2021

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A R T I C L E   I N F O

A B S T R A C T

We examine the effect of co-opted boards on corporate misconduct and document a significant positive relationship. Utilising a large sample of public U.S. companies from the period 2001 to 2015, we find that a one standard deviation increase in the proportion of co-opted directors on a board leads to a 4.3% rise in corporate misconduct. This outcome is robust to a series of sensitivity tests and continues to hold after accounting for potential endogeneity concerns. Further analyses indicate that co-opted directors propose fewer board agenda items, exhibit lower attendance at board meetings, and receive compensation packages in excess of industry norms, which exacerbate stakeholder-agency conflicts. Cross-sectional analysis demonstrates that the documented relationship is most pronounced among firms with weak external monitoring, greater CEO-board social ties, boards whose members have high career concerns, and where CEO power is low. Additional tests reveal that co-opted directors engage in more environmental- and workplace-related violations than other types of stakeholder violations. Overall, our investigation generates original evidence that the presence of co-opted directors aggravates the incidence of corporate wrongdoing. Our study contributes to the continuing debate on the role of boards of directors and has policy implications for those responsible for devising and monitoring effective systems of corporate governance.

1. Introduction

We examine whether, and how co-opted directors (those appointed after a CEO assumes office) influence corporate misconduct. Our study is motivated by a series of high-profile corporate scandals, ranging from accounting malpractice (e.g., Enron in 2001 and World Com in 2002); to environmental violations (e.g., the Volkswagen emissions case of 2015; the Duke Energy oil spill of 2017; and the Apple product obsolescence case of 2019); and some recent data breaches (e.g., Uber in 2018 and British Airways in 2019). Extensive media coverage given to these scandals has invoked universal condemnation and inflicted considerable reputational damage on the culprits, resulting in severe financial consequences for both companies and stakeholders (Karpoff and Lott Jr, 1993; Zaman

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et al., 2020a).[1] The estimated penalties imposed on US-listed companies for corporate misconduct amounted to US$1098.52 billion during the period 2002–2015 (Jain and Zaman, 2020). As well as these severe financial penalties and associated legal costs, loss of trust in a company undermines investors' confidence, damages shareholder value, causes misallocation of capital resources, and increases financial market instability (Cumming et al., 2015a; Cumming et al., 2018; Johnson et al., 2009; Karpoff, 2020; Köster and Pelster, 2017). The incidence of such scandals makes it clear that boards of directors (BoDs) have failed to fulfil their fiduciary duties, betraying the trust of not only stakeholders but of society in general. Given such far-reaching negative consequences of corporate misconduct, our study investigates the extent to which co-opted directors fulfil their fiduciary duty to protect the interests of stakeholders, who depend on them to obviate the negative consequences of corporate malpractice.

Many studies have emphasised the role played by corporate governance in reducing instances of corporate wrongdoing (Jain and Jamali, 2016; Zaman et al., 2020b). A large proportion of these studies suggest that a well-structured board needs to have gender diversity (Cumming et al., 2015b), well-functioning board committees (Agrawal and Chadha, 2005; Beasley et al., 2000), and more independent directors in order to reduce corporate misconduct through effective monitoring (Avci et al., 2018; Jain and Zaman, 2020).[2] However, a recent surge in cases of corporate misbehaviour has inspired further research, and the latest studies have identified directors' connections to management as a primary cause of poor or negligent monitoring (Baghdadi et al., 2020; Lee et al., 2020; Lim et al., 2020). For example, Coles et al. (2014) demonstrate that an increase in the proportion of co-opted directors (irrespective of whether they are executive or independent directors) diminishes the effectiveness of board monitoring.

Despite the new listing requirements of the NYSE and NASDAQ following the Sarbanes-Oxley Act (SOX), which aims to reduce the direct involvement of a CEO in the nomination of new board members, the process is still substantially influenced by the CEO (Cai et al., 2009; Wintoki and Xi, 2019).[3] Clearly, whether a CEO can orchestrate corporate outcomes by appointing directors of his or her choice is of paramount importance for stakeholders, regulators and the public. Therefore, in this study, we seek to determine if, and to what extent, a CEO's control of a board's composition shapes a firm's propensity to engage in acts of corporate misconduct.

Co-opted directors, regardless of whether they are executive or independent directors, are more inclined to pledge their allegiance to the CEO than to a company's stakeholders because of the CEO's patronage in securing their appointment. In support of this contention, Coles et al. (2014) demonstrate that co-opted boards do not compel a CEO's resignation in the aftermath of poor performance, while displaying a propensity to increase a CEO's remuneration package, as well as supporting management's risky or suboptimal investment decisions (Harris et al., 2019). Anecdotal evidence, derived from a case brought by shareholders against an independent director of Facebook Inc., provides evidence of the corrosive influence of co-opted directors[4] (Frier and Feeley, 2016). In a more recent case, the BoDs of Alphabet Inc. were cited for rejecting 14 independent shareholders' proposals to increase management accountability (S&P Global, 2019). Such examples support our assertion that the weak monitoring consequential to board co-option is more likely to obfuscate management accountability and increase the probability of stakeholder violations.

Founding our investigation on stakeholder-agency theory, we examine the extent to which a co-opted board is conducive to the violation of stakeholders' interests. Stakeholder-agency theory posits the existence of an implicit contract between stakeholders (multiple principals) and agents (managers), whereas traditional agency theory focuses on the relationship between shareholders and managers (Hill and Jones, 1992). We base our argument on the findings of the board co-option literature, hypothesising that directors (whether executive or independent) appointed following a CEO's accession are disinclined to fulfil their fiduciary duty to protect stakeholders by questioning the management's status quo. Motivated by self-interest, such managers may compromise stakeholders' interests (Hill and Jones, 1992; Jain and Zaman, 2020). Anecdotal evidence of co-opted directors' involvement in the violation of stakeholders' rights is provided by the U.S. *Securities and Exchange Commission* (SEC) v. *Carlos Ghosn and Gregory Kelly*, which involved the Nissan Motor Company. The SEC charged Carlos Ghosn, the company's CEO, and Gregory Kelly with fraudulently concealing US$140 million of compensation and retirement benefits from Nissan's investors.[5] This gross violation resulted in a fine being imposed on Nissan of US$15 million. Similarly, in the more recent Airbus Inc. global bribery scandal, the AirAsia co-opted board Chair and CEO were jointly accused of accepting a bribe of US$50 million from Airbus Inc. for placing an order for aircraft (Das, 2020).

Conversely, the empirical work of others asserts that directors are more inclined to fulfil their fiduciary duties because of career concerns and to maintain the perceived legitimacy of the board (Cowen and Marcel, 2011; Fich and Shivdasani, 2007). Despite being co-opted, such directors are diligent monitors because they fear reputational damage and a loss of legitimacy, and this may help to align the divergent interests of managers and stakeholders and reduce corporate misconduct.

To test these competing arguments, we use penalties data obtained from the Violation Tracker, produced by the *Corporate Research*

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[1] For example, a week after the announcement of the Volkswagen (VW) scandal, the price of VW stock crashed by 50% (La Monica, 2015). In the WorldCom case, the Securities and Exchange Commission (SEC) fined the company $2.25 billion, which led to its bankruptcy and district court negotiations resulted in $750 million costs.

[2] Another stream of literature shows that CEO risk-taking incentives (Bouslah et al., 2018), CEO tournament incentives (Hass et al., 2015), CEO tenure (Altunbaş et al., 2018), CEO hubris (Tang et al., 2015) and compromised auditors, as happened in the case of the Enron and Arthur Andersen scandal (Dyck et al., 2013), increase the likelihood of corporate misconduct.

[3] The CEO in any case approves, if not actually chooses, the slate of directors, who are ultimately available for shareholders to vote for in annual general meetings (Hermalin et al., 1998).

[4] Mark Andreessen was alleged to be co-opted by CEO Mark Zuckerberg and subsequently was sued by shareholders for voting rights violations (Frier and Feeley, 2016).

[5] See SEC Press release: https://www.sec.gov/litigation/litreleases/2019/lr24606.htm.

Project of Good Jobs First[6] to identify instances of corporate misconduct. Data relating to board co-option are collected from Lalitha Naveen's website from 2001 to 2015 (Coles et al., 2014). Our analysis provides the first evidence that a larger proportion of co-opted directors on a board increases the cost as well as the occurrence of corporate misconduct. Our results are not only statistically significant but also economically meaningful. Most importantly, we find that a one standard deviation increase in the proportion of co-opted directors on a board leads to a 4.3% rise in corporate misconduct, which equates to an increase of US$0.323 million in fines.

These findings remain consistent following the application of a large number of robustness tests: (i) adopting alternative measurement of corporate misconduct and board co-option; (ii) controlling for the 2008 Global Financial Crisis (GFC); and (iii) taking into account the state fixed effect. Our results consistently demonstrate that co-opted directors, due to their allegiance to management, fail to protect stakeholders' interests, supporting the theoretical argument that co-option leads to weaker board monitoring and a higher level of corporate misconduct.

We employ a number of techniques to counter potential endogeneity issues. First, we address possible reverse causality by examining a subset of firms that have had a constant co-option ratio for at least two consecutive years. Second, we perform a Propensity Score Matching (PSM) analysis to identify firms with co-opted directors, which are indistinguishable from firms without co-opted directors. Third, we undertake a difference in difference (DiD) analysis using CEO sudden deaths to represent an exogenous shock to board composition. Fourth, we address the measurement error whereby board co-option may reflect the CEO's power and directors' inexperience and lack of skills rather than board connectedness with management. In all four tests that formally address endogeneity concerns, we find that the results are consistent with our baseline findings.

Building on the proposition that board co-option leads to increased corporate misconduct due to poor monitoring, we perform subsample analysis tests, conditional on directors' engagement in proposing board agenda items, directors' meeting attendance, and directors' compensation levels. Our findings indicate that co-opted directors: (i) make fewer agenda item proposals, (ii) attend fewer board meetings, and (iii) receive levels of compensation above industry norms. These factors exacerbate stakeholder-agency conflicts, resulting in an increase in corporate misconduct incidents and/or costs. We further examine the conditions engendering the baseline effect. Our analysis demonstrates that the positive relationship between co-opted boards and corporate misconduct is stronger among businesses that are poorly governed. In other words, they have a poorer information environment, and are subject to weaker monitoring by institutional investors or fewer analysts' following. Further, this relationship is more pronounced when a CEO and board members have high social ties, when directors have more intense career concerns, and when a CEO's powers are weak.

In a supplementary analysis, we demonstrate that co-opted directors are more likely to engage in violations that incur less long-term reputational damage (as in environmental breaches) and where regulators implement lower punitive measures (as when workers' rights are contravened). In our final analysis, we consider heterogeneity among co-opted and non-co-opted directors and the corporate misconduct nexus. Our results confirm that firms with a higher proportion of non-co-opted board members, including non-co-opted independent directors, experience significantly fewer incidents of misconduct. Taken together, our results consistently demonstrate that the presence of co-opted directors leads to a higher level of corporate misconduct due to their failure to fulfil their fiduciary duties to protect stakeholders' interests.

Our study makes a valuable contribution to two strands of the literature. First, it augments the growing body of research on corporate misconduct by examining the behaviour of co-opted directors. Prior literature demonstrates that CEO risk-taking incentives (Armstrong et al., 2013; Bouslah et al., 2018), CEO hubris (Tang et al., 2015), gender diversity (Cumming et al., 2015a), audit committees (Agrawal and Chadha, 2005; Beasley et al., 2000), and board independence influence corporate misconduct (Avci et al., 2018; Jain and Zaman, 2020; Mishina et al., 2010). We extend this literature by identifying an important factor that magnifies corporate misconduct, namely, co-opted directors. We further contribute to the misconduct literature by documenting the levels of heterogeneity across different types of misconduct in the board co-option and misconduct nexus.

Second, our research contributes to the long-standing debate on board effectiveness. Previous studies demonstrate that co-opted directors exhibit partiality in monitoring and that other decisions they make may be influenced, in part, by their allegiance to the CEO (Baghdadi et al., 2020; Coles et al., 2014). Recent studies of co-opted directors suggest that an increase in their proportion on a board causes inefficient R&D investment (Harris et al., 2019), lower dividend payout (Jiraporn and Lee, 2018), higher-earnings manipulation (Cassell et al., 2018), a reduced likelihood of adopting a firm clawback provision (Huang et al., 2019), greater loan covenant restriction (Lim et al., 2020), and more erratic and arbitrary decision-making (Baghdadi et al., 2020). We augment this strand of literature by highlighting the adverse influence of co-opted directors on firms' behaviours in general and corporate misconduct in particular. Our study, therefore, adds fresh evidence to a growing body of literature that investigates the "dark side" of co-opted boards.

Further, our study has policy value. Our findings contribute to the debate on the effectiveness of the SOX Act 2002, which legislated for greater board independence in curbing corporate misconduct, as we demonstrate that not all independent directors behave consistently in their monitoring to reduce such infractions. Our study, in unpacking the board co-option and corporate misconduct nexus, has important implications for senior management seeking to reduce irresponsible business practices.[7]

The remainder of the paper is organised as follows. Section 2 discusses the theoretical framework and hypothesis development. Section 3 discusses the research design. Section 4 reports and analyses the empirical results, including a set of robustness tests and tests

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[6] We are grateful to Philip Mattera of 'Good Jobs First' for giving us access to the data on corporate misconduct.
[7] CEOs of leading US listed companies (including Walmart, Apple and Exxon Mobil Corporation), in recent business roundtables, have expressed the opinion that the purpose of corporations is to deliver value to diverse stakeholders, the wider society and their shareholders. See the summary of the Business Roundtable meeting on August 19, 2019 at https://opportunity.businessroundtable.org/ourcommitment/.

dealing with endogeneity concerns. Section 5 presents the channel analysis. Section 6 examines the role of external monitoring agencies, board members' personal attributes, and CEO power on the documented relationship. Section 7 presents the results of an additional analysis of corporate misconduct heterogeneity and the role played by non-co-opted directors in curtailing corporate misconduct. Section 8 concludes this study.

