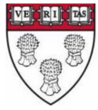

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# GLOBAL CORPORATE GOVERNANCE COLLOQUIUM

GCGC | HARVARD

1-2 June 2018

4th Annual Global Corporate Governance Colloquium
Harvard Law School
Cambridge
MA 02138, USA

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# Conference Report

By Roberto Tallarita (Harvard Law School)

Hosted by Harvard University in Cambridge, Massachusetts (USA), the 4th Annual Global Corporate Governance Colloquium (GCGC) brought together researchers in law, economics, and finance from leading universities around the world, and selected industry experts and practitioners, to discuss some of the most relevant current topics in corporate governance. The Colloquium, held on June 1 and 2, 2018, consisted of three sessions of paper presentations and one panel discussion for each day.

This report covers some of the key topics and issues discussed in each session and panel.

For materials from the presentations (videos, papers, slides), visit the GCGC website at

**www.gcgc.global/events/harvard-2018/**

## FRIDAY 1 JUNE 2018

After the opening remarks of **John F. Manning,** Dean of Harvard Law School, and conference chair **Allen Ferrell**, Harvey Greenfield Professor of Securities Law at Harvard Law School, the first morning session focused on the role of managerial labor markets on mutual funds and hedge funds. **Renée Adams**, Professor of Finance at the University of New South Wales, presented her paper "Unsuccessful Teams" (co-authored with Min S. Kim), on the asymmetry of labor market outcomes for mixed-gender teams. The paper finds that, following mutual fund closures, female team-managers are more likely to exit the fund family and the industry than male team-managers. According to Professor Adams, this gender gap does not seem to be driven by a gender gap in skills, but by "attributional rationalization" – the fact that employers allocate more blame for unsuccessful teamwork to females. Professor Adams concluded that the absence of individual performance signals in teams may foster discrimination.

Discussant **Fabrizio Ferri**, Regina Pitaro Associate Professor of Business Accounting at Columbia Business School, stressed the need to collect more evidence on how the performance of team members is assessed. In particular, Professor Ferri advanced the hypothesis that the asymmetric outcome identified by Professor Adams could be the result of taste-based discrimination (for example, by male peers if teams used peer reviews for assessing performance). Furthermore, it was suggested that employers who hire many female managers

might have better expectations for female managers (and therefore be less biased when assigning blame) and that many employers might realistically believe that women that “make it” into the hostile world of finance are in the upper tail of the skill distribution (and therefore have high expectations on their performance).

Other participants commented on the need to distinguish voluntary exits from forced exits, on the effect that the recent cultural push for more diverse teams might have had on the phenomenon studied in the paper, and on how the recent “tectonic shift” in the fund industry might have affected the managerial labor market.

**Marco Pagano**, Professor of Finance at the University of Naples Federico II, presented his paper (co-authored with Andrew Ellul and Annalisa Scognamiglio) on “Career Risk and Market Discipline in Asset Management”. Careers in finance, especially in asset management, have high compensation (especially compared to non-finance workers), large discretion in risk taking, and performance-based compensation that is mostly indexed to the upside risk. The paper aims at measuring whether asset managers also face downside risk and finds that fund liquidations, preceded by poor performance, are followed by sharp and persistent drops in job level and compensation, especially for top employees. According to Professor Pagano, the data provides evidence that labor market discipline complements firm-level incentives and might compensate for the tendency of pay packages to reward success rather than penalize failure.

Discussant **Cláudia Custódio**, Associate Professor of Finance at Imperial College, focused on the challenges posed by the empirical strategy adopted by the authors, especially with reference to such unobservable variables as talent or risk preferences. She also raised the question on the external validity for the whole economy of the effect identified by the paper in the asset management sector. Other participants commented on the effect of industry downturns and how the fact that the asset management sector and the public market are shrinking affect career opportunities and labor market discipline.

