

Challenges for Corporate Governance at the National and Firm Levels

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Abstract

This paper reviews recent literature on corporate governance at the national and firm level. On the national level, we examine topics pertinent to law and finance, financial market development and literacy, and financial regulation. Our corporate-level review features literature on boards of directors, focusing on board meetings and gender diversity. We summarize how the six papers in this special issue contribute to this literature and suggest directions for future research.

This Version: November 29, 2021

Keywords: Corporate Governance, Law and Finance, Boards of Directors, Gender Diversity

JEL Classification: G12, G14, G18, K22

1. Introduction

Corporate governance is in a state of flux. Structural shifts in the economy have changed the nature of entrepreneurial firm formation. New modes of finance have given rise to more complex governance solutions. And the international integration of firms, business, and trade, along with globally evolving cultural norms have created different needs for governance solutions. These changes spurred interest in *Corporate Governance: An International Review* hosting a special issue conference at Florida Atlantic University in late February 2020, perhaps one of the last in-person conferences held before the Covid-19 pandemic. The goal of the conference was to present and discuss research that investigates the causes and ensuing consequences of these changes. The collection of papers in this issue represent the most relevant of those presented at the conference.

A key feature of the conference and the special issue papers was to explore the risks associated with shifting governance changes and investigate their skewness effects, or “tipping points”, giving rise to success versus failure. The papers in this special issue are at the forefront of corporate governance research and suggest many novel avenues for research.

This introductory paper does not review the corporate governance literature but outlines the papers in the special issue that illustrate advances in governance research resulting from connected changes in governance needs and structures. Section 2 depicts research trends in Google Scholar on topics pertinent to the special issue, and highlights the recent massive growth in research on board diversity and alternative finance. These topics are among the collection of works in this special issue.

Corporate governance research generally fits into one of two themes. The first is national-level governance, which is sometimes referred to as public governance (Zahra, 2014). Seminal work, known widely as the “Law and Finance” literature, quantified country-level governance

standards to understand how national-level governance affects corporate outcomes such as firm valuation, dividend policy, ownership structures, liquidity, growth, access to equity financing, and new stock market listings (La Porta et al., 1997, 1998, 2000, 2006; Djankov et al., 2008). Section 3 discusses the three special issue papers that contribute to this literature on national-level governance.

The second theme is firm-level governance, which includes the role of the board of directors, activists, and concentrated ownership on firm outcomes such as fraud, growth, compensation, risk, innovation, employee welfare, and related stakeholder issues. Section 4 discusses the three special issue papers that contribute to firm-level governance. The final section offers concluding remarks and numerous suggestions for future research.

2. Trends in Governance Research

Figure 1 presents Google Scholar terms for the items pertaining to this special issue, including “law and finance,” “purpose of the corporation,” “role of corporate governance,” “corporate ownership structure,” “alternative finance,” and “board gender diversity.” The data clearly show that the two main areas of growth are board gender diversity and alternative finance. Governance research in general has increased, up 70% from 2015 to 2020, with exponential growth in gender diversity on boards (up 500%) and alternative finance (up 250%).

[Figure 1 About Here]

The increased popularity of research on gender diversity and alternative finance is perhaps understandable, for several key reasons. First, gender diversity is an issue of fairness and anti-discrimination, which is appealing on many levels since men and women bring different roles to a board (Singh et al., 2008; Terjesen et al., 2009). Second, there is mixed evidence that diversity improves board monitoring and governance, and thus financial performance. Some work shows

that performance gains associated with diversity are insignificant or tend to disappear after controlling for endogeneity, and even become negative for well-governed firms (Adams and Ferreira, 2009; Carter et al., 2010). But, other work, relying heavily on international data, find the opposite (Terjesen et al., 2016). Third, there is evidence that gender diversity positively affects innovation even after controlling for endogeneity (Cumming and Leung, 2021). This recent paper controls for endogeneity given institutional differences, such as in China, which has regional variation in female populations due to their one-child policy. Fourth, there is evidence that gender diversity on boards mitigates securities fraud—again, regardless of controls for endogeneity (Cumming et al., 2015).¹

