated a policy which required all firms to adopt a Lead Independent Director (hereafter referred to as LID) position on their boards (Penbera, 2009). According to this mandate, the LID must be a non-management director who

chairs all executive sessions, monitors the CEO, and leads the independent directors (Spencer Stuart, 2007). Firms trading on NASDAQ do not have such formal requirements, but due to immense pressure from investors, many NASDAQ firms have also adopted similar practices (Penbera, 2009). By the end of 2005, more than 94 percent of S&P 500 boards had designated a LID (Spencer Stuart, 2007) and this number increased to 99 percent by the end of 2015 (Spencer Stuart, 2016). The adoption of the LID was suggested to enhance the monitoring function of the board (Dalton and Dalton, 2005). In addition, there has been a long debate in the corporate governance literature focused on whether to split the role of CEO and chairman of the board (Finkelstein and D'aveni, 1994). The appointment of a LID works as a compromise between agency theory's prescription of independent monitoring and classical organization theory's prescription of the unity of command (e.g., Moyer, 2012; Penbera, 2009). As a part of this compromise, non-management directors are led by LIDs, while board chairs continue to preside over the board. The adoption of the LID can also reduce the workload of the Chairman of the Board, as board related tasks can now be shared between two leaders (Dalton and Dalton, 2005).

On its face, it seems like the adoption of the LID has improved corporate governance practices, but empirical testing is needed to validate this claim. From an agency theory perspective, the adoption of the LID should give additional control to the board of directors to ensure that executives' interests are not misaligned from those of shareholders, thus enhancing the overall governance of the firm (Dalton and Dalton, 2005). However, a contrasting view drawing from the symbolic management literature suggests that firms may adopt this policy merely as a response to institutional pressures, and there is a possibility they will decouple adoption from substantive implementation (Bromley and Powell, 2012). In such a case, adopting new governance practices may be a symbolic management tactic used by firms and will be

unlikely to improve governance quality (Zajac and Westphal, 1995; Westphal and Zajac, 1998, 2001). It has been more than a decade since the implementation of the LID, and research is now warranted to explore which firms implemented this role substantively to actually improve their governance standards, as opposed to those firms that implemented symbolic changes to just “tick a box” and essentially have no or minimal changes to their governance mechanisms.

Thus, in this paper I ask two important research questions: 1) which firms are more likely to select an effective LID for substantive purposes, versus which firms are likely to select a less effective (or ineffective) LID for symbolic purposes, and 2) once a LID is selected, how does this individual influence the monitoring function of the board. To answer these questions, in this dissertation, I explore the antecedents and consequences of firms that selected an effective LID. In order to measure the effectiveness of LIDs, I rely on Hambrick, Misysangi and Park’s (2015) quad model and develop a composite measure of effective LIDs using the following four factors: 1) independence, 2) expertise, 3) bandwidth (whether the LID has enough time on hand to perform these responsibilities), and 4) motivation. According to this model, a director must have a combination of all four factors in order to be an effective monitor. I explore the characteristics of firms that are more likely to select an effective LID for substantive purposes. I predict that underperforming firms, firms with high strategic complexity, as well as firms with a large number of dedicated institutional investors are more likely to select an effective LID for substantive purposes.

Research on symbolic management suggests that firms can satisfy the external demands of regulators and shareholders by influencing the selection of independent directors, who may simply act as window dressing, by not engaging in serious monitoring behaviors (Wade, Porac, and Pollock, 1997; Westphal and Zajac, 1994, 1998; Helland and Sykuta, 2004). Thus,

shareholders may elect a director who has the capacity to be effective--who may have the potential to enhance the monitoring function of the board--but whether they will actually improve board monitoring is still in question. LIDs were mainly adopted for three primary reasons: to chair executive sessions, to monitor the CEO, and to lead and evaluate independent directors (Spencer Stuart, 2007). Thus, based on these responsibilities assigned to LIDs, I explore whether effective LIDs are able to: 1) enhance the effectiveness of board meetings, 2) monitor the CEO by ensuring their compensation package is designed in a way to align their interests with shareholders, and 3) dismiss problem directors that could hurt the reputation of the board (See Figure 1). Results from this study help us gain a better understanding of what types of firms hired LIDs for symbolic versus substantive purposes.

Insert Figure 1 Here

Contributions

This study makes several contributions to research on corporate governance. First, this study contributes to the board leadership literature by examining a relatively new role that has been introduced to the board's leadership team in the last 15 years. Traditionally, boards have been led by the CEO Chair (i.e., CEO duality); however, after recent structural reforms, firms have added a new position, the LID, to their boards' leadership team. Thus, this paper explains how the addition of this new role has influenced governance outcomes.

Second, I extend the discussions by Krause, Withers, and Semadeni (2017) and Shi and Connelly (2018). Recently, Krause et al., (2017) suggested that the LID balances power between CEOs and boards of directors. Their study suggests that CEOs will prefer relatively less

powerful board members to serve as the LID. As such a board member would render the newly created position weak and largely ceremonial, thus protecting the CEO's power. Shareholders, on the other hand, will prefer a more powerful member to serve as the LID. As such a board member would be better able to monitor the CEO and impose greater accountability on the CEO. They also found that the adoption of a LID does not necessarily increase financial or shareholder performance, but analysts do react positively to such announcements.

Shi and Connelly (2018), on the other hand, explore the differences in the adoption of a LID between NYSE and NASDAQ firms. They found that NYSE firms that adopted LIDs in response to regulatory pressure were more likely to use this role symbolically. On the other hand, NASDAQ firms, who adopted LIDs without any regulatory pressure, were more likely to be motivated by substantive goals. They also found that following the adoption of a LID, NYSE firms had lower gains in operating performance than NASDAQ firms.

However, both of these studies present a simplistic view of the LID, that is, either by comparing the firms that appointed the position of LID on their boards to the firms that did not (Krause et al., 2017) or studying the differences between the LIDs of NYSE and NASDAQ firms (Shi and Connelly, 2018), and both of these studies examine distal outcomes such as firm performance. As a result, they caution about inferring too much from their results and highlight the possibility of Type II errors, suggesting that we look deeper into the characteristics of LIDs. Thus, I take a more fine-grained approach and examine the effectiveness of the individual in this role, instead of merely examining firms with and without LIDs.

Third, I extend the symbolic management and institutional literatures and examine organizational decoupling in the case of LIDs (Meyer and Rowan, 1977; Scott, 1995).

“Organizational decoupling occurs when organizations symbolically conform to external

pressures, but do not actually implement meaningful change at the operational level (Shi and Connelly, 2018, p:2390). Thus, I examine whether firms adopted a LID for symbolic purposes to enhance organizational legitimacy or for substantive purposes to improve their governance standards.

Fourth, I contribute by empirically testing the quad model introduced by Hambrick and colleagues (2015). The quad model focuses on the characteristics of individual directors, not the entire board, and suggests that when an individual director possess a combination of four characteristics, he or she is more likely to be effective in their monitoring tasks. The quad model specifies that the four characteristics of an effective director are: 1) bandwidth (whether the LID has enough time on hand to perform these responsibilities), 2) ability, 3) motivation, and 4) independence. Based on this approach, I apply these characteristics to measure the effectiveness of a LID and test the quad model to examine the antecedents and consequences of firms adopting an effective LID. To my knowledge, the quad model has not yet been empirically tested. As a result, in examining the implementation of the LID, this is the first attempt to empirically apply this model.

In a related vein, I also extend the theory underlying the quad model. As mentioned above, Hambrick and colleagues suggest that a director must have a combination of all four characteristics (bandwidth, ability, motivation, and independence) in order to be effective. However, it is plausible that certain characteristics could be more important than others in a given context. For instance, firms with high strategic complexity will benefit more from a director who has greater bandwidth and ability and less from a director who only has independence but no bandwidth and ability. Therefore, in a post hoc analysis, I explore the four characteristics of the LID individually and examine whether certain characteristics are more

important than others in specific contexts. Thus, I assess boundary conditions for the quad model and identify directors' characteristics that may be more valuable in different contexts.

Finally, I contribute to practice by investigating the LID phenomenon, a governance practice that, despite its widespread acceptance over the last 15 years, has received scant theory-driven scholarly attention. In doing so, I offer valuable insights for directors, executives, and other observers of board phenomena, such as regulators and investors. The results from this paper could help policymakers and boards of directors to make changes to the roles and responsibilities of the LID.

The dissertation begins with a theoretical explanation of why firms would prefer to have a LID on their boards. Then I briefly present background and past research conducted in the area of the LIDs. Following that, I explain the different ways in which an effective LID can help improve the governance standards of the firm. Next, I hypothesize several firm characteristics that predict firms which are more likely to adopt an effective LID. Following that, I focus on the consequences of having an effective LID on the board and hypothesize different ways in which a LID can influence the monitoring function of the board. I follow with research methods and data analysis. Finally, I conclude the paper with implications of the findings and provide suggestions for future research in this area.

II. Theoretical Explanation

Before suggesting the antecedents and consequences of having an effective LID, it is important to understand why the role of a LID was prescribed to most US firms. In the section below, based on the logic of agency theory, stewardship theory, and dual leadership theory, I provide a theoretical explanation of how the adoption of the LID could benefit the firm in three ways: 1) enhance board independence, 2) provide an alternative solution to the issue of CEO

duality, and 3) reduce the workload of board-related tasks assigned to the Chairman of the Board.

Board Independence

A preference for a LIDs is largely grounded in agency theory. Agency theory is built on the notion that the separation of ownership and control is a characteristic of the modern corporation, and agents, who control the organization may engage in self-interested actions, which may not be in the best interest of principals (Jensen and Meckling, 1976). Agency theory also suggests that agents have an advantage as they have more firm-specific knowledge and managerial expertise than principals (Mizruchi, 1983). Due to this conflict of interest and information asymmetry between owners and managers, monitoring mechanisms by boards of directors are suggested as ways to protect the owners of the firm (e.g., Fama and Jensen, 1983). Corporate governance scholars suggest that monitoring by boards of directors can be effective when boards are comprised of greater proportions of independent directors (Lorsch and MacIver, 1989; Mizruchi, 1983; Zahra and Pearce, 1989). Similarly, agency theory suggests that boards are more effective when they are led by an independent director (Rechner and Dalton, 1991). Based on this logic, the adoption of a LID is more likely to improve the monitoring capacity of independent directors and reduce the power of the CEO, thus enhancing overall board independence (Krause and Semadeni, 2013).

An alternative solution to issue of CEO Duality

To understand how a LID can provide an alternative solution to CEO duality, it is important to understand the pros and cons of CEO duality. The proponents of agency theory believe that board leadership is considered less effective when a board is chaired by the CEO (i.e., CEO duality) (Rechner and Dalton, 1991). Having the CEO chair the board which evaluates

his/her own work weakens the oversight provided by the board. This is because CEO duality signals the absence of separation of management and control, limiting the board's ability to effectively monitor and evaluate the CEO (Fama and Jensen, 1983; Finkelstein and D'Aveni; 1994). Powerful CEOs, who also may hold title of chair are more likely to use their power to influence the selection of independent directors who are less likely to challenge their actions (Westphal and Zajac, 1995). Research suggest that when the CEO controls the board as a chair, the independence and vigilance is suffered, which creates further agency problems and may deter firm performance (Pi and Timme, 1993; Rechner and Dalton, 1991). Agency theory suggests that splitting the board chair and CEO positions facilitates more effective monitoring and control of the CEO, and that firms failing to do so may underperform than those who split the two top positions (Rechner and Dalton, 1991).

However, a contrasting view based on the unity of command principle suggests that it is better to have one leader, instead of two, who can clearly communicate his or her vision to all the stakeholders (Fayol, 1949; Gulick and Urwick, 1937). Similarly, stewardship theory argues that CEO duality establishes strong, unambiguous leadership embodied in a unity of command and that firms with CEO duality may make better and faster decisions and, consequently, may outperform those which split the two positions (Donaldson and Davis, 1991). CEO duality, therefore, helps to avoid confusion among employees and the board of directors, as one leader can clearly communicate to both groups in a more timely and effective manner (Finkelstein and D'Aveni, 1994). Otherwise, the firm may experience conflicts at the top, delayed and ineffective decision-making and, ultimately, have poor performance (Baliga, Moyer, and Rao, 1996; Brickley et al., 1997).

