



Preface

The dynamics of corporate governance: Changes in contractual relations

This special issue of the *Journal of Corporate Finance* presents papers from the Symposium on Contractual Corporate Governance held at the University of Sheffield on June 22, 2007. The *JCF* has found that the publication of special issues, focused on a single topic, is beneficial to both its readers and authors. By concentrating similar-topic papers in a single issue, readers are able to study several related papers without searching through reference lists. Authors benefit from additional exposure of their work by being linked with other papers in the area. Researchers who are experts in the area are invited to be guest editors of many of these special issues. As editors, we believe that working with the guest editors gives us new perspectives on issues that are timely and important to our readership. In addition, if the special issue is affiliated with a conference or symposium, as was this one, all participants benefit from the opportunity to interact in a comfortable environment with much give-and-take about research and other topics of interest.

The special issue begins with an overview paper by guest editors [Goergen et al. \(2008-this issue\)](#). In this paper, they develop the theme of the special issue – how can corporate contractual devices such as cross-border mergers and acquisitions, (re-)in corporations and cross-listing on multiple exchanges affect the characteristics of corporate governance within firms and across industries. The analysis draws from the long-standing discussion of the market for regulation as typified by [Cary \(1974\)](#), [Romano \(1985\)](#), [Bebchuk \(1992\)](#) among (many) others. Much of the earlier analysis focused on the “race for the bottom” with state competition for corporate charters leading to the prospect of the easing of standards. Thus, a debate arose of whether there was a need for federal pre-emption of state laws to protect investors. In today’s environment, corporations are able to choose readily from a global slate of incorporation, listing, accounting and governance standards, and enforcement environments. The dynamics of this market for governance is an important consideration in global firm decision making.¹ This special issue investigates many of these alternatives and the impact they have on corporate governance, shareholder wealth, creditor rights, and merger and acquisition decisions.

Goergen and Renneboog focus on the significance of cross-border M&A, (re-) incorporations and cross-listings, as indicated above, as do several of the papers in the issue. [Martynova and Renneboog \(2008-this issue\)](#), for example, consider the impact of differences between bidder and target corporate governance standards, as measured by newly developed country indices. They find that when the bidder is from a country with stronger shareholder protection than the target, both bidder and target shareholders experience greater wealth benefits from a takeover than otherwise. This finding extends to partial acquisitions, also. As found by [Doidge et al. \(2007\)](#), it cannot be ignored that these governance indices also reflect important information about the underlying country characteristics. [Bris et al. \(2008-this issue\)](#) extend this analysis to show that acquisitions where the target firm imports the better corporate governance system of the acquiring company can have positive spillover effects to the target firm’s industry. For a sample covering 41 countries and 39 industries from 1990 through 2001, they find that the Tobin’s Q of other firms in the industry improves when a target is acquired by a firm coming from a country with better shareholder protection and better accounting standards. These papers offer unique contributions to cross-border M&A literature through the development of innovative governance indices and through analysis of the transfer of governance standards to firms not directly involved in takeover activity.

In the U.S., reincorporations into Delaware have been studied extensively. The empirical evidence (beginning with [Dodd and Leftwich, 1980](#), followed by others such as [Romano, 1985](#) and [Netter and Poulsen, 1989](#)) in general reports positive shareholder wealth reactions at the announcement of reincorporations into Delaware suggesting that firms benefit from the well-defined structure of Delaware’s laws and the greater certainty it gives to firms regarding contractual relations (see [Romano, 1998](#), p. 364 for an excellent overview of the competition for state law). [Bebchuk and Cohen \(2003\)](#), however, argue that the importance of

¹ [Wintoki et al. \(2008\)](#) explore methodological considerations in the analysis of dynamic corporate financial decisions.

Delaware has declined recently as other states have adopted corporate laws that offer attractive alternative contracting environments.

