

CRANFIELD UNIVERSITY

HARSH KHEDAR

Director Prestige, Firm Performance, Value, and Risk

CRANFIELD SCHOOL OF MANAGEMENT

PhD Finance

PhD

Academic Year: 2018 - 2022

Supervisor: Professor Sunil Poshakwale

Associate Supervisor: Dr Vineet Agarwal

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ABSTRACT

This thesis investigates the impact of director prestige on firm performance, value, and risk. The first essay, entitled, “Are prestigious directors mere attractive ornaments on the corporate Christmas tree?”, examines the impact of appointments of prestigious directors on both short- and long-term firm performance. Using the UK’s unique institutional setting of Queen’s honours to measure director prestige, I find that the market reacts positively to the appointment announcements of Prestigious Award-Winning Directors (PAWDs). Further, I show that firms appointing PAWDs show a significant improvement in performance than firms appointing Non-Award-Winning Directors (NAWDs). However, it is the first appointment of a PAWD to firms that are driving the significance implying that there is no incremental value in appointing more than one PAWD to the board. I attribute these findings to the monitoring, legitimacy, and preferential access to resources roles of prestigious directors. My results are robust to several checks controlling for endogeneity arising through omitted variable bias and self-selection bias.

In the second essay, entitled, “Prestigious Directors, Firm Acquisitions, Financial Policies and Risk”, I investigate the impact of prestigious directors on the firm’s acquisition behaviour, financial policies such as cash holdings and net leverage and its risk and valuation. I find that firms undertake less acquisitions, especially, diversifying acquisitions, after appointing PAWDs. Moreover, they increase their cash holdings after appointing PAWDs, and hence, their net leverage decreases as firms need not borrow externally due to excess cash. Finally, I find that the firm risk declines and the value increases after the appointment of prestigious directors. I consider these findings to diligent monitoring performed by prestigious directors that reduce managerial private benefits.

Overall, my findings are consistent with both the Agency Theory and the Resource Dependence Theory that suggest that prestige not only acts as an incentive to effectively monitor management but also signals higher human and social capital.

Keywords:

Director prestige, Independent directors, Queen's honours, System of awards,
Entropy Balancing Method

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TABLE OF CONTENTS

ABSTRACT.....	i
ACKNOWLEDGEMENTS.....	iii
LIST OF FIGURES.....	vii
LIST OF TABLES	viii
LIST OF EQUATIONS	ix
LIST OF ABBREVIATIONS	x
Introduction	12
1.1 Contributions.....	16
1.2 Thesis structure	17
Chapter 2 Are Prestigious Directors Mere Attractive Ornaments on the Corporate Christmas Tree?	20
2.1 Introduction	21
2.2 Literature review and hypotheses development.....	25
2.2.1 Awards as a signal of prestige	25
2.2.2 Queen’s Honours and Director Prestige.....	26
2.2.3 Firms’ motives for hiring prestigious directors	27
2.2.4 Prestige and financial performance	28
2.3 Data and method	29
2.3.1 Data sources	29
2.3.2 Independent variable: prestigious directors.....	30
2.3.3 Dependent variable: abnormal returns	32
2.3.4 Control variables	33
2.3.5 Board characteristics.....	34
2.3.6 Director characteristics.....	34
2.4 Empirical analysis	35
2.4.1 Firm, board, and PAWD characteristics	35
2.4.2 Market reaction to the appointments of PAWDs.....	37
2.4.3 Difference in market reactions to PAWD and NAWD appointments.....	38
2.4.4 Does the market reward monitoring and resource provision contributions of PAWDs?	42
2.4.5 PAWD appointments and long-term performance	45
2.5 Conclusion	49
2.6 References	51
Appendix A2	72
Chapter 3 Prestigious Directors, Firm Acquisitions, Financial Policies and Risk	78
3.1 Introduction	79
3.2 Literature review and hypotheses development.....	84

3.2.1 Firm Acquisition Behaviour.....	84
3.2.2 Firm's Cash Holdings and Net Leverage.....	86
3.2.3 Firm Risk and Value	92
3.3 Data and method	93
3.3.1 Independent variable: Prestigious directors	93
3.3.2 Dependent variables	94
3.3.3 Control variables	95
3.3.4 Empirical Framework.....	96
3.4 Empirical Results and Discussion.....	97
3.4.1 Summary statistics	97
3.4.2 Firm acquisition behaviour	98
3.4.3 Cash/Assets and Net Leverage.....	99
3.4.4 Stock Volatility and Firm Value.....	101
3.4.5 Do PAWDs get rewarded for effective monitoring?	102
3.4.6 Robustness checks	103
3.5 Conclusion	105
3.6 References	107
Appendix A3	107
Conclusion.....	130
4.1 Limitations and Future Research	132
References	134

LIST OF FIGURES

Figure 3-1 DID Estimation Window 115

LIST OF TABLES

Table 1-1 Summary of thesis structure.....	19
Table 2-1 Key roles performed by different categories of PAWDs	59
Table 2-2 Distribution of PAWD appointments by announcement year	60
Table 2-3 Firm, board, and director characteristics of firms appointing PAWDs	61
Table 2-4 Market reaction to appointments of PAWDs.....	62
Table 2-5 Difference in appointment announcement returns between PAWDs and NAWDs.....	63
Table 2-6 Multivariate analysis of CAARs	64
Table 2-7 Difference in market reaction to the value created by PAWDs based on firm, board, and director characteristics.....	66
Table 2-8 Difference in market reaction to the value created by PAWD sub-groups.....	67
Table 2-9 Multivariate analysis of change in operating performance (ROA)	67
Table 2-10 Endogeneity	70
Table 3-1 Summary Statistics.....	116
Table 3-2 Director Prestige and Acquisitions.....	117
Table 3-3 Director prestige and corporate financial policies.....	119
Table 3-4 Director prestige and firm risk and value	121
Table 3-5 Director prestige and their remuneration	123
Table 3-6 Covariate balance of treated and control sample	125
Table 3-7 Comparison of outcome variables between treated and control sample for the year immediately prior to the treatment.....	127

LIST OF EQUATIONS

(2-1)..... 32

(2-2)..... 32

(2-3)..... 33

(2-4)..... 41

(2-5)..... 46

(2-6)..... 46

(3-1)..... 96

(3-2)..... 103

LIST OF ABBREVIATIONS

2SLS	Two-Stage Least Squares
BHAR	Buy and Hold Abnormal Returns
BJM	British Journal of Management
BTM	Book-to-Market
CAAR	Cumulative Average Abnormal Returns
CAPM	Capital Asset Pricing Model
CAR	Cumulative Abnormal Returns
CBE	Commander of the Order of the British Empire
CEO	Chief Executive Officer
DID	Difference-in-Differences
EBIT	Earnings Before Interest and Taxes
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortisation
FTSE	Financial Times Stock Exchange
ICB	Industry Classification Benchmark
IFABS	International Finance and Banking Society
IMR	Inverse Mills Ratio
IPO	Initial Public Offering
IV	Instrument Variable
M&A	Mergers and Acquisitions
MP	Member of Parliament
NAWDs	Non-Award-Winning Directors
NPV	Net Present Value
NED	Non-Executive Director
OLS	Ordinary Least Squares
PAWDs	Prestigious Award-Winning Directors
PM	Prime Minister
PSM	Propensity Score Matching
RDT	Resource Dependence Theory

R&R	Revise and Resubmit
R&D	Research and Development
ROA	Return on Assets
SCS	Senior Civil Service
SIC	Standard Industrial Classification
SG&A	Selling, General and Administrative Expenses
UK	United Kingdom
USA	United States of America

Introduction

Corporate governance has received considerable interest by academics, investors and regulators in the past two decades. Large corporate scandals such as Enron and WorldCom in the USA, Satyam in India, etc. as well as the 2008 financial crisis further highlighted the importance of understanding the role of corporate governance. Shleifer and Vishny (1997, p. 737) define corporate governance as the “ways in which suppliers of finance to corporations assure themselves of getting a return on their investment”. Their definition is primarily rooted in the Agency Theory formulated by Jensen and Meckling, (1976). According to the Agency Theory, there is a mismatch between the interests of managers and shareholders as managers are less than 100% of the residual claimants. Hence, managers might take decisions that increases their own utility while potentially decreasing shareholder value.^{1,2} Corporate governance measures are needed to minimise agency costs arising from these conflicts.

These measures can be classified into two broad categories: internal and external corporate governance. According to Gillan (2006), internal governance measures include board of directors, managerial incentives, internal control systems, capital structure, and bylaw and charter provisions. Laws and regulations, market measures, providers of capital market information such as analysts, auditing from external parties, and media constitute external governance measures. The scope of this thesis is limited to board of directors as providers of internal corporate governance.

Past research views directors “as the lynchpin of corporate governance” (Gillan, 2006, p. 385). A director’s job is not just limited to monitoring the management but also entails providing advice and counsel and contributing to the strategic direction of the firm. This advice and counsel role of directors emanates from

¹ Suppliers of finance can be categorised into two broad categories: equity holders and debtholders. In this thesis, my sole focus is on the agency costs emanating from the conflict between equity holders and managers. Another source of agency cost is the mismatch between shareholders and debtholders.

² In these essays, I use the terms equity holders, shareholders, and investors interchangeably.

the Resource Dependence Theory (RDT) (Pfeffer and Salancik, 1978). The RDT, focusing on the resource providing role of directors, argues that they have four important functions: (1) provide legitimacy; (2) act as information channels between the firm and external organisation; (3) offer advice and counsel; and (4) provide preferential access to resources. Due to such importance of the board, extensive research has focused on their impact on firm value.

Traditionally, researchers have focused on the effect of board characteristics such as board size (e.g., Raheja, 2005; Yermack, 1996), independence (e.g., Daily and Dalton, 1992; Harris and Raviv, 2008; Rosenstein and Wyatt, 1990), and CEO duality (e.g., Goyal and Park, 2002). Further, previous literature focused on the changes in board structure over time (e.g., Boone et al., 2007; Coles, Daniel and Naveen, 2008) and subcommittees (e.g., Anderson, Deli and Gillan, 2005; Klein, 1998).

However, there has been a recent push to move away from investigating general board characteristics and examine the impact of different types of directors such as independent directors (Fahlenbrach, Low and Stulz, 2017; Nguyen and Nielsen, 2010), directors with financial expertise and commercial bankers on the board (e.g., Agrawal and Chadha, 2005; Booth and Deli, 1999), politically connected directors (e.g., Schoenherr, 2019), busy directors (Ferris, Jagannathan and Pritchard, 2003; Fich and Shivdasani, 2012; Field, Lowry and Mkrtchyan, 2013), CEOs as outside directors (Fahlenbrach, Low and Stulz, 2010), academic directors (Chen, Garel and Tourani-Rad, 2019; White et al., 2014), female directors (Adams and Ferreira, 2009), and directors with bankruptcy experience (Gopalan, Gormley and Kalda, 2021), etc.

The rationale behind this shift is that individuals constitute boards and their upbringing, educational background as well as their previous work experience shape their individual traits. These traits, in turn, influence their decision-making which manifests into board deliberations and affect the firm's policy choices. In other words, not all directors are the same and their human (e.g., education and experience) and social capital (e.g., connections and network) can have an impact on the decisions they take for the firm.

Prestige is one way of distinguishing between directors who possess high human and social capital and those who do not. According to D'Aveni (1990), a director with high prestige will have higher status and aggregated human and social capital. The extant literature uses either the RDT or the Agency Theory to hypothesise the impact of prestigious directors on firm attributes. Although both theories postulate that director prestige benefits firms, the rationale used in each differs. On one hand, RDT contends that prestige acts as an antecedent to providing resources (Hillman and Dalziel, 2003) and directors with high prestige will be better able to provide legitimacy, preferential access to resources, advice and counsel, and act as information channels between firm and external organisations. On the other hand, Agency Theory postulates that prestige will act as an incentive for directors to diligently monitor the management (Fama and Jensen, 1983). It posits that directors, acting in their self-interest, will provide effective monitoring as not doing so will harm their reputation and prospects of gaining additional directorships.

Although theoretical arguments establishing a link between prestigious directors and firm performance were set forth decades ago, empirical literature examining this relationship is less developed. For instance, Certo (2003) and Pollock et al. (2010) find that young firms gain organisational legitimacy by appointing prestigious directors. Gogolin, Cummins and Dowling (2018) find that appointments of reputable directors lead to a significantly positive market reaction and Oehmichen et al. (2017) show that appointing prestigious directors improves firm performance.³ However, there are still significant gaps in the literature. First, one possible reason for the lack of studies on the impact of prestigious directors could be because it is very hard to measure director prestige. Second, although past research finds that prestigious directors are beneficial to firms, it still has not identified the channels through which they improve firm performance i.e., monitoring or resource provisioning. Finally,

³ Although there are several other studies exploring director reputation (e.g., Ferris, Jagannathan and Pritchard, 2003; Fich and Shivdasani, 2007; Kaplan and Reishus, 1990), it is not their main explanatory variable. These studies examine the impact of poor performance, financial fraud, and dividend cuts on directors' reputation respectively.

previous literature fails to identify the changes in corporate financial policies that prestigious directors enact.

In this thesis, I present two empirical papers answering the following research questions:

- In Chapter 2, we answer the following questions: (1) How do you measure director prestige? (2) What is the impact of prestigious directors on firms' short- and long-term performance? and, (3) What are the channels through which they impact firm performance? I introduce a new measure of director prestige by using the UK's unique institutional setting: The Queen's honours. I find that the appointment announcement of Prestigious Award-winning Directors (PAWDs) leads to a significant market reaction. Further, firms appointing PAWDs lead to a 2.5% larger and significant change in their long-term firm performance. I find that it is the first appointment of PAWDs that are driving the significant short- and long-term performance implying that there is no incremental benefit in appointing multiple PAWDs. Further, I assign these findings to the monitoring, legitimacy, and preferential access to resources functions of PAWDs.
- In Chapter 3, I explore the monitoring role of PAWDs and answer following research questions: (1) Do prestigious directors, relative to others, lead to a greater reduction in managerial rent-seeking behaviour? (2) Does this effective monitoring lead to reduction in firm risk? (3) Does reduction in firm risk translate into an increase in firm valuation? and, (4) Are prestigious directors rewarded for better monitoring? To investigate these questions, I examine the implications of prestigious directors on firm acquisition behaviour, financial policies such as cash holdings and net leverage and on firm risk and valuation. I find that firms undertake less acquisitions, especially diversifying acquisitions, after appointing PAWDs. Further, firms appointing PAWDs increase their cash holdings and decrease their net leverage as they do not need to raise external debt to fund future growth opportunities. Further, I find that firm risk declines and their value increases after PAWD appointments. Finally, I find that PAWDs are indeed rewarded

for greater monitoring as both their salary and compensation are higher than that of NAWDs.

1.1 Contributions

This thesis makes several important contributions. In Chapter 1, first, I contribute by extending the two strands of existing literature on the measure of reputation; one that primarily uses number of other directorships (e.g. Shivdasani, 1993) and the other which employs CEO awards (e.g. Malmendier and Tate, 2009) by introducing “The Queen’s honours” as a new and unambiguous proxy of director prestige.

Second, I provide new evidence of the channels through which prestigious directors contribute to firm performance. Oehmichen et al. (2017) and Gogolin, Cummins, and Dowling (2018) show that prestigious directors are beneficial to firms, however, there is no study which investigates the channels through which prestigious directors contribute to firm performance.

Finally, I contribute to the literature by examining the both the monitoring and resource provisioning contributions of PAWDs simultaneously. In practice, directors are expected to discharge both monitoring and resource providing roles simultaneously and hence, looking at their contribution in a holistic way is insightful in overcoming the current myopia in the literature.

In Chapter 2, I further make three important contributions. First, I contribute to the literature on implications of corporate governance on firm acquisitiveness behaviour. Past research provides evidence that the number of diversifying acquisitions reduce with greater monitoring by directors (Denis, Denis and Sarin, 1997; Goranova et al., 2017; Schommer, Richter and Karna, 2019). We extend this literature by showing that prestige is also an important distinguishing director characteristic and those with prestige are better monitors. To the best of my knowledge, this is the first study to provide empirical evidence of the role of prestigious directors in reducing firm acquisition activity.

Second, I extend the literature on determinants of cash holding. Indeed, past research argues that agency costs go down with better corporate governance

and equity holders feel “safe and comfortable” in keeping cash with managers in firms with high levels of corporate governance (e.g., Chou and Feng, 2019; Dittmar, Mahrt-Smith and Servaes, 2003; Harford, 1999; Kalcheva and Lins, 2007; Pinkowitz, Stulz and Williamson, 2006; Tong, 2011). However, prior literature primarily examines the impact of external governance such as weak/strong shareholder environment on corporate cash holdings with notable exceptions of Tong (2011) and Chou and Feng (2019). I contribute to this literature by providing evidence that internal governance is also an effective way to reduce agency costs and measures such as appointing prestigious directors positively impact firms’ cash holdings.

Finally, I contribute to the literature on corporate boards. Past literature highlights the importance of going beyond generic board characteristics (board size or fraction of independent directors) and focus on director’s individual traits that shape their opinions and risk preferences (e.g., Adams and Ferreira, 2009; Chen, Garel and Tourani-Rad, 2019; Fahlenbrach, Low and Stulz, 2010; Gopalan, Gormley and Kalda, 2021). Similarly, Oehmichen et al. (2017) show that prestigious directors improve firm performance, however, the channel(s) through which they improve the performance are yet to be empirically tested.⁴ We extend this literature by showing that firms benefit by appointing prestigious directors as they provide effective monitoring, thereby, reducing risk and increasing firm value. To the best of my knowledge, this is the first study to offer evidence of the impact of prestigious directors on firm risk and value.

1.2 Thesis structure

This thesis is organised in paper format with two distinct yet related empirical papers. Each paper contains separate sections viz. abstract, introduction, literature review and hypotheses development, data and method, results, and conclusion. Chapter 2 contains the first empirical chapter examining the impact

⁴ In Chapter 2, we provide some limited results. They conduct a univariate analysis and find that appointment of prestigious directors to firms with high volatility generates a greater market reaction than their appointments to firms with low volatility.

of prestigious directors on short- and long-term firm performance. Chapter 3 comprises the second empirical paper of the effect of prestigious directors on the firm's acquisition behaviour, cash holdings, risk, and valuation. Finally, I end this thesis with a common conclusion detailing the implications of my thesis, and limitations and scope for future research. Table 1.1 describes the thesis structure.

Table 1-1 Summary of thesis structure

Chapter	Title	Dissemination	Key Findings
2	Are prestigious directors' mere attractive ornaments on the corporate Christmas tree?	<ul style="list-style-type: none"> Received Revise and Resubmit (R&R) from the British Journal of Management (BJM; ABS 4) Presented by co-author Professor Sunil Poshakwale at the International Finance and Banking Society (IFABS) 2022 	This paper provides evidence that director prestige matters and that prestigious directors significantly improve a firm's short- and long-term performance
3	Prestigious directors, firm acquisitions, financial policies, and risk	<ul style="list-style-type: none"> Presented at the Financial Management Association (FMA) Europe Conference 2023 Presented by co-author Professor Sunil Poshakwale at the Annual Global Finance Conference (GFC) 2023 Upcoming presentation (paper accepted for presentation) at the International Conference in Finance, Banking and Accounting (ICFBA) 2023 	This paper provides evidence that prestigious directors reduce a firm's acquisitions, increases cash holdings, and reduce firm risk
4	Overall Conclusion		

Chapter 2

Are Prestigious Directors Mere Attractive Ornaments on the Corporate Christmas Tree?

Abstract

Using the UK's unique institutional setting of Queen's honours, we examine the influence of director prestige on both short-term and long-term firm performance. We find that the market reacts positively to appointments of Prestigious Award-Winning Directors (PAWDs). Firms appointing PAWDs also show a significant improvement in long-term performance. We attribute these findings to the monitoring and facilitating preferential access to resources and legitimacy roles of PAWDs. Our evidence is consistent with both the Resource Dependence and the Agency Theory which suggest director prestige not only signals higher human and social capital but also incentivises effective monitoring of managerial decisions.

Keywords:

Director reputation, Independent directors, Queen's honours awards, Propensity Score Matching, Event study

2.1 Introduction

Do all directors have same efficacy in discharging their roles on the corporate boards? Their key tasks are to monitor the management (Jensen and Meckling, 1976), and provide resources such as advice and counsel, legitimacy, and preferential access to resources (Pfeffer and Salancik, 1978). Hillman and Dalziel (2003) argue that the ability of directors in performing their duties depends on their human and social capital. Prestige is one type of director capital which may influence their ability in performing monitoring and resource provisioning roles (Oehmichen et al. 2017). In this paper, we propose a new measure of director prestige and empirically examine its influence on firms' short and long run performance. Additionally, we offer new evidence of different channels through which prestige affects firm performance.

Most research studies consider number of additional directorships as a proxy of director prestige (e.g. Ferris, Jagannathan and Pritchard, 2003; Fich and Shivdasani, 2007; Kaplan and Reishus, 1990; Shivdasani, 1993). However, investors, regulators and management dislike 'overboarding' arising from multiple directorships (Papadopoulos, 2019). Further, this measure of prestige suffers from reverse causality as directors may be getting multiple directorships because they are prestigious and not vice versa.

Many studies use CEO awards as a proxy of prestige (e.g. Graffin et al., 2008; Li et al., 2022; Malmendier and Tate, 2009; Shi, Zhang and Hoskisson, 2017). For example, Gogolin, Cummins and Dowling, (2018) examines the role of director reputation using a sample of CEO award winners as outside director appointments. However, very few firms appoint CEO award winners as prestigious directors and thus this too is an inadequate proxy since it excludes a large number of firms who either do not or are not able to appoint such directors. Further, Oehmichen et al. (2017) use a proxy which treats directors as prestigious if they have worked for a large value firm(s) in the past five years. However, whilst this proxy may have been convenient to use in a cross-country study, it is an imperfect measure of director prestige. We argue that director

prestige should be based on their personal achievement and not where they have worked in the past.

