



Professionals on Company Boards: Cops, Counsel, or Entrepreneurs?

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Motivation for this research



Emerged within the INCAS programme

- Kubo's longstanding interest in executives and executive pay
- Sako's interest in comparative professionals for startup and established firms
- The role of professionals on company boards is an important aspect of corporate governance

Research questions: what are the causes and consequences of appointing professionals on company boards?

- What are the determinants of corporate professionals on boards?
- What impact does the presence of corporate professionals have on corporate performance?

Preliminary evidence

- Descriptive statistics and preliminary analysis of 2004-2015 panel data of quoted companies in Japan
- Interviews at around 20 companies during July 2014 – Nov 2015

Plans for further research

- How to address the endogeneity problems
- Interview approaches to establish causal links – impact of professionals on performance

Literature review: a few insights



- **Nelson and Nielson (2000): cops, counsel, or entrepreneurs**
 - Tension in inside lawyers' role as 'policemen' and 'advisors'
 - Cops limit their advice to legal mandates
 - Counsel combine legal and business advice
 - Entrepreneurs give priority to business objectives, not to legal analysis
 - Interview-based study focused on categorizing lawyers into ideal-types; no evidence on why firms employ one type of lawyer over another.

- **Bagley (2008) on legal astuteness**
 - "Legal astuteness" = corporate top management's proactive stance to use internal legal resources to make strategic decisions
 - Corporate top management team (TMT)'s perspective generates a hypothesis
 - Appointing professionals on company boards is a manifestation of legal astuteness, potentially generating greater value for the firm.

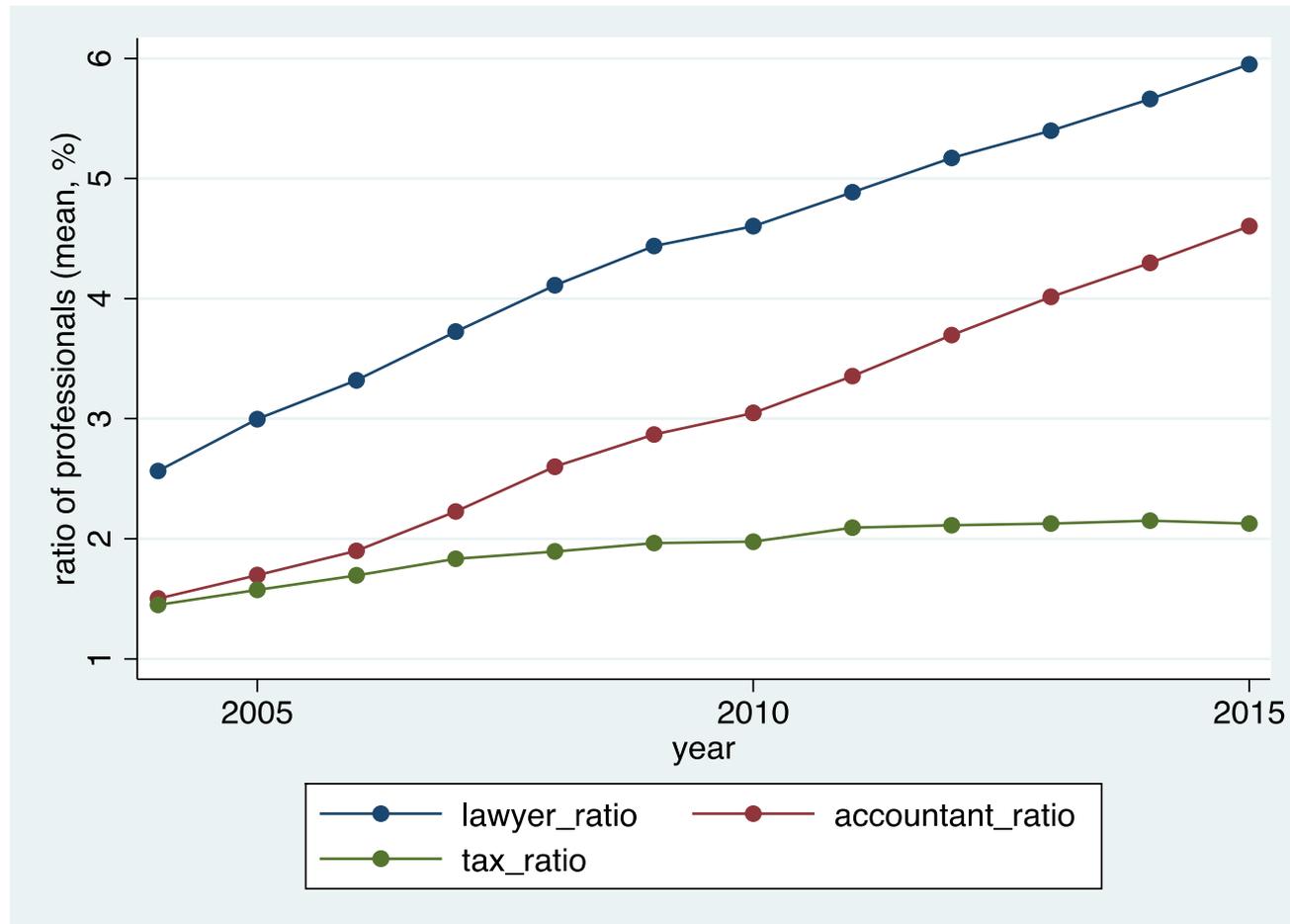
- **Litov, Sepe and Whitehead (2014: lawyers and fools**
 - Received wisdom that lawyer-directors have fools for their clients
 - But US quantitative evidence that lawyer-directors have a beneficial impact overall on corporate value creation by monitoring and providing valuable advice

