

# Corporate Governance: A Review of Current Research

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# Sources of Research Agenda

- Finance
  - Agency theory – investigation of different corporate governance practices and firm performance
- Law
- Management
  - Firm life cycle
  - Stakeholder analysis

# Research

- Effectiveness may be based on a number of different dimensions of corporate governance, ranging from monitoring and control over managerial discretion to promoting corporate entrepreneurship and innovation.
- Regulating managerial power

# Research

- Board characteristics and composition
- Resource dependency approach
- Transaction costs theory
- Role and effects of independence of non-executive directors
- Codes of best practice
- Internal and external control mechanisms

# Research

- Board processes
- Effects of duality of CEO role
- Stewardship theory
- Executive compensation
- Managerial stock ownership and performance

# La Porta et al. 1998

- Manuscript Type: Empirical and Conceptual
- Research Question/Issue: Do differences in legal protections of investors explain why firms are financed and owned so differently in different countries? Does a country's membership in one of the two principle legal families affect the corporate governance mechanisms?

# La Porta et al. 1998

- Why do Italian companies rarely go public?
- Why does Germany have such a small stock market but also maintain very large and powerful banks ?
- Why is the voting premium small in Sweden and the United States, and much larger in Italy and Israel
- Why were Russian stocks nearly worthless immediately after
- privatization—by some estimates 100 times cheaper than Western
- stocks backed by comparable assets—and why did Russian companies have virtually no access to external finance ?
- Why is ownership of large American and British companies so widely dispersed?

# La Porta et al. 1998

- Unit of analysis – country; generalized to legal family
- Methods – statistical analysis of investor protection; student t-test



# La Porta et al. 1998

- Independent Variables
  - Country
  - Legal Family
- Dependent variables
  - Shareholder rights
  - Creditor rights
  - Enforcement
  - Ownership

# Results

Country	One Share– One Vote	Proxy by Mail Allowed	Shares Not Blocked before Meeting	Cumulative Voting/ Proportional Representation	Oppressed Minority	Preemptive Right to New Issues	Percentage of Share Capital to Call an Extraordinary Shareholder Meeting	Antidirector Rights	Mandatory Dividend
A. Shareholder Rights (1 = Investor Protection Is in the Law)									
Common vs. civil law	−.72	3.03*	4.97*	.15	5.59*	−.91	1.48	5.00*	−2.55**
English vs. French origin	−.87	2.82*	3.87*	−.05	5.45*	−1.08	−2.53**	4.73*	−2.67**
English vs. German origin	−.85	3.29*	5.00*	.00	2.83*	.46	2.54**	3.59*	.00
English vs. Scandinavian origin	1.84***	.50	.00	2.55**	17.00*	−1.09	−1.00	1.91***	.00
French vs. German origin	−.22	1.00	−1.78***	−.22	−.96	1.23	2.64**	.00	2.67**
French vs. Scandinavian origin	2.83**	−1.37	−3.87*	2.82**	2.83	−.48	2.43**	−1.06	2.67**
German vs. Scandinavian origin	1.58	−1.00	−5.00*	1.58	2.23***	−1.27	−4.62*	−1.08	.00

NOTE.—Variables are defined in table 1.

<sup>a</sup> As a percentage of votes.

<sup>b</sup> As a percentage of the number of shares.

\* Significant at the 1 percent level.

\*\* Significant at the 5 percent level.

\*\*\* Significant at the 10 percent level.

# La Porta et al. 1998

- Research Findings/Results: The results show that common-law countries generally have the strongest, and French civil-law countries the weakest, legal protections of investors, with German- and Scandinavian-civil-law countries located in the middle. Also found that concentration of ownership of shares in the largest public companies is negatively related to investor protections, consistent with the hypothesis that small, diversified shareholders are unlikely to be important in countries that fail to protect their rights

# Shleifer and Vishny 1997

- Agency problem
  - Contracts
  - Managerial Discretion
  - Incentive Contracts
  - Evidence on agency problem – does it exist?
- How to solve?

# Shleifer and Vishny 1997

- Finance without governance – reputation
- Legal Enforcement of Rights
- Large Investors
- Takeovers
- Large Creditors

# Shleifer and Vishny 1997

- Debt versus equity choice
- LBO
- Cooperatives and State ownership

# La Porta et al. 1999

- Studied ownership structures of large corporations in 27 wealthy economies to identify the ultimate controlling shareholders of these firms.
- Found that except in economies with very good shareholder protection, relatively few of these firms are widely held, in contrast to Berle and Means's image of ownership of the modern corporation.
- Rather, these firms are typically controlled by families or the State.
- Equity control by financial institutions is far less common.
- The controlling shareholders typically have power over firms significantly in excess of their cash flow rights, primarily through the use of pyramids and participation in management.

# Yermack 1996

- Smaller boards of directors are more efficient than larger boards
- Theory
  - Large boards have higher monitoring costs
  - Larger groups are less able to reach agreement and thus take no tough decisions
- Model: Tobin's Q will vary inversely with board size



# Jensen 1993

- Claims that since 1973 technological, political, regulatory, and economic forces have been changing the worldwide economy in a fashion comparable to the changes experienced during the nineteenth century Industrial Revolution.
- During the 1970s and 1980s indicate corporate internal control systems have failed to deal effectively with these changes

# Jensen 1993

- IC systems have failed to require managers to make decisions to properly manage the efficient and capacity of their companies
- Misspending in R&D as example

# Jensen 1993

- How to improve CG?
- Board culture
- Information problems
- Legal liability
- Oversized boards
- No shareholder democracy – but more activism
- Separate CEO and Chair