Hence, we introduce a new measure of director prestige to the literature by using the UK's unique institutional setting: the Queen's honours. These awards are unlike the other business awards used in the literature (e.g., Malmendier and Tate, 2009), the Queens honours are conferred by the sovereign after a rigorous process involving several independent experts and government stakeholders. Hence, these are an appropriate measure of director prestige. Additionally, these awards are both credible and prestigious as these are given for life-long exemplary services and are therefore highly selective and inimitable. Further, these awards are highly visible since the recipient uses the title of the honour as either a suffix or a prefix to their name. Our proxy of prestige is consistent with Spence (1973) who suggests that a credible signal (Queen's honours in our case) must be costly to imitate and observable.

Another gap in the existing research is that though previous research has focused on director prestige (Oehmichen et al. 2017; Gogolin, Cummins and Dowling, 2018), they do not offer detailed insights of the channels through which prestigious directors benefit firm performance. We hand-collect a unique sample of 375 award-winning director appointments between 2003 and 2020⁵ and classify our sample of Prestigious Award-Winning Directors (PAWDs) into four subgroups based on the award they won for their business expertise, resources and wider contributions to the society⁶ thereby capturing the channels through which they contribute to the board. The first category is *politically connected* PAWDs who have had past or present experience in the government (Members of either Houses of Parliament, and/or ex-civil servants). These directors facilitate preferential access to resources, in gaining government contracts, and helping in overcoming regulations (Faccio, 2006; Shleifer and Vishny, 1994). The second category of PAWDs is of those who

⁵ Although, the tradition of awarding honours dates back to many centuries, Boardex data of appointment of award-winning directors are available only from 2003.

⁶ We hand-collect data from London Gazette to confirm the reason(s) for the award(s).

receive honours for *voluntary* services to charity, public service, etc. Such PAWDs are community influencers and bolster the public image of the firm (Hillman, Cannella and Paetzold, 2000). Third category is of directors who win honours for their contributions to *business* and industry. These are business experts who act as important information channel with outside firms and other organizations as well as provide legitimacy to the firm (Hillman, Cannella and Paetzold, 2000). The fourth and final category of PAWDs is of directors who receive honours for their *specialist* knowledge and/or skills in a particular area (e.g., services to medical science, engineering, technology, etc). Following Hillman, Cannella and Paetzold (2000), we consider these directors as *support specialists* who provide key advice and counsel to the firm.

Finally, most empirical research examining the impact of director attributes on firm performance has either used the Resource Dependence Theory (RDT) (e.g. Certo, 2003) or the Agency Theory (e.g. Jiang, Wan and Zhao, 2016). In practice, directors monitor as well as provide resources (Korn/Ferry, 2017), and, theoretically, both are related to firm performance. Thus, combining the two perspectives is important as both agency and resource dependence theorists have examined one board function at the expense of the other, leading to an incomplete understanding of what boards do and how they affect firm performance (Hillman and Dalziel, 2003). We fulfil this gap by providing a wholistic view of directors' monitoring and resource providing roles by integrating both the Agency Theory and the RDT.

We analyse the impact of the appointment of PAWDs on both short- and long-term financial performance of firms in the FTSE All Share Index. First, using an event study, we find significant positive market reaction to the appointments of PAWDs. Further, the market reacts positively only to the first appointment of the PAWD which suggests there is no incremental value in appointing another PAWD. We check the robustness of our initial findings, by using the Propensity Score Matching (PSM) and Entropy Balancing methods. Our findings demonstrate that the difference in market reaction to the appointments of PAWDs and NAWDs is positive and statistically significant confirming that

investors believe prestigious directors add value to the firm. Additionally, we match appointments of PAWDs to NAWDs of the same sub-group (for e.g., politically connected PAWDs vs politically connected NAWDs) and confirm that the significant market reaction is because of the award and not because of their connections or expertise. Further, we investigate differences in the market response to PAWD appointments based on director, board, and firm characteristics. We find that the positive market reaction is associated with the monitoring, preferential access to resources, and legitimacy contributions of PAWDs.

Second, we investigate whether PAWDs positively contribute to the long-term performance by analysing the changes in the operating performance before and after appointments. We find that firms appointing PAWDs exhibit a 2.5% improvement in Return on Assets (ROA) as compared to those appointing NAWDs.

We make three novel contributions to the current literature. First, we extend the two strands of the existing literature on the measure of director prestige; one that primarily uses number of other directorships (e.g. Shivdasani, 1993) and the other which considers CEO awards as a measure of reputation (e.g. Malmendier and Tate, 2009) by introducing “The Queen’s Honours” as a new and unambiguous proxy of director prestige.

Second, we provide new evidence of the channels through which prestigious directors contribute to both short- and long-term financial performance. Current literature highlights the importance of going beyond the board characteristics, by considering different types of directors (Chen, Garel and Tourani-Rad, 2019; Fahlenbrach, Low and Stulz, 2010; White et al., 2014). However, there is no study which has comprehensively examined the channels through which prestigious directors contribute to firm performance.

Finally, as discussed in Louca, Petrou, and Procopiou (2020), the board of directors are expected to discharge both monitoring and resource providing roles and hence, looking at their contribution in a holistic way is both insightful and valuable in overcoming the current myopia in the literature. In this paper,

we examine the contributions of PAWDs by considering both the resource provisioning and monitoring functions through their specific skills and expertise.

Rest of the paper is organised as follows. Section 2 provides a review of the current literature and develops our research hypotheses. Section 3 describes the data. Section 4 presents and discusses results and Section 5 concludes the paper.

2.2 Literature review and hypotheses development

The RDT proposed by Pfeffer and Salancik (1978) explains that board of directors provide four important benefits to firms: (1) offer legitimacy; (2) act as information channel between the firm and external organizations; (3) provide advice and counsel; and (4) facilitate preferential access to resources. On the contrary, Fama and Jensen (1983) argue that independent directors are motivated to act as diligent monitors in their self-interests of maintaining and enhancing their prestige and furthering their careers. Combining both the RDT and the Agency theory, Hillman and Dalziel (2003) contend that director's human and social capital are the antecedents to providing these benefits. Since winning awards signals enhanced human and social capital, prestigious directors will be pre-disposed in providing required resources and effective monitoring.

2.2.1 Awards as a signal of prestige

Neckermann and Frey (2013) postulate that awards signal ability of individuals (or groups) since award-winners are deemed more competent than the non-winners. Additionally, awards do not just serve as a response to an individual's (or organization's) retrospective behaviour but are an indication about their prospective behaviour (Gallus and Frey, 2016). Further, stakeholders prefer organizations to be publicly assessed under uncertain conditions (Rao, 1994) even when the evaluation criteria of the appraisal bodies are not comprehensive (Fombrun, 1996). Similarly, Wade et al. (2006) argue that during uncertain environment, certification contests provide a mechanism through which the quality of organizations can be established. Hence, awards will be considered

as a signal of high quality by the market. We use Queen's Honours for measuring director prestige.

2.2.2 Queen's Honours and Director Prestige

Awards can take various forms; international, national, and those internal to the organization. Although Hansen and Weisbrod (1973) provide a building block of 'general theory of awards', research on their impact in the organizational context has only recently gained impetus (e.g. Frey and Neckermann, 2009; Gallus and Frey, 2016; Neckermann and Frey, 2013). Frey and Gallus (2017) argue that awards are used in various organizational settings and have important implications for reputation.

We use Queen's honours for determining director prestige.⁷ The process for selecting the recipients of these awards is very rigorous which makes them both credible and legitimate. Any individual or organization can nominate anyone for an award. Citizens of the *Commonwealth realm*⁸ can be nominated for an honour and other foreign nationals can be nominated for honorary awards. Public nominations put forward by Government departments and private nominations made by individuals or representatives of organizations are sent to the Cabinet Office. Nominations are thereafter divided into ten subject areas and are appraised by honours sub-committees.⁹ Each sub-committee, comprising majority independent members, is chaired by an independent expert. Other members of the committee include the permanent secretaries of the departments under whose expertise the committee specialisation falls. In addition, for each meeting, a representative from the Prime Minister's (PM's) office is invited. The independent experts are appointed through public appointments process by the Cabinet Office.

⁷ These are awarded twice a year; every new year and on the Queen's birthday.

⁸ Commonwealth Realm consists of the UK and 15 other countries that recognise Queen Elizabeth II as their Head of State.

⁹ The ten subject areas are – arts and media, community and voluntary service, economy, education, health, parliamentary and political service, public service, science and technology, sport, and state.

Assessments made by individual sub-committees are then sent to a main selection committee which comprises the chair of each honours sub-committee, the Chief of Defence Staff and the Permanent Under Secretary of the Foreign and Commonwealth Office. The committee is chaired by the head of the civil services and produces the final list that is sent to the Queen for approval by the PM. It is important to note that the selection committee works independently of the Government lending credibility to these awards.

2.2.3 Firms' motives for hiring prestigious directors

Previous research offers several reasons which explain why firms hire reputed directors. First, prestigious directors signal legitimacy and increase firms' reputation. Bazerman and Schoorman (1983) argue that the reputation of an organization is affected by the quality of personnel serving on the board. Deutsch and Ross (2003) opine that young firms enhance their validity by appointing reputable directors. Certo (2003) finds that board prestige improves IPO stock performance since it signals organizational legitimacy to potential investors.

Second, prestigious directors provide preferential access to resources and act as a key information channel between the firm and external organizations. D'Aveni (1990) argues that managerial prestige derives from previous employment in other corporations, external board memberships and political and military associations which improves their social and/or relational capital. Firms can, therefore, utilise prestigious directors to act as a channel with external organizations who are more likely to deal with people with prior relationships. Furthermore, firms can leverage directors' prestige in soliciting favours, preferential treatment, and access to resources otherwise not available without such connections and networks. For instance, past research indicates politically-connected (a key measure to gain prestige) directors enhance firm value and performance (Brown and Huang, 2020). They also help the firm in gaining key government contracts (Schoenherr, 2019).

Third, prestigious directors provide key advice and counsel to firms as they have high human capital owing to their elite education background and past work experience (D'Aveni, 1990). Firms can utilise this expertise for valuable counsel. For instance, past research shows that the market reacts positively (negatively) to appointments (resignations) of academic directors with high educational background and specialised expertise (Chen, Garel and Tourani-Rad, 2019; White et al., 2014).

Finally, prestigious directors act as diligent monitors of firms' top management since not doing so will lead to a substantial devaluation of their human capital. Therefore, they act in their self-interest of maintaining and enhancing their own prestige in furthering their careers (Fama and Jensen, 1983). Indeed, Kaplan and Reishus (1990) find that while boards retain loyal directors, appointment of new directors is mainly based on their reputation. Further, Jiang et al. (2016; p 658) study the voting behaviour of independent directors in China and find that highly reputed directors dissent more often and this dissention is rewarded "by more outside career opportunities (measured by gains in board seats at other companies) and better reputation protection (measured by avoidance of regulatory sanctions associated with firm wrong-doing)". Furthermore, Mobbs (2013) shows that reputable directors are more likely to become CEOs.¹⁰

2.2.4 Prestige and financial performance

Past research documents both positive and negative effects of prestige on firm performance. On one hand, research shows that winning a prestigious award has a "dark side" associated with it. First, it can potentially induce narcissistic behaviour in the award-winner.¹¹ For example, Malmendier and Tate (2009) show that "superstar" CEOs spend more time writing books and getting external

¹⁰ They measure reputation by the number of outside directorships.

¹¹ This is also true for award winners in other fields. For instance, in academia, Field Medal recipients focus more on unfamiliar topics than writing papers in their own research fields after winning the award (Borjas and Doran, 2015). Similarly, Samuelson (2002) notes that Nobel prize winners "become pontificating windbags, preaching to the world on ethics and futurology, politics and philosophy".

directorships and underperform relative to non-award-winning CEOs as well as their own prior performance. Similarly, Li et al. (2022) find that award-winning CEOs are more likely to commit financial misconduct after winning the award. They attribute their finding to the inflated sense of entitlement which prompts them to break the rules. Second, winning an award also increases their self-worth and hubris. For instance, Malmendier and Tate (2005), in their study on the corporate investment decisions of Forbes 500 CEOs, find that overconfident CEOs view external funds as costly and tend to overinvest internal cash.

On the other hand, Wade et al. (2006) find that the announcement of a CEO winning the *CEO of the Year* award generates positive market return and Gogolin, Cummins and Dowling (2018) show that the market reacts significantly positively to appointments of reputed outside directors. Similarly, Oehmichen et al. (2017) show that having prestigious directors on the board leads to higher firm performance.

RDT suggests that prestige signals higher director capital which helps in provisioning of key resources while the Agency Theory suggests director prestige acts as an incentive for directors to effectively monitor the management. Thus, both the RDT and the Agency Theory imply that, albeit in different ways, director prestige is beneficial to firms' performance. Hence, we hypothesise that:

Hypothesis 1: The market will react positively to the appointment announcements of prestigious directors, and

Hypothesis 2: Appointments of prestigious directors will lead to higher long-term firm performance.

2.3 Data and method

2.3.1 Data sources

Our sample consists of all constituents of the FTSE All-share index from 2003 to 2020. We match these firms on the BoardEx and collect appointment announcement dates of all independent directors. Our full sample consists of

375 PAWDs and 2948 NAWDs appointment announcements. This includes 278 unique PAWDs and 2221 NAWDs covering 819 firms. Although director appointment announcements may coincide with other price sensitive events, we do not check and remove those events because such events would be the same for both samples of PAWDs and NAWDs. Hence, their effect will cancel each other out. The accounting and financial data are collected from the Datastream.

2.3.2 Independent variable: prestigious directors

We manually search for individual director names in the semi-annual lists of Queen's Honours published in the London Gazette to construct our sample of PAWDs. We identify the dates when a director won the award, the reason and the title of the award and the job description of the director at the time of winning the award.¹² The hand collected data enables to capture PAWDs' status at the time of appointment by identifying directors who won award(s) prior to announcement of their appointments and those who received award(s) during their board tenure.

2.3.2.1 Classification of PAWDs

Past research shows that the type of director appointed to the board depends on the resources needed by the firm (Hillman, Cannella and Paetzold, 2000). We, therefore, further classify PAWDs into four categories based on the nature of the award and their likely contributions to the firm¹³:

- (1) Politically connected. If the appointed director(s) has been (or is currently) a Member of Parliament (MP) in the House of Lords and/or the House of Commons, and/or served as a civil servant, they are included in this category. Previous research suggests that politically-connected directors provide important relational resources (Liu, 2020; Tihanyi et al., 2019).

¹² If the director has won multiple awards, then the information is collected for all the awards.

¹³ Their job description at the time of the award is used if the reason for the award is missing.

Therefore, we argue that such directors would provide preferential access to resources.

- (2) Voluntary. Directors who win an award “for services to young people and volunteering, for public service, for charitable services overseas, for services to the Arts, for services to Rugby Football in Scotland¹⁴, for services to Disabled people”, etc. are included in this category. Such directors are considered as community influencers who not only provide non-business perspective but also influence powerful groups in the community.
- (3) Business. This category includes directors who win an award for contribution to business including “for services to business, industry” etc. These directors would provide general business advice and will act as important channels of communications with external organizations.
- (4) Specialised. Directors who win the award for reasons specific to a certain field or industry, for instance, for services to corporate finance and governance, medical science, electronics industry, etc. Such directors possess specialist knowledge and skills and will therefore act as *support specialists* providing key advice and counsel to firms.

Table 2-1 summarises the roles performed by different categories of PAWDs.

<< INSERT TABLE 2-1 HERE >>

Prior studies show that the impact of appointment of independent directors depends on the existing composition of the board. For instance, Fahlenbrach, Low and Stulz (2010) find that there is a positive market reaction when the CEO of another company is appointed as director when there is no existing CEO outside director on the board. Hence, we further divide our sample of PAWDs into two categories:

- First PAWD: if a director is the first PAWD appointed on the board.

¹⁴ For reasons involving sports, we have checked manually if the appointing firm has any sports revenue stream. If they do, then that director is classified as a specialised director.

- Existing PAWD: if there is at least one PAWD on the board at the time of the appointment announcement.

2.3.2.2 PAWD distribution

Table 2-2 reports the distribution of PAWDs. It shows the most common type of PAWD appointed by firms is specialised director, representing nearly 46% of total sample. This is followed by politically connected directors (30%), business directors (17%), and voluntary directors (7.5%).

<< INSERT TABLE 2-2 HERE >>

2.3.3 Dependent variable: abnormal returns

We use Cumulative Average Abnormal Returns (CAARs) over the three-day window [-1,+1] surrounding the appointment announcements of both PAWDs and NAWDs. Past research shows that the three day window is appropriate for measuring abnormal returns as it allows for information leakage prior to the event and slow response on the day after the event (Pfarrer, Pollock and Rindova, 2010).

$$CAR_i = \sum_{t=-1}^{+1} [R_{it} - E(R_{it})] \quad (2-1)$$

$$CAAR = \left(\sum_{i=1}^n CAR_i \right) / n \quad (2-2)$$

Where

CAR_i is the Cumulative Abnormal Return for firm i from $t = -1$ to $t = +1$;

R_{it} is the return for firm i on day t ;

$E(R_{it})$ is the CAPM expected return for firm i on day t ;

CAAR is the Cumulative average abnormal return, and

n is the total number of appointments.

We test for the significance of CAAR over the event window using the test-statistic:

$$t = \frac{CAAR}{\sigma_{CAR} / \sqrt{n}} \quad (2-3)$$

Where

σ_{CAR} is the cross-sectional standard deviation of the CARs, and other variables are as defined previously.

2.3.4 Control variables

We control for firm, board, and director characteristics which could influence the appointment of prestigious directors. We discuss below the rationale for including control variables under each category. Please see Appendix A-1 for variable definitions.

2.3.4.1 Firm characteristics

- Firm size. Fama and French (1995) document a positive relationship between firm size and performance which suggests that firm size is a key determinant of profitability.
- Stock volatility. French, Schwert and Stambaugh (1987) and Pindyck (1983) show that as the forecasted volatility increases, stock prices decline due to increase in required returns. Further, Fu et al. (2017) report that high volatility firms experience a greater loss in firm value.
- Leverage. Existing literature shows a negative relationship between leverage and profitability (e.g. Fama and French, 2002).
- Intangible investments. Past research documents a positive association between investments in intangible assets such as R&D and advertising, and firm value. For instance, Lev and Sougiannis (1996) find a positive relationship between R&D capital and stock returns. Similarly, Chan, Lakonishok and Sougiannis (2001) show that firms with high R&D to equity market value and high advertising intensity earn significantly large excess returns.

- Market-to-book. Extensive research shows that stocks with lower market-to-book ratio outperform those with higher market-to-book ratio (Fama and French, 1995; Jaffe et al., 2020).
- Industry effect. We control for industry effect as firms in particular sector may appoint prestigious directors owing to the nature of their business. For instance, firms whose revenue are highly dependent on government contracts are more likely to appoint politically connected directors (Sun, Hu and Hillman, 2016). We divide firms into 12 industries based on the Industry Classification Benchmark (ICB).

2.3.5 Board characteristics

- CEO Duality. Past literature argues that CEO duality indicates conflict of interest and reduces the board's ability to effectively monitor the management. For instance, Rechner and Dalton (1991) find that firms with independent chairperson significantly outperform firms with CEO duality.
- Board size. RDT posits a positive relationship between board size and firm performance. Pfeffer and Salancik (1978) argue that "The greater the need for effective external linkage, the larger the board should be" (p. 172). Indeed, Dalton et al. (1999), in their meta-analysis, find a positive relationship between the size of the board and firm performance in smaller firms. On the contrary, Yermack (1996) argues that larger boards are slower in decision making and reports a negative relation between board size and firm value.
- Board independence. Previous research has considered greater presence of independent directors as a favourable board characteristic. For example, Daily and Dalton (1992) find that higher proportion of independent directors leads to better firm performance.

2.3.6 Director characteristics

- Director Gender. Adams and Ferreira (2009) find that gender diversity is positively related to firm performance because female directors are better at monitoring than male directors.

- Director busyness. Existing evidence regarding the impact of busy directors is contradictory. Fich and Shivdasani (2012) show that when directors become busy, the firms in which they serve experience negative abnormal returns. An alternative view is that busy directors are excellent advisors. Field et al. (2013) find that busy directors positively contribute to firm value.
- Director education. Anderson et al. (2011) suggest that shareholders greatly value directors' heterogeneous educational backgrounds since it enhances a firm's relational capital. They show that replacing two directors holding undergraduate degrees by two directors possessing postgraduate degrees increases the industry-adjusted Tobin's Q by 7.49%.
- Director age. Similarly, Anderson et al. (2011) argue that different perspectives brought by heterogeneity in directors' age improves boards' decision making and firm performance. Being less risk averse, younger directors provide greater energy and impetus to innovative but risky projects. On the contrary, older directors provide greater stability and wisdom.

2.4 Empirical analysis

2.4.1 Firm, board, and PAWD characteristics

Table 2-3 presents the summary statistics of the firm, board, and director characteristics at the time of PAWD appointment announcements. Column (1) of Panel A reports that the firms appointing PAWDs have an average market-to-book value of 2.98, 6% ROA, 0.84 CAPM beta, 39% leverage, and 32% annual stock returns volatility. We find that firms appointing PAWDs are larger, have

higher beta, and lower intangible investments compared to those appointing NAWDs. They are similar in terms of other characteristics.¹⁵

Column (1) of Panel B shows that on average, boards of firms appointing PAWDs comprise approximately 9 members (significantly higher than firms appointing NAWDs) with around 59% of them being independent directors. Further, 12% of firms appointing PAWDs exhibit CEO duality. Panel C reports that the average PAWD is 59 years old, male and has a postgraduate degree. It also shows that the PAWDs are older, better educated, and more likely to be female as compared to NAWDs. In other words, there are significantly fewer PAWDs who are male compared to NAWDs.

