Corporate Governance

Module 3, 2024-25

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Course description

This course provides an introduction to Corporate Governance from an economic perspective. Shleifer and Vishny (1997) give a simple definition in their survey: "Corporate Governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment." We mostly limit ourselves to this so-called shareholder view of corporate governance but discuss also the broader stakeholder view that includes employees, suppliers, creditors and society as stakeholders in a firm.
The need for corporate governance stems from conflicts of interest between shareholders and managers (agency conflict of type I) or between large and small shareholders (agency conflict of type II). To mitigate such agency costs, a variety of mechanisms can be used: monitoring by a board of directors, the managerial labor market, incentive contracts for top managers, large shareholders, the threat of takeover, and government regulation to protect investors, among others. We study each of these mechanisms of corporate governance in detail.
Classes will be a mix of lectures, case discussions, and short presentations. Most of the topics are discussed in an international context, but we will refer to the Russian reality and present some data on boards of directors and ownership structure in Russian companies.

Course requirements, grading, and attendance policies

Requirements: It is recommended to take Corporate Finance before this course.

The course grade is composed of five subgrades with different weights.

1. Class participation (15%). This course requires quite a bit of reading. We will discuss the topics based on the readings that I indicate before each class. I expect active participation from each student. I will assign papers from the reading list whose main ideas one student should present in 5-10 minutes. This will develop a special type of presentation skill – summarizing a potentially complex issue in a very short time. Obviously, a necessary condition for active class participation is your presence.
2. Class presentation and submission of a data search and analysis assignment (10%).
3. Class presentation and write-up of one out of two case studies (20%). I will take into account your preferences for one of the two cases but reserve the right to assign a case if the distribution is too unequal.
4. Critical discussion of the case study presentation of another group that I will assign to you 1-2 days before the presentation in class (5%). This will be the case that you did *not* choose under point 3. Apart from providing your comments in class, you need to submit a one-page essay or at least four slides.
5. Final exam (50%).

Presentations and discussions (points 2 to 4) are evaluated individually or for groups of two students. In order to pass the course, you need to pass two thresholds: You need to get a minimum of 35% of points in the exam and 50% for the course in total.

Class attendance is highly recommended to pass the exam. It is strictly required on those days when you or your group is scheduled for a presentation or discussion.

Course material

Required textbooks and material
David F. Larcker, Brian Tayan, Corporate Governance Matters: A Closer Look at Organizational Choices and Their Consequences (3rd edition), Pearson 2020 **(LT)**.
Papers indicated as required readings in the section "Course contents".

Additional material
See references in the section "Course contents".

Course contents

Week	Topic and readings
1	**Introduction** - What is Corporate Governance? - In whose interest a firm should be run: Shareholder vs stakeholder view - Agency problems of type I (shareholders vs managers) and II (large vs small shareholders) - The history of corporate governance in developed and developing countries - Overview of mechanisms to address agency problems: Board monitoring, CEO turnover, compensation contracts, large shareholders (blockholders), market for corporate control (M&A), legal protection of investors, in particular minority shareholders. *Required readings:* • LT Ch. 1-2 • Shleifer Andrei and Robert Vishny (1997), A Survey of Corporate Governance, *The Journal of Finance*, 52(2), 737-783. • Mehrotra, Vikas and Randall Morck (2017), Governance and Stakeholders, in: The Handbook of the Economics of Corporate Governance, Editors: Benjamin Hermalin and Michael Weisbach, 637-683. • Döttling, Robin, Doron Levit, Nadya Malenko, and Magdalena Rola-Janicka (2024), Voting on Public Goods: Citizens vs. Shareholders, Working Paper. Link *Recommended readings:* • Hilt, Eric (2014), History of American Corporate Governance: Law, Institutions, and Politics, *Annual Review of Financial Economics*, 6, 1–21 • Forbes, William and Lynn Hodgkinson (2015), Corporate Governance in the United Kingdom: Past, Present and Future, Palgrave Macmillan. • Jiang, Fuxiu, and Kenneth A. Kim (2020), Corporate Governance in China: A Survey, *Review of Finance*, 733–772.