Due to these two different perspectives, CEO duality is one of the more controversial topics in corporate governance research (Finkelstein and D'Aveni, 1994). Dalton et al. (1998) examined the conflict between agency theory and stewardship theory and meta-analyzed the correlation between CEO duality and firm performance and found no meaningful relationship between the two variables. However, twenty years later, the debate on CEO duality still continues in the realm of corporate governance. Proponents of CEO duality value the unity of command, while proponents of CEO non-duality value entrenchment avoidance. Therefore, to satisfy both sides, the adoption of the LID was proposed as an alternation solution (Dalton and Dalton, 2005). Firms now have an option to maintain CEO duality in order to have unity of command and simultaneously have a leader of the independent directors who can monitor the CEO's actions, and thus avoid entrenchment (Lipton and Lorsch, 1992). Thus, the appointment of a LID works as a compromise between agency theory's prescription of independent monitoring and classical organization theory's prescription of the unity of command (e.g., Moyer, 2012; Penbera, 2009). As a result of this compromise, firms have adopted different board leadership structures according to needs of the organization. Table 1 demonstrates examples of different board leadership structures firms may adopt. The key difference between a LID and the Chairman of the Board is that in most cases, a LID will not have an office in the company and in case of an emergency, the Chairman of the Board should be able to run the company.

Insert Table 1 Here

Chairman of the Board and the Lead Independent Director

The splitting of leadership roles between the Chairman of the Board and the LID is also consistent with dual leadership theory, which suggests that as organizations get more complex, they may require two or more leaders to divide tasks and responsibilities to address the needs of multiple stakeholders (Etzioni, 1965). The board tasks that were performed by the Chairman of the Board can now be shared with the LID. As a result, the LID will be able to take some responsibilities from the Chairman of the Board, such as reviewing and approving board meeting agendas, serving as a liaison between independent directors and the CEO, and chairing outside director meetings (Penbera, 2009). The CEO/Chair will still have a voice on the board, provide superior knowledge to the board and increase information available to it. The board members can also have confidence that their CEO/Chair is fully aware of the firm's strengths and weaknesses, along with the issues that need to be addressed moving forward. The time saved from sharing these responsibilities with the LID can be used to focus on formulating and implementing firm strategies. Finally, dual leadership theory also cautions about the potential downsides of sharing leadership roles among two leaders. If two leaders do not get along or if there is a potential for conflicts between the LID and CEO/Chair, this may slow the decision making of the firm, and thus ultimately have a negative impact on firm performance.

III. Background and Past Research

In the above section, I discussed theoretical reasons for why firms may have adopted the role of the LID on their boards. In the section below, I explain the institutional pressures firms faced which lead them to implement the LID on their boards. In addition, I present research provided by practitioners and scholars on the topic of the LID.

Institutional Pressures

As mentioned earlier, the number of firms adopting the LID increased after 2003. The primary reason for this increase was the NYSE's policy mandate that required all member firms to adopt a LID position on their boards (NYSE, 2003). In addition to the NYSE's mandate, some prominent institutional investors and business associations also pressed for the designation of lead directorship as an improvement to board independence and as an alternative to CEO and board Chair separation. For instance, TIAA-CREF, one of the nation's largest pension funds, in its 2004 Policy Statement on Corporate Governance states: "when the board chooses not to separate the positions, it should designate a lead or presiding director who would preside over executive sessions of independent directors" (TIAA-CREF, 2004). Similarly, The Conference Board, a leading business association, recommended in its 2003 Commission on Public Trust and Private Enterprise that when the chairman is not an independent director or when the chairman is the CEO of the firm, then a LID or a presiding director should be specifically established to improve the board's independence (Conference Board, 2003). Firms trading on NASDAQ did not have a formal requirement; however, due to the immense pressure from investors, most NASDAQ firms adopted similar practices (Shi and Connelly, 2018). By the end of 2005, more than 95% of S&P 500 boards had designated a LID (Spencer Stuart, 2007) and by 2015, 99% of S&P 500 firms had a LID (Shi and Connelly, 2018).

Practitioner recommendations

Spencer Stuart (2007) surveyed 68 LIDs of S&P 500 firms in 2005 and found that in most cases, LIDs believed that the overall board monitoring and effectiveness were enhanced with the adoption of this role. This is mainly because the LIDs were able to share the roles and responsibilities with the Chairman of the Board, who in most cases is also the CEO of the firm.

Instead of the Chairman of the Board, the person in the role of the LID serves as the focal point of contact between executives and outside directors (Dalton and Dalton, 2005). Outside directors are encouraged to contact the LID if they have any concerns regarding the firm, and the LID is responsible for requesting necessary information from company executives (Spencer Stuart, 2007). This protects CEOs from being contacted by multiple board members and streamlines communication between executives and outside board members (PricewaterhouseCoopers, 2010). In addition to acting as the liaison between firm executives and non-executive directors, the LID also chairs executive sessions without the presence of management (Spencer Stuart, 2007). The LID coordinates with the CEO and corporate secretary to ensure that outside directors receive all necessary meeting materials in a timely manner to enable the outside directors to evaluate the CEO's performance (Spencer Stuart, 2007). The LID is responsible for leading discussions of sensitive issues such as executive compensation and performance reviews in executive sessions (PricewaterhouseCoopers, 2010).

Recently, Shi and Connelly (2018) surveyed directors and consultants, which gave additional insights about this role. In their survey, they found that most LIDs were selected by the existing board of directors, and in most cases, the CEO and/or Chairman of the Board also had a role in this decision. Approximately, 42 percent of LIDs also served as the nominating and governance committee chair, 28 percent of LIDs served as audit committee chair, and 21 percent of LIDs served as compensation committee chair (Shi and Connelly, 2018). Their survey also revealed that LIDs play an important role in key governance outcomes such as executive pay and hiring and firing of the CEOs and other directors. They also found that some LIDs hold CEOs and other directors accountable and advocate on behalf of shareholders. The LIDs did this by communicating directly with the company's largest shareholders so that they could better operate

as a liaison for shareholder concerns and demands (Penbera, 2009). Moreover, the survey results indicated that LIDs communicate directly with the company's largest shareholders so that they hear demands and concerns directly from shareholders. In addition to the monitoring role, many LIDs mentored, advised, and provided expertise to management, and were also involved in making recommendations about corporate strategies (Shi and Connelly, 2018).

Past Research on Lead Independent Director

It is surprising that despite the widespread acceptance of the LID on boards, scholarly research on LIDs has not received much attention. As mentioned earlier, Krause et al. (2017) explored the power balance between boards of directors and CEOs to determine the antecedents and consequences of adopting the role of LID. Specifically, they found that the firms with balanced power between the CEO and the board were likely to select a LID that has moderate power relative to other independent directors. While examining the consequences of the LID on performance, they found a direct effect of LIDs' appointment on only analyst ratings; however, they also found that LID appointments affected analyst ratings, stock performance, and ROI when CEO power was low.

As referenced earlier, Shi and Connelly (2018) studied the differences in the adoption of LIDs between NYSE and NASDAQ firms. In addition to the work they did surveying directors and consultants about the LID role, they also examined performance consequences of the LID. In their study, they found that NYSE firms which adopted LIDs in response to regulatory pressure were more likely to use the LID in a symbolic way. On the other hand, NASDAQ firms, who adopted LIDs without any regulatory pressure, were more likely to be motivated by substantive goals. Specifically, they found underperforming NYSE firms that adopted a LID were less likely to dismiss a CEO and separate the CEO and board chair than NASDAQ firms. They also found

that NYSE firms had lower operating performance and observed a decrease in dedicated institutional investor holdings than NASDAQ firms after the adoption of LIDs.

In sum, the adoption of the LID is one of the most significant changes to the US corporate governance system in recent decades. Most US firms have adopted this role either because of a mandate by regulators or due pressures from investors. This role was implemented so the LID could chair executive sessions, monitor the CEO, and evaluate the performance of independent directors. As a result, the individual in this role has the potential to enhance board independence, provide an alternative solution to the issue of CEO duality, and reduce the workload of board-related tasks assigned to the Chairman of the Board. However, there is the possibility that some firms may have adopted the role of the LID for symbolic purposes, selecting a director who is less effective or ineffective and unable to improve firm's governance practices. Therefore, in the next section, I explain the characteristics of an effective LID. Then, I explore the types of firms that are more likely to adopt this role for substantive versus symbolic purposes.

IV. Hypotheses Development

The Effectiveness of Lead Independent Directors

The previous articles, surveys, and scholarly studies suggest that the position of LID is an important one because, by definition, the person in this role has the job of leading the independent directors. Thus, if an effective person is in this role, the monitoring function of the board can be improved, as this person is not only involved in decisions related to selecting, evaluating, and compensating the CEO but also acts as a liaison between corporate executives and outside directors (Krause et al., 2017; Shi and Connelly, 2018).

In order to determine the effectiveness of monitoring by a LID, I rely on the quad model developed by Hambrick et al., (2015). The authors suggest considering two perspectives in order to determine the effectiveness of a director. First is the classic theory from organizational behavior, which suggests that an individual must have the joint presence of *ability and motivation* (or $E = f(A \times M)$) to do their task well (e.g., Lawler, 1966). From the LID's perspective, he or she must possess both ability and motivation above threshold levels to do their monitoring task well. If one of these qualities is lacking or below some minimum level, the other will generate a small effect. The second factor they suggest to consider is based on the logic of agency theory and the attention-based view (Hambrick et al., 2015; Ocasio, 1997). According to these perspectives, a director must be truly independent and have adequate time and resources for monitoring (Hambrick et al., 2015; Ocasio, 1997). During the director selection process, if CEOs can influence who will be sitting on their boards, then this calls into doubt the true *independence* of the new incoming independent directors. Studies have shown that outside directors who were hired with the influence of the CEO are less likely to effectively monitor their CEOs on behalf of the firm's owners and more likely to adhere to allegiances and conform to the norms of desirable boardroom behaviors (e.g., Westphal and Zajac, 1995; Adams, Hermalin, and Weisbach, 2010). Also, the vast majority of outside directors have responsible professional positions and have multiple directorships; thus, their primary responsibilities may lie someplace other than the focal firm (Hambrick et al., 2015). As a result, they may not have the *bandwidth* or may not be able to devote requisite time and attention to their monitoring tasks. From a LID's perspective, if he or she feels beholden to the CEO or does not have adequate time to monitor then the LID is less likely to be an effective monitor.

Combining these two perspectives, an effective LID can be defined as when an individual in this role possesses the combination of the following four elements: *independence* (ability to be independent and objective), *expertise* (ability to comprehend the issues at hand), *bandwidth* (ability to devote requisite time and attention to the focal company), and *motivation* (desire to engage in monitoring behaviors) (Hambrick et al., 2015). All four of these attributes are needed, above some threshold level, for a LID to have a high likelihood of being an effective monitor (Hambrick et al., 2015). If a LID is missing any of these qualities, the likelihood that he or she will be an effective monitor is diminished. Next, I discuss the antecedents of firms that are more likely to adopt an effective LID.

Antecedents of effective LIDs

In order to examine the antecedents of effective LIDs, it is important to understand the selection process of LIDs within boards. In most cases, firms choose the LID from the existing rank of independent directors (Shi and Connelly, 2018). Recent surveys suggest that in most cases, LIDs were selected by the existing board of directors and shareholders did not get a chance to vote on the selection process (National Association of Corporate Directors, 2011; Shi and Connelly, 2018). In some boards, only independent directors were allowed to vote to choose their LID, whereas others made the decision at the full board level, thus including the CEO in this process (Shi and Connelly, 2018). The mandate by NYSE stated that companies must disclose the procedure by which their LID was selected, but the NASDAQ stock exchange did not have any such formal policies. As noted, the selection process of the LID was idiosyncratic; the idea behind selecting a LID should be choosing an individual who brings out the best in the board and enhances the success of the company (Shi and Connelly, 2018).

However, research on symbolic management cautions that some firms could select a LID only to meet external demands, and the selected director may not be in a position to bring any meaningful changes to the firm's governance practices (Westphal and Zajac, 1994, 1995). In other words, it is plausible that some firms may adopt the role of the LID ceremonially while other firms may adopt the position to implement substantive changes to their governance practices. In the next section, I explore the antecedents of firms that are likely to select an effective LID for this position. More specifically, I suggest that firms with dedicated institutional investors and high strategic complexity, as well as underperforming firms are more likely to select an effective lead independent director for substantive purposes. LIDs at these firms should be better equipped and effective in making difficult governance decisions that may enhance the board's monitoring function.

Institutional Investors

In recent decades, institutional ownership has played an important role in shareholder activism by influencing managerial decisions and bringing change at the executive and board level (Gillan and Starks, 2007). Following this rationale, I suggest that institutional investors can indirectly influence the selection of LIDs. As mentioned above, shareholders do not get to vote when a LID is selected, as this individual is selected by the board from the rank of existing directors. However, powerful investors can pressure board members to select the most effective independent director as the LID, who can do a better job of monitoring on behalf of shareholders (Connelly et al., in press).