In columns (2), (3), (4) and (5), we present the sample means of each of the PAWD categories. Panel A shows that there is little difference in firm characteristics appointing different categories of PAWDs, except in the case of politically connected PAWDs where firms have lower beta and those appointing business PAWDs show significantly higher market-to-book ratio.¹⁶

However, Panels B and C show there are significant differences in board and director characteristics. Boards of firms appointing specialised PAWDs are significantly larger (mean of 9.65) whereas those appointing voluntary PAWDs are smaller (8.36). Similarly, the boards of firms appointing politically connected PAWDs are significantly less independent (57% independent directors) and exhibit CEO duality. Moreover, politically connected PAWDs are more likely to be male (74.11%) and business PAWDs are more likely to be female (52.38%).¹⁷

¹⁵ For ease of presentation, we do not present the mean values of firms appointing NAWDs. However, in column (1) we show if the sample means of PAWD firms are significantly greater (+) or less (-) than the NAWD firms at 10% significance level or more.

¹⁶ One potential reason for the significantly higher market-to-book ratio for Business PAWDs could be that the majority of them are women. Past research shows that firms with gender diverse boards have higher valuation (Adams and Ferreira, 2009).

¹⁷ One possible reason could be that there are more males serving in both parliament and civil services. As of 11th September 2021, women constituted 28.26% and 34.15% of the House of Lords and the House of Commons respectively (UK Parliament, 2021). In the British Senior Civil

<< INSERT TABLE 2-3 HERE >>

2.4.2 Market reaction to the appointments of PAWDs

We analyse short-term market reaction to the appointment announcements of PAWDs by conducting an event study. As discussed earlier, we expect the market to react positively to appointments of PAWDs since prestige signals higher human and social capital (D'Aveni, 1990) and incentivises them to carefully monitor the management (Fama and Jensen, 1983). Further, we also investigate the market reaction to the appointments of different categories of PAWDs.

Results in Column (1) of Panel A in Table 2-4 confirm our expectations. The CAAR (0.5%) is significant at 1% level.¹⁸ Results in Column (5) show that the market reacts positively to the appointments of specialised PAWDs (CAAR: 0.8%; significant at the 1% level). However, as seen from Columns (2) to (4), the reaction to appointment of PAWDs in other categories is statistically insignificant. This suggests that the significant market reaction to the appointments of PAWDs is driven by the specialised PAWDs.

Panel B presents CAARs when there is no existing PAWD on the board. Column (1) shows that the market reaction to the appointment of first PAWDs is positive and significant at 1%. Further, Columns (2) and (5) show that the market reacts significantly positively to the appointments of politically connected and specialised PAWDs. On the contrary, appointments of voluntary and business PAWDs do not generate a significant market reaction.¹⁹ Panel C

Service (SCS), as of March 2020, 46.7% were women rising from 35.2% in March 2010 (Cabinet Office, 2021).

¹⁸ We repeat our analysis using Buy and Hold Abnormal Returns (BHARs). Our results are qualitatively similar and are reported in Appendix A2-3. Further, I also repeat our analysis using the market-adjusted model instead of CAPM. Results are reported in Appendix A2-4 and are qualitatively similar.

¹⁹ This may be due to the small sample size of such appointments of Voluntary (n = 10) and Business (n = 27) PAWDs.

shows there is a lack of market reaction to appointment of PAWDs when there is at least one PAWD already on the board.²⁰

<< INSERT TABLE 2-4 HERE >>

Overall, the above findings indicate that there is a strong positive market reaction to the appointments of PAWDs implying that the market values the monitoring and/or resources providing roles of prestigious directors. The market reaction is particularly strong when the firms appoint first PAWD on the board and subsequent appointments of PAWDs are not seen as value adding by the market. One potential reason for why the market does not react significantly to additional PAWD appointments could be that it primarily associates PAWD appointments with an increase in legitimacy for the firm. Once this legitimacy is gained, the market does not seem to care if you appoint additional PAWDs leading to no significant market reaction. Our results are similar to Fahlenbrach, Low and Stulz (2010) who find that the market reacts significantly positively only to appointments of the first outside CEO director.

2.4.3 Difference in market reactions to PAWD and NAWD appointments

In this sub-section, we investigate if the market reaction is stronger when the independent director is prestigious. Past research shows that the appointment of an independent director is not random but systematically depends on the needs of the firm, the board, and the director's own characteristics. For instance, firms with greater advising needs such as those with high R&D

²⁰ A possible concern could be that the market reaction could vary by the type of director already on the board i.e., if a politically connected PAWD is on the board, then adding a specialised PAWD could be of significance. Hence, we divide observations in Panel C into two categories: (1) when a PAWD is appointed while a PAWD of other sub-groups is already on the board, and (2) when there is a PAWD of the same category. For instance, appointment of a politically connected PAWD when there is a PAWD of other sub-group present on the board and appointment of a politically connected PAWD when a politically connected PAWD is present on the board. In unreported results, we find that our results are not dependent on the type of PAWD present on the board and presence of any existing PAWD is sufficient to capture the implied benefits of prestigious directors.

intensity and growth (White et al., 2014), might appoint busy directors because they are excellent advisors (Field, Lowry and Mkrtchyan, 2013). Firms might also appoint older directors and/or better educated directors for their wisdom and expertise (Anderson et al., 2011; Chen, Garel and Tourani-Rad, 2019). Firms that need relational resources might increase their board size (Pfeffer and Salancik, 1978). Likewise, firms with greater monitoring needs, for e.g., with CEO duality (Rechner and Dalton, 1991), might increase proportion of independent directors (Daily and Dalton, 1992) and/or appoint female directors (Adams and Ferreira, 2009).

Additionally, other firm-level characteristics can also influence the appointment of a PAWDs and NAWDs. For example, past literature shows that smaller firms are more likely to appoint prestigious directors to reduce information asymmetry and hence increase their legitimacy (Certo, Daily and Dalton, 2001). Similarly, firms are more likely to appoint politically connected directors if they operate in an industry where revenues are highly dependent on government contracts (Sun, Hu and Hillman, 2016) or if they want easier access to financing (Tihanyi et al., 2019).

Therefore, we employ two matching techniques to identify our control sample. First, we ensure a robust comparison of market reaction to the appointment of PAWDs and NAWDs using the Propensity Score Matching (PSM). Rosenbaum and Rubin (1983) argue that propensity scores are sufficient to remove any bias emanating from observed covariates (firm, board, and director characteristics in our case). Hence, after matching each appointment of PAWD to that of NAWD on firm, board, and director characteristics, the remaining difference in the market reaction should be due to the prestige of the award. We match treatment (PAWD) and control (NAWD) samples on firm, board, and director characteristics (firm size, industry, ROA, market-to-book ratio, volatility, beta, leverage, intangible investments, board size, board independence and CEO duality, director gender, education, age, and busyness). We first calculate propensity scores using a Probit model and then identify optimal matches using the nearest neighbourhood matching technique. Propensity scores are

calculated with common support, no set caliper default setting), and with replacement. We then estimate the difference in market reaction to the appointments of PAWDs and PSM matched NAWDs.

Second, we use entropy balancing method (Hainmueller, 2012), a quasi-matching technique, wherein each observation is weighted such that there is no difference in the distributional properties (mean and variance) of the treatment and control sample. In contrast to the PSM where control observations are assigned a weight of 0 or 1, i.e., they are either excluded or included in the final matched sample, entropy balancing method weighs observations on a continuous scale and identifies the precise weights of each control observation such that an optimal weighted match with the treated observations is achieved thereby preserving the whole control sample (Chapman, Miller and White, 2019).

Entropy balancing method is an iterative method, it first determines the distributional properties i.e., mean and variance, of the treatment sample (*PAWD indicator* in our case) and then iteratively adjusts the weights of the control sample till the mean and variance of the two samples are identical. Treatment observations are always assigned the weight of 1 whereas control observations have weights that can be greater or less than 1. Subsequent regression analyses use these weights.

Column (1) of Panel A of Table 2-5 shows that the market reaction is significantly higher (All appointments: diff. in CAAR 0.69%; significant at 5% level) to appointments of PAWDs compared to a matched sample of NAWDs. Columns (2) and (5) show greater market reaction to the appointments of politically connected and specialised PAWDs. We further examine the market reaction when there is no existing PAWD on the board. The results are similar to those reported above. Furthermore, we also show that there is no significant difference in market reaction between appointments of PAWDs and NAWDs when there is already a PAWD on the board. These findings suggest that it is the first appointments of 'politically connected' and 'specialised' PAWDs that are driving the significant market reaction. Our results in Panel A of Table 2-5 are

similar to those reported in Table 2-4 which suggest that the market only values the first appointment of PAWDs.

2.4.3.1 Robustness Check

In Panel B, we match PAWDs to NAWDs of the same sub-group to clearly identify that the market reaction is due to the award rather than their connections or expertise. For example, we investigate whether the observed market reaction is a result of the appointment of PAWDs and not because they may be politically connected. Hence, we estimate the difference in market reaction to the appointments of politically connected, voluntary, business, and specialised PAWDs and the corresponding NAWDs.²¹

We find that our results in Panel B are similar to those reported in Panel A of Table 2-5. They confirm that the significant difference in market reaction is a consequence of the prestige of the appointed director and not due to their political connections, specialisation, or expertise.

<< INSERT TABLE 2-5 HERE >>

We further test the robustness of our findings in Table 2-5 by regressing the CAARs of our PSM and entropy balanced sample against a PAWD indicator variable, and a set of control variables.

$$\begin{aligned} CAAR_i = & \alpha_i + \beta_1 (PAWD\ indicator)_i + \beta_2 (First\ PAWD\ indicator)_i \\ & + \beta_3 (Existing\ PAWD\ indicator)_i + kZ_i + \varepsilon_i \end{aligned} \quad (2-4)$$

Where *PAWD indicator* is a dummy variable which sets to 1 if a PAWD is appointed to the board; 0 otherwise, *First PAWD indicator* sets to 1 if it is the first PAWD; 0 otherwise, and *Existing PAWD indicator* sets to 1 if there is

²¹ We identify politically connected NAWDs as those with past or present experience in the government, voluntary NAWDs by their experience with charities and the remaining NAWDs as the business NAWDs i.e., all NAWDs excluding politically connected, voluntary, and specialised NAWDs. Following the literature that argues academic directors are appointed for their specialised expertise (Chen, Garel and Tourani-Rad, 2019; White et al., 2014), we define specialised NAWDs as those associated with the universities.

already a PAWD present on the board; 0 otherwise, and Z_i is a vector of all the control variables: Market-to-book, Volatility, Beta, Log (Firm Size), ROA, Leverage, Intangible Investment, Log (Board Size), % Independent Directors, CEO Duality, Award-winning CEO²², Log (Director Age), Gender, Postgraduate Degree, Director Busyness, and the industry and year dummies.

Results in Table 2-6 confirm our earlier findings that the market indeed values the appointment of PAWDs more highly than that of NAWDs. Columns (1) and (2) present the results when a PSM matched control sample is used whereas for results in Columns (3) and (4), we identify our control sample using the entropy balancing method. Column (1) shows the CAARs associated with announcement of PAWD appointments are higher by 0.7% (significant at the 5% level). Similarly, the CAARs of announcement of first PAWD in Column (2) are higher by 1% (significant at the 5% level).²³ As expected, our control variables remain insignificant. In Columns (3) and (4), we find similar results when an entropy balanced control sample is used, albeit, significant at 10% level.

<< INSERT TABLE 2-6 HERE >>

2.4.4 Does the market reward monitoring and resource provision contributions of PAWDs?

We expect that due to their higher director capital, PAWDs would be more effective at monitoring as well as in providing resources. Following Chen, Garel and Tourani-Rad (2019), we partition our sample using above and below median values of firm, board, and director characteristics and examine the market response to the first appointment of PAWD.²⁴

²² Since past research shows that CEOs winning a prestigious award generate a positive market reaction (Wade et al., 2006), we control if the CEO has won a Queen's Honours. Our results are qualitatively similar after excluding award-winning CEOs as a control variable.

²³ As expected, none of the control variables are significant because they have already been matched using PSM. This also acts as an additional check that our PSM worked effectively.

²⁴ We restrict our analysis to the first PAWD because as shown in sub-section in 4.3, the market significantly reacts only to the first PAWD appointment.

From results in Table 2-7, we note that firms with above median volatility (CAAR 1.67% above median v 0.36% below median; significant at 5% level), and below median ROA (CAAR 1.56% below median vs 0.39% above median; significant at 10% level) earn higher returns. This suggests that the market recognises the first appointment of PAWD as more valuable for risky and low performing firms. Further, we find that the appointment of first PAWD to firms with below median market value generates a significantly higher reaction compared to firms with above median market value (CAAR 1.79% below median vs 0.22% above median; significant at 5% level). This shows that the market puts greater value to the appointment of PAWDs to smaller firms compared to larger firms. Our results are consistent with those reported by Certo, Daily and Dalton (2001) who find that appointing prestigious directors reduces information asymmetry and offers legitimacy for smaller and less-known firms.

Further, the market reacts significantly to the first appointment of PAWD in firms with CEO duality (1.88%; significant at the 10% level). Our evidence lends support to the argument that firms with CEO duality need greater monitoring due to the concentration of power in the hands of one person (Goyal and Park, 2002). These results are also consistent with the argument that PAWDs are more likely to monitor effectively since their own reputational capital is at stake (e.g. Jiang, Wan and Zhao, 2016).

<< INSERT TABLE 2-7 HERE >>

Next, we examine the other functions performed by PAWDs which include preferential access to resources, advice and counsel, and external linkages to other organizations. First, we examine the preferential access to resources function of PAWDs. Firms with smaller board size will likely have fewer networks to solicit preferential access to resources. However, previous research has shown that politically connected PAWDs could bring several benefits including easier borrowing and winning government contracts (Schoenherr, 2019; Tihanyi et al., 2019). Therefore, we expect that the appointments of politically connected PAWDs in firms with smaller board size should generate greater market reaction.

Further, Hillman (2005) argues that government is a major source of uncertainty for firms and Hassan et al. (2019) show that firms facing greater political risk establish links with politicians. Hence, we posit that high volatility firms will benefit more by appointing politically connected PAWDs.

Results reported in Table 2-8 are consistent with above expectations. We find a stronger market reaction to the appointment of politically connected PAWD in firms with below median board size (CAAR 2.22% below median vs 0.03% above median) and above median volatility (CAAR 0.35% below median vs 2.40% above median).

Second, we investigate the advice and counsel function provided by PAWDs. Specialised PAWDs have the necessary knowledge, skills, and expertise to advice and counsel firms. Therefore, firms in need of advice and counsel such as, those with high intangible investments (Chen, Garel and Tourani-Rad, 2019; White et al., 2014) will benefit more by appointing specialised PAWDs. However, we find that the market reaction to the first appointment of specialised PAWD to firms with above median intangible investments is not significantly different to those with below median intangible investments. Hence, our evidence does not support the advice and counsel role of PAWDs.

Third, we examine the links to non-business organizations provided by voluntary PAWDs. Pfeffer and Salancik (1978) argue firms which have greater need for external links, should have larger boards. Therefore, appointments of voluntary PAWDs to firms with smaller board size should generate a higher market reaction. However contrary to our expectations, our results show that the market reacts significantly positively to the appointment of first voluntary PAWD for firms with above median board size (-0.42% below median vs 1.57% above median).²⁵

Finally, we investigate links to business organizations by considering the number of board seats currently held by PAWDs. We expect the market to react

²⁵ The results should be viewed with caution; the sample size for voluntary PAWDs is only 10.

positively to the appointments of PAWDs with greater additional directorships. However, our findings suggest that there is no significant difference in the market reaction to the first appointments of PAWDs for firms with above and below median current number of board seats. Overall, we find no evidence with regard to PAWDs role of providing links to the external organizations.²⁶

<< INSERT TABLE 2-8 HERE >>

2.4.5 PAWD appointments and long-term performance

So far, we have examined the short-term investor reaction to appointment of prestigious directors. In this sub-section, we investigate the long-term performance implications of appointing PAWDs. Drawing on the RDT and the Agency Theory, we expect that a firm's operating performance will improve after the appointment of a PAWD. We obtain the effective dates when a director in our sample started their directorship.²⁷ To avoid any bias due to multiple appointments, we restrict our sample to firms that appointed only one director (either PAWD independent, NAWD independent or inside director) in any given year. We also remove 22 independent directors appointed in 2020 due to the lack of availability of long-term data. Our final sample consists of 1509 appointments of independent directors (151 PAWDs) from 2003 to 2019.

We measure operating performance using the Return on Assets (ROA).²⁸ Following Fahlenbrach, Low and Stulz (2010), we estimate ROA as the average of -2 and -3 years before and years 1,2 and 3 following the directors' appointments.²⁹ We further control for industry, past performance and size

²⁶ We examine the monitoring and resource-provisioning functions through indirect proxies and these results should be interpreted with caution. Further research is required to find direct measures of both monitoring and resource provisioning functions.

²⁷ Earlier we used the announcement date of directors' appointment for our event study analysis. However, since we are now focusing on operating performance, we use the starting date of director's tenure for our subsequent analysis of firm performance.

²⁸ For additional robustness, we also measure performance using Return on Invested Capital (ROIC). Our results are qualitatively similar and are reported in Appendix A-5.

²⁹ We recalculated the change in performance using -3 to -1 as an estimation window. Results are qualitatively similar and are reported in Appendix A-5.

using the PSM and compare the operating performance around the PAWD appointments with a matched sample of NAWDs.³⁰

Operating performance (ROA) could change as a result of appointments of all types of directors (prestigious or not), so care is needed in attributing the significant change in performance to the PAWD appointments. We, therefore, employ differences-in-differences (DID) approach and compare the change in performance around PAWD appointments with the change in performance around other NAWD appointments.

Even though the events are happening at different time periods, we do not employ staggered DID approach as once a firm has been treat (first event occurred), it will always consider that firm as treat for subsequent time periods. However, it is not appropriate to our case. To overcome this issue, we start by manually calculating the average ROA before and after the event and then subtract them to obtain the first difference. Thereafter, the second difference is calculated using the following model:

$$\Delta ROA_i = \alpha_i + \beta_1 PAWD\ Indicator + \beta_2 Z_i + \delta_t + \gamma_{ind} + \varepsilon_i \quad (2-5)$$

Where ΔROA_i is the change in ROA surrounding the event (for both PAWD and NAWD), *PAWD Indicator* that takes the value of 1 when the director appointed is a PAWD (treated sample); 0 otherwise, Z_i is the set of control variables for whom the values are calculated 1 year prior to the event, δ_t controls for the year effects and γ_{ind} controls for the industry effects.

Table 2-9 reports multivariate regression results. In Columns (1) and (2), we show the results when the control sample is identified using the PSM whereas in Columns (3) and (4), the results presented use an entropy balanced control sample. Column (1) shows firms appointing a PAWD show a larger change in performance (2.5%, significant at 5% level) than those appointing NAWDs. In

³⁰ We rerun the PSM by, (1) excluding firms that appoint more than one director during the year, and (2) matching the firms based on characteristics two years before the actual appointment of the directors rather than the date of appointment announcement.

Column (2), we separate the appointments of PAWDs into first appointments and when there is an existing PAWD on the board. We find that appointments of first PAWDs result in a significant change in operating performance (4.3%, significant at 5% level). Further, we find that the appointment of a PAWD when there is an existing PAWD on the board does not result in a significant change in operating performance. When the control sample was identified using the entropy balancing technique, we find similar results (Columns (3) and (4); significant at 5% level). This is similar to the results of the short-term study in Table 2-6 where we reported that market only reacts to the first PAWD appointments.

<< INSERT TABLE 2-9 HERE >>

2.4.5.1 Endogeneity

Endogeneity is a key issue in corporate governance research (e.g. Wintoki, Linck and Netter, 2012). Roberts and Whited, 2013 (p. 493) define endogeneity as “a correlation between the explanatory variables and the error term in a regression.” In this paper, there are two potential sources of endogeneity: omitted variables and self-selection bias. Omitted variable bias originates when variables that should have been added as explanatory variables are missing whereas self-selection bias could arise from PAWDs systematically choosing larger and better performing firms. Indeed, in Table 2-3, we do find that firms appointing PAWDs are bigger in size compared to firms appointing NAWDs.³¹ Thus our results could be affected by endogeneity.

We address this issue by using three different approaches: (1) combined approach of using PSM or entropy balancing method to identify a matched control sample and DID method, (2) two-stage least-squares (2SLS) method using an instrument variable (IV), and (3) Heckman two-part model. First, following Liu et al. (2021), Roberts and Whited (2018), Usman et al. (2022), Ye

³¹ However, there is statistically insignificant difference between the ROAs of firms appointing PAWDs and NAWDs.

et al. (2020), and Zaman et al. (2021), we employ DID method with a PSM or entropy balanced matched sample. Results shown in Columns (1) to (4) in Table 2-9 highlight that firms appointing PAWDs exhibit a significantly larger change in performance compared to a matched sample of firms appointing NAWDs. However, although using a matched sample with DID approach controls for observed heterogeneity, our results can still be influenced by unobserved heterogeneity.

