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CHAPTER 2

What Do Outsiders in the Board of Directors Know? Evidence from Outsider Trading (joint with Paola Sapienza)

2.1. Introduction

In recent years criticism of companies' corporate governance has covered many issues.

Policymakers around the world have responded by creating codes to improve ethical standards in business (e.g. Sarbanes-Oxley Act (in U.S.), the Higgs Report, and the Smith Report (in U.K.)). A common theme in these guidelines is the independence of boards of directors that oversee corporate managers. Board members should not have personal or professional relationships with the company or its managers. For example, in 2002, the New York Stock Exchange and NASDAQ submitted proposals that required that boards had a majority of independent directors with no material relationships with the company. In the UK, in 1992 the London Stock Exchange adopted the Code of Best Practices. The Code includes recommendations that boards have at least three outside directors. Although the adoption of the Code is voluntary, the London Stock Exchange requires companies to state whether they adopted it or not.