CORPORATE GOVERNANCE

MANAGEMENT 242

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COURSE OVERVIEW

How firms are controlled? Who actually runs the corporation – and to what ends? Depending on who you talked to, you might think that firms were run by three different groups of people: their investors; their senior managers; and their boards of directors. Each of these groups has an important role to play in setting the goals and managing the performance of the firm. This course explores those roles, and their implications for firm behavior. By examining these questions, we understand:

- The tools available to investors to protect their interests. While we might often assume that firms exist to serve shareholders, that isn't always the case. We will examine the theory and practice about the kinds of rights investors have to protect their holdings. Understanding these rights is critical to professional investors, be they fund managers or venture capitalists.
- How critical decisions are made - such as hiring and firing CEOs or selling the firm. These decisions often trigger significant conflicts among the interests of major decision-makers. We understand the roles that each of them play in determining the fate of the firm.
- The legal rights and responsibilities of shareholders, directors and managers. Recent years have seen many cases of individuals ignoring their responsibilities – and paying the price. We detail the accountability of each of the participants to the firm.
- The role of corporations in society.

Summary of Course Content

We start by examining the basic governance problems: Who should run the firm? What should be the rights of different groups such as managers, shareholders and employees? We will develop a framework for understanding these problems, to enable us to identify and analyze the issues that are raised by any corporate governance problem.

The second part of the course lays out the main issues involved in corporate governance. We discuss what boards of directors do – and what they should do. We examine the role of the CEO, who becomes a CEO, and the contentious topic of how CEOs get paid. We look at why corporate governance sometimes goes badly wrong, and how national environments shape the nature of corporate governance problems.

The third part of the course broadens our understanding of governance by looking at how different types of firms can have different goals and different governance challenges. Not all firms are shareholder owned. We also see firms owned by Private Equity, by families, by employees, as partnerships, and even as non-profits. We examine how these different ownership structures affect how firms behave and how they should be governed. We also examine the governance issues specific to publicly traded firms by exploring governance in takeovers and investor activism.

The fourth part of the course looks at how national differences also affect governance, extending our discussions to governance issues in Europe and in emerging markets.

We finish the course by hearing about research that the students have done on governance throughout the semester. Their projects are described in more detail below.

ASSIGNMENTS AND GRADING

The grade will have four components

Participation: 20%

In order to achieve a high grade on this course, participants will need to come to class prepared and participate actively in discussions. Where the readings contain case studies, you should not only have read the case, but also have come to a point of view on the key decisions that the case describes, and thought through the governance issues that the case involves.

Quick Response Paragraphs: 20%

At least 90 minutes before class, you are required to send a short paragraph (between 5 and 10 lines) with your responses to the class readings. At least 16 such paragraphs must be submitted over the course of the term. Topics you might cover include: what you found most interesting in the readings; points made in the readings that you disagreed with; questions that the readings raised for you; issues you would particularly like to see discussed in class. These paragraphs will help to guide our class discussions, and are an important part of participating actively.

Individual Assignments: 30%

The class has two individual assignments. The first assignment – due in session 6 – requires you to look up the detailed governance requirements for either the US or another country of your choice. Based on the legal requirements for firms, you should write 2 pages on:

a. What rights do shareholders have?
b. What is the structure of the board?
c. What rights do the directors have?
d. What responsibilities do the directors have?
e. What are the responsibilities of senior management?

The second assignment, due in session 17, is a 5 page summary paper on the problems of the US corporate governance system. What do you think are the main problems that exist in the US corporate governance system? What recommendations do you have about how regulators should fix these problems?

Each of the assignments will be graded on clarity and communication as well as the contents. Writing clearly is an important skill in business. We will practice it in this class.

Team Project: 30%

The Team project should be carried out in groups of **three** or **four** students. It is an opportunity for you to get practice in researching and writing about specific firms. You will be asked to pick a topic within the first three weeks of the class, so that you can develop the project throughout the period.

Pick a firm that has interesting governance issues, and write about them. Imagine that you are writing a consulting report for a particular set of stakeholders (maybe the CEO, investors, or employees). Analyze the governance issues that the firm faces, paying attention to the interests of all of the different stakeholders. Describe the strengths and weaknesses of the governance system, and how it shapes participants' behaviour. Then make recommendations for your client.