However, there are different types of institutional owners, and some are more influential than others (Bushee, 2004). Scholars have classified institutional investors in different ways. For instance, Brickley and colleagues (1988) classified institutional investors as "pressure resistant,"

"pressure-sensitive," and "pressure indeterminate" institutions. Tihanyi and colleagues (2003) classified institutional investors as professional investment fund managers and pension fund managers. I adopt the classification of institutional investors suggested by Porter (1992). He focused on two extreme types of institutional investors: dedicated institutional investors and transient institutional investors. Dedicated institutional investors concentrate their shareholdings into a small number of firms that they hold for an extended period of time. Such investors do not react to short-term earnings reports and instead are concerned with a firm's ability to compete over time (Bushee, 2001; Shi and Connelly, 2018). Transient institutional investors are the opposite and have diverse shareholdings in a large number of firms, frequently trade in and out of stocks, and are highly sensitive to short-term results (Connelly et al., in press).

I suggest that when a firm has a higher number of dedicated institutional investors, boards are more likely to select an effective LID from the existing group of independent directors. Dedicated institutional investors are familiar with firms in which they invest and are knowledgeable of the effectiveness of directors on the board. Given their sizable long-term investments, high-quality institutional investors develop relationships with the board of directors and know which directors may have the *bandwidth*, *independence*, *motivation*, and the *ability* to be effective monitors and act in the best interest of the shareholders (Connelly et al., 2010). Moreover, if that person has a long history with the CEO, does not sit on any other boards, does not have financial expertise, or does not seem to be motivated to monitor, such factors would be indicators that the appointment is symbolic. If a board attempts to select such a LID for simply symbolic purposes, dedicated institutional investors should be able to detect and prevent this behavior. Dedicated institutional investors would prefer an effective LID, who can obtain necessary information from executives and more effectively monitor executives' actions and

performance over time (Bushee, 2004). In addition, dedicated institutional investors will ensure that the selected LID has adequate time and motivation to monitor the CEO on behalf of investors. Thus, I predict:

Hypothesis 1: The higher the amount of equity owned by dedicated institutional investors, the higher the likelihood that the independent director selected for the position of the LID will be effective.

Firm performance

Past research suggests that boards of directors associated with underperforming firms pay additional attention to their monitoring duties (Tuggle et al., 2010). This is because boards have a fiduciary responsibility to shareholders to monitor and assess the performance of management (Zald, 1969). Boards often use firm performance as a proxy for management effectiveness because of the complexity and ambiguity surrounding the managerial task (Walsh and Seward, 1990). Moreover, firm performance is important for most shareholders (Tuggle et al., 2010). In addition, studies have shown that poor firm performance not only diminishes shareholders' value but also tarnishes director's reputations. For example, Gilson (1990) found that outside directors who left the boards of financially distressed firms held approximately one-third fewer directorships three years after their departure. Therefore, due to the boards' fiduciary responsibility and reputational effects, directors allocate more attention to monitoring when firms are underperforming (Tuggle et al., 2010).

“Weak firm performance...may require a board to signal to stakeholders that there is a ‘captain in charge of the ship’ in whom the board has confidence.” (Finkelstein and D’Aveni, 1994: p.1086). When a firm’s past performance is weak, boards seek optimal board leadership arrangements that can help a firm to get back on track. (Krause, 2016). During the selection

process of the LID, I suggest that boards associated with firms that have poor performance are likely to pay more attention to who is being selected for this role. Boards associated with underperforming firms are likely to ensure that individuals selected for this role are among the most effective independent directors available, that have the combination of *bandwidth*, *independence*, *motivation*, and *ability* that can help improve firm performance. In contrast, if a board associated with an underperforming firm selects a less effective or ineffective director, it will be “much more difficult for the board to perform its critical function.” (Jensen, 1993: p.36)

In addition, selecting an effective LID will send a positive signal to shareholders, suggesting an improvement in the monitoring function of the board (Connelly, Certo, Ireland, and Reutzel, 2011). Selecting an effective LID can also reduce the issue of information asymmetry between management and shareholders, and individuals in this role can provide support and assistance to the CEO of the underperforming firm (Rutherford and Buchholtz, 2007). Finally, this will also help board members regain their reputations which were tarnished by associating themselves with an underperforming firm (Yermack, 2004). Thus, I predict:

Hypothesis 2: The lower the firm performance, the higher the likelihood that the independent director selected for the position of the LID will be effective.

Strategic complexity

Strategic complexity refers to the “range and concentration of concerns and activities” within a firm's strategic repertoire (Miller, Lant, Milliken, and Kom, 1996, p. 863). Strategic complexity can be categorized in many ways, such as when firms operate in technologically intense or turbulent industries or when firms have high levels of internationalization activities (Barney, 1991). However, one widely accepted indication of a firm's complexity is its level of corporate diversification (Barney, 1991; Rivkin, 2000; Wernerfelt, 1984; Zajac and Westphal,

1994). As the level of diversification increases, the firm's diversity of customers, competitors, and regulations also increases. As a result, the volume and variety of information that management and boards must process become more complex (Weick and Van Orden, 1990). Studies have shown that boards of firms that are only in one industry face less complexity than boards of firms that are active in multiple industries (e.g., Zajac and Westphal, 1994).

I predict that boards of firms that have high levels of strategic complexity are more likely to select an effective LID from the rank of existing directors. This is because as the firms become more diversified, it becomes costlier for boards of directors to monitor (Zajac and Westphal, 1994), and an effective LID that has the combination of *bandwidth, independence, motivation, and ability* can do a better job of monitoring in such complex situations. According to agency theory, the problem of information asymmetry increases as firms become more complex in nature (Zajac, 1990). An effective LID can help reduce information asymmetry by effectively communicating with the CEO and board members. In addition to that, an effective LID can synthesize complex information and share it with both sides in subtle and efficient ways (Zajac and Westphal, 1994). Finally, boards of directors of complex firms will have limited ability to understand the complexity a firm is facing in multiple industries (Calori, Johnson, and Sarnin, 1994). An effective LID will have greater ability to understand firm complexities and monitor the CEO on behalf of the board of directors. Thus, I predict:

Hypothesis 3: The higher the strategic complexity of a firm, the higher the likelihood that the independent director selected for the position of the LID will be effective.

Consequences of an effective LID on the monitoring function of the board

In this section, I explain how an effective LID can influence a board's monitoring functions. The literature based on symbolic management suggests that firms can satisfy the

external demands of regulators and shareholders by bringing powerful, prestigious, and effective independent directors to the board. However, these directors may choose not to actively engage in monitoring behaviors (Wade et al., 1997; Westphal and Zajac, 1994, 1998; Helland and Sykuta, 2004). A key concept underlying symbolic management is decoupling, which describes the process through which organizations detach normative or prescriptive structures from actual operations (Bromley and Powell, 2012; Meyer and Rowan, 1977). “Organizational decoupling occurs when organizations symbolically conform to external pressures, but do not actually implement meaningful change at the operational level (Shi and Connelly, 2018, p:2390). In the case of LIDs, decoupling may occur when a board selects an individual for the LIDs position, but the person in this role may not engage in behaviors that are likely to improve the monitoring function of the board. Thus, I investigate whether firms adopt the LID to gain legitimacy or to improve their governance standards.

However, an important question is how a LID can improve the monitoring function of the board. Past research suggests that corporate governance is a system of interrelated practices that will be effective only when a bundle of governance mechanisms are in place (Sundaramurthy, Mahoney, and Mahoney, 1997; Aguilera, Desender, and Kabbach de Castro, 2011; Aguilera, Filatotchev, Gospel, and Jackson 2008; Adams and Ferreira, 2007). Hermalin and Weisbach, (1998) suggest that effective monitoring hinges on three parameters: board tasks, interest alignment, and reputational concern. Board tasks depend on the role of an individual director. For instance, one of the major tasks of the LID is to chair executive sessions, where independent directors meet to evaluate the company and CEO performance. Interest alignment refers to the responsibility boards of directors hold to align the interests of the principals and agents through the means of executive compensation. Finally, boards of directors may also have reputational

concerns that they would like to be viewed as monitoring experts in the labor market of directors (Hermalin and Weisbach, 1998).

The position of LID was implemented for three primary reasons: to chair executive sessions, to monitor the CEO, and to lead and evaluate independent directors (Spencer Stuart, 2007; Shi and Connelly, 2018). Therefore, based on the three parameters suggested by Hermalin and Weisbach, (1998) and responsibilities assigned to the LID, I suggest that an effective leader of independent directors will be able to influence the monitoring function of the board by: 1) having productive meetings during executive sessions, 2) aligning CEO's compensation with the interest of shareholders, and 3) dismissing directors that may hurt the reputation of the focal firm. Below, I explain in more detail how an effective LID can influence each of these monitoring elements of the board.

Board meeting effectiveness

Past research in the corporate governance literature has used board meetings as one of the key metrics to assess the level of boards monitoring (e.g., Brick and Chidambaran, 2010). Firms that have a high number of board meetings tend to have a greater degree of board monitoring (Adam, 2005). The frequency of board meetings is considered as an important board attribute that not only enhances board monitoring but also has important implications for firm value (Vafeas, 1999). This is because, during board meetings, directors evaluate past firm performance, discuss current corporate events such as mergers and acquisitions, and provide resources and counsel for future growth opportunities (Forbes and Milliken, 1999; Adams, 2005).

Board meetings are generally considered effective when all directors are present and engaged in boardroom discussions (Van den Berghe and Levrau, 2004). Prior research suggests

that directors must not just be physically present but also mentally present and actively involved in the decision-making process (Van den Berghe and Levrau, 2004). The LID is not only responsible for organizing board meetings but is also the person who leads discussions in the boardroom (Shi and Connelly, 2018). Thus, I suggest that an effective LID who has the combination of *bandwidth, independence, motivation, and ability* is more likely to chair effective board meetings for the following reasons. First, an effective LID is more likely to obtain the necessary information from executives and the corporate secretary before the meeting and share that data with other independent directors in ways that are easy to comprehend (Minichilli, Zattoni, and Zona, 2009). As a result, directors will be better prepared and involved in boardroom discussions. Second, an effective LID can intervene constructively in the boards' decision-making process. Such a LID will ensure that each director gets an opportunity to speak freely and to contribute, but at the same time preserve a comfortable and constructive climate (Judge and Zeithaml, 1992; Pearce and Zahra, 1991). Third, an effective LID will have a clear and accurate knowledge of the firm's financial position and will be able to ask useful and discerning questions to management in order to exert effective behavioral and strategic control (Daily and Dalton, 1994). Thus, I hypothesize:

Hypothesis 4: The effectiveness of a LID is positively related to effective board meetings.

CEO Compensation Structure

Total CEO compensation is composed of four major components: salary, bonuses, equity-based pay, and benefits. Salary is considered fixed-based pay and CEOs expect those two as a part of their annual cash compensation (Gomez-Mejia, 1994). Benefits are not only paid in cash, but most large companies offer services like a company car, company plane, and chauffeur service to their CEOs (Schellhardt, 1994). Equity-based pay is considered to be an outcome-

based contract awarded to CEOs as a part of their long-term incentive plans (Gomez-Mejia, 1994). The equity-based pay may be allocated in different forms, such as an allocation of equity ownership in the firm, or it could be in the form of cash awards or stock options (Gomez-Mejia, 1994). Prior research suggests that CEOs prefer compensation contracts that minimize firm-specific risk and maximize their personal wealth (Amihud and Lev, 1981). In contrast, shareholders prefer executive compensation contracts that reward executives for working toward shareholder value enhancement (Amihud and Lev, 1981).

From an agency perspective, having an appropriate pay-mix is important for CEOs who are considered to be risk-averse and self-interested (Bloom and Milkovich, 1998; Eisenhardt, 1989; Gomez-Mejia and Balkin, 1992; Tosi, Werner, Katz, and Gomez-Mejia, 2000; Wiseman and Gomez-Mejia, 1998). Board members generally cannot closely supervise the activities of CEOs, and information asymmetries also favor CEOs as they have more firm-specific knowledge than directors (Mizruchi, 1983). Therefore, boards can use outcome-based pay for CEOs in order to align the interests of shareholders and CEOs. Holmstrom (1979) suggests that when boards cannot supervise CEO's behavior, then outcome-based pay is the second-best solution to the moral hazard problem. Thus, a proportion of total CEO pay is suggested to be based on outcome-based contracts as a solution to reduce agency costs (Conlon and Parks, 1990; Eisenhardt, 1985, 1988; Fernie and Metcalf, 1996; Gomez-Mejia and Balkin, 1992; Henderson and Fredrickson, 1996; Tosi, Katz, and Gomez-Mejia, 1997; Welbourne, Balkin, and Gomez-Mejia, 1995). Principals can transfer risk to the CEO by basing their compensation contracts on some form of observed performance outcomes, which makes the CEOs part owners and, thus align their interests with shareholders (Eisenhardt, 1989; Barkema and Gomez-Mejia, 1998).

