Director Tenure and Leadership Effectiveness over Internal Controls

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The purpose of this paper is to empirically examine the relationship between director tenure and leadership effectiveness as measured by weaknesses in internal control. Using data on over 3,000 U.S. companies for the years 2004-2014, we document a significant and positive relationship between the length of director tenure and corporate governance effectiveness. This result is consistent with the hypothesis that directors gain valuable expertise/experience as their tenure increases. Our results should be useful to management, corporate directors, investors, and other stakeholders that have an interest in the impact of director tenure on the leadership effectiveness of the board of directors.

INTRODUCTION

Director tenure, board entrenchment, and board refreshment are corporate governance buzzwords that increasingly are becoming hot-button issues for institutional investors, proxy advisory firms, shareholder activists, and other governance advocates (Libit and Freier, 2015). For example, the National Association of Corporate Directors lists director tenure as one of several board leadership issues for directors to focus on in 2016 (NACD, 2015). In this paper, we empirically examine the relationship between the length of service of corporate board members (i.e., director tenure) and leadership effectiveness in overseeing the company's internal controls.

There are often conflicting points of view on whether increased director tenure is beneficial or detrimental to a company. On the one hand, a number of organizations have expressed serious concerns about the possible negative consequences of corporate directors serving too long in their role as board members. In fact, certain groups have argued for placing term limits on corporate directors. Those who advocate term limits for directors contend that directors become "entrenched," complacent, and overly friendly toward management as their length of board service grows. As a result, long-tenured directors may tend to overly rely on the assertions of management and may become lax in their duties to monitor management activities. However, on the other hand, some argue that directors gain valuable firm-specific information as their board tenure increases, with a resulting increase in the expertise needed to effectively govern the firm.

Although there is limited empirical evidence, the evidence that does exist is conflicting about whether long periods of director tenure increase or decrease corporate governance effectiveness. One strand of prior research tests what we label the "Expertise Hypothesis," which proposes that board members gain valuable knowledge about a company and its operating environment over time and that their expertise in firm-specific governance matters grows over time. Another line of research examines what we refer to as the "Entrenchment Hypothesis," which asserts that board members become less independent over time as they become more entrenched in their position on the board and start to put management concerns over shareholder concerns. They become, in effect, insiders rather than true outside directors. Prior research results are conflicting in that results consistent with both hypotheses have previously been documented. Interestingly, Huang (2013) demonstrates that increased board tenure is beneficial up to a point (around nine years), and then becomes detrimental after that point.

In this paper, we first attempt to reconcile the conflicting results of past research. Consistent with prior research (see Johnstone et al., 2011), we use a company's number of reported material weaknesses in internal control as a proxy for corporate governance effectiveness. Using a large sample of over 30,000 firm-year observations collected from the *Audit Analytics* database over the years 2004-2014, we find a significant positive correlation between director tenure and corporate governance effectiveness. This result is consistent with the hypothesis that directors gain valuable expertise/experience as their tenure increases, which leads to lower internal control weaknesses (i.e., improved governance). Our results therefore provide positive support for the Expertise Hypothesis.

We then extend prior research by examining the effect of increased tenure from serving on *outside boards* (i.e., multiple directorships). In our analysis, we define "inside tenure" as a director's length of tenure on a particular company's board of directors. For board members with multiple directorships, we define "outside tenure" as the length of tenure a board member has from also serving on the boards of other companies. Overall, after controlling for the length of inside tenure, there is also a negative relationship between average outside tenure and the number of internal control weaknesses. These results imply that increased tenure on outside boards also results in increased expertise, which leads to improved governance.

However, for firms where directors' outside board memberships are on smaller company boards, outside tenure is no longer significantly associated with corporate governance effectiveness. In other words, we find that outside tenure is beneficial, but only if the outside tenure is on larger company boards where the beneficial experience effects would be greater. Inside tenure, however, continues to remain significant regardless of the company size of the outside directorships.

Our results are relevant to the discussion of whether term limits should be set for corporate directors. Our results do not support the need for term limits for board members. In contrast to Huang (2013), we find that director tenure increases governance effectiveness up to a point and then tends to level off, rather than decreasing after that point. We demonstrate that companies are benefited by increased board tenure up to a certain point, and for levels of overall tenure above that point, incremental increases in tenure no longer have a significant effect on corporate governance.