Panel data description

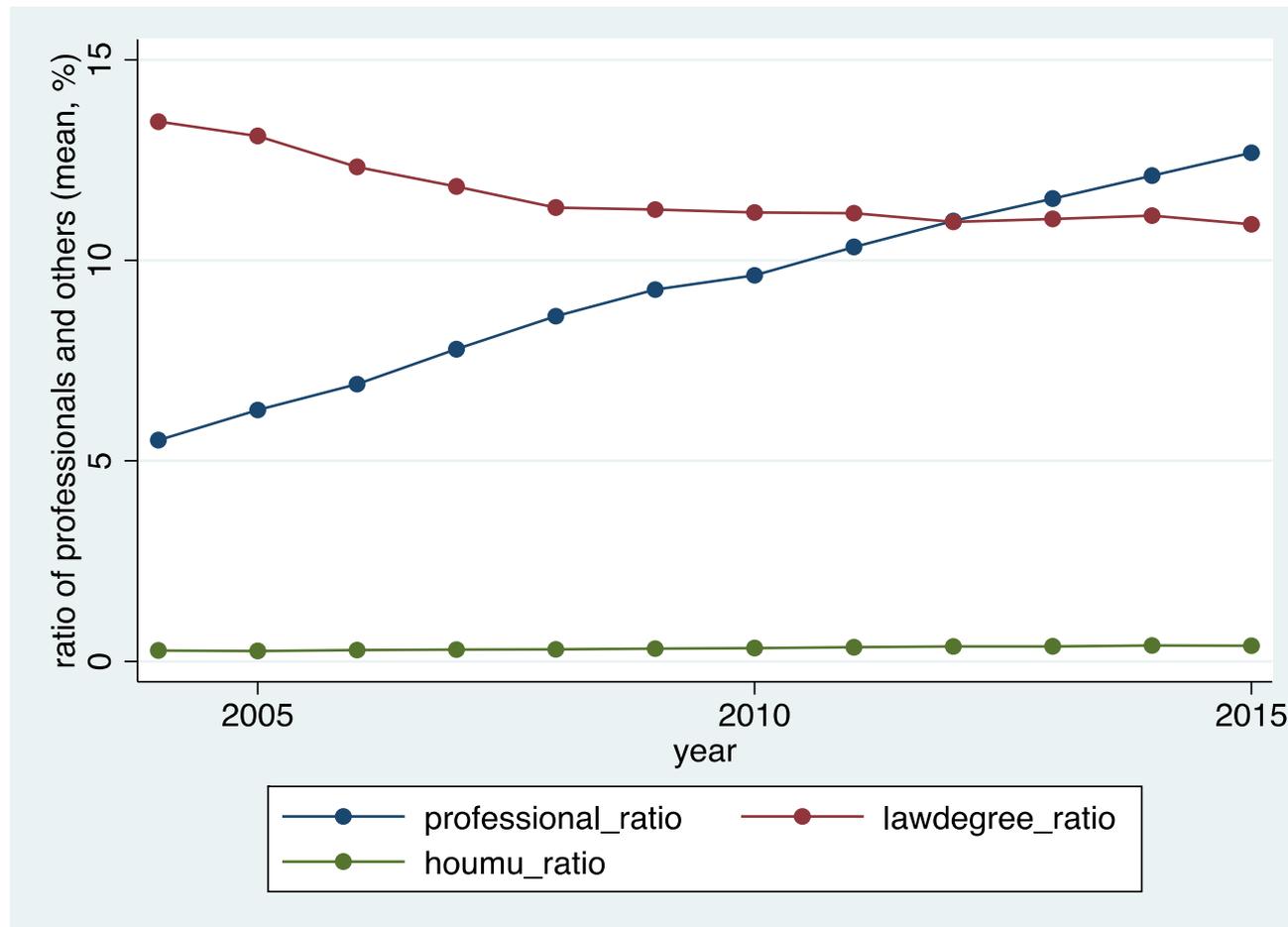


- Listed companies during the period 2004-2015: 44560 observations
- Data are taken from Development Bank of Japan Finance Database, Nikkei Needs Corporate Governance Evaluation System (CGES) Database and *TOYO KEIZAI Yakuin* database (Directory of directors and auditors).
- Directors (executive and non-executive) and auditors
- Ratio of the following among directors and auditors
 - Lawyers
 - Accountants
 - Tax accountants
 - Heads of corporate legal departments (houmu)
 - Graduates with law degree

