Abstract

This study consists of two essays. The first essay investigates whether non-CEO inside director reputation matters in bank loan contracting. Reputable inside directors (RIDs) can improve borrowers' financial reporting quality and reduce agency risk in loan contracting. Based on regression analysis of 5,104 loan facilities during 1999-2007 in the U.S., I find that borrowers with reputable inside directors enjoy lower loan interest rate and a smaller number of restrictive covenants, and are less likely to have the loans secured by collateral, compared with borrowers without RIDs. The results still hold after I control for CEO reputation, and address the endogeneity of RIDs and the joint determination of various loan contracting terms. These findings shed new light on the impact of director-level reputation in the context of bank loan market.

The second essay investigates whether non-CEO inside directors with reputation incentives affect the effectiveness of a firm’s internal control over financial reporting. Internal control effectiveness is an important indicator of financial reporting quality. Using a large sample of 7,352 firm-year observations from 2004 to 2012, I find that firms with RIDs are less likely to have reported internal control weaknesses (ICWs). I also find that RIDs have a more pervasive impact on account-level ICWs than company-level ICWs. Empirical results also demonstrate that the association between RIDs and ICWs is more pronounced for firms with lower audit quality, higher CEO entrenchment, and higher cost of misreporting. Further test shows that RIDs can help to improve earnings quality through mitigating ICWs. The study results still hold after I control for CEO reputation, employing alternative proxies and estimation methods, and address the potential endogeneity problems of RIDs. The study findings add to the few empirical studies examining the determinants of ICWs and have corporate governance policy implications for regulators by supporting the desirable role of inside directors in terms of efficient contracting.
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