

Discussion of

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

Vidhan K. Goyal

HKUST

FIRS 2017

# 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 20<sup>th</sup> 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

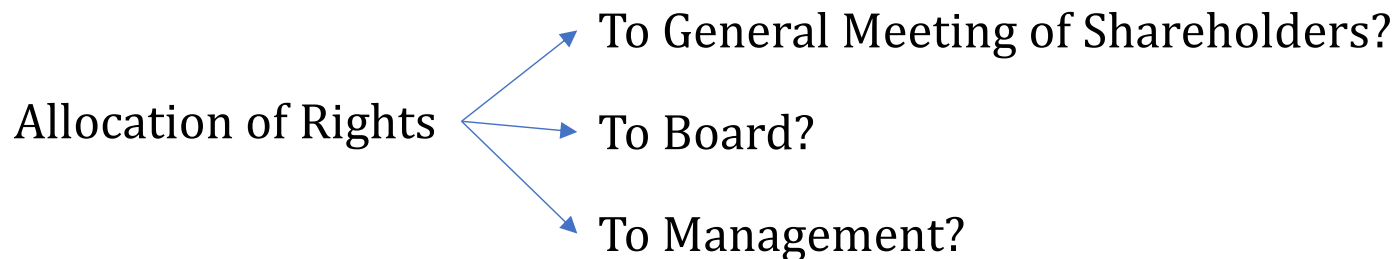
1. Dividend payments

# 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 wealthy, 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

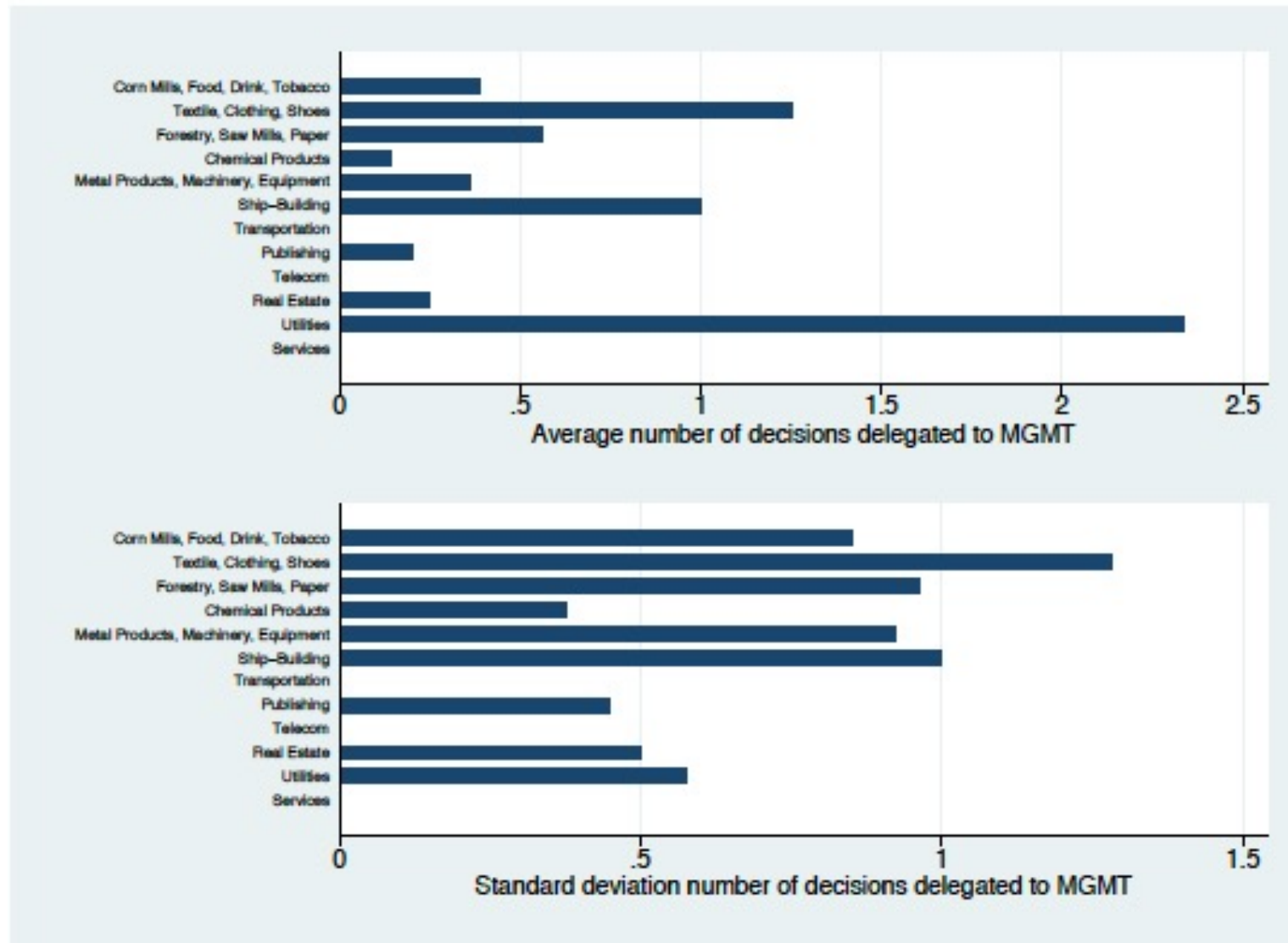
- How do we understand firm age?
  - Are older firms less complex?
    - Older firms rely more on established and standardized production technologies. Younger firms use newer, less tested technologies.
    - More about the production technology and not about age.
  - Fixed asset ratio
    - Tangible 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.