INDEPENDENT DIRECTORS IN SWEDEN AND THEIR INFLUENCE ON EARNINGS THROUGH ACCRUAL AND REAL ACTIVITIES MANAGEMENT

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Abstract

The dominating perspective grounded in agency theory predicts that independent boards are more effective in monitoring and thereby reducing earnings management, yet the extant empirical evidence is inconclusive. We nuance the relationship between board independence and earnings management by introducing two additional theories that explain independent directors' role on the board: the theory of personal dependence and praxis theory. According to personal dependence theory, the influence of independent directors on earnings management is a function of their competitiveness in the labor market, whereas the praxis theory attributes directors' influence to the influence of the dominant coalition. We focus on two dimensions of earnings management — accrual and real activities management, and account for both direction and magnitude of directors' influence. Through an empirical test on 148 Swedish corporations from 2017, our findings indicate that the presence of independent directors may not necessarily reduce earnings management. Instead, independent directors may be subject to multiple and sometimes conflicting task demands which differently influence both magnitude and direction of earnings management. Implications for our understanding of the role of independent directors and their influence on corporations are presented.

Keywords: Independent Directors, Earnings Management, Sweden

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1. INTRODUCTION

Independent directors are considered to be a cornerstone of an efficient corporate governance system (Baysinger & Hoskisson, 1990; Canella, Finkelstein, & Hambrick, 2009; Liu, Miletkov, Wei, & Yang, 2015; Neville, Byron, Post, & Ward, 2019). Their outsider status is argued to enable independent directors with a more objective view on the managerial decisions and places them in a better position to defend shareholder interests by reducing managerial opportunism (Fama, 1980). The presence of outsiders on the board can also counterbalance the power of a controlling shareholder, thereby protecting the interests of minority investors (Aguilera, Crespí-Cladera, Infantes, & Pascual-Fuster, 2020; Collin, Ponomareva, Ottosson, & Sundberg, 2017). In line with this reasoning recommendations concerning directors' independence are included in governance codes (Hermes, Postma, & Zivkov, 2006), embodying the evolved ideology of good governance (Ponomareva, Federo, Aguilera, & Collin, 2021; Shukla & Limbasiya, 2015) in a broader realm of shareholder value model (Braun, 2021). In response to the institutional pressure, the presence of independent directors on boards has increased prominently over the past two decades (Chen & Moers, 2018). Today outsiders constitute a supermajority on S&P500 boards (Spenser Stuart, 2018).

However, despite the convergence of the views about superior monitoring of more independent boards, research investigating the influence of independent directors on firm outcomes has shown mixed and inconclusive results (Collin & Smith, 2019; Dalton, Daily, Ellstrand, & Johnson, 1998; Khan, Nijhof, Diepeveen, & Melis, 2018). Studies have begun to question the ability of independent directors to exercise vigilant monitoring (Boivie, Bednar, Aguilera, & Andrus, 2017), their incentives to do so (Jiang, Xia, Devers, & Shen, 2021), and institutional differences in the roles of independent directors (Kalantonis, Schoina, & Kallandranis, 2021; Osma & Noguer, 2007). Delving on this emerging stream of literature, we formulate an overarching research question:

RQ: What are the functions of independent directors?

We aim to answer this *RQ* by introducing a more nuanced view on the influence of independent directors incorporating three distinct perspectives, namely: agency theory, director personal dependence theory, and praxis theory. We focus on the specific domain of director influence — earnings management, which is paramount for their mandate to assure that the corporation provides relevant information to its investors thereby reducing the information asymmetry.

The balance sheet and the earnings statement present two critical sources of information for the investors. However, these two statements are a subject of influence by the management and the board of directors through manipulation, termed earnings management (Zang, 2012; Chen, Huang, & Fan, 2012; Cohen, Dey, & Lys, 2008; Doukakis, 2014; Enomoto, Kimura, & Yamaguchi, 2015). Earnings management can be reflected in two characteristics: direction and magnitude (Ipino & Parbonetti, 2017; Zéghal, Chtourou, & Sellami, 2011; Sun & Liu, 2016; Sohn, 2016). One could manipulate earnings to create a specific result, upwards or downwards, depending on the motive (Watts & Zimmerman, 1986) or it can reveal the ambition to influence the earnings, but without any directional interest as such. For example, earnings could be manipulated to present, within the limits of IFRS, what is considered by the reporters to be the true and fair value of a corporation. This could lead to a high magnitude of manipulation, but without any specific direction on the earnings upwards or downwards.

In addition to studying the direction and the magnitude of earnings management, the latter can be categorized into two different activities: accrual and real activities management (Cohen et al., 2008; Braam, Nandy, Weitzel, & Lodh, 2015; Li, 2019). Accrual management pertains to the direct management of financial reports, using flexibility in the accounting regulation through accruals. Real activities management denotes the influence on operating activities and the value-creating process of the corporation which reflects in financial reporting. Previous research has viewed the two activities as complements (Chen et al., 2012; Li, 2019; Das, Mishra, & Rajib, 2017) and as substitutes (Achleitner, Günther, Kaserer, & Siciliano, 2014; Barton, 2001; Cohen et al., 2008; Zang, 2012; Doukakis, 2014; Enomoto et al., 2015; Ipino & Parbonetti, 2017).

Based on the agency theory perspective, independent directors are expected to induce the board to reduce the top management temptation towards earnings management, both accrual, and real activities management, through performing their monitoring function. In this paper we nuance this view further by considering complementary explanations provided by a theory of directors' personal dependence and a praxis theory, each pointing to a distinct driver of both magnitude and direction of the relationship between board independence and earnings management. Drawing on the personal dependence theory, we argue that the labor market for independent directors (Masulis & Mobbs, 2014; Chen & Moers, 2018) and the employment concerns create incentives for independent board members to engage in earnings management out of opportunistic reasons. We then turn to the praxis theory, which suggests that independent directors may engage in both increasing and decreasing earnings management, i.e., the magnitude of manipulation, following the demands of the dominant coalition of the firm (Collin & Smith, 2019). Thus, instead of directional influence, the presence of independent board members will reflect in the magnitude of manipulation as the concerns of the dominant coalition may vary from firm to firm.