PRIOR LITERATURE AND HYPOTHESIS DEVELOPMENT

Prior research presents opposing views and conflicting empirical evidence as to whether increased director tenure results in increased or decreased corporate governance effectiveness. We will categorize prior research studies into those that examine the Expertise Hypothesis versus those that examine the Entrenchment Hypothesis.

The Expertise Hypothesis

The Expertise Hypothesis proposes that increased director tenure enhances a director's ability to effectively monitor management and to govern the firm. This is because a director's knowledge about the firm and its operating environment grows over time. Katz and McIntosh (2014) summarize this point of view as follows:

> Long tenure on a corporate board historically has been understood – and demonstrated – to be an asset to board effectiveness and a feature that goes hand-in-hand with solid corporate performance and good management. Having a core group of long-term directors has been seen as beneficial to board dynamics as well as to the relationship between the board and management (Canavan et al., 2014). According to some estimates, new directors require between three and five years to acquire sufficient company-specific knowledge (Van Ness et al., 2010), with more time required for directors of companies with complex operations and more intangible assets (Huang, 2013). Long-serving outside directors thus are highly valued for their experience and organizational memory. Often, they have made important and useful industry connections over the course of their careers. Such directors frequently have gained a deep understanding of the relevant industry, and in board discussions they can offer historical context for consideration in corporate strategic decision making.

In essence, the Expertise Hypothesis predicts a positive relationship between director tenure and corporate leadership effectiveness due to long-tenured directors obtaining and possessing a large amount of firm-specific knowledge not possessed by newer directors. In addition, Bebchuk et al. (2002) argue that long-tenured directors would be more likely to challenge and/or criticize the company CEO than newer board members. Bebchuk et al. (2010) contend that newer board members would tend to be more deferential in their interactions with management. In a similar vein, Katz and McIntosh (2014) state that "long-tenured directors may be in the best position to manage a powerful chief executive by virtue of their shared history and many years of building trust and collegiality together."

A few prior studies report empirical results that are consistent with the Expertise Hypothesis. For example, Beasley (1996) examines the relationship between board of director composition and financial statement fraud and finds that increased tenure by outside directors is associated with a reduced likelihood of financial statement fraud. Huang (2013) also provides empirical evidence that supports the Expertise Hypothesis and documents that firm value and director tenure are positively associated, but only up to a point (approximately nine years). He finds that firm value declines after that point. Fiegener et al. (1996) find a positive correlation between director tenure and financial performance for their sample of companies in the banking industry.

Recent research by Dou et al. (2015) suggests that calls for term limits on directors may be misguided since "extended tenure" directors (i.e., those with tenure of at least 15 years) tend to take on more committee memberships and tend to attend more board meetings. In addition, "Firms with a higher proportion of these directors have lower chief executive (CEO) pay, higher CEO turnover-performance sensitivity, and a smaller likelihood of intentionally misreporting earnings" (Dou et al., 2015, p. 583).

The Entrenchment Hypothesis

Prior research has also tested a competing hypothesis, which we refer to as the Entrenchment Hypothesis. It has also been called the Management Friendliness Hypothesis (Vafeas, 2003) and the CEO-Allegiance Hypothesis (Byrd et al., 2010). Regardless of how the hypothesis is labeled, the predictions are the same; namely, that "entrenched" or "management friendly" directors are ineffective in their efforts to monitor management and to effectively govern the company. Katz and McIntosh (2014) summarize this viewpoint as follows:

> Boards with many long-serving directors are now described as "entrenched" and deaf to shareholder concerns (Hymowitz and Green, 2013). Critics posit that older directors – who are typically the longer-tenured directors – can no longer keep current with respect to industrial or technological developments and are unable to offer new insights into corporate issues; they fear that these directors may hold fossilized positions that are no longer relevant in the changing economic and business environment (Canavan et al., 2004). Some argue that extended board service can create a culture of undue deference to

management, particularly in cases where the chief executive also has held the position for many years.