The LID is responsible for holding executive sessions; in such sessions, the LID meets with other independent directors in the absence of the CEO to evaluate overall firm and the CEO's performance (Spencer Stuart, 2007; Shi and Connelly, 2018). In these meetings, CEO compensation is one of the key issues discussed (Shi and Connelly, 2018). More recently, due to reforms such as the say-on-pay voting system and the Dodd-Frank Act, the discussion of executive compensation has increased in board meetings (Shi and Connelly, 2018). I suggest that an effective LID who works in the best interests of shareholders is more likely to play an important role in decisions related to CEO compensation. Essentially, an effective LID may have the ability to influence the CEO pay-mix – the proportion of outcome-based pay to fixed pay. Based on the logic of agency theory, if a LID is an effective monitor, he or she can reduce agency costs by suggesting that the compensation committee offer the CEO a compensation package with a higher proportion of outcome-based pay in comparison to fixed-based pay, thus aligning the interests of the CEO to shareholders. Thus, I hypothesize:

Hypothesis 5: The effectiveness of a LID is positively related to outcome-based provisions in the CEO's total compensation package.

Dismissal of Problem directors

Boards that include problem director(s) convey a serious concern to shareholders, regulators, and policymakers (Bhuiyan, 2015). Problem directors are defined “as directors who have been personally involved as a director or executive, in one or more corporate bankruptcies, major litigation or corporate infractions, major accounting restatement and other accounting scandals or have served on compensation committees that have approved particularly egregious CEO compensation packages, or other similar circumstances” (Board Analyst, 2007).

Boards of directors are considered as one the most important governance mechanisms to monitor the CEOs on behalf of owners (Hermalin and Weisbach, 1998). In cases when board members happen to be professionally unethical, shareholders will have difficulty in trusting their boards of directors who were appointed to serve in the best interest of the owners (Hermalin and Weisbach, 1998). The existence of problem directors may lead to severe agency conflicts, assuming poor monitoring quality in the firm. Past research suggests that the existence of problem directors may not only affect the monitoring quality of the board but also reduce the operating performance of the focal firm (Bhuiyan, 2015). Moreover, problem directors may cause concern over financial reporting quality at the focal firm (Bhuiyan and Habib, 2014).

In addition to evaluating CEOs, LIDs are also responsible for evaluating independent board members and the board's overall performance (Spencer Stuart, 2007). When boards are composed of problem directors, firm reputation may be tarnished, and analysts are more likely to give weak ratings for the board's governance standards (Fich and Shivdasani, 2007). As a result, an effective LID who has the proper combination of *bandwidth, independence, motivation, and ability* would prefer to not have problem directors on board in order to preserve monitoring standards and the reputation of the focal firm. In addition, if a board includes problem directors, it may signal the ineffectiveness of a LID's leadership on the board. The LID may not possess the power to directly fire a problem director, but they may pressure problem directors to resign or not stand for re-election once their term is over (Boivie, Graffin, and Pollock, 2012). In rare instances, when a problem director refuses to resign, an effective LID can call for a vote by independent directors to fire the problem director (Cowen and Marcel, 2011). On the other hand, an ineffective LID mainly selected for symbolic purposes may not be motivated to remove problem directors from the board. Thus, I hypothesize the following:

Hypothesis 6: Firms selecting an effective LID are more likely to dismiss problem directors from their boards.

V. Methodology

Sample

To test my hypotheses, I observe the first appointment of a LID for S&P 500 firms between the years 2003 and 2017. I identified 455 S&P500 firms that had complete director and firm-level data. Among those, 60 firms did not have a LID on their boards. This was mainly because they had a non-executive chairman or felt no need to have a LID on their board. This brought the final sample to 395 firms. To assess the influence of time, the antecedent variables (institutional ownership, firm performance, and strategic complexity) are measured for the year prior to adoption of the LID (t-1), and the consequences variables (board meeting effectiveness, CEO compensation structure, and dismissal of problem directors) are measured for the year after the adoption of the LID (t+1). The data for characteristics of effective LIDs and measures for CEOs and directors are gathered from BoardEx, Institutional Shareholder Services (formerly known as RiskMetrics), and firms' proxy statements. The data for firm performance, diversification, and control variables are collected from Compustat. Finally, the data on institutional investors are obtained from Bushee's (2017) and the Thomson Reuters database.

Measures

Selection of an Effective LID

The dependent variable in hypotheses 1-3 is the likelihood that the independent director selected for the position of the LID is effective. As mentioned earlier, in most cases, a LID is selected from the existing firm directors. Thus, the effectiveness of a LID can only be as great as the most effective director on the board during the time of selection. In other words, this creates

an issue of range restriction, because in most cases, a LID is selected from the existing rank of directors. Therefore, in order to build the measure for hypotheses 1-3, I use a relative measure, i.e., data for all independent directors is compared to the LID to measure the effectiveness of the selected LID. In order to do this, I measure the effectiveness of all independent directors (i.e., possible LID candidates), including the LID chosen for this position. Then the effectiveness between the independent directors and the LID is assessed using the four measures of director effectiveness (explained below) for all independent board member-LID dyads. This approach is similar to the approach used by Westphal and Zajac (1995), where they measured the characteristics of (dis)similarity between a new director (an individual director) and the rest of the board members (group).

As mentioned earlier, in order to measure the effectiveness of individual independent directors, I created proxies based on four elements suggested by Hambrick and colleagues (2015): *independence* (ability to be independent and objective), *expertise* (ability to comprehend the issues at hand), *bandwidth* (ability to devote requisite time and attention to the focal company), and *motivation* (desire to engage in monitoring behaviors). Below, I discuss how each of these qualities is relevant in the context of a LID's role.

Independence. Unlike inside directors, who are executives of the firm and affiliated directors, who may have family ties or business dealings with the firm, LIDs by definition are independent directors, who are “unaffiliated” with the firm (Dalton, Hitt, Certo, and Dalton, 2007). To be capable of monitoring, a LID must be independent or objective about the company's executives and their policies. It is only with such objectivity that a LID will be able to genuinely question or dissent from a CEO's initiatives (Hambrick et al., 2015). A LID who is concerned about staying in his or her good graces with the CEO is unlikely to effectively monitor the CEO. As the title of

this role suggests, a LID is an independent director, but he or she could still be beholden to the CEO. For example, a LID selected by the CEO (or with his or her significant involvement) may be sympathetic to the CEO (Daily and Dalton, 1995). Past research suggests that only unaffiliated directors who predate the CEO's appointment can be considered truly independent (e.g., Boeker, 1992; Daily and Dalton, 1995; Hambrick et al., 2015). Similarly, other studies have suggested that a director is truly independent when selected by a nominating committee consisting only of unaffiliated directors (e.g., Monks and Minow, 2011).

Based on these arguments, a LID who joined the board before the CEO's appointment is more likely to be a tough monitor and a truly independent director (Hambrick et al., 2015). Thus, in order to measure the independence of each director, I create a dummy variable, which observes whether the current CEO during the appointment of the director was also the CEO of the firm when that individual was first appointed to the board. Then, I compare the appointment of each director to the LID. For instance, if an independent director was selected prior to the CEO's selection, but the LID was selected after the CEO's appointment, then the LID is considered less independent than the other director and is assigned a value of -1. On the other hand, if a LID joined the board prior to the CEO's selection and an independent director joined after the CEO's selection, then the LID is assigned a value of +1. However, if an independent director and a LID are both hired before the CEO was selected, then they both are considered equally effective and given a value of 0. Finally, the values for each independent director-LID dyad are averaged to get an overall score for a LID's independence, which ranges between -1 and 1.

Expertise. A director must have the ability to comprehend different issues in order to ask the right questions or to evaluate decisions in complex situations (Hambrick et al., 2015). Being an

effective monitor requires expertise—in-depth knowledge and understanding of the domain being monitored. It is difficult to specify a general domain of expertise needed for effective monitoring, as every director and committee bring different sets of skills and expertise to the board. The need for expertise in domains, such as assessing acquisitions or environmental compliance, may depend on the firm’s industry, strategy, and life cycle stage (Hambrick et al., 2015). However, domains, such as expertise in financial matters might be thought of as universally and perennially important (Linck, Netter, and Yang, 2009; Hambrick et al., 2015). A director who happens to have expertise in the financial area may be able to identify a potential problem, or at least ask the right questions, helping to avert a bad outcome (DeFond, Hann, and Hu, 2005; Krishnan and Visvanathan, 2008; Linck, Netter, and Yang., 2009).

Similarly, in the case of LIDs, expertise in finance is one of the important requirements to be an effective monitor (Krause et al., 2017; Shi and Connelly, 2018). The expertise of a LID in finance could not only help the company to make good financial decisions but also prevent many missteps, misdeeds, and fraudulent activities by carefully scrutinizing the company’s financial reports. As the LID assumes the role of liaison between inside executives and outside directors, the CEO will first present financial reports to the LID, and it is his or her job to understand and carefully evaluate the reports before passing on the reports to other directors for review. Thus, LIDs with financial expertise can offer necessary oversight and ask tough questions when needed. As part of the Sarbanes-Oxley Act, boards are required to designate outside directors they consider to be finance experts. When a LID is a financial expert, he or she is more likely to have a greater influence on firm-level decisions (Krause et al., 2017; Guner, Malmendier, and Tatec, 2008).

To measure financial expertise, first, I create a count variable that ranges between 0 and 2. When a director has an education and work experience with finance or legal or accounting background, he or she gets a score of 2, when he or she either has education or work experience, he or she receives a score of 1, and when neither is present, a score of 0 is given (Jensen and Zajac, 2004). Then, similar to the independence measure, I compare the financial expertise of the LID to all other independent directors. For instance, if a LID receives a score of 0 and an independent director receives a score of 2, then the relative score for the independent director-LID dyad would be -2. However, if a LID receives a score of +2 and an independent director receives a score of 1, then the relative score for this dyad would be +1. Finally, the values for each independent director-LID dyad are averaged to get an overall score for a LID's expertise.

Bandwidth. As mentioned earlier, another key element for a LID to be effective in monitoring is whether he or she has the bandwidth—the ability to devote the requisite time and attention to their roles and responsibilities. In the past, studies found that busy directors who have three or more board seats paid less attention to their board duties and were considered as less effective monitors (Cashman Gillan, and Jun, 2012; Ferris, Jagannathan, and Pritchard, 2003; Fich and Shivdasani, 2006; Johnson, Schnatterly, and Hill, 2013). In the case of LIDs, their time commitment is often more than the time spent by the chairman of the audit or compensation committee (National Association of Corporate Directors, 2011). The LID's job is demanding and may require up to 25 hours every month to perform the tasks associated with this role (PricewaterhouseCoopers, 2010). If a LID is too busy, he or she may not have enough time to evaluate the materials received from their CEO and may find it difficult to manage demands by outside directors and shareholders who ask for additional information or raise contentious issues. Thus, I suggest that a LID with adequate bandwidth is more likely to be an effective monitor, as

he or she will have sufficient time to perform the additional duties required for this role. Prior research and The National Association of Corporate Directors suggests that directors should not hold more than three directorships over concern that the additional appointments will reduce the likelihood that they will effectively monitor management (e.g., Fich and Shivdasani, 2007).

Thus, based on this rationale, I calculate the number of directorships a director holds in other firms and reverse code this variable to measure the bandwidth of that director. Then, I calculate a relative bandwidth between each independent board member and LID dyad (Miller and Triana, 2009). Finally, the values for each independent director-LID dyad are averaged to get an overall score for a LID's bandwidth.

Motivation. The LID has many responsibilities beyond the typical duties of a director. However, like most independent directors, LIDs may also have executive jobs or responsible positions they may hold outside the focal firm. Thus, a LID must be motivated to be actively engaged in their monitoring tasks (Hambrick et al., 2015). This is especially true since LIDs, on average, have to spend 15 hours more than other independent directors every month to fulfill their duties (Spencer Stuart, 2007). This additional time is mainly spent planning the agendas for executive meetings and coordinating communication between management and independent directors. Prior research based on agency theory suggests that equity stakes give directors substantial incentive for being conscientious in their duties and to be effective monitors (e.g., Bhagat, Carey, and Elson, 1999; Fama and Jensen, 1983; Dalton, Daily, Certo, and Roengpitya, 2003).