2. Theoretical framing and hypothesis development

2.1. Theoretical framework for stakeholder–agency conflicts: stakeholder–agency theory

Traditional agency theory argues that the separation of ownership and control creates agency problems. This dichotomy is typically observed in public listed companies, in which opportunistic managers are able to exploit corporate resources to their own advantage because it is difficult and expensive to monitor their behaviour and decisions (Jensen and Meckling, 1976). However, the minimisation of agency costs to shareholders relies primarily on a BoD's ability to protect their interests through effective monitoring. Whereas one theoretical approach argues that the BoDs is of value in this respect (Adams and Ferreira, 2007; Adams et al., 2010; Faleye et al., 2011), the empirical literature offers divergent opinions on their efficacy, and especially of independent directors (Jain and Jamali, 2016). Scholars who advocate BoDs as a symbol of good corporate governance contend that independent directors are in a position to monitor managers impartially and restrain their opportunistic behaviour (Brickley et al., 1997; Hambrick et al., 2015; Jiang et al., 2016), curbing corporate wrongdoing (Agrawal and Chadha, 2005; Jain and Zaman, 2020).

Conversely, a number of studies demonstrate that the presence of independent directors on boards does not reduce firms' engagement in corporate misconduct (Boivie et al., 2016; Cumming et al., 2015b; Dah et al., 2014). These studies stigmatise directors as weak monitors and find that BoDs sometimes create unintendedly negative consequences for companies, exacerbating agency conflicts (Arthaud-Day et al., 2006; Boivie et al., 2016). Ineffective BoDs can result in suboptimal agent monitoring and thus provide managers with an opportunity to pursue personal agendas and engage in misconduct without fear of accountability (Cavaco et al., 2017; Dah et al., 2014; Neville et al., 2019). Inevitably, managers' self-interested wrongdoing will not only have adverse consequences for shareholders, reducing the value of their investments, but will also undermine other stakeholders' interests. Hence, far-reaching consequences arising from corporate misconduct extending beyond shareholders' interests can result in a significant stakeholder-agency problem (Hill and Jones, 1992; Jain and Zaman, 2020). Stakeholder agency theory maintains that managerial agents enter into an implicit contract with all other stakeholders (Hill and Jones, 1992). However, the standard agency theory model, based on the principal-agent relationship, ignores this implied contractual relationship. Therefore, it is unable to explain why BoDs that are responsible for aligning agents' and principals' interests fail to achieve this objective, and why they permit managements to engage in irresponsible actions at the expense of stakeholders.

Hence, to examine the co-opted board and corporate misconduct relationship, we adopt stakeholder–agency theory (Hill and Jones, 1992). According to the principles of this theory, firms give implicit substance to an incomplete contract between a CEO (management agent) and multiple stakeholders. We argue that the assumption of agent opportunism and self-interest still holds in a stakeholder-agency relationship, albeit examining the divergent interests between management and stakeholders. We define corporate misconduct as a firm's deviant behaviour towards multiple principals, namely, stakeholders (including shareholders), in contrast to similar behaviour towards a single principal (shareholders) according to standard agency theory. Thus, corporate violations of stakeholders' interests create agency-like problems between multiple principals and the agent (Fama and Jensen, 1983; Jain and Zaman, 2020; Jensen and Meckling, 1976).

Stakeholders rely on the monitoring of boards of directors, and especially independent directors, because they have a statutory and fiduciary duty to oversee management and safeguard stakeholders' rights by obviating conflicts between them (Hill and Jones, 1992; Jain and Zaman, 2020; Krause et al., 2017; Mitchell et al., 2016). This mandate is proactive and contemplates the full engagement of BoDs. Similarly, directors are generally protected by the business judgement rule when carrying out their duties, so long as they do not violate their fiduciary responsibility of care and loyalty, which establishes the principle that directors must act in good faith towards all stakeholders. However, BoDs face constraints when conducting their fiduciary duties, and scholars have linked their ineffectiveness to a lack of expertise, a lack of independence, weak incentives, limited resources, and connectedness with management (Boivie et al., 2016). Even if boards were independent, well-qualified and had ample resources, their connectedness with management would remain an intrinsic limitation of their ability to perform their duties and protect stakeholders' interests (Baghdadi et al., 2020; Coles et al., 2014). Therefore, we argue that co-opted directors, due to their allegiance to the CEO, fail to perform due diligence in executive monitoring. Thus, the prevailing corporate ethos will induce managers to pursue their personal agendas at the expense of stakeholders, leading to substandard board performance (Dah et al., 2014; Jain and Zaman, 2020). Accordingly, the theoretical background that we explore identifies stakeholder-agency theory as an appropriate lens through which to focus on the impact of co-opted BoDs on levels of corporate misconduct. Next, we hypothesise the mechanisms that create a relationship between co-opted boards and corporate misconduct.

2.2. Co-opted BoDs and corporate misconduct

Prior literature has raised significant concerns about the role of the CEO in making appointments to BoDs, questioning the impartiality and efficacy of such directors' decision-making (Baghdadi et al., 2020; Chaivisuttangkun and Jiraporn, 2020; Coles et al., 2014; Jiraporn and Lee, 2018; Lee et al., 2020; Lim et al., 2020). The literature appears univocal in asserting that a CEO will appoint board members with whom management can establish a comfortable working relationship and who share reciprocal work ethics (Adams and Ferreira, 2007; Coles et al., 2014; Wade et al., 1990; Wintoki and Xi, 2019). Co-opted board members have subsequently been considered to be faithful to

those making the appointment; namely, management. Serving loyalties and personal ties with the latter compromises their monitoring abilities and often results in prejudiced behaviour towards stakeholders (Kuang and Lee, 2017; Lim et al., 2020).

Studies have demonstrated that the presence of co-opted directors, regardless of whether they are executive or independent, weakens their ability to monitor management, which compromises the protection of stakeholders' rights. Such weak monitoring is proportional to the number of co-opted directors on a board, and firms with a higher proportion of co-opted directors not only protect managers from dismissal (Coles et al., 2014) but also reward them with excessive stock compensation (Morse et al., 2011). Therefore, the presence of co-opted BoDs induces managers to pursue personal agendas, exacerbating agency conflicts between agents and principals (stakeholders). Recently, Jiraporn and Lee (2018) find that companies with a high proportion of co-opted BoDs retain more cash instead of correctly distributing this uninvested surplus among shareholders. Such excessive cash holding in the presence of weak governance encourages managers to seek short-term goals (Jiraporn and Lee, 2018). Hence, managers driven by personal motives may implicate their companies in misconduct (Armstrong et al., 2010; Bouslah et al., 2018; Jain and Zaman, 2020). In classic scandals, such as the Enron accounting fraud and, more recently, the Airbus Inc. global bribery case, there is a significant association between co-opted boards of directors and senior executives, namely, CEOs (Batson, 2003; O'Connor, 2002; Pegg and Evans, 2020). Indeed, the UK court judgement in the Airbus Inc. case cites many instances of directors and CEOs of global companies jointly committing acts of corporate misconduct by accepting millions of dollars in bribes from Airbus staff.[8]

Based on the foregoing discussions, we argue that the propensity of a firm to engage in corporate misconduct at the expense of its stakeholders will be particularly high in the presence of co-opted board members. Co-opted boards, due to their allegiance to management, might be reluctant to reprimand or dismiss senior executives in the event of corporate infractions (Coles et al., 2014). Further, the presence of co-opted BoDs may also wrongly bolster management's confidence and belief in their ability to evade any negative consequences of their misconduct (Tang et al., 2015). For example, in the event of their corporate wrongdoing, management may put pressure on co-opted members to fabricate or obfuscate internal records, making it harder for prosecutors to prove malfeasance in court proceedings (Arlen and Carney, 1992). Follow-up studies further suggest that co-opted BoDs are associated with lower CEO turnover (Coles et al., 2014), higher earnings management (Cassell et al., 2018), significantly increased R&D investment (Chintrakarn et al., 2016), a lower likelihood of clawback provisions (Huang et al., 2019), more stringent debt regulations (Lim et al., 2020), and high stock volatility (Huang et al., 2020). Overall, the literature documents a negative relationship between board co-option and the effectiveness of governance.

We further argue that the presence of co-opted BoDs will weaken the monitoring of managerial decisions and of a firm's governance practices, reducing stakeholder protections. In line with our arguments, Lim et al. (2020) find that creditors include more covenant restrictions when making loans to firms with a high proportion of co-opted BoDs. Likewise, analysts award higher recommendations to firms with fewer co-opted directors (Papangkorn et al., 2020). Other studies provide supportive evidence that stakeholders do not trust co-opted BoDs to alleviate stakeholder-agency conflicts (Hill and Jones, 1992; Jain and Zaman, 2020; Mitchell et al., 2016). Therefore, the participation of co-opted directors on a board, complying with their CEO's wishes, compromises their monitoring of managers' decisions. Consequently, as the proportion of co-opted directors increases, it becomes progressively less likely that managerial decisions will be questioned or challenged, or that managers will be held to account for their wrongful actions by the board. This increases the probability that managers will seek to pursue their own agendas at the expense of stakeholders, and, in certain circumstances, will engage in acts of self-interested corporate malpractice. Hence, we formulate our hypothesis as follows:

H1. : Ceteris paribus, a higher proportion of co-opted directors on a board is likely to be positively associated with corporate misconduct.

3. Research design

3.1. Data and sample

We obtain our data from multiple databases, including Violation Tracker, Bloomberg, Compustat, ExecuComp and ISS analytics. We first extract penalties data from Violation Tracker. We then manually match companies' names from Violation tracker with companies' names extracted using the Bloomberg terminal. We employ a search of Google and stock exchange websites to verify our matching based on company names. This process allows us to compile comprehensive and fine-grained data of penalties for 763 US companies with Bloomberg tickers, ISINs, and CUSIPs as unique identifiers across the sample period from 2001 to 2015.[9] We then download board co-option data from the Lalitha Naveen website (Coles et al., 2014).[10] Data on other board-related variables are downloaded from Bloomberg and ISS. The company accounts data are taken from Compustat. CEO data are obtained from ExecuComp. Data for agenda items and management proposal recommendations are taken from ISS analytics. The number of analysts following companies is obtained from the Institutional Brokers' Estimate System database. Institutional ownership data are obtained from Thomson Reuters Institutional (13F) holdings. To remove the effects of outliers, we winsorise all continuous variables at the first and 99th percentiles. Our final sample for the empirical analysis comprises 5571 firm-year observations for 696 US-listed companies.

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[8] For details concerning the Airbus Inc. bribery case judgement, see: https://www.judiciary.uk/wp-content/uploads/2020/01/Director-of-the-Serious-Fraud-Office-v-Airbus-SE-1.pdf.

[9] Our sample starts from 2001 because this is the first year in which Violation Tracker collected penalties data.

[10] Data on board co-option can be downloaded from https://sites.temple.edu/lnaveen/data/.

3.2. Variable measurement

3.2.1. Dependent variable: corporate misconduct

While a significant number of studies on corporate misconduct have focused largely on financial misreporting (Armstrong et al., 2013; Beasley et al., 2000), accounting irregularities (Armstrong et al., 2010), and financial market manipulations (Cumming et al., 2015a; Cumming et al., 2018) mainly to the detriment of shareholders, there remains a dearth of research on corporate misconduct and its implications for a broad spectrum of stakeholders. Therefore, in this study, we examine corporate misconduct and measure it by the amount of financial penalties imposed on a firm due to violation of stakeholders' interests (*Ln (Total Penalties $)*), as suggested by recent literature (Heese and Pérez-Cavazos, 2019; Jain and Zaman, 2020).[11] We use penalties data obtained from Violation Tracker, which contains records of violations that resulted in penalties of at least US$5000. Violation tracker data is produced by the Corporate Research Project of Good Jobs First, a national policy resource centre whose objective is to promote corporate and governmental accountability (Good Jobs First, 2020).

Violation Tracker is the first wide-ranging database of corporate irresponsibility and has been used in a recent study examining antecedents of workplace related misconduct (Heese and Pérez-Cavazos, 2019; Raghunandan, 2021). It records corporate misconduct relating to an extensive range of infringements of stakeholders' rights, comprising the following categories: i) shareholder-related misconduct; ii) customer-related misconduct; iii) employee-related misconduct; iv) environmental-related misconduct; and v) society-related misconduct.[12] Violation Tracker has collected these data from more than 50 federal regulatory agencies of the Department of Justice since 2001.

3.2.2. Independent variable: board co-option

Our co-option proxy is based on the proportion of directors co-opted by an incumbent CEO. We define co-opted directors as those who join a company's board after an incumbent CEO assumes office (Coles et al., 2014). Accordingly, we use four proxies of board co-option (*ibid.*). Our first measure, *Co-option*, is the number of *co*-opted directors divided by the total number of directors on a board. Our second measure, *Co-option (TW),* is the tenure-weighted *co*-option variable and is defined as the sum of tenure of *co*-opted directors divided by the sum of the tenure of all directors. This measure captures the sensitivity of directors' tenure in board co-option because longer serving co-opted directors are expected to have more influence on board decisions. Our third measure, *Co-option (Independence),* is the number of *co*-opted independent directors divided by board size. These co-opted directors, due to their independent status, are in a stronger position to influence board processes. Our fourth measure, *Co-option (TW Independence),* is the tenure-weighted measure of independent *co*-opted directors. It is defined as the sum of the tenures of independent co-opted directors divided by the sum of the tenures of all directors.