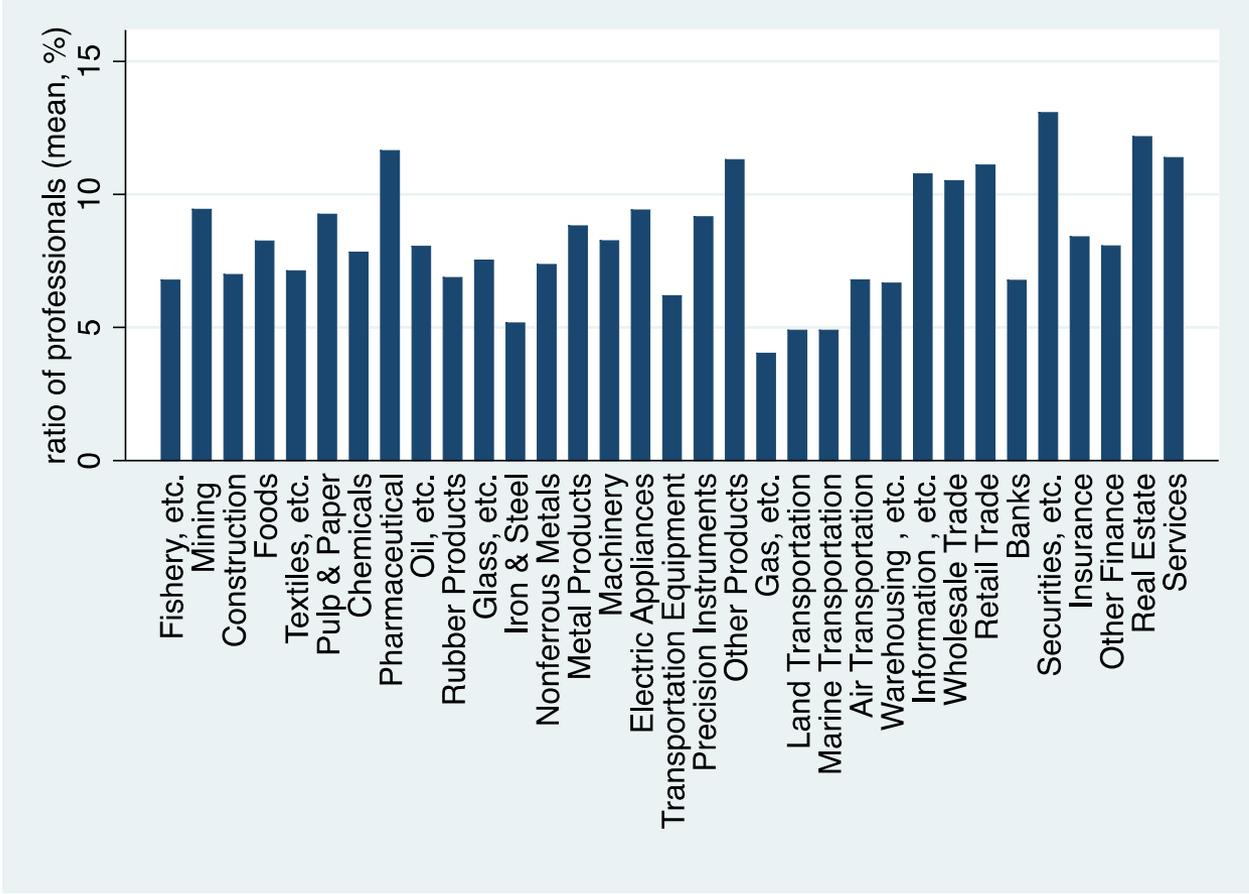
Increase in professionals 2004-2015



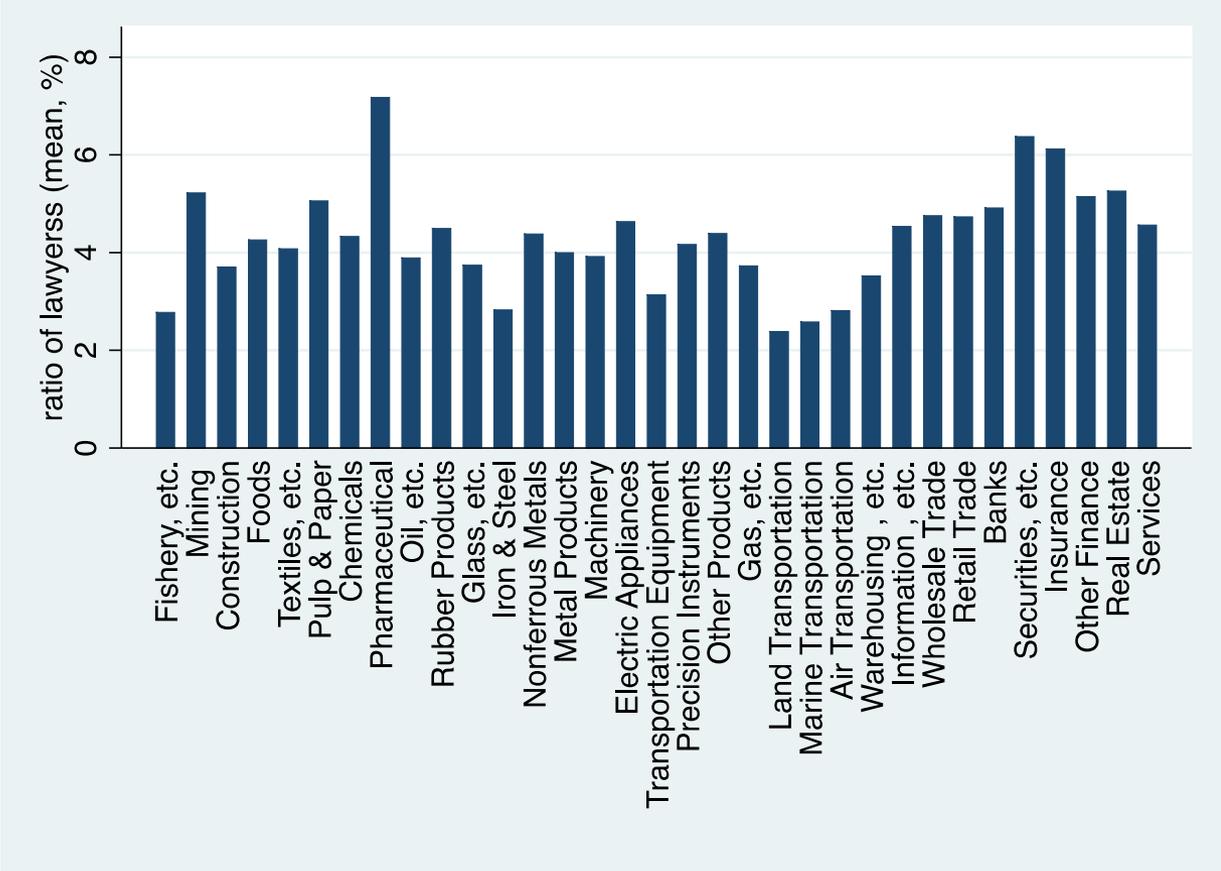
Increase in professionals compared to other categories, 2004-2015



Professionals by sector



Lawyers by sector



Which firms have more professionals on board?



