Blog Series: Good Governance for Value Creation
Blog Post no.5

Director independence: a critical driver of long-term value creation.

Written by Jen Sisson (ICGN CEO) and Jakub Brejdak (Senior Policy Executive) on 6 February 2026

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Effective board independence matters because boards exercise power on behalf of others. In public companies, boards play a central role in safeguarding shareholder interests by helping to address the fundamental *agency problem*, the separation of ownership and control. Shareholders, as owners, are not involved in the day-to-day management of the business, yet they bear the economic consequences of managerial decisions. When those making decisions do not fully share the same risk exposure as those providing the capital, conflicts of interest can naturally arise.

Independent directors are therefore essential if boards are to provide objective oversight, challenge management where necessary, and act in the long-term interests of the company and its shareholders. Board independence is not a box-ticking exercise; it is a foundational pillar of good governance and a core part of the governance ecosystem that underpins investor trust and confidence in capital markets.

In this blog we start by setting out board independence matters, talk about legal definitions, substance vs form and touch on some key regulatory developments related to independence around the world. We then dive into challenges in controlled companies and real-life director testimonies with examples and case studies illustrating the consequences when independence has failed in practice.

Why does board independence matter?

1. Board independence reduces the risk of abuse of minority shareholders

Independent directors play a critical role in safeguarding the interests of minority shareholders, particularly in companies with controlling owners. They are better placed to question decisions that may favour insiders, request additional information and ensure that transactions are conducted on fair terms. Boards with a strong independent presence are more effective in guiding and monitoring management, and in ensuring that the company is run for the benefit of all shareholders rather than a selected few.

Academic research supports this view. Studies show that independent directors, in seeking to fulfil their fiduciary duties, demand higher-quality information and encourage greater transparency from management. This improves the information environment, strengthens oversight and reduces the risk of value being transferred away from minority investors.[1]

2. **Independence has positive impact on company's performance**

Independence does not guarantee higher returns, but it materially improves the quality of board decision making. Independent directors are more likely to challenge management proposals, scrutinise major acquisitions, test assumptions behind capital expenditure and question incentive structures that reward short term outcomes at the expense of long-term value. Governance failures rarely stem from a lack of information; they arise when insufficient challenge is applied at critical moments.

Evidence suggests that the benefits of independence are most visible when the stakes are highest. Large scale research finds that companies with more independent boards tend to perform better in major transactions such as mergers and acquisitions, where disciplined oversight of strategy, valuation and execution is essential.[2] Market based studies also indicate that investors attach tangible value to genuinely influential independent directors. Share prices react negatively when independent directors are unexpectedly removed from the board, suggesting that markets view their contribution as economically meaningful rather than symbolic.[3]

These effects are particularly important at strategic inflection points, including transformative investments, restructurings or shifts in business direction, where the risks of managerial overconfidence, groupthink or pressure from dominant shareholders are greatest. By strengthening oversight of strategy, risk and capital

[1] Armstrong, C. S., Core, J. E., and Guay, W. R. (2014), Do independent directors cause improvements in firm transparency?, *Journal of Financial Economics*, 113(3), 383–403.
[2] Hussaini, M. (2025), Acquirer board independence and acquisitions performance: A meta-analysis, International Review of Financial Analysis, 102, 104130
[3] Nguyen, B. D., & Nielsen, K. M. (2010). The value of independent directors: Evidence from sudden deaths. Journal of Financial Economics, 98(3), 550–567.

allocation at precisely these moments, board independence supports more resilient performance and a closer alignment between management actions and long-term shareholder interests. Independence, therefore, is not about constraining entrepreneurship, but about ensuring that growth decisions are well judged, transparent and accountable.

3. **Independent boards strengthen trust and market confidence**

Board independence is also fundamental to investor confidence and the functioning of capital markets. Investors are more willing to allocate capital when they believe boards can exercise effective oversight and act as a counterbalance to management power. Where boards lack independence, confidence erodes, engagement becomes more confrontational and the cost of capital can increase.