In the second morning session, **Bernard Black**, Nicholas D. Chabraja Professor at Northwestern University, and **Pablo Slutzky**, Assistant Professor of Finance at the Smith School of Business of the University of Maryland, presented their studies on corporate governance in emerging markets. Professor Black's paper ("Which Aspects of Corporate Governance Matter in Emerging Markets: Evidence from Brazil, India, Korea, and Turkey", co-authored with Antonio Gledson de Carvalho, Vikramaditya Khanna, Woochan Kim, and Burcin Yurtoglu) builds country-specific corporate governance indices for four major emerging markets and finds evidence that country-specific indices can outperform broad, one-size-fits-all indices, and that disclosure and board structure seem to be more relevant for firm value than other governance aspects.

Discussant **Johan Sulaeman**, Associate Professor of Finance at the National University of Singapore, suggested the possibility that firm value might determine the quality of corporate governance (reverse causality: better firms can afford better governance) and focused on the interplay of demand and supply in financial disclosure. Professor Sulaeman also explored the idea of building a better multi-country index based on the authors' data.

Professor Slutzky's paper ("The Hidden Costs of Being Public: Evidence from Multinational Firms operating in Emerging Markets") exploits a natural experiment (a new ban on profit repatriation introduced in Argentina in 2012) to show that public companies comply with regulation more than privately held ones. In presenting his paper, Professor Slutzky observed that his analysis of new confidential data shows that private companies have more flexibility when operating in emerging markets and managed to mitigate the regulatory effect considered in the paper by 46%. This flexibility, according to the author, is large enough to affect M&A patterns in emerging markets.

Discussant **Pedro Matos**, John G. Macfarlane Professor in Business Administration at the University of Virginia, suggested further tests, in particular with respect to “transfer overpricing” mechanisms or other mechanisms that public companies might use to circumvent the ban on profit repatriation in other ways.

In the afternoon session, **Charles Wang**, Glenn and Mary Jane Creamer Associate Professor of Business Administration at Harvard Business School, and **Doron Levit**, Assistant Professor of Finance at The Wharton School, presented their papers on index funds and common ownership. Professor Wang presented his study (co-authored with Akash Chattopadhyay and Matthew Shaffer) on how stock indices can affect corporate behavior. He illustrated evidence that Japanese firms close to being included in the JPX400 index improved their return on equity (ROE). According to Professor Wang, this shows how firms respond to purely symbolic incentives, such as belonging to a prestigious index. Discussant **Vicente Cuñat**, Associate Professor at the Department of Finance of the London School of Economics, commented on the complex econometric issues raised by the paper, in particular how the aggregate time-series variation in ROE might be a potential confounding factor, and how the stability of coefficients might indicate cross-sectional heterogeneity, and proposed possible strategies to address them. Other participants commented on the role that other economic forces might have played on the behavior of those firms (for example, the inclusion in the index might not be purely symbolical, but perhaps causes improvements too).

Professor Levit observed how the rise in common ownership has led many scholars and practitioners to worry about important implications for acquisitions, executive pay, governance, and other strategic corporate choices. This concern has led some observers to advocate for limiting indexing. Professor Levit discussed different “naïve” measures of common ownership (that capture the extent to which two stock ownerships overlap) and presented a model-driven measure that quantifies the impact of common owners on managerial motives. The model and empirical findings illustrated by Professor Levit highlight the difficulties of quantifying common ownership and its impacts on managerial motives. According to the paper, while the growth of indexing and passive investment strategies may contribute to ownership overlaps, their impact on managerial motives is far less certain.

Discussant **Jennifer Hill**, Professor of Corporate Law at Sidney Law School, discussed the legal literature on common ownership and horizontal shareholding and the competing narratives of the role of institutional investors that can be found in legal scholarship and court decisions over the last few decades.

