UNIVERSITÉ CÔTE D'AZUR

Corporate Governance in the 21st century

Jackie Krafft

Academia Nationale dei Lincei
Fondazione Edison
Rome, 27 October 2016

Topics of the conference

- Is it true that a new industrial revolution started?
- What are the drivers behind?
- What policies recommendations for it?

- This talk will focus on the main challenges to stimulate **investments** which involve:
  - On the **investors** side: good monitoring, less risk, good return
  - On the **managers** side: better efficiency, growth, innovation

- What could be **corporate governance** in the 21st century?

"Yes, the planet got destroyed. But for a beautiful moment in time we created a lot of value for shareholders."

State of the art

- Well governed firm or good governance

  = shareholders/investors primacy

  More of the firm's profit would come back to (the investors) as interest or dividends as opposed to being expropriated by the entrepreneur who controls the firm

- **Dominant belief**: better governance will result in higher firm value and more profitable firm performances

- **2 implications:**

  - **issue of convergence –** True there, true everywhere
  - **issue of innovation –** True for all kind of investments

Questions

- But, do we really have robust evidence ?
- Is the most recent evidence stimulating new avenues of research?
- Is there a need to update the belief?
- What are the challenges ahead both at the theoretical and empirical level?
- What are the recommendations for a corporate governance in the 21st century?

Outline

Convergence

- Inputs from theory
- Evidence

Innovation

- Inputs from theory
- Evidence

Where do we go?

Convergence

- Agency theory, transaction costs economics (Williamson, 1988), new property rights theory (Hart , 1995)

- Good governance is needed to:
  i) realign the incentives of the manager in the interests of the shareholder
  ii) guarantee high cash flow and low cost of capital
  iii) use resources more efficiently and stimulate growth

- The US model of corporate governance was elaborated to come up with these issues => it should spread all over the world both in US and non US firms

Convergence

- Stakeholder perspective (Blair, 1995); varieties of capitalism (Hall and Soskice, 2001); economics of innovation (Lazonick and O'Sullivan, 2000)
- All suggest that the adoption of the US model in firms is not leading to the best results, as country-level or firm-level differences are at work
- There is no overall 'best' system

Evidence on convergence

	Country	Nb of firms	Impact on firm performance
Gompers, Ishii, Metrick (2003)	US	1500	+
Bebchuk, Cohen, Ferell (2008)	US	1500	+
Core, Guay, Rusticus (2006)	US	1500	+
Klapper and Love (2004)	Emerging countries	374	+
Black, Jang, Kim (2006)	Korea	515	+
Drobetz, Schillhofer, Zimmermann (2004)	Germany	162	+
Beiner, Drobetz, Schmid, Zimmermann (2006)	Switzerland	~100	+
Krafft, Qu, Quatraro, Ravix (2014)	Non US (Europe, Asia, etc.)	2500	+

Is there convergence in CG?

- Convergence of non US firms towards the US best practice
- Corporate governance operates and generates more performance

- … But this does not put an endpoint to the discussion on corporate governance:

- Investigate firm level differences with more scrutiny: compare the governance of non US firms to the governance of comparable US firms
- Investigate whether the adoption of the US best practice firms may involve a greater sensitivity in performances over time

Innovation

Standard vision:

- Good governance involves better monitoring
- Creates greater transparency and public disclosure
- Generates increase in investor trust
- Produces decrease in manager discretion and rent expropriation
- Guarantees less risk
- Stimulates more efficient operations
- Is beneficial to innovation (Aghion, Van Reenen, Zingales, 2013)

Innovation

Alternative vision:

- Good governance puts a large emphasis on the interests of the shareholders as a primary goal (Hansmann, 1996)
- Shareholders and investors are mostly interested by dividends and returns on investments, not about R&D strategy which is highly uncertain (Holmstrom, 1989)
- Introduces a short-term perspective while innovation is long-term (Lazonick and O'Sullivan, 2000)

Evidence on innovation

	Country	Firms	Impact on innovation
Lhuillery (2011)	F	110	No effect on R&D
Becker-Blease (2011)	US	600	+ R&D
Lerner, Sorensen, Stromberg (2011)	US	427	- R&D + patents
Driver and Guedes (2012)	UK	91	- R&D
O'Connor and Rafferty (2012)	US	1719	+ R&D
Brossard, Lavigne, Sakinc (2013)	Europe	324	- R&D
Honoré, Munari, vanPottelsberghe (2015)	Europe	177	- R&D
Bianchini, Krafft, Quatraro, Ravix (2016)	Europe, Asia, Canada	2500	No effect on R&D - patents; - - patents of younger firms
Brav, Jiang, Ma, Tian (2016)	US	1770	- R&D + on patents

Is CG pro-innovation?

- Emerging literature on the **negative impact** of ‘good governance’
- **Distinctive impact on R&D** (input of innovation) **and patent** (output of innovation)

- Explanation: « Activist investors or blockholders can spur innovation by presurizing lazy managers »
- This has been argued by some in relation to private equity (Lerner et al. 2011) or hedge funds (Brav et al. 2016) who see such interventions as increasing patents even though they may decrease R&D
- But to argue this seems to suggest that the main problem is lazy managers who are not sufficiently utilizing the patent stock and that the generation of new knowledge is less problematic

Is CG pro-innovation?

- Emerging literature showing that the distinctive impact on R&D and patents is related with **firms age**

- Here the argument of activist investor does not hold
  - R&D is not stimulated in all firms, young and old
  - Patents are declining in all firms, and younger firms turn to be even more affected although their development depends on patenting

- Creating new perspectives:

- At a theoretical level: possible link between economics of innovation and economics of governance, and not only between agency theory and the economics of governance
- At the empirical level: ways in which innovation interacts with corporate governance

Where do we go?

Basic recommendations

- As corporate governance is negatively related to innovation performances, firms tend to privilege shorter term rather than longer term strategies
- Even more problematic if convergence operates

- Patient capital is a key issue
- Further investigation on corporate governance in high growth firms, green firms, etc.
- Data and metrics used are still highly influenced by agency theory and standard theory, and much less by innovation theory and alternative approaches
- Significant efforts should be made in that direction

Thanks!