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Do boards create value?

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Boards play a crucial role in corporate governance. In theory, they hire and fire the executives, monitor corporate finance, ratify and develop corporate strategies, check risk management and represent the firm vis-à-vis key stakeholders like owners and creditors (Adams, Hermalin and Weisbach 2010). And yet, we know little of their contribution to firms. Many CEOs are sceptical and claim that boards do very little in practice. In this paper we answer the fundamental question of whether boards create value? Does it pay to have a board? Under what circumstances?

One major problem for an empirical strategy is that boards are mandatory in joint stock corporations. To some extent we can get around this problem by examining limited partnerships, which resemble joint stock companies but are not required to have a board. However, this rules out most of the important corporations in an economy, in which we believe that boards are particularly likely to create value. An alternative strategy lies in the fact that many boards are boards in form more than substance. We could then analyse firms that change from form to substance and see if the change makes a difference. For example an insider board composed of the founder-CEO, his wife and other family members can hardly be expected to fulfil the value creation functions, which corporate law and corporate governance theory expect.

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In this paper we investigate the relationship between the existence of real boards with independent board members and firm performance. We use register data on incorporated firms merged with a register of board members, which again is merged with register data about these board members.

We divide boards in family dominated and boards with one or more external members, who are not in family with others in the board or the CEO and who are not employed in the firm. We are addressing these issues at the population level using unique Danish register data.

Boards are almost equally divided between family dominated and external members with a shifting balance over time. Up to the financial crisis of 2008 there were more family dominated boards than external firms. After the crisis this balance changes in favour of external members. Every year about 5% of all family dominated firms get external members. Regressions are run as OLS and as fixed effects to determine reasons for the change from family board to external board. Furthermore, a diff-in-diff analysis is run on firms.

We examine economic performance in firms changing from family dominated to external boards. First, we run an OLS estimation on all firms starting out as family dominated. The results show that a new external board member does have significant effect on revenue and total factor productivity of the firm. This positive effect can be isolated to the smaller firms in the sample. It is shown that external board members have higher level of Human Capital than internal members for the smaller firms. For the larger firms this is not the case and we do not find any effects of electing external members here.

Similarly, results are confirmed running a fixed effect regression. And finally, we have run a diff-in-diff analysis on a restricted sample, where we find similar results.