Introduction

What is corporate governance?

Corporate governance has different meanings. Broadly speaking, the traditional perspective – developed by scholars and practitioners in Anglo-American countries – argues that corporate governance concerns the design of the board of directors and other governance mechanisms (like executive compensation or internal control systems) to address agency issues (*i.e.*, managerial opportunism) and to promote shareholder value in widely held listed companies. This book departs from that perspective and adopts a broader view of corporate governance. More precisely, it argues that corporate governance involves the design of a bundle of governance mechanisms and processes to promote a firm's value creation in the long-term. From this broad perspective, corporate governance concerns all type of companies – *e.g.*, co-operatives, family firms, state-owned enterprises, nonprofit organizations – with the sole exception of micro-businesses owned and managed by one entrepreneur.

Corporate governance is an extremely fascinating subject. It concerns both the delegation of power and the check on the use of power. On the one hand, corporate governance involves the allocation of decision-making power to the most competent actors so that they may fulfill the company's objective (*i.e.*, the common good). At the same time, it involves the design of both incentive mechanisms aimed at favoring proper behaviors of these powerful actors (*e.g.*, the CEOs), and control mechanisms aimed at monitoring if they are pursuing their personal interests at the expense of the common good. Powerful actors must be accountable, *i.e.*, they are responsible for what they do and operate under the oversight of other actors (*e.g.*, the board of directors). The accountability implies that powerful actors must both provide information about their decisions and actions, and justify them in front of who is responsible for their oversight. It also implies that who is in charge of monitoring powerful actors can sanction them when they fail to fulfill the common good.

Governance mechanisms and processes influence the most important business decisions and so contribute to determining a firm's long-term survival and performance. From a broad perspective, corporate governance mechanisms include (i) the formal norms regulating the company (*e.g.*, legal form, articles of association or of incorporation, shareholder agreements, etc.); (ii) the mechanisms through which shareholders and stakeholders participate – directly or through their representatives – in corporate governance processes (*e.g.*, the functioning and decision-making processes of the shareholders' meeting, or the composition, functioning and decision-making processes of the board of directors); (iii) the delegation of decision-making powers and responsibilities (*e.g.*, delegation of some shareholder assembly prerogatives to the board of directors, or of some board prerogatives to executive directors); (iv) the system of internal and external controls (*e.g.*, internal control systems, external auditors, media); (v) the top management and employees' remuneration system (*e.g.*, the fixed and variable compensation for top management and employees, and the distribution of risk and rewards between the firm and its stakeholders); (vi) the effectiveness of external market forces (like the market for corporate control or managerial labor market); (vii) the informal norms and culture driving people's behavior (*e.g.*, their individualism-collectivism, risk orientation, power distance), and so on. In short, corporate governance heavily affects a company's objectives, the efficiency of its value production, and the fairness of its value distribution.

Corporate governance is multifaceted because it can be analyzed from different disciplinary perspectives (*e.g.*, economics, finance, management, sociology, or law), each of which is based on specific assumptions, uses different theories, and applies specific methods of investigation. It is also multifaceted because corporate governance mechanisms should be designed coherently with a firm's and a country's specific characteristics. Key variables at the firm level include size, listing, ownership structure, industry, strategy, performance, and life cycle. Key variables at the country level include formal institutions (*i.e.*, its corporate law, financial markets law, labor law, etc.); informal institutions (*i.e.*, culture, social norms, traditions); the enforcement of both types of institutions; and the efficiency of markets (*e.g.*, for goods, services, labor, and financial resources).

Corporate governance is an ever-evolving issue. The several waves of corporate scandals and frauds, the unexpected and rapid collapse of apparently healthy and reputable companies, top managers' illegal and unethical behavior, the high compensation packages distributed to powerful CEOs, and several other events have periodically drawn the attention of the media, legislators, investors, and the public to corporate governance. As a result, after every wave of scandals or frauds, legislators and regulators enact more stringent rules and encourage companies to adopt stricter controls aimed at preventing opportunistic behavior. However, after a few years, new scandals and frauds occur which encourage regulators and policymakers to introduce more stringent or new practices aimed at addressing the open issues. In this way, corporate governance practices are continuously being redesigned and strengthened.

Corporate governance is usually identified with controls, or checks-and-balances, aimed at preventing and sanctioning illegal and unethical behaviors. But this is only half of the story. Corporate governance mechanisms can also promote entrepreneurial behavior and incentivize value creation for a firm, its stakeholders, and the society as a whole. So, it is important to adopt a more balanced and comprehensive view of corporate governance, that includes both the incentives for efficient value creation and the controls on fair value distribution. An excessive emphasis on control – *e.g.*, the continuous introduction of new mechanisms or the strengthening of existing mechanisms – may inhibit business decisions aimed at improving firms' efficiency and value creation. Moreover, while it is important to develop an appropriate legal framework protecting shareholders' and stakeholders' rights, an excessive emphasis on rules and sanctions may not fully address potential misappropriation by powerful actors. It is, therefore, important to complement regulatory activity with corporate governance education aimed at disseminating ethical principles and good governance practices among investors, directors, managers, and all other relevant actors, so as to increase the chances that they implement these principles and practices through their leadership and decisions.

What is the content of this book?

This volume is divided into two parts, each consisting of four chapters. The first part presents corporate governance issues, theories, and models; the second part analyzes corporate governance mechanisms and practices.