Hence, we employ 2SLS regression using IV approach. Following Usman et al. (2022), we use the percentage of firms appointing PAWDs in an industry as the IV. We contend that it is an appropriate IV because firms are more likely to appoint PAWDs in an industry with higher proportion of companies with PAWDs. Further, the proportion of PAWDs in the industry is unlikely to have an impact on the profitability of any company in the industry. First is the relevancy condition which states that the IV and the endogenous variable must be correlated after controlling for all other exogenous variables. From Column (1) in Table 2-10, we see that our IV is significantly related to the *PAWD Indicator* (significant at 1% level). Second, our IV should not affect firm performance other than the indirect effect via the appointment of a PAWD. However, this condition cannot be empirically tested (Fahlenbrach, Low and Stulz, 2010). Column (2) shows the results of the second stage 2SLS regression. We find that after correcting for endogeneity, appointment of a PAWD leads to a larger change in firm performance (Coeff: 0.143; significant at 5% level). We further test whether our OLS coefficients were consistent using Durbin chi-square and Wu-Hausman F-tests (e.g., Chakravarty and Hegde, 2019; Farag and Dickinson, 2020). The null hypothesis is that the PAWD indicator is exogenous and therefore, there is no need to use an IV using 2SLS regression. We find that the p-value for both the Durbin chi-square and Wu-Hausman F-test is 0.019 indicating that the PAWD indicator was indeed endogenous. Therefore, we conclude that the OLS estimations in Table 2-9 are consistent.

Finally, we apply Heckman two-part model to further address any concerns regarding self-selection bias. In the first part, we run a probit model to estimate the likelihood of appointing PAWDs.

$$Probability(PAWD Indicator)_i = \alpha_i + \beta_1 Instrument_i + kZ_i + \varepsilon_i \quad (2-6)$$

Where *PAWD Indicator* is a dummy variable equalling one when a firm appoints a PAWD; 0 otherwise. *Instrument* is the percentage of firms with PAWDs in an industry, *Z* is the set of variables controlling for firm, board, director characteristics and industry and year dummies.

Column (3) of Table 2-10 report the result of the first part model. We find that our IV is significantly related (at 1% significance level) to the likelihood of appointing PAWDs as required for Heckman's estimators (Tao et al., 2022). We, then, estimate the Inverse Mills Ratio (IMR) from the first part probit model and include it as an additional independent variable in our second part model. Column (4) reports the results of the second-part model. We see that the coefficient of IMR is not statistically significant indicating that there is no self-selection bias in our model. However, even without IMR being significant, we still find that the *PAWD Indicator* is positive and significant (albeit at 10% level) confirming that PAWDs indeed lead to a significantly larger change in operating performance of firms compared to those appointing NAWDs.

<< INSERT TABLE 2-10 HERE >>

2.5 Conclusion

In this paper, using the UK's unique institutional setting of Queen's honours as an unambiguous proxy of prestige, we examine whether prestigious directors add value to the appointing firms. We make a notable contribution to the extant literature by highlighting the relevance of director prestige and the associated benefits of appointing PAWDs on corporate boards. Using the RDT and the Agency Theory, we argue that board prestige not only acts as a signal of

greater human and social capital but also as an incentive for directors to monitor the management effectively.

Consistent with the above arguments, we find that appointing PAWD is beneficial to firms both in the short and long term. The market's short-term reaction is positive and significant to the initial appointments of PAWDs. We find further evidence that supports the monitoring, preferential access to resources and legitimacy roles of prestigious directors. Our findings with regard to the long-term performance, suggest that firms appointing PAWDs experience a larger positive change in their operating profits compared to those appointing NAWDs.

Our empirical evidence has important implications for both the Agency Theory and the RDT. Our finding that prestigious directors are better monitors imply that reputation plays an important role in board's oversight of managerial decisions particularly in the presence of CEO duality and high volatility and low performing firms. Also, we show that prestigious directors provide important resources and legitimacy which rejects the perception that directors with titles are mere "attractive ornaments on the corporate Christmas tree" (Mace, 1986, p.107).

2.6 References

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Table 2-1 Key roles performed by different categories of PAWDs

Role	Politically connected	Voluntary	Business	Specialised
Preferential access to resources	Yes			
Advice and counsel				Yes
Info. Channels between firm and external organizations		Yes	Yes	
Legitimacy	Yes	Yes	Yes	Yes
Monitoring	Yes	Yes	Yes	Yes

This table lists the potential roles performed by each PAWD category. These likely contributions assigned to each PAWD category is based on the resources needed by the firm as pointed out by Hillman, Cannella and Paetzold (2000).

Table 2-2 Distribution of PAWD appointments by announcement year

Year	Total	Politically Connected		Voluntary		Business		Specialised	
		Frequency	% Total	Frequency	% Total	Frequency	% Total	Frequency	% Total
Total	375	112	29.87	28	7.47	63	16.80	172	45.87
# Unique Directors ³²	278	87		23		47		122	
# Unique Firms	259	100		28		58		134	

This table presents the distribution of 375 appointment announcements of PAWDs. We report announcements of all PAWDs and four subgroups.

³² Baroness Denise Patricia Kingsmill was awarded CBE on 31/12/1999 and joined the House of Lords on 15/06/2006. We therefore consider her as business director (appointment announcement 11/10/2004) for British Airways Plc, and as Politically connected director (appointment announcement 01/02/2011) for Betfair Group Plc. Hence the total number of unique directors is one less than the sum of all unique directors of four subgroups.

Table 2-3 Firm, board, and director characteristics of firms appointing PAWDs

Variable	Full sample (1)	Politically Connected (2)	Voluntary (3)	Business (4)	Specialised (5)
# of appointments	375	112	28	63	172
<i>Panel A: Firm characteristics</i>					
Market to Book	2.98	2.62	2.99	4.35 ^b	2.71
Volatility	0.32	0.32	0.30	0.29	0.33
Market Value (£m)	9117.53+	7232.22	8813.06	10100	10100
ROA	0.06	0.06	0.07	0.07	0.05
Beta	0.84+	0.78 ^c	0.91	0.82	0.87
Leverage	0.39	0.41	0.30	0.39	0.39
Intangible investment	0.12-	0.13	0.14	0.12	0.12
<i>Panel B: Board characteristics</i>					
Board size (#)	9.26+	9.14	8.36 ^c	8.82	9.65 ^b
% Independent Directors	59.33	56.69 ^c	64.32	59.49	60.13
CEO Duality (%)	12.23	20.37 ^a	3.57	6.45	10.59
<i>Panel C: Director characteristics</i>					
Director Age (years)	58.99+	59.30	59.36	58.59	58.88
Gender (1 = Male) (%)	68.00-	74.11 ^c	78.57	47.62 ^a	69.77
Postgraduate (%)	82.40+	79.46	75.00	82.54	85.47
Current boards (#)	3.85	4.79 ^c	2.86	3.57	3.51

This table presents firm, board and director characteristics of PAWD appointments in Panels A, B and C respectively. In column (1), + and - denote that sample means are significantly greater or less than the matched sample of NAWDs at 10% significance levels or better. In columns (2), (3), (4), and (5), ^a, ^b and ^c denote that the means of a particular PAWD subgroup is significantly different than the remaining PAWDs at 1%, 5% and 10% significance levels respectively. All firm characteristics except market value and beta are winsorised at 1% and 99% levels. See Appendix A-1 for definitions.

Table 2-4 Market reaction to appointments of PAWDs

	All (1)	Politically connected (2)	Voluntary (3)	Business (4)	Specialised (5)
<i>Panel A: All appointments</i>					
N	375	112	28	63	172
CAAR[-1,+1]	0.50%*** (2.85)	0.55% (1.40)	0.11% (0.23)	0.05% (0.12)	0.78%*** (2.88)
<i>Panel B: First PAWD</i>					
N	147	46	10	27	64
CAAR[-1,+1]	1.01%*** (3.16)	1.50%** (2.53)	0.38% (0.77)	-0.68% (-0.86)	1.46%*** (3.09)
<i>Panel C: Existing PAWD</i>					
N	228	66	18	36	108
CAAR[-1,+1]	0.24% (1.02)	-0.12% (-0.23)	-0.04% (-0.06)	0.60% (1.25)	0.38% (1.16)

This table reports the Cumulative Average Abnormal Returns (CAARs) for the day before, on the event day and the day after PAWD appointments announcements. All variables are defined in Appendix A-1. t-stats are reported in brackets (two-tailed) and *,** and *** denote the statistical significance at 10%,5% and 1% levels respectively.

Table 2-5 Difference in appointment announcement returns between PAWDs and NAWDs

	All (1)	Politically connected (2)	Voluntary (3)	Business (4)	Specialised (5)
	Difference CAAR[-1,+1]				
<i>Panel A: Vs PSM Matched NAWDs</i>					
All appointments	0.69%** (2.19)	1.22%** (2.10)	0.19% (0.21)	0.00% (0.05)	0.74%* (1.85)
First PAWD	1.19%** (2.53)	1.57%* (1.90)	1.75% (0.97)	-0.08% (-0.08)	1.42%** (2.03)
Existing PAWD	0.33% (0.94)	0.99% (1.25)	-0.53% (-0.54)	0.12% (0.17)	0.23% (0.59)
<i>Panel B: Vs NAWDs of same sub-group</i>					
All appointments		0.81% (1.37)	-0.76% (-0.99)	-0.18% (-0.33)	1.04%** (2.41)
First PAWD		1.76%** (2.49)	-0.49% (-0.42)	-0.91% (-1.11)	1.72%*** (2.95)
Existing PAWD		0.14% (0.22)	-0.91% (-0.96)	0.38% (0.53)	0.64% (1.34)

This table reports the difference in appointment announcement returns between PAWDs' and NAWDs' appointments. In Panel A, we report the difference in market reaction between appointments of PAWDs and Propensity Score Matching (PSM) matched NAWDs and in Panel B, we report the difference in market reaction to appointments of politically connected, voluntary, business and specialised PAWDs and NAWDs. PSM is done using the nearest neighbourhood matching technique. Definitions of all variables used in the matching process are provided in Appendix A-1. t-stats are reported in brackets (two-tailed) and *, ** & *** denote the statistical significance at 10%, 5% and 1% levels respectively.

Table 2-6 Multivariate analysis of CAARs

	PSM Matched Sample		Entropy Balanced Sample	
Dependent Variable: CAAR	(1)	(2)	(3)	(4)
PAWD Indicator	0.007** (2.04)		0.004* (1.75)	
First PAWD Indicator		0.010** (2.13)		0.007* (1.83)
Existing PAWD Indicator		0.005 (1.18)		0.003 (0.82)
<i>Firm characteristics</i>				
Market-to-book	-0.000 (-0.73)	-0.000 (-0.72)	0.000 (0.07)	0.000 (0.08)
Volatility	0.020 (1.14)	0.020 (1.15)	0.005 (0.38)	0.005 (0.38)
Beta	-0.005 (-0.79)	-0.005 (-0.78)	-0.004 (-0.95)	-0.004 (-0.94)
Log (Firm Size)	0.000 (0.03)	0.000 (0.17)	-0.001 (-0.49)	-0.001 (-0.35)
ROA	-0.006 (-0.36)	-0.006 (-0.39)	-0.014 (-0.97)	-0.015 (-1.00)
Leverage	0.003 (0.52)	0.003 (0.55)	-0.000 (-0.04)	0.000 (0.00)
Intangible Investment	0.002 (0.21)	0.002 (0.21)	0.001 (0.14)	0.001 (0.13)
<i>Board characteristics</i>				
Log (Board size)	0.004 (0.41)	0.004 (0.42)	0.005 (0.68)	0.005 (0.69)

% Ind. Directors	-0.013 (-1.02)	-0.012 (-0.94)	-0.012 (-1.41)	-0.012 (-1.34)
CEO Duality (1=Yes)	0.008 (1.53)	0.008 (1.54)	0.008** (2.19)	0.008** (2.20)
Award-winning CEO (1=Yes)	-0.019 (-1.13)	-0.017 (-1.03)	-0.008 (-0.61)	-0.007 (-0.54)
<i>Director characteristics</i>				
Log (Director Age)	-0.006 (-0.25)	-0.007 (-0.29)	0.013 (0.81)	0.013 (0.79)
Director Gender (1=Yes)	0.002 (0.46)	0.002 (0.40)	0.004* (1.69)	0.004 (1.63)
Education (1=Postgraduate)	0.002 (0.40)	0.002 (0.42)	-0.002 (-0.57)	-0.002 (-0.58)
Director Busyness	0.003 (1.29)	0.003 (1.31)	0.002 (1.21)	0.002 (1.23)
Constant	0.016 (0.17)	0.016 (0.17)	-0.044 (-0.69)	-0.046 (-0.71)
Industry Dummies	Yes	Yes	Yes	Yes
Year Dummies	Yes	Yes	Yes	Yes
Observations	572	572	3,151	3,151
R-squared	0.082	0.084	0.057	0.058

This table reports results from regressions of CAARs. In Columns (1) and (2), we matched the control sample of NAWDs on firm, board, and director characteristics using the Propensity Score Matching whereas in Columns (3) and (4), we use an entropy balanced sample. All firm characteristics except firm size and beta are winsorised at 1 and 99 percentile levels. Industry and year dummies are taken in all regressions and robust standard errors are taken. T-statistics are presented in the brackets and *, ** and *** denote the statistical significance at 10%, 5%, and 1% respectively.

Table 2-7 Difference in market reaction to the value created by PAWDs based on firm, board, and director characteristics

	CAAR [-1,+1]				
	<= Median	Obs.	>Median	Obs.	Difference
<i>Firm Characteristics</i>					
Market-to-book	0.88	74	0.87	73	-0.27
Volatility	0.36	74	1.67	73	-1.31**
ROA	1.56	78	0.39	69	1.16*
Leverage	0.93	74	1.09	73	-0.15
Intangible Investments	0.76	75	1.27	72	-0.51
Beta	1.00	74	1.02	73	-0.00
Market Value	1.79	74	0.22	73	1.58**
<i>Board characteristics</i>					
Board size	1.16	88	0.79	59	0.37
% Ind. Directors	1.14	79	0.86	68	0.29
CEO Duality	0.81	125	2.68	18	-1.88*
<i>Director characteristics</i>					
Director Age	0.83	86	1.26	61	-0.43
Director Gender (1 = Male)	0.38	48	1.32	99	-0.94
Postgraduate Degree	2.51	31	0.61	116	1.91**
# Current board seats	0.94	93	1.13	54	-0.19

*, ** and *** denote the statistical significance at 10%, 5%, and 1% respectively. In case of categorical variables i.e., CEO Duality, Director Gender, Postgraduate degree, sample is divided on based on 0 and 1.

Table 2-8 Difference in market reaction to the value created by PAWD sub-groups

CAAR [-1,+1]												
	Politically connected (n = 46)			Voluntary (n = 10)			Business (n = 27)			Specialised (n = 64)		
	<=Med	>Med	Difference	<=Med	>Med	Difference	<=Med	>Med	Difference	<=Med	>Med	Difference
<i>Firm characteristics</i>												
Market-to-book	1.07	1.93	-0.86	-0.27	1.03	-1.30	-0.28	-1.25	0.98	1.53	1.40	0.13
Volatility	0.35	2.40	-2.05*	1.07	-1.23	2.30***	-0.91	-0.29	-0.62	0.92	1.94	-1.02
ROA	1.82	1.10	0.71	-0.21	0.97	-1.17	-0.19	-1.06	0.87	2.21	0.56	1.66*
Leverage	1.61	1.39	0.22	0.60	0.04	0.56	0.09	-1.50	1.58	0.86	2.00	-1.14
Intangible Investments	1.52	1.49	0.03	0.09	0.58	-0.49	-0.64	-0.72	0.08	0.92	2.12	-1.19
Beta	1.08	2.05	-0.97	1.04	-0.28	1.32	-0.86	-0.45	-0.42	1.91	1.11	0.80
Market Value	2.44	0.05	2.39**	-0.79	0.88	-1.68*	0.07	-2.17	2.23	2.61	0.73	1.89*
<i>Board characteristics</i>												
Board size	2.22	0.03	2.19*	-0.42	1.57	-1.99**	-0.51	-1.16	0.65	1.47	1.45	0.02
% Ind. Directors	1.53	1.45	0.08	0.40	0.35	0.05	-0.50	-0.82	0.32	1.55	1.39	0.16
CEO Duality	1.17	2.91	-1.74				-0.64	-1.84	1.20	1.30	3.02	-1.72
<i>Director characteristics</i>												
Director Age	2.25	0.62	1.63	-0.10	1.49	-1.59	-1.23	0.27	-1.50	0.99	2.11	-1.11
Director Gender (1 = Male)	1.80	1.39	0.41	0.72	0.30	0.42	-1.90	0.46	-2.35	0.89	1.72	-0.83
Postgraduate Degree	3.30	0.87	2.43*	0.54	0.31	0.23	2.13	-1.66	3.79**	2.42	1.31	1.12
# Current board seats	0.97	2.14	-1.17	0.58	-0.09	0.67	0.03	-1.70	1.73	1.30	1.85	-0.55

*, ** and *** denote the statistical significance at 10%, 5%, and 1% respectively. In case of categorical variables i.e., CEO Duality, Director Gender, Postgraduate degree, sample is divided on based on 0 and 1.

Table 2-9 Multivariate analysis of change in operating performance (ROA)

Dependent Variable: Δ ROA	PSM Matched Sample		Entropy Balanced Sample	
	(1)	(2)	(3)	(4)
PAWD Indicator	0.025** (2.00)		0.018** (2.32)	
First PAWD Indicator		0.043** (2.26)		0.027** (2.18)
Existing PAWD Indicator		0.012 (0.93)		0.009 (1.16)
<i>Firm Characteristics</i>				
Market-to-Book	-0.002 (-0.93)	-0.002 (-0.90)	0.001 (0.78)	0.001 (0.78)
Volatility	-0.148* (-1.84)	-0.155* (-1.94)	-0.029 (-0.81)	-0.032 (-0.93)
Beta	0.010 (0.38)	0.011 (0.39)	0.006 (0.40)	0.006 (0.40)
Firm Size	-0.003 (-0.46)	-0.002 (-0.27)	-0.001 (-0.42)	-0.001 (-0.20)
Leverage	0.057** (2.07)	0.060** (2.19)	0.037* (1.91)	0.039** (2.01)
Intangible Investment	0.041 (1.35)	0.041 (1.35)	0.044* (1.93)	0.044* (1.92)
<i>Board Characteristics</i>				
Ln (Board Size)	0.004 (0.11)	0.006 (0.17)	-0.018 (-0.69)	-0.017 (-0.65)
% Independent Directors	-0.010 (-0.18)	0.006 (0.12)	-0.061* (-1.74)	-0.053* (-1.66)
CEO Duality	0.016 (0.81)	0.014 (0.71)	-0.011 (-0.81)	-0.012 (-0.93)
Award-winning CEO	-0.006 (-0.25)	-0.001 (-0.04)	-0.011 (-0.96)	-0.009 (-0.76)
<i>Director Characteristics</i>				
Ln (Director Age)	0.014 (0.20)	0.013 (0.19)	0.003 (0.07)	0.002 (0.05)
Director Gender (1=Male)	0.002 (0.15)	0.003 (0.16)	-0.000 (-0.04)	0.000 (-0.01)
Director Education (1 = Postgraduate)	-0.010 (-0.54)	-0.012 (-0.66)	-0.016 (-1.52)	-0.017* (-1.65)
Director Busyness	0.013 (1.50)	0.014 (1.52)	0.003 (0.60)	0.003 (0.60)
Constant	0.110 (0.35)	0.096 (0.31)	0.127 (0.67)	0.125 (0.66)
Observations	242	242	1,419	1,419
R-squared	0.215	0.225	0.155	0.159
Industry Effects	Yes	Yes	Yes	Yes

Year Effects	Yes	Yes	Yes	Yes
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This table reports results from regressions of changes in ROA. Performance before the appointment is calculated by the average over -2 and -3 event years whereas performance after the appointment is calculated as the average over +1 to +3 event years. *PAWD Indicator* is a dummy variable that equals to one if a PAW is the appointed director. *First PAWD Indicator* is an indicator variable equal to one if at the time of appointment, no other PAWD is on the board. *Existing PAWD Indicator* is a dummy variable equal to one if a PAWD is present on the board at the time of the appointment of PAWD. In columns (1) and (2), dependent variable is the change in ROA over the propensity score matched sample of NAWD appointments. In columns (3) and (4), we compare ROA around PAWD appointments to an entropy balancing matched sample of NAWDs. We match them on their industry, performance, and natural logarithm of total assets wherein performance and total assets two years prior to the event are used. T-statistics are presented in the brackets and *, ** and *** denote the statistical significance at 10%, 5%, and 1% respectively.

