

CORPORATE GOVERNANCE

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Spring 2010

COURSE OBJECTIVES

This course studies the relationship between the firm and its owners. Managing owners and other external stakeholders is a core part of senior leaders' job. On the other side, the firm's owners need to be able to effectively control the behavior of management if they are to protect their investments. This course aims to train students to deal with corporate governance issues from both sides of the table. Specifically, the goals of the course are to:

- Prepare students for leadership roles in firms as entrepreneurs, CEOs or senior managers. We will learn about the core issues that leaders face in managing investors and other stakeholders, and the strategies that they can pursue to manage them.
- Prepare students to manage investments in companies in Venture Capital, Private Equity or investment funds. Success in these professions requires being able to manage your relationship with the companies that you have invested in. We will learn the tools that are available to investors to run companies, and the problems that they can face.
- Educate students in the responsibilities they may face as directors of companies, and how they can be effective in these roles
- Give students an overview of how business activities fit into broader society, by discussing who should control the firm, and the goals they should pursue.

Throughout the course, I will introduce a variety of recent frameworks from organizational economics and incentive theory that we will use to analyze governance problems. While these frameworks are derived from academic research, we will focus on applying them to solve the practical problems of governing firms.

The course will involve a mixture of lectures, case analysis and guest speakers. Each class will involve extensive discussion. The best way to understand ownership and governance issues is to gain practice in grappling with them. I believe that class discussion offers the best opportunity to do this.

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.

We will then go on to explore the specific governance problems associated with a range of different kinds of firms. We start by considering the governance of large, publicly owned firms, before turning to other kinds of organizations commonly encountered by MBA graduates: partnerships; non-profits; family firms; and small entrepreneurial firms. Looking at these different kinds of firms exposes us to a wide variety of governance issues that crop up across all kinds of organizations. It also helps us understand how such ownership differences lead to differences in how firms behave.

The problems involved in controlling firms also vary widely across countries. The third part of the course examines some of the most common forms of governance found in other parts of the world: stakeholder firms, and business groups. We will examine some of the practical consequences of different national regimes for how firms are managed. We will also study how governance regimes across the world are changing.

We then move on to a consideration of corporate governance scandals. How does governance break down? What are the personal consequences for the individuals involved? What does this mean for us as managers? We then finish the course by hearing about research that the students have done on corporate governance during the course. Their projects are described in more detail below.

Description of readings and case material

The readings will take the form of case studies and articles that will be included in the course package or distributed during class. Many of the readings are required. I expect all participants to turn up to class having read these and ready to discuss them. I have also included some optional readings on the list. These readings will not be directly discussed in class. However, I strongly encourage participants to read some of these, as they will provide additional depth on some of the topics that we will study.

The Grading Scheme

The grading scheme for the course will be:

Class Participation:	30%
Individual Assignment:	30%
Team Project:	40%

Description of Assignments

Much of the learning in this class will be interactive. 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. For articles, you need to make sure that you understand the arguments, and their implications for managers.

There are two individual assignments. The first individual assignment involves your becoming familiar with the corporate governance code of the country that you come from, and summarizing its main provisions for the class. The second individual assignment asks you to describe and reflect on a governance problem that was faced by the last organization that you worked at. These assignments are designed to explore some of the most important themes to emerge in the course, and should be carried out individually.

The Team project is an opportunity for you to get a deeper grounding in a specific area of the course. It should be carried out in groups of three or four. You will be asked to pick a topic within the first two weeks of the class, so that you can develop the project throughout the period. Each team should meet with me to discuss their topic, and how they plan to address it. Where possible, we will also discuss the projects in class as they are relevant to specific issues that we are covering. The final assignment should be 10-15 double-spaced sides, excluding exhibits, references etc.

Each team will also present their project in the last session of the term, so that the different groups can learn from one another, and discuss each others' work. Both the write-up and the presentation will contribute to the grade.

You can write the project on one of the two following topics:

Topic 1: 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. Try to pick real examples. These might be a firm for which there is a lot of information in the public domain, or a company that one of the team members has worked for.

Topic 2: Pick a specific country and write about its corporate governance regime (not the US – we will discuss it enough in this class!). Imagine you are writing this memo to the government suggesting ways to improve its corporate governance regime. Outline the main elements of both its formal regulations, and the standard business practices that shape corporate governance within this country. Then go on to discuss their impact on the main stakeholders within firms. How do they affect both their rights, and their behaviour? How does the governance regime affect the costs of doing business in this country? Then make some recommendations. Describe the steps that you think the government should carry out, and make a compelling argument for your recommendations.

For both of these topics, I expect the groups to do additional research, both to build a deeper understanding of the issues involved, and to understand the particulars of the firm or country that they are studying. I can help to provide some ideas for readings on this.

In grading all of the written assignments, I will be looking for both a thorough understanding of the issues, and a clear presentation of your points. I will not grade on the basis of your written English, but rather your ability to organize and summarize an argument. Writing for business is an important skill, and these assignments should be a chance to practice it.