Those who argue that long-serving board members are detrimental to effective corporate governance typically express two major concerns. First, directors with long tenures on the board are predicted to be overly deferential to management and unwilling to challenge and criticize managerial positions. Vafeas (2003, p. 1045) suggests that "seasoned directors are more likely to befriend, and less likely to monitor managers," and over time "may be co-opted by management as directors become less mobile and less employable." Vafeas (2003) contends that this overly deferential attitude or "management friendliness" is particularly likely to occur when the company CEO is viewed as powerful. A second and similar concern is that the allegiance of long-tenured directors "shifts away from shareholders and towards managers" (Byrd et al., 2010, pp. 87-88). If such a shift occurs, outside directors in essence become insiders, rather than true outside directors.

Several prior studies provide empirical support for the Entrenchment Hypothesis. For example, Niu and Berberich (2015) analyze a sample of S&P 1500 directors and find that long-tenured directors are more likely to be associated with governance problems such as major litigation or regulatory infractions, major accounting restatements, or corporate bankruptcy. As stated earlier, Huang (2013) documents that firm value and director tenure are positively associated, but only up to a point (approximately nine years). He finds that firm value declines after that point, which implies that entrenchment effects become more important than expertise effects for long-tenured directors.

Byrd et al. (2010) document a positive association between director tenure and CEO pay for a sample of firms with CEO tenure of at least six years. Their results are consistent with their CEO allegiance hypothesis and "suggest that the independence of outside directors may be compromised when they serve for longer tenure periods together with the same CEO" (Byrd et al., 2010, p. 86). Vafeas (2003) also finds a positive association between director tenure and CEO compensation. Specifically, Vafeas (2003) documents that CEO salaries tend to rise when a company's most senior director is on the compensation committee. Vafeas (2003, p. 1062) concludes, "given the opportunity, Senior directors compromise shareholder interests by inflating CEO salaries."

Hypothesis Development

The previous literature review on the relationship between director tenure and corporate governance effectiveness clearly demonstrates conflicting hypotheses and conflicting empirical results. In this paper, we attempt to not only reexamine previous conflicting results, but also to extend prior research by examining additional aspects of the relationship between director tenure and governance effectiveness. Our first series of empirical tests is designed to test the competing Expertise and Entrenchment Hypotheses.

In our empirical tests, we utilize a company's number of reported material weaknesses in internal control as a proxy for directors' corporate governance effectiveness. We employ this proxy for governance effectiveness for two reasons. First, previous research provides support for our proxy for corporate governance effectiveness. For example, Doyle et al. (2007, p. 202) state that they "expect a well-governed firm to exhibit fewer material weaknesses, all else equal." Johnstone et al. (2011, p. 333) concur with Doyle et al. and state: "The limited related research in this area reports a positive association between levels of internal control quality and superior corporate governance." Elbannan (2009) examines internal control weakness disclosures and finds that corporate governance strength is positively associated with internal control quality. The findings of Krishnan (2005), Hoitash et al. (2009), and Zhang et al. (2007) also provide support for our proxy, since each study documents that internal control weaknesses are less likely for those companies that have a high quality audit committee of the board of directors. Second, the number of reported internal control weaknesses is an appropriate proxy since the Sarbanes-Oxley Act of 2002 holds corporate directors responsible for a company's effective internal control environment.

Thus, previous research has documented that the number of material weaknesses in internal control decreases as corporate governance effectiveness increases. We therefore use the number of reported material weaknesses in internal control as our measure of governance effectiveness.

Since there are numerous arguments (and empirical evidence) both for and against the Expertise and the Entrenchment Hypotheses, we do not make a directional hypothesis. Our hypothesis is:

There is an association between the average tenure of a company's board of directors and the number of reported material weaknesses in internal control.

A finding of a significant negative relationship between director tenure and internal control weaknesses would support the Expertise Hypothesis since such a result would suggest that corporate governance effectiveness increases as directors gain additional experience. Conversely, a finding of a positive association between internal control weaknesses and director tenure would provide support for the Entrenchment Hypothesis since governance effectiveness would decrease as director tenure increases.

