

Contractual Governance in the Absence of Law: Bylaws of Norwegian Firms in the Early 20th Century

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Motivation

How would firms design structure of governance if no legal constraints?

- How allocate formal authority on owners/board/manager?
- Today formal authority often decided by statutory law
 - ▶ BoD has authority over major corporate decisions (DE law)
 - ▶ BoD doesn't necessarily take decision
- Theory does not offer easily testable predictions (e.g. Aghion&Tirole JPE 1997)

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Our paper

Authority allocation in a “free contracting environment”

- Prior to 1910, Norway had no corporate law
- Free private right to found companies and write bylaws
- Norway had well-functioning legal system
 - ▶ Law of obligations (contracts)
 - ▶ Limited liability and entity shielding recognized by courts
 - ▶ Bylaws were enforceable private contracts
 - Breaches of bylaws brought before the courts

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What we do

Cross-section of 85 bylaws of (curb) traded industrial firms around year 1900

- Hand-code individual bylaw provisions
- Stock prices, equity capital, share size, dividends
- Only few shareholder lists

Equilibrium relations btwn authority structure and firm characteristics

- Governance is endogenous
- Estimates cannot be given causal interpretation

Split the sample

- Likelihood of retail investors

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Relations to literature

Authority in organizations

- Aghion&Tirole (JPE 1997); Burkart, Gromb&Panunzi (QJE 1997); Baker, Gibbons&Murphy (JLEO 1999)

Statutory law and “good” governance

- LLSV (JF 1997, JPE 1998, JF 2000); Coffee (WP 2000); Cheffins (WLLR 2006); Musacchio (BHR 2008); Franks, Mayer&Rossi (RFS 2009)

Theory of boards

- Adams, Hermalin&Weisbach (JEL 2010)

Bylaws typically outline things like...

- Value of paid-in equity and nominal size of shares
- Rules for transferring ownership, issuance of new shares
- Authority and duties of particular constituencies
 - ▶ Is there a Board of Directors, a Board of Representatives?
 - ▶ Who appoints directors and representatives
 - ▶ Size, duties of board(s)
 - ▶ Who hires officers/clerks/auditor, decides salary, bonus of directors
- General meeting
- Release of information to shareholders
- Liquidation, issuance of debt, dividends

First observations

Three main governance bodies

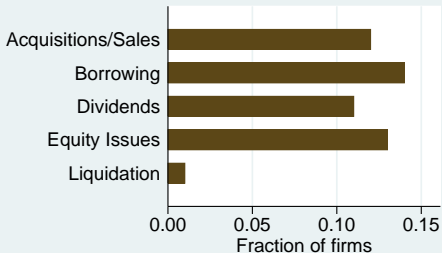
- Board of Directors
- Board of Representatives (26%)
- General Meeting