Alternative finance includes a variety of investor types outside traditional examinations of bank (debt) finance and equity investment in publicly traded companies. This line of inquiry examines venture capital, private equity, hedge funds, and new forms of finance made possible by financial innovations such as equity and debt crowdfunding. Venture capital, private equity, and hedge fund investors are typically viewed as performing more intensive screening and monitoring roles, as well as adding value to their investees. Equity and debt crowdfunding investors likewise play unique governance roles depending on the design of the platform and the structure of the investment contracts offered to the crowd (Cumming and Johan, 2019; Cumming, Johan, and Reardon, 2021). Crowdfunding has grown rapidly in recent years, from \$23 million in 2016 to \$244 million in 2020 in the U.S.,² and from £272 million in 2016 to £549 million in 2020 in the U.K.³ (Cumming, Johan, and Reardon, 2021). The rise in crowdfunding research matches the

¹ Research on diversity and fraud is growing, with consistent evidence revealed in both China and the U.S. But there are other ways of measuring diversity and other board member characteristics. For example, new research shows that scant director experience is associated with less fraud (Bai and Wu, 2021). More work examining different director characteristics and board composition in relation to fraud and other corporate outcomes is warranted.

² <https://business.fau.edu/equity-crowdfunding-tracker/>

³ <https://www.jbs.cam.ac.uk/wp-content/uploads/2021/06/ccaf-2021-06-report-2nd-global-alternative-finance-benchmarking-study-report.pdf>. In comparison, the U.K. venture capital market was only £272 million in 2016.

growing importance of the asset class for the industry and reflects a growing academic interest in the role of alternative finance in corporate governance.

The next section discusses work on gender diversity and alternative finance, as well as other areas in governance presented in this special issue. We focus first on national-level governance indicators, followed by firm-level governance analyses.

3. National-Level Governance Indicators

Empirical evidence shows that national-level governance through legal standards offers corporate governance solutions that are important to economic growth and to investors (La Porta et al. (1997, 1998, 2000, 2006). In this special issue, Bhagat and Hubbard (2021) summarize this empirical literature on the role of “law and finance” in corporate governance. The rule of law protects property rights to minimize investment risks, thereby generating greater investment in human capital, physical capital, and innovation, and fostering economic growth. More specifically, a number of empirical measures pertinent to, e.g., protecting minority shareholder rights, enforcing contracts, and the efficiency of the judiciary, are available on a time series and cross-country basis at the World Bank’s [doingbusiness.org](https://www.doingbusiness.org) dataset.

Bhagat and Hubbard (2021) discuss the current debates among policymakers, corporate leaders, institutional investors, and social activists on the purpose of the modern corporation. Should the modern corporation be accountable to shareholders only, or to a broader set of stakeholders, including employees, customers, and society at large, through ESG (environmental, social, and governance) measures? One concern about being accountable to everyone, however, is that you end up being accountable to no one. Bhagat and Hubbard (2021) review the evidence and

arguments in this debate and conclude that the modern corporation should maximize long-term shareholder value, while conforming to the law of the land.

[Table 1 About Here]

International comparisons of regulations bring an important understanding of the general factors that affect entrepreneurship, innovation, and economic growth. But, for some countries, such comparisons do not directly address the central issues germane to their specific institutional structures. Korea, for example, features unique pyramidal ownership structures called “chaebols. Recent regulatory changes aim to improve governance among firms at the bottom of the pyramid. Choi, Choi, Gam, and Shin (2021) examine one such change, and find significant improvements in research and development among these firms.

The idea that national-level governance directly enables improved financial outcomes depends on the critical assumption of an educated society. However, in many countries around the world, even developed countries, financial literacy rates are extremely low. Cumming and Johan (2020) present evidence that financial literacy and fintech usage are highly positively correlated (76% Pearson correlation coefficient). Their regression analysis shows that financial literacy explains over 57% of the variation in fintech usage.

In this special issue, Meoli, Rossi, and Vismara (2021) show that financial literacy is critical for successful fintech adoption in the case of crowdfunding. This important evidence adds to the empirical body of work on other factors that have been examined in fintech (Allen et al., 2021), crowdfunding (Rossi et al., 2021; Coakley and Lazos, 2021), and initial coin offerings (Philippi et al., 2021). Prior research has not examined how financial literacy ties to the adoption and success

of fintech across countries. Policy efforts to improve access to capital could be directed towards improving financial education and literacy.

4. Firm-Level Governance Through Boards

A large, established literature studies boards of directors. But, until recently, we had limited information on what actually goes on inside boardrooms due to the confidential nature of the discussions. In this issue, Bonini, Brogi, and Lagasio (2021) introduce a new dataset that shows boards' inner operations based on a long history of board meeting minutes. Their analyses shed light on effective and ineffective governance mechanisms. They also note delays of release of pertinent information to the market, and conjecture that these delays could be associated with insider trading.