METHODOLOGY AND EMPIRICAL RESULTS

We collected all required data from the *Audit Analytics* database. We used both the Audit Data and Corporate Governance subsets of *Audit Analytics* for the years 2004 through 2014. For each company, we gathered the following annual data: the number of reported material weaknesses in internal control (MWIC), the total number of board members (MEMBERS), firm size as measured by the natural log of sales (SIZE), the stock exchange on which the company's stock is traded (EXCHG), and the name of the company's auditor (AUDITOR). In addition, we gathered annual data for each company on three measures of director tenure: the average number of years of tenure for directors from serving on that company's board (INSIDETENURE), the average number of years of tenure for directors from serving on the boards of outside companies (OUTSIDETENURE), and the average number of years of tenure for directors from serving on all boards (ALLTENURE). A total of 30,665 firm-year observations were gathered.

In our regression models, we label the dependent variable MWIC, which indicates a company's number of reported material weaknesses in internal control in a given year. For the 30,665 firm-year observations, the mean number of reported material internal control weaknesses was 0.10 per firm-year, and the range was from zero to 26. Table 1 provides descriptive statistics on our dependent variable, along with descriptive statistics for both our independent and control variables. Table 1, Panel A displays descriptive statistics for the entire sample of firms, "small" firms, and "large" firms, respectively.

Panel A provides details about our primary independent variable of interest, which we label INSIDETENURE. This variable is defined as the average number of years that a company's board of directors have served as board members for that company. Panel A of Table 1 reveals that the mean of our primary independent variable (INSIDETENURE) is 7.40, with values ranging from zero to 29.57. The mean of this inside tenure variable is also approximately seven years for both our large company and small company subsamples. Therefore, the directors of the companies in our sample have an average tenure of around seven years on that company's board. That contrasts with an average tenure of 2.37 years on outside boards, with a resulting total tenure on all boards (both inside and outside) of 9.78 years. Thus, Panel A of Table 1 demonstrates that the directors in our sample have an average overall tenure of approximately 10 years.

Table 1 also provides information on two variables that we utilize in our regression models as control variables. We utilize a company's total number of board members (MEMBERS) and the natural log of sales (SIZE) as control variables. Both of these variables represent measures of firm size and are included in an attempt to control for the effects of extraneous factors. Table 1 demonstrates that our sample companies have an average board size of approximately nine members, with values ranging from one to 54 members.

Also included in Table 1 are descriptive statistics for the two categorical variables that we utilize as control variables in our regression models. In our regression models, we control for the effects of both stock exchange differences (EXCHG) and auditor type (AUDITOR) on the relationship between director tenure and reported material internal control weaknesses. Both a company's auditor and exchange listing may affect the company's effectiveness in monitoring internal controls, and we therefore employ these two categorical variables in an effort to control for such potential effects. As expected, the data reveal that for our sample firms, larger companies are typically listed on a major stock exchange and tend to be audited by either a "Big Four" or national auditing firm. However, the descriptive statistics provided in Table 1 demonstrate that there appears to be sufficient cross-representation of auditor association and exchange listing for our results to be robust.

TABLE 1
DESCRIPTIVE STATISTICS FOR INTERVAL REGRESSION VARIABLES

Panel A: Descriptive Statistics for Interval Regression Variables

Variable	N	Mean	Std. Dev.	Median	Min	Max
Descriptive Statistics for Full Sample:						
MWIC	30665	0.1039	0.6353	0.0000	0.0000	26.0000
MEMBERS	30665	9.2048	2.8599	9.0000	1.0000	54.0000
SIZE	30665	21.2185	2.0008	21.1284	13.3047	28.8158
ALLTENURE	30665	9.7751	5.1841	9.1000	0.0000	61.1111
INSIDETENURE	30665	7.4017	3.9560	6.8000	0.0000	29.5714
OUTSIDETENURE	30665	2.3733	2.9884	1.4167	0.0000	48.4444
Descriptive Statistics for "Small" Firms:*						
MWIC	15327	0.1398	0.6762	0.0000	0.0000	17.0000
MEMBERS	15327	7.8735	1.9979	8.0000	1.0000	22.0000
SIZE	15327	19.6647	1.0915	19.8577	13.3047	21.1381
ALLTENURE	15327	9.3859	5.2969	8.5000	0.0000	61.1111
INSIDETENURE	15327	7.5798	4.1973	6.8333	0.0000	29.5714
OUTSIDETENURE	15327	1.8058	2.8797	0.7777	0.0000	48.4444
Descriptive Statistics for "Large" Firms:*						
MWIC	15338	0.0681	0.5895	0.0000	0.0000	26.0000
MEMBERS	15338	10.5351	2.9511	10.0000	1.0000	54.0000
SIZE	15338	22.7858	1.3957	22.4277	21.1382	28.8158
ALLTENURE	15338	10.1639	5.0391	9.6250	0.0000	61.1111
INSIDETENURE	15338	7.2236	3.6908	6.7777	0.0000	28.6667
OUTSIDETENURE	15338	2.9403	2.9875	2.1818	0.0000	36.2222