The first panel discussion addressed the role of index providers as a potentially powerful force in corporate governance. **Marco Becht**, Professor of Finance and Goldschmidt Professor of Corporate Governance at the Solvay Brussels School for Economics and Management, opened the discussion by pointing out how the IPO of Snap, Inc., with its offering of non-voting stock to the public, pushed the envelope too far and caused a backlash against unequal voting structures among observers and investors. **Stephen Davis**, Associate Director and Senior Fellow of the Harvard Law School Program on Corporate Governance, recalled that index providers had always been agnostic on the governance structures of the member firms of their indices and that Snap’s IPO was the proximate cause of such a radical change. Now, index providers are at the center of the policy discussion around dual-class structures and shareholder voting rights. **David Blitzer**, Chairman of the Index Committee at S&P Dow Jones Indices, discussed the historical role of index providers and the importance of simple rules to admit firms to an index. He suggested that the decision on whether dual-class structures should be banned or limited should be a decision taken by legislatures, regulators, and stock exchanges, not index providers. However, the latter became involved due to the substantial negative feedback received from many investors after the IPO of Snap.

**Matthew Mallow,** Vice Chairman of Blackrock, provided a historical overview of the use of dual-class structures by U.S. public companies and expressed his personal view on how dual-class stock might be valuable in the short-term but extremely harmful in the long run. Mr. Mallow seconded the view that indices should not become policymakers and shape corporate governance instead of regulators. **Jonas Jølle**, Head of Policy at Norges Bank Investment Management, observed that the purpose of going public is not only raising capital (as this could be done very easily today in the private market) but is increasingly more often to provide liquidity. For this reason, firms go public later and with stronger contractual power. Mr. Jølle also pointed out that the role of stock exchanges has changed too, due to increasing global competition, as shown by the fact that two major stock exchanges in Asia recently changed their listing standards on dual-class structures for fear of losing listed firms. Mr. Jølle expressed his agreement on the view that corporate governance should be created by regulators, but since the growing contractual power of listing companies and the fierce competition among exchanges is worsening the quality of governance, he suggested that investors should be open to the idea of indices taking action on this issue.

Some participants observed how the problem is exacerbated by the fact that index funds are forced to buy all stocks included in an index, and therefore cannot create any disincentive for indexed firms against adopting dual-class structures. It was also suggested that, even if we welcomed the role of index providers in shaping corporate governance, we should not expect them to be effective in that role, as long as investors are willing to invest in dual-class stock.

## SATURDAY 2 JUNE 2018

The first morning session was dedicated to the theme of management insulation from shareholders. **Emiliano Catan**, Associate Professor at the New York University School of Law, presented his paper ("Board declassification and firm value: Have shareholders and boards really destroyed billions in value?", co-authored with Michael Klausner) on the effect of the recent wave of board declassifications on firm value. Professor Catan observed that other studies concluded that the phenomenon of board declassification had substantially destroyed firm value, but this conclusion reflects a spurious correlation because declassifications disproportionately occurred in firms with large market capitalization and these firms also experienced disproportionate and unrelated drops in Tobin's Q over the same period.

Discussant **Arpit Gupta**, Assistant Professor of Finance at New York University Stern School of Business, drew attention to the estimation error in the paper's model and discussed the misleading use of Tobin's Q as a measure of firm value. Other participants suggested to control for the firm's propensity of being a target of shareholder activism (which might affect the decision to have a staggered board in the first place) and raised the point of the normative consequences of the paper. While the studies showing a large negative effect of board declassification on firm value had a clear normative claim, it was suggested that the new paper by Catan & Klausner left the policymaker with the same "non-empirical judgment" to make. A discussion on the limits of econometrics and its consequence on policy decision-making followed.

**Lucian Bebchuk,** William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance at Harvard Law School, presented his new paper on dual-class companies ("The Perils of Small-Minority Controllers", co-authored with Kobi Kastiel). Professor Bebchuk provided an overview of the various mechanisms used by dual-class companies to separate ownership from control and presented data showing that a significant portion of dual-class public companies allow high-vote shareholders to maintain a majority of voting rights with a small minority of shares (even below 5% of the total capital).