3.2.3. Control variables

We include two sets of control variables, based on previous corporate misconduct and board co-option literature. Our first set of control variables includes board characteristics such as *Board CSR committee, Board size,* and *Board gender diversity*, the absence of which is considered to be associated with corporate misconduct (Jain and Zaman, 2020; Nadeem, 2020). Second, we include a set of firm characteristics that have also been identified by the literature as being related to corporate misconduct. In particular, we control for firm performance using return on assets (*ROA*), as how well a firm is performing affects its propensity to engage in misconduct (Johnson et al., 2009; Köster and Pelster, 2017). We also control for firm tangibility, defined as the proportion of property, plant and equipment to total assets (*PPE*) (Bouslah et al., 2018). We include firm size (*Firm size*) because large firms are more exposed to agency problems (Jensen and Meckling, 1976), and thus their managers have more opportunities to engage in corporate wrongdoing (McKendall et al., 1999). We include capital expenditure (*CAPEX*), as Bouslah et al. (2018) and Cohn and Wardlaw (2016) argue that firms with a long-term view tend to invest more in socially responsible projects. Since the need for debt from external providers promotes corporate transparency/full disclosure, we include firm leverage (*Leverage*) in our regression (Ferrell et al., 2016). We control for cash holding (*Cash holding*), as a firm's retained cash is held at managerial discretion (Bouslah et al., 2018; Tang et al., 2015). We follow Wowak et al. (2015) and Tang et al. (2015) and control for research and development (*R&D*), market-to-book value (*MB*), firm age, and firms' risk-taking ability (*Firm risk*). Detailed descriptions of the variables are provided in the Appendix.

3.3. Descriptive statistics

We first analyse the industry-wide distribution of corporate stakeholder violations according to the Fama-French 12 industry

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[11] We have also utilised the number of penalties imposed on firms due to violation of stakeholders' interests as an alternative measure (*Ln (Number of Penalties)*).

[12] i) Shareholder-related misconduct includes the fines or penalties for accounting and tax-related controversies such as aggressive to non-transparent accounting, tax fraud, and parallel imports or money laundering practices; ii) customer-related misconduct includes fines or penalties related to customer health and safety, product and service quality, customer privacy and integrity, price-fixing and anti-competitive behaviours; iii) employee-related misconduct includes fines/penalties for health and safety breaches, and employment discrimination; iv) environmental-related misconduct includes fines/penalties due to toxic chemical releases, oil spills, etc.; and v) society-related misconduct includes fines or penalties for public health or industrial accidents harming health and safety of third parties, and ethical issues including bribery and corrupt practices.

Table 1

Corporate misconduct distribution by industry.

	Costs of penalties (sum, US$)	Number of penalties (sum)
Consumer (Nondurables)	629,000,000	850
Consumer (Durables)	159,000,000	169
Manufacturing	1,480,000,000	1540
Oil, Gas, and Coal Extraction	1,820,000,000	1536
Chemicals and Allied Products	618,000,000	735
Business Equipment	2,720,000,000	431
Telephone & TV Transmission	1,700,000,000	363
Utilities	10,300,000,000	681
Wholesale & Retail	3,160,000,000	1163
Healthcare	17,700,000,000	275
Finance	125,000,000	57
Mines, Construction & Others	1,420,000,000	6518
Total	41,831,000,000	14,318

This table presents costs of penalties (US$) and the number of financial penalties according to the Fama-French 12 industry classifications during the study period from 2001 to 2015.

Table 2

Descriptive statistics.

	N	Mean	Std.	P25	Median	P75
Panel A: Dependent variable						
Ln (Total Penalties $)	5571	6.113	6.179	0.001	8.631	11.185
Panel B: Independent variables						
Co-option	5571	0.444	0.298	0.200	0.400	0.667
Co-option (TW)	5571	0.274	0.298	0.043	0.154	0.412
Co-option (Independence)	5571	0.373	0.257	0.154	0.333	0.571
Co-option (TW Independence)	5571	0.218	0.230	0.032	0.128	0.343
Panel C: Control variables						
CSR committee	5571	0.179	0.384	0.000	0.000	0.000
Board size	5571	2.351	0.223	2.197	2.398	2.485
Board gender diversity	5571	0.139	0.096	0.083	0.125	0.200
ROA	5571	0.151	0.081	0.101	0.141	0.189
PPE	5571	0.306	0.231	0.118	0.240	0.453
Firm size	5571	8.502	1.450	7.464	8.432	9.531
CAPEX	5571	5.349	5.182	2.147	3.859	6.646
Leverage	5571	0.232	0.165	0.116	0.224	0.330
Cash holding	5571	0.091	0.079	0.043	0.080	0.125
R&D	5571	0.018	0.038	0.000	0.000	0.022
MB	5571	1.923	1.103	1.259	1.597	2.172
Firm age	5571	43.621	18.599	25.999	44.000	63.001
Firm risk	5571	0.524	0.181	0.426	0.473	0.585
Panel D: Alternative dependent variable						
Ln (Number of Penalties)	5571	0.661	0.826	0.001	0.693	1.099

This table presents descriptive statistics for the variables used in this study. The sample consists of 5571 firm-year observations during the study period from 2001 to 2015. Detailed definitions of variables are provided in the Appendix.

classifications. The statistics reported in Table 1 show that companies operating in the healthcare industry are the greatest violators in terms of monetary costs. Such companies have paid more than US$17.7 billion in fines during the study period. They are followed by utilities and wholesale and retail companies, which paid fines amounting to US$10.3 billion and US$3.16 billion, respectively, for corporate misconduct. However, mining and construction firms are the worst offenders in terms of the number of corporate infractions committed, which amount to 6518. This is followed by manufacturing firms and those operating in oil, gas, and coal extraction, with 15,140 and 1536 corporate violations, respectively. Overall, sample companies in our study have paid in excess of US$41.83 billion in penalties for committing 14,318 corporate violations.

In Table 2, we present the descriptive statistics for all variables used in our analyses. On average, our sample companies have paid US$7.5 million in fines (mean of raw value before log transformation - *Ln (Total Penalties $)*). The average number of incidents of misconduct committed by sample companies were 2.57 (mean of raw value before log transformation). On average, sample companies have 44.4% co-opted directors on their boards (*Co-option*). The averages of *Co-option (TW), Co-option (Independence),* and *Co-option (TW Independence)* are 27.4%, 37.3%, and 21.8%, respectively. In respect of control variables, on average 17.9% of boards have established a CSR committee (*CSR committee*) to oversee sustainability-related issues. Companies have an average of 10 directors (mean of raw value before log transformation) on their boards (*Board size*), of whom 13.9% are female (Board gender diversity). All financial control variables are comparable with those reported by Coles et al. (2014), Lim et al. (2020), Jain and Zaman (2020) and Baghdadi et al. (2020).

4. Empirical results and discussions

4.1. Baseline results

To examine the impact of board co-option on corporate misconduct, we construct our empirical model, as specified in Eq. (1). We include year and industry fixed effects, and also correct the standard error at the firm-year level.

Table 3
Co-opted directors and corporate misconduct.

	Ln (Total Penalties $) $_{t+1}$			
	(1)	(2)	(3)	(4)
Co-option $_t$	0.880***			
	(3.39)			
Co-option (TW) $_t$		1.069***		
		(4.04)		
Co-option (Independence) $_t$			0.860***	
			(2.88)	
Co-option (TW Independence) $_t$				1.137***
				(3.34)
CSR committee $_t$	0.509**	0.515**	0.516**	0.520**
	(2.20)	(2.23)	(2.23)	(2.25)
Board size $_t$	0.223	0.228	0.233	0.238
	(0.52)	(0.53)	(0.54)	(0.55)
Board gender diversity $_t$	−3.151***	−3.066***	−3.245***	−3.240***
	(−3.40)	(−3.30)	(−3.50)	(−3.49)
ROA $_t$	2.679*	2.787*	2.652*	2.733*
	(1.82)	(1.89)	(1.80)	(1.85)
PPE $_t$	3.486***	3.479***	3.478***	3.485***
	(4.82)	(4.81)	(4.81)	(4.82)
Firm size $_t$	1.261***	1.262***	1.256***	1.255***
	(16.47)	(16.50)	(16.39)	(16.39)
CAPEX $_t$	−0.087***	−0.087***	−0.086***	−0.086***
	(−3.67)	(−3.68)	(−3.62)	(−3.61)
Leverage $_t$	−0.833	−0.859	−0.829	−0.856
	(−1.16)	(−1.19)	(−1.15)	(−1.18)
Cash holding $_t$	−1.649	−1.614	−1.665	−1.643
	(−0.95)	(−0.93)	(−0.96)	(−0.95)
R&D $_t$	−10.594***	−10.726***	−10.411***	−10.515***
	(−3.62)	(−3.67)	(−3.54)	(−3.59)
MB $_t$	−0.358***	−0.367***	−0.358***	−0.366***
	(−3.54)	(−3.62)	(−3.53)	(−3.61)
Firm age $_t$	0.020***	0.022***	0.019***	0.021***
	(3.81)	(4.11)	(3.62)	(3.88)
Firm risk $_t$	0.205***	0.204***	0.208***	0.208***
	(3.90)	(3.91)	(3.95)	(3.95)
Industry & Year FE	YES	YES	YES	YES
Observations	5571	5571	5571	5571
Adjusted R^2	0.233	0.234	0.233	0.234

This table presents regression results for the relationship between co-opted directors and corporate misconduct. All regressions control for industry and year fixed effects. The t-statistics are based on standard errors clustered by firm and year. The t-statistics are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. Detailed definitions of variables are provided in the Appendix.

$$Ln(Total\ Penalties)_{it+1} = \beta_0 + \beta_1 Co\text{-}option_{it} + \beta_z Controls_{it} + \varepsilon_{it} \tag{1}$$

where *Ln (Total Penalties)* is the amount of penalties in US$ for a firm in a given year. Co-option measures are *Co-option, Co-option (TW)*, *Co-option (Independence)* and *Co-option (TW Independence)* as stated in Coles et al. (2014) and Lim et al. (2020). The control variables include *CSR committee, Board size, Board gender diversity*, return on assets ratio (*ROA*), property, plant and equipment ratio (*PPE*), *Firm size*, capital expenditure ratio (*CAPEX*), *Leverage, Cash holding*, research and development ratio (*R&D*), market-to-book ratio (*MB*), *Firm age,* and *Firm risk*. We report the baseline results in Table 3.

Columns (1) to (4) show that coefficient estimates of *Co-option, Co-option (TW), Co-option (Independence)* and *Co-option (TW Independence)* are positive and significant at the 1% level. These results clearly indicate that the proportion of both co-opted directors and co-opted independent directors on a board increases corporate misconduct. The effect of co-option on corporate misconduct is not only statistically significant but also supports economic rationality. For example, an increase of one standard deviation in the proportion of co-opted directors on a board causes an increase of 0.262 (0.880*0.298) in *Ln (Total Penalties $)*. This is equivalent to approximately 4.3% of the mean value of *Ln (Total Penalties $)*. In terms of the dollar value, this is equivalent to an increase of US$0.323 million in fines (4.3%*7.5 million). Our results are comparable to work undertaken by Coles et al. (2014), Huang et al. (2020) and Lim et al. (2020), who report that an increase of one standard deviation in the proportion of co-opted directors on a board leads to 2.27%, 3.0%, and 3.4% increases in corporate investment, firm total risk, and covenant restrictions, respectively.

The results reported in Table 3 support our prediction that having more co-opted directors on a board leads to a higher level of corporate misconduct. Our findings, highlighting the adverse influence of co-opted independent directors on corporate behaviour, challenge prior studies, which fail to account for board co-option and demonstrate that independent directors are in a better position to be impartial when monitoring management and protecting stakeholders' interests (Avci et al., 2018; Jain and Zaman, 2020; Kuang and Lee, 2017; Mishina et al., 2010). Boivie et al. (2016) contend that the effectiveness of board independence is overstated because there are certain barriers (for example, external job demands and norms of deference) that prevent independent directors from being effective monitors. Our findings confirm the complex nature of board construction and associated monitoring and extend the arguments of Boivie et al. (2016). It demonstrates that BoDs' allegiance to management limits a board's ability to fulfil its fiduciary duty to protect stakeholders, encouraging the former to engage in corporate misconduct to the detriment of the latter.

Notably, the results of all our control variables are in line with the literature (Bouslah et al., 2018; Jain and Zaman, 2020; Tang et al., 2015), with the exception of the *CSR committee*, which, contrary to our expectations, is significantly and positively associated with corporate misconduct. Since the companies in our sample are guilty of corporate wrongdoing to a significant extent, there is a high probability that managements in such companies take only symbolic action by creating a CSR committee, rather than seeking to integrate beneficial social practices into their core business strategies. Hence, such an ostensibly responsible act is purely symbolic, having the purpose of disguising the weakness of stakeholders' protections. These findings accord with much prior literature that makes similar assertions (Cho et al., 2015; Diouf and Boiral, 2017; Michelon et al., 2015). Arguably, CSR committees might also be dominated by co-opted directors, facilitating even greater levels of misconduct.

4.2. Robustness tests

In this subsection, we retest our predictions and provide supporting evidence that board co-option leads to a higher level of corporate misconduct. We consider whether our main results remain robust when we use: i) alternative measures of both dependent and independent variables; (ii) control for the 2008 Global Financial Crisis (GFC); and (iii) incorporate state fixed effect. We utilise the same set of control variables as in the baseline regressions, including industry and year fixed effects, and correcting standard errors clustered at the firm-year level. We report the results in Table 4.

Panel A of Table 4 presents the results where the dependent variable is *Ln (Number of Penalties),* which is an alternative measure of corporate misconduct. We find that the coefficient estimates are positive and statistically significant at the 1% level for all four proxies of board co-option. These findings provide supportive evidence for our hypothesis H1 that board co-option results in significant increases in the number of incidents of corporate misconduct and in the costs incurred as a consequence.

