# Equities

## Hiring Cheerleaders: Board Appointments of "Independent" Directors

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What makes a good monitor? Embodied in some regulatory requirements is the notion that independent directors provide a particular type of objective, shareholder-minded oversight. At the same time, little is known about the characteristics of independent directors, or the factors that influence the selection process of these directors.

In this paper we exploit a unique, hand-collected database of independent directors to test the hypothesis that boards appoint directors who, while technically independent according to regulatory definitions, nonetheless may be overly sympathetic to management. To do so, we investigate a subset of independent directors — analysts who covered the company — for whom we have detailed, micro-level data on their views regarding the firm prior to being appointed to the board.

We use these data to compare the roles of optimism versus skill in the board-appointment process. Focusing on ex-ante, observable characteristics of the independent directors themselves allows us to directly evaluate the objectivity and potential efficacy of independent directors based solely on their actual opinions about the firm in question.

We find that board-appointed analysts issue significantly more positive recommendations on companies that subsequently appoint them to the board; both relative to the other stocks they cover, and relative to other analysts covering these same stocks.

Additionally, board-appointed analysts demonstrate inferiority overall, both for earnings forecasts and for stock recommendations, not only for the companies that later invite them to join their boards but across the entire portfolio of stocks they cover.