Research shows that diversity is an important avenue through which boards may operate with improved governance. Diverse boards potentially bring more ethical oversight, and a richer set of perspectives through which corporate monitoring and decision-making can become more effective. In this special issue, two new articles show that diverse boards affect acquisitions (Askarzadeh, Islam, Modhaddam, and Guldiken, 2021) and improve ethical conduct (Turrent, 2021). In particular, Askarzadeh et al. (2021) show that boards with more females are associated with lower levels of ownership in foreign acquisitions and tend to undertake less risky actions in the context of acquisitions. Turrent (2021) shows that female representation on boards improves transparency with respect to ethics and conflicts of interest. Gender-diverse boards are also more likely to institute ethical codes of conduct and promote a stakeholder orientation.

5. Conclusions and Suggestions for Future Work

This introduction outlines two separate streams of recent research on corporate governance. The first stream examines the role of the rule of law, alongside financial development and financial literacy, and national rules in fostering improved corporate governance. The work in this issue shows that the rule of law is critical for the functioning of the modern corporation and economic prosperity around the globe (Bhagat and Hubbard, 2021). The work in this issue also shows that financial literacy is an essential element in entrepreneurs' ability to make use of new developments in financial technology (Meoli et al., 2021). Further, the work in this issue suggests that there is a strong role for national laws in curtailing agency costs with certain ownership structures (Choi et al., 2021). The second stream reviews work on boards of directors. The work on boards reported in this issue advances the literature by examining board minutes in detail (Bonini et al., 2021), the role of board diversity in reducing the risks of foreign acquisitions (Askarzadeh et al., 2021), and improving ethical conduct and transparency (Turrent, 2021).

Future scholarship could highlight two areas that would push the development of the literature even further: 1) governance in extreme institutional environments, and 2) the intersection of firm-level governance mechanisms and national-level governance standards. Regarding extreme institutional environments, in cross-country scholarship, there is a tendency to treat differences across countries along linear dimensions. But, in practice—in extreme institutional environments, for example—it is possible to find very unusual corporate governance practices with implications that do not fit standard cross-country analyses (Cumming, Girardone, and Sliwa, 2021). For example, stewardship codes promote economic growth and sustainability in certain extreme environments (Klettner, 2021), but in other contexts there is a dearth of compliance (Shaw et al., 2021). In the banking sector, there have been differences across countries in regulatory reforms intended to foster stability and cost efficiency (Ayadi et al., 2021). Governance consequences vary

in different political environments for environmental policies (Gaganis et al., 2021) and for policy changes, even in developed countries like the U.S., with the rise of right-wing populism (Bedendo and Siming, 2021). There are numerous unanswered questions arising from such research. What are the determinants or forces behind the emergence and evolutions of these extreme environments? What combinations of factors drive them? Are corporate governance practices or regulatory reforms simple responses to a particular situation that end up precluding other more effective responses? How can we assess their efficiency against other alternatives? Can such responses be transplanted to other markets or countries? Or are they unique and very specific? What lessons do we learn from them? There is much work to be done.

Future work could explore the intersection of firm-level and national-level corporate governance further. For example, do boards play an equal role in mitigating risk-taking and misconduct in different legal, religious, and cultural settings? Consider five examples.

First, in this issue, Turrent (2021) shows that females on boards are more likely to play a role in promoting a stakeholder orientation of a firm and reducing risk-taking, while Bhagat and Hubbard (2021) argue, based on national-level comparisons, that societies are better off if firms pursue a shareholder orientation. Similarly, risk-taking on boards is mitigated by religiosity (Mollah et al., 2021). To this end, more work should be done to understand whether firm-level governance mechanisms are consistent with national-level governance mechanisms, and whether they are complements or substitutes. This work could further reflect on what societal aims should be with respect to shareholder and stakeholder outcomes in promoting innovation and economic growth in a sustainable world. For example, should we design national-level regulations to bring

about changes in the governance practices of firms to adopt stakeholder orientations (such as those observed with select regulations in Europe) (e.g., Bianchini and Croce, 2022)?

Second, with this issue we observe concerns about pyramidal ownership structures (Choi et al., 2021), and we see that specific regulations are effective at curtailing agency issues with ownership (Choi et al., 2021; Bhagat and Hubbard, 2021). National-level regulations, however, are not the only way in which public policy can improve the relations among ownership, innovation, and economic growth. For example, governmental bodies can take direct ownership stakes in companies, which may help stabilize firm outcomes and a country's overall financial system (Boubakri et al., 2021; Chen et al., 2021). Future work could directly compare the legal and institutional mechanisms that promote private ownership versus the role of the state in corporate ownership, so that we better understand the effectiveness of different ownership structures in different institutional environments around the world.