In sum, we explain the direction of influence and the magnitude of earnings management within accrual management and real activities management based on three theories, namely: agency theory, director personal dependence theory, and praxis theory. We explore these theories empirically on a sample of 148 corporations listed in 2017 on the Stockholm Stock Exchange. Sweden presents an interesting context to evaluate the three theories. It has a semi-strong efficient stock market, but also the presence of strong owners, such as business groups and family ownership (Collin et al., 2017). Sweden has a rather small population (10 million), which makes the business elite resemble a small world (Sinani, Stafsudd, Thomsen, Edling, & Randøy, 2008), and thereby creates a relatively small size independent directors' market, and create networks that are dense and highly interlocked, which

presumably limits the information asymmetry conditions of the market for independent directors. We find indications that independent directors may not reduce earnings management as a general tendency, which could indicate that independent directors have more complex tasks to perform at the board. More specifically, we suggest that independent directors are subjects of multiple countervailing forces that compete in their influence on directors' actions. One of them is the mandate to monitor managerial decisions, the function that has to date received the most attention from scholars, policymakers, and corporate governance activists (Boivie at al., 2017). However, the inconsistency of empirical support of the association between the presence of independent directors and earnings management might be also attributed to the presence of other drivers including director self-interest and a pressure to conform to the influence of the dominant coalition.

Our study contributes to the current debate concerning directors' independence (Almadi & Lazic, 2016; Reguera-Alvarado & Bravo, 2018; Crespí-Cladera & Pascual-Fuster, 2014; Napoli, 2019) by providing a multi-theoretical perspective disentangling the concept of earnings management into two dimensions, accruals, and real activities management and subsequently distinguishing between the direction and magnitude of directors' influence. While previous studies have been largely focusing on a single dimension of earnings management — the direction of influence assuming a negative relationship between the presence of independent directors and earnings management — and relying on a single theoretical perspective, mainly agency theory, we provide a more nuanced view on the role of independent directors. Our exploratory comparison of three theoretical perspectives each providing a distinct view on the relationship between board independence and earnings management provides an initial step towards a richer conception of the function of independent directors on corporate boards.

Our study is organized as follows. Section 2 presents two complementary views to agency theory concerning independent directors, the personal dependency, and the praxis theories. It also deduces hypotheses for the three theoretical perspectives concerning the magnitude and direction of earnings management, where we consider both accrual and real activities management. Section 3 presents the empirical method. Section 4 reveals the results of the empirical test. Section 5 discusses the theoretical consequences and points out the limitations of our study. Section 6 describes the function of the independent director and a policy implication.

2. THEORETICAL FRAMEWORK

Agency theory draws attention to the divergence of interests between management and shareholders as a source of losses, termed agency costs (Jensen & Meckling, 1976). While shareholders, assumed to be motivated by the maximization of returns on their capital, can assume risks thanks to portfolio diversification, managers whose employment risks are linked to a single corporation, are prone to risk aversion and the pursuit of opportunistic strategies such as empire building and maximization of compensation at the expense of shareholders' interests (Fama, 1980). To align the interests of managers with those of the shareholders' agency theorists advocate the use of governance mechanisms such as incentive alignment and monitoring (Jensen & Meckling, 1976). The board of directors constitutes a critical governance mechanism serving as the "ultimate internal monitor whose most important role is to scrutinize the highest decision-makers within the firm" (Fama, 1980, p. 294). To assure effective oversight directors require discipline and detachment from the management. Outsider directors, independent from the management are considered to be in a better position to exercise vigilant monitoring due to greater objectivity and ability to confront the top managers (Hambrick, Misangyi, & Park, 2015).

In recent years, witnessing numerous scandals related to incentive-based executive compensation and evidence of it becomes more a source rather than a remedy of agency problem (Devers, Cannella, Reilly, & Yoder, 2007), the importance of board independence has become so prevalent in the management literature that some have even equated it with good governance (Boivie et al., 2017; Ponomareva et al., 2021). However, the extant literature on the relationship between board independence and board outcomes has not managed to consolidate to a uniform opinion. Meta-analyses have consistently shown that independent directors do not associate with organizational outcomes in a meaningful way and when there is a relationship the effect is weak (Dalton et al., 1998). Some researchers have questioned the effectiveness of board independence as a monitoring instrument (Boivie et al., 2017), while others explored contingency determinants of influence of independent directors on earnings management such as the information environment (Chen, Cheng, & Wang, 2015), ownership type (Prencipe & Bar-Yosef, 2011) and institutional context (Osma & Noguer, 2007) suggesting that monitoring effectiveness of independent directors is a subject of multiple forces at the individual, organizational and environmental levels.

While some argued for the implausibility of effective monitoring due to a number of inherent barriers stemming from board processes (Boivie et al., 2017), others have attempted to reverse the polarity in principal-agent relationship questioning the incentives of the principals (Goranova & Zajac, 2015). Following the transaction cost theory's behavioural assumptions (Williamson, 1996), it can be suggested that the director's judgement can be influenced by, and thus be dependent on, opportunism or bounded rationality. The independent director's judgement is directed by the individual's self-interest as being an actor reacting to the incentives created on the market for independent directors. While this reasoning still is located within the agency theory context, we will term this special branch of agency theory as the theory of director personal dependence since it emphasizes the self-interest of the independent director. Since independent directors are independent of majority shareholders, their ability to claim the residual is limited leading to self-interest problems similar to those in the principal agent dyads (Alchian & Demsetz, 1972). The theory of director personal dependence predicts that by accepting a position on a board, a director enters a situation of personal dependence defined as "the extent to which directors rely on a firm to fulfill

personal needs" (Jiang et al., 2021, p. 902). This personal dependence derived from personal returns such as prestige and economic rewards, as well as experience and achievements, have significant implications for directors' behavior and influence on their firms.

Another potential determinant of the nature of independent directors' influence on firm outcomes is the influence of the dominant coalition (Cyert & March, 1963). Agency theory focuses primarily on the principal-agent dyad without considering the influence of other important stakeholders, such as majority shareholders. The behavioral theory of the firm views firm decisions as an outcome of bargaining among multiple stakeholders — members of the dominant coalition. Due to the presence of bounded rationality, independent directors' judgement is directed by their specific competence and value system. In the praxis theory of the independent director (Collin & Smith, 2019), the independent director, due to the directors' specific profile, has been selected by the dominant coalition of the corporation, since it conforms to the interest of the dominating coalition. Thus, praxis theory suggests that the influence of independent directors is a reflection of the influence of the dominant coalition.