- ▮ Professionals are more likely to be appointed:
 - ▮ At firms with institutional investors
 - ▮ At firms with high advertisement cost
- ▮ Dependent variable: the number of professionals

	lawyer	accountant	tax	professional	lawdegree	houmu
Institutional investor	0.0031 [0.0007]***	0.0031 [0.0006]***	-0.0007 [0.0005]	0.0055 [0.0010]***	-0.0064 [0.0017]***	0.0008 [0.0003]***
# segments	0.0072 [0.0057]	-0.0108 [0.0044]**	-0.0089 [0.0039]**	-0.0137 [0.0083]	0.1202 [0.0155]***	0.0084 [0.0023]***
R&D	0.5244 [0.4129]	-0.1471 [0.3214]	0.029 [0.2589]	0.4654 [0.6237]	-3.0743 [0.8210]***	0.1418 [0.1729]
advertisement	0.9602 [0.3831]**	1.1745 [0.4026]***	0.7707 [0.3695]**	2.9717 [0.7317]***	-1.4954 [0.8473]*	0.0947 [0.1615]

Impact of professionals on corporate practices



- ▮ Firms with professionals on the board are:
 - ▮ More likely to introduce stock options
 - ▮ Less likely to pay excessive bonus to executives
 - ▮ More likely to take risks measured by stock return volatility

The effect of professionals on stock option

- Dependent variable: stock option dummy
- Firms with professionals on the board are more likely to introduce stock options

ratio_lawyer	0.0061 [0.0028]**				
ratio_accountant		0.0193 [0.0028]***			
ratio_tax			0.0029 [0.0033]		
ratio_professional				0.0103 [0.0017]***	
ratio_lawdegree				-0.0036 [0.0014]***	
ratio_houmu					0.0009 [0.0091]

The effect of professionals on bonus overpayment



- Dependent variable: a dummy variable set to one if director bonus is larger than profit minus dividend
- Firms with professionals are less likely to make such payment

ratio_lawyer	-0.0065 [0.0041]				
ratio_accountant		-0.008 [0.0037]**			
ratio_tax			-0.0032 [0.0043]		
ratio_professional				-0.0061 [0.0023]***	
ratio_lawdegree					-0.003 [0.0017]*
ratio_houmu					-0.01 [0.0135]

The effect of professionals on stock return volatility

- Dependent variable: volatility of stock return for three years
- The volatility of firms with professionals are larger

ratio_lawyer	0.003				
	[0.0024]				
ratio_accountant	0.0036				
	[0.0025]				
ratio_tax		0.0062			
		[0.0048]			
ratio_professional			0.0041		
			[0.0019]**		
ratio_lawdegree				0.0023	
				[0.0010]**	
ratio_houmu					0.0101
					[0.0054]*

Impact of professionals on corporate performance



- ▣ We also test the effect of professionals on Tobin's Q and ROA

The effect of professionals on Tobin's Q



- Dependent variable: Tobin's Q, calculated by dividing firm value plus liability by total asset
- Firms with accountants (but not lawyers) are more likely to achieve higher Tobin's Q

ratio_lawyer	0.003			
	[0.0019]			
ratio_accountant	0.0065			
	[0.0020]***			
ratio_tax		-0.0069		
		[0.0018]***		
ratio_professional			0.0017	
			[0.0012]	
ratio_lawdegree				0.0007
				[0.0007]
ratio_houmu				0.0081
				[0.0042]*

The effect of professionals on ROA

- Dependent variable: ROA
- Firms with professionals are more likely to achieve higher ROA

ratio_lawyer	0.0242				
	[0.0166]				
ratio_accountant	0.0432				
	[0.0188]**				
ratio_tax		-0.0065			
		[0.0238]			
ratio_professional		0.0235			
		[0.0125]*			
ratio_lawdegree			-0.0182		
			[0.0062]***		
ratio_houmu				-0.0436	
				[0.0385]	

Additional analyses: differential impact of executive and non-executive directors



- Professionals are more heavily represented as non-executive directors
 - 0.07% of executives and 4.31% of non-executives lawyers
 - 0.023% of executives and 2.73% of non-executives accountant
- We examine the effect of each category (executive vs non-executive professionals) on firms' practices and performance, and find that the effect of executive professionals are stronger
 - Why?

Conclusion and further research



- Surprisingly pronounced increase in the ratio of professionals on company boards during the 2004-2015 period

- Professionals are more likely to sit on boards of companies with certain characteristics
 - What other characteristics can we explore?

- Professionals have a beneficial impact on corporate practices and performance
 - Professionals appear to add to corporate value creation by acting as cops, counsel, and entrepreneurs
 - What other indicators can we investigate?