Based on these arguments, I suggest that in order for a LID to be motivated in their monitoring role, they must be given additional equity, so they feel it is worth their time and effort needed for this role. Thus, to measure motivation, I observe the equity ownership of all the independent directors of the board. Then, similar to the measure of bandwidth, I measure the

difference between equity ownership between each independent board member and LID dyad. Finally, the values for each independent director-LID dyad are averaged to get an overall score for a LID's motivation.

The combination of these four attributes will enhance the likelihood that a selected director will be an effective LID. The four sub-measures of effectiveness are standardized and summed in order to create an overall measure of LID's effectiveness, with the lowest number indicating the least effective and the highest number suggesting the most effective LID.

The Effectiveness of LID.

The dependent variable in hypotheses 1-3 explained above is the likelihood that the independent director selected for the position of the LID is effective. In contrast, the independent variable for hypotheses 4-6 is the effectiveness of the selected LID. Both of these measures are based on the same four sub-dimensions of effectiveness (i.e., *independence*, *expertise*, *bandwidth*, and *motivation*). However, the measure for hypotheses 1-3 is a relative measure, where I compare the effectiveness of the selected LID to other independent directors. In contrast, the measure for hypotheses 4-6 is an absolute measure, where I observe the influence of the selected LID on monitoring outcomes. In other words, once a LID is selected, he or she can influence the monitoring outcomes based on their own abilities. Thus, I did not have to consider the relativity of LID's effectiveness to other directors, as this director was already selected. Below, I explain how these measures are calculated.

Independence. In order to measure the *independence* of the LID, I create a dummy variable, which indicates whether the current CEO during the appointment of LID was also the CEO of the firm when the LID was first appointed to the board.

Expertise. To measure expertise, a count variable is created that ranges between 0 and 2. When a director has an education and work experience with finance or legal or accounting background, he or she is given a score of 2, when he or she has one of the two, he or she receives a score of 1, and when neither is present, a score of 0 is given.

Bandwidth. To measure bandwidth, I calculate the number of directorships a director holds in other firms and reverse code this variable to measure the bandwidth of a LID.

Motivation. Finally, to measure motivation, I observe the equity ownership given to the LID.

The final measure of the effectiveness of the LID is a standardized composite measure of *independence, expertise, bandwidth, and motivation*, with the lowest number indicating the least effective and the highest number suggesting the most effective LID.

Antecedents Variables

Below, I explain the ways in which I measure the institutional ownership, firm performance, and strategic complexities as antecedents of effective LID. These variables are measured for the year prior to the selection of the LID.

Institutional ownership.

To categorize institutional owners as dedicated or transient investors, I use Bushee's (2017) classification. Bushee (2017) used factor and cluster analysis to classify investors based on portfolio diversification (i.e., breadth), portfolio turnover, and momentum trading (i.e., earnings sensitivity). Previous studies have examined institutional investors and classified them as dedicated institutional investors, transient institutional investors, or quasi-indexer based on the three factors described above (e.g., Shi and Connelly, 2018). Dedicated institutional investors tend to have concentrated portfolio holdings, low turnover, and are not sensitive to current earnings reports. By contrast, transient institutional investors tend to have diversified portfolios, high portfolio turnover and are highly sensitive to earnings. Quasi-indexer investors tend to be in

between dedicated and transient institutional investors. Thus, the measure of dedicated institutional ownership is a percentage yielded by dividing the number shares owned by dedicated institutional shareowners in a given year by the total number shares outstanding (Connelly, Tihanyi, Certo, and Hitt, 2010).

Underperforming firm

The ROA of underperforming firms is generally below the industry average, while over performing firms have an ROA above the industry average. In order to measure firm performance, I measured the ROA of the firm, one year prior to the appointment of LID's position. Then calculate the average ROA of the focal firm's industry based on 4-digit SIC code. Then, in order to determine whether a firm was underperforming, I created a ratio of a firm's ROA to average ROA of the industry.

Strategic complexity

Strategic complexity is measured in two different ways. First, I use the entropy measure of diversification (Jacquemin and Berry, 1979). This measure incorporates the number of segments in which a firm operates and the relative importance of each segment as a portion of total sales (Zajac and Westphal, 1994). The formula for this measure is:

$$E = - \sum_{i=1}^n P_i \ln P_i$$

where, where P_i is the ratio of a firm's business segment sales to total sales. Second, I measured the level of internationalization of the firm by measuring the total amount of international sales divided by total sales (Tihanyi, Ellstrand, Daily, and Dalton, 2000).

Consequences Variables

Below, I explain the ways in which I measure board meeting effectiveness, CEO compensation structure, and dismissal of problem directors as consequences of effective LIDs. These variables are measured for the year after the selection of LID.

Board meeting effectiveness

The data on boardroom discussions are not publicly available. However, firms report the number of board meetings held in a fiscal year and the number of independent directors that were able to attend those meetings. Thus, based on this information, I measure board meeting effectiveness by calculating the difference between the percentage of independent directors that attended the board meetings the year before and after the LID was selected. Thus, if an effective LID was selected for this position, he or she is more likely to increase the attendance of the board meetings.

CEO Compensation Structure

To measure the proportion of outcome-based provisions in the CEO's total compensation, I use the ratio of cash compensation (i.e., salary plus short and long-term bonuses) plus Stock Options Grants (i.e., a valuation of Options held at the end of the period for the director based on the closing stock price of the Annual Report Date) divided by total compensation received (Craighead, Magnan, and Thorne, 2004). This ratio is compared to the prior year ratio to examine the change in the CEO's pay mix.

Dismissal of Problem Directors

As mentioned earlier, problem directors are defined "as directors who have been personally involved as a director or executive, in one or more corporate bankruptcies, major litigation or corporate infractions, major accounting restatement and other accounting scandals or have served on compensation committees that have approved particularly egregious CEO compensation packages, or other similar circumstances" (Board Analyst, 2007). Thus, I measure the number of problem directors that resign or are fired the year after the selection of a LID (Bhuiyan, 2014). The data for this measure is obtained by the *Institutional Shareholder Services*

database (ISS). The ISS database flags a director as problem director when he or she is an employee of a firm that is going through bankruptcy, major litigation, has committed corporate infractions, a major accounting restatement or is involved in other accounting scandals.

Control Variables

I control for a number of firm, CEO, and board-level factors in my analysis. Shi and Connelly (2018) found that NYSE and NASDAQ firms had different motives for the appointment of the LID's role. Thus, I control using a dummy variable to indicate whether the firm is listed in the NYSE or NASDAQ stock exchanges. Firm size is a recognized factor that influences CEO power and board dynamics (Josefy, Kuban, Ireland, and Hitt, 2015). Thus, firm size is measured as the natural log of total assets. I also control for debt ratio (measured as the ratio of the sum of long-term debt and debt in current liabilities to total assets) because it may be related to the amount of resources under the CEOs' control, which in turn influence CEO-related outcomes (Shi and Connelly, 2018). I control for several board-level variables that could influence the selection of a LID and monitoring by boards— board size, the ratio of affiliated directors, board independence, and CEO duality (Hillman, Shropshire, Certo, Dalton, and Dalton, 2011). I also control for CEO tenure (in years), CEO network (number of directorships held), and CEO duality (whether CEO is also the chair of the board) because these variables are related to CEO power, which in turn could influence the dependent variables (Finkelstein, 1992). In addition, I control for the ratio of outstanding shares held by transient and quasi investors. Finally, I include industry fixed effects using two-digit SIC codes.

Results

Descriptive statistics and pairwise correlations for all variables are shown in Table 2 and 3. As noted in Table 3, the pair-wise correlation between the relative measure of LID's

effectiveness and industry-averaged ROA is negatively significant. Surprisingly, I found the pair-wise correlation between the relative measure of LID's effectiveness and dedicated institutional investors is negatively significant. In addition, the absolute measure of LID's effectiveness is positively and significantly correlated with board meeting effectiveness and the dismissal of problem directors variables.

Insert Table 2 and Table 3 Here

Further, I use multivariate regression analysis to test the direct effects discussed in hypotheses 1-6. The results for hypotheses 1-3 are reported in Table 4, while the results for hypotheses 4-6 are reported in Table 5, 6, and 7 respectively. I use ordinary least square (OLS) regression for these analyses (see Wooldridge, 2003). In all models of specifications, I include industry fixed effects.

In Model 1 of Table 4, I present the regression outcome comprised of only control variables. Next, in a stepwise manner, I add the antecedent variables in the Model 2-3 of Table 4. The control and antecedent variables are included in model 4 of Table 4.

Hypotheses 1-3 propose the antecedents of firms that are likely to select an effective independent director for the role of the LID. Hypothesis 1 proposes that when a larger amount of firm's equity is owned by dedicated institutional investors, boards are more likely to select an effective LID among the existing independent directors. As Table 4 shows, surprisingly, Hypothesis 1 receives empirical support in the opposite direction with a negative and significant *dedicated institutional investor* coefficient in all models ($\beta = -2.785$, $p < 0.05$). Contrary to my prediction, these results suggest that firms with a high ratio of dedicated institutional investors

are less likely to select an effective LID. In the discussion, I provide an alternative rationale for this finding. Following the procedure outlined by Wiersema and Bowen (2009), I also examine the distributions of the marginal effects and corresponding z-statistics for the sample. The marginal effect of *dedicated institutional investor* ranges from 0.306 to -0.407 for 5th to 95th percentile. I found that the marginal difference between selecting an effective LID that has the lowest and highest ratio of dedicated institutional investors can be as much as 71.3 percent (Wiersema and Bowen, 2009).

Hypothesis 2 proposes that boards of firms with lower performance are more likely to select an effective LID among the existing independent directors. Hypothesis 2 receives empirical support with a negative and significant industry average ROA coefficient in all models ($\beta = -0.305, p < 0.05$), thus, suggesting that underperforming firms are more likely to select an effective LID. The marginal effect of *ROA* ranges from 0.222 to -0.312 for 5th to 95th percentile. The marginal difference between selecting an effective LID that has the lowest and highest ROA can be as much as 53.42 percent (Wiersema and Bowen, 2009).

Hypothesis 3 proposes that firms with greater strategic complexity are more likely to select an effective LID among the existing independent directors. I found that both measures for strategic complexity— entropy and international diversification ($\beta = -0.114, p > 0.10$; $\beta = -0.300, p > 0.10$), had negative coefficients. However, these coefficients are not statistically significant. Thus, no support for hypothesis 3 is found.

Insert Table 4 Here

Hypotheses 4-6 propose consequences of the monitoring function when a board selects an effective LID. Hypothesis 4 proposes a positive relationship between the effectiveness of a LID and having an effective board meeting. As Model 2 of Table 5 shows, hypothesis 4 receives empirical support with a positive and significant effective LID coefficient ($\beta = 0.032$, $p < 0.05$). This finding suggests that firms with highly effective LIDs are more likely to see an increase in the percentage of independent directors attending board meetings. The marginal effect of an effective LID ranges from -0.051 to 0.105 for 5th to 95th percentile. The marginal difference between having an effective board meeting that has the lowest and highest effective LID can be as much as 15.63 percent (Wiersema and Bowen, 2009).

Insert Table 5 Here

Hypothesis 5 proposes a positive relationship between the effectiveness of a LID and outcome-based provisions in the CEO's total compensation package. As Model 2 of Table 6 shows, the variable representing an effective LID has a positive but a non-significant coefficient ($\beta = 0.005$, $p > 0.10$). Thus, hypothesis 5 is not supported.

Insert Table 6 Here

Hypothesis 6 proposes a positive relationship between the effectiveness of a LID and dismissal of problem directors from the boards. As Model 2 of Table 7 shows, hypothesis 6 receives empirical support with a positive and significant coefficient ($\beta = 0.087$, $p < 0.05$). This suggests that firms with a highly effective LIDs are more likely to dismiss problem directors

from their boards. The marginal effect of an effective LID ranges from -0.336 to 0.091 for 5th to 95th percentile. The marginal difference between a dismissal of problem directors that has the lowest and highest effective LID can be as much as 42.67 percent (Wiersema and Bowen, 2009).

Insert Table 7 Here

Post Hoc Analysis

As mentioned above, according to Hambrick's quad model, a director must have a combination of all four characteristics (bandwidth, ability, motivation, and independence) in order to be effective. However, it is plausible that in certain contexts some director characteristics may be more valuable than others. Therefore, instead of a composite measure of effectiveness, I analyze all hypotheses with the four individual characteristics of effectiveness to explore if there are certain characteristics which are more important than others. By doing this, I assess the boundary conditions of Hambrick's quad model.