In sum, independent directors' influence on the firm is a subject of multiple countervailing forces. The currently dominating agency theory perspective assumes that more independent boards will augment the monitoring capacity of the board. We subsequently complement this view by considering two additional perspectives. The theory of directors' dependence highlights the self-interest motives behind independent directors' influence on the corporation, while praxis theory turns attention to the pressure exercise on independent directors by the members of the dominant coalition, responsible for directors' appointments. We now apply the three theories to explain the influence of independent directors in the specific domain of earnings management.

2.1. Board independence and earnings management: The agency theory perspective

According to the agency theory perspective, the presence of independent board members will restrain managerial opportunism and consequently reflect in the reduction of earnings management (Marra, Mazzola, & Prencipe, 2011; Siagian & Tresnaningsih, 2011). It may also curb opportunistic actions of dominant shareholders who may manipulate accounting information at the expense of minority investors (Armstrong, Core, & Guay, 2014). It is thus assumed that independent directors will reduce information asymmetry through adherence to accounting regulation to assure that accounting information provided to shareholders represents a true and fair view of the corporation. This capacity can certainly vary among independent directors, for example, it may depend on the information gained through one's network (Chen, Wang, & Lin, 2014). But the overall prediction is that independent directors will reduce the magnitude of accrual management (Klein, 2002; Peasnell, Pope, & Young, 2005). Since independent directors do not want accrual management to influence earnings, they will not exercise influence on accrual management in any direction, but only reduce its magnitude. Thus, based on agency theory, we hypothesize:

H1a: The greater is the proportion of independent directors on the board of directors, the lower is the magnitude of accrual management.

Following the arguments above, directors' independence is expected to also reduce the real activities management, that is the magnitude but not necessarily implies a particular direction of influence. Since the task is to reduce the manipulation per se, whether it is to increase or decrease earnings, a non-correlation between directors' independence and direction of accruals management is expected. Thus, based on agency theory, we hypothesize:

H1b: The greater is the proportion of independent directors on the board of directors, the lower is the magnitude of real activities management.

2.2. Board independence and earnings management: The personal dependence perspective

The personal dependence perspective assumes that independent directors rely on their firms to pursue personal interests such as prestige, status, economic benefits as well as valuable experience (Jiang et al., 2021). This view contrasts the agency theory perspective acknowledging that board members' self-interest may not always resemble those of the shareholders. The pursuit of benefits derived through personal dependence also promotes directors' position at the market for independent directors which, in turn, opens up even greater personal benefits (Masulis & Mobbs, 2014; Sila, Gonzalez, & Hagendorff, 2017; Chen & Moers, 2018). To maximize their employability on the market for independent directorships, directors may engage in accruals management and real activities management to signal the success of the company they are serving at. An independent director is a specialized category of labor, with specialized abilities in monitoring. This monitoring ability, combined with the characteristic of the individual, to be independent, is what is presented at the market for independent directors. In this market, nominating committees of corporations are scanning the pool of individuals, to find the best performer. Therefore, each individual on the job market has the interest to signal their ability as an independent director through increasing the earnings of the focal firm. Overall, the personal dependence theory suggests that the presence of imperfect share markets makes it possible for independent directors to influence earnings management without being discovered.

Since monitoring is hard to evaluate, and since some levels of earnings management cannot be discerned by the market, an independent director signals one's ability through being a director at a profitable corporation. To be able to send such a signal, the independent director will promote manipulation that increases the earnings of the corporation and limit any manipulation that reduces earnings. In this theory, the independent director has only an interest in the direction of the manipulation, not the magnitude.

We thus formulate the following hypotheses:

H2a: The greater is the proportion of independent directors on the board of directors, the greater is accrual management.

H2b: The greater is the proportion of independent directors on the board of directors, the greater is the real activities management.

2.3. Board independence and earnings management: The praxis theory

According to the praxis theory (Collin & Smith, 2019), independent directors are not truly independent from the management and dominant shareholders, but their independence is influenced by a dominant coalition that governs the corporation. The dominant coalition is not solely dominated by managers, as suggested by Cyert and March (1963), but it can also include board members and owners and their representatives. Scandinavian corporations tend to have strong owners such as families and corporations, and boards are separated from the managers of the corporation (Collin, 1998; Huse, 2007; Stafsudd, 2009), thus constituting more of a governance triad of relationships between owners, management, and board directors. The influence of the dominant coalition is shaped through a bargaining process between the members of this triad.

The dominant coalition is interested in combining the compliance with the institutional pressure of having independent directors as a signal of good governance (Thomsen, 2006; Ferrarini & Filippelli, 2015; Jonnergård & Larsson-Olaison, 2016), with the demand to have directors that can support the board in developing and implementing the dominant coalition's strategy of the firm. Thus, they select independent directors primarily based on their ability to exercise a resource provision function (Hillman & Dalziel, 2003) and to support the dominant coalition in their strategy development, while at the same time signalling adherence to the institutional pressure of having independent directors. Praxis theory differs from the agency and personal dependency theories in the sense that the monitoring function performed by independent directors is not emphasised. According to the praxis perspective, the appointment of independent directors on the board is more of a signalling mechanism of compliance to the institutional forces (Wu, Chen, & Lee, 2016).

For the dominant coalition, manipulation of earnings through accruals management is just one means of influencing the share market. They could manipulate accounting numbers since they believe that the conventional way of accounting reporting is not enough, due to particularities in the corporation that conventional application of accounting reporting cannot handle well, as indicated by the low-value relevance of reporting earnings, for example, values of intangibles (Merchant & Sandino, 2009; Wyatt, 2008). For the dominant coalition, accruals management will give a more truthful and fair value to the corporation, according to the perception of the dominant coalition. It could be the case that the owner in the dominant coalition is dominant due to large investments in the corporation, and therefore experience a lower level of diversification. This will make them less susceptible to pleasing the market through deceptive use of manipulation. Instead, their manipulation could be performed due to corporate strategic reasons.

The dominant coalition could use voluntary information to present the corporation, for example, through NON-GAAP measures (Young, 2014), but they could also manipulate the actual accounts. The independent directors are recruited to be a resource for the dominant coalition to exercise their control over the firm, maybe not only as a signal of monitoring but also through their expertise, for example, in earnings management. Thus, hiring independent directors can be considered as a tool for the accrual's management activities. Independent directors can, therefore, be assumed to promote the magnitude of accruals management. Since the motivation is a true and fair representation of the company's value, there is no expectation that the manipulation will have a particular direction. We thus formulate the following hypothesis:

H3a: The greater is the proportion of independent directors on the board of directors, the greater is the magnitude of accrual management.