2	**Boards of directors (1)** • Duties and liabilities • Advice and monitoring • Selection of and voting for board members (majority, cumulative voting) • Size and structure • Board independence • Board committees *Required readings:* • LT Ch. 3-4 • Adams, Renée B., Benjamin E. Hermalin, and Michael S. Weisbach (2010), The Role of Boards of Directors in Corporate Governance: A Conceptual Framework and Survey, *Journal of Economic Literature*, 48(1), 58–107. *Presentation: Three country studies (US, UK, China), based on* • LT, Ch.2 • Hilt, Eric (2014), History of American Corporate Governance: Law, Institutions, and Politics, *Annual Review of Financial Economics*, 6, 1–21 • Forbes, William and Lynn Hodgkinson (2015), Corporate Governance in the United Kingdom: Past, Present and Future, Palgrave Macmillan. • Jiang, Fuxiu, and Kenneth A. Kim (2020), Corporate Governance in China: A Survey, *Review of Finance*, 733–772.
3	**Boards of directors (2)** - The optimal independence of boards (Adams and Ferreira, 2009) - Empirical research on board independence and business connections of boards - Empirical research on the effects of the gender composition of boards (and diversity more generally) *Required readings:* • LT Ch. 5 • Adams, Renée B., and Daniel Ferreira (2007), A Theory of Friendly Boards, *The Journal of Finance,* 62(1), 217-250. *Recommended readings:* • Fogel, Kathy, Liping Ma, and Randall Morck (2021), Powerful Independent Directors, *Financial Management*, 50(4), 935-983. • Knyazeva, Anzhela, Diana Knyazeva, and Robert Masulis (2013), The Supply of Corporate Directors and Board Independence, *Review of Financial Studies*, 26, 1561-1605. • Knyazeva, Anzhela, Diana Knyazeva, and Lalitha Naveen (2021), Diversity on Corporate Boards, *Annual Review of Financial Economics*, 13, 301-320. *Presentations:* - Data search: The board composition of a selected Russian company.
4	**CEOs** - CEO characteristics, corporate decisions and firm performance - CEO succession and CEO turnover - Executive compensation: base salary, bonuses, stock based and option-based compensation. The rising trend of executive compensation.

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Required readings:

LT Ch. 7-8
Frydman, Carola, and Dirk Jenter (2010), CEO Compensation, Annual Review of Financial Economics, 2, 75–102.
Gabaix, Xavier and Augustin Landier (2008), Why Has CEO Pay Increased So Much? Quarterly Journal of Economics, 123(1), 49–100.

Recommended readings:

Bertrand, Marianne (2009), CEOs, Annual Review of Financial Economics, 1, 121–49.
Jenter, Dirk and Katharina Lewellen (2021), Performance-Induced CEO Turnover, The Review of Financial Studies, 34, 569–617.
Bell, Brian, Simone Pedemonte and John Van Reenen (2021), CEO Pay and the Rise of Relative Performance Contracts: A Question of Governance?, Journal of the European Economic Association, 19(5), 2513–2542.

Presentation of case study “Parmalat SpA: An Impressive Milking System”, based on IMD case #183.
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Owners (1)

Types of owners: families, institutional owners, managers, the government
Ownership concentration.
Cash flow vs voting vs control rights: dual-class shares, ownership pyramids and cross-shareholdings.
Measurement issues: How to compute ultimate ownership shares, Power indices.
Empirical research on the structure and formation of business groups
Empirical research on the long-run evolution of ownership and control of firms around the world.

Required readings:

LT Ch. 9, 12
Almeida, Heitor, Sang Yong Park, Marti G. Subrahmanyam, and Daniel Wolfenzon (2011), The structure and formation of business groups: Evidence from Korean chaebols, Journal of Financial Economics, 99, 447–475.
Aminadav, Gur and Elias Papaioannou (2020), Corporate Control around the World, The Journal of Finance, 1191-1246, Sections 1 to 3.

Recommended readings:

Chernykh, Lucy (2008), Ultimate ownership and control in Russia, Journal of Financial Economics, 88, 169–192.

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Owners (2)

Shareholder activism.
Non-profits and foundations: organizations without owners.
State ownership: Social objectives (the helping hand) or private benefits for politicians (the grabbing hand)

Presentation: Data search of ownership structures of a selected Russian company
Presentation of case study “Executive Compensation at General Electric”, based on Harvard Business School case #9-105-072
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7	**The Market for Corporate Control** - Stock Market Evaluation of M&A - Takeover defenses Required readings: • LT Ch. 11 • Karpoff, Jonathan M. and Michael D. Wittry (2024), Corporate takeover defenses, in: Handbook of Corporate Finance, edited by David J. Denis, 410-454. Recommended readings: • Stegemoller, Mike (2008), Corporate Takeovers and Restructurings, in: Corporate Governance – A Synthesis of Theory, Research and Practice, edited by H. Kent Baker and Ronald Anderson, Wiley, 517-533. **Measurement and Regulation of Corporate Governance** - Investor protection at the country level - Corporate governance and ESG indices - Corporate Governance standards and requirements for stock market listings - The law and finance literature Required readings: • LT Ch. 13 • La Porta, Rafael, Florencio Lopez-de-Silanes, and Andrei Shleifer (2013), Law and Finance After a Decade of Research, Handbook of the Economics of Finance, edited by George M. Constantinides, Milton Harris and Rene M. Stulz, Volume 2, Part A, 425-491. • Aminadav, Gur and Elias Papaioannou (2020), Corporate Control around the World, *The Journal of Finance*, 1191-1246, Section 5. Recommended readings: • Aggarwal, Reena, Isil Erel, René Stulz and Rohan Williamson (2009), Differences in Governance Practices between U. S. and Foreign Firms: Measurement, Causes, and Consequences, *The Review of Financial Studies*, 22 (8), 3131-3169.

The schedule and readings are preliminary. Assignments and readings (except for the Parmalat and GE case studies) can be changed during the course.

Description of course methodology

The course will cover theoretical models of corporate governance, empirical research and case studies. It will be taught by a combination of lectures, case discussions, and short presentations of papers and relevant data.

Academic integrity policy

Cheating, plagiarism, and any other violations of academic ethics are not tolerated at NES.