Third, the evidence in this issue shows that gender diversity plays a role in promoting firm stability and ethical outcomes (Askarzadeh et al., 2021; Turrent, 2021). Recent work more directly examines corporate culture within a firm (Zhang, 2022) and national culture (Mourouzidou-Damtsa et al., 2019). In which corporate culture or national culture settings is gender diversity most effective? More research could be directed toward understanding how national institutions intersect and operate in conjunction with, or against, corporate culture and governance solutions associated with diversity. This evidence could further inform the literature on the extent to which corporate culture can substitute for extremely weak regulatory institutions in promoting innovation outcomes (e.g., Wang et al., 2021) and internationalization (e.g., Puthusserry et al., 2021).

Fourth, while this issue offers a wealth of research on national-level governance standards (Bhagat and Hubbard, 2021), there is less evidence on compliance with these standards. More work could be done to understand the degree of compliance with corporate governance and ethical

practices in different institutional settings (Fotaki et al., 2021). It could also examine whether compliance or over-compliance has different implications for more innovative new technology firms in various countries.

Fifth, there is evidence that female directors play an important role in mitigating firm risk and promoting ethical conduct and disclosure (Askarzadeh et al., 2021; Turrent, 2021). But we know less about their roles in different institutional environments. Diverse boards can serve to protect minority shareholders in certain weak institutional environments (Herdhayinta et al., 2021). Evidence also shows that external financing for entrepreneurs in weak institutional environments can lead to a comparatively smaller presence of women (Johan and Valenzuela, 2021). Future research could better determine when a female presence on boards serves as complement versus substitute for weak institutional environments around the world.

Overall, this special issue brings many new insights into national-and firm-level corporate governance practices and outcomes. We hope the papers inspire future researchers to think critically about these topics and to engage in more innovative theoretical and empirical analyses of corporate governance worldwide.

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Figure 1. Google Scholar Hits on Various Search Terms for Modern Corporation and Corporate Governance Issues

This figure shows the number of Google Scholar hits on the search terms "law and finance" (base in 2015 is 2,180), "purpose of the corporation" (base 817), "role of corporate governance" (base 489), "corporate ownership structure" (base 461), "alternative finance" (base 274), and "board gender diversity" (base 259). The base numbers in 2015 are indexed to 100 for comparability.