Table 2-9 Endogeneity

	2SLS		Two Part Model	
	First Stage (1)	Second Stage (2)	First Stage (3)	Second Stage (4)
% Of Firms with PAWDs in an Industry (<i>Instrument</i>)	0.503*** (3.51)		2.984*** (3.21)	
PAWD Indicator (<i>Instrumented</i>)		0.143** (2.58)		
PAWD Indicator				0.015* (1.77)
Inverse Mills Ratio (IMR)				0.126 (1.05)
<i>Firm Characteristics</i>				
Market-to-Book	0.001 (0.89)	0.001 (1.03)	0.008 (0.85)	0.002 (1.35)
Volatility	-0.025 (-0.36)	-0.067*** (-3.07)	-0.250 (-0.50)	-0.085** (-2.02)
Beta	-0.010 (-0.40)	0.017* (1.93)	0.046 (0.27)	0.017 (1.49)
Ln (Firm Size)	0.011 (1.39)	-0.005 (-1.63)	0.071 (1.26)	0.006 (0.86)
Leverage	0.001 (0.04)	0.019* (1.95)	-0.021 (-0.10)	0.021 (1.58)
Intangible Investment	-0.053 (-1.64)	0.015 (1.17)	-0.444 (-1.59)	-0.039 (-0.82)
<i>Board Characteristics</i>				
Ln (Board Size)	0.020 (0.56)	-0.015 (-1.04)	0.122 (0.49)	-0.009 (-0.45)
% Independent Directors	-0.010 (-0.19)	0.005 (0.29)	-0.086 (-0.22)	-0.013 (-0.54)
CEO Duality (1 = Yes)	-0.016 (-0.65)	-0.002 (-0.20)	-0.092 (-0.55)	-0.019 (-1.30)
Award-winning CEO	0.034 (0.30)	-0.012 (-0.26)	0.230 (0.33)	0.025 (1.06)
<i>Director Characteristics</i>				
Ln (Director Age)	0.450*** (6.88)	-0.092*** (-2.71)	3.952*** (7.10)	0.399 (0.99)
Director Gender (1 = Male)	-0.051** (-2.79)	0.009 (1.30)	-0.444*** (-3.47)	-0.049 (-1.08)
Director Education (1 = Postgraduate Education)	0.040** (2.26)	-0.012 (-1.61)	0.286** (2.17)	0.023 (0.79)
Director Busyness	0.004 (0.33)	0.008* (1.69)	0.061 (0.78)	0.013* (1.67)

Constant	-1.945*** (-6.93)	0.435*** (3.18)	-18.954*** (-8.10)	-1.867 (-0.95)
Observations	1419	1419	1419	1419
Industry Effects	YES	YES	YES	YES
Year Effects	YES	YES	YES	YES
Adjusted R ²	0.058		0.156	0.052
Tests for Endogeneity (H ₀ : Regressors are exogenous)				
Durbin chi2 (p-value)		0.019		
Wu-Hausman F test (p-value)		0.019		

This table reports the results of the two-stage least-squares (2SLS) (Columns (1) and (2) and Heckman two-part model (Columns (3) and (4)) regressions. We use the percentage of firms appointing PAWDs in an industry as the instrument variable. We also report the p-value of Durbin chi² and Wu-Hausman F test for endogeneity. The null hypothesis is that the regressors are exogenous. T-statistics are presented in the brackets and *, ** and *** denote the statistical significance at 10%, 5%, and 1% respectively.

Appendix A 2

Table A2-1 Variable definitions

Variable	Definition	Source
<i>Firm Characteristics</i>		Datastream
Log (Firm size)	Natural logarithm of market value	
Leverage	Total Debt divided by (Total Debt + Common Equity)	
Market-to-book	Market Value divided by Common Equity	
Stock volatility	Standard deviation of stock returns starting from 280 days before the event to 31 days before the event (approximately 1 year)	
Intangible Investments	SG&A plus R&D divided by total assets	
ROA	EBIT divided by total assets	
Beta	CAPM beta estimated by the regression of excess stock returns on excess market returns from 280 days prior to the event to 31 days prior to the event	Hand collected
CAAR[-1,+1]	Cumulative average abnormal return using CAPM	Hand collected
<i>Board Characteristics</i>		BoardEx
Log (Board size)	Natural logarithm of total number of board members prior to the director announcement	
% Independent directors	Number of independent NED / Total board size * 100	
CEO duality	Executive Chairman present on Board or Combined role of CEO & Chairman is present (1- Yes, 0 - No)	
Award-winning CEO	CEO is a Queen's Honours recipient (1- Yes, 0- No)	
<i>Director Characteristics</i>		BoardEx
Postgraduate Degree	Dummy variable offset to 1 if the director educational background includes either a Master level or Doctorate level degree	
Gender	Dummy variable offsets to 1 if director is male	
Director Busyness	Natural logarithm of the total number of quoted and private boards that a director serves on at the time of the appointment announcement	
Log (Director age)	Natural Logarithm of the age of the director at the time of the announcement	
PAWD Indicator	Dummy variable offsets to 1 if the director appointed is a PAWD	Hand collected
First PAWD	Dummy variable offsets to 1 if there are no PAWD present on the board at the time of the announcement of the appointment of an PAWD	Hand collected
Existing PAWD	Dummy variable offsets to 1 if there is at least one PAWD present on the board at the time of the announcement of the appointment of an PAWD	Hand collected

Table A2-2 Correlation Matrix

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
ROA (1)	1.000															
PAWD Indicator (2)	-0.022	1.000														
Market-to-book (3)	0.232***	0.014	1.000													
Volatility (4)	-0.216***	-0.036	0.019	1.000												
Beta (5)	0.043	0.039	0.035	0.209***	1.000											
Log (Firm Size) (6)	0.197***	0.143***	0.126***	-0.199***	0.496***	1.000										
Leverage (7)	-0.020	0.055**	-0.001	0.158**	0.067***	0.162***	1.000									
Intangible Investments (8)	0.076***	-0.047*	0.204***	0.073***	-0.105***	-0.086***	-0.060**	1.000								
Log (Board Size) (9)	0.054**	0.121***	0.072***	0.105***	0.364***	0.637***	0.276***	-0.021	1.000							
% Ind. Directors (10)	-0.067**	-0.043*	-0.108***	-0.270***	0.132***	0.034	-0.197***	-0.161***	-0.391***	1.000						
CEO Duality (11)	-0.045*	0.010	0.023	0.119***	-0.017	-0.052**	0.023	0.039	0.093***	-0.248***	1.000					
Log (Director Age) (12)	-0.012	0.169***	-0.067***	0.024	0.020	0.055**	-0.011	-0.057**	0.024	0.017	0.021	1.000				
Gender (13)	-0.037	-0.017	0.021	0.108***	-0.075***	-0.122***	0.002	-0.002	-0.026	-0.111***	0.031	0.182***	1.000			
Postgrad. Education (14)	0.023	0.069***	0.027	-0.054**	0.070***	0.148***	-0.007	0.022	0.085***	0.039	-0.003	-0.087***	-0.123***	1.000		
Director Busyness (15)	-0.048*	0.062**	0.001	-0.004	-0.014	0.035	-0.050*	-0.050*	0.018	0.027	0.006	0.178***	0.079***	0.053**	1.000	
PAW CEO (16)	-0.024	0.014	0.003	0.008	0.067***	0.076***	0.058**	-0.026	0.055**	0.017	-0.023	-0.026	-0.031	-0.014	0.002	1.000

*, ** and *** denote the statistical significance at 10%, 5%, and 1% respectively.

Table A2-3 Market reaction to appointments of PAWDs (BHARs)

	All	Politically connected	Voluntary	Business	Specialised
	(1)	(2)	(3)	(4)	(5)
<i>Panel A: All appointments</i>					
N	375	112	28	63	172
BHAR [-1,+1]	0.53%***	0.55%	0.10%	0.02%	0.76%***
	(2.74)	(1.39)	(0.22)	(0.05)	(2.77)
<i>Panel B: First PAWD</i>					
N	147	46	10	27	64
BHAR[-1,+1]	1.00%***	1.49%**	0.37%	-0.66%	1.46%***
	(3.13)	(2.53)	(0.75)	(-0.85)	(3.02)
<i>Panel C: Existing PAWD</i>					
N	228	66	18	36	108
BHAR[-1,+1]	0.22%	-0.11%	-0.05%	0.54%	0.35%
	(0.92)	(-0.22)	(-0.07)	(1.01)	(1.08)

This table reports the Buy and Hold Abnormal Returns (BHARs) for the day before, on the event day and the day after PAWD appointments announcements. All variables are defined in Appendix A-1. t-stats are reported in brackets (two-tailed) and *, ** and *** denote the statistical significance at 10%, 5% and 1% levels respectively.

Table A2-4 CAARs using Market-adjusted Model

	All (1)	Politically connected (2)	Voluntary (3)	Business (4)	Specialised (5)
<i>Panel A: All appointments</i>					
N	375	112	28	63	172
CAAR[-1,+1]	0.59%***	0.63%*	0.16%	0.18%	0.27%***
	(3.14)	(1.67)	(0.36)	(0.40)	(2.85)
<i>Panel B: First PAWD</i>					
N	147	46	10	27	64
CAAR[-1,+1]	1.10%***	1.63%***	0.19%	-0.55%	1.56%***
	(3.50)	(2.92)	(0.46)	(-0.68)	(3.33)
<i>Panel C: Existing PAWD</i>					
N	228	66	18	36	108
CAAR[-1,+1]	0.26%	-0.06%	0.15%	0.73%	0.32%
	(1.13)	(-0.12)	(0.22)	(1.56)	(0.96)

This table reports the Cumulative Average Abnormal Returns (CAARs) based on the Market-adjusted Model for the day before, on the event day and the day after PAWD appointments announcements. All variables are defined in Appendix A-1. t-stats are reported in brackets (two-tailed) and *,** and *** denote the statistical significance at 10%,5% and 1% levels respectively.

Table A2-5 Multivariate analysis of change in performance (ROA and ROIC)

VARIABLES	ΔROA (1)	$\Delta ROIC$ (2)
PAWD Indicator	0.015** (2.09)	0.023** (2.02)
<i>Firm Characteristics</i>		
Market-to-Book	0.000 (0.16)	0.003 (1.48)
Volatility	0.018 (0.50)	-0.089 (-1.55)
Beta	-0.008 (-0.61)	0.029 (1.49)
Firm Size	-0.001 (-0.22)	0.001 (0.12)
Leverage	0.041** (2.44)	0.126*** (5.32)
Intangible Investment	0.048** (2.30)	0.037 (1.11)
<i>Board Characteristics</i>		
Ln (Board Size)	-0.009 (-0.36)	-0.080*** (-2.66)
% Independent Directors	-0.041 (-1.29)	-0.155*** (-4.04)
CEO Duality	0.000 (0.00)	-0.008 (-0.40)
Award-winning CEO	0.003 (0.12)	0.068* (1.85)
<i>Director Characteristics</i>		
Ln (Director Age)	0.026 (0.65)	0.022 (0.33)
Director Gender (1=Male)	0.001 (0.11)	0.015 (1.27)
Director Education (1 = Postgraduate)	-0.011 (-1.12)	-0.027* (-1.93)
Director Busyness	0.003 (0.47)	0.015* (1.71)
Constant	0.110 (0.63)	-0.511 (-1.48)
Observations	1,419	1,419
R-squared	0.205	0.426
Industry Effects	YES	YES
Year Effects	YES	YES

This table reports results from regressions of changes in ROA and ROIC. Performance before the appointment is calculated by the average over -1 to -3 event years whereas performance after the appointment is calculated as the average over +1 to +3 event years. *PAWD Indicator* is a dummy variable that equals to one if a PAWD is the appointed director. Control Sample is matched using the Entropy Balancing Method. T-statistics are presented in the brackets and *, ** and *** denote the statistical significance at 10%, 5%, and 1% respectively.

Chapter 3

Prestigious Directors, Firm Acquisitions, Financial Policies and Risk

ABSTRACT

We examine the implications of prestigious directors on firm acquisition behaviour, financial policies such as cash holdings and net leverage, and on firm risk and valuation. We find that firms undertake less acquisitions after appointing prestigious directors. Further, their cash holdings go up and the net leverage decreases. Finally, we find that after appointment of prestigious directors, firms' risk declines and their value increases. We consider these findings to effective monitoring performed by prestigious directors that reduces managerial private benefits. Our findings corroborate Fama and Jensen's (1983) argument that maintaining and enhancing their own reputation is indeed a powerful incentive for prestigious directors.

Keywords:

M&A, Cash holdings, Net Leverage, Firm Value, Queen's honours awards

3.1 Introduction

Agency Theory, developed by Jensen and Meckling (1976), argues that managers make decisions that increase their utility while potentially decreasing shareholder value. These activities involve either investing less effort in managing firm resources or using firm resources for personal benefits such as spending on corporate jets or lavish offices or constructing “empires”. Managers undertake such activities because they are less than 100% of the residual claimants. The resulting loss in value from the mismatch between the interests of managers and shareholders constitutes significant portion of the overall agency cost.^{1,2}

One way in which shareholders can reduce agency costs and align managers’ interests with theirs is by appointing independent directors. They will monitor managers reducing rent-seeking behaviour and ensuring decision-making that increases shareholder wealth. Extensive research shows that independent directors are best suited for effective monitoring and disciplining management (Hermalin and Weisbach, 1988; Masulis and Mobbs, 2014). In support of this view, Masulis and Zhang (2019) find that firms with independent directors who are preoccupied with personal and professional distracting events in their lives have declining operating performance and lower firm valuation. Their results are even stronger when such independent directors hold key monitoring roles.³ This signifies the importance of independent directors in monitoring managerial decisions. Hence, we only focus on independent directors in our study.

¹ Another source of agency cost for a firm is the conflict between equity holders and debtholders. Diamond (1989) and Hirshleifer and Thakor (1992) show how reputation plays a moderating factor in the resolution of conflict between shareholders and debtholders. For a discussion on both sources of agency problems, please see Harris and Raviv (1991). However, in this paper, we focus exclusively on the shareholder-manager agency problem.

² Jensen and Meckling (1976) define agency costs as the sum of: (1) residual loss i.e., the amount lost by the shareholders due to divergence between decisions in the interest of managers and those aimed at maximising shareholder wealth, (2) monitoring expense incurred by the shareholders, and (3) bonding costs which are costs incurred by managers to guarantee shareholders limiting their activities that may cost the firm, e.g., contractual limitation on managers’ decision-making power or obligation to get the accounts audited.

³ Other important studies showing position association between board independence and corporate outcomes include Aggarwal et al. (2009), Cotter, Shivdasani and Zenner (1997), Dahya, Dimitrov and McConnell (2008), and Nguyen and Nielsen (2010).

Further, recent empirical research has moved from focusing on general board characteristics such as board size or percentage of independent directors to examining the impact of directors' experiences and traits on corporate outcomes such as their bankruptcy experience (Gopalan, Gormley and Kalda, 2021), their education and experience (Chen, Garel and Tourani-Rad, 2019; White et al., 2014), their gender, financial knowledge and tenure (Mollah, Liljeblom and Mobarek, 2021) as well as the impact of their reputation (Jiang, Wan and Zhao, 2016; Oehmichen et al., 2017; Sila, Gonzalez and Hagendorff, 2017). In line with this, we consider director prestige as an important distinguishing feature and investigate if prestigious independent directors are better at reducing agency conflicts than other independent directors i.e., if they are better monitors. We answer the following research questions: (1) Do prestigious directors lead to greater reduction in managerial rent-seeking behaviour relative to other directors? (2) Does this effective monitoring lead to reduction in firm risk? and, (3) Does this reduction in firm risk translate into an increase in firm valuation?

Fama and Jensen (1983) provide theoretical arguments in support of the association between director prestige and monitoring. They argue that directors' primary motive is to preserve and enhance their reputation. This incentivises them to monitor the management effectively as not doing so could potentially damage their reputation and reduce the likelihood of obtaining future directorships. Hence, according to the agency perspective, prestige will act as an incentive, and prestigious directors, acting in their self-interests, will monitor the management diligently reducing the agency costs related to managerial rent-seeking behaviour. In support of this view, past empirical literature shows that reputed directors are more likely to dissent (Jiang, Wan and Zhao, 2016), improve corporate transparency (Sila, Gonzalez and Hagendorff, 2017), generate a significantly positive market reaction when their appointments are announced and lead to higher long-term operating performance (Oehmichen et al., 2017).

In this paper, we investigate firm acquisition activities, corporate financial policies such as cash holdings and net leverage, firm risk and value to comprehensively examine whether prestigious independent directors provide greater monitoring. Past research argues that diversifying acquisitions are a tool for managers to increase

their private benefits and shows that they reduce firm value (Aggarwal and Samwick, 2003; Berger and Ofek, 1995; Jensen, 1986; Lang and Stulz, 1994; Schommer, Richter and Karna, 2019; Shleifer and Vishny, 1989; Stulz, 1990). However, Denis, Denis and Sarin (1997) and Goranova et al. (2017) find that with firms with greater monitoring are less likely to diversify and reduce their M&A losses.

Past research on corporate cash holdings also shows that although firms are motivated to hold cash due to the precautionary motive of investing in future growth opportunities (Cunha and Pollet, 2020; Opler et al., 1999), excess cash also increases the agency costs arising from managerial misuse (Dittmar, Mahrt-Smith and Servaes, 2003; Harford, 1999; Jensen, 1986). However, this agency cost of holding cash decreases with effective corporate governance (Pinkowitz, Stulz and Williamson, 2006; Tong, 2011). We expect that firms with prestigious directors will have fewer diversifying acquisitions and hold more cash, since such directors keep a check on managers reducing their ability to gain private benefits by providing enhanced monitoring. This should, in turn, reduce the risk and result in increased firm value.

To test above conjectures, we begin by collecting a novel dataset of Prestigious Award-Winning Directors (PAWDs) by identifying directors who won Queen's honours.⁴ We hand collect a unique sample of 278 PAWDs and 2232 Non-Award-Winning Directors (NAWDs) appointed to all non-financial constituents of FTSE All-Share Index between 2003 and 2020. Thereafter, we employ entropy balancing method to identify an optimally matched control sample that has similar characteristics to treated firms. Finally, we use differences-in-differences (DID) estimation technique to derive several significant and novel findings.

4 Although existing research uses the number of additional directorships as a measure of director prestige (e.g., Ferris, Jagannathan and Pritchard, 2003; Fich and Shivdasani, 2007; Kaplan and Reishus, 1990), we use Queen's honours as a proxy following Chapter 2. Please refer Gallus and Frey (2016), Neckermann and Frey (2013), and Wade et al. (2006) for detailed reasonings on why awards act as effective signals. Past research in finance and management utilizes awards to proxy for prestige (e.g., Graffin et al., 2008; Li et al., 2022; Malmendier and Tate, 2009; Shi, Zhang and Hoskisson, 2017), albeit, exclusively for measuring CEO prestige. To the best of our knowledge, Chapter 2 is the first paper to use awards as a proxy of director prestige and provide detailed reasons for why Queen's honours are an appropriate system of awards for measuring director prestige.

First, we find that firms undertake fewer acquisitions after appointing PAWDs compared to those appointing NAWDs. The results are even stronger for diversifying acquisitions which suggests that PAWDs reduce managerial rent-seeking behaviour. Second, we show that after the appointment of PAWDs, cash holdings of firms significantly increase, and net leverage decreases relative to other firms. These results suggest that prestigious directors reduce agency costs of holding cash (one such cost is in fact diversification). Further, reduction in net leverage signifies that due to the excess cash, they do not have to take on external debt to finance future growth opportunities. The finding is consistent with both the precautionary motive of holding cash and the Pecking Order Theory. Third, decrease in acquisitions and increase in cash holdings have an overall positive influence on the risk and value of firms appointing prestigious directors. We find that such firms exhibit a larger reduction in stock volatility and Book-to-Market (BTM) ratio as compared to those appointing NAWDs. Finally, we show that PAWDs are rewarded for their enhanced monitoring as they have higher salary and total compensation compared to NAWDs.

We take several measures to ensure that our results are robust. First, we show that entropy balancing method indeed achieves covariate balance i.e., the mean and variance of covariates are the same for both treated and control samples. Second, we report that our outcome variables follow the assumption of parallel trends. In parallel trends, the inherent assumption between assigning the significant difference to appointments of PAWDs is that in the absence of their appointments, there would be no difference between treated and control firms. Covariate balance and parallel trends are two important conditions mentioned in Atanasov and Black (2021) checklist for modelling a credible DID estimation.⁵ Finally, DID estimation with a matched control sample such as the entropy balanced sample controls for endogeneity originating from the omitted variable bias (Liu et al., 2021; Roberts and Whited, 2018; Usman et al., 2022; Ye et al., 2020; Zaman et al., 2021).

⁵ Atanasov and Black (2021) primarily focus on shock-IV design, however, they argue that similar checklist is applied for DID and regression discontinuity research designs.

We make three important contributions to the literature. First, we contribute to the literature on the implications of corporate governance on firm acquisition behaviour. Past literature provides empirical evidence of a negative relationship between greater monitoring by directors and the number of diversifying acquisitions (Denis, Denis and Sarin, 1997; Goranova et al., 2017; Schommer, Richter and Karna, 2019). We extend this literature by showing that not all directors are the same and prestige acts as an important distinguishing director characteristic. To the best of our knowledge, this is the first study to provide empirical evidence that prestigious directors are better at reducing firm acquisition activity than other directors.

Second, we extend the literature on the determinants of corporate cash holding. Indeed, prior literature argues that better corporate governance reduces agency costs of holding cash and equity holders feel safe in keeping cash with managers in firms with high level of corporate governance (e.g., Chou and Feng, 2019; Dittmar, Mahrt-Smith and Servaes, 2003; Harford, 1999; Kalcheva and Lins, 2007; Pinkowitz, Stulz and Williamson, 2006; Tong, 2011). However, past research primarily focuses on external corporate governance measures such as countries with weak/strong shareholder environment with notable exceptions of Tong (2011) and Chou and Feng (2019). We contribute to this literature by providing evidence that internal corporate governance measures such as firms appointing prestigious directors also have a positive influence on cash holdings and this increment in cash reserve does not translate into higher risk for firms.

Last, we contribute to the literature on corporate boards. Past literature highlights the importance of going beyond generic board characteristics such as board size or fraction of independent directors to focus on individual director traits that shape their opinions and risk preferences like gender (e.g., Adams and Ferreira, 2009), education and occupation such as academics on board (e.g., Chen, Garel and Tourani-Rad, 2019; Fahlenbrach, Low and Stulz, 2010), later-life experiences with bankruptcy (Gopalan, Gormley and Kalda, 2021), etc. Similarly, previous research shows that prestigious directors improve firm performance (Oehmichen et al., 2017),

however, the channel through which they improve firm performance is yet to be empirically tested.⁶ We extend this literature showing that prestigious directors are beneficial to firms because they reduce managerial rent-seeking behaviour such as firm acquisition activity leading to an increase in cash holdings and decrease in their net leverage. This reduces firm risk, thereby increasing the value of the firm. To the best of our knowledge, this is the first study to offer evidence of the impact of prestigious directors on firm risk and value.

