Foreword

In the 1980s and 1990s, corporate governance developed as a separate field in financial economics. This coincided with a move in the US financial markets to align managerial interests with stockholder interests and was a return to an earlier research agenda. In their seminal book, *The Modern Corporation and Private Property*, Berle and Means (1932) had argued that, in practice, managers pursued their own interests rather than the interests of shareholders. The contractual aspect of the firm together with the problem highlighted by Berle and Means led to the development of the agency approach to corporate governance by, among others, Coase (1937) and Jensen and Meckling (1976). The main focus was the question: "How can shareholders ensure that managers pursue their interests?" This literature described a number of corporate governance mechanisms that encourage managers to act in the interests of the shareholders.[1]

The first mechanism is the *board of directors*. This is the starting point for shareholders to control managers and ensure the company is run in their interest. The way that boards are chosen and structured differs significantly across countries. The limited empirical evidence available suggests that different countries' systems are equally effective (or ineffective) at disciplining management. A second method of ensuring that managers pursue the interests of shareholders is to structure *executive compensation* appropriately. Compensation can be conditioned on the firm's stock price and this reflects information gathered by analysts. Stock prices are not the only contingency that can be used to motivate managers. Accounting-based performance measures are also frequently used. Managers who perform extremely well may be bid away at higher compensation levels to other companies. A third mechanism is the *market for corporate control*. Inefficient managers are removed and replaced with people who are better able to do the job. It can operate through proxy contests, friendly mergers, and hostile takeovers.

[1] For surveys of this and other approaches, see Shleifer and Vishny (1997), Allen and Gale (2000), Vives (2000), Becht, Bolton and Röell (2001), Denis and McConnell (2003) and Goergen (2012).

Another important way that value maximization by firms can be ensured is through *concentrated holdings and monitoring by financial institutions*. More wealth commitment by owners increases monitoring and firm performance. Many have argued that the Hausbank system in Germany and the main bank system in Japan were good examples of this. A large strand of the corporate governance literature has focused on the role of *debt* as a means of disciplining managers and overcoming the agency problem. Managers can precommit to work hard by using debt rather than equity and debt be used to prevent managers from squandering too much free cash flow. However, debt can have undesirable as well as desirable effects on managers' behavior. It can create an incentive to take risks and destroy value. Also there is the debt overhang problem where firms may forego good projects if they have significant debt outstanding since in this case a large part of the returns to a good project goes to bondholders. *Competition in product markets* is a very powerful force for solving the agency problem. If the managers of a firm waste or consume large amounts of resources, the firm will be unable to compete and will go bankrupt.

Finally, one important issue is the extent to which the Anglo-Saxon view of the firm as being a profit-maximizing entity is valid. For example, in countries such as Germany and China, legal governance mechanisms explicitly incorporate workers. In practice, stakeholders other than shareholders play an important role in other countries too. A very important issue concerns the relative merits of *shareholder* versus *stakeholder governance*.

The financial crisis that started in 2007 has led to resurgence in interest in corporate governance. How much responsibility for the crisis can be laid at the door of corporate governance failures? Or alternatively, how much can be blamed on the fact that shareholders, particularly in banks, may want the firm to take risks because of convex payoff functions? This book contains many excellent essays that reflect the recent increase in interest in corporate governance research. The editors have skillfully selected and organized the chapters.

This book is divided into four parts. The first is concerned with ownership structure and corporate governance. The chapters range from a study of management entrenchment using data on CEO purchases of houses and how they are financed by Crocker Liu and David Yermack to an essay on shareholder activism in Canada by Sylvie Berthelot and Vanessa Serret. There is also an interesting study of corporate governance mechanisms in China by Michael Firth and Oliver Rui and a discussion of the role of multiple large shareholders in publicly listed firms by Ana Paula Matias Gama.

The second section returns to the classic topic of executive compensation. Jarrad Harford, Sattar Mansi, and William Maxwell study the relationship between corporate governance and cash reserves. They find that weakly governed US corporations spend cash quickly on acquisitions and investments rather than hoarding it. Divya Anantharaman and Vivian Fang look at the literature on the role of debt-like compensation, such as pensions in controlling managerial risk taking. Gang (Nathan) Dong considers the role of board director compensation and finds evidence that this depends on directors' effectiveness in monitoring and friendliness in advising CEOs. Lisa Goh and Aditi Gupta look at the compensation of bank CEOs and find that it is lower but more short term than for nonbank firms, while nonexecutive directors are more highly paid. Jason Ridge investigates the positive effects of compensation on aligning managerial and shareholder interests and the trade-off with negative effects such as fraudulent reporting, earnings manipulation, and so forth.

The third part focuses on boards of directors. Eliezer Fich and Anil Shivdasani consider whether busy boards are more or less effective and conclude they are less effective. Peter-Jan Engelen, Gerwin van der Laan, and Annette van den Berg look at the effect of different types of board diversity in Dutch companies during the crisis. They find age, expertise, and background diversity matter for firm financial performance while gender, nationality, and educational diversity do not. Rayna Brown, Ning Gao, Edward Lee, and Konstantinos Stathopoulos investigate the role of CEO social networks on their compensation and conclude the size of the network is positively related to the level but negatively related to pay-performance sensitivity. Ramzi Ben Kraiem studies an institutional change in France and concludes that independent directors can moderate earnings management that uses discrete accruals.

The final section of this book looks at new trends in governance. Lucian Bebchuk and Michael Weisbach review and comment on the current state of corporate governance research. Shann Turnbull develops a sustainable paradigm of corporate governance drawing on ideas from the natural sciences. Wolfgang Breuer and Astrid Julianne Salzmann use cross-country comparisons to demonstrate the importance of national cultures in corporate governance. Keanon Alderson focuses on the governance structures of family-owned businesses and highlights their advantages and disadvantages. In the wake of the crisis, Stelios Andreadakis considers how to reconcile traditional market-based governance systems with stakeholder systems that are ethically and socially responsible.

In summary, this is a collection of essays that any serious scholar of corporate governance should read.

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