Examples of topics could be a firm undergoing a takeover or takeover bid, an entrepreneurial firm seeking a new round of financing, a professional services firm that is going public, a firm that is hiring a new CEO or thinking of designing a new compensation package for its senior management team, or a company that is wrestling with issues of corporate social responsibility. It is important to pick real examples. That might be a firm for which there is a lot of information in the public domain, or possibly a company that one of the team members has a great deal of inside knowledge about.

You must provide me with a brief one page summary of your proposed project during session 8. Each team will then briefly present their topic and interim ideas in session 15, and answer questions from the class.

The final assignment is due in at the end of the term and should be 10-15 double-spaced sides, excluding exhibits, references etc. Each team will also make a detailed presentation of their project in the last two classes of the term. Both the write-up and the presentation will contribute to the grade. Your work will be graded on the quality and depth of your research, your analysis, and your ability to communicate your thoughts clearly and concisely.

CLASS OUTLINE AND READINGS

Part 1: Introduction

Session 1: What is Corporate Governance and Why Should You Care?

Session 2: The Corporation: A History and a Definition

Fernand Braudel (1982) "Individual Firms and Merchant Companies" in *The Wheels of Commerce,* University of California Press pp 433-450

Session 3: Understanding Ownership

Oliver Hart (1995) "Introduction" in *Firms, Contracts and Financial Structure*, Oxford University Press, pp 1-12

Henry Hansmann (1996) "Chapter 3: The Costs of Ownership" in *The Ownership of Enterprise* Belknap Harvard, pp 35-49

Session 4: The Goals of the Corporation: Shareholder Maximization

Michael Jensen (2001) "Value Maximisation, Stakeholder Theory and the Objective Function", *Journal of Applied Corporate Finance,* Vol. 14, No. 3

Joel Bakan (2001) *The Corporation,* Chapter 3, pp. 60-84

Margaret M. Blair, 1995. "Corporate Ownership," *The Brookings Review*, Winter, pp. 16-19.

Session 5: Stakeholder governance

Thomas A. Kochan and Saul A. Rubinstein, 2000. "Toward a Stakeholder Theory of the Firm: The Saturn Partnership," *Organization Science*, vol. 11, no. 4, July-August, pp.367-386.

Part 2: Understanding the Main Actors

Session 6: Boards of Directors in Theory

Jay Lorsch and Alison Watson (1993) "Praxair: Creating a Board (A)" Harvard Business School Case # 9-493-038

John Colley, Jacqueline Doyle, George Logan and Wallace Stettinius (2003). "The Legal Obligations of Directors". *Corporate Governance* McGraw Hill pp 13-31

Assignment 1 Due

Session 7: The Board of Directors in Practice

Colin Carter and Jay Lorsch (2003) "Why Boards Struggle" Chapter 2 in *Back to the Drawing Board: Designing Corporate Boards for a Complex World*, Harvard Business School Press, 2003, pp. 15-39.

Robert A.G. Monks and Neil Minow, "Directors: Monitoring", 1995, Chapter 3 in Corporate Governance

Session 8: What Do CEOs Do?

Christopher Bartlett and Meg Wozny (2000) "GE's Two-Decade Transformation: Jack Welch's Leadership," HBS case no. 9-399-150

Rakesh Khurana (2002) "The Curse of the Superstar CEO". *Harvard Business Review*, September

Project proposals due

Session 9: The Market for CEOs

Takia Mahmood and Ashish Nanda (1997) "Vermeer Technologies (A): A Company is Born." HBS Case Study No 9-397-078

Jay W. Lorsch and Rakesh Khurana (1999) "Changing Leaders: The Board's Role in CEO Succession" Harvard Business Review Article # 99308

John Markoff (2005) "Fiorina's Confrontational Tenure at Hewlett Comes to a Close." *New York Times* February 10th

Session 10: Executive Pay – Understanding Incentives

Besanko, Dranove, Stanley & Shaefer (2007) "Agency and Performance Measurement" Chapter 14 *Economics of Strategy* 454-486

Session 11: Executive Pay – A Case Study

V.G. Narayanan, "Executive Compensation at General Electric (A)", HBS Case No. 9-105-072

Jonathan D. Glater , "Stock Options are Adjusted After Many Share Prices Fall", New York Times, March 27th 2009

Louise Story, "On Wall Street, Bonuses, Not Profits, Were Real." New York Times, December 18th 2008.