Discussant **Julian Franks,** Professor of Finance at the London Business School, opened the discussion with a brief history of unequal voting rights in the United Kingdom. He observed that we would need more empirical evidence on the size of private benefits enjoyed by dual-class controllers; however, even if those benefits were actually large, we should not be concerned as long as the relevant costs are fully internalized by the issuer. The existing evidence that voting premiums in countries with high-quality corporate governance are small show, according to Professor Franks, that there is little expropriation of non-controlling shareholders. Furthermore, Professor Franks suggested that we should collect evidence on the long-term performance of dual-class companies before imposing severe constraints on the contractual freedom of issuers and investors.

In his rejoinder, Professor Bebchuk observed that his main concern was not about the risk of expropriation but the massive distortion that dual-class structures cause on ordinary and strategic business decisions. Other participants commented on the role that sunset provisions (providing for an expiration of the dual-class structures after a certain number of years after the IPO) might play in limiting the risks associated with these structures and the use of other “control enhancing mechanisms” such as pyramids or cross-shareholdings.

The second morning session was opened by **Jeffrey Gordon**, Richard Paul Richman Professor of Law at Columbia Law School, who discussed the role of corporate governance on income inequality, economic insecurity, and slow economic growth, and possible remedies to these problems. Discussant **Miriam Schwartz-Ziv**, Assistant Professor in the Department of Finance at Michigan State University, focused on the uncertain causes of the raise in CEO compensation (decreased slack vs. increased agency problem) and how psychological factors and a coordination problem among firms may exacerbate the problem of high executive compensation.

A point was raised on the difficulties that institutional investors may face in addressing problems of income inequality. It was also suggested that while CEO pay has increased relative to the compensation of other employees, there is evidence that it has been stagnating relative to other top skilled earners’ pay. Other participants raised the question whether income inequality should be a problem addressed by corporate governance, while a representative from a large asset manager observed that macro-economic conditions are certainly part of asset managers’ concerns.

**Samuel Hartzmark**, Assistant Professor of Finance at the University of Chicago Booth School of Business, presented his paper on whether investors value sustainability (“Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows”, co-authored with Abigail Sussman). Professor Hartzmark presented evidence from a natural experiment (the introduction of easy-to-understand sustainability ratings by Morningstar) to show that investors do value sustainability and respond to extreme low and high ratings (while ignoring more nuanced or detailed information on sustainability).

Discussant **Giovanna Nicodano**, Professor of Financial Economics at the University of Torino, advanced the suggestion that two other events, occurred around the same time when Morningstar introduced its sustainability ratings, might have had an effect on investment flows in and out of funds: the requirements of the UN Principles of Responsible Investment that investors consider ESG issues in their decision-making and some changes in U.S. tax rules that encourage some types of legal entities to have an ESG certification in order to obtain a tax exemption. Other participants suggested that different kind of investors might put different weight on the Morningstar ratings. The discussion then focused on how people can misinterpret these ratings, the role of cultural changes in investor behavior, and the use of different methodologies to rate sustainability.

The **panel discussion** on “Corporate Social Responsibility and Impact Investing: Framing the Question” was opened by moderator **Allen Ferrell** who invited **John Loder,** Partner at Ropes & Gray, to give an overview of U.S. rules on the fiduciary duties of retirement assets managers. Mr. Loder reminded that pension funds own $ 28.3 trillion in assets and a not small part of them are subject to the fiduciary principles of the Employee Retirement Income Security Act of 1974 (ERISA), according to which the fiduciaries must act solely in the interest of participants and beneficiary and for the exclusive purpose of providing benefits to them. A recent new bulletin from the Department of Labor made it clear that EIRSA plan fiduciaries in managing and investing plan assets cannot assume greater investment risks, or sacrifice investment returns, to fulfil social policy goals. However, ESG factors, metrics or analyses can be taken into account if fiduciaries believe they would impact an investment’s risk or return. **Robert Sitkoff**, John L. Gray Professor of Law at Harvard Law School, observed that the ERISA rules derive from trust law. The aforementioned principles apply also to charities or university endowments. Professor Sitkoff focused on the distinction between using ESG factors as “collateral benefits” in addition to risk-adjusted return and using them as a component of a multi-factor model aimed at a better risk-adjusted return.