For hypothesis 1, the above analysis found that firms with a greater percentage of their stock held by dedicated institutional investors are less likely to select an effective LID. The measure of an effective LID is comprised of four variables (bandwidth, ability, motivation, and independence). In the post-hoc analysis, instead of using a composite measure of LID's effectiveness as a dependent variable, I regress individual four measures of LID's effectiveness separately on the dedicated institutional investors variable, along with the control variables. Surprisingly, similar to prior analysis, the results from the post-hoc analysis reported in Table 8 also suggest that firms with a greater percentage of their stock held by dedicated institutional investors are less likely to select a LID who has lower bandwidth ($\beta = -1.959$, $p < 0.01$), expertise

($\beta = -0.254$, $p > 0.10$), and motivation ($\beta = -0.953$, $p > 0.10$). However, analysis for expertise and motivation are not statistically significant. In contrast, when firms have a greater percentage of their stock held by dedicated institutional investors, firms are more likely to select an independent LID ($\beta = 0.381$, $p > 0.10$). However, this result is also not statistically significant.

For hypothesis 2, the above analysis found that firms with lower performance are more likely to select an effective LIDs. In the post-hoc analysis, I regress the four individual measures of a LID's effectiveness separately on industry average ROA, along with control variables. Similar to the main analysis, the results from the post-hoc analysis reported in Table 8 also suggest that when prior performance is high, firms are more likely to select a LID with lower independence ($\beta = -0.063$, $p < 0.10$), expertise ($\beta = -0.166$, $p < 0.10$), and motivation ($\beta = -0.171$, $p < 0.10$). In contrast, when prior performance is high, firms are more likely to select a LID with higher bandwidth ($\beta = 0.096$, $p > 0.10$). However, these results are not statistically significant.

The above analysis found no empirical support for hypothesis 3. Similarly, the results from the post-hoc analysis reported in Table 8 also suggest no significant relationship between firms with higher levels of diversification and the likelihood of selecting a LID with greater independence (entropy $\beta = -0.037$, $p > 0.10$; international diversification $\beta = -0.019$, $p > 0.10$), bandwidth (entropy $\beta = -0.099$, $p > 0.10$; international diversification $\beta = -0.208$, $p > 0.10$), expertise (entropy $\beta = 0.112$, $p > 0.10$; international diversification $\beta = -0.133$, $p > 0.10$), and motivation (entropy $\beta = -0.091$, international diversification $p > 0.10$; $\beta = 0.060$, $p > 0.10$).

Insert Table 8 Here

Hypotheses 4 proposes the consequences of having an effective LID on the quality of board meetings. In the post-hoc analysis reported in Table 9, instead of using a composite measure of an effective LID as a predictor variable, I regress board meeting variable on four effectiveness (bandwidth, ability, motivation, and independence) and control variables. Similar to prior results, I found that when the board selects a LID with high independence ($\beta = 0.110$, $p < 0.10$), bandwidth ($\beta = 0.023$, $p > 0.10$), expertise ($\beta = 0.015$, $p > 0.10$), and motivation ($\beta = 0.034$, $p > 0.10$), the attendance of the board meeting increases. However, these results are not statistically significant for bandwidth, expertise, and motivation variables and only marginally significant for the independence variable.

Hypothesis 5 proposes the consequences of having an effective LID on the CEO's compensation structure. In the post-hoc analysis reported in Table 9, I regress CEO outcome-based pay variable on four effectiveness (bandwidth, ability, motivation, and independence) and control variables. Contrary to prior results, I found that when the board selects a LID with high independence ($\beta = 0.008$, $p > 0.10$), bandwidth ($\beta = 0.019$, $p > 0.10$), and expertise ($\beta = 0.004$, $p > 0.10$), the outcome-based provisions in the CEO's total compensation package increases. However, when the motivation ($\beta = -0.007$, $p > 0.10$) for a LID increases, the outcome-based provisions in the CEO's total compensation package decreases. However, these results are not statistically significant.

Hypothesis 6 proposes the consequences of having an effective LID on the dismissal of problem directors. In the post-hoc analysis reported in Table 9, I regress the problem director dismissal variable on four effectiveness (bandwidth, ability, motivation, and independence) and control variables. Similar to prior results, I found that when the board selects a LID with high independence ($\beta = 0.073$, $p > 0.10$), bandwidth ($\beta = 0.061$, $p > 0.10$), expertise ($\beta = 0.015$, $p > 0.10$),

and motivation ($\beta = 0.179$, $p < 0.10$), the likelihood that problem directors will be dismissed increases. However, these results are significant only for the motivation variable and non-significant for the independence, bandwidth, and expertise variables.

Insert Table 9 Here

VI. Discussion

In this section, I provide a brief summary of my dissertation, along with a discussion of the results that are reported above. Possible explanations for non-findings and promising ideas for future related research are also presented. I conclude with a discussion of the limitations of the present study and potential implications for research and practice.

Summary

Scholars supporting agency theory suggest that the interests of managers do not align perfectly with those of shareholders without some adjustment or monitoring (e.g., Jensen and Meckling, 1976). The board of directors is one of the most important internal corporate governance mechanisms that monitors management and ensures that managers are acting in the best interests of shareholders to minimize agency costs. Beyond that, board independence is considered to be one of the most important factors underlying board effectiveness since the CEO may be motivated to control the board of directors to maximize his or her own interests (Hermalin and Weisbach, 2003). It is generally believed that boards are not truly independent of management since CEOs generally are able to influence the nomination and tenure of independent directors. Lipton and Lorch (1992) were among the first to suggest that firms should implement the LID. By doing that firms could: 1) enhance board independence, 2) provide an

alternative solution to the issue of CEO duality, and 3) reduce the workload of board-related tasks assigned to the Chairman of the Board.

A decade later, after major scandals by firms like Enron, WorldCom, and Tyco, boards begin to adopt the LID in order to enhance the board's monitoring function. This adoption happened, in part, due to a 2003 NYSE legal mandate, which required all member firms to adopt a LID's on their boards (Penbera, 2009). Firms trading on NASDAQ adopted similar practices due to immense pressure from their investors (Penbera, 2009). According to a Spencer Stuart report, between 2003 and 2015, 99 percent of S&P 500 firms had designated a LID (Spencer Stuart, 2016). However, after a decade, executives of firms like Valeant Pharmaceuticals who had a designated LID, are still being convicted of significant corporate fraud and other scandals (Thomas, 2018). Events like these raise the question, did firms adopt the role of LIDs to substantively improve their governance standards, or did they implement this role for symbolic purposes which resulted in minimal change to their governance systems.

The main purpose of this dissertation is to identify firms that implemented the LID for symbolic versus substantive reasons. In order to do that, I suggest that firms that adopted an effective individual for this role (or who has a combination of 1) independence, 2) expertise, 3) bandwidth, and 4) motivation) did it for substantive reasons. By contrast, firms which adopted a less effective or an ineffective LID implemented it more for symbolic reasons. In particular, I predict that firms with a greater percentage of their stock held by dedicated institutional investors (Hypothesis 1), firms with lower performance (Hypothesis 2), and firms with greater strategic complexity (Hypothesis 3) are more likely to select an effective LID for substantive purposes.

Next, I explore the possibility of how an effective individual in the role of LID can influence the monitoring function of the board. The position of LID was implemented for three

primarily reasons: to chair the executive sessions, to monitor the CEO, and to lead and evaluate independent directors (Spencer Stuart, 2007; Shi and Connelly, 2018). Based on these reasons, I explore whether an effective LID could: enhance the effectiveness of board meetings (Hypothesis 4), monitor the CEO by ensuring their compensation package is designed in a way to align their interest with shareholders (Hypothesis 5) and dismiss problem directors that could hurt the reputation of the board (Hypothesis 6).

To test my hypotheses, I used a sample of 395 S&P 500 firms that appointed their first LID between 2003 and 2017. Contrary to the Spencer Stuart report (2016) that suggested 99 percent of S&P 500 firms had adopted the role of LID by 2015, I found 13 percent (or 60 firms) did not have a designated LID. I believe this could be partly because some firms may not have officially disclosed the name of the person in this role or some firms had a non-executive chairman and felt no need to appoint a LID to their board.

Findings, Limitations and Future Research

Hypothesis 1 suggests that when firms have a greater amount of equity owned by dedicated institutional investors, boards are more likely to select an effective LID. This may be due to the fact that dedicated investors have an on-going, long-term relationship with the firm and its board. When a firm has a greater representation of such investors, they are more likely to ensure that the board selects an effective individual for the role of LID to monitor the CEO on behalf of investors. However, results from the OLS analysis are contrary to my prediction. I found that when firms have a greater percentage of their stock owned by dedicated institutional investors, boards are less likely to select an effective LID. An alternative explanation for this finding could be that dedicated owners have low levels of information asymmetry and “extensive resources to devote to monitoring managerial behavior” (Shi, Connelly, and Hoskisson, 2017, p:

1271). Given the nature of their holdings, they are motivated and have the resources to carefully monitor the managers themselves. Thus, dedicated institutional investors do not have to rely on a LID for extensive monitoring. In addition, an effective LID may monitor in a way that may not align with the goals of some dedicated institutional investors. For instance, agency theorists suggest that the independent directors and institutional investors will both encourage managers to take risks (Johnson et al., 1993). However, independent directors may pursue different risk-taking strategies than institutional investors (Tihanyi and Ellstrand, 1998). Thus, dedicated institutional investors may prefer a less effective LID in this role, so they can work directly with decision makers to engage in strategic activities that align with their best interests.

It is also noteworthy that the coefficients of transient and quasi-institutional investor variables in Table 4 are positive ($\beta = 0.314$, $p > 0.10$; $\beta = 0.686$, $p > 0.10$). Although, these variables are not statistically significant, this may indicate that when firms have a high ratio of transient and quasi-institutional investors, boards may select an effective LID who can monitor the CEOs on their behalf. Future research may consider examining different mechanisms and contextual factors which can help explain the preferences of different institutional investors regarding LIDs.

Hypothesis 2 suggests that firms experiencing lower performance are more likely to select an effective LID. Results from the OLS analysis provided support for this argument. Results suggests that during the selection process, boards of underperforming firms are more likely to ensure that individuals selected for this role are among the most effective independent directors available. By selecting an effective individual for this role, a LID could reduce information asymmetry between management and shareholders and thus, help the firm and its CEO to improve firm performance. However, I only use one measure of accounting performance: industry average ROA, to predict the likelihood of a board selecting an effective

individual for this role. In the future, scholars may use other performance measures, such as CSR performance, stock performance or Tobin's q , in order to examine whether the implications of selecting an effective LID results in similar outcomes for other performance measures.

Similarly, in this study, I examine the consequences related to the monitoring functions (e.g., board meetings, CEO compensation, and dismissal of the problem directors). However, it could be fruitful to examine the consequences related to firm performance. Moreover, scholars could examine whether underperforming firms improved their firm performance after selecting an effective LID. In addition, researchers may wish to look beyond financial performance. It may be plausible that by having an effective LID, firms can meet the needs of multiple stakeholders, thereby increasing their corporate social performance. In addition, Krause and colleagues (2017) found that analysts reacts positively when a firm appoints a LID. However, scholars may wish to examine whether analysts pay attention to the qualifications of individual appointed in this role. If they do, the positive reaction should be stronger when a board appoints an effective individual in this role.

Hypothesis 3 suggests that firms with higher strategic complexity are more likely to select an effective LID. The OLS analysis provided no empirical support for this argument. Strategic complexity was measured in two different ways: an entropy measure of diversification and the total amount of international sales divided by total sales. Interestingly, coefficients for both of these measures were negative and non-significant. Prior literature on diversification suggest that "one way firms may handle the increased and varied dependencies associated with international operations is to add members to the board who represent or have particular expertise in some of the many international constituencies (Pfeffer, 1972) or who more generally increase the overall information-processing capacity of the group (Jackson, 1992)" (Sanders and

Carpenter, 1998: p:164). The relative measure of a LID's effectiveness used in this study compares the effectiveness of the LID to other independent directors who could potentially be selected for this position. It could be plausible that strategically complex firms may have more effective independent directors than firms with low strategic complexity (Sanders and Carpenter, 1998). Thus, when boards of a strategically complex firm select a LID, their relative score to other independent directors may not be much different. As a result, a strategically complex firm may be selecting an effective LID however, the qualifications of the LID may not differ much from other independent directors on the board. In addition, I used the LID's financial education and background as a measure of expertise. In the future, researchers may examine specific expertise, such as prior experience in M&As or internationalization, as such factors may be more salient for strategically complex firms.

Overall, hypotheses 1-3 suggest three characteristics of firms that may be more likely to select an effective LID for substantive reasons. However, based on the results, only one of the three predictors: low firm performance, seems to be a meaningful and significant predictor of firms who are likely to select an effective LID. These results corroborate the results of previous studies based on the attention based view (Ocasio, 1997; Tuggle et al., 2010). This may suggest that boards only pay attention to the selection process of a LID when their firms are not performing well (Tuggle et al., 2010).