Real activities management significantly differs from accruals management. It implies the manipulation of actual operations, potentially influencing the competitive advantage (Anagnostopoulou & Tsekrekos, 2017; Chang & Chen, 2018) and influencing performance (Alsharairi, Khamis, & Alkhalaileh, 2020; Cohen & Zarowin, 2010; Taylor & Xu, 2010). Independent directors are recruited, among other motives, to be a resource supporting the dominant coalition in their strategy formation and implementation. Thus, any manipulation of the actual operations to influence earnings, for example, to manipulate the level of R&D, will run the risk of interfering in the strategy implementation, which is not in the interest of the dominant coalition and is, therefore, suppressed by independent directors. Based on this theory we expect to find that the greater proportion of independent directors on the board decreases the magnitude of real activities management. The direction is of no concern since any direction, positive or negative, will harm the strategy implementation.

We, thereby, suggest the following hypothesis:

H3b: The greater is the proportion of independent directors on the board of directors, the lower is the magnitude of real activities management.

The three distinct explanations of the influence of board independence on earnings management, each provided by the agency, personal dependence, and praxis theory are summarized in Table 1.

Table 1. Summary of the theories hypotheses

	AM	*RM*
	Agency theory	
Direction		
Magnitude	*H1a*: Negative	*H1b*: Negative
	Personal dependence theory	
Direction	*H2a*: Positive	*H2b*: Positive
Magnitude		
	Praxis theory	
Direction		
Magnitude	*H3a:* Positive	*H3b*: Negative

The agency theory and the praxis theory explanations focus mainly on the magnitude of management, while the personal dependence theory explains the direction of earnings management. In magnitude, the agency theory predicts a negative correlation, while the praxis theory predicts a positive since the two theories assume that independent directors are directed towards two different principals, the general investor or the dominant coalition.

3. RESEARCH METHODOLOGY

To test the hypotheses, we collected data from Swedish corporations listed on Stockholm Stock Exchange[1] (large, mid, and small cap) from 2017. Financial data were collected mainly from the Thomson Reuters database "Datastream"[2], while data on the boards were hand-collected from the annual reports. There were 329 corporations, where we excluded 57 that were in the financial industry (Chouaibi, Harres, & Brahim, 2018). After deleting firms that lacked data on specific variables and had extreme outliers, the final sample consisted of 205 complete observations for the model with accrual management as the dependent variable and 148 observations for the one with real activities management. Winsorizing was considered, but due to limited sample size, it reduces the variance, which made us use a different path, that of deleting outliers and in some cases transformation techniques, as indicated below. With this sizable dropout, and with the cross-sectional nature of our data, we have to note that our sample is not sufficient to draw any definite conclusions and is exploratory.

3.1. Dependent variables

Accrual management has been observed through measuring discretionary accruals using the modified Jones model (Dechow, Sloan, & Sweeney, 1995), which also includes the possibility to observe revenue manipulation through credit sales. While it has been criticised to underestimate the degree of manipulation (Agnes Cheng, Zishang Liu, & Thomas, 2012; Canitz, Fieberg, Lopatta, Poddig, & Walker, 2018; DeFond & Jiambalvo, 1994; Kothari, Leone, & Wasley, 2005; McNichols, 2002), it is considered to be a common method (Almahrog, Ali Aribi, & Arun, 2018; Klein, 2002; Park & Shin, 2004), which makes it possible to compare results. We use the model, as specified in Dechow et al. (1995), but estimate industry-specific parameters by using 15 years of observations (Roychowdhury, 2006). The discretionary accruals are presented as:

DAD: Discretionary accruals (DA) with direction (D) to observe if they are used to increase or decrease earnings.

DAM: Discretionary accruals (DA) observing the magnitude (M) in absolute values (A), i.e., |*DAD*|.

Real activities management variable was proxied by sales manipulation, production manipulation, and manipulation of discretionary expenditures (Roychowdhury, 2006). In line with previous studies that followed Roychowdhury (2006) method (Cohen et al., 2008; Gunny, 2010; Zang, 2012), we calculate the residuals, i.e., the manipulation compared to expected normal activities of cash flow, production costs, and discretionary expenditures. The residual has a sign, i.e., indicating direction, and a value, indicating magnitude. We create two variables, one of the direction and one of the magnitude.

RMD: Real activities management (RM) observing its direction (D) where we take a sum of the standardised values of the residual from Production costs – Sales – Discretionary expenditures.

RMM: Real activities management (RM) observing its magnitude (D) through using the absolute values of the standardised values of the residual from |Production costs| + |Sales| + |Discretionary expenditures|.

3.2. Independent variable

The influence of independent directors can be measured in different ways, or rather, it can be identified by different dimensions. We create three dimensions: the share of independent directors on the board, their presence at the board meetings, and independent directors' tenure.

ID Share: One dimension is the share of independent directors at the board of directors. It assumes that the actions of independent directors have a stronger influence when their share at the board increases. This is a common measure to observe the influence of the independent directors (Ebrahim, 2007; Osma & Noguer, 2007; Klein, 2002; Park & Shin, 2004; Peasnell et al., 2005; Xie, Davidsson, & DaDalt, 2003). The variable is defined as the number of independent directors as identified by the annual report/number of directors appointed by the shareholder meeting.

ID Presence: In addition, being part of the board, an independent director can exercise their influence through participation in board activities. One way to measure their participation is by observing their attendance at the board meetings (Min & Chizema, 2018; Nowland & Simon, 2018; Liu et al., 2015). Thus, we create a board attendance variable measuring the number of meetings the independent directors have attended divided by the number of possible board meeting attendance.

ID Tenure: The influence and actions of independent directors could also vary due to their tenure on the board (Reguera-Alvarado & Bravo, 2018). With longer tenure, one could assume that the directors get more power in the group and have a better knowledge of how to influence the board (Reguera-Alvarado & Bravo, 2017). On the other hand, as the tenure increases, one could assume that the independent directors become more acquainted with the leading actors of the board, and behave more like them (Ghazalat, Islam, Noor, & Abu Haija, 2017; Sharma, 2011). That is not important for the praxis theory, since it assumes that independent directors are part of the dominant coalition, but in the other two theories, tenure is expected to reduce the predicted relationships. Thus, we create a tenure variable measuring it as a number of years for all independent directors serving at the board.