Since co-opted directors pledge their loyalties to those who appoint them, they consequently fail to protect stakeholders' interests, leading to corporate misconduct. We believe that co-opted directors' loyalty to their CEOs increases over time, and that their influence on decisions also strengthens in line with their tenure on a board. Our inference is based on an extensive scholarly literature contending that the lengthening duration of a director's tenure is associated with an increasing commitment to management and the status quo (Oschlies and Wuestenhagen, 2012; Stevens et al., 1978) and deepening entrenchment (Anderson et al., 2004), leading to weak board monitoring (Vafeas, 2003). In contrast, a few studies argue that a longer tenure of BoDs might reduce their susceptibility to management pressure (Beasley, 1996) and increase their firm-specific knowledge (Li and Wahid, 2018), leading to greater protection of stakeholders' interests. However, since co-opted directors' appointments are influenced by CEOs, heterogeneity in CEO tenure may influence such directors' tenure, and hence organisational outcomes (namely, corporate misconduct in the context of our study). To alleviate such concerns, we examine whether the relative durations of board tenure and CEO tenure influence corporate misconduct by replacing our standard measure of co-opted directors with the proportion of co-opted tenure to CEO tenure and re-estimate Eq. (1).[13]

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[13] We are grateful to one anonymous reviewer for suggesting this line of reasoning.

Table 4

Co-opted directors and corporate misconduct – robustness check.

Panel A: Alternative dependent variables

	Ln (Number of Penalties)$_{t+1}$			
	(1)	(2)	(3)	(4)
Co-option $_t$	0.078*** (2.68)			
Co-option (TW) $_t$		0.105*** (3.56)		
Co-option (Independence) $_t$			0.088*** (2.59)	
Co-option (TW Independence) $_t$				0.112*** (2.88)
All control variables included	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES
Observations	5571	5571	5571	5571
Adjusted R^2	0.438	0.439	0.438	0.439

Panel B: Alternative independent variables

	Ln (Total Penalties $) $_{t+1}$	Ln (Number of Penalties) $_{t+1}$
	(1)	(2)
Co-option tenure / CEO tenure	0.775*** (2.68)	0.034** (2.48)
All control variables included	YES	YES
Industry & Year FE	YES	YES
Observations	5571	5571
Adjusted R^2	0.253	0.452

Panel C: Excluding the GFC years: 2007–2009

	Ln (Total Penalties $) $_{t+1}$			
	(1)	(2)	(3)	(4)
Co-option $_t$	0.856*** (2.93)			
Co-option (TW) $_t$		0.944*** (3.16)		
Co-option (Independence) $_t$			0.834** (2.50)	
Co-option (TW Independence) $_t$				0.9479** (2.48)
All control variables included	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES
Observations	4325	4325	4325	4325
R^2	0.194	0.195	0.195	0.195

Panel D: Controlling for firms headquarter location

	Ln (Total Penalties $) $_{t+1}$			
	(1)	(2)	(3)	(4)
Co-option $_t$	0.900*** (3.38)			
Co-option (TW) $_t$		1.188***		

The result reported in Panel B of Table 4 indicates a significant positive relationship between *Co-option Tenure / CEO Tenure* and corporate misconduct. This finding suggests that behaviours induced by board co-option grow stronger over time, confirming the management friendliness hypothesis that extended board tenure favours management at the expense of stakeholders (Coles et al., 2014; Vafeas, 2003).

In Panel C of Table 4, we exclude the 2008 Global Financial Crisis (GFC), since prior studies report a shift in management behaviour

Table 4 (*continued*)

Panel D: Controlling for firms headquarter location				
	Ln (Total Penalties $) $_{t+1}$			
	(1)	(2)	(3)	(4)
		(4.36)		
			0.914***	
Co-option (Independence) $_t$			(3.00)	
				1.325***
Co-option (TW Independence) $_t$				(3.84)
All control variables included	YES	YES	YES	YES
State & Year FE	YES	YES	YES	YES
Observations	5571	5571	5571	5571
Adjusted R^2	0.204	0.205	0.204	0.205

This table presents regression results of robustness tests for the relationship between co-opted directors and corporate misconduct. We have included all control variables in the regressions as reported in Table 3; however, for purposes of brevity, we only present the results of the main independent variables. In the regression in Panel A, we replace our standard measure of corporate misconduct *Ln (Total Penalties $)* with the number of penalties *Ln (Number of Penalties)*. In the regression in Panel B, we replace our standard measure of co-opted directors with the the ratio of co-opted director tenure to the CEO tenure. Panel C presents regression results excluding the GFC period, i.e., 2007–2009. Panel D presents regression results controlling for firms headquarter location. All regressions control for the industry- and year fixed effects. The t-statistics are based on standard errors clustered by firm and year. The t-statistics are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. Detailed definitions of variables are provided in the Appendix.

during this period due to increased uncertainty (Köster and Pelster, 2017; Jain and Zaman, 2020). It may well be possible that the GFC affects board appointments and subsequently our baseline results. Similarly, anecdotal evidence suggests that companies strive to cut their costs by outsourcing or preserving their resources, delaying payments to staff, creating excessive redundancies or suspending payments to suppliers (Anner, 2020), all of which may result in stakeholder violations. Therefore, to account for these possible influences, we follow Jain and Zaman (2020) and exclude 2007–2009 from our sample and re-estimate Eq. (1). The results in Panel B unequivocally indicate that the relationship between board co-option and corporate misconduct remains consistent after excluding the period covering the GFC.[14]

Another factor to consider for our analyses is that our baseline results might be driven by the state-level legislative structure, as some states in the US have more stringent regulations than others. For instance, firms may choose to register in Delaware due to its business-friendly regulations.[15] To avoid such biases, we control for firm headquarters' states. Our results, reported in Panel D of Table 4, remain consistent with our baseline findings, supporting our claim that the positive association between board co-option and the corporate misconduct nexus is not driven by the state-level legislative structure.

4.3. Addressing endogeneity

The relationship between board dynamics and corporate performance often suffers from endogeneity biases because of the black-box nature of corporate boards (Baghdadi et al., 2020; Jain and Jamali, 2016). It is difficult to assert causation in the board co-option and corporate misconduct nexus without addressing such issues (Wintoki et al., 2012). Endogeneity might arise from three possible sources. First, reverse causality, in the sense that firms' anticipation of irresponsible activities or misconduct may drive executive behaviours to alter board structure by appointing more or fewer directors. Second, omitted variable bias, as there might be some unobservable factors that have the potential to influence both board co-option and corporate misconduct. Third, measurement error, because board co-option might simply capture: (i) CEO power, and (ii) directors' inexperience and lack of skills.

4.3.1. Reverse causality
We follow prior literature and identify a group of violators (firms with monetary penalties) where board co-option remains constant for two successive years across our sample period (Lim et al., 2020), finding 36% of firm-year observations where board co-option remains unchanged for two consecutive years. It is argued that the inverse effect of corporate violations on board co-option is unlikely to occur in firms where it remains constant over time (Jiraporn and Lee, 2018; Lim et al., 2020). Table 5 reports the results of the relationship between corporate misconduct and co-opted directors for a subsample of firms where the proportion of co-opted directors remains unchanged over two consecutive years. The results demonstrate that the coefficient estimates of board co-option across all four proxies, i.e., *Co-option, Co-option (TW), Co-option (Independence)* and *Co-option (TW Independence),* are positive and significant,

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[14] We also test the variation between co-opted directors and corporate misconduct around the GFC period, i.e., pre-GFC < 2007; GFC 2007–2009; and post-GFC > 2009. We find qualitatively similar results for all three periods, which indicates that co-opted directors do not change their behaviour during stressful times (results available upon request).

[15] See https://www.nytimes.com/2012/07/01/business/how-delaware-thrives-as-a-corporate-tax-haven.html.

Table 5
Co-opted directors and corporate misconduct – reverse causality.

	Ln (Total Penalties $) $_{t+1}$			
	(1)	(2)	(3)	(4)
Co-option $_t$	1.298*** (3.21)			
Co-option (TW) $_t$		1.465*** (3.72)		
Co-option (Independence) $_t$			1.557*** (3.29)	
Co-option (TW Independence) $_t$				1.811*** (3.44)
CSR committee $_t$	−0.268 (−0.65)	−0.256 (−0.62)	−0.262 (−0.63)	−0.249 (−0.60)
Board size $_t$	0.831 (1.10)	0.800 (1.06)	0.908 (1.20)	0.887 (1.17)
Board gender diversity $_t$	−2.373 (−1.52)	−2.257 (−1.44)	−2.592* (−1.66)	−2.642* (−1.69)
ROA $_t$	2.899 (1.30)	3.078 (1.39)	2.952 (1.33)	3.065 (1.38)
PPE $_t$	4.299*** (3.53)	4.300*** (3.54)	4.279*** (3.51)	4.332*** (3.56)
Firm size $_t$	1.319*** (9.78)	1.320*** (9.82)	1.308*** (9.66)	1.303*** (9.66)
CAPEX $_t$	−0.111*** (−3.06)	−0.111*** (−3.08)	−0.110*** (−3.01)	−0.109*** (−2.98)
Leverage $_t$	−0.526 (−0.47)	−0.555 (−0.49)	−0.516 (−0.46)	−0.565 (−0.50)
Cash holding $_t$	−2.359 (−0.77)	−2.296 (−0.75)	−2.444 (−0.80)	−2.333 (−0.77)
R&D $_t$	−5.880 (−1.22)	−6.121 (−1.27)	−5.653 (−1.17)	−5.883 (−1.22)
MB $_t$	−0.339** (−1.98)	−0.347** (−2.02)	−0.343** (−2.01)	−0.354** (−2.07)
Firm age $_t$	0.018** (1.98)	0.022** (2.30)	0.017* (1.84)	0.020** (2.14)
Firm risk $_t$	−0.519 (−1.07)	−0.520 (−1.09)	−0.546 (−1.12)	−0.553 (−1.15)
Industry & Year FE	YES	YES	YES	YES
Observations	2003	2003	2003	2003
Adjusted R^2	0.214	0.215	0.214	0.214

This table presents regression results for the relationship between co-opted directors and corporate misconduct, based on a subsample of corporate misconduct where the level of co-opted directors remains unchanged over two consecutive years. All regressions control for the industry- and year fixed effects. Robust standard errors are clustered at the firm level and t-statistics are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. Detailed definitions of variables are provided in the Appendix.

consistent with our baseline findings.

4.3.2. Propensity score matching

We employ a propensity score matching (PSM) analysis to address selection bias arising from firm-related characteristics and bias related to functional misspecification (Armstrong et al., 2010; Rosenbaum and Rubin, 1983). To conduct our PSM analysis, we define firms whose proportion of board co-option is above the top quartile as the treatment group. The control firms are those whose ratio of board co-option is below the bottom quartile. To ensure that our treated and control firms are comparable, we match treatment and control firms using propensity score matching, where we utilise the nearest neighbour with replacement matching. The matching is undertaken based on all the control variables that are used in the baseline regressions in Table 3. We report the results in Table 6.

Panel A of Table 6 reports the univariate mean comparisons between treatment and control firms' characteristics and their corresponding *t*-statistics. The results demonstrate that the average values of the matching variables are qualitatively similar across the treatment and control firms. The average value of the corporate misconduct measure (*Ln (Total Penalties $)*), however, is found to be significantly different between the treatment and control firms.[16] To examine whether this variation is due to the presence of co-opted directors, we perform PSM regressions using the post-matched sample in panel B of Table 6. The results indicate that the presence of co-opted directors increases the amount of corporate misconduct across all four measures. These findings are consistent with our baseline results that firms with co-opted directors engage in more corporate wrongdoing.

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[16] In unreported results, we also find significant differences in the average values of *Ln (Number of Penalties)* between the treatment and control firms.

Table 6

Co-opted directors and corporate misconduct – PSM analysis.

Panel A: Comparison of treatment and control firms					
Dependent variables	N	Treated	N	Control	Differences	t-statistics
Ln (Total Penalties $) $_{t+1}$	345	6.934	345	6.028	0.907**	1.97
Control variables	N	Treated	N	Control	Differences	t-statistics
CSR committee $_t$	345	0.194	345	0.171	0.023	0.790
Board size $_t$	345	2.375	345	2.367	0.008	0.460
Board gender diversity $_t$	345	0.134	345	0.130	0.003	0.460
ROA $_t$	345	0.155	345	0.157	−0.002	−0.290
PPE $_t$	345	0.324	345	0.321	0.003	0.180
Firm size $_t$	345	8.537	345	8.531	0.006	0.050
CAPEX $_t$	345	5.383	345	5.491	−0.108	−0.290
Leverage $_t$	345	0.242	345	0.233	0.009	0.740
Cash holding $_t$	345	0.085	345	0.092	−0.006	−1.060
R&D $_t$	345	0.014	345	0.016	−0.001	−0.530
MB $_t$	345	1.835	345	1.898	−0.063	−0.790
Firm age $_t$	345	43.047	345	43.357	−0.310	−0.230
Firm risk $_t$	345	0.527	345	0.519	0.008	0.580

Panel B: Co-opted directors and corporate misconduct: PSM regression				
	Ln (Total Penalties $) $_{t+1}$			
	(1)	(2)	(3)	(4)
Co-option $_t$	1.403** (2.50)			
Co-option (TW) $_t$		1.357** (2.25)		
Co-option (Independence) $_t$			1.713*** (2.61)	
Co-option (TW Independence) $_t$				1.886** (2.45)
All control variables included	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES
Observations	690	690	690	690
Adjusted R^2	0.261	0.259	0.261	0.260

This table presents regression results for the relationship between co-opted directors and corporate misconduct using Propensity Score Matching (PSM). We define firms whose proportion of board co-option is above the top quartile as belonging to the treatment group. Control firms are those matched firms whose proportion of board co-option is below the bottom quartile. Control firms are matched using PSM (nearest firm with replacement) on the same control variables as reported in Table 3. Panel A presents the univariate mean comparisons between treatment and control firms' characteristics and their corresponding t-statistics. Panel B presents the results of PSM regressions on the matched sample. All regressions control for the industry- and year fixed effects. Robust standard errors are clustered at the firm level and t-statistics are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. Detailed definitions of variables are provided in the Appendix.