Each chapter in the first part addresses a relevant question in the corporate governance domain. The first chapter presents an historical overview of corporate governance issues and explains why corporate governance is attracting increasing attention from academics, investors, managers, policymakers, media, and the society in general. The second chapter presents the foundations and the implications of the two dominant perspectives on corporate governance studies (*i.e.*, the shareholder and the stakeholder theories). The third chapter describes the causes and consequences of agency problems and explains how corporate governance mechanisms can satisfactorily address them. The fourth chapter presents a framework to guide choices about strategy, ownership structure, and corporate governance, so that these three variables are internally coherent and consistent with the external environment.

The second part presents the configuration of key corporate governance mechanisms (*i.e.*, ownership structure, board of directors, executive compensation) in large listed companies around the world. The fifth chapter describes the distinctive elements of the Anglo-American, German-Japanese, Latin, and Emerging economies' governance models, and assesses their consequences for firm strategy and performance. The sixth chapter analyzes the ownership structure, focusing on its key elements and its influence on corporate governance and firm performance. The seventh chapter describes the board of directors, examining board roles and best practices for designing effective boards (*i.e.*, composition, structure, and functioning). The eighth chapter deals with top management's compensation systems, presenting their objectives, the principles that should guide their design, and the characteristics of most common stock incentive plans.

How to use this book?

We have structured this book's chapters so as to facilitate the understanding of the contents. In particular, each chapter analyzes a corporate governance topic using different tools, *i.e.*, presenting an exemplary company case study, summarizing the literature and studies on the subject, making a check list of the main points to remember, and concluding with endnotes citing references (*i.e.*, books, journal articles, reports, and videos).

The business case studies at the beginning of each chapter aim to introduce the core themes analyzed within it. They are intended to facilitate an understanding of the potential positive or negative consequences associated with some business decisions. The case studies are representative of different type of companies and governance models so as to allow students to appreciate the variety of corporate governance practices. They are also exemplary cases, *i.e.*, cases that have attracted the attention of the media and public opinion because of the large potential consequences for the stakeholders. Finally, these corporate cases have fostered a debate on how to design governance practices and, in some cases, have also promoted an evolution of legislation or good governance codes.

The core section of each chapter analyzes a key corporate governance topic. The text explains the relevance of the topic, the evolution of the debate, different viewpoints, and current practices at international level. The chapter is written with the intent of going beyond a single perspective, theory, or country's experience, and providing a framework aimed at helping readers to understand how to design better corporate governance practices.

The check list at the end of each chapter allows readers to verify their understanding of the key learning goals. This is particularly important for students attending a corporate governance course within a Bachelor or Master of Science degree program. Each chapter also includes endnotes, whose aim is to provide readers with further readings on the specific topic covered in the chapter.

Finally, thanks to the encouragement of the publisher, the book is supported by a multimedia educational platform (http://mybook.egeaonline.it) with links to videos and reports on corporate governance issues presented in the text. The videos enrich the content of the book both by presenting the point of view of authoritative scholars, businessmen, and policymakers, and by describing interesting business cases. The reports – *i.e.*, guidelines, best practices, or company reports – give substance to the main points presented in the text. While they were not originally designed for this book, they may help students to get closer to corporate governance practices, and to better understand the debate surrounding several corporate governance topics.

Acknowledgments

There are many people to whom the author wishes to express deep gratitude with regard to the discussion of the issues contained in this book.

First, I started to analyze corporate governance while I was working at Bocconi University, under the guidance and support of Giuseppe Airoldi. He played a special and relevant role, as he mentored both my degree and PhD thesis, transmitted his passion for academic life, encouraged me to critically explore corporate governance topics, and contributed to the development of my work with several stimulating discussions. I am also extremely grateful to Vittorio Coda for all fruitful discussions on corporate values and *good companies* that have recently intensified after I joined the scientific committee of ISVI (*Istituto per i Valori di Impresa*). My deepest thanks also go to Giorgio Brunetti, for our several discussions on the Italian capitalist model and its main actors.

Luckily, I had the opportunity to work with a number of excellent international scholars who helped me develop a deeper understating of global corporate governance. I am particularly indebted to Morten Huse and all colleagues involved in the *Value creating board* research program as they help me to better realize the importance of board processes and task performance. Furthermore, I greatly thank Bill Judge and all colleagues involved in the IPO research program that contributed to improving my understanding of IPO corporate governance around the world. Then, I warmly thank all scholars that supported me during the six years I was co-Editor-in-chief of *Corporate Governance: An International Review*, *i.e.*, Praveen Kumar (co-Editor-in-chief), all the Associate editors, the Screening editors, the members of both the Editorial review board and the Editorial advisory board, ad-hoc reviewers, submitters, readers, and Wiley managers. Finally, I thank all co-authors and colleagues who contributed to developing studies on the antecedents and consequences of governance mechanisms in different national settings.

A special thanks goes to all colleagues from Bocconi University and SDA Bocconi School of Management in Milan, Parthenope University in Naples, and LUISS Guido Carli University in Rome. I am also greatly indebted to all Bachelor, Master of Science, and PhD students, MBAs' and executive programs' participants whose questions and experiences allowed me to deepen my understanding of the various facets of corporate governance. From this perspective, I warmly thank all entrepreneurs and managers who commissioned me with consulting projects on corporate governance, or appointed me to the governing bodies of their companies, thus allowing me to gain real experience on how corporate governance mechanisms can support the pursuit of the company's objective (*i.e.*, the common good). Last but not least, I am really grateful to EGEA as they have published most of my books and encouraged me to write this work as well.

My sincere thanks go to all of you, while the exclusive responsibility for the shortcomings and imperfections that can characterize this work can be attributed only to its author.

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