Available online at www.sciencedirect.com

SCIENCE DIRECT®

Journal of Corporate Finance 12 (2006) 381–402

Journal of CORPORATE FINANCE

www.elsevier.com/locate/jcorpfin

Recent Developments in Corporate Governance: An Overview

Stuart L. Gillan *,[1]

Department of Finance, W. P. Carey School of Business, Arizona State University, P.O. Box 873906, Tempe, AZ 85287-3906, USA

Received 18 November 2005; accepted 19 November 2005
Available online 25 January 2006

Abstract

I develop a corporate governance framework, provide a broad overview of recent corporate governance research, and place each of the Special Issue papers within the context of this framework. The papers in the issue contribute to our understanding of a wide range of governance topics including: the role of antitakeover measures, board structure, capital market governance, compensation and incentives, debt and agency costs, director and officer labor markets, fraud, lawsuits, ownership structure, and regulation. In short, the papers span almost every aspect of governance systems.
© 2005 Elsevier B.V. All rights reserved.

JEL classification: G30; G32; G34
Keywords: Corporate governance; Corporate boards; Executive compensation; Ownership structure

1. Introduction

The amount of corporate governance research has increased dramatically during the last decade. A search of Social Sciences Research Network abstracts containing the term "corporate governance" results in more than 3500 hits. As a result, a survey of recent work is a daunting task – and not the purpose of this article.[2] Rather, my objective is to present a corporate governance framework,

* Tel.: +480 965 7281.
E-mail address: Stuart.Gillan@asu.edu.
[1] I am indebted to Jennifer Bethel, George Cashman, Jeff Coles, Jay Hartzell, Jim Linck, Jeff Netter, Laura Starks, Tina Yang, and participants of the Arizona State University Finance Department brownbag seminar series for comments and suggestions.
[2] For general review articles see Becht et al. (2003), Denis (2001), Shleifer and Vishny (1997), and Zingales (1998a, 2000). Papers focusing on specific aspects of governance include Adams and Mehran (2003) and Macey and O'Hara (2003) on banks and bank holding companies, Claessens and Fan (2002) on Asian corporate governance, Denis and McConnell (2003) and Gillan and Starks (2003) on international issues, Black (1998), Gillan and Starks (1998), and Karpoff (1998) on shareholder activism, and John and Senbet (1998) on boards.

0929-1199/$ - see front matter © 2005 Elsevier B.V. All rights reserved.
doi:10.1016/j.jcorpfin.2005.11.002

provide a broad overview of the issues and recent work in the area, and place each of the Special Issue papers within this context. In doing so, I emphasize the papers that I am more familiar with and that are, as a rule, finance-oriented papers focusing on U.S. corporate governance. Moreover, I focus primarily on research areas addressed by papers in the Special Issue. I have surely omitted reference to a number of noteworthy papers – to those authors, I apologize.

The paper proceeds with definitions of corporate governance and a governance framework in Section 2. Section 3 discusses elements of internal governance, Section 4 focuses on external governance mechanisms, while Section 5 adopts a broad view of governance emphasizing the study of multiple governance mechanisms. Section 6 offers some thoughts on future research and concludes. Papers in the special issue appear in **bold** throughout this discussion.

2. Corporate governance defined

The definition of corporate governance differs depending on one's view of the world. From a broad perspective, Zingales (1998a) views governance systems as the complex set of constraints that shape the ex post bargaining over the quasi-rents generated by the firm. Shleifer and Vishny (1997) define corporate governance as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. Taking a broad perspective on the issues, Gillan and Starks (1998) define corporate governance as the system of laws, rules, and factors that control operations at a company. Irrespective of the particular definition used, researchers often view corporate governance mechanisms as falling into one of two groups: those internal to firms and those external to firms.

The simple balance sheet model of the firm, depicted in Fig. 1, captures the essence of this relationship. The left-hand side of the diagram comprises the basics of internal governance. Management, acting as shareholders' agents, decides in which assets to invest, and how to finance those investments. The Board of Directors, at the apex of internal control systems, is charged with advising and monitoring management and has the responsibility to hire, fire, and compensate the senior management team (Jensen, 1993). The right-hand side of the diagram introduces elements of external governance arising from firm's need to raise capital. Further, it highlights that in the publicly traded firm, a separation exists between capital providers and those who manage the capital. This separation creates the demand for corporate governance structures.