Panel B: Descriptive Statistics for Categorical Regression Variables (# of observations within each category)

Variable	Full Sample	"Small" Firms*	"Large" Firms*
EXCHG=0	1,084	593	491
EXCHG=1	29,581	14,735	14,846
	30,665	15,328	15,337
AUDITOR=0	5,084	3,948	1,136
AUDITOR=1	25,581	11,380	14,201
	30,665	15,328	15,337

* Small firms are defined as firms with log of total assets less than the median of 21.1284

In order to test our hypothesis on the effects of director tenure on corporate governance effectiveness, we employ a Tobit regression model. Tobit regression is appropriate in situations where the dependent variable is truncated. In this case, the dependent variable (number of reported internal control weaknesses) cannot be less than zero. In such cases, a Tobit regression model fits the data better than an ordinary least squares model or a model such as logit that assumes a binary dependent variable (McDonald and Moffitt, 1980). Our primary regression model is as follows:

$$\text{MWIC} = a_0 + b_1 \text{ MEMBERS} + b_2 \text{ SIZE} + b_3 \text{ EXCHANGE} + b_4 \text{ AUDITOR} + b_5 \text{ INSIDETENURE} + \text{e} \quad (1)$$

where: MWIC equals the number of reported material weaknesses in internal control,
MEMBERS is a company's total number of board members,
SIZE is the natural log of sales,
EXCHG is coded 1 if the firm is listed on the NYSE, AMEX, or NASDAQ and 0 otherwise,
AUDITOR is coded 1 if the firm's auditor is a "Big Four" or national firm and 0 otherwise, and
INSIDETENURE is the average number of years of director tenure from service on that company's board.

Table 2 reports our regression results for the entire sample of 30,665 firm-year observations. Panel A of Table 2 reveals a significant negative correlation between the average number of years of director tenure on a company's board (INSIDETENURE) and reported material weaknesses in internal control (MWIC). As expected, each of the control variables are also negatively associated with internal control weaknesses, since larger firms that are audited by national or international accounting firms and are listed on major stock exchanges tend to have fewer internal control weaknesses. The results reported in Table 2 are consistent with the hypothesis that corporate governance effectiveness increases as director tenure on a company's board increases. Therefore, these results provide positive support for the Expertise Hypothesis. The results reported in Panel A of Table 2 are provided as a comparison to prior research, since the majority of prior research efforts all employ a tenure variable similar to our INSIDETENURE variable.

In Panel B of Table 2, we extend the analysis by *separately* examining the impact of inside tenure and outside tenure on corporate governance effectiveness. Panel B reveals a significant negative correlation between years of tenure from serving on outside boards (OUTSIDETENURE) and internal control weaknesses, even after controlling for the effects of INSIDETENURE. Thus, our results imply that a board's corporate governance effectiveness increases as directors gain experience from serving on that company's board as well as from serving on outside company boards. This result extends prior research findings since, as stated earlier, prior research has largely examined what we label INSIDETENURE and does not explore the effects of outside board tenure on governance effectiveness.

