

Discussion of

Why Do Boards Exist? Governance Design in the Absence of Corporate Law

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What Do Boards Do?

“Given that all corporations have boards, the question of whether boards play a role cannot be answered econometrically as there is no variation in the explanatory variable”

Adams, Hermalin and Weisbach (2010)

Research Setting

At the turn of the 20th century, owners of publicly traded firms could decide:

- Whether to install a board?
- Which decision rights to give to the board (if instituted)?
 - And, which rights to delegate to management, or to the general meeting of the shareholders?

Asset Decisions

1. Purchase or sale of assets
2. Secured borrowing
3. Equity issuance
4. Liquidation



Management

Board of Directors ?

General Meeting of Shareholders

Dividend Decision

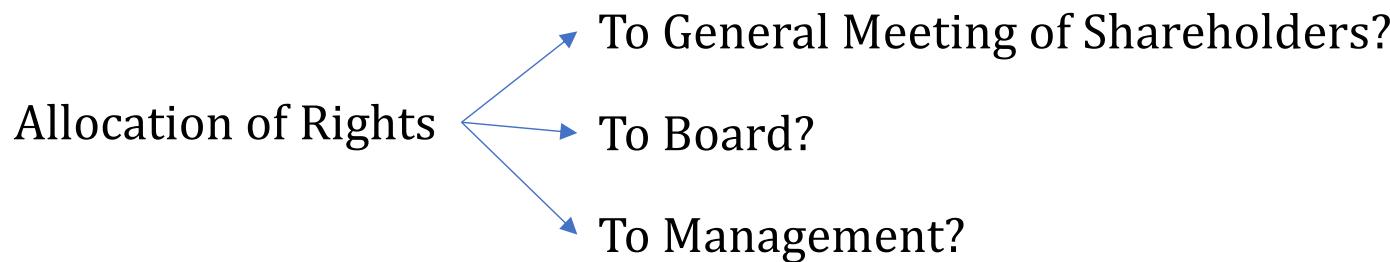
1. Dividend payments

Research Questions

- When are boards set up?
- How are decisions allocated? Who gets to make what decisions and why?

How Should We Think About These Questions?

- Boards should be set up:
 - When agency conflicts are large
 - (and monitoring on behalf of dispersed shareholder adds value).
 - When information and collective-action problems are severe
 - (and shareholders cannot directly evaluate management decisions).



What Does This Paper Do?

- Logit (or ordered logit) regressions to explain:
 - Board existence
 - Authority delegation to:
 - General Meeting (GM) of shareholders
 - Management
- Explanatory Variables
 - A proxy for collective-action problem
 - Firm characteristics
- OLS regression:
 - Board task indices on asset and dividend authority indices

What Does it Find? Board Setup

- Boards are more likely:
 - In firms with more dispersed shareholders (small-denomination).
 - Large denomination firms almost never set up a board.
 - In large firms.
 - Firms without founders in management (or named persons)

What Does it Find? Delegation of Authority

- Shareholders delegate:
 - When share denomination is small (collective action problems severe).
- Boards with authority over asset decisions are required to collect information.
- Management has more authority when managers are also shareholders (and when founder is involved).
 - When management has authority, boards provide mostly advice.

Inferences

- Collective action problems and agency conflicts play a role in decisions to set up a board and to allocate decision to corporate bodies.
- Authority is allocated to the best informed party
- Information acquisition channels are established when a body endowed with authority does not have superior information

Not to be Interpreted in a Causal Manner

- “estimates should be thought of as equilibrium relations between jointly determined variables”
- Reduces the scope of what we can infer from these results.

General Comments

- Do boards matter? Do they increase firm value?
Does firm performance improve with boards?
- Do authority allocations matter?
 - What are the efficiency implications of these decisions?
- **Change of Statutes**
 - Firms change statutes from time to time.
 - What causes these changes?
 - Are firms off-equilibrium? What are the value implications of changing statutes?

Comments: Understanding the Key Explanatory Variable

- Share denomination as a proxy for collective action problem
 - Small denomination (Share values from 100 NOK to 500 NOK)
 - Large denomination (1000 NOK to 10,000 NOK)
- Assumption:
 - Large denomination shares are presumably owned by the wealthy.
 - They have greater incentives to be informed (?)
 - Because they are wealth, they have more connections to business communities and networks, and are better informed (?)

Comments: Ownership Structure and Governance Design

- Firms with greater concentration of ownership are typically firms with:
 - Greater scope for managerial discretion.
 - Lower fixed assets to total assets ratio.
 - Investment in fixed assets are observable and more easily monitored.
 - Greater information intensity.

Comments: Ownership Structures

- Large-denomination firms (greater concentration of ownership):
 - are large
 - have fewer shares outstanding
 - tend to be older firms
 - fixed asset ratio is the same
 - overrepresented in chemical, but underrepresented in transportation, shipbuilding and telecommunication
- Some of these findings are puzzling.

Comments: Explaining Other Features of Governance Design

- Some firms have **voting caps**. Others don't.
- **Board sizes** vary from five to 24 members.
- **Meeting frequency** varies from two to four times a year.
- **Size of the management group**
- **Meeting frequency of the management group**
- Composition of boards?