The first approach is against U.S. fiduciary law, while the second is compatible with it. Professor Sitkoff also commented on the high degree of subjectivity that ESG-motivated decisions imply and proposed a pragmatic heuristic to help the fiduciary to make decisions on this area, based on whether a given factor could be legitimately used to justify a distribution. **Ronald Gilson**, Stern Professor of Law and Business at Columbia Law School and the Meyers Professor of Law and Business (Emeritus) at Stanford Law School, stressed the problem of reconciling the creation of social value with market level of risk-adjusted return and expressed his skepticism on the ability of investors to promote social goals as long as the remuneration of General Partners is tied to financial return, as currently is the case. Professor Ferrell pointed to evidence presented in his recent paper on corporate social responsibility (Allen Ferrell, Hao Liang & Luc Renneboog, Socially Responsible Firms, 122 J. Fin. Econ. 585 (2016)), showing that, contrary to the traditional view, firms with fewer agency problems perform better on ESG metrics.  The discussion then focused on the role of enforcement on CSR, on the interplay between symbolic speech and actual economic action, and on the relevance of local rules in the global market.

The last session focused on the impact on busyness and distraction on the effectiveness of institutional investors and board members. **Ron Masulis**, Scientia Professor of Finance and the Macquarie Group Chair of Financial Services at the Australian School of Business, University of New South Wales, presented his paper addressing the question whether institutional investors have sufficient incentives to affect firm governance when directors appear to have weak incentives to monitor managers ("Monitoring the Monitor: Distracted Institutional Investors and Board Governance", co-authored with Claire Yang Liu, Angie Low, and Le Zhang). Professor Masulis presented evidence that exogenous shocks to institutional investors' portfolios (an unrelated positive or negative shock to another portfolio company in a different industry), by distracting investors' attention away from the company, reduce monitoring efforts and affect corporate governance. Discussant **Michelle Edkins**, Managing Director at BlackRock, offered a practitioner's perspective on Professor Masulis' presentation. She explained that BlackRock screens events based on its own data and third party research and engages if there is a major event that requires BlackRock's attention. She observed that the company needs to have time to respond to the investor's requests and input, and discussed the importance of private and confidential conversations between the shareholder and the management for an effective outcome of the engagement. The discussion then moved onto the design of Professor Masulis' research and it was suggested that further studies should take into account the effect of relative performance on investor monitoring and how the mechanical compliance with the recommendations of the major proxy advisors would affect the results of the paper.

**Alexander Ljungqvist**, Ira Rennet Professor of Finance and Entrepreneurship at New York University, presented his paper on how busy directors benefit or harm shareholders ("Busy Directors: Strategic Interaction and Monitoring Synergies", co-authored with Konrad Raff). Professor Ljunqvist presented a model that identifies two key determinants of the costs and benefits of busy directors: whether directors regard their effort choices as strategic substitutes or complements and whether busy directors experience positive or negative synergies across firms. The empirical analysis presented in the paper suggests that having a busy director on the board is only going to be harmful when the firms on whose boards she serves have little in common so that monitoring synergies are negative.

Discussant **Dan Puchniak**, Associate Professor at the National University of Singapore Law School, commented on the challenge of measuring and empirically proving synergies and interactions between directors. He questioned the assumption that a drop in analyst coverage (the event used by Professor Ljunqvist as a shock to measure a change in the busyness of directors) might actually have an effect on the efforts of directors and suggested to examine the role of personal reputation. Professor Puchniak also observed that the traditional view in corporate governance is that a decrease in external monitoring would decrease the efforts put by directors in their job, while the paper argues that the opposite is true.

The discussion then focused on other possible measures of synergies and interactions between directors, such as educational and professional background, complementarity between firms and directors, and the use of other events (e.g. M&A) to measure changes in directors' busyness.