

MISQ Archivist

Board Independence and Firm Performance in the IT Industry: The Moderating Role of New Entry Threats

Yang Pan, Peng Huang, and Anandasivam Gopal

Abstract

Prior research on corporate governance has offered contradictory empirical evidence on the relationship between the independence of the board of directors (the degree to which the board consists of outside directors who are not affiliated with the company) and firm performance. Building on the contingency view of corporate governance, we argue that the presence of significant new entry threats (NET), a unique feature that differentiates the IT industry from many other industries, is a critical contextual variable that moderates this relationship. Leveraging a novel NET measure based on text mining, we show that facing high NET, firms with boards that have a higher proportion of independent directors, who contribute to explorative organizational learning, carry out more effective monitoring, and offer independent opinions in strategic decision making, outperform firms with fewer independent board members. To address the endogeneity of board independence, we use the enactment of the Sarbanes-Oxley Act and related changes to the NYSE/NASDAQ listing rules as exogenous shocks; we show that our results are robust to the correction for endogeneity issues. Further, we show that our findings are generalizable to other high tech industries that face significant threats of new entry emerging from fast-moving industry dynamics. However, these results do not extend to slow-moving industries that have stable market structure and thereby face lower and more homogenous levels of NET. We discuss the implications for future research, and provide managerial guidelines for practice as well.

Keywords: New entry threats, board independence, board of directors, corporate governance, firm performance, Sarbanes-Oxley Act, text mining