About Your Instructor

Matthew Bidwell studied Chemistry at Oxford, and then went on to get a Masters in Political Science at MIT as a Kennedy Scholar. He spent two years working for McKinsey and Company in London, working primarily in the energy and entertainment sectors. Matthew received a PhD in Management from the MIT Sloan School in 2004, and taught Corporate Governance at INSEAD for four years before joining Wharton.

Matthew's research applies ideas from organizational and institutional economics to understanding how firms are organized. Much of his research examines how organizations use external workers and outsourcing firms, as well as which workers choose to work as contractors rather than regular employees. He also studies how workers build careers across different kinds of firms.

OUTLINE OF SESSIONS

Part 1: Principles of Ownership and Governance

1. Overview – What is Governance and Why Does it Matter?

- Geraldine Fabrikant, 1st September 2004, “Hollinger Files Stinging Report on Ex-Officials”, The New York Times, A1
 - Francisco Guerrera and Peter Thal Larsen, 26th June 2008 “Gone by the Board”, The Financial Times.
 - “Shareholder Democracy: Battling for Corporate America.” The Economist. March 11th, 2006
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2. Who Should Govern? Shareholder Capitalism vs. Stakeholder Capitalism

- 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

For each reading

- What do you agree with?
 - What do you disagree with?
 - What would they say about the other’s arguments?
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3. The Tools of Corporate Governance Around the World

Assignment 1 Due:

1. Look up the corporate governance code of your own country, or a country that you are very familiar with. Many examples can be found on <http://www.ecgi.org/>
 2. Briefly summarize (less than two pages)
 - 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?
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4. Publicly Held Firms

- HBS Case No. 9-801-403, “Circon (A)”, Rev. December 11, 2003

Should Circon have accepted USSC’s offer?

What are the Board of Director’s responsibilities?

5. Investor Activism

- Kellogg Case KEL181 “McDonald’s, Wendy’s and Hedge Funds: Hamburger Hedging?” 2006
- Leo Strine, 2009 “Why Excessive Risk Taking is Not Unexpected” www.nytimes.com “Deal Book” 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

Should McDonald’s accept the Hedge Funds’ demands?

Do activist investors play a constructive role in corporate governance?

One page project proposals due in class

6. Executive Compensation: Getting What You Pay For?

- HBS Case No. 9-105-072, “Executive Compensation at General Electric (A)”, Rev. May 26, 2005
- “Stock Options are Adjusted After Many Share Prices Fall”, Jonathan D. Glater, New York Times, March 27th 2009
- “On Wall Street, Bonuses, Not Profits, Were Real.” Louise Story, New York Times, December 18th 2008.

Does the GE pay scheme seem effective? What problems might it cause? What are its strengths?

7. The Governance of Entrepreneurial Firms

- HBS Case No. 9-405-023, “Digitas (A)”, July 27, 2004

What are the advantages of the different kinds of ownership?
 What changes when Digitas is bought by a private equity firm?
 What changes when Digitas goes public?

8. Governance in Partnerships

John Gabarro and Andrew Burtis (2006) “Bennis, Brainard & Farrell” HBS Case No. 9-495-037

How should the bonus pool be divided among the lawyers?
 How do these discussions affect corporate governance?

9. Family Firms

- HBS Case 9-801-147, “J. Perez Foods (A)”, March 27th 2001

How does family ownership affect how Jaime Perez needs to manage Perez foods?
 How should Jaime deal with his sister Mercedes?

Assignment 2 Due

Describe a corporate governance problem faced by the last organization that you worked with. What was the cause of the problem? How would you advise the board to resolve it? You need not have personal experience of this problem. However, it should be an opportunity for you to think

10. Germany

- Ulrich Harmuth, 2007, “Corporate Governance at Daimler Chrysler”

What are the main differences between German and US corporate governance?
 Do you think the new company should be based in Germany or the US?

11. Business Groups

- Morck, Wolfenson and Yeung, 2005 “Corporate Governance, Economic Entrenchment and Growth” Journal of Economic Literature, 43: 655-720
 Section 3, pages 658-669 **ONLY**
- Tarun Khanna & Krishna Palepu, “The Right Way to Restructure Conglomerates in Emerging Markets” Harvard Business Review, July –August 1999, pp. 125-134
- Moon Ihlwan “Putting Investors First – Sometimes”, Business Week, January 24, 2005, p51
- “Creative Construction” – The Economist November 30th 2006

What issues do business groups raise for investors? Would you invest in a member of a business group?
 Why might business groups have an advantage in some countries?

12. Corporate Scandals

- HBS Case No. 9-104-071, “Accounting Fraud at WorldCom”, Rev. May 19, 2004

What caused the accounting fraud at Worldcom?
What would you have done in Betty Vinson's position?

13. Presentation of Projects