BoD has character of a management board

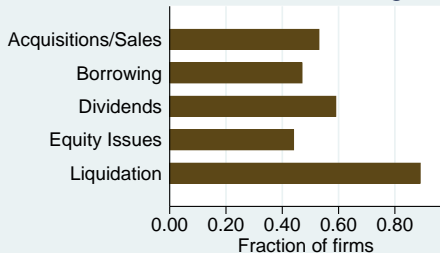
- Common at this time

Allocation of Authority Over Asset Decisions

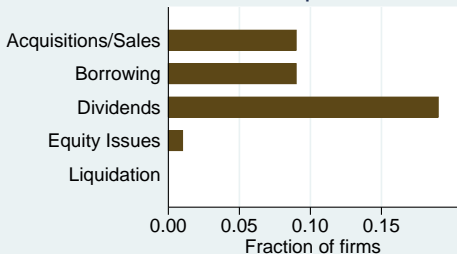
Board of Directors



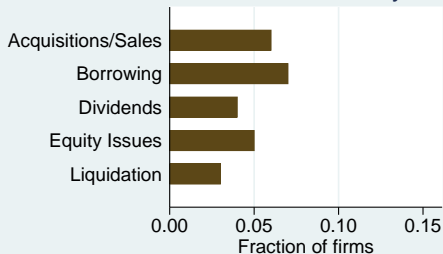
General Meeting



Board of Representatives

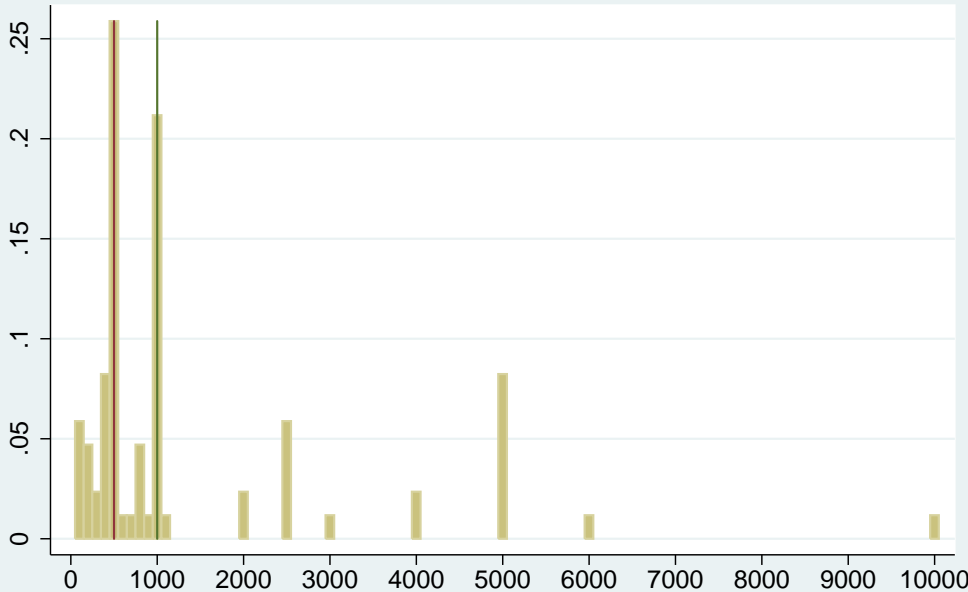


Shared Authority

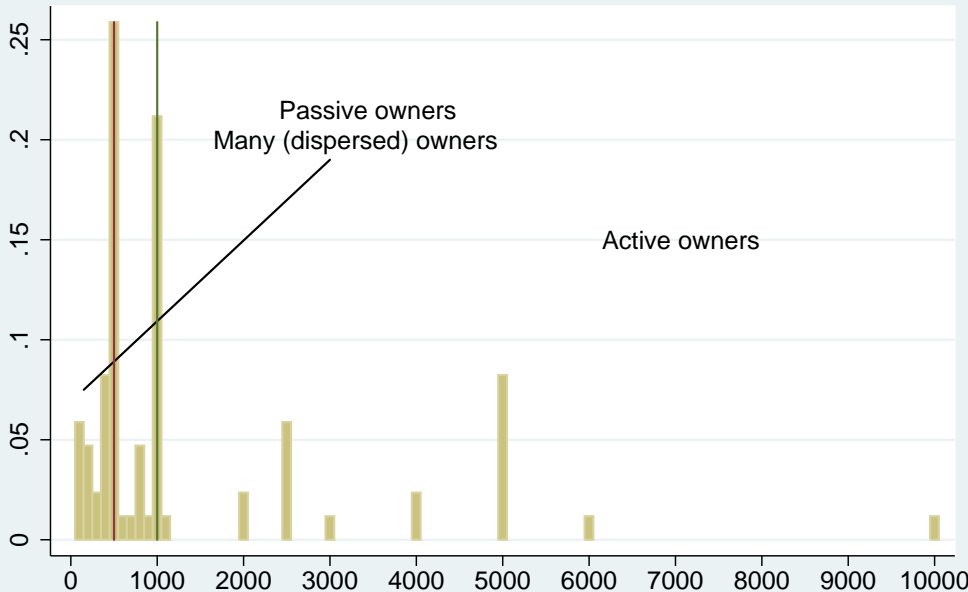


Which firms allocate authority to BoD?

Nominal value of shares (Norwegian kroner)



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Formal authority to the Board of Directors

	Index of formal authority	
Large Denomination Dummy	-1.56* (0.06) [-0.235]**	
Small Denomination Dummy		1.37* (0.09) [0.228]*
Size (log)	0.27 (0.35)	0.36 (0.25)
Firm age in 1900	-0.02 (0.34)	-0.02 (0.34)
Fixed Assets Ratio	-3.58+ (0.12)	-2.98 (0.20)
Obs.	85	85
p-value	0.23	0.19
Pseudo R-squared	0.06	0.06

Results I

- Active owners retain authority and can overrule managers
- Dispersed owners more often confer authority to BoD
 - ▶ Collective action problems

Which firms allocate authority to BoR?

Functions of BoR mentioned in bylaws

- Appoints directors (73%) and determines their salary
- Appoints auditor (85%) and determines his salary
- Make random inspections of company books and cash holdings
- Discusses/advises complex issues with BoD
- Has (sometimes) formal authority over major decisions

Results II

- Large denomination-firms never have a BoR!
- 45% of small denomination-firms have a BoR
 - ▶ Within this group, firms w/ BoR are larger and have more shares outstanding
- \Rightarrow BoR emerges when collective action problems among owners become too large

Does presence of BoR change allocation of authority?

- Both BoD and GM “lose” authority to BoR
 - ▶ GM loss of dividend-authority is pronounced
- That is, presence of BoR doesn't transfer authority “back to” GM
 - ▶ Is better informed and can monitor better
 - ▶ Better at trading off consumption needs and opportunity cost of dividends

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Conclusions

- In a free-contracting environment firms allocate formal authority differently
- In firms least likely to have small and uninformed owners, owners retain authority and never set up a BoR
- BoR has a dual role
 - ▶ Monitor managers
 - ▶ Address collective action problems
- We can add to debate about what modern-day boards do
 - ▶ We have firms with and without boards
 - ▶ When owners are active, boards don't add much

Thanks for your attention!