Next, hypotheses 4-6 examine the consequences of having an effective LID. Hypothesis 4 suggests that when a board selects an effective LID, the effectiveness of board meetings may increase. To measure the effectiveness of board meetings, I observe an increase (or decrease) in director attendance the year before and after the selection of a LID. Results from the OLS analysis suggest that when firms select a highly effective LID, firms observe an increase in the

percentage of independent directors attending the board meetings. Due to the limitations of available data, I used board attendance records as a proxy measure of board meeting effectiveness. However, future studies can benefit from qualitative studies and surveys which can better inform us as to how an effective LID adds value to board meetings. Scholars may examine whether highly effective LIDs are better prepared and chair board meetings in more efficient ways than less effective or ineffective LIDs.

Hypothesis 5 suggests that firms with an effective LID are more likely to provide their CEOs a compensation package that has greater outcome-based provisions. This is mainly because the LIDs are responsible for chairing executive sessions, where he or she meets with other independent directors to evaluate CEO's performance (Spencer Stuart, 2007; Shi and Connelly, 2018). In such meetings, CEO compensation is one of the key issues discussed, and if a LID is an effective monitor, he or she is more likely to ensure that the CEO's pay aligns with shareholders' interests. However, results from the OLS analysis found no support for this argument. This could be partly because CEO pay is a complex issue and the LID may not be powerful enough to influence the pay structure of the highest paid employee of the firm. A number of factors could impact CEO compensation, including stock performance, external responsibilities, and social pressures (e.g., Ferris, Jagannathan, and Pritchard, 2003; Westphal and Khanna, 2003). It may also be that an effective LID may have the ability to design a CEO's compensation package that aligns with shareholder's interest; however, they may lack the power to actually implement it (Krause et al., 2017). In the future, it will be fruitful to examine the power balance between the LID and CEO and examine whether it affects the CEO's compensation package.

Hypothesis 6 suggests that firms with an effective LID are more likely to dismiss problem directors from their boards. This is because one of the main responsibilities of a LID is to evaluate independent board members and the board's overall performance (Spencer Stuart, 2007). When boards include problem directors, the firm's reputation could be jeopardized (Fich and Shivdasani, 2007) and it is the responsibility of a LID to ensure that qualified directors sit on the board. Results from the OLS analysis found support for this argument. I found that when boards selected an effective LID, the following year the number problem directors decreased. This is an interesting finding, and in the future, scholars may wish to investigate this further by examining the nature of the problem that resulted in a director dismissal. In this study, problem directors are defined as directors who have been associated with corporate bankruptcies, major litigation or corporate infractions, major accounting restatement and other accounting scandals (Board Analyst, 2007). However, it is plausible that when a firm has an effective LID, high profile problem directors (e.g., associated with accounting scandals) are more likely to exit the firms than problem directors with trivial issues (such as chapter 11 bankruptcies).

Overall, results from the consequences hypotheses provide some evidence of the decoupling argument made earlier in the paper. When firms select an effective LID, we observe an increase in board meeting attendance and the dismissal of problem directors. However, when firms select an ineffective LID or less effective LID, the effectiveness of board meetings and the dismissal of problem directors decreases. This suggests that some firms may appoint an ineffective or less effective LID for symbolic purposes so they can meet the demands of the external pressures (e.g., NYSE mandate, pressure from institutional investors) and bring only minimal changes to governance standards of the firm.

Table 10 summarizes the findings of all the hypotheses tested in this dissertation.

Insert Table 10 Here

One of the contributions of this study is to empirically test and assess the theoretical quad model (Hambrick et al., 2015). In this study, I used Hambrick and colleagues (2015) quad model to develop a composite measure of the effectiveness of a LID using four factors: 1) independence, 2) expertise, 3) bandwidth, and 4) motivation. According to this model, a LID must have a combination of all four factors, in order to be an effective monitor. If a LID lacks one or more of these factors, they may be less effective. To assess this argument, I conducted a post-hoc analysis. For instance, while assessing the antecedents, results in Table 8 suggest that firms with a greater percentage of dedicated institutional investors are more likely to select a LID who has more independence but less bandwidth, expertise, and motivation. However, underperforming firms are more likely to select a LID who has more independence, expertise, and motivation but less bandwidth. On the consequences side, results in Table 9 suggest that the LID's independence is the strongest predictor for having an effective board meeting. However, the LID's motivation is the strongest predictor for predicting the dismissal of problem directors. Results from the post-hoc analysis suggest that it is plausible that some factors may be more important than others in a given context.

Implications for Practice

CEOs and TMTs may feel threatened by the requirement of having a LID on their boards. In order to prevent an unwanted measure of control, they may influence the selection process of the LID and may want to diffuse the power of a LID and appoint a less effective director to this role who may not implement any needed governance changes. This study would caution against

such tactics because most governance reforms are designed to improve organizations and protect against problems, so ceremonial adoption could be counterproductive.

This study should also interest a wide range of stakeholders. After the scandals at firms like Enron, regulators made a mandate for some firms (i.e., NYSE firms) to appoint a LID with the expectation that it would lead to improved monitoring standards. Firms that did not face such mandates were pressured by investors to adopt similar practices (e.g., NASDAQ firms). However, regulators and investors often fail to give attention to how firms implement such practices (Westphal and Zajac, 1994). In the case of the LID, some firms adopted this role merely for window dressing and engaged in symbolic management practices by selecting an ineffective or less effective LID who failed in some key monitoring tasks delegated to them. Therefore, if regulators impose mandates or investors pressure firms to implement new governance changes, they should provide guidance or create policies in a way such that firms do not implement these practices for symbolic purposes. It may be helpful if regulators and investors provide guidance about some key characteristics that a director in this role should possess and prescribe some metrics through which firms can evaluate the performance of their LIDs.

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VIII. Tables and Figures

Figure 1: Antecedents and Consequences of LID

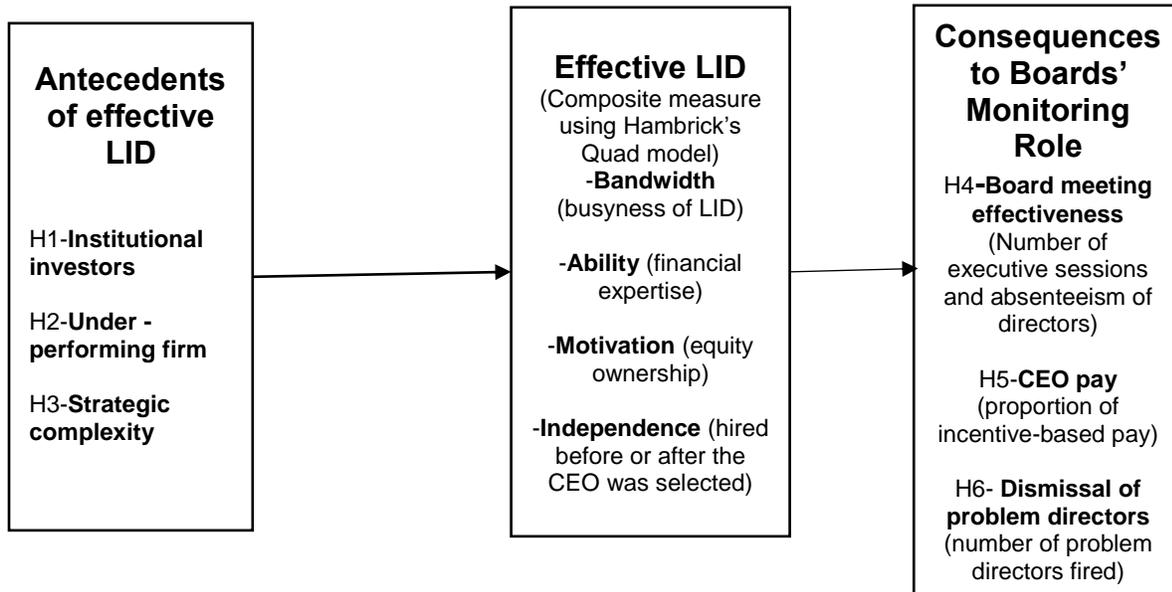


Table 1: Possible Configurations of Board Leadership Structures

Leader 1	Leader 2	Leader 3	Example
CEO/Chair			Berkshire Hathaway (2015) Warren E. Buffett – CEO/Chairman of the Board
CEO/Chair	LID		Hershey Co (2015) JP Bilbrey - Chairman/President/CEO Doctor Jim Nevels - Lead Independent Director
CEO	Insider COB	LID	Ross Stores (2015) Barbara Rentler – CEO Michael Balmuth – Executive Chairman of the Board George P. Orban – Lead Independent Director
CEO	Outside COB	LID	Qorvo, Inc (2015) Bob Bruggeworth – President and CEO Ralph G. Quinsey – Independent COB Walter H. Wilkinson, Jr – Lead Independent Director

Table 2: Descriptive Statistics

Variables	Mean	Std.Dev	Min	Max
LID absolute effectiveness	.319	1.76	-4.485	13.356
LID relative effectiveness	.112	1.742	-18.856	6.127
Dedicated investors	.07	.091	0	.51
ROA industry	.278	.679	-1.864	5.829
Entropy	.611	.587	0	2.148
Intl diversification	.506	.53	0	2.133
Meeting effectiveness	.025	.467	-1	4
CEO equity change	.035	.299	-1	1
Problem director dismissal	-.127	1.383	-11	13
Stock exchange	.759	.428	0	1
Assets log	4.031	.707	2.134	6.326
Debt ratio	.243	.183	0	1.44
Total directors	10.587	2.9	5	34
Board independence	.768	.127	.273	1
Affiliated directors	.068	.099	0	.571
Gender ratio	.859	.091	.583	1
CEO tenure	13.572	10.871	0	47.9
CEO Network	2.653	1.743	1	13
CEO duality	.734	.442	0	1
Quasi investors	.417	.228	0	.966
Transient investors	.185	.177	0	1.201

N=395

Table 3: Pairwise Correlations

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
(1) LID absolute effect.	1.00									
(2) LID relative effect.	0.63*	1.00								
(3) Dedicated investors	-0.08	-0.12*	1.00							
(4) ROA industry	-0.02	-0.11*	-0.01	1.00						
(5) Entropy	-0.04	-0.02	0.03	-0.05	1.00					
(6) Intl diversification	-0.07	0.02	-0.02	0.15*	0.20*	1.00				
(7) Meeting effectiveness	0.15*	0.12*	0.07	-0.02	-0.04	0.00	1.00			
(8) CEO equity change	-0.04	-0.06	-0.00	0.00	-0.05	-0.03	-0.03	1.00		
(9) Problem dir. dismissal	0.13*	0.05	-0.12*	0.03	-0.09	0.04	0.03	-0.01	1.00	
(10) Stock exchange	-0.03	0.05	0.12*	-0.19*	0.23*	-0.10*	0.04	0.10	-0.10*	-0.07
(11) Assets log	-0.06	-0.00	-0.16*	-0.14*	0.24*	-0.04	0.02	0.01	-0.04	0.08
(12) Debt ratio	-0.07	-0.05	0.07	-0.07	0.01	-0.12*	-0.01	0.15*	0.01	0.11*
(13) Total directors	0.04	0.05	-0.13*	-0.15*	0.12*	-0.13*	0.09	-0.09	-0.10	0.05
(14) Board independence	-0.10	0.04	-0.15*	0.06	0.05	0.11*	-0.06	0.05	0.05	-0.05
(15) Affiliated directors	0.05	-0.07	0.04	-0.07	0.05	-0.19*	0.02	-0.03	-0.02	0.02
(16) Gender ratio	0.06	-0.00	0.05	0.03	-0.14*	0.02	-0.01	-0.10*	0.01	-0.05
(17) CEO tenure	-0.13*	-0.03	0.00	-0.03	0.12*	0.05	-0.01	-0.13*	-0.10	-0.14*
(18) CEO Network	-0.01	-0.03	-0.01	-0.05	0.05	-0.06	-0.02	-0.04	0.05	0.07
(19) CEO duality	-0.04	0.10	0.04	0.06	0.00	-0.10	-0.00	-0.01	-0.01	-0.09
(20) Quasi investors	0.06	0.05	-0.08	0.06	0.07	0.10*	-0.05	-0.16*	-0.01	-0.10*
(21) Transient investors	-0.01	-0.03	0.55*	-0.03	0.01	0.06	0.08	-0.02	-0.06	0.00

Table 3: Pairwise Correlations (Cont.)