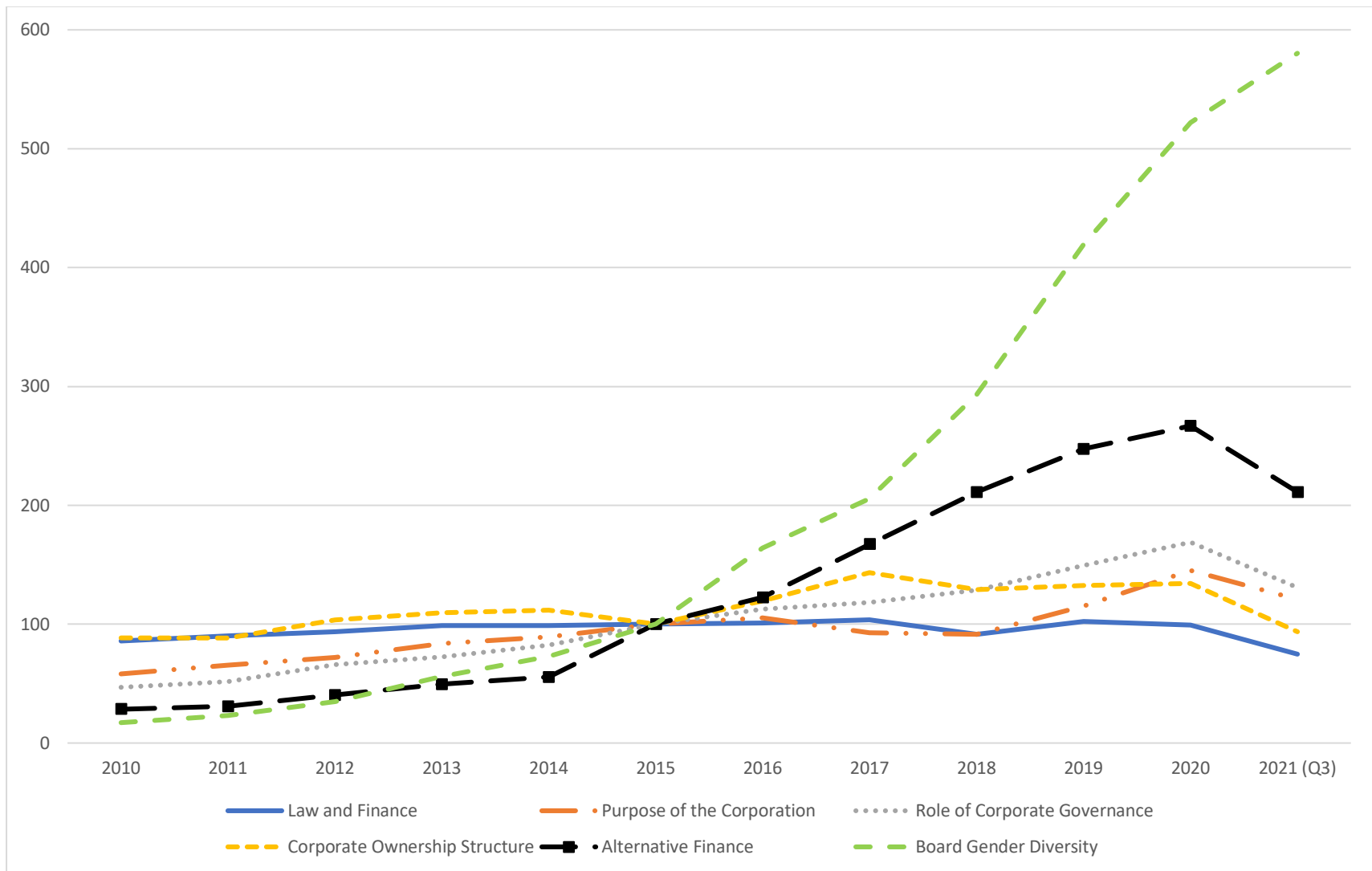


Table 1. Overview of Studies on 21st Century Challenges for Corporate Governance

This table summarizes various papers on the new challenges for corporate governance of firms. The findings are largely paraphrased and/or copied from the abstracts in order to succinctly represent the authors' contributions, but are not meant to exhaustively represent all of the findings from the papers.

Title	Authors	Section	Data	Abstract
Rule of law and purpose of the corporation	Sanjai Bhagat Glenn Hubbard	The modern corporation	The authors utilize multiple datasets representing 134 countries for the period 1984–2019. GDP per capita (GDPPC) comes from the International Monetary Fund (2019), World Economic Outlook Database. Data on Rule of Law come from Worldwide Governance Indicators (2019) Update. An alternative law and order (LAW) index focused on their assessment of the strength and impartiality of the legal system and the popular observance of the law on country governance variables is obtained from PRS Group's International Country Risk Guide (ICRG) (2020). The GINI index constructed by The World Bank (2020) measures income inequality	The authors provide empirical evidence on the role of the rule of law in enhancing economic prosperity and diminishing income inequality across the globe. They draw on the law and finance literature and the finance and growth literature to highlight how the rule of law can enable corporations to be the main drivers of a country's economic growth. Specifically, the rule of law is necessary for a citizenry's belief in secure private property rights, which confers the confidence to invest in physical capital, human capital, and innovation—the three catalysts of economic growth. It also allows for an effective judiciary that can enforce legal contracts. Shareholder reliance on limited liability and debtholder rights originates from the legal contracts among shareholders, debtholders, and other stakeholders. This highlights the importance of the rule of law in enabling companies to raise equity and debt financing, leading to financial development. Given this background on the role of the rule of law in the issuance of equity capital to provide financial resources to corporations, the authors analyze the current debate among policymakers, corporate leaders, institutional investors, and social activists on the purpose of the modern corporation. They conclude that the modern corporation should maximize long-term shareholder value, while conforming to the law of the land.