[1] https://sseinitiative.org/stock-exchange/nasdaq-stockholm/
[2] https://www.refinitiv.com/en/products/datastream-macroeconomic-analysis

3.3. Control variables

Opt B Size: The size of the board can be assumed to influence the efficiency of the board to be able to perform its functions. The size of the board is frequently measured by the number of directors. That is hard to argue for since when used only as a linear correlation, it would imply that either a board with no directors or with an infinite number of directors is the most efficient board. One could use a non-linear approach, or the approach that we start with, that of the efficient size of the board. We chose to represent the size with a dummy, indicating 1 for a board consisting of 7–10 directors, which has been considered as an interval of efficient size (Lipton & Lorsch 1992; Jensen, 1993), and 0 for all other boards.

BM: The number of board meetings could be a proxy of a board's level of activity (Ebrahim, 2007; Xie et al., 2003). It is said that a high number of board meetings may also indicate that a corporation is in crisis (Vafeas, 1999).

Size: The size of the corporation is measured by its sales and transformed through logarithmation. Positive accounting theory predicts that larger firms will tend to manipulate to reduce earnings (Watts & Zimmerman, 1986). Other studies claim that it is not the direction that is reduced, but the magnitude (Ebrahim, 2007; Park & Shin, 2004; Xie et al., 2003).

D/E: Debt-to-equity is the relationship between total debt and equity, according to the balance sheet. The financial risk can be assumed to influence the tendency to engage in earnings management. Positive accounting theory predicts a positive correlation since the corporation could run close to exceeding conditions from debts. This relationship has been found in a number of empirical studies (Anagnostopoulou & Tsekrekos, 2017; Chen et al., 2015; DeFond & Jimbavalov, 1994; Klein, 2002; Lazzem & Jilani, 2018; Sweeney, 1994).

ROA: Return on asset is defined as (income before tax + interest expenditures) / Total assets. It can be assumed that profitable corporations have no incentive to influence the direction of earnings, at least not upwards. According to positive accounting theory, however, they could be interested in reducing the profitability not to attract attention (Watts & Zimmerman, 1986).

WOM: The share of women on board could influence the earnings management, especially its magnitude since it has been found that females are more likely to report illegal activities (Gavious, Segev, & Yosef, 2012) or fraudulent reporting (Kaplan, Pany, Samuels, & Zhang, 2009). Indeed, studies have found a negative correlation between female directorships and earnings management (Gavious et al., 2012; Gull, Nekhili, Nagati, & Chtioui, 2018; Srinidhi, Gul, & Tsui, 2011), with income-reducing accruals management (Arun, Almahrog, & Aribi, 2015) and a positive relationship with value relevance of fair value accounting according to IFRS 13 (Velte, 2017). But these results have been contested by the study of Lara, Osma, Mora, and Scapin (2017). It shows that they are only valid in firms where female directors are discriminated.

The model under consideration is:

$$DAD \text{ or } DAM \text{ or } RMD \text{ or } RMM = k + \beta_1 * ID\ Share + \beta_2 * ID\ Presence + \beta_3 * ID\ Tenure + \\ + \beta_4 * Opt\ B\ Size + \beta_5 * BM + \beta_6 * Size + \beta_7 * ROA + \beta_9 * WOM + \varepsilon \quad (1)$$

It should be noted that we consider the variables observing the independent director as being dimensions of independent directors, which motivates their inclusion in the equation estimation at the same time, thus we do not expect them to observe the same characteristics of independent directors and therefore cannot be assumed to be correlated.

4. RESULTS

We have a small data set consisting of 148 observations for real activity management. All numbers and statistics presented here are from that data set. We have, however, a larger data set, 205 observations, due to more data for accrual management calculation. We will indicate in the text when we consider the larger data set. With a dropout analysis we could note that the corporations in the small data set compared to the one we lost through less data access were larger, presumably because they have stronger institutional pressure to perform more reporting.

Inspecting the means of the variables in Table 2, it should be noted that the dependent variables measuring the absolute values, i.e., the magnitude of accrual management and real activities management (*DAM* and *RMM*, respectively) has a negative mean, which is because they are logged to reduce some of the remaining extreme values.

The independent variables mean values show that 71% of the directors are considered to be independent, that their attendance is 94% of the possible board meetings, and that the average tenure is 25 years (measured as a sum of all independent directors' tenure).

The control variables show that 52% of the corporations are in the range of optimum board size, that they tend to have almost one board meeting a month, that *ROA* is 6,5% but with a high standard deviation, and that number of women on board is 2.24.

Inspecting the correlation matrix, we notice first the dependent variables. *DAD* and *RMD*, the directional measures of earnings management, and the magnitude measures, *DAM* and *RMM*, are positively correlated, which indicates that they are not substitutes but complements. Roychowdhury (2006) claims that managers have reasons to not exploit the accruals management too much since it can attract the auditor's attention, and at the same time, to be able to use real activities management, it has to be performed before the year's end, thus the latter needs more of planning than the former. On the other hand, the accruals management measures, *DAD* and *DAM*, as well as the real activity management measures, *RMD* and *RMM*, are significantly negatively correlated, which indicates that those that increase in the magnitude of manipulation tend to reduce earnings.

Table 2. Descriptive statistics and Pearson's correlation coefficients

Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13
(1) *DAD*	-0.0324	0.1307	X	-0.267***	0.219***	-0.143*	-0.070	-0.044	0.045	0.085	0.044	0.126	0.086	0.213***	-0.041
(2) *DAM*	-1.3637	0.5398		X	-0.120	0.282***	0.173**	0.225***	-0.119	-0.148*	0.207**	-0.360***	-0.009	-0.172**	-0.203**
(3) *RMD*	-0.1563	1.2580			X	-0.221***	-0.184***	0.097	-0.012	-0.004	0.114	-0.029	0.027	-0.384***	-0.099
(4) *RMM*	-0.1171	0.3665				X	-0.076	-0.036	-0.065	-0.134	0.165**	-0.410***	-0.060	-0.156*	-0.102
(5) *ID Share*	0.7100	0.1741					X	.138*	0.276***	-0.155	0.028	-0.088	0.020	-0.038	-0.029
(6) *ID Presence*	0.9442	0.0575						X	0.072	-0.211***	0.166**	0.028	0.071	-0.129	0.000
(7) *ID Tenure*	25.05	14.084							X	0.255***	-0.199**	0.240	-0.019	0.246***	0.267***
(8) *Opt B Size*	0.52	0.501								X	-0.027	0.432***	0.070	0.174**	0.378***
(9) *BM*	11.89	5.081									X	-0.096	-0.106	-0.161**	-0.113
(10) *Size*	6.5517	0.9677										X	0.141*	0.372***	0.576***
(11) *D/E*	2.7316	8.3237											X	-0.025	-0.037
(12) *ROA*	0.0653	0.1524												X	0.219***
(13) *WOM*	2.24	1.086													X

