Director Liability Protection and the Quality of Outside Directors

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Abstract

We investigate how state Universal Demand statutes (UD) that lower director liability in derivative lawsuits affect recruitment and retention of outside directors. Using a difference-in-differences analysis, we document improvements in outside director experience following UD adoptions, especially for firms facing greater litigation risk or smaller local supplies of director candidates. UD adoptions also make high-quality director candidates from non-UD states firms more willing to join boards at firms incorporated in UD states. We find some limited evidence that UD adoptions help attract outside director candidates with better educational and professional backgrounds, and reduce voluntary departures of high-quality directors.

Keywords: Legal liability; board of directors; board quality; litigation; derivative suits

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