Rest of the paper is organised as follows. The next section provides a review of the literature and develops hypotheses. Section 3 describes the data and the empirical testing strategy. Section 4 reports and discusses results and Section 5 concludes the paper.

3.2 Literature review and hypotheses development

3.2.1 Firm Acquisition Behaviour

Why do firms engage in diversification activities when overwhelming evidence points to their negative effects on performance? For instance, Berger and Ofek (1995) find an average loss of 13% to 15% in firm value due to diversification. Lang and Stulz (1994) also show a negative relationship between firm diversification and Tobin's Q. Their results hold true when comparing diversified versus specialised firms as well as for firms that increase their segments versus those that keep constant number of segments. A met-analysis performed by Schommer, Richter and Karna (2019) confirms the above findings of negative relationship between unrelated diversification and firm performance (both accounting- and market-based performance measures).

Past literature provides two sets of agency reasonings for diversification. First, managers diversify to reduce their idiosyncratic risk. Managers have large equity ownerships in their firms which increases the idiosyncratic risk they face (Jin, 2002).

⁶ In Chapter 2, we provide some results. We conduct a univariate analysis and find that appointment of prestigious directors to firms with high volatility generates a greater market reaction than their appointments to firms with low volatility.

Hence, they engage in diversifying activities to reduce their risk. In support of this argument, May (1995) finds that CEOs with large equity ownership engage in more diversified acquisitions.

Second, managers diversify because they derive private benefits from running a more diversified firm (Jensen, 1986; Stulz, 1990). These private benefits take various forms. One such benefit is enhanced prestige or better career prospects (Denis, Denis and Sarin, 1997). Running a diversified firm enhances the perceived ability of the managers and can further elevate the social status of the manager (Aggarwal and Samwick, 2003). These benefits create a positive image of the manager in the external labour market that might lead to future job opportunities in larger firms.

Other benefits include managerial entrenchment and classic rent seeking. According to Shleifer and Vishny (1989), managers entrench themselves by making investments that makes it harder for shareholders to replace them. In other words, managers increase their worth by making investments that complement their expertise so that it becomes costlier and less probable to replace them. This might also provide them with greater discretionary power and higher compensation. Additionally, shareholder-manager agency problem can also increase managers' chances of higher wages (Jensen and Murphy, 1990) and opportunities for skimming firm resources (Bertrand and Mullainathan, 2001). Although both sets of agency reasonings postulate a negative effect of diversification on firm value, Aggarwal and Samwick (2003) develop a contracting model and test both motives of managers to diversify. They find that managers diversify to acquire private benefits rather than to mitigate their idiosyncratic risk.

However, Schommer, Richter and Karna (2019) note that there has been a gradual decline in the number of unrelated diversifications performed by firms. Further, they find that unrelated diversification has less detrimental effect on performance in recent times. They allude their findings to better corporate governance measures that keep a check on managers such that they do not pursue value-destroying

“empire-building” strategies.⁷ In particular, past literature documents a negative association between monitoring performed by board of directors and number of value-destroying M&As undertaken by firms. For instance, Denis, Denis and Sarin (1997) also find that firms with greater monitoring are significantly less likely to diversify. Goranova et al. (2017) find that effective monitoring by directors lead to lower M&A losses.⁸ Similarly, Mira, Goergen and O’Sullivan (2019) show that the external labour market rewards (penalises) non-executive directors who were involved in “good” (bad) acquisitions i.e., when the performance of the acquiring firm increases (decreases) post-acquisition. They find that such directors are rewarded for their good decision-making and monitoring and hold more directorships in listed firms after acquisitions. In summary, past literature points that better monitoring by directors leads to less diversifying acquisitions.

Following similar arguments, we would expect prestigious directors to have a negative relationship with diversifying acquisitions. Fama and Jensen (1983) also argue that prestigious directors will be better at monitoring compared to other directors since not doing their duties will potentially damage their reputation. Combining these two strands, we hypothesise that:

Hypothesis 1: Appointments of prestigious directors will lead to less diversifying acquisitions.

3.2.2 Firm’s Cash Holdings and Net Leverage

To examine the implications of prestigious directors on firm cash holdings, we first investigate the determinants of corporate cash levels. Past literature provides the tradeoff and the financing hierarchy models to determine the antecedents and implications of firm cash holdings (Cunha and Pollet, 2020; Dittmar, Mahrt-Smith and

⁷ Other reasons include better institutional environment, capital market pressures and greater competition in product markets. Results related to the relationship between related diversification and firm performance has remained relatively the same.

⁸ However, they further find that effective monitoring also has a negative influence on M&A gains because CEOs discretion to undertake M&As significantly decreases with monitoring. Hence, although it limits CEOs ability to undertake value-destroying M&As, it also inhibits their ability to partake in value-enhancing M&A activities.

Servaes, 2003; Jensen, 1986; Keynes, 1937; Opler et al., 1999). We follow the framework developed by Opler et al. (1999) to motivate our discussion.

3.2.2.1 Tradeoff Model

Tradeoff model hypothesises that the optimal cash is at the level where the marginal benefits and costs of holding cash are equal. There are two main benefits of holding cash: transaction cost motive and precautionary motive (Keynes, 1937). Transaction cost motive for holding cash arises when there is a substantial transaction cost involved in raising cash needed for investment. A firm that is short of liquid assets can either raise funds in the capital markets, reduce its dividends, renegotiate existing contracts, or sell existing assets (or some mixture of these activities). If the cost of liquidating assets is high, the firm will opt to raise funds in the capital markets. Regardless of the action taken, raising funds is expensive. Hence, firms will use these methods infrequently and would prefer to have buffer cash and cash equivalents.

According to the precautionary motive, even if firms have access to capital markets, information asymmetry and agency costs of debt will make it harder to raise external capital. Hence, to not let go of positive Net Present Value (NPV) projects, firms will ensure they have sufficient funds by holding cash and cash equivalents. Managers have better information compared to outsiders regarding the true value of the security which creates an information asymmetry between managers and outsiders. Thus, outsiders might underprice the security which makes it unattractive for the managers to sell them. This will lead to reduced investment in profitable projects. Myers and Majluf (1984) propose a solution and argue that firms will build up financial “slack” in the form of cash and cash equivalents and risk-free borrowings to overcome this problem. Another issue that makes it difficult for firms to borrow money is the agency cost of debt. Such costs arise when the interests of debtholders are different from the interests of shareholders and debtholders put restrictions on not only the use of capital but also on raising more funds. Firms would certainly want to avoid instances where such agency costs are so high that they find it impossible to finance potentially profitable projects. Of course, one way to avoid these costs is

to reduce the leverage. However, we would expect firms to hold more cash reserves as a precautionary measure when the cost of raising external funds is high.⁹

There are two main costs associated with holding cash reserves. First, firms holding cash miss out on the chance of higher rate of return had it been invested. The difference between the return on the cash held if invested and the interest that needs to be paid if the same amount was borrowed externally is termed as the “cost of carry”. Second, holding cash might lead to agency costs due to managers pursuing private benefits. Jensen (1986) describes it as the “agency costs of free cash flow”. The inherent assumption in the benefits of holding cash discussed above is that managers will act in the best interests of shareholders. However, this is not always the case. If the interests of managers and shareholders are not aligned, managers might pursue value-destroying activities such as undertaking diversifying acquisitions.

3.2.2.2 Financing Hierarchy Model

According to the financing hierarchy model, there is no optimal amount of cash just as there is no optimal amount of debt. Cash is simply considered as negative debt and it does not matter if the cash comes from internal savings or borrowed externally through debt.¹⁰ This model argues that even if there is an optimal capital structure for a firm, it will specify an optimal amount of net debt or net leverage (debt minus cash) and it is indifferent to whether this optimal capital structure is achieved through changing debt or cash. Hence, cash holdings are considered to be merely an outcome of historical cash flow patterns, and investment and financing decisions of the firm. If the firm has high cash flows, it will repay debt, give dividends and accumulate cash. When the firm’s cash flows are low, it will reduce cash holdings and issue debt to finance its investments. Equity financing will be the last option to raise funds for firms due to information asymmetries. This is similar to the pecking order of financing. Although tradeoff model and financing hierarchy models have

⁹ Another potential benefit of holding cash is that it hedges firms against financing and predation risk especially in economic downturns (Acharya, Almeida and Campello, 2007; Denis and Sibilkov, 2010; Harford, Mikkelsen and Partch, 2003; Haushalter, Klasa and Maxwell, 2007).

¹⁰ This reasoning is similar to the one suggested by Pecking Order Model of Capital Structure.

similarities, there is one major difference between them. While tradeoff model predicts a positive relationship between cash levels and investments, financing hierarchy model envisages a negative relationship between the two.

3.2.2.3 Empirical Literature

Prior to Opler et al. (1999), empirical literature largely focused on the transaction cost motive as the main determinant of corporate cash holdings and find that firms hold more cash when the marginal cost of cash shortfall is higher (Mulligan, 1997). Opler et al. (1999) expanded this research by comparing the tradeoff and financing hierarchy models and provide substantial support for the tradeoff model. They find that firms with better investment opportunities, riskier cash flows and higher performance accumulate more cash. They further show that large firms and those with greater access to capital markets hold less cash. When considered together, these results imply that firms indeed give importance to the investment opportunities and adjust their cash holdings. Firms with low borrowing and easy access to external capital do not need to hold larger amount of cash whereas those with high borrowing cost keep large cash reserves. However, Opler et al.'s (1999) findings do not provide evidence of whether larger cash reserves are because of transaction cost or precautionary motive.

Cunha and Pollet (2020) provide empirical evidence in support of the precautionary motive of holding cash. They find that firms significantly increase their cash holdings in response to improved demand in future investment opportunities.¹¹ Further, they find financially constrained firms start saving earlier and accumulate cash using internal sources of funds whereas unconstrained firms invest and increase their cash reserves using external financing. Thus, they do not have to save for longer time reducing their costs to carry. Likewise, Duchin (2010) and Subramaniam et al. (2011) find that diversified firms hold significantly less cash than focused firms due to the availability of "internal" capital markets to invest in growth opportunities. These

¹¹ They exploit exogenous variations in future demand due to demographic shifts to identify future investment opportunities. For instance, a significant increase in births today will translate into an increase for bicycles 5 to 10 years later.

findings provide evidence for the precautionary motive as firms indeed care about the future growth opportunities and either hold cash or raise cash in external markets to fund these opportunities.

One reason for diversified firms to have lower levels of cash might be because they already invested their cash reserves on financing such acquisitions. This is in accordance with Jensen's (1986) "agency costs of free cash flow" and is due to the agency conflict between managers and shareholders. Indeed, Harford (1999) provides evidence in support of this proposition. He finds that cash-rich firms are more likely to undertake diversifying acquisitions and these acquisitions lead to reduction in firm value. Consistent with the free cash flow problem, Dittmar, Mahrt-Smith and Servaes (2003) show that firms in countries with lower shareholder protection hold twice as much cash as firms in countries with high shareholder protection. They attribute their findings in support of the agency cost of holding cash as shareholders in weaker external corporate governance environments cannot force managers to dissipate excess cash reserve back to them in the form of dividends or share repurchases.

However, better corporate governance should resolve this issue of agency conflict and reduce private benefits that managers can possibly pursue due to large cash reserves. Indeed, past empirical research finds evidence in support of this view. For instance, Pinkowitz, Stulz and Williamson (2006) show that the relation between cash and firm value is weaker in countries where investor protection is low compared to other countries. They also find that the relationship between dividends and firm value is lower in countries where investor protection is high.¹² These results suggest that shareholders feel safe leaving cash in the hands of managers in countries with high investor protection. Similarly, Tong (2011) finds that diversification only has a negative impact on the value of cash when firm corporate governance level is low.

¹² Kalcheva and Lins (2007) find similar results to those found by Pinkowitz, Stulz and Williamson (2006). They show that in countries with weak shareholder protection, firm value is lower when controlling managers hold larger cash reserve and is higher when these managers pay dividends. In countries, with high shareholder protection, firm value is independent of the cash held by controlling managers.

Using the same logic, we argue that internal corporate governance measures such as appointing prestigious independent directors on the board should also mitigate these agency conflicts. Since prestigious directors have greater motivation to keep managerial private benefits in check compared to other directors (Fama and Jensen, 1983), we would expect that shareholders should feel safe leaving cash in the hands of managers when such directors are on the board. Hence, the cost of holding cash related to the free cash flow problem will be lower for firms with prestigious directors compared to other directors.

Further, we argue that marginal benefits for holding cash will increase with prestigious directors on the firm's board. As previously noted, the main benefit of holding cash is that firms are able to invest in future growth opportunities and do not have to raise capital in the external market i.e., the precautionary motive. If firms with prestigious directors hold more cash, they will be able to readily invest in growth opportunities as well as hedge themselves against predation risk. Further, diversified firms have internal source of funding such as one segment funding opportunities in another or selling assets from non-core segments. Hence, they do not need to hold as much as cash as focused firms. However, as hypothesised above, firms with prestigious directors will have less acquisitions than others and therefore, will have fewer non-core assets to sell and less segments to create internal financing. Hence, we argue that the marginal benefit of holding cash in such firms with prestigious directors will be higher than other firms.

Therefore, we hypothesise that:

Hypothesis 2: Appointments of prestigious directors will lead to higher cash holdings.

We now turn our attention to the impact of higher cash holdings on the overall capital structure of firms with prestigious directors on their boards. Overall capital structure includes both debt and cash holdings. Thus, we examine how prestigious directors will impact net leverage (total debt minus cash scaled by total assets) given our earlier hypothesis that the cash holdings of firms will go up after appointing prestigious directors.

Previously, we saw that the main motive of firms to hold cash or to raise cash through external markets (raising debt or selling assets) is to invest in future growth opportunities. According to the tradeoff model, firms will prefer holding cash rather than raising debt due to information asymmetries and transaction costs. Similarly, according to the pecking order of financing, firms will try to save and use their cash holdings before going to the market to borrow funds. Both models predict that debt will be their second option after internal cash holdings. As cash holdings of firms increase following the appointments of prestigious directors, there will be no need to raise debt to finance potential growth opportunities. Consequently, there will be no change in debt holdings of firms. Since cash holdings go up while total debt remains unchanged after appointing prestigious directors, we would expect that the overall net leverage, viz. the difference between total debt and cash holdings, will go down. Therefore, we hypothesise that:

Hypothesis 3: Appointment of prestigious directors will reduce net leverage of firms.

3.2.3 Firm Risk and Value

Extensive empirical research shows that diversifying acquisitions have a negative impact on firm value (e.g., Berger and Ofek, 1995; Lang and Stulz, 1994; Schommer, Richter and Karna, 2019). One possible reason for this finding is that firm risk increases with diversifying acquisitions. This is because these acquisitions were in fact pursued by managers for purely private gains instead of enhanced synergy that might be beneficial to firms. Indeed, Moeller, Schlingemann and Stulz (2005) find that the decrease in shareholder wealth around acquisitions from 1998 to 2001 in the US is due to negative synergy gains from a small number of acquisitions. Since better monitoring by prestigious directors reduces the number of diversifying acquisitions, we would expect that the firm risk will reduce, and the firm value will be higher when prestigious directors serve on the board.

Further, we argue that greater cash holdings by firms will also have a positive influence on firm value and will reduce firm risk. First, higher cash reserve will act as a hedge against predation risk, in particular, during economic downturns (e.g, Acharya, Almeida and Campello, 2007; Haushalter, Klasa and Maxwell, 2007).

Moreover, higher corporate cash levels ensure that debt is not needed to finance growth opportunities and hence, act as a hedge against the increased risk associated with debt. Since firms with prestigious directors have greater cash levels, we would expect such firms to have lower risk and higher firm value. Combining the above arguments, we hypothesise that:

Hypothesis 4: Appointments of prestigious directors will reduce firm risk; and

Hypothesis 5: Appointments of prestigious directors will be positively related to firm value.

3.3 Data and method

We begin by identifying all constituents of FTSE All-share index between 2003 and 2020 using Datastream and exclude financial firms based on the Industry Classification Benchmark (ICB) because these are heavily regulated, thereby limiting the role directors can play in influencing firms' risk appetite. We then collect the directorship starting dates of independent directors appointed to these firms from BoardEx. Our final sample includes 2510 director appointments covering 591 non-financial firms.

3.3.1 Independent variable: Prestigious directors

Following Chapter 2, we consider a director prestigious if they have won a Queen's honours award before their appointment to the firm. These awards are granted semi-annually to celebrate the recipients' extraordinary achievements in various fields ranging from arts and cultural to business and economics. They are an appropriate signal of director prestige as these awards are inimitable because they are extremely selective. Further, they are also highly visible since the award-winner uses the title of the honour bestowed upon them as either a prefix (e.g., Sir) or a suffix (e.g., CBE).

Hence, they satisfy the Signalling Theory's requirement given by Spence (1973) that a credible signal must be costly to imitate and observable.¹³

We manually search semi-annual lists of Queen's honours published in the London Gazette and identify if a director in our sample firm has won a Queen's Honours. We further hand collect the date of the announcement of the award as well as the title and the reason for the award. This enables us to construct a *PAWD Indicator* which sets to 1 if a director has been appointed to the firm after they are awarded a Queen's honours; 0 otherwise. Our final sample includes 278 PAWDs' and 2232 NAWDs' appointments.

3.3.2 Dependent variables

We calculate risk on three sets of measures - measures of firm acquisition behaviour such as *Total Number of Acquisitions (# of Acquisitions)* and *Total Number of Diversifying Acquisitions (# of Diversifying Acquisitions)*, risk associated with corporate financial policies such as *Net Leverage* and *Cash/Assets* and outcomes of firm risk such as *Stock Volatility*. The motivation behind using these sets is to mirror the risk measures used in past research (e.g., Gopalan, Gormley and Kalda, 2021; Gormley and Matsa, 2016). Further, we measure firm value using *Book-to-Market (BTM) ratio*.

We use SDC Platinum for collecting data on firm acquisition activity. Following Gopalan, Gormley and Kalda (2021), we only include acquisitions that satisfy the following conditions: (1) the acquiring company owns 100% of the target company after the acquisition is completed or acquiror owns less than 50% of the target firm prior to the announcement, (2) the acquirer's and the target's ultimate parent is not the same i.e., no consolidation or buybacks, (3) either the acquirer or the target is a non-financial firm (excluding primary 2-digit SIC codes: 60, 61, 62, 63, 64, and 67), and (4) the deal was completed within the one thousand days of the announcement date i.e., difference between effective and announcement date is less than 1000

¹³ Please refer Chapter 2 for a detailed discussion on the process of obtaining a Queen's Honours as well as on the suitability of these awards to measure director prestige.

days. We, thereafter, construct the two measures of firm acquisition behaviour: *# of Acquisitions* and *# of Diversifying Acquisitions*. An acquisition is considered to be diversifying if the first three-digits of the acquirer's primary SIC code are different than the first three-digits of the target firm's primary SIC code.

Further, *Cash/Assets* is Cash holdings divided by the lagged value of Total Assets. *Net Leverage* is the difference between Total Debt and Cash scaled by the lagged value of Total Assets. *Stock Volatility* is calculated as the annual standard deviation of daily stock returns (250 days) and *BTM* is the ratio of Book Value of Equity and Market Value of Equity. We obtain these data from Datastream.

3.3.3 Control variables

We control for firm, board, and director characteristics across all models that could potentially influence firm risk-taking behaviour. Following Bernile, Bhagwat and Rau (2017), we control for *Firm Size* measured by natural logarithm of total assets, *Book-to-Market (BTM)* as the ratio of book value and market value of assets, *Return on Assets (ROA)* calculated as Earnings before interest, taxes, depreciation and amortisation (EBITDA) divided by the lagged value of Total Assets, *Ln (Director age)* as the natural logarithm of director age, and *Director Gender* as a dummy variable which takes the value of 1 if male; 0 otherwise. Additionally, we control for the Percentage of Independent Directors on the board (*% Independent Directors*), *CEO Duality* (1 if the same person is the chair of the board and the CEO; 0 otherwise), *Director Education* (1 if the director has a postgraduate degree; 0 otherwise), and *Ln (Board Size)* as the natural logarithm of *Board Size* (e.g. Gopalan, Gormley and Kalda, 2021).

Data for firm-level control variables are collected using Datastream and for board and director level control variables using BoardEx. BTM and ROA are winsorised at 1 and 99 percent level and all control variables are measured a year prior to the appointment.

3.3.4 Empirical Framework

We examine the relationship between prestigious directors and firm risk using Difference-in-Differences (DID) framework. The first difference is between the time before and after the appointment of the director to the firm, and the second difference is between the treated firms (firms with PAWD(s) on board) and the control firms (a matched sample of observationally similar firms obtained using the Entropy Balancing Method or the full sample of non-financial firms). As pointed out in Chapter 2, although events are happening at different time periods, we do not use staggered DID method because in staggered DID, once a firm has been treated (appointed a PAWD in our case), it is considered a part of the treated sample for all subsequent time periods. Since, it is not appropriate for our case (a firm could appoint a PAWD in 2010, that PAWD could leave the board in 2015 and subsequently it appoints a NAWD making it part of the control sample), we, first, manually calculate the first difference before and after the event and then employ the following model to calculate the second difference.

$$y_i = \alpha_i + \beta_1(PAWD\ indicator)_i + kZ_i + \delta_{ind,t} + \epsilon_i \quad (3-1)$$

where y measures risk-taking by firm i . *PAWD indicator* is a dummy variable which sets to 1 for treated firms following the appointment of a PAWD on the board; 0 otherwise. Z_i is a vector of firm-level, time-varying control variables that might affect firm risk: Firm Size, ROA, BTM, % Independent Directors, Ln (Board Size), CEO Duality, Ln (Director Age), Director Gender, and Director Education. $\delta_{ind,t}$ is industry-by-year effects controlling for time-varying industry-level characteristics. We estimate our dependent variables over two years either side of the appointment i.e., difference between the average over two years leading up to the appointment and the average over the two years after the appointment as shown in Figure 3-2. All control variables are estimated a year prior to appointments of directors.