Session 12: Executive Pay – Politics and Problems

Steven Kaplan (2008) "Are US CEOs Overpaid?" *Academy of Management Perspectives.* 22:5-20

Lucian Bebchuk and Jesse Fried (2004) "Have Boards Been Bargaining at Arm's Length" Chapter 2 and "The Managerial Power Perspective" Chapter 5 in *Pay without Performance: The Unfulfilled Promise of Executive Compensation.* Harvard. Pp 23-43 and pp 61-79

Session 13: When it Goes Wrong: Corporate Scandals

Robert Kaplan and David Kiron, (2004) HBS Case No. 9-104-071, "Accounting Fraud at WorldCom"

Joseph Fuller and Michael Jensen (2002) "Just Say No to Wall Street: Putting a Stop to the Earnings Game" *Journal of Applied Corporate Finance* 14 (4): 41-46

Session 14: Do Cross-National Corporate Governance Differences Matter?

Rafael La Porta, Florencio Lopez-De-Silanes, Andrei Shleifer, Robert W. Vishny (1998) "Law and Finance," *Journal of Political Economy*, Vol. 106, 6, pp. 1113-1155

Session 15: Group Assignments. Presentation of Questions and Discussion

<u>Part 3: Corporate Governance and Variation in Corporate Forms</u>

Session 16: Corporate Governance in Venture Capital and Private Equity
Michael Roberts (1998) "Walnut Venture Associates (A) and Walnut Venture Associates (D)" HBS Case 9-899-062 and 9-899-097

Julie Cresswell (2009) "Buyout Firms Profited as a Company's Debt Soared" New York Times, October 5th 2009.

Optional:

- Joe Nocera, May 30 2009 "Investor Exits and Leaves Puzzlement" www.nytimes.com
- Joe Nocera, June 1 2009 "Bill Ackman Bites Back" www.nytimes.com

Session 17: Venture Capital and Private Equity: A Case Study
Constance Bagley and Craig Dauchy (1998) "Venture Capital" From *The Entrepreneur's Guide to Business Law.*

<u>Assignment 2 due</u>

Session 18: Directors and Takeovers
Brian Hall, Christopher Rose and Guhan Subramanian (2003) "Circon (A)" HBS Case No. 9-801-403

Session 19: Investor Activism
David Stowell (2006) "McDonald's, Wendy's and Hedge Funds: Hamburger Hedging?" Kellogg Case KEL181

Leo Strine, 2009 "Why Excessive Risk Taking is Not Unexpected" www.nytimes.com "Deal Book" October 5th, 2009

Session 20: Employee Ownership
Henry Hansmann (1996) "The Benefits and Costs of Employee Ownership" Chapter 5 in *The Ownership of Enterprise* Harvard, Belknap pp66-88

Session 21: Partnerships
John Gabaro and Andrew Burtis (2006) "Bennis, Brainard & Farrell"HBS Case No. 9-495-037

Session 22: Non-Profits
Jaan Elias and Walter Salomon (1998) "Appalachian Mountain Club" HBS Case No. 9-598-066

Regina Herzlinger (1994) "Effective Oversight: A Guide for Nonprofit Directors" *Harvard Business Review*. July-August Product # 94404

Session 23: Family Business
Kacie LaChappelle and John Davis (2001) "J. Perez Foods (A)", HBS Case 9-801-147

Joan Magretta, Governing the Family-Owned Enterprise: An Interview with Finland's Krister Ahlström" Harvard Business Review, January – February 1998 pp112-123 Product # 98107

Part 4: Corporate Governance around the World

Session 24: European Corporate Governance in the Age of Globalization
Ulrich Harmuth, 2007, "Corporate Governance at Daimler Chrysler"

Session 25: Business Groups
Tarun Khanna (1997) "RPG Enterprises" HBS Case No. 9-797-106

Morck, Wolfenson and Yeung, 2005 "Corporate Governance, Economic Entrenchment and Growth" *Journal of Economic Literature.* 43: 655-720 Section 3, pages 658-669 **ONLY**

Part 5: Presentations
Sessions 26 and 27: Final Presentations of Group Projects