*Notes: *** p < 0.01, ** p < 0.05, * p < 0.10.*

Table 3. Results of hierarchical regression analysis

Variables	Model 1			Model 2			Model 3			Model 4		
	DAD			DAM			RMD			RMM		
	Std B	Std. Error	VIF	Std B	Std. Error	VIF	Std B	Std. Error	VIF	Std B	Std. Error	VIF
Constant	-0.048	0.196		-2.412	0.741		-1.078	1.717		1.378	0.501	
Opt B Size	0.033	0.026	1.471	0.104	0.098	1.471	-0.023	0.226	1.471	-0.037	0.066	1.471
BM	0.093	0.002	1.132	0.123	0.008	1.132	0.079	0.020	1.132	0.173**	0.006	1.132
Size	0.113	0.015	1.895	-0.392***	0.057	1.895	0.166	0.133	1.895	-0.545***	0.039	1.895
D/E	0.08	0.001	1.083	0.032	0.005	1.083	0.003	0.012	1.083	0.055	0.003	1.083
ROA	0.201**	0.078	1.253	0.03	0.296	1.253	-0.450***	0.686	1.253	0.000	0.200	1.253
WOM	-0.162	0.012	1.619	0.022	0.047	1.619	-0.135	0.110	1.619	0.218**	0.032	1.619
ID Share	-0.064	0.066	1.178	0.148*	0.252	1.178	-0.253***	0.583	1.178	-0.149*	0.170	1.178
ID Presence	-0.03	0.2	1.171	0.226***	0.758	1.171	0.038	1.757	1.171	-0.048	0.512	1.171
ID Tenure	0.044	0.001	1.38	-0.098	0.003	1.380	0.183**	0.008	1.380	0.097	0.002	1.380
Adj R^2	0.025			0.179			0.189			0.188		
F-value	2.052*			4.559***			4.806***			4.792***		
Δ Adj R^2	0.005			0.065			0.062			0.022		
Δ F-value	0.23			3.878**			3.768**			1.347		

*Notes: *** p < 0.01, ** p < 0.05, * p < 0.10. Constant is unstandardized value.*

Inspecting their correlation with the independent variables, we see that the accruals management magnitude measure, *DAD*, is positively correlated with both board share and the meeting attendance of independent directors. This is the opposite of the prediction of the agency theory but is in line with the praxis theory hypothesis that the independent directors are a resource supporting the dominant coalition by managing the information released to the market. The other significant correlation is the negative correlation between the share of independent directors and the direction of real activities management, *RMD*, i.e., the more directors' independence the less the real activities management is used to promote earnings. Here it supports the agency theory, saying that board independence will reduce the tendency to use real activity management to promote earnings.

Having more independent directors on the board has been considered to be a synonym of good governance; thus, one would expect a positive correlation with *ROA*. Whereas the share of independent directors is not correlated with *ROA*, independent directors' tenure as expected, is positively correlated, indicating that if independent directors influence *ROA*, they do it through long tenure. But here we should remember the competing ideas, that long tenure could imply that they gain in independence, or the opposite, following the praxis theory, that they become even more dependent on the dominant coalition.

Inspecting correlations with control variables we notice that the number of board meetings is positively correlated with the earnings management magnitude measures, which could be due to the possibility that more board meetings are held in financially distressed corporations, which induce more magnitude of earnings management. But that interpretation is not strongly supported by the correlation with the direction of earnings management, where we should expect to also get a positive correlation. But, on the other hand, the negative correlation between board meetings and *ROA* indicates that financial distress necessitates more frequent board meetings. The size of the corporation is strongly negatively correlated with the magnitude measures, which could be a sign of institutional pressure to reduce manipulative behavior. Interesting is that *ROA* is positively correlated with the direction of accruals management, but negatively with real activities management, thus indicating that real activities management is less of an instrument to increase *ROA*. Finally, women on board all have negative signs on the dependent variables, but only significant on the magnitude of accruals management. Thus, they follow the trend in other studies, to indicate that females tend to be present in corporations that are less likely to engage in earnings management. If this is due to female-specific behavior or is a selection bias, as indicated by Lara et al. (2017), is not clear. There are some indications of selection bias since a greater proportion of women on board is positively correlated with firm size, indicating an institutional pressure to have more female directors.

We measure board independence with three dimensions, share, attendance at meetings, and tenure. All have positive signs, but only one relationship has a significant correlation, which is the share of independent directors and their tenure on the board. This correlation is more mathematical since more directors will create more tenure years. We believe that the number of years at the board is a necessary measure since there are two opposite ideas connected with the variable, either more tenure makes the independent directors stronger in their independence, i.e., get more power and stronger in their monitoring, or they become more on friendly foot with the management and majority owners, and, therefore, will be less likely to engage in monitoring. The other correlations are low, thus indicating that we have identified three rather different dimensions of board independence.

The multiple regression analysis (see Table 3) is performed as a hierarchical regression, to inspect the joint contribution by the three dimensions of board independence to the explanation. It should be noted that when the larger sample could be used, with the dependent variable of *DAD* and *DAM*, the same significant variables appeared, and the models were significant, but all on higher levels of significance, which imply that the correlations identified exist in both the large and the smaller, presented sample.

Model 1, with *DAD*, is weakly significant when only the control variables are considered, mainly driven by *ROA*, which have a positive sign. When we add board independence measures, the model becomes insignificant. It thus does not provide support to the personal dependence theory, arguing that greater independence of the board would induce higher earnings through earnings management.

Model 3, with *RMD*, is significant, with a significant joint contribution by independent directors. A negative correlation between *ROA* and *RMD* indicates that corporations do not engage in real activity management when having satisfactory profitability. The board independence variables show interesting correlations: the share of independent directors decreases the real activity management, but their cumulative tenure increases it. This partially contradicts the personal dependence theory, which predicted a positive correlation for the share of independent directors, but supports it concerning tenure.

Inspecting the magnitude of discretionary accruals management, Model 2, with *DAM*, is significant showing significant effects of two dimensions of board independence. Here we find that board independence increases the magnitude of accrual management, both through its share and directors' presence at the board meetings dimensions. This goes against the prediction of agency theory but supports the praxis theory. In addition, our results indicate that the size of the corporation tends to reduce the magnitude of accrual management.