4.3.3. Difference-in-differences estimation (DiD)

Our second approach is to test the changes in board co-option around an exogenous event, CEO sudden deaths, to address endogeneity. Specifically, we analyse the board co-option causal effects of corporate misconduct around CEO sudden deaths between 2001 and 2015, adopting the approach of Bernile et al. (2017), who analyse the change in corporate policies around exogenous CEO turnover. Coles et al. (2014) argue that co-opted directors pledge their allegiance to the CEO because the CEO is instrumental to their initial appointment. If that is the case, one would argue that unexpected CEO turnover, i.e., CEO sudden deaths, are more likely to change the board of directors' composition, including co-opted directors' representation. Therefore, we investigate the effects of co-option on corporate misconduct following CEO sudden deaths.[17] In so doing, we gauge the change in proportion of co-option after a CEO passes away in a given year and test its effect on corporate misconduct. If the association is causal, we would observe a decline in corporate misconduct following a decrease in the co-option ratio in a year when the CEO dies.

To conduct the test, we create a treatment group consisting of firms that have experienced reductions in their co-opted board ratios a year following the sudden death of a CEO. We also create a control group, which includes businesses that have not experienced such reductions in their co-opted board ratios in the same year. After applying these criteria, we identify 42 incidents of CEO sudden deaths and 17 events where the co-option ratio falls. We then match treatment and control observations using propensity score matching by choosing the nearest neighbour with the replacement of the same control variables as reported in Table 7, to ensure that both groups are comparable and there are no significant differences between them, other than their relationship to co-opted directors. We further

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[17] We are grateful to Associate Professor Tim Quigley (University of Georgia) for sharing CEO death data used in his published paper (Quigley et al., 2017).

Table 7

Co-opted boards and corporate misconduct - difference-in-differences analysis.

Panel A: Post-matched sample mean differences

Variable	Treated	Control	Differences	t-statistics
Ln (Total Penalties $) $_{t+1}$	3.372	8.376	−5.004**	−2.329
CSR committee $_t$	0.176	0.176	0.000	0.000
Board size $_t$	2.366	2.416	−0.049	−0.737
Board gender diversity $_t$	0.134	0.144	−0.010	−0.320
ROA $_t$	0.147	0.164	−0.017	−0.557
PPE $_t$	0.355	0.377	−0.022	−0.243
Firm size $_t$	8.961	8.789	0.172	0.325
CAPEX $_t$	7.591	7.640	−0.049	−0.016
Leverage $_t$	0.201	0.185	0.017	0.375
Cash holding $_t$	0.096	0.105	−0.008	−0.309
R&D $_t$	0.016	0.014	0.001	0.114
MB $_t$	1.735	1.589	0.146	0.517
Firm age $_t$	43.343	44.765	−1.422	−0.235
Firm risk $_t$	56.656	54.465	2.191	0.326

Panel B: Difference-in-differences estimators

	Mean treatment difference (after–before)	Mean control difference (after–before)	Mean DiDs (treat–control)
	(1)	(2)	(3)
Ln (Total Penalties $) $_{t+1}$	−1.088 (1.66)	4.175** (2.17)	−5.263** (2.422)

This table presents the difference-in-differences (DiD) regression results of corporate misconduct around CEO sudden deaths during the study period from 2001 to 2015. The treatment group consists of firms that experienced reductions in co-opted board ratio a year following CEO sudden deaths. Control firms are those matched firms that have not experienced such reductions in co-opted board ratio in the same period. Control firms are matched using propensity score matching (nearest firm with replacement) with the same control variables as reported in Table 3. Panel A presents the univariate mean comparisons between treatment and control firms' characteristics and their corresponding t-statistics. Panel B presents the DiD estimators. t-statistics are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. Detailed definitions of variables are provided in the Appendix.

require that the maximum difference between the propensity score (i.e., the calliper) of each firm with co-opted directors and that of its matched peer does not exceed 1.0%. We report the results in Table 7.

Panel A of Table 7 reports the univariate mean comparisons between treatment and control firms' characteristics and their corresponding t-statistics. The results indicate that treatment and control firms before the shock are statistically identical, except for those relating to co-opted directors. To estimate the DiD estimator, we adopt the approach of Hong and Kacperczyk (2010), He and Tian (2013) and Irani and Oesch (2013), measuring and evaluating the effects of such exogenous events on corporate misconduct. Specifically, in Panel B of Table 7, we calculate the change in corporate misconduct incidents from the pre-event period (defined as the three years preceding the shock) to the post-event period (defined as the three years following the shock) for both treatment and control groups. The difference is then averaged over the treatment and control groups and reported in Columns 1 and 2, respectively. The DiD estimator is the difference in the differences for the treatment and control groups, which is reported in Column 3. We cluster standard errors of the DiD estimators at the event level (namely, a CEO's sudden death), as suggested by Hong and Kacperczyk (2010). We find that a reduction in corporate misconduct is associated with an exogenous reduction in the co-option ratio. Specifically, the average change in the three-year *Ln(Total Penalties)* for treatment firms is −1.088, while that for control firms is much larger at 4.175. The DiD estimator for *Ln (Total Penalties)* is −5.263 and significant at the 5% level. These results suggest that the association is indeed causal.

4.3.4. Measurement issues

Despite the significant positive association between board co-option and corporate misconduct, there are two possible concerns associated with the board co-option proxies. Specifically, board co-option simply captures: (i) CEO power; and (ii) directors' inexperience and lack of skills. For example, Coles et al. (2014) demonstrate that board co-option is influenced by CEO tenure (a proxy for CEO power). In this case, our results might be due to CEO power rather than co-option. Additionally, a lack of skill and experience in directors might be an alternative explanation for board co-option. High co-option might be due to the presence of a large number of new directors who lack skill and experience (Coles et al., 2014). Therefore, we may presume it is a lack of skill and experience that drives these directors to become lax and incompetent monitors and support management, rather than their allegiance to the CEO (Lim

Table 8
Co-opted directors and corporate misconduct – alternative explanations.

Panel A: Control for CEO power

	Ln (Total Penalties $)$_{t+1}$			
	(1)	(2)	(3)	(4)
Co-option $_t$	0.865***			
	(3.25)			
Co-option (TW) $_t$		1.064***		
		(3.92)		
Co-option (Independence) $_t$			0.833***	
			(2.74)	
Co-option (TW Independence) $_t$				1.115***
				(3.21)
CEO power $_t$	0.043	0.013	0.068	0.049
	(0.26)	(0.08)	(0.42)	(0.30)
All control variables included	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES
Observations	5571	5571	5571	5571
Adjusted R^2	0.245	0.246	0.245	0.245

Panel B: Control for CEO tenure

	(1)	(2)	(3)	(4)
Co-option $_t$	1.038***			
	(3.64)			
Co-option (TW) $_t$		1.170***		
		(4.20)		
Co-option (Independence) $_t$			1.050***	
			(3.14)	
Co-option (TW Independence) $_t$				1.265***
				(3.51)
CEO tenure $_t$	−0.241	−0.198	−0.231	−0.180
	(−1.36)	(−1.16)	(−1.27)	(−1.05)
All control variables included	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES
Observations	5571	5571	5571	5571
Adjusted R^2	0.233	0.234	0.233	0.233

Panel C: Control for board skills and experience

	(1)	(2)	(3)	(4)
Co-option $_t$	0.940**			
	(2.13)			
Co-option (TW) $_t$		1.086**		
		(2.40)		
Co-option (Independence) $_t$			0.974*	
			(1.95)	
Co-option (TW Independence) $_t$				1.188**
				(2.05)
Board skills $_t$	0.639	0.597	0.631	0.601
	(0.49)	(0.46)	(0.48)	(0.46)
All control variables included	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES
Observations	1996	1996	1996	1996
Adjusted R2	0.254	0.254	0.253	0.254

Panel D: Control for board tenure

	(1)	(2)	(3)	(4)
Co-option $_t$	0.639**			
	(2.03)			
Co-option (TW) $_t$		0.793**		
		(2.49)		
Co-option (Independence) $_t$			0.728**	
			(2.06)	
Co-option (TW Independence) $_t$				0.921**
				(2.31)
Board tenure $_t$	0.013	0.013	0.014	0.014
	(0.49)	(0.47)	(0.50)	(0.50)
All control variables included	YES	YES	YES	YES

Table 8 (*continued*)

Panel D: Control for board tenure				
	(1)	(2)	(3)	(4)
Industry & Year FE	YES	YES	YES	YES
Observations	3699	3699	3699	3699
Adjusted R^2	0.241	0.241	0.241	0.241

Panel E: Replacing Co-option with CEO power and board skills and experience proxies				
	(1)	(2)	(3)	(4)
CEO power $_t$	0.164 (1.03)			
CEO tenure $_t$		0.022 (0.14)		
Board skills $_t$			0.729 (0.56)	
Board tenure $_t$				0.015 (0.56)
All control variables included	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES
Observations	5571	5571	1996	3699
Adjusted R^2	0.232	0.231	0.252	0.240

This table presents regression results for the relationship between co-opted directors and corporate misconduct, addressing the possibility that CEO power, CEO tenure, board skills and experience, and board tenure may have driven the effect of co-option on corporate misconduct. We have included all control variables in the regressions as reported in Table 3; however, for purposes of brevity, we only present the results of the main independent variables. All regressions control for industry and year-fixed effects. The t-statistics are based on standard errors clustered by firm and year. The t-statistics are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. Detailed definitions of variables are provided in the Appendix.

et al., 2020).

To address such concerns, we perform two tests. First, we include four variables pertaining to CEO power: CEO tenure, board skills and experience, and board tenure in our baseline regressions. Second, we replace the board co-option proxies with variables mentioned in supra. To control for CEO power, we use: (i) *CEO power*, which takes the value of one if the CEO is the founder and chairman of the board, and zero otherwise; and (ii) *CEO tenure*, which measures the length of CEO tenure in office. To capture board skills and experience, we use: (i) *Board skills*, defined as the percentage of board members who have either an industry-specific background or a strong financial and accounting background; and (ii) *Board tenure*, defined as the average tenure of all directors on the board. We report the results in Table 8.

Panels A to D of Table 8 report the results of board co-option and corporate misconduct with the four additional control variables representing CEO power, CEO tenure, board skills and experience, and board tenure. We find that the coefficient estimates of board co-option across all four proxies are consistently similar to our baseline findings, being positive and significant. Concomitantly, the insignificant results of *CEO power*, *CEO tenure*, *Board Skills* and *Board Tenure* with corporate misconduct reported in Columns (1–4) of Panel E suggest that CEO power and directors' inexperience and lack of skills do not influence corporate misconduct. Taken together, these results corroborate our baseline findings that board co-option is significantly associated with corporate misconduct.

5. Channel analysis

BoDs' monitoring and advice play an instrumental role in corporate decision-making and how boards behave. Scholars of corporate governance, therefore, advocate the deconstruction of the mechanisms that make BoDs lax monitors and lead to erratic and suboptimal decision-making (Baghdadi et al., 2020; Boivie et al., 2016; Jain and Zaman, 2020). However, as stated previously, boards are deemed to be black boxes, which makes it very difficult, if not impossible, for researchers to gain access to details of internal deliberations and records of meetings (Bezemer et al., 2018; Pugliese et al., 2015). Due to the intramural nature of board discussions, it is difficult to capture board monitoring information explicitly; however, it is possible to do so by inference (Baghdadi et al., 2020). Nevertheless, we have attempted to capture monitoring data through close observation of board dynamics and discuss our findings in subsequent sections.

Table 9

Co-opted directors and corporate misconduct – directors' monitoring.

Panel A: Board co-option and the number of board agenda items

| | Ln (Total Penalties $)$_{t+1}$ | | | | | | | |
| | High number of agenda items | | | | Low number of agenda items | | | |
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Co-option $_t$	0.640 (0.97)				1.106** (2.26)			
Co-option (TW) $_t$		1.159 (1.60)				1.026** (2.09)		
Co-option (Independence) $_t$			0.266 (0.36)				1.270** (2.30)	
Co-option (TW Independence) $_t$				1.060 (1.24)				1.315** (2.07)
All control variables included	YES	YES	YES	YES	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Observations	1245	1245	1245	1245	1539	1539	1539	1539
Adjusted R^2	0.292	0.293	0.292	0.292	0.173	0.173	0.173	0.173

Panel B: Board co-option and board meeting attendance

| | High board meeting attendance | | | | Low board meeting attendance | | | |
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Co-option $_t$	0.319 (0.49)				2.346*** (3.45)			
Co-option (TW) $_t$		0.757 (0.86)				2.685*** (3.88)		
Co-option (Independence) $_t$			0.466 (0.63)				2.548*** (3.08)	
Co-option (TW Independence) $_t$				0.724 (0.81)				3.355*** (3.60)
All control variables included	YES	YES	YES	YES	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Observations	1061	1061	1061	1061	936	936	936	936
Adjusted R^2	0.302	0.303	0.302	0.302	0.217	0.220	0.214	0.217

Panel C: Board co-option and directors' compensation

| | High compensation | | | | Low compensation | | | |
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Co-option $_t$	1.135* (1.86)				0.633 (1.36)			
Co-option (TW) $_t$		1.363*** (4.08)				0.632 (1.35)		
Co-option (Independence) $_t$			0.982*** (2.63)				0.567 (1.08)	
Co-option (TW Independence) $_t$				1.491*** (3.48)				0.531 (0.90)
All control variables included	YES	YES	YES	YES	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Observations	3946	3946	3946	3946	1622	1622	1622	1622
Adjusted R^2	0.235	0.237	0.235	0.236	0.204	0.204	0.203	0.203

This table presents regression results of whether the effect that co-opted directors have on corporate misconduct is affected by the degree of board monitoring. We use three variables to capture board monitoring: i) board agenda items in Panel A; ii) board attendance in Panel B; and iii) BoDs compensations in Panel C. We have included all control variables in the regressions as reported in Table 3; however, for purposes of brevity, we only present the results of the main independent variables. All regressions control for the industry- and year fixed effects. The t-statistics are based on standard errors clustered by firm and year. The t-statistics are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. Detailed definitions of variables are provided in the Appendix.