<< INSERT FIGURE 3-1 HERE >>

3.3.4.1 Control firms

The control sample used to estimate our regressions is obtained using two approaches. First, we employ the full sample of control observations in our regression analyses. Second, we use the entropy balancing method (Hainmueller, 2012). In this method, each observation is weighted so that distributional properties (mean and variance) of the treatment and control sample are similar.¹⁴

Entropy balancing method comprises two steps. In the first step, the distributional properties i.e., mean and variance, of the treatment sample (*PAWD indicator* in our case) are determined. In the second step, it assigns possible weights to the control sample and tests whether the mean and variance of the control and the treatment sample are identical. If not, the second step iterates adjusting the weights of the control sample until they are identical for both samples. Only the control sample observations are reweighted with weights that can be less or greater than one whereas treatment observations are always assigned the weight of 1. All subsequent regression analyses use these weights.

3.4 Empirical Results and Discussion

3.4.1 Summary statistics

Table 3-1 presents the summary statistics of the full sample (Columns (1) through (3)), treated sample of firms appointing PAWDs (Columns (4) and (5)) and control sample of firms appointing NAWDs (Columns (6) and (7)). Column (4) reports that the average firm appointing a PAWD exhibit an ROA of 13%, Net Leverage of 0.21, Cash-to-assets ratio of 0.09 and its board consists of 60% independent directors.

¹⁴The benefit of using this technique over the traditional Propensity Score Matching (PSM) method is that there is no loss of the control sample. In PSM, control observations are assigned a weight of 0 or 1, i.e., they are either excluded or included in the final matched sample. In contrast, entropy balancing weighs observations on a continuous scale and identifies the precise weights of each control observation such that an optimal weighted match with the treated observations is achieved thereby preserving the whole control sample (Chapman, Miller and White, 2019).

10% of such firms exhibit CEO Duality. On the other hand, the average firm appointing a NAWD has a Net Leverage of 0.19, an ROA of 13% and Cash-to-assets ratio of 0.11. 13% of such firms have the same person as the CEO as well as the Chairperson and their boards consist of an average 59% independent directors.

In Column (8), we report the difference of the characteristics' means between treated and control sample. We find that there are significant differences between firms appointing PAWDs and NAWDs. Firms appointing PAWDs are larger, perform more acquisitions including diversifying acquisitions, have higher volatility, and lower BTM ratio compared to firms appointing NAWDs. Their boards are also larger in size (9.48 vs 9.03). Further, PAWDs in our sample are significantly older, better educated and are more likely to be female than NAWDs. They also get paid significantly more both in terms of salary and total compensation.

The results of the univariate analysis shown above provide two interesting insights that might justify firms' decision of appointing PAWDs. First, in the year leading up to their appointment, firms appointing PAWDs do more diversifying acquisitions than firms appointing NAWDs. Since M&A is viewed as a tool for managers to extract private benefits, this finding acts as evidence that these firms are in need of greater monitoring. This might be a reason why such firms are appointing PAWDs. Second, such firms also have significantly higher risk than firms appointing NAWDs. Therefore, to decrease the risk originating from value-destroying activities such as diversifying acquisitions, firms might appoint PAWDs on their boards. We now explore the effects of PAWDs appointments on firm behaviour such as their acquisitions, cash holdings, and net leverage and on the outcomes of firm risk and value in a multivariate setting.

3.4.2 Firm acquisition behaviour

We begin by examining the impact of appointing prestigious directors on firms' acquisition behaviour. As discussed earlier, we expect that firms who appoint PAWDs engage in less acquisitions than those appointing NAWDs. Results are reported in Table 3-2. In Columns (1) and (2), we present the results related to the *Total Number of Acquisitions (# of Acquisitions)* and *Total Number of Diversifying*

Acquisitions (# of Diversifying Acquisitions) when the control sample is obtained using the entropy balancing method. Columns (3) and (4) report results when the full sample of non-financial firms appointing NAWDs is used as the control sample.

We find firms undertake fewer acquisitions after appointing prestigious directors. Treated firms i.e., firms appointing PAWDs carry out 0.208 fewer acquisitions following the appointment of PAWDs relative to the matched sample of control firms (Column (1); significant at 10% level). Similarly, in Column (2), we report that treated firms undertake significantly fewer diversifying acquisitions after appointing PAWDs compared to the matched sample of firms appointing NAWDs (Coefficient: -0.029; significant at 5% level). Our results are robust to using all firms appointing NAWDs as the control sample (Columns (3) and (4)). We find similar results for both *# of Acquisitions* (Coefficient: -0.210; significant at 10% level) and *# of Diversifying Acquisitions* (Coefficient: -0.269; significant at 5% level).

<< INSERT TABLE 3-2 HERE >>

The findings provide clear evidence in support of our hypothesis that appointments of prestigious directors will lead to fewer acquisitions due to such directors effectively monitoring the management. However, not all acquisitions are value-destroying, and some might even be beneficial to firms. As pointed earlier, diversifying acquisitions, in particular, lead to reduction in firm value (Berger and Ofek, 1995; Lang and Stulz, 1994; Schommer, Richter and Karna, 2019). Since prestigious directors provide better monitoring that reduces managerial private benefits (Fama and Jensen, 1983), we would expect their effect to be stronger for diversifying acquisitions. Consistent with this view, the negative effect of appointments of prestigious directors on diversifying acquisitions is stronger than on all acquisitions. Overall, the above findings are similar to past research which states that good corporate governance in the form of greater monitoring leads to reduction in acquisition behaviour (e.g, Goranova et al., 2017).

3.4.3 Cash/Assets and Net Leverage

In this section, we investigate the impact of PAWDs on corporate cash holdings and net leverage. We expect that after appointing PAWDs, firms will increase their cash

holdings and decrease their net leverage relative to firms appointing NAWDs. We report our results in Table 3-3. In Columns (1) and (2), we present the results when the control sample is estimated using the entropy balancing method whereas Columns (3) and (4) show the results when the full sample of firms appointing NAWDs is used as the control sample.

We find that firms' increase their cash holdings after appointing prestigious directors. Column (1) reports that treated firms' cash holdings improve by 0.8% relative to the matched sample of control firms (statistically significant at 10% level).¹⁵ In Column (2), we show that this relative increase in cash holdings decreases the net leverage of treated firms. We find that treated firms who appoint PAWDs experience a 1.2% decline in net leverage compared to matched sample of control firms appointing NAWDs (statistically significant at 5% level). In untabulated results, we test if our results for net leverage could be driven by a decrease in debt (since net leverage is debt minus cash scaled by lagged value of total assets). We do not find any significant difference in debt holdings between firms appointing PAWDs and NAWDs.

Further, we repeat our analysis after including all non-financial firms appointing NAWDs as the control sample to test the robustness of our results. Columns (3) and (4) report the results. We find that our results for net leverage are robust to using all firms as the control sample rather than just using the entropy balanced matched sample (albeit at 10% significance level). However, the estimates for cash holdings are no longer significant. This is not surprising as past research notes that the marginal benefits of holding cash increases when firms find it costly to raise cash in external markets due to information asymmetry (e.g., Opler et al., 1999). Since large, better performing and financially unconstrained firms might find it comparatively easy to raise cash with external financing, they hold less cash (Cunha and Pollet, 2020). Hence, the insignificant results of cash holdings between treated and control sample

¹⁵ Opler et al. (1999) argue that firms with higher R&D costs will hold more liquid assets. Further, Subramaniam et al. (2011) find that the organizational structure of the firm i.e., whether the firm is diversified also affects levels of cash holdings. Hence, in unreported results, we rerun our analysis controlling for *Tangibility* and *# of Diversifying acquisitions* performed in the year prior to the appointment and find similar results (Coefficient: 0.009; significant at 5% level).

when using the full sample of non-financial firms might be driven due to such heterogeneity in firm characteristics.

<< INSERT TABLE 3-3 HERE >>

Results discussed above provide clear evidence in support of our hypothesis that prestigious directors have a positive influence on firm cash holdings. By reducing marginal costs of holding cash, such as, managers undertaking diversifying acquisitions, firms with prestigious directors are able to increase their cash holdings. This further increases the marginal benefits of holding cash as firms do not have to raise debt and can utilise the excess cash to fund their future growth opportunities. Hence, prestigious directors decrease the net leverage of treated firms after their appointment to the board; relative to firms appointing NAWDs. Our results provide support to the findings in past research that good corporate governance increases the value of cash holdings (e.g., Chou and Feng, 2019; Pinkowitz, Stulz and Williamson, 2006).

3.4.4 Stock Volatility and Firm Value

So far, we find that prestigious directors reduce firms' acquisitions, increase their cash holdings, and decrease their net leverage. We now examine if these changes in corporate behaviour translate into a reduction in risk and an increase in value.

Table 3-4 reports the results of the impact of prestigious directors on firm risk and value measured by *Stock Volatility* and *BTM* respectively. Columns (1) and (2) show the results when the control sample is identified using entropy balancing method and Columns (3) and (4) when the full sample of non-financial firms appointing NAWDs is taken as the control sample.

Results are in accordance with our expectations. In Column (1), we report that the stock volatility decreases by 0.1% after the appointment of PAWDs compared to the matched sample of NAWDs (statistically significant at 10% level). Similarly, in Column (2), we show that relative to the matched sample of control firms, treated firms' BTM ratio decreases by 0.099 (statistically significant at 5% level). This confirms our hypothesis that firm value increases after appointing prestigious directors (a lower BTM ratio means higher firm value). We rerun our analysis using

the full sample of non-financial firms appointing NAWDs. Although we find that the difference between the treated firms' and control firms' stock volatility is no longer significant, we show that the BTM ratio of treated firms is significantly lower after appointment of PAWDs than that of control firms (significant at 10% level).¹⁶

<< INSERT TABLE 3-4 HERE >>

Our results shed important light on the role of prestigious directors. Our findings imply that prestigious directors reduce managerial rent-seeking behaviour (proxied by diversifying acquisitions) which translates into reduced risk and increased valuation. Firms, after appointing of prestigious directors, undertake fewer acquisitions. This increases firm's cash holdings and decreases their net leverage. As past research points out, increased cash holdings can even be detrimental if managers partake in value-destroying activities instead of investing the cash in future growth opportunities (e.g., Dittmar, Mahrt-Smith and Servaes, 2003; Harford, 1999). Had it been the case, we would have seen that the value of firms appointing PAWDs is lower than that of firms appointing NAWDs. However, we find the opposite i.e., valuation of such firms is increasing and the risk is going down. Therefore, we conclude that shareholders trust prestigious directors to keep a check on managers such that they invest the cash reserve in an efficient manner in future positive NPV projects. In other words, we find support for the precautionary motive of holding cash similar to Cunha and Pollet (2020).

3.4.5 Do PAWDs get rewarded for effective monitoring?

In this section, we examine if PAWDs are rewarded for superior monitoring. We use two measures i.e., *Salary* and *Compensation*. *Salary* is the base annual pay in cash received by the director in a year whereas *Compensation* also includes bonuses in

¹⁶ In Appendix A3-1, we also report results with alternate measures of firm risk (idiosyncratic risk) and value (Tobin's Q). We find that idiosyncratic risk significantly reduces after the appointment of PAWDs compared to NAWDs (Column (1)). Further, in untabulated results, we also find the market risk (measured by Beta) is unaffected implying that the reduction in total risk is driven by a decrease in firm-specific or idiosyncratic risk. Additionally, Column (2) shows that results with Tobin's Q as a proxy for value are similar to those reported above for BTM. Hence, our results are robust to using alternative measures of firm value.

addition to the base pay. We collect the data from BoardEx and investigate if PAWDs' salary and compensation in the first year of their appointment was higher than that of NAWDs. We run an OLS regression as specified below:

$$y_i = \alpha_i + \beta_1(PAWD\ indicator)_i + kZ_i + \delta_{ind,t} + \epsilon_i \quad (3-2)$$

where y_i measures director remuneration. *PAWD indicator* is a dummy variable which sets to 1 for treated firms following the appointment of a PAWD on the board; 0 otherwise. Z_i is a vector of firm-level, time-varying control variables that might affect director's remuneration: Firm Size, ROA, BTM, % Independent Directors, Ln (Board Size), CEO Duality, Ln (Director Age), Director Gender, and Director Education. $\delta_{ind,t}$ is industry-by-year effects controlling for time-varying industry-level characteristics.

Table 3-5 reports the results. Columns (1) and (2) report the results when the control sample is estimated using the entropy balancing method whereas in Columns (3) and (4), the control sample is the full sample of non-financial firms appointing NAWDs. In Column (1), we find that PAWDs get significantly higher salary than NAWDs (Coeff. of Ln (Salary): 0.131, statistically significant at 5%). This corresponds to around 14% higher pay for PAWDs relative to NAWDs. Further, their overall compensation (salary plus bonus) is also significantly higher by around 16.7% than that of NAWDs (Column (2); Coeff. Of Ln (Compensation): 0.155, significant at 1% level). Our results are robust to using the full sample of non-financial firms as the control sample (Columns (3) and (4)). This is not surprising as in addition to the firm, board, and director level characteristics that might influence the remuneration amount, we also controlled for industry and year effects. Our results imply that firms anticipate and recognise PAWDs' value and accordingly reward them for their hard work.

<< INSERT TABLE 3-5 HERE >>

3.4.6 Robustness checks

Atanasov and Black (2021) develop a framework to test the validity of DID and shock-based instrument variable models. For a valid DID framework, two most

important conditions are: covariate balance and parallel trends. First, covariate balance entails that prior to the treatment (appointment of directors in our case), all the covariates for both the treatment and the control sample be balanced. To achieve pretreatment covariate balance, we employed entropy matching technique. Entropy matching assigns weights to the control sample such that the mean and variance of the treated and the control sample are identical. In Table 3-6, we report that entropy balancing method is able to achieve covariate balance of both samples. In Panel A, we show the mean and variance of control variables before balancing and in Panel B, we report results after employing entropy balancing method. From Panel A, we see that there is substantial difference in the means and variance between treated and control sample (see, Column (1) vs (3) and Column (2) vs (4)). However, Panel B shows that after employing entropy balancing method, mean and variance of both treated and control sample are identical. Thus, Table 3-6 provides evidence that entropy balancing method is able to achieve covariate balance.

<< INSERT TABLE 3-6 HERE >>

Second, we test the assumption of parallel trends. The inherent assumption with assigning the difference between treated and control firms to the dependent variable is that of parallel trends. It means that in the absence of the prestigious director's appointment to the board, one would expect that the outcome variables for both treated and control firms would move in a similar pattern. Hence, we check for the difference in means of outcome variables between treated and control firms for the year immediately prior to appointments. Any significant difference will possibly violate the assumption of parallel trends.

Table 3-7 reports the results. In Columns (1) through (6), we show the mean, median and standard deviation of dependent variables for both treated and control samples a year prior to the appointment. Column (7) reports the difference in means between treated and control firms. We find no statistically significant difference between treated and control samples except for acquisitions. Difference in means between two samples for both *# of acquisitions* and *# of diversifying acquisitions* are statistically significant at 5% level. This, however, is not an issue. On closer inspection, we see that a year immediately prior to appointments, treated firms are

carrying out more acquisitions than control firms. Further, we earlier find that after the appointment of PAWDs, treated firms undertake significantly less acquisitions than control firms (see Table 3-2). Hence, we see a reversal in trend of number of acquisitions performed between treated and control firms before and after directors' appointments. Overall, we conclude that the condition of parallel trends is satisfied and there is no difference in outcome variables of treated and control prior to appointments of PAWDs and NAWDs.

<< INSERT TABLE 3-7 HERE >>

Further, testing whether the firm risk-taking and valuation of treated and control firms prior to directors' appointments is similar also addresses the issue of endogeneity. A possible source of endogeneity in our study could be that PAWDs are systematically joining less risky and higher value firms. However, since there is no difference in risk-taking and value between treated and control samples, we infer that PAWDs are not systematically joining less risky and higher valuation firms and any changes in risk and value are attributed to the appointments of PAWDs. Further, Liu et al. (2021), Roberts and Whited (2018), Usman et al. (2022), Ye et al. (2020), and Zaman et al. (2021) argue that using DID with a matched control sample is sufficient to control for endogeneity.

3.5 Conclusion

In this paper, we examine the implications for firms appointing prestigious directors. However, a related issue is why would firms hire prestigious directors even if they extract higher remuneration? Our findings suggest that it is because they reduce agency costs related to managerial rent-seeking behaviour. The enhanced monitoring has several important implications on corporate behaviour. Prestigious directors limit firms' acquisition activities, in particular, diversifying acquisitions. This reduction in acquisitions further leads to an increase in corporate cash holdings as firms are able to save cash and not spend on value-destroying activities. Also, firms need not increase their borrowings and can now invest this excess cash in future growth opportunities increasing the marginal benefits of holding cash. Further, until

such growth opportunity arises, shareholders are not worried leaving excess cash with the firm as they “trust” that prestigious directors will keep a check on managers. This reduces the marginal costs of holding cash. Finally, we find that such corporate policy changes, in turn, reduces firm risk and increases firm valuation.

These findings support that not all directors are the same. We provide evidence that individual directors and not just overall board characteristics such as size, independence, etc. can influence corporate outcomes. In particular, our paper accentuates the importance of research that tries to answer why firms hire directors who stand up to the management (e.g., Fahlenbrach, Low and Stulz, 2010).

Finally, our results imply that reputation plays a huge role in motivating directors to fulfil their fiduciary duties towards shareholders. In general, directors are retained because of their loyalty to the board (Kaplan and Reishus, 1990). Then the question arises that why would directors go against the CEO? We show that prestigious directors indeed keep a check on the CEO, thereby, corroborating Fama and Jensen’s (1983) argument that the primary motivation of directors is to preserve and enhance their reputation.

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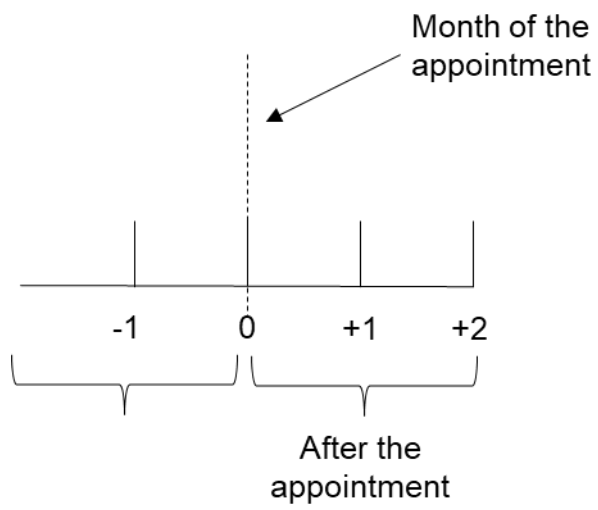


Figure 3-1 DID Estimation Window

This figure shows the estimation windows of two years on either side of the appointment used in the DID framework.

Table 3-1 Summary Statistics

	Full Sample			PAWDs		NAWDs		PAWDs - NAWDs
	Obs. (1)	Mean (2)	Std. Dev (3)	Mean (4)	Std. Dev (5)	Mean (6)	Std. Dev (7)	Difference (8)
Ln (Total Assets)	2504	20.81	1.86	21.28	1.88	20.75	1.85	0.53***
ROA (%)	2492	0.13	0.13	0.13	0.12	0.13	0.13	-0.00
BTM	2421	0.64	0.71	0.57	0.52	0.64	0.73	-0.08*
% Ind. Directors	2507	0.60	0.13	0.60	0.13	0.59	0.13	0.01
Board Size (#)	2507	9.08	2.44	9.48	2.52	9.03	2.43	0.38**
CEO Duality (1 = Yes)	2488	0.12	0.33	0.10	0.30	0.13	0.33	-0.02
Director Age (#)	2486	55.56	6.50	59.02	5.76	55.13	6.46	3.88***
Director Gender (1= Male)	2510	0.73	0.44	0.67	0.47	0.74	0.44	-0.07**
Director Education (1=Postgraduate Degree)	2510	0.76	0.42	0.83	0.38	0.77	0.42	0.06**
# of Acquisitions	2197	0.46	0.97	0.57	1.11	0.44	0.95	0.13*
# of Diversifying Acquisitions	1944	0.32	0.74	0.40	0.87	0.31	0.72	0.09*
Cash/Assets	2461	0.10	0.12	0.09	0.10	0.11	0.12	-0.01
Net Leverage	2280	0.19	0.24	0.21	0.23	0.19	0.24	0.01
Volatility	2492	0.02	0.01	0.02	0.01	0.02	0.01	0.00*
Salary ('000)	2432	29.58	27.30	33.79	27.45	29.06	27.25	4.73***
Total Compensation ('000)	2433	31.56	55.20	42.31	122.04	30.20	39.55	12.11***

This table presents summary statistics of dependent, independent and control variables. ROA, BTM, Cash/Assets, Net Leverage and Volatility are winsorised at 1% level. In Column (8), *, **, and *** denote statistical significance at 10%, 5% and 1% level respectively. See Section 3 for variable definitions.