Finally, Model 4, with *RMM*, is significant, however, board independence variables are not significant predictors of the magnitude of real activities management. Here we find that board meetings and women on board increase the magnitude of real activities management, and the size of the corporation sharply decreases it. The share of independent directors is weakly significant and appears to reduce the magnitude of real activities management, which supports both the agency and the praxis theories.

Summarizing the outcome of this exploration of the three theories, we have found that the agency theory had one prediction supported, the personal dependence theory had partial support since there were mixed results in the dimensions of board independence variables of *RMD*, and the praxis theory had two predictions supported.

5. DISCUSSION

Our results indicate that it is unlikely that independent directors in Swedish large corporations fulfil a strong monitoring function. Independent directors do not appear to influence the manipulation of accounting reporting, neither downwards nor upwards. Instead, we found some support for the agency theory, but stronger support through no rejection of both two hypotheses of the praxis theory. Our interpretation is that independent directors are part of or in consent with the dominant coalition, providing resources to the board, be it the signal of the monitoring by the board, but not actual monitoring since then *H1a* and *H1b* would have gained support, and the capacity to present what the dominant coalitions regard as a true and fair view of the corporation.

The conclusion of independent directors being part of the dominant coalition, much in line with the praxis theory, is more supported in the context of the magnitude of earnings management (*DAM* and *RMM*), where independent directors increase the magnitude through accrual management and reduce it through real activities management.

Our findings, though being limited to a small sample, indicate that the agency theory may not be the best predictor of independent directors' influence in a Swedish sample, while the praxis theory finds stronger support. These findings demand further reflections and more rigorous empirical testing.

We find different results in our data analysis, compared to most studies, performed mainly in the North American context, where board independence has been shown to negatively correlate with accruals management (Klein, 2002; Ebrahim, 2007; Reguera-Alvarado & Bravo, 2018), even if there are exceptions, such as the no correlation found in a Canadian sample (Park & Shin, 2004). It is, however, important to notice the limitation of the empirical test is performed using a small number of observations. Our findings should therefore be considered as explorative providing only indications of theory relevance rather than being a test of the theories. But if similar results would be present in studies without our study's limitations, i.e., with a larger sample, covering more years and more control variables, what could be the reason that independent directors have an influence more in accordance to the praxis theory, i.e., they appear to have more a resource function than a monitoring function?

One possible explanation is that different theories are more or less suited to different institutional setups (Lubatkin, Lane, Collin, & Very, 2007), where the power of the owner and the functioning of the labor market for independent directors vary between countries shaping multiple mandates for independent directors that they fulfil on the board. Studies (Zattoni et al., 2017; Johanson & Østergren, 2010) have found indications that independent directors could play different roles in different corporate governance systems. Possibilities to create dominant coalitions, as in the praxis theory, could differ, where there is a higher probability in governance systems similar to the Swedish system, characterized by strong owners than in systems characterised by a high level of owner dispersion. Indeed, Napoli (2019) found no support of the agency theory monitoring hypotheses in his sample of listed Italian family firms, presumably with strong coalition capacities. In a study (Franzoi, Mietzner, & Thelemann, 2021) of family firms, presumably with strong coalitions, in Germany, which have governance similarities with Sweden, the results indicate that earnings management were used to safe-guard the strategy of the coalition, to support the long-term survival of the firm, at the expense of dividends to investors. Additionally, the size and the functioning of the director labor market could differ and, therefore, change the conditions according to the personal dependence theory.

Indications of institutional variance and its influence on earnings management have been found by Degeorge, Ding, Jeanjean, and Stolowy (2013), where they found that analysts coverage reduced accruals management in countries with a high developed financial environment, while no effect was found in lower developed environments. Enomoto et al. (2015) replicated the results that analysts reduce real activities management, but overall, they found, as did Sun and Liu (2016), that firms preferred real activities management in high investor protection environments, with the interpretation that real activities management is less costly than accruals management in these environments. On the other hand, Cang, Chu, and Lin (2014) found that analysts' presence in China stimulate accrual management above the line but reduced it below the line, thus indicating a more complex relationship. Thus, it appears that the emphasis on different dimensions within earnings management differs across institutional environments.

More specifically, focusing on board independence, we find a theory close to our praxis theory, which Crespí-Cladera and Pascual-Fuster (2014) term the optimal independence theory. It claims that independent directors are recruited as a result of a negotiation game between actors of governance, such as the chief executive officer(CEO), the board, and major shareholders, i.e., our dominant coalition, where the actors in the negotiation are looking for an optimal independence level (Hermalin & Weisbach, 1998). Indeed, some studies appear to support this theory (Chou, Hamill, & Yeh, 2018; Krause, Withers, & Semadeni, 2017). One study (Cao, Dhaliwal, Li, & Yang, 2015) found that independent directors that were socially connected to the top management team (TMT), yet considered to be independent of the management, earned higher profit from stock trading than less socially connected independent directors, indicating that the information available, and therefore capacity to monitor, would differ significantly between formally independent directors with different degree of social independence from the management. Cohen, Frazzini, and Malloy (2012) found that

analysts that prior to join the board as an independent director had positive evaluations of the corporation, i.e., being "cheerleaders", quite similar to the praxis theory of the managed board independence. Finally, Crespí-Cladera and Pascual-Fuster (2014) found that of the 32.5% of independent directors in Spanish firms, only 14.2% were truly independent, according to their assessment, indicating that more than 50% of Spanish boards have managed independence. This indicates that we need to be more elaborated in our conception and observation of board independence, where "*the will of the dominant coalition directs the recruitment and the way of dealing with the independent directors in the actual board processes*" (Collin & Smith, 2019, p. 201), i.e., independent directors could be independent in appearance but managed in reality.

It also indicates that conditions for the negotiation game could differ due to formal and informal institutions. It could be the case that the negotiation game or the possibility to organize a dominant coalition is more probable in institutional environments where owners are strong because of high ownership concentration or access to other means of ownership power. In an institutional environment where the CEO is not only monitored by the owners but even included in the dominant coalition, actual monitoring of the CEO by independent directors is not crucial. More important is for the corporation to signal the presence of independent directors, mainly to foreign investors that can be assumed to adhere to the ideology of good governance, and for the independent directors to signal profitability to committees in Sweden looking for an independent director. In the US/UK system, where the CEO and the TMT constitute the dominant coalition, monitoring is important, which makes it important for the independent board members to show their capacity to monitor, where fewer earnings management is a signal of monitoring performance.