5.1. BoDs' preparation for board meeting agenda

BoDs' participation in decision-making is an important indication of effective monitoring (Pugliese et al., 2015). Directors' participation in board meetings can be time-consuming, if not arduous, and requires their involvement in tasks such as developing agendas. Recent studies have unpacked the black-box nature of board meetings using active board meeting coverage (Bezemer et al., 2018; Pugliese et al., 2015). While it can be argued that the duty to set a board's meeting agenda relies on the Chair, the findings of Pugliese et al. (2015) suggest that the Chair always consults directors on how agenda items are developed. Consequently, the number of agenda items prepared by BoDs should be a measure of directors' active board engagement.

Whether a list of comprehensive agenda items supports an effective board is a matter of debate. Scholars argue that due to limited time, including too many agenda items might divert boards' attention from key issues (Cornforth and Edwards, 1999), thus compromising their monitoring. Yet, there is a voluminous literature that considers a long list of agenda items to be an indication of effective board engagement and monitoring (Baghdadi et al., 2020; Van den Berghe and Levrau, 2004). Based on these assumptions, in their study of co-opted directors and the likelihood of default risk, Baghdadi et al. (2020) demonstrate that a high proportion of co-opted directors leads to fewer agenda items being tabled, since co-opted boards exhibit less involvement in making decisions.

Based on the foregoing discussions, we expect the relationship between board co-option and corporate misconduct to be more pronounced in firms with fewer board agenda items than in firms with a more comprehensive list of such items. To test the effectiveness of co-opted directors' active involvement in decision-making, we estimate our model for two subsamples based on the total number of agenda items. High agenda items are linked to firms that fall in the top quartile, and low agenda items to firms that fall in the bottom quartile. We report the results in Table 9.

Panel A of Table 9 shows that coefficient estimates of board co-option are positive and statistically significant only in firms with a small number of board agenda items. This evidence indicates that co-opted BoDs pledge their allegiance to management by becoming less involved in setting firms' agenda items. Such omissions will compromise their ability to confront management or detect any bad decisions or irregularities, deterring them from voting against decisions that might result in corporate misconduct and preventing them from fulfilling their fiduciary duty to protect stakeholders' interests in the event of malfeasance.

5.2. BoDs' board meeting attendance

Board meeting attendance is an essential means of evaluating directors' monitoring effectiveness. A director's absence from a meeting signals unwillingness or an inability to fulfil monitoring duties, compromising their monitoring ability (Baghdadi et al., 2020; Jain and Zaman, 2020). Most of the literature considers poor attendance to be a sign of ineffective monitoring (Baghdadi et al., 2020; Vafeas, 1999). Such scholars believe that minimal directors' attendance reflects lower levels of board engagement, which encourages managerial opportunism at the expense of stakeholders' interests (Jain and Zaman, 2020). Conversely, more frequent board meeting attendance leads to higher levels of directors' engagement and improves board monitoring. Consistent with these arguments, Baghdadi et al. (2020) show that co-opted directors often skip board meetings and contend that co-opted boards are less involved and less committed to discharging their fiduciary duties, due to their allegiance to the CEO. Such non-attendance makes them lax monitors and compromises their supervisory role in protecting stakeholders' interests.

We posit that if the board engagement argument for board meeting attendance holds, then we would expect the relationship between board co-option and corporate misconduct to be more pronounced in firms with lower board meeting attendance than in firms with regular or high board meeting attendance. To test the validity of our arguments, we estimate the model based on two subsamples: firms with high board meeting attendance (higher than 75%) as opposed to those with low board meeting attendance (lower than 75%), as suggested by Baghdadi et al. (2020). The result in Panel B of Table 9 shows that coefficient estimates of board co-option are positive and statistically significant only in firms with low board meeting attendance. This result supports our contention that co-opted directors skip board meetings, which limits their ability to monitor management and protect stakeholders' interests, leading to a higher level of corporate misconduct.

5.3. Board directors' compensation

Executive compensation has been at the epicentre of academic and public debate over the past decade[18] (Fedaseyeu et al., 2018). The implications of a large number of studies indicate that excessive executive compensation/salary packages, and particularly those related to BoDs, significantly impair directors' monitoring ability. For example, Cullinan et al. (2008) find that firms in which directors do not receive stock options exhibit significantly fewer misstatements than firms rewarding directors with stock options. A similar finding by Ye (2014) supports this argument, suggesting that higher cash compensation for independent directors compromises their independence and reduces their effectiveness in financial reporting oversight.

Several studies have also commented on the reasons for the positive association between director's higher compensation and managerial oversight, with some linking this phenomenon to board co-option. For example, Brick et al. (2006) detect a significant positive relationship between a CEO's and directors' compensation, attributing excessive rewards to what they term 'mutual back-

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[18] Recently promulgated regulations and the listing requirements of US and other stock exchanges have expanded directors' responsibilities, especially on issues related to risk management and directorial oversight (Fedaseyeu et al., 2018). This has increased their remuneration with average director's fees rising from $82,082 in 2005 to $163,434.10 in 2012 (Dah and Frye, 2017).

scratching'. Fedaseyeu et al. (2018) report that 'board members who shared a personal connection with the CEO before joining the board (co-opted directors) 'are more likely to receive discretionary compensation' (p. 818). Such directors tend to hesitate in questioning the managerial status quo, which is due to their close ties with the CEO and also from a desire to safeguard their positions and remuneration.

Rewarding directors with excessive compensation will cause misalignment between managers' and stakeholders' interests because well-paid directors may be less likely to 'rock the boat' (Brick et al., 2006). In the absence of effective monitoring, opportunistic managers may favour their personal goals at the expense of stakeholders' interests. In line with our arguments, Crutchley and Minnick (2012) find that firms rewarding directors with high pay incentives face more corporate malpractice lawsuits. Thus, the positive relationship between co-opted BoDs and corporate misconduct will be stronger when directors' compensation is higher than that of the industry median. To test this hypothesis, we split our sample based on directors' total compensation into higher and lower compensation groups compared with directors' industry peers. For high director compensation, this refers to firms with higher board compensation (board compensation higher than the industry median) versus low director compensation. The latter are firms with lower board compensation (board compensation lower than the industry median).

Our results in Panel C of Table 9 demonstrate that the relationship of board co-option with corporate misconduct is positive and significant across firms with higher directors' remuneration. This finding supports our argument that firms reward co-opted directors with higher compensation packages, reducing their propensity to question the status quo, thus encouraging corporate misconduct.

6. Co-opted boards and corporate misconduct: cross-sectional evidence

6.1. The role of firms' informational environment (external monitoring)

Thus far, we have analysed the impact of poor internal monitoring on the relationship between co-opted directors and corporate misconduct. In this section, we extend our investigation by examining the role of the information environment prevailing in a firm, as it relates to external monitoring agencies at the co-opted board and corporate misconduct nexus.[19] Our motivation for this analysis is driven by recent literature, which has recognised the influence of information asymmetry in encouraging corporate wrongdoing (Cumming et al., 2015a; Cumming et al., 2018; Zona et al., 2013). Managers in companies with high information asymmetry are in a strong position to obfuscate evidence of their corporate malpractices, and such an environment encourages managers to pursue their own agendas at the expense of stakeholders' interests (Sims and Brinkmann, 2003). Since co-opted directors serve management interests and are considered to be lax monitors, we expect that the presence of a large proportion of them will engender a poor information environment. This, in turn, will exacerbate management and stakeholder conflicts, increasing the probability that the latter will suffer violations of their interests (Cumming et al., 2015b).

Extant research has also observed that external monitoring agencies, comprising institutional investors and analysts following, wield a positive influence by promoting information transparency. The presence of a significant proportion of institutional investors and equity analysts curbs managements' opportunistic behaviour and promotes information transparency (Zaman et al., 2021). Research indicates that their involvement enhances board monitoring, reduces stakeholder-management conflicts, and improves the protection of stakeholders' rights (Chen et al., 2015; Jain and Zaman, 2020). In line with these arguments, we expect that the positive association between co-opted directors and corporate misconduct would be more pronounced in companies with a poor information environment as a result of less effective external monitoring. We adopt three measures to capture the corporate information environment (external monitoring), namely: Aggarwal Cao and Chen's (2012) *Information Environmental Metric*; the presence of monitoring institutional investors (*Monitoring IO*); and *Analysts Following*.

For the first measure, i.e., *Information Environmental Metric*, we follow Aggarwal et al. (2012), using the presence of institutional investors, securities analysts, and stock traders in our evaluation of firm-specific information. We define institutional ownership (IO) as the total number of institutional shares divided by the total shares outstanding; financial analysts (*Analysts Following*) as the natural logarithm of one plus the average number of analysts following a given firm over a fiscal year; and share trading volumes as the natural log of one plus total market trading volume of the firm over a fiscal year. We then formulate our firm-level information environment measure (*Information Environmental Metric*) as the average decile ranking across the three measures, which ranges from 1 to 10, with higher values indicating higher information environments.

For the second measure, i.e., *Monitoring IO*, we follow the process specified in Fich et al. (2015), and define monitoring institutional owners as institutional shareholders who hold the top 10% of their portfolio value in firm *i* at year *t*. We calculate *Monitoring IO* as the proportion of shares held by such monitoring institutional owners in relation to the total number of shares outstanding of firm *i* in year *t*.

Finally, we measure *Analysts Following* using the number of analysts following firm *i* in year *t* (Atawnah et al., 2018). We then adopt a subsample regression approach and divide the sample into two groups. Firms with a high information environment (stronger external monitoring) are those whose value of *Information Environmental Metric*, *Monitoring IO* and *Analysts Following* is greater than the cross-sectional median. Conversely, firms with a poor information environment (weaker external monitoring) are those whose value of *Information Environmental Metric*, *Monitoring IO* and *Analysts Following* is lower than the cross-sectional median. We re-run the baseline results for both subsamples and present the results in Table 10.

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[19] We are thankful to the two anonymous reviewers for suggesting that we take this direction.

Table 10
Co-opted directors and corporate misconduct – the role of firms' informational environment (external monitoring).

Panel A: Firms' information environment - Aggarwal, Cao and Chen's (2012) Information Environmental Metric

	Ln (Total Penalties $)$_{t+1}$							
	High information environment metric				Low information environment metric			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Co-option $_t$	0.270 (0.66)				1.379*** (3.78)			
Co-option (TW) $_t$		0.676 (1.56)				1.511*** (4.22)		
Co-option (Independence) $_t$			0.280 (0.60)				1.322*** (3.11)	
Co-option (TW Independence) $_t$				0.695 (1.27)				1.717*** (3.67)
All control variables included	YES	YES	YES	YES	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Observations	2594	2594	2594	2594	2594	2594	2594	2594
Adjusted R^2	0.258	0.258	0.258	0.258	0.182	0.182	0.180	0.181

Panel B: Monitoring institutional ownership

	High monitoring IO				Low monitoring IO			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Co-option $_t$	0.812** (2.23)				1.354*** (3.50)			
Co-option (TW) $_t$		0.895** (2.42)				1.687*** (4.26)		
Co-option (Independence) $_t$			0.712* (1.73)				1.350*** (3.00)	
Co-option (TW Independence) $_t$				0.774 (1.63)				1.916*** (3.73)
All control variables included	YES	YES	YES	YES	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Observations	2784	2784	2784	2784	2784	2784	2784	2784
Adjusted R^2	0.243	0.243	0.242	0.242	0.240	0.242	0.239	0.241

Panel C: Analysts following

	High analysts following				Low analysts following			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Co-option $_t$	0.383 (0.97)				1.416*** (4.11)			
Co-option (TW) $_t$		0.798* (1.91)				1.333*** (3.87)		
Co-option (Independence) $_t$			0.373 (0.83)				1.307*** (3.23)	
Co-option (TW Independence) $_t$				0.918* (1.77)				1.242*** (2.73)
All control variables included	YES	YES	YES	YES	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Observations	2784	2784	2784	2784	2784	2784	2784	2784
Adjusted R^2	0.269	0.270	0.269	0.270	0.205	0.204	0.203	0.202

This table presents regression results of whether the effect that co-opted directors have on corporate misconduct is affected by firms' informational environment (external monitoring). Panel A presents the results for the role of firms' information environment based on Aggarwal, Cao and Chen's (2012) Information Environmental Metric. Panels B and C present the results for the roles of monitoring institutional investors and analysts following, respectively. We have included all control variables in the regressions as reported in Table 3; however, for purposes of brevity, we only present the results of the main independent variables. All regressions control for the industry- and year fixed effects. The t-statistics are based on standard errors clustered by firm and year. The t-statistics are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. Detailed definitions of variables are provided in the Appendix.

The results reported in models (1) to (8) of Panels A-C confirm our conjecture that the documented positive relationship between co-opted boards and corporate misconduct is more pronounced in firms with a poor information environment (i.e., *Low Information Environmental Metric*, *Low Monitoring IO* and *Low Analysts Following*), compared to firms with a transparent information environment. These results clearly indicate that firms with a poor information environment (weak external monitoring) are more likely to be affected by the presence of co-opted boards, inducing corporate wrongdoing. This is consistent with our central thesis that co-opted boards facilitate firms' misconduct because of their ineffective monitoring of corporate managers.