The analogy in the context of international incorporations is investigated by [Becht et al. \(2008-this issue\)](#). In 1999, the European Court of Justice adopted the concept that firms operating in one Member State of the EU are free to do business in any other Member State and confirmed the decision in a 2003 appeal involving Inspire Art Ltd, a company incorporated in England while operating entirely in the Netherlands. The cross-border incorporation allowed Inspire Art Ltd to circumvent Dutch minimum capital requirements. Becht, Mayer and Wagner report that almost 700 firms per year from 2003 through 2006 incorporated in the UK without any operational activity there and suggest that many of the UK incorporations were driven by minimum capital requirements and costs of incorporation in other EU Member States. Most of the incorporations represent small entrepreneurial firms incorporating for the first time. Becht, Mayer and Wagner also report a move by some Member States, such as Germany and the Netherlands, to match the UK's less strict listing requirements. The question remains, however, whether larger public firms would also benefit from the differences in UK corporation laws. At this time, it does not seem that the "race for the bottom" is driving incorporations into the UK for firms that need legal environments more closely tied to the location of their operations or that satisfy the complexity of the needs of larger firms.

An alternative means to adopt governance standards is to cross-list on an exchange with its own listing guidelines. [Abdallah and Goergen \(2008-this issue\)](#) report that in addition to providing access to capital and a broader shareholder base, corporations that cross-list on exchanges in other countries benefit from better shareholder protection. In particular, they find that the control structure within firms prior to cross-listing helps determine the location of the cross-listing. Companies with concentrated control and with substantial private benefits of control are more likely to cross-list on markets with better investor protection. The importance of access to alternative capital markets seems to be an important factor in the decision; firms where minority shareholders are more likely to have their wealth expropriated, firms that need substantial access to capital and higher risk firms are all more likely to cross-list on exchanges with better investor protection.

The papers in the special issue described above consider how corporate governance characteristics and standards may be affected through cross-country movement, whether through M&A, decisions on the location of incorporation, or cross-listing decisions. Several of the papers in the special issue provide additional perspective on governance within single countries. [Bhagat and Bolton \(2008-this issue\)](#) provide important insights on both the relation between governance characteristics and firm performance, and on the appropriate methodological approach to this question. They find that firm performance is positively related to better governance, as measured through operating performance. They cannot confirm the finding of earlier researchers that future stock market performance is related to governance measures and note that their finding is consistent with efficient markets.² Important to their analysis is the careful consideration of the endogeneity of performance, managerial turnover and measures of governance. They also provide analysis of several alternative measures of governance and suggest that a measure such as the monetary value of the holdings of board members provides a consistent and readily observed alternative to the more complex indices.

[Guo et al. \(2008-this issue\)](#) and [Andres and Theissen \(2008-this issue\)](#) consider two specific governance choices – "destaggering" a classified board and the German comply-or-explain principle, respectively. Guo et al. report that firms that destagger their board experience a positive share price reaction at the announcement that they will do so, especially if the change is implemented quickly, and are more likely to experience significant restructuring in the period following the change. They also find that firms that are subject to more stringent shareholder activism are more likely to destagger their boards. Andres and Theissen describe the comply-or-explain principle as a developing feature of the German Corporate Governance Code. Initially adopted in 2002, the Code suggested that firms disclose the remuneration of the members of the executive board on an individual basis or explain why they refuse to do so. Given the remarkable number of firms that did not adopt the suggestion, a law was passed that mandated that firms after 2006 must disclose the information unless 75% of shareholders vote otherwise. Even after the strictest form of the law was adopted, approximately 30% of the firms still chose to opt-out of the disclosure recommendation. Andres and Theissen found that the opt-out firms were characterized by relatively high pay and relatively low minority shareholder protections. They argue that further revisions of the law would be needed to provide more transparency in these cases.

Overall, the papers in the special issue provide evidence that governance is a dynamic interaction among the control forces of internal governance and the external standards of the legal environment. An important part of the dynamics is mobility of the firm and evolving governance mechanisms at the firm and state, federal and international level. These dynamic changes often lead to improvements in the wealth of shareholders and other stakeholders. While M&A has traditionally received the most emphasis as the catalyst for change in corporate governance, the articles presented here highlight ways in which firms or their stakeholders can move firms to standards that result in higher value. The importance of cross-border alternatives also emphasizes the need to move our corporate governance research to incorporate this global perspective.

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² Interestingly, [Renneboog et al. \(2008-this issue\)](#) confirm that socially responsible funds, that include corporate governance considerations in their selection of stocks, do not earn risk-adjusted excess returns, again lending support to the efficient market hypothesis.

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