Table 3-2 Director Prestige and Acquisitions

	Entropy Balancing Matched Sample		Full Sample	
	# of Acquisitions	# of Diversifying Acquisitions	# of Acquisitions	# of Diversifying Acquisitions
	(1)	(2)	(3)	(4)
PAWD Indicator	-0.208*	-0.269**	-0.210*	-0.233**
	(-1.83)	(-2.51)	(-1.78)	(-2.28)
Firm Size	0.014	-0.054	0.006	-0.006
	(0.30)	(-1.37)	(0.19)	(-0.22)
ROA	-0.082	0.090	-0.261	0.027
	(-0.18)	(0.22)	(-0.79)	(0.09)
BTM	0.090	0.073	0.069	0.034
	(1.16)	(1.11)	(1.21)	(0.67)
% Independent Directors	-0.697	0.037	-0.160	-0.060
	(-1.13)	(0.07)	(-0.46)	(-0.19)
Ln (Board Size)	-0.170	-0.261	-0.159	-0.140
	(-0.60)	(-1.03)	(-0.77)	(-0.77)
CEO Duality	-0.117	-0.121	0.096	0.043
	(-0.77)	(-0.75)	(0.81)	(0.41)
Ln (Director Age)	0.426	0.403	0.204	0.181
	(0.76)	(0.74)	(0.65)	(0.66)
Director Gender (1 = Male)	0.104	0.147	0.084	0.095
	(0.89)	(1.36)	(0.93)	(1.21)
Director Education (1 = Postgraduate Degree)	0.087	0.027	0.175*	0.071
	(0.58)	(0.19)	(1.95)	(0.89)
Constant	-0.996	0.070	-0.591	-0.503
	(-0.45)	(0.03)	(-0.38)	(-0.37)

Observations	2,013	1,797	2,013	1,797
R-squared	0.260	0.199	0.125	0.115
Industry # Year Effects	YES	YES	YES	YES

This table reports results from DID regressions of the effect of appointment of prestigious directors on firm acquisition behaviour. We estimate the following regression equation:

$$y_i = \alpha_i + \beta_1(PAWD\ indicator)_i + kZ_i + \delta_{ind,t} + \epsilon_i$$

where y_i measures firm acquisition behaviour. *PAWD indicator* is a dummy variable which sets to 1 for treated firms following the appointment of a PAWD on the board; 0 otherwise. Z_i is a vector of firm-level, time-varying control variables: Firm size, ROA, BTM, % Independent Directors, Ln (Board Size), CEO Duality, Ln (Director Age), Director Gender, and Director Education. All control variables are estimated a year prior to appointments of directors. $\delta_{ind,t}$ is industry-by-year effects controlling for time-varying industry-level characteristics. *# of Acquisitions* is the total number of acquisitions completed by a firm and *# of Diversifying Acquisitions* is the total number of acquisitions where the target firm is in a different industry than the acquiring firm. Columns (1) and (2) report the regression results when the control sample is obtained using entropy balancing method whereas Columns (3) and (4) reports results using the full sample of firms appointing NAWDs as the control sample. t-statistics is reported in brackets and *, **, and *** denote significance at 10%, 5% and 1% levels respectively.

Table 3-3 Director prestige and corporate financial policies.

	Entropy Balancing Matched Sample		Full Sample	
	Cash/Assets (1)	Net Leverage (2)	Cash/Assets (3)	Net Leverage (4)
PAWD Indicator	0.008* (1.68)	-0.012** (-2.17)	0.007 (1.19)	-0.010* (-1.69)
Firm Size	0.008*** (3.08)	0.005** (2.07)	0.009*** (5.47)	-0.002 (-1.14)
ROA	0.024 (0.75)	0.004 (0.12)	0.056*** (3.31)	-0.023 (-1.17)
BTM	0.007 (1.55)	-0.011*** (-2.79)	0.005* (1.82)	-0.002 (-0.67)
% Independent Directors	0.020 (0.92)	-0.049* (-1.87)	0.008 (0.43)	-0.018 (-1.06)
Ln (Board Size)	-0.024* (-1.72)	-0.030* (-1.76)	-0.041*** (-3.93)	-0.001 (-0.08)
CEO Duality	-0.012 (-1.24)	-0.010 (-1.12)	-0.003 (-0.48)	-0.018*** (-3.07)
Ln (Director Age)	-0.005 (-0.24)	0.023 (0.81)	-0.034** (-2.08)	0.026* (1.66)
Male	0.002 (0.43)	0.005 (0.97)	0.003 (0.72)	-0.002 (-0.38)
Postgraduate Degree (1 = Yes)	-0.006 (-0.87)	0.008 (0.98)	-0.001 (-0.18)	0.004 (0.87)
Constant	-0.041	-0.071	0.076	-0.019

	(-0.47)	(-0.61)	(0.71)	(-0.19)
Observations	2,159	1,894	2,159	1,894
R-squared	0.328	0.298	0.162	0.203
Industry * Year Effects	YES	YES	YES	YES

This table reports results from DID regressions of the effect of appointment of prestigious directors on firm financial policies.

We estimate the following regression equation:

$$y_i = \alpha_i + \beta_1(PAWD\ indicator)_i + kZ_i + \delta_{ind,t} + \epsilon_i$$

where y_i measures firm financial policies. *PAWD indicator* is a dummy variable which sets to 1 for treated firms following the appointment of a PAWD on the board; 0 otherwise. Z_i is a vector of firm-level, time-varying control variables: Firm size, ROA, BTM, % Independent Directors, Ln (Board Size), CEO Duality, Ln (Director Age), Director Gender, and Director Education. $\delta_{ind,t}$ is industry-by-year effects controlling for time-varying industry-level characteristics. All control variables are estimated a year prior to appointments of directors. *Cash/Assets* is cash and cash equivalents scaled by the lagged value of total assets. *Net Leverage* is the fraction of total debt minus cash and the lagged value of total assets. Columns (1) and (2) report the regression results when the control sample is obtained using entropy balancing method whereas Columns (3) and (4) reports results using the full sample of firms appointing NAWDs as the control sample. t-statistics is reported in brackets and *, **, and *** denote significance at 10%, 5% and 1% levels respectively.

Table 3-4 Director prestige and firm risk and value

	Entropy Balancing Method Sample		Full Sample	
	Stock Volatility	Book-to-Market (BTM) ratio	Stock Volatility	Book-to-Market (BTM) ratio
	(1)	(2)	(3)	(4)
PAWD Indicator	-0.001* (-1.91)	-0.099** (-1.99)	-0.001 (-1.10)	-0.095* (-1.77)
Firm Size	-0.000 (-0.58)	0.004 (0.19)	-0.000 (-1.23)	-0.013 (-0.68)
ROA	0.001 (0.56)	0.103 (0.36)	-0.003 (-1.62)	-0.166 (-0.80)
BTM	-0.002*** (-3.30)		-0.001*** (-5.52)	
% Independent Directors	0.004 (1.58)	-0.022 (-0.89)	0.004** (2.36)	-0.023 (-1.07)
Ln (Board Size)	-0.001 (-0.65)	-0.006 (-0.05)	-0.000 (-0.10)	0.168 (1.54)
CEO Duality	-0.002* (-1.91)	-0.155* (-1.71)	-0.000 (-0.38)	-0.031 (-0.43)
Ln (Director Age)	0.005* (1.91)	0.320 (0.99)	0.002 (1.15)	0.303* (1.70)
Director Gender (1 = Male)	-0.000 (-0.03)	-0.039 (-0.60)	0.000 (0.26)	-0.013 (-0.31)
Director Education (1 = Postgraduate Degree)	0.001 (1.41)	0.067 (1.23)	0.001*** (3.14)	0.082* (1.78)
Constant	-0.032***	-2.084*	-0.023**	-2.227***

	(-3.06)	(-1.69)	(-2.23)	(-2.79)
Observations	2,275	2,255	2,275	2,255
R-squared	0.576	0.270	0.508	0.227
Industry * Year Effects	YES	YES	YES	YES

This table reports results from DID regressions of the effect of appointment of prestigious directors on firm risk and value. We estimate the following regression equation:

$$y_i = \alpha_i + \beta_1(PAWD\ indicator)_i + kZ_i + \delta_{ind,t} + \epsilon_i$$

where y_i measures firm risk and value. *PAWD indicator* is a dummy variable which sets to 1 for treated firms following the appointment of a PAWD on the board; 0 otherwise. Z_i is a vector of firm-level, time-varying control variables: Firm size, ROA, BTM, % Independent Directors, Ln (Board Size), CEO Duality, Ln (Director Age), Director Gender, and Director Education. All control variables are estimated a year prior to appointments of directors. $\delta_{ind,t}$ is industry-by-year effects controlling for time-varying industry-level characteristics. *Stock Volatility* is calculated as the standard deviation of daily stock returns at yearly level (250 days). *Book-to-Market ratio* is the fraction of book value of equity and market value of equity. Columns (1) and (2) report the regression results when the control sample is obtained using entropy balancing method whereas Columns (3) and (4) reports results using the full sample of firms appointing NAWDs as the control sample. t-statistics is reported in brackets and *, **, and *** denote significance at 10%, 5% and 1% levels respectively.

Table 3-5 Director prestige and their remuneration

	Entropy Balancing Method Sample		Full Sample	
	Ln (Salary)	Ln (Total Compensation)	Ln (Salary)	Ln (Total Compensation)
	(1)	(2)	(3)	(4)
PAWD Indicator	0.131** (2.35)	0.155*** (2.68)	0.134** (2.24)	0.168*** (2.78)
Firm Size	0.167*** (6.49)	0.146*** (5.00)	0.203*** (12.64)	0.191*** (11.75)
ROA	0.001 (0.00)	-0.211 (-0.70)	0.106 (0.66)	-0.022 (-0.14)
BTM	-0.083 (-1.62)	-0.091* (-1.77)	-0.054* (-1.91)	-0.042 (-1.49)
% Independent Directors	-0.360 (-1.32)	-0.376 (-1.36)	-0.462*** (-2.69)	-0.457*** (-2.63)
Ln (Board Size)	-0.414*** (-2.66)	-0.333* (-1.76)	-0.543*** (-5.38)	-0.498*** (-4.86)
CEO Duality	0.065 (0.59)	0.037 (0.33)	0.040 (0.69)	0.033 (0.55)
Ln (Director Age)	0.310 (1.18)	0.299 (1.12)	0.372** (2.33)	0.374** (2.31)
Director Gender (1 = Male)	0.224*** (3.43)	0.245*** (3.66)	0.149*** (3.32)	0.158*** (3.47)
Director Education (1 = Postgraduate Degree)	-0.029 (-0.40)	-0.050 (-0.62)	0.035 (0.80)	0.031 (0.69)
Constant	-2.697**	-2.384**	-3.352***	-3.274***

	(-2.33)	(-2.03)	(-3.16)	(-3.05)
Observations	2,278	2,279	2,278	2,279
R-squared	0.304	0.286	0.247	0.241
Industry * Year Effects	YES	YES	YES	YES

This table reports results of prestigious directors and their remunerations. We estimate the following regression equation:

$$y_i = \alpha_i + \beta_1(PAWD\ indicator)_i + kZ_i + \delta_{ind,t} + \epsilon_i$$

where y measures director remuneration. *PAWD indicator* is a dummy variable which sets to 1 for treated firms following the appointment of a PAWD on the board; 0 otherwise. Z_i is a vector of firm-level, time-varying control variables that might affect director's remuneration: Firm Size, ROA, BTM, % Independent Directors, Ln (Board Size), CEO Duality, Ln (Director Age), Director Gender, and Director Education. $\delta_{ind,t}$ is industry-by-year effects controlling for time-varying industry-level characteristics. Columns (1) and (2) report the regression results when the control sample is obtained using entropy balancing method whereas Columns (3) and (4) reports results using the full sample of firms appointing NAWDs as the control sample. t-statistics is reported in brackets and *, **, and *** denote significance at 10%, 5% and 1% levels respectively.

Table 3-6 Covariate balance of treated and control sample

	Treated Sample (PAWD Appointments)		Control Sample	
	Mean (1)	Variance (2)	Mean (3)	Variance (4)
<i>Panel A: Before balancing</i>				
Firm Size	21.260	3.563	20.740	3.470
ROA	0.124	0.013	0.133	0.016
BTM	0.628	0.440	0.640	0.595
% Independent Directors	0.600	0.016	0.592	0.017
Ln (Board Size)	2.215	0.072	2.168	0.070
CEO Duality	0.106	0.095	0.128	0.111
Ln (Director Age)	4.054	0.010	3.986	0.015
Director Gender (1 = Male)	0.675	0.220	0.734	0.196
Director Education (1 = Postgraduate Degree)	0.835	0.138	0.771	0.177
<i>Panel B: After balancing through entropy balancing method</i>				
Firm Size	21.260	3.563	21.260	3.563
ROA	0.124	0.013	0.124	0.013
BTM	0.628	0.440	0.628	0.440
% Independent Directors	0.600	0.016	0.600	0.016
Ln (Board Size)	2.215	0.072	2.215	0.072
CEO Duality	0.106	0.095	0.106	0.095
Ln (Dir. Age)	4.054	0.010	4.054	0.010
Director Gender (1 = Male)	0.675	0.220	0.675	0.220

Director Education (1 = Postgraduate Degree)	0.835	0.138	0.835	0.138
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This table reports the mean and variance of the covariates. In Panel A, we show the mean and variance of covariates before balancing and in Panel B, we report the mean and variance after achieving covariate balance through entropy balancing method.

Table 3-7 Comparison of outcome variables between treated and control sample for the year immediately prior to the treatment.

	Treated Sample			Control Sample			Treated-Control
	Mean	Median	Std Dev	Mean	Median	Std Dev	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Net Leverage	0.20	0.18	0.23	0.21	0.19	0.25	-0.01
Cash/Assets	0.10	0.06	0.14	0.11	0.06	0.13	-0.00
Stock Volatility	0.02	0.02	0.01	0.02	0.02	0.01	-0.00
BTM	0.62	0.43	0.66	0.65	0.42	0.78	-0.03
# of Acquisitions	0.57	0	1.05	0.43	0	0.94	0.14**
# of Diversifying Acquisitions	0.43	0	0.85	0.30	0	0.75	0.13**

This table reports summary statistics for the outcome variables for both treated and control firms for the year immediately prior to the treatment. The last column shows the difference between treated and control firms. *, **, and *** denote statistical significance at 10%, 5%, and 1% level respectively.

Appendix A3

Table A3-1 Director prestige and firm risk and value

	Idiosyncratic Volatility (1)	Ln (Tobin's Q) (2)
PAWD Indicator	-0.0001** (-2.22)	0.1263** (2.55)
Firm Size	0.0000 (0.93)	-0.2060*** (-9.40)
BTM	-0.0001** (-1.98)	
ROA	-0.0002 (-0.54)	2.4551*** (8.49)
% Independent Directors	0.0001 (0.36)	0.4311* (1.82)
Ln (Board Size)	-0.0004** (-2.37)	0.8006*** (5.94)
CEO Duality	0.0000 (0.07)	-0.1255 (-1.42)
Ln (Director Age)	0.0010*** (3.19)	0.1515 (0.53)
Director Gender (1 = Male)	-0.0001 (-1.31)	-0.0470 (-0.70)
Director Education (1 = Postgraduate Degree)	0.0001	-0.0146

Constant	(1.21) -0.0048*** (-3.36)	(-0.24) 1.7474 (1.52)
Observations	2,275	2,307
R-squared	0.353	0.427
Industry # Year Effects	YES	YES

This table reports results of the effect of appointment of prestigious directors on firm's risk and value. Firm risk is measured using idiosyncratic risk where

$$Idiosyncratic\ risk = s^2(R_i) - \beta^2 * s^2(R_m)$$

And, firm value is measured using Tobin's Q following Bhagat and Black (2002), where

$$Ln(Tobin's\ Q) = Ln\left(\frac{MV\ of\ Common\ Stock + BV\ of\ Preferred\ Stock + BV\ of\ Long-term\ Debt}{BV\ of\ Total\ Assets}\right)$$

PAWD indicator is a dummy variable which sets to 1 for treated firms following the appointment of a PAWD on the board; 0 otherwise. All control variables are estimated a year prior to appointments of directors. Both Columns (1) and (2) report the regression results when the control sample is obtained using entropy balancing method. t-statistics is reported in brackets and *, **, and *** denote significance at 10%, 5% and 1% levels respectively.

Conclusion

Independent directors are crucial to monitoring the management and providing resources (Fahlenbrach, Low and Stulz, 2017; Nguyen and Nielsen, 2010). But not all independent directors have the same ability or the expertise. Indeed, research has moved on from examining general board characteristics (e.g., board size, fraction of independent directors) to investigating the impact of various types of directors such as academic directors (e.g., Chen, Garel and Tourani-Rad, 2019), female directors (e.g., Adams and Ferreira, 2009), directors with bankruptcy experience (Gopalan, Gormley and Kalda, 2021), etc. The key reason behind this shift is that individual traits shape directors' decision-making which in turn affects the firm's policy choices.

My thesis contributes to this strand of literature by arguing that prestige is one such characteristic that identifies directors with high human and social capital. Firms would want to hire directors who are better monitors and who provide key resources needed by them. But the question arises that how a firm would identify such directors? The Resource Dependence Theory (RDT) as well as the Agency Theory argues that prestigious directors will be better than others in performing their roles; albeit using different rationale. On one hand, the RDT posits that prestigious directors will be better than others in bringing key resources to the firm. On the other hand, the Agency Theory postulates that directors will act as effective monitors as not doing so will harm their reputation and reduce their chances of additional directorships (Fama and Jensen, 1983). Thus, preserving their reputation in the director labour market is a sufficient incentive for directors to conduct diligent monitoring.

Past research considers either the number of additional directorships (e.g., Ferris, Jagannathan and Pritchard, 2003; Kaplan and Reishus, 1990, Shivdasani, 1993), CEO awards (Gogolin, Cummins and Dowling, 2018) or firm size (e.g., Oehmichen et al., 2017) as a proxy of director prestige. However, these are either outdated or inapt measures. First, investors, regulators, and management dislike "overboarding" because of the negative implications of

busy directors (e.g., Fich and Shivdasani, 2006). Hence, number of additional directorships is an outdated measure of director prestige. Second, many firms do not or are not able to appoint CEOs as outside directors. Thus, CEO awards is not an appropriate proxy of director prestige as it excludes a large number of firms from the sample. Finally, previous literature deems a director to be prestigious if he or she works for a large firm. I argue that prestige emanates from their personal achievement and not from where they previously worked.

We take advantage of the unique institutional setting of the UK: The Queen's honours as a proxy of director prestige. I argue that they are an appropriate proxy for two reasons. First, they are conferred by the sovereign for life-long exemplary services after a rigorous vetting process by several independent experts as well as the government. Hence, they are highly selective, credible, and inimitable. Second, recipients of these awards add the title of the honour either as a prefix or suffix to their names making them highly visible. Therefore, I investigate the impact of prestigious directors on firm performance, risk, and value by using the Queen's honours.

In Chapter 2, I, first, provide detailed reasonings of why Queen's honours are an appropriate proxy of director prestige. I, then, examine the impact of director prestige on firm performance and find that prestigious directors significantly improve both short- and long-term performance. My results are robust to using an entropy balanced control sample and after controlling for endogeneity using 2SLS and Heckman two-part model regression models. I also find that the significance is driven by the first appointment of prestigious directors suggesting that there is no incremental value in associating more than one PAWD. An important contribution of my research is that I investigate the channels through which prestigious directors benefit firms and show that the improved firm performance is due to monitoring, providing preferential access to resources, and legitimacy roles of prestigious directors.

In Chapter 3, I investigate the impact of director prestige on firm acquisition behaviour, cash holdings, risk, and value. I find that firms appointing prestigious

directors significantly reduce their acquisitions and increase their cash holdings. This leads to a reduction in net leverage as firms need not borrow externally to fund their future projects. I also show that there is a significant reduction in risk and an increase in the value of the firm after the appointment of prestigious directors. As past literature proxies managerial rent-seeking behaviour through acquisitions and cash holdings, these findings suggest that prestigious directors reduce agency costs because they are better monitors. Moreover, I find that they are awarded for being effective monitors as their salary and total compensation are significantly higher than other non-award-winning directors (NAWDs).

My findings have several important implications. First, they suggest that it is not just the board-level characteristics (e.g., independence, size, etc.) but also individual directors' traits that influence corporate outcomes. My finding that the significant performance results are driven by the first appointment of a PAWD also indicates that even one reputable director can make a significant difference to the firm. Second, my findings explain why firms prefer hiring some directors over others even if they extract higher remuneration. This thesis sheds light on the fact that not all directors are the same and that director prestige could be a distinguishing feature through which firms can identify directors with greater ability to contribute to board deliberations. Finally, my study highlights that the theoretical arguments made in the RDT and the Agency Theory about prestigious directors hold true and that directors are not mere "attractive ornaments on the Corporate Christmas Tree" (Mace, 1986; p. 107).

4.1 Limitations and Future Research

Although I present a holistic picture of the implications of director prestige on firm outcomes, this thesis is not without its limitations. These limitations, in turn, open new avenues for future research. First, I use Queen's honours to measure director prestige. These awards are well-known in the UK context. However, whether such national prestigious awards can be used in other institutional contexts is still yet to be examined. Every country has such system of awards.

For instance, in the Commonwealth countries, similar, if not the same, award system not only exists but carries similar importance and hence it may be possible to replicate these studies to test if the results of the impact of prestigious awards in such nations are the same.

Second, in Chapter 2, I find that the market significantly values the monitoring, preferential access to resources, and legitimacy roles of prestigious directors. Moreover, in Chapter 3, I examine the impact of PAWDs on several risk-related firm outcomes motivating my hypotheses via the monitoring contribution of prestigious directors. However, for further research, it would be interesting to find a direct measure of monitoring to provide evidence that the effect of PAWDs is indeed due to their effective monitoring. Similarly, further research is required to see if PAWDs help firms in gaining government contracts thereby examining the preferential access to resources contribution in detail.

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