Variables	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
(10) Stock exchange	1.00										
(11) Assets log	0.20*	1.00									
(12) Debt ratio	0.23*	0.01	1.00								
(13) Total directors	0.11*	0.53*	-0.06	1.00							
(14) Board indep.	0.00	0.07	-0.03	0.00	1.00						
(15) Affiliated directors	0.05	0.14*	0.00	0.22*	-0.70*	1.00					
(16) Gender ratio	-0.11*	-0.27*	-0.04	-0.16*	-0.14*	-0.03	1.00				
(17) CEO tenure	0.05	0.09	-0.03	0.10	-0.08	0.03	-0.06	1.00			
(18) CEO Network	0.09	0.13*	0.08	0.06	0.01	-0.01	0.07	0.05	1.00		
(19) CEO duality	0.16*	0.01	0.05	-0.07	0.20*	-0.09	-0.02	0.11*	0.12*	1.00	
(20) Quasi investors	0.00	0.07	-0.10*	0.04	-0.02	0.12*	-0.07	0.18*	-0.05	-0.05	1.00
(21) Transient invest.	0.05	-0.24*	0.04	-0.15*	-0.14*	-0.02	0.05	-0.02	-0.00	0.02	0.11*

Table 4: Regression results – Antecedents

	(1)	(2)	(3)	(4)
LID relative effectiveness				
Stock exchange	0.358 (0.249)	0.395 (0.248)	0.306 (0.251)	0.345 (0.256)
Assets log	-0.281 (0.187)	-0.281 (0.186)	-0.273 (0.185)	-0.193 (0.197)
Debt ratio	-0.007 (0.626)	0.011 (0.623)	0.001 (0.620)	-0.001 (0.621)
Total directors	0.066 (0.041)	0.061 (0.041)	0.054 (0.041)	0.049 (0.041)
Board indepen.	-1.707 (1.185)	-1.796 (1.180)	-1.800 (1.175)	-1.748 (1.177)
Affiliated dirs.	-3.311** (1.521)	-3.250** (1.514)	-3.247** (1.507)	-3.301** (1.521)
Gender ratio	-0.257 (1.128)	-0.327 (1.123)	-0.383 (1.118)	-0.495 (1.122)
CEO tenure	-0.014 (0.009)	-0.013 (0.009)	-0.013 (0.009)	-0.013 (0.009)
CEO network	-0.020 (0.057)	-0.026 (0.057)	-0.026 (0.056)	-0.022 (0.056)
CEO duality	0.343 (0.241)	0.359 (0.240)	0.394 (0.239)	0.334 (0.243)
Quasi investors	0.808* (0.436)	0.627 (0.442)	0.662 (0.441)	0.686 (0.443)
Transient investors	-0.362 (0.562)	0.365 (0.658)	0.231 (0.658)	0.314 (0.661)
Dedicated investor		-2.701** (1.288)	-2.672** (1.282)	-2.785** (1.285)
ROA industry			-0.305** (0.154)	-0.305** (0.154)
Entropy				-0.114 (0.196)
Intl. Diversification				-0.300 (0.243)
_cons	0.853 (2.204)	1.301 (2.203)	1.922 (2.216)	2.158 (2.223)
Obs.	395	395	395	395
R-squared	0.165	0.176	0.186	0.191
Industry Dummy	YES	YES	YES	YES

Standard errors are in parenthesis

*** p<0.01, ** p<0.05, * p<0.1

Table 5: Regression results – Consequences (1)

Board meeting effectiveness	(1)	(2)
Stock exchange	-0.022 (0.065)	-0.022 (0.065)
Assets log	-0.030 (0.049)	-0.020 (0.049)
Debt ratio	0.028 (0.164)	0.057 (0.163)
Total directors	0.024** (0.011)	0.022** (0.011)
Board indepen.	-0.402 (0.310)	-0.334 (0.310)
Affiliated dir.	-0.365 (0.398)	-0.329 (0.396)
Gender ratio	-0.033 (0.295)	-0.040 (0.293)
CEO tenure	-0.002 (0.002)	-0.001 (0.002)
CEO network	0.001 (0.015)	0.001 (0.015)
CEO duality	0.002 (0.063)	-0.001 (0.063)
Quasi investors	-0.085 (0.114)	-0.113 (0.114)
Transient investors	0.277* (0.147)	0.294** (0.146)
LID abs. effective.		0.032** (0.015)
_cons	-0.381 (0.576)	-0.440 (0.574)
Obs.	395	395
R-squared	0.205	0.216
Industry Dummy	YES	YES

Standard errors are in parenthesis

*** p<0.01, ** p<0.05, * p<0.1

Table 6: Regression results – Consequences (2)

CEO performance based pay	(1)	(2)
Stock exchange	0.028 (0.040)	0.028 (0.040)
Assets log	0.011 (0.030)	0.013 (0.030)
Debt ratio	0.163 (0.100)	0.168* (0.101)
Total directors	-0.006 (0.007)	-0.006 (0.007)
Board indepen.	-0.000 (0.190)	0.011 (0.191)
Affiliated dir.	0.004 (0.244)	0.010 (0.244)
Gender ratio	-0.220 (0.181)	-0.221 (0.181)
CEO tenure	-0.004*** (0.002)	-0.004** (0.002)
CEO network	0.008 (0.009)	0.007 (0.009)
CEO duality	-0.046 (0.039)	-0.047 (0.039)
Quasi investors	-0.078 (0.070)	-0.083 (0.070)
Transient investors	-0.039 (0.090)	-0.036 (0.090)
LID abs. effect.		0.005 (0.009)
_cons	0.288 (0.353)	0.278 (0.354)
Obs.	395	395
R-squared	0.183	0.184
Industry Dummy	YES	YES

Standard errors are in parenthesis

*** p<0.01, ** p<0.05, * p<0.1

Table 7: Regression results – Consequences (3)

	(1)	(2)
<hr/>		
Problem director dismissal		
Stock exchange	-0.258 (0.184)	-0.260 (0.183)
Assets log	-0.056 (0.138)	-0.029 (0.138)
Debt ratio	0.515 (0.464)	0.593 (0.463)
Total directors	-0.055* (0.030)	-0.061** (0.030)
Board indepen.	0.778 (0.878)	0.964 (0.878)
Affiliated dir.	0.735 (1.127)	0.834 (1.122)
Gender ratio	0.049 (0.835)	0.030 (0.831)
CEO tenure	-0.013* (0.007)	-0.011 (0.007)
CEO network	0.058 (0.042)	0.056 (0.042)
CEO duality	0.004 (0.178)	-0.004 (0.177)
Quasi investors	0.299 (0.323)	0.223 (0.323)
Transient investors	-0.388 (0.416)	-0.342 (0.415)
LID abs. effect.		0.087** (0.041)
_cons	0.538 (1.632)	0.377 (1.626)
Obs.	395	395
R-squared	0.274	0.284
Industry Dummy	YES	YES

Standard errors are in parenthesis

*** p<0.01, ** p<0.05, * p<0.1

Table 8: Regression results Antecedents Post-hoc

	LID Independence relative	LID Bandwidth relative	LID Expertise relative	LID Motivation relative
Dedicated invest.	0.381 (0.282)	-1.959*** (0.716)	-0.254 (0.743)	-0.953 (0.781)
ROA industry	-0.063* (0.034)	0.096 (0.086)	-0.166* (0.089)	-0.171* (0.094)
Entropy	-0.037 (0.043)	-0.099 (0.109)	0.112 (0.113)	-0.091 (0.119)
Intl. diversification	-0.019 (0.053)	-0.208 (0.135)	-0.133 (0.140)	0.060 (0.147)
Stock exchange	0.034 (0.056)	0.149 (0.142)	-0.013 (0.148)	0.176 (0.155)
Assets log	0.019 (0.043)	-0.056 (0.110)	-0.087 (0.114)	-0.068 (0.120)
Debt ratio	0.107 (0.136)	-0.221 (0.346)	-0.374 (0.359)	0.487 (0.377)
Total directors	-0.005 (0.009)	0.037 (0.023)	-0.004 (0.024)	0.022 (0.025)
Board indepen.	0.311 (0.258)	-0.630 (0.656)	-0.630 (0.681)	-0.800 (0.715)
Affiliated dirs.	0.205 (0.334)	-1.088 (0.848)	-0.489 (0.880)	-1.928** (0.924)
Gender ratio	-0.189 (0.246)	-1.315** (0.625)	-0.006 (0.649)	1.015 (0.681)
CEO tenure	-0.004** (0.002)	-0.006 (0.005)	-0.003 (0.005)	-0.000 (0.006)
CEO Network	-0.013 (0.012)	0.011 (0.031)	0.010 (0.033)	-0.030 (0.034)
CEO duality	0.017 (0.053)	-0.085 (0.136)	0.213 (0.141)	0.189 (0.148)
Quasi investors	0.055 (0.097)	0.358 (0.247)	-0.045 (0.256)	0.318 (0.269)
Transient investors	0.131 (0.145)	0.170 (0.368)	-0.115 (0.382)	0.128 (0.402)
_cons	-0.026 (0.488)	0.997 (1.238)	1.430 (1.285)	-0.243 (1.350)
Obs.	395	395	395	395
R-squared	0.164	0.240	0.182	0.097
Industry Dummy	YES	YES	YES	YES

Standard errors are in parenthesis

*** p<0.01, ** p<0.05, * p<0.1

Table 9: Regression results Consequences Post-Hoc

	Board meeting effectiveness	CEO performance based pay	Problem director dismissal
LID independence	0.110* (0.058)	0.008 (0.036)	0.073 (0.164)
LID bandwidth	0.023 (0.026)	0.019 (0.016)	0.061 (0.073)
LID expertise	0.015 (0.025)	0.004 (0.015)	0.015 (0.071)
LID motivation	0.034 (0.025)	-0.007 (0.016)	0.179** (0.072)
Stock exchange	-0.027 (0.065)	0.029 (0.040)	-0.263 (0.184)
Assets log	-0.027 (0.049)	0.016 (0.030)	-0.048 (0.139)
Debt ratio	0.046 (0.164)	0.176* (0.101)	0.545 (0.464)
Total directors	0.022** (0.011)	-0.006 (0.007)	-0.064** (0.030)
Board independence	-0.379 (0.311)	0.018 (0.192)	0.899 (0.881)
Affiliated directors	-0.367 (0.397)	0.030 (0.245)	0.713 (1.125)
Gender ratio	-0.041 (0.295)	-0.207 (0.182)	-0.108 (0.836)
CEO tenure	0.000 (0.003)	-0.004** (0.002)	-0.012 (0.007)
CEO Network	0.001 (0.015)	0.007 (0.009)	0.060 (0.042)
CEO duality	0.005 (0.063)	-0.045 (0.039)	0.007 (0.178)
Quasi investors	-0.116 (0.115)	-0.089 (0.071)	0.230 (0.324)
Transient investors	0.259* (0.148)	-0.028 (0.092)	-0.371 (0.420)
_cons	-0.367 (0.578)	0.247 (0.357)	0.726 (1.639)
Obs.	395	395	395
R-squared	0.223	0.188	0.290
Industry Dummy	YES	YES	YES

Standard errors are in parenthesis

*** p<0.01, ** p<0.05, * p<0.1

Table 10: Summary of Hypotheses Testing

Hypothesis	Results
Antecedents of an effective LID	
<p>Hypothesis 1: The higher the amount of equity owned by dedicated institutional investors, the higher the likelihood that the independent director selected for the position of the LID will be effective.</p>	<p>No support for hypothesis 1. Found opposite results. Firms that have higher ratio of dedicated institutional investors are less likely to select an effective LID.</p>
<p>Hypothesis 2: The lower the firm performance, the higher the likelihood that the independent director selected for the position of the LID will be effective.</p>	<p>Support found for hypothesis 2. Firms with low performance are more likely to select an effective LID.</p>
<p>Hypothesis 3: The higher the strategic complexity of a firm, the higher the likelihood that the independent director selected for the position of the LID will be effective.</p>	<p>No support for hypothesis 3.</p>
Consequences of an effective LID	
<p>Hypothesis 4: The effectiveness of a LID is positively related to effective board meetings.</p>	<p>Support found for hypothesis 4. Firms with effective LIDs are more likely to have higher attendance of directors during their meetings.</p>
<p>Hypothesis 5: The effectiveness of a LID is positively related to outcome-based provisions in the CEO's total compensation package.</p>	<p>No support for hypothesis 5.</p>
<p>Hypothesis 6: Firms selecting an effective LID are more likely to dismiss problem directors from their boards.</p>	<p>Support found for hypothesis 6. Firms with effective LIDs are more likely to dismiss problem directors from their boards.</p>