While the different institutional environments create conditions for dominant coalitions to exist, it could also condition the labor market for board directorships. Chen and Moers (2018), in a study of the US labor market for directors, found that independent directors have incentives to avoid firms that are hard to monitor and that the market changed during their study period, 1996–2006, where experienced independent directors reduced the number of their directorships, probably because of a greater workload and/or personal liability risk, which together with higher demands of independent directors, implied an inflow of new independent directors on the market that got directorships in these firms. Their finding is that the labor market has changed due to harder regulation and public scrutiny, and because of newcomers possibly also the direction and efficiency of the independent directors.

In the case of Sweden, we could speculate about a segmented market for independent board members. The argument starts with the important remark that an independent director in the US corporation is the common director in Sweden, since executives, except the CEO, cannot hold directorship on the board. A director in Sweden cannot be dependent in the sense of a dependent director in the US, that it is employed by the corporation. They can, however, be termed dependent if they have close ties to the dominant owner. Independence in Sweden is, therefore, a function of management ties and ownership ties. In this context, one interesting question is why independent directors influence corporations? Presumably, the directors that are considered to be dependent on the dominant owner are selected because they support the dominant coalition. This would imply that both the dependent and the independent directors can be expected to be similar, with similar behaviour, thus share of independent directors on the board should not significantly correlate with, for example, earnings management, since both dependent and independent directors can be expected to act in the same way. One possible explanation to the significance of the independent directors is that the dependent directors are selected from a restricted sample of directors, probably from a close network belonging to the dominant coalition members, while independent directors are selected from a different and larger sample, where directors with specialized competence, and maybe also with more advanced competence, can be selected. In another context, that of the audit committee, it has been found that specialized financial competence influences earnings quality (Bilal, Chen, & Komal, 2018), and it has been found that accounting competence on supervisory board influences accounting information quality (Ran, Fang, Luo, & Chan, 2015). It has, indeed, been found by Collin et al. (2017) that board independence drives directors' compensation in Sweden, which could be due to them being more competent, which Cavaco, Crifo, Rebérioux, and Roudaut (2017) found in a French sample, and/or them being selected from another group than the dependent directors. This is in line with the praxis theory, that independent directors constitute first and foremost a resource, complementing or increasing the strategy competence of the board. The regulation demands independent directors on the board force and legitimizes the scanning of a wider range of people than would have been done if the regulation would not have been present. It forces or legitimizes the recruiters to have a wider scanning of possible directors. It could be the case that Sweden has experienced the same regulative and institutional pressure as the US did, but several years later, which increased the market for directors, maybe even created a market segment of independent directorships, but embedded in the context of dominant ownership, where the independent board members were recruited to complement the dependent directors sending a signal of independence and eventually with some other resources.

This argument is close to the personal dependence theory, where it is claimed that independent directors promote their candidature in the labor market. It makes us pay attention to their incentives, assuming that their actions can vary due to incentives, such as reputation effects. For example, Zhu, Ye, Tucker, and Chan (2016) found that independent directors with higher rank, as indicated by the presentation they had in the annual report, were negatively correlated with accruals management, indicating a variation among independent directors. But other incentives could also be considered. Ye (2014) found that the capacity

to reduce earnings management is negatively correlated with their compensation in China. In the study from Taiwan (Cang et al., 2014), the effect of corporate insurance of directors against stockholder legal action was studied. They found an increase in accruals management, indicating that "true" independent directors when they could become independent of the owners and their legal actions are engaged in earnings management. Thus, even if we disregard institutional influence, incentives can induce a variety of actions by independent directors, thus making them dependent on the incentives provided.

This could shed some speculative light on the different dimensions of independence we offered. While the dimensions of independence tend to operate in the same direction in three of the models, they created contradictory results in Model 3, the case of the direction of real activities management, where the share of independent directors reduced real activities management and the tenure increased it, the latter in accordance to the personal dependence theory. Maybe a bold interpretation, but if the share of independent directors indicates more the recruitment of independent directors, where they could have been selected according to the praxis theory, being aligned with the dominant coalition, probably even repressing real activities management, it could explain the negative sign of share of independent directors. But, with increasing tenure, they gain in power and can act more out of their self-interest, which according to personal dependency theory is to increase the real activities management towards higher profit. This interpretation is rather speculative, but it is made possible due to the three different dimensions of independence and the personal dependence theory.

The discussion shows that we are far from understanding the function of the independent directors. The level of "independence" and its behavioural implications appear to be dependent on the governance system, on the labor market for directorships, and incentives. In our paper, we presented two additional theories that provide both complementary and countervailing motives for independent directors' actions on the board. Thus, we are in a need of theory development, whether it has an integrative purpose or aim at developing the three theories presented here, or even develop more theories that incorporate multiple behavioural forces explaining board decision-making. The importance put on independent directors all over the world makes this research effort important.

6. CONCLUSION

We started with a broad *RQ*, asking what are the functions of independent directors? Studying earnings management in Swedish corporations, as discretionary accrual management and real activities management, with independence represented by three dimensions, and discussing the results, we concluded that independent directors may vary in their capacity and interest to monitor, partly due to the institutional setup, that creates incentives and capacity of independent directors to perform monitoring and service functions. Our empirical conclusion, from an explorative study based on a limited data set from Swedish listed corporations, indicates that independent directors appear to face multiple task demands and as a result of these complementary but also competing demands may perform more of service, probably towards the dominant coalition, than monitoring role on the board.

With this conclusion, we can question if board independence is an important part of good governance (Boivie et al., 2017) and if it is necessary to include independent directors in a code of corporate governance. If independent directors' behaviour, and thus their function, is influenced by the institutional set-up, the stress on board independence in a governance code should vary due to the institutional environment. In the case of Sweden, our study claims that we have reasons to believe that independent board members do not perform a strong monitoring function but have more emphasis on service provision on behalf of the dominant coalition. That could be a reason to not include regulation of directors' independence in the Swedish Corporate Governance Code. On the other hand, as we speculate, demands put on board independence could enlarge the pool of possible candidates considered for the board, which could improve the board's other functions, such as the resource provision function. It is, therefore, conceivable that demand for independent directors increases the size of the labor market for board directorships, which would improve the possibilities to find directors that may excel in both monitoring and resource provision functions. Our policy advice is, therefore, to maintain the demand for independent directors in the code, not for the sole argument of monitoring, but for improving the board's performance due to increased resource provision.

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