6.2. The role of co-opted directors' personal attributes

In this section, we investigate the impact of the personal attributes of co-opted directors, in respect of their social ties with chief executive officers (CEOs) and directors' age, on the relationship between co-opted boards and corporate misconduct. Prior literature has documented two competing views concerning the influence of a director's social ties with a CEO.

One strand of literature argues that strong social ties between board members and CEOs facilitate trust and openness, increasing the flow of information that is valuable in decision-making and monitoring (Adams and Ferreira, 2007; Cai et al., 2009; Westphal, 1999) and encourage corporate innovation (Faleye et al., 2014; Kang et al., 2018). In contrast, opponents contend that social ties result in poor board monitoring. Board members who have social connections with a CEO might be reluctant to be effective monitors and curb their wrongdoing, as this can impose a strain upon the relationship between them. Consistent with this, Fracassi and Tate (2012) find that the ineffective monitoring of boards where such social connections prevail encourages greater managerial opportunism and value-destroying investments. Khedmati et al. (2020) provide supportive evidence that CEOs with strong ties to board members are associated with inefficient labour investment.

Based on the foregoing discussions, we argue that if CEO-director ties encourage more information sharing that is helpful in decision-making and facilitating effective monitoring, we would expect the negative relationship between co-opted boards and misconduct to be weaker for firms with strong CEO-director social ties. However, if CEO-director ties obstruct effective monitoring of the CEO, we would expect to observe a greater incidence of corporate misconduct in firms with a larger proportion of co-opted directors. To construct an aggregate measure of CEO-director ties, we follow Schmidt (2015), defining socially connected boards as those whose members are connected to the CEO by means of educational background or common membership of non-business organisations, which comprise golf clubs, fraternities, charitable organisations, trusts, and university boards (*ibid.*). Following Schmidt (2015), we determine each director's membership of various non-business organisations using the BoardEx director profile. Such non-business classifications can fall into one of the following categories: (i) not-for-profit foundations; (ii) professional network clubs; (iii) clubs

Table 11
Co-opted directors and corporate misconduct – the role of personal attributes.

Panel A: CEO-director social ties

	$Ln\ (Total\ Penalties\ \$)_{t+1}$							
	High social ties				Low social ties			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Co-option $_t$	1.011***				0.827**			
	(2.85)				(2.04)			
Co-option (TW) $_t$		0.995***				1.291		
		(2.84)				(1.64)		
Co-option (Independence) $_t$			1.158***				0.470	
			(2.81)				(1.03)	
Co-option (TW Independence) $_t$				1.179***				1.100**
				(2.59)				(2.06)
All control variables included	YES	YES	YES	YES	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Observations	3018	3018	3018	3018	2553	2553	2553	2553
Adjusted R^2	0.226	0.226	0.226	0.226	0.262	0.264	0.261	0.262

Panel B: Directors' age

	Age $= \geq 65$				Age < 65			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Co-option $_t$	0.485				1.394***			
	(1.52)				(3.00)			
Co-option (TW) $_t$		0.744**				1.539***		
		(2.28)				(3.24)		
Co-option (Independence) $_t$			0.426				1.365**	
			(1.15)				(2.56)	
Co-option (TW Independence) $_t$				0.775*				1.536**
				(1.82)				(2.57)
All control variables included	YES	YES	YES	YES	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Observations	3213	3213	3213	3213	2355	2355	2355	2355
Adjusted R^2	0.236	0.237	0.236	0.237	0.234	0.235	0.233	0.233

This table presents regression results of whether the effect that co-opted directors have on corporate misconduct is affected by the director's personal attributes. Panel A presents the results for the role of social ties between the CEO and co-opted directors. Panel B presents the results for the role of BoD age. We have included all control variables in the regressions as reported in Table 3; however, for purposes of brevity, we only present the results of the main independent variables. All regressions control for the industry- and year fixed effects. The t-statistics are based on standard errors clustered by firm and year. The t-statistics are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. Detailed definitions of variables are provided in the Appendix.

or fraternities; (iv) background; and (v) school affiliations (if a director and CEO attended the same school at the same time).

We classify a director to be socially connected with a CEO if s/he shares a common affiliation under one of these categories. We then sum the total number of socially connected board members in firm *i* in year *t* and divide this number by board size. In our study, our proxy for socially connected boards corresponds to the proportion of directors that are socially connected with an incumbent CEO to the total number of directors on a board. We then adopt a subsample regression approach by splitting the sample into two groups. The *High Social Ties* board group includes firms where the proportion of socially connected directors to the total number of directors on a board is greater than the cross-sectional median. Conversely, a *Low Social Ties* board group comprises businesses where the proportion of socially connected directors to the total number of directors on a board is lower than the cross-sectional median. We re-run the baseline model for both subsamples and present the results in Table 11.

The results presented in Panel A indicate that the effect of co-opted boards on corporate misconduct is more prevalent among companies with high CEO-director social ties. Specifically, the coefficient estimates on co-opted boards proxies are stronger and more significant for the *High Social Ties* group than the *Low Social Ties* group. Overall, the results are consistent with the view that stronger CEO ties to boards reduce the effectiveness of their monitoring, which, in turn, exacerbates corporate misconduct.

Next, we examine whether the relationship between co-opted boards and corporate misconduct can be affected by BOD age.[20] Senior directors have greater reputational capital and therefore fear reputational damage and a loss of legitimacy if they are seen to be remiss in their duties as monitors (Helland, 2006; Fich and Shivdasani, 2007). In addition, senior directors, and especially those who are close to the retirement age, are likely to have fewer future career concerns. Thus, we expect impartiality in executive monitoring by such directors and argue that the positive effect of co-opted boards on corporate misconduct will be less evident for boards whose directors are reaching retirement age (fewer career concerns).

To test this intuition, we divide our sample into two groups based on directors' retirement age. Boards where the average age of its members is above 65 years[21] are considered to be less influenced by career concerns, whereas the boards of firms whose directors are younger than 65 are considered to be more influenced by career concerns. We utilise the Institutional Shareholder Services (ISS, formerly RiskMetrics) database, which covers firms in the S&P 1500 index, to construct our measure, i.e., board average age. We re-run the baseline results for both subsamples and present the results in Panel B of Table 11.

The results in Panel B of Table 11 confirm our conjecture that directors' career concerns play an important role in explaining the relationship between co-opted directors and corporate misconduct. Specifically, the coefficient estimates on co-opted boards are stronger and more significant for firms whose directors have greater career concerns (i.e., those who are not close to retirement) compared to those who exhibit fewer career concerns, substantiating our baseline result with respect to the co-opted boards and misconduct nexus. Such a finding highlights the complexity of boards of directors as an effective monitor under varying conditions (see Boivie et al., 2016).

6.3. The role of CEO power

In this section, we examine whether the co-opted directors and corporate misconduct relationship varies with CEO Power.[22] Our analysis is motivated by one recent study undertaken by Withisuphakorn and Jiraporn (2017), which argues that in the presence of co-opted directors, CEOs relinquish their board powers. Their reasoning is based on the inference that co-opted directors exert weaker oversight and safeguard management interests, therefore a large proportion of them on a board can grant CEOs the assurance that they do not need to impose their executive authority to achieve their favoured outcomes. We consider that such an argument is more relevant in the event of corporate stakeholder violations for two reasons. First, entrenched CEOs expect co-opted directors to obfuscate internal records and make it harder for prosecutors to prove malfeasance in court proceedings (Arlen and Carney, 1992). Second, the presence of co-opted directors also reduces the probability of a CEO's dismissal for wrongdoing (Harris and Erkan, 2021). Therefore, entrenched CEOs may strategically choose not to exert their powers in the presence of 'friendly' boards of directors. We expect that the positive relationship between co-opted directors and misconduct should be more pronounced in the presence of low CEO power.

To test this intuition, we re-estimate Eq. (1) and perform a subsample analysis based on high (low) CEO power. We use two proxies to capture CEO power: CEO tenure and CEO duality. The High CEO Power group includes firms in which CEOs remain in office for three or more years (High *CEO Tenure*) and firms where the CEO also chairs the board (*Dual CEO*). In contrast, the Low CEO Power group comprises firms where a CEO's tenure in office is less than three years (Low *CEO Tenure*) and firms where the CEO does not chair the board (*Non-dual CEO*). We report the results in Table 12.

The results clearly show that the coefficient estimates of board co-option are more positive and statistically significant in firms with low CEO Power, i.e., *Low CEO Tenure* (Panel A) and *Non-dual CEO* (Panel B). These results support our contention that the presence of co-opted directors encourages CEOs not to exercise their board powers.

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[20] We are grateful to one anonymous reviewer for suggesting this line of reasoning.

[21] Previous studies use a CEO's retirement age of 60 years and above as a proxy for CEO career concerns. However, in this study we are interested in the BOD's retirement age, which is, on average, around 73 according to the U.S. Spencer Stuart Board Index (2018). Therefore, we use 65 years of age as our benchmark instead of 60 for our proxy to capture board career concerns. Our benchmark is consistent with Helland (2006) that considers directors over 65 to be close to retirement age.

[22] We are grateful to one anonymous reviewer for suggesting that we undertake these tests.

Table 12
Co-opted directors and corporate misconduct – the role of CEO power.

Panel A: CEO tenure

	$Ln \ (Total \ Penalties \ \$)_{t+1}$							
	High CEO tenure				Low CEO tenure			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Co-option $_t$	0.711 (1.53)				1.047*** (3.12)			
Co-option (TW) $_t$		0.961** (2.09)				1.309*** (3.75)		
Co-option (Independence) $_t$			0.613 (1.15)				0.967** (2.51)	
Co-option (TW Independence) $_t$				0.955 (1.63)				1.346*** (3.01)
All control variables included	YES	YES	YES	YES	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Observations	2784	2784	2784	2784	2784	2784	2784	2784
Adjusted R^2	0.275	0.276	0.275	0.276	0.206	0.206	0.205	0.205

Panel B: CEO duality

	Dual CEO				Non-dual CEO			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Co-option $_t$	0.479 (1.02)				1.151*** (3.47)			
Co-option (TW) $_t$		0.682 (1.47)				1.436*** (4.19)		
Co-option (Independence) $_t$			0.354 (0.66)				1.096*** (2.88)	
Co-option (TW Independence) $_t$				0.590 (1.00)				1.535*** (3.48)
All control variables included	YES	YES	YES	YES	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Observations	2784	2784	2784	2784	2784	2784	2784	2784
Adjusted R^2	0.269	0.270	0.269	0.270	0.205	0.204	0.203	0.202

This table presents regression results of whether the effect that co-opted directors have on corporate misconduct is affected by the CEO power. We have included all control variables in the regressions as reported in Table 3; however, for purposes of brevity, we only present the results of the main independent variables. All regressions control for industry and year-fixed effects. The t-statistics are based on standard errors clustered by firm and year. The t-statistics are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. Detailed variable definitions are provided in the Appendix.

7. Additional analysis

7.1. Co-opted directors and corporate misconduct heterogeneity

In this section, we examine whether the behaviour of co-opted directors varies across different types of stakeholder-related misconduct. Our analysis is motivated by the extant literature reporting that managers are more inclined to engage in some categories of corporate misconduct (Carberry et al., 2018) for three reasons. First, a cost-benefit framework of criminal behaviour (Becker, 1968; Glaeser et al., 1996; Sah, 1991) suggests that a decision to commit corporate violations may be determined by a cost-benefit analysis, since violations that result in trivial costs but greater benefits might be a company's favoured option. For instance, in the US, workplace-related violations (e.g., wage theft, safety issues, etc.) are liable to only trivial penalties (Raghunandan, 2021), and such lax disciplinary action has made them multibillion-dollar crimes. Consistent with this argument, Caskey and Ozel's (2017) findings strongly suggest that managers who are subject to pressures due to under-performance are often involved in workplace-related misconduct. This is because it is easier and potentially less costly, in the event of detection, for them to increase employees' workloads and cut safety-related expenditure (Raghunandan, 2021).

Second, divergent interests between multiple stakeholders encourage companies to prioritise powerful stakeholders' interests at the expense of potentially less vocal stakeholders. Anecdotal evidence from the Volkswagen (VW) emissions scandal and the British Petroleum (BP) Deepwater Horizon oil spill case suggests that company management in both instances bolstered company performance by surreptitiously compromising environmental standards, thereby 'hoodwinking' stakeholders (Crête, 2016; Goldenberg, 2011). The corollary argument is that reputational concerns are a significant factor inducing managers to change the nature of corporate misbehaviour in relation to different types of misconduct. For example, such environmental violations as those described above, despite undermining stakeholders' values, do not result in a significant, long-term reputational loss for management (Jones and Rubin, 2001). Conversely, dishonest managers committing ethical violations will suffer substantial and lasting reputational damage as a consequence (Cline et al., 2018).

Table 13

Co-opted directors and types of corporate misconduct.