Financial literacy and security-based crowdfunding	Michele Meoli Alice Rossi Silvio Vismara	Alternative finance	Sample of 432 security-based crowdfunding platforms working under an all-or-nothing model launched between 2007 and 2019 in the 37 OECD countries. The authors analyze each security-based platform identified from crowdfunding national registries, examine all national crowdfunding-related associations and members' lists, and review reports focused on crowdfunding in one or more of the OECD countries.	The authors investigate the relationship between financial literacy and the survival profile of the security-based crowdfunding platforms. Security-based crowdfunding has recently emerged as a novel market that allows small investors to engage directly in financing entrepreneurial ventures. However, a certain level of financial literacy is required to understand and manage these digital finance tools effectively. A better understanding of the impact of financial literacy is, therefore, central to the development of these markets and the achievement of their inclusive potential. The authors find higher platform survival profiles where the level of financial literacy is high. Financial literacy, however, needs to combine with specific platform characteristics to take full effect, as it matters more to those platforms that deliver voting rights and provide poorer value-added services to crowdfunding investors.
R&D Investment Decisions in Business Groups: Evidence from a Natural Experiment	Daewoung Choi Seungho Choi Yong Kyu Gam Hojong Shin	Ownership structure	Sample of 1,179 firm-year observations (353 unique firms) from the 24 largest Korean chaebols from 1998 to 2004. The authors utilize detailed information on founding families' ownership to identify the chaebols' pyramidal ownership structure.	The authors examine R&D investment decisions in firms under a pyramidal ownership structure. They use the Monopoly Regulation and Fair Trade Act, which places limits on group affiliates' equity investments, to provide new evidence that controlling owners tend to increase long-term R&D expenditures in firms that are largely subject to the equity investment regulation. This result is more significant for firms where owners have low cash-flow rights, firms located in the lower layers of the pyramid, and firms that hold fewer equity shares than do other group affiliates.
Board meetings dynamics and information diffusion	Stefano Bonini Marina Brogi Valentina Lagasio	Board governance	Sample of 884 board meetings' minutes from 2004 to 2016. The authors exploit a unique regulatory requirement of the Italian Stock Exchange that mandates publication of board meeting minutes when the board votes on "price sensitive" matters to analyze detailed data about directors' participation, discussions, voting, and the dissemination of their decisions to the market.	Using a large, multi-year sample of board meetings' minutes, the authors highlight previously unavailable patterns of board meetings participation and discussion, and the moderating role of key governance mechanisms that shed novel light on board effectiveness. Looking at the economic value of board meetings, the authors document significant delays in the diffusion of information in the market that may be indicative of information leakage.

<p>The Effect of Female Board Representation on the Level of Ownership in Foreign Acquisitions: New Insights for Corporate Governance in the 21st Century</p>	<p>Fatemeh Askarzadeh Habib A Islam Kaveh Moghaddam Victoria Orhun Guldiken</p>	<p>Board governance</p>	<p>Sample of 1,118 firm-year observations comprising 447 acquirers from 48 countries engaged in acquisitions in 72 countries, as extracted from the Thomson One M&A database. The authors use all reported cross-border acquisitions undertaken by publicly traded companies from 1997 to 2016. Additional data from the COMPUSTAT and World Bank databases are collected to operationalize the moderator and control variables.</p>	<p>How female representation on corporate boards affects firm outcomes that have significant implications for stakeholders is a major corporate governance issue. The authors examine the effect that female representation on acquirers' boards has on the level of ownership in foreign acquisitions. They find that greater female representation on acquiring firms' boards is associated with lower levels of ownership in foreign acquisitions. In addition, only firms with a critical mass of three or more women on the board prefer low ownership. Institutional distance between home and host countries tends to magnify these relationships. The authors' findings support their arguments that female directors prefer different types of risk than their male counterparts, which drives choices about the appropriate level of ownership.</p>
<p>Board Gender Diversity and Corporate Ethical Behavior in Latin American Emerging Countries</p>	<p>Guadalupe Briano Turrent</p>	<p>Board governance</p>	<p>Sample of 1,285 year-observations of companies in the most liquid stock indices of Argentina (Merval), Brazil (IBovespa), Chile (IPSA), and Mexico (IPyC), from 2004 to 2014. Information related to board composition and corporate governance was manually collected from annual reports and corporate web sites for selected companies. Financial variables were obtained from the COMPUSTAT database.</p>	<p>The authors seek to determine whether female representation on a board enhances corporate ethics performance. Focusing on the ethics of care theory and critical mass theory, they highlight the relevance of gender diversity to strengthen corporate ethical governance. Research Findings/Insights: Using different GMM estimators and Logit regressions, they reveal a positive effect of female representation in boardrooms over boards' ethical functioning, transparency on ethics and conflicts of interest, adoption of ethical codes, and promotion of a stakeholder orientation. Moreover, they report a greater effect in some ethical dimensions when women on the board make up a critical mass of two or three.</p>