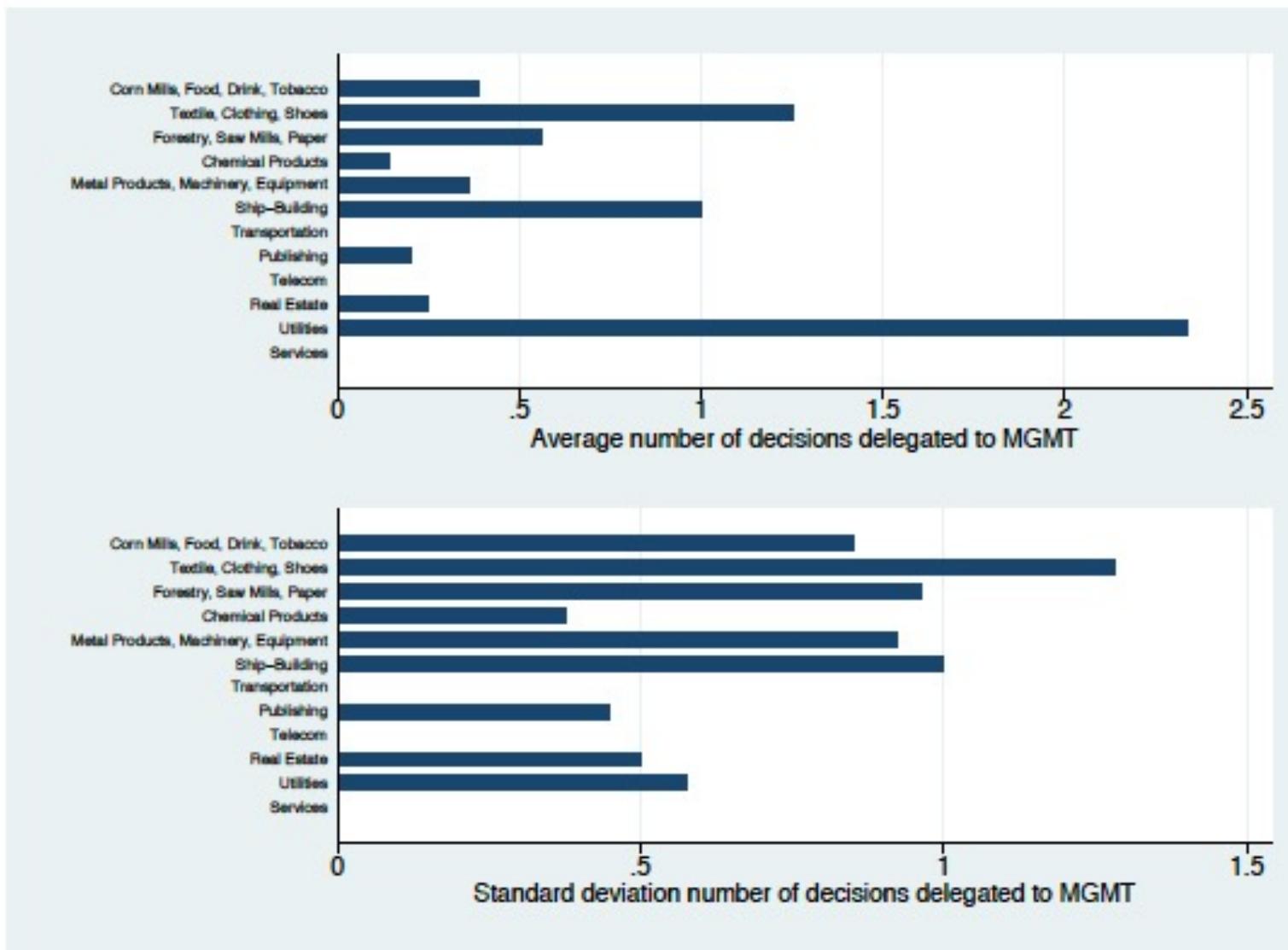
Comments: Semi-Exogenous Factors

- How do we understand firm age?
 - Are older firms less complex?
 - Older firms rely more on established and standardized production technologies. Younger firms use newer, less tested technologies.
 - More about the production technology and not about age.
 - Fixed asset ratio
 - Tangible assets are easier to monitor. Thus, we should see more delegation.
 - This paper argues that fixed assets ratio implies more frequent capital adjustments
 - Shareholders want to control decisions concerning assets (to avoid dilution).

Comments: Board Authority and Allocation of Tasks

- When management controls asset decisions, boards do not have to be informed.
 - These firms deliberately give management authority and do not impose measures for boards to become informed.
 - Why would boards not want to be informed (even if they are giving advice).

Comment: Strategic Decisions Delegated to Management



Comments: Formal Delegation to Management

- More delegation when the founder is involved in management:
 - Founder enjoys private benefits
 - Founder has expertise
- Since we cannot distinguish between the two, it is difficult to make inferences about value implications of these decisions.

Conclusions

- Extremely interesting paper. Was a great fun to read!
- Some suggestions about what else can be done.
- Perhaps adding some case studies would make it richer.