Panel A: Co-opted directors and corporate misconduct *Ln* (*Total Penalties $*)$_{t+1}$

	Shareholders misconduct	Workplace misconduct	Customers misconduct	Environmental misconduct	Society misconduct
	(1)	(2)	(3)	(4)	(5)
Co-option (TW) $_t$	0.020*	0.740***	0.387**	0.660***	0.200**
	(1.69)	(3.12)	(2.37)	(2.70)	(2.37)
All control variables					
included	YES	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES	YES
Observations	5571	5571	5571	5571	5571
Adjusted R^2	0.036	0.143	0.182	0.131	0.041

Panel B: Co-opted directors and corporate misconduct *Ln* (*Number of Penalties*)$_{t+1}$

	Shareholders misconduct	Workplace misconduct	Customers misconduct	Environmental misconduct	Society misconduct
	(1)	(2)	(3)	(4)	(5)
Co-option (TW) $_t$	0.001*	0.060**	0.053**	0.067***	0.010**
	(1.72)	(1.97)	(2.16)	(2.88)	(2.11)
All control variables					
included	YES	YES	YES	YES	YES
Industry & Year FE	YES	YES	YES	YES	YES
Observations	5571	5571	5571	5571	5571
Adjusted R^2	0.032	0.190	0.300	0.146	0.036

This table presents regression results for the relationship between co-opted directors and corporate misconduct against stakeholders across various classifications. We have included all control variables in the regressions as reported in Table 3; however, for purposes of brevity, we only present the results of the main independent variables. All regressions control for industry and year fixed effects. The t-statistics are based on standard errors clustered by firm and year. The t-statistics are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. Detailed definitions of variables are provided in the Appendix.

The above studies imply that firms modify their behaviours in relation to different types of misconduct. To capture such heterogeneous effects, we re-run the baseline model, replacing the aggregate measure of corporate misconduct with the five different types of stakeholder violations, namely those against shareholders, employees, customers, the environment, and society at large. We report the results in Table 13.

The results in Panel A show that the coefficient estimates on co-opted directors are positive and significant for all five types of stakeholder violations, based on the amount of financial penalties imposed (*Total Penalties $*). Such a positive relationship is more pronounced in respect of environmental- and workplace-related misconduct compared with other types of stakeholder violations. Panel B reports the results of five types of misconduct against stakeholders, based on the number of penalties imposed (*Number of Penalities*). Overall, these findings emphasise that co-opted directors are more likely to become involved in violations that incur lower long-term reputational damage, such as environmental infractions, or attract less punitive measures from regulators, such as breaches of workers' rights.

7.2. What reduces corporate misconduct?

The positive association between board co-option (including co-opted independent directors, as hereinafter designated) and corporate misconduct, for which our investigation provides copious evidence, raises the question of whether non-co-opted BoDs are effective in helping to prevent corporate misconduct. This is important because stakeholders rely on BoDs to protect their interests (Jain and Zaman, 2020), while BoDs' failure to do so not only destroys stakeholders' confidence but also increases the risk that firms will default (Baghdadi et al., 2020). In addition, our earlier findings demonstrate that co-opted directors exhibit partiality in monitoring, showing that their decisions are also influenced, in part, by their allegiance to management, which exacerbates stakeholder–agency conflicts.

Coles et al. (2014) unpack heterogeneity between co-opted and non-co-opted directors, suggesting that the latter are effective monitors. We argue that non-co-opted directors, including non-co-opted independent directors, better represent stakeholders' interests and are genuinely hired for their knowledge, skills and experience rather than for their connection to the CEO (Fedaseyeu et al., 2018). Such directors do not feel constrained by allegiance to the CEO. Indeed, the involvement of firms in corporate misconduct practices can significantly undermine their reputational capital in the directors' labour market (Cowen and Marcel, 2011; Coles et al., 2014; Fich and

Table 14

Non-co-opted directors and corporate misconduct.

	Ln (Total Penalties $)$_{t+1}$		Ln (Number of Penalties)$_{t+1}$	
	(1)	(2)	(3)	(4)
Non - Co-option $_t$	−0.880*** (3.39)			
Non- Co-option (Independence) $_t$		−0.609** (2.07)		
Non - Co-option $_t$			−0.078*** (2.68)	
Non- Co-option (Independence) $_t$				−0.622* (1.89)
CSR committee $_t$	0.509** (2.20)	0.509** (2.20)	0.037 (1.32)	0.037 (1.32)
Board size $_t$	0.223 (0.52)	0.223 (0.52)	0.018 (0.36)	0.018 (0.36)
Board gender diversity $_t$	−3.151*** (−3.40)	−3.151*** (−3.40)	−0.530*** (−5.25)	−0.530*** (−5.25)
ROA $_t$	2.679* (1.82)	2.679* (1.82)	0.444*** (2.58)	0.444*** (2.58)
PPE $_t$	3.486*** (4.82)	3.486*** (4.82)	0.528*** (6.02)	0.528*** (6.02)
Firm size $_t$	1.261*** (16.47)	1.261*** (16.47)	0.190*** (20.81)	0.190*** (20.81)
CAPEX $_t$	−0.087*** (−3.67)	−0.087*** (−3.67)	−0.014*** (−4.85)	−0.014*** (−4.85)
Leverage $_t$	−0.833 (−1.16)	−0.833 (−1.16)	−0.171** (−2.39)	−0.171** (−2.39)
Cash holding $_t$	−1.649 (−0.95)	−1.649 (−0.95)	−0.437** (−2.24)	−0.437** (−2.24)
R&D $_t$	−10.594*** (−3.62)	−10.594*** (−3.62)	−1.184*** (−3.66)	−1.184*** (−3.66)
MB $_t$	−0.358*** (−3.54)	−0.358*** (−3.54)	−0.023** (−2.15)	−0.023** (−2.15)
Firm age $_t$	0.020*** (3.81)	0.020*** (3.81)	0.001* (1.94)	0.001* (1.94)
Firm risk $_t$	0.205*** (3.90)	0.205*** (3.90)	0.013 (0.87)	0.013 (0.87)
Industry & Year FE	YES	YES	YES	YES
Observations	5571	5571	5571	5571
Adjusted R^2	0.233	0.233	0.445	0.445

This table presents regression results for the relationship between non-co-opted directors and corporate misconduct. All regressions control for in-dustry and year fixed effects. The t-statistics are based on standard errors clustered by firm and year. The t-statistics are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. Detailed definitions of variables are provided in the Appendix.

Shivdasani, 2007). Given the gravely negative implications of corporate misconduct (Neville et al., 2019), one would expect the presence of non-co-opted BODs to reduce board tolerance of corporate malpractice and exert greater pressure on managers to forswear such behaviour.

To test whether non-co-opted BoDs play a significant role in reducing corporate misconduct, we construct two measures: *Non-Co-option* and *Non-Co-option (Independence)*. We then regress *Non-Co-option* and *Non-Co-option (Independence)* on both proxies of corporate misconduct, i.e., *Ln (Total Penalties $) and Ln (Number of Penalties)*. We report the results in Table 14.

We find that the coefficient estimates of *Non-Co-option* and *Non-Co-option (Independence)* are negative and significant with both proxies of corporate misconduct, i.e., *Ln (Total Penalties $) and Ln (Number of Penalties)*. Our results confirm the monitoring efficiencies of non-co-option and suggest that non-co-opted executive directors are in a better position to protect stakeholders' interests than co-opted independent directors (Jain and Zaman, 2020).[23] These findings endorse our contention that non-co-opted directors can reduce the incidence of corporate wrongdoing, mitigating the damage that such malpractices inflict on stakeholders. Our findings are sig-nificant because they demonstrate monitoring heterogeneity where not all independent board directors are effective monitors of

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[23] Since the presence of co-opted directors can cause tension/conflicts within the board itself, such tension/conflicts will be minimal if these directors have more seats/votes than non-co-opted directors. To ensure our results are not driven by such tension/conflicts, we perform a subsample analysis by dividing the sample based on 50.1% co-opted board representation. We believe that such a proportion will provide co-opted directors with a simple majority, reducing conflict within the board. Our results reveal a significant, positive relationship between co-opted directors and corporate misconduct for companies with boards comprising more than 50% of co-opted directors. Such directors fail to influence board decisions in companies where non-co-opted directors hold a simple majority of more than 50%. This means that our results are not affected by board tensions/conflicts (results are available upon request).

stakeholders' interests. In the presence of board co-option, the monitoring of process is compromised by such directors' connections with management. Our conclusion contributes a valid explanation for the divergent results of past studies concerning the association between board independence and corporate misconduct (see Neville et al., 2019).

8. Conclusion

Our original study examines the extent to which the presence of co-opted directors (including co-opted independent directors), appointed after a CEO takes office, determines the degree and incidence of a company's corporate misconduct, and evaluates the monitoring efficiency of board processes. Utilising a unique dataset of monetary penalties imposed on 696 US-listed companies as a proxy for corporate misconduct, we demonstrate a strong and positive relationship between co-opted directors and corporate misconduct. Our findings also embody economic significance, revealing that an increase of one standard deviation in the proportion of co-opted directors on a board leads to a 4.3% rise in corporate misconduct. These results remain robust to a series of robustness tests and after addressing endogeneity concerns.

We further explore the underlying channels through which co-opted boards facilitate managerial wrongdoing, finding supportive evidence that poor monitoring by co-opted directors plays a critical part in determining the relationship between co-option and corporate misconduct, which our investigation has established. In particular, we provide nuanced evidence that co-opted directors are less active in contributing to board agenda items, attend board meetings less frequently, and receive above industry-average compensation packages, exacerbating stakeholder-agency conflicts and increasing the incidence of corporate misconduct. Our cross-sectional analysis further reveals that these effects are most pronounced among firms with weak external monitoring; when CEO-directors' social ties are strong; when board members have more intense career concerns; and when CEOs wield less power. In our additional analyses, we find that co-opted directors are more likely to be involved in violations that incur lower long-term reputational damage, as in the case of environmental infractions, or that attract lower punitive measures, such as breaches of workers' rights.

In our final analysis, we test for the monitoring efficiencies of non-co-opted BoDs, including non-co-opted independent directors. Our results confirm the monitoring efficiencies of non-co-opted BoDs, demonstrating that non-co-opted executive directors outperform co-opted independent directors in safeguarding the wealth of shareholders as well as the claims of other stakeholders, obviating the negative consequences of corporate malpractice.

Our study makes valuable contributions to the literature and policy in three ways. First, our findings contribute to the literature on corporate misconduct (Armstrong et al., 2013; Cumming et al., 2015a; Cumming et al., 2018; Hass et al., 2015; Heese and Pérez-Cavazos, 2019; Jain and Zaman, 2020; Karpoff, 2020; Neville et al., 2019). We extend this strand of research by identifying a significant weakness in corporate governance that magnifies corporate misconduct, namely the appointment of co-opted directors. Second, our study contributes to the understanding of board effectiveness (Boivie et al., 2016; Coles et al., 2014; Hermalin and Weisbach, 1998; Krause et al., 2017; Shivdasani and Yermack, 1999). We augment the literature in this field by highlighting the consequences of lax monitoring on the part of co-opted directors, which enables firms to engage in corporate misconduct. Our study, therefore, is part of a small but growing body of literature that highlights the "dark side" of co-opted boards. Third, our findings will be of particular relevance to policymakers and those responsible for devising effective systems of corporate governance, in the aftermath of numerous corporate scandals, which have consistently demonstrated the importance of the independence of directors in protecting stakeholders' interests.

Our original findings will be of significant value to regulators seeking to enforce SOX 2002, as we demonstrate that board ethics and systems of corporate governance can be seriously compromised by partisan directors, whose lack of independence both sanctions and encourages corporate misbehaviour. Most importantly, our findings call into question the legitimacy of board processes in the appointment of co-opted directors. The lack of accountability of those responsible, clearly demonstrated by our results, strongly suggests that governance procedures need to be reformed to prevent what in many observed cases amounts to proxy voting, damaging the interests of stakeholders. These deficiencies also militate against the interests of society, making it imperative that legislators take prompt action for the benefit of us all. Finally, at a time of rising corporate malpractice, we suggest that future research explore the role of co-opted directors on various board committees, and especially the CSR committee, to determine how their representation on such bodies might impact organizational outcomes, with especial reference to the incidence of corporate violations.

Appendix A. Definitions of variables

Variable	Definitions	Sources
Dependent variable		
Ln (Total Penalties $)	The natural logarithm of one plus the amount of financial penalties in US dollars imposed by regulatory agencies on firm i in year t due to its engagement in corporate misconduct activities	Authors' calculation based on the Violation Tracker database
Independent variables		
Co-option	The proportion of co-opted directors to the total number of directors on a board as in Coles et al. (2014)	
Co-option (TW)	The tenure weighted measure of co-option, defined as the sum of the tenure of co-opted directors divided by the sum of all directors' tenures as in Coles et al. (2014)	Co-option data are from Lalitha Naveen's webpage: https://sites.temple.edu/lnaveen/data/
Co-option (Independence)	The number of co-opted independent directors divided by the total number of directors on a board as in Coles et al. (2014)	
Co-option (TW Independence)	The tenure weighted measure of independent co-opted directors, defined as the sum of the tenure of independent co-opted directors divided by the sum of all directors' tenures as in Lim et al. (2020)	
Control variables		
CSR committee	A dummy variable, which equals one if the company has a CSR committee, and otherwise zero	Bloomberg
Board gender diversity	The number of female directors divided by the total number of directors on a board	Bloomberg
Board size	The natural logarithm of the total number of directors on a board	Bloomberg
ROA	The ratio of net income to total assets	Compustat
PPE	The ratio of property, plant and equipment to total assets	Compustat
Firm size	The natural logarithm of total assets	Compustat
CAPEX	The natural logarithm of capital expenditure	Compustat
Leverage	Total debt divided by total assets	Compustat
Cash holding	Cash and assets readily convertible to cash at the end of the fiscal year divided by total assets	Compustat
R&D	R&D intensity at the end of the fiscal year, defined as research and development expenditure divided by total assets, with missing values set to zero	Compustat
MB	The market-to-book ratio = (total assets – common equity + price close * common shares outstanding)/total assets	Compustat
Firm age	The number of years from the earliest year when a firm's name appears in the Compustat Database	Compustat
Firm risk	The standard deviation of monthly stock returns (annualised)	CRSP
Additional dependent variable		
Ln (Number of Penalties)	The natural logarithm of one plus the number of financial penalties in US dollars imposed by regulatory agencies on firm i in year t due to its engagement in corporate misconduct activities	Authors' calculation based on the Violation Tracker database

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