In Panel C of Table 2, we re-examine the relationship between length of director tenure and corporate governance effectiveness by utilizing a different measure of director tenure. In Panel C, we use a variable labeled ALLTENURE, which is defined as the total number of years of tenure that a director has accrued on all boards on which he/she serves. In other words, it includes tenure earned on outside boards as well as the previously examined inside tenure. Panel C of Table 2 demonstrates that the ALLLTENURE variable is also significantly negatively associated with reported material weaknesses in internal control. Thus, our results indicate that corporate directors' leadership effectiveness increases as the directors' overall tenure (both on that company's board and outside boards) increases. Again, the results provide support for the Expertise Hypothesis.

TABLE 2
REGRESSION RESULTS EXAMINING THE RELATIONSHIP BETWEEN INTERNAL CONTROL WEAKNESSES AND AVERAGE DIRECTOR TENURE FROM SERVING ON THE CURRENT COMPANY BOARD (INSIDE TENURE)

Variable	Coefficient	Std. Error	z-value	P>|z|
Panel A: Results Using Full Sample of Firms:				
MEMBERS	-0.15566	0.027898	-5.58	0.000
SIZE	-0.31722	0.038761	-8.18	0.000
EXCHG	-1.36103	0.271308	-5.02	0.000
AUDITOR	-0.62190	0.153013	-4.06	0.000
INSIDETENURE	-0.12222	0.015869	-7.70	0.000
Panel B: Results Using Full Sample of Firms:				
MEMBERS	-0.15718	0.027716	-5.67	0.000
SIZE	-0.28218	0.039037	-7.23	0.000
EXCHG	-1.26888	0.271014	-4.68	0.000
AUDITOR	-0.51572	0.153580	-3.36	0.001
INSIDETENURE	-0.11300	0.015819	-7.14	0.000
OUTSIDETENURE	-0.12538	0.023699	-5.29	0.000
Panel C: Results Using Full Sample of Firms:				
MEMBERS	-0.15704	0.027726	-5.66	0.000
SIZE	-0.28442	0.038679	-7.35	0.000
EXCHG	-1.26783	0.271039	-4.68	0.000
AUDITOR	-0.52589	0.151718	-3.47	0.001
ALLTENURE	-0.11701	0.012663	-9.24	0.000

ADDITIONAL ANALYSES

The results reported in Table 2 indicate that corporate governance effectiveness increases as director tenure increases. These results imply that directors gain valuable experience/expertise from board service that grows over time, and that governance effectiveness increases with directors' years of service on outside boards even after controlling for service on inside boards. In Table 3, we explore the possibility that not all outside board service is equal in terms of directors acquiring experience/expertise that will help them in their governance duties.

Clements et al. (2015) predict that directors gain more of what they label "beneficial experience" from serving on outside boards of comparatively larger companies. Clements et al. (2015) state that the "opportunity to serve on the board of a larger company may afford a level of experience and information acquisition not possible in smaller organizations since larger companies are typically more complex and would have more opportunities for relevant information flows." Their empirical results provide support for this prediction. However, Clements et al. (2015) do not include a director tenure variable in their analysis.

In Table 3, we extend prior research by testing whether director tenure on outside boards is beneficial regardless of company size or whether the benefits vary according to whether the outside companies are larger or smaller than the company in question. In Table 3, we divide our sample based on whether the ratio of the size of the outside companies for which their directors serve as board members to that company's size is greater than or equal to one. If a director serves on an outside board for a company of equal size, then the ratio of the size of the outside company to the size of the current company would equal one. However, if the director serves on an outside board for a larger company, then the ratio of the size of the outside company to the size of the current company would be greater than one.

Specifically, Panel A (B) of Table 3 reports regression results for those companies where the outside directorships are on relatively larger (or smaller) companies. The results indicate that INSIDETENURE is significantly negatively correlated with internal control weaknesses for both subsamples, while the OUTSIDETENURE variable is only significant (at the .05 level) for the subsample where outside directorships are on comparatively larger companies. These results support the conclusion that inside tenure (INSIDETENURE) is valuable regardless of the size of the company related to the outside board, but tenure on outside boards (OUTSIDETENURE) is only beneficial if the outside companies are larger than the company in question.

TABLE 3
REGRESSION RESULTS EXAMINING THE RELATIONSHIP BETWEEN INTERNAL CONTROL WEAKNESSES AND AVERAGE DIRECTOR TENURE FROM SERVING ON INSIDE AND OUTSIDE COMPANY BOARDS (CATEGORIZED BY THE RELATIVE SIZE OF THE OUTSIDE COMPANY BOARDS)

Variable	Coefficient	Std. Error	z-value	P>|z|
Panel A: Results for firms where the ratio of outside company size to current company size is greater than 1:				
MEMBERS	-0.13013	0.044379	-2.93	0.003
SIZE	-0.47247	0.064779	-7.29	0.000
EXCHG	-0.64140	0.424625	-1.51	0.131
AUDITOR	-0.07445	0.252279	-0.30	0.768
INSIDETENURE	-0.11397	0.024008	-4.75	0.000
OUTSIDETENURE	-0.08235	0.030009	-2.74	0.006
Panel B: Results for firms where the ratio of outside company size to current company size is less than 1:				
MEMBERS	-0.15285	0.035097	-4.36	0.000
SIZE	-0.24903	0.052817	-4.71	0.000
EXCHG	-1.70879	0.354035	-4.83	0.000
AUDITOR	-0.53952	0.198931	-2.71	0.007
INSIDETENURE	-0.12654	0.021301	-5.94	0.000
OUTSIDETENURE	-0.07629	0.046913	-1.63	0.104

Finally, in Table 4 we examine the possibility that our previously documented findings of a significant positive association between director tenure and corporate governance effectiveness might diminish over time. In other words, does the significant positive association hold for all levels of director tenure, or does it level it off or even decrease as director tenure increases? Huang (2013) finds that firm value and director tenure are positively correlated, but only up to a point (approximately nine years). He demonstrates that firm value declines after that point. In Table 4, we report the results of a test to determine if corporate governance effectiveness continues to increase over all levels of director tenure. In this analysis, we divide the sample firms into quartiles based on the average total tenure of the firm's directors, as measured in years. In Panels A and B, we report the results for those firms in the first and second quartile of director tenure. The results reveal a significant negative association between director tenure and internal control weaknesses for these firms with relatively low average director tenure. In other words, internal control weaknesses decrease and corporate governance effectiveness increases as director tenure increases for firms whose directors are below the median level of tenure. For both subsamples in Panel A and Panel B, the coefficients for the variable "ALLTENURE" are significant and negative. As tenure increases for these firms, the company experiences fewer weaknesses in internal control. These results are therefore consistent with the Experience Hypothesis and with the notion that relatively inexperienced directors gain considerable valuable experience/expertise as their years of board service increase. This conclusion is also consistent with the previous results in Tables 2 and 3.

TABLE 4
REGRESSION RESULTS EXAMINING THE RELATIONSHIP BETWEEN INTERNAL CONTROL WEAKNESSES AND AVERAGE DIRECTOR TENURE FROM SERVING ON ALL BOARDS (CATEGORIZED BY THE LENGTH OF OVERALL DIRECTOR TENURE)

Variable	Coefficient	Std. Error	z-value	P>|z|
Panel A: Results for firms in the 1st quartile of ALLTENURE:				
MEMBERS	-0.08737	0.042446	-2.06	0.040
SIZE	-0.26640	0.057315	-4.65	0.000
EXCHG	-0.31283	0.351113	-0.89	0.373
AUDITOR	-0.46326	0.242431	-1.91	0.056
ALLTENURE	-0.25928	0.067853	-3.82	0.000
Panel B: Results for firms in the 2nd quartile of ALLTENURE:				
MEMBERS	-0.28439	0.058058	-4.90	0.000
SIZE	-0.17614	0.076719	-2.30	0.022
EXCHG	-2.59768	0.573004	-4.53	0.000
AUDITOR	-0.37923	0.305048	-1.24	0.214
ALLTENURE	-0.27569	0.135817	-2.03	0.042
Panel C: Results for firms in the 3rd quartile of ALLTENURE:				
MEMBERS	-0.16636	0.062235	-2.67	0.008
SIZE	-0.43815	0.091869	-4.77	0.000
EXCHG	-3.38527	0.725198	-4.67	0.000
AUDITOR	-0.74711	0.324043	-2.31	0.021
ALLTENURE	0.01688	0.122897	0.14	0.891
Panel D: Results for firms in the 4th quartile of ALLTENURE:				
MEMBERS	-0.09594	0.070359	-1.36	0.173
SIZE	-0.31692	0.105347	-3.01	0.003
EXCHG	0.59746	1.116292	0.54	0.593
AUDITOR	-0.44849	0.397992	-1.13	0.260
ALLTENURE	-0.04686	0.037011	-1.27	0.206

By contrast, Panels C and D of Table 4 report the results for companies in the third and fourth quartiles of average director tenure (i.e., companies where director tenure is above the median). These results reveal that director tenure is not associated with governance effectiveness for firms that already have relatively higher levels of director tenure. In other words, once a firm already has a high level of director tenure, additional years of tenure do not appear to increase governance effectiveness for these groups of already experienced directors. However, in contrast to Huang (2013), our results do not demonstrate that additional years of tenure beyond a certain point negatively affects our sample firms. In our case, we find that corporate governance effectiveness is positively associated with director tenure up to a point, and then tends to level off. We do not find any evidence that companies are negatively impacted by having long-tenured directors serving on their board.

It should be noted that the fact that leadership effectiveness tends to level off after a certain level of director tenure could partially be due to the effects of the Entrenchment Hypothesis. For lower levels of director tenure, the Experience Hypothesis dominates the Entrenchment Hypothesis, resulting in an increase in leadership effectiveness. However, as levels of director tenure reach higher levels, the results are consistent with the explanation that the negative effects of entrenchment begin to counterbalance the positive effects of experience. Alternatively, the results are consistent with the notion that the marginal effects of experience become insignificant beyond a certain level of director tenure.

CONCLUSIONS AND SUGGESTIONS FOR FUTURE RESEARCH

This paper explores the relationship between director tenure and the corporate leadership effectiveness of the board of directors. Prior research has examined two competing hypotheses in an attempt to determine whether having long-tenured directors is beneficial or detrimental to a company. The Entrenchment Hypothesis predicts that long-tenured directors become overly deferential to management and become ineffective in their role as monitors of management, resulting in a corresponding decrease in leadership effectiveness. Alternatively, the Expertise Hypothesis posits that as directors' tenure increases, they gain valuable expertise/experience which results in increased governance effectiveness.

First, when examining the overall sample of firms, we find a significant and positive relationship between the length of director tenure and corporate governance effectiveness (as measured by internal control weaknesses). This result strongly supports the Expertise Hypothesis. We then extend prior research by separately examining a director’s *inside tenure*, which we define as tenure from serving on a particular company’s board, and *outside tenure* earned from serving on the boards of outside companies. We find that inside tenure is consistently positively associated with leadership effectiveness. However, we demonstrate that outside tenure is only associated with corporate governance effectiveness when directors serve on outside boards of comparatively larger companies. Finally, we find that director tenure increases governance effectiveness up to a point and then tends to level off, rather than decreasing after that point.

The one constant in all of our findings is that our results never demonstrate that corporate governance effectiveness *decreases* as director tenure increases. Although at higher levels of director tenure we find that governance effectiveness becomes unrelated to tenure, we find no support for the Entrenchment Hypothesis actually causing a decrease in governance effectiveness. The implication of these results is that our findings do not support the need for setting term limits on directors.

There are some potential limitations of this study, as well as suggestions for future research, that should be considered. For example, we employ a company’s number of reported material weaknesses in internal control as our proxy for corporate leadership effectiveness. Even though this proxy is well supported in the literature, there are likely other suitable measures of governance effectiveness. Therefore, future studies could replicate our analyses to determine if the results are consistent for other proxies of leadership effectiveness. A second potential limitation is that our empirical analysis only includes U.S. companies. Future studies could replicate our analyses using data from other countries to determine whether our results hold in other economies. In our empirical tests, we include variables to control for the potential effects caused by differences in exchange listing, auditor identity, and company size. Our results could be affected to the extent that we did not control for other factors that might impact the relationship between director tenure and governance effectiveness. Future research could also examine the robustness of our results to this potential limitation. However, our results provide information that should be useful to management, corporate directors, investors, and other stakeholders that have an interest in the impact of director tenure on governance effectiveness and whether term limits should be set for board members.

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