Strong independent boards therefore benefit not only individual companies but market as a whole. They support accountability, enhance credibility and reinforce the trust on which long-term investment depends.

Different technical definitions, same objectives

While legal definitions of independence vary across the world, they share a common objective: ensuring that directors designated as independent are free from relationships or circumstances that could impair their judgement.

In some jurisdictions, independence is defined in company law, while in others it is addressed through corporate governance codes, listing rules, codes of conduct or sector-specific guidance. Independence is typically assessed through a combination of factors, including a director's relationship with the company, its executives, significant shareholders or the wider corporate group.

The underlying consistent principle is that independent directors should be able to exercise objective judgement, without undue influence or conflicting loyalties, when overseeing management and making decisions that affect all shareholders. An individual's independence should not be viewed as static and should be regularly reassessed, including by the independent directors themselves, as corporate transactions and relationships evolve.

Specific challenges in controlled companies

A controlled company is one in which a single shareholder, or a coordinated group of shareholders, exercises effective control over key corporate decisions. Control most commonly takes the form of family or founder ownership but can also arise through state ownership or influence by public entities. With such structures, there is an increased risk that board decisions reflect the interests of controlling shareholders rather than those of the company and its minority investors. These concerns are especially acute in state-controlled companies, where political influence or non-commercial objectives can undermine board autonomy and dilute the practical independence of directors.

Recent reforms in Korea provide one example. In 2025, Korea adopted a package of governance reforms aimed, among other objectives, at strengthening board independence in large, family-controlled conglomerates (*chaebols*). Board of directors in Korea have long been criticised for prioritising the interests of controlling families over those of minority shareholders, contributing to persistent valuation discounts relative to global peers, described as “Korean discount”.[4] This reflects a broader challenge across many Asian markets, where concentrated ownership, family control, or state influence are common and can heighten the risk that boards prioritise controlling shareholders’ interests over those of minority shareholders.

Italy offers a contrasting case, where a long-standing mechanism designed to support board independence is now under pressure. The *voto di lista* (slate voting) system, which reserves board and statutory auditor seats for candidates proposed by minority shareholders, has historically been viewed by investors as an important safeguard in a market characterised by controlled companies. However, legislative changes adopted recently as part of the simplified governance regime for newly listed companies and listed SMEs significantly weaken this framework.

Under the revised regime, mandatory minority representation is no longer a general requirement and applies only in limited circumstances, such as for state-owned companies or issuers that do not meet a threshold of “independent” directors.

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[4] South Korea parliament passes bill expanding duty of boards to shareholders, Reuters, 13.03.2025. https://www.reuters.com/world/asia-pacific/south-korea-parliament-passes-bill-expanding-duty-boards-shareholders-2025-03-13/

Crucially, the definition of independence for these purposes has been substantially diluted, allowing individuals with close ties to controlling shareholders or even public authorities to qualify as independent. At the same time, the new rules raise the minimum shareholding threshold required to submit a slate of candidates, potentially up to 5%, which in practice may make minority nominations unworkable in many controlled companies. Together, these changes risk hollowing out minority representation on boards and undermining substantive board independence, despite the continued formal existence of the slate voting mechanism.

Independence challenges beyond controlled ownership

Challenges to director independence are not limited to controlled-company environments. In companies with more dispersed ownership, independence may instead be challenged by dominant executives, long-standing management influence, or entrenched personal and professional relationships. Recognising these differing sources of influence is critical to assessing whether independence is substantive rather than merely formal.

Independence in substance, not just in form

Formal independence on paper does not always translate into independence in practice. Directors may meet every requirement and still hesitate to challenge management or controlling shareholders. Boards are human institutions: directors work closely together over many years, relationships inevitably form, and social or professional loyalties can influence judgement even in the absence of financial conflicts.

These dynamics matter not only as a matter of board culture, but also because legal and regulatory frameworks often rely on formal independence criteria that may struggle to capture these more subtle influences on judgement. For example, Delaware's 2024 SB 21 reform introduces statutory safe harbours that limit judicial scrutiny of director independence by allowing boards to rely on compliance with stock exchange listing standards. As a result, courts are constrained from assessing independence based on the facts and circumstances of a case and must instead defer to formal definitions embedded in listing rules. This represents a significant shift. Previously, courts could examine whether directors were independent in substance, including by assessing personal, financial or relational ties that might compromise judgment. Following the reform, shareholders' ability to challenge conflicted board decisions on independence grounds is reduced, weakening litigation as a mechanism of accountability. The change follows high-profile litigation involving board independence, including cases arising from transactions involving dominant executives, and raises broader questions about whether formal compliance is increasingly being allowed to substitute for substantive independence.[5]

This gap between independence *de jure* and *de facto* has increasingly been recognised by courts. In *Marchand v. Barnhill* (2019), the Delaware Supreme Court observed that assessments of independence cannot ignore "the social nature of humans" or the fact that directors may be motivated by factors other than money, including friendship and collegiality.

For investors, the implication is clear: genuine board independence ultimately rests on individual integrity and moral courage. Independent director should be willing to ask difficult questions, resist pressure and when necessary dissent, even when doing so is uncomfortable.

The bottom line on independence

When boards are dominated by individuals with close personal, financial or family ties to management or controlling shareholders, the risk of poor decision-making increases. History shows that boards composed primarily of insiders or close associates are more vulnerable to weak oversight, conflicts of interest and, in extreme cases, misuse of invested capital. Independent directors are therefore not a regulatory formality but a necessary condition for effective governance.

This is why investors expect, as a general rule, that the board be comprised of a majority of independent non-executive directors and chaired by an independent director and that key oversight committees (such as audit, related-party transactions) be composed of independent directors.

Testimonies from non-executive directors

[5] What boards should know about Delaware's planned reforms, Governance Intelligence, 03.03.2025. https://www.governance-intelligence.com/boardroom/what-boards-should-know-about-delawares-planned-reforms-updated

The following anonymised testimonies highlight the difference between independence on paper and independence in practice. While many boards meet the formal requirements for independent non-executive directors (INEDs), these testimonies reveal how easily real independence can be undermined by social dynamics, implicit pressures, or entrenched power structures.

Extraordinary bonus

The board of a health care company agreed to pay the CEO and largest shareholder USD 40 million as a "non-compete fee". The stock price fell 30% on the news. Despite the fact that one of the provisions of the contract was the obligation that the CEO remain as a shareholder for 6 years, he left and sold his shares 2 years later. He kept the money. None of the three "independent" directors objected to the payment.

Corruption and conflict of interest/RPTs

A non-executive director (NED) nominated by a large institutional investor in a private service organisation witnessed obvious instances of corruption and embezzlement by one particular senior executive with close personal ties to, and therefore protection from, highly-placed government officials. This executive bought a property, then offered it for sale to the organisation, in clear violation of the board's by-laws and RPT procedures. The NED representing the large investor objected, but was dismissed and vilified by fellow directors, despite the Compliance department supporting the NED's concerns and condemning the transaction. The NED was ultimately removed, and the transaction went ahead.

Executive remuneration & financial statements manipulation

An INED and member of the Remuneration Committee spotted that in order to meet the annual KPI targets needed to secure the highest possible bonus payouts, line managers would negotiate temporary volume transfers from joint-venture partners that would inflate the company's sales volumes, then reverse these volumes back to the partners in the first quarter of the following year. The night before the Remuneration Committee meeting, the INED alerted the Chair (also classed as independent) of this concern. The Chair agreed and encouraged the INED to raise this concern in the meeting, saying he would support the objection. In the meeting, after first seeking confirmation from the CFO and other senior executives that this interpretation of the facts was correct, the INED explained that this was problematic, as it artificially inflated revenue and profit figures in a manner that had led to successful criminal prosecutions in the U.S., where the company was listed. The other Committee members, albeit all nominally independent, strongly disagreed with the INED, on grounds management had worked very hard in these last few months to secure these temporary transfers, and would suffer a blow to morale if the higher bonus figures were not paid out, also berating the INED for not understanding that institutional investors value stable financial figures over the volatility that the true figures would have revealed.

Seeing that the INED was outnumbered, the Remuneration Committee elected to leave the maximum bonus payouts unchanged for that year, but then announced that the volume reversals in the following quarter would not be recognised in setting the baseline sales figures for the following bonus year, thereby forcing management to achieve an even higher number if they wanted to earn the maximum bonus. The following year, the INED was removed from the Remuneration Committee, and the Chair was demoted to ordinary member, with his replacement rescinding the change his predecessor had introduced to the revenue baseline.

Case studies

Petrobras: Independent directors defend transparency[6]

Background: Brazil's Lava Jato (Car Wash) scandal was a major investigation that uncovered how Petrobras executives and politicians in Brazil accepted bribes from construction companies and used a network of businesses, including a car wash, as fronts to launder and move illicit funds. In 2014–2015, Petrobras faced growing concerns over corruption and inflated asset values.

[6] Shaking the Latin American Equilibrium: The Petrobras & Odebrecht Corruption Scandals, 04.11.2019.
https://news.law.fordham.edu/jcfl/2019/11/04/shaking-the-latin-american-equilibrium-the-petrobras-odebrecht-corruption-scandals/

Outcome: Several Petrobras executives were investigated and convicted in connection with the corruption scandal, and Petrobras agreed to pay more than USD 850 million to resolve violations of the US Foreign Corrupt Practices Act.[7] The case also led to a regulatory response aimed at strengthening governance in Brazilian state-owned enterprises, culminating in the adoption of the State-Owned Enterprise Statute (Law 13.303/2016). The statute introduced stricter governance requirements, including a minimum requirement that at least 25% of board members in state-owned enterprises be independent.[8]

Parmalat: When family ties undermine board independence[9]

Background: In 2003, Parmalat, once a major Italian dairy and food conglomerate, became the centre of one of Europe's largest corporate frauds. CEO Calisto Tanzi orchestrated a complex scheme involving fictitious transactions, forged bank confirmations, and extensive use of offshore entities to conceal more than €14 billion in debt and divert company funds for personal use. The company's board was dominated by insiders, including members of the Tanzi family, and formally independent directors lacked both the autonomy and information needed to exercise effective oversight. Key board committees failed to challenge management assumptions or scrutinise related-party transactions and treasury operations.

Outcome: The absence of genuine board independence allowed fraudulent practices to persist unchecked over a prolonged period, undermining internal controls and financial reporting. Independent directors were unable to counterbalance the influence of the controlling shareholder or trigger timely external scrutiny. The eventual disclosure of the fraud led to Parmalat's collapse, criminal convictions of senior executives including Tanzi, and far-reaching reforms in Italian and European corporate-governance frameworks, reinforcing the central role of independent directors in safeguarding transparency and accountability.

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[7] https://www.justice.gov/archives/opa/pr/petr-leo-brasileiro-sa-petrobras-agrees-pay-more-850-million-fcpa-violations
8 OECD Review of the Corporate Governance of State-Owned Enterprises: Brazil, 14.12.2022 https://www.oecd.org/en/publications/oecd-review-of-the-corporate-governance-of-state-owned-enterprises-brazil_ce25dd28-en.html
[9] Storelli, C. (2005). Corporate Governance Failures–Is Parmalat Europe's Enron? Columbia Business Law Review, 2005(3), 765–823.

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We encourage dialogue by contacting Jakub Brejdak, Senior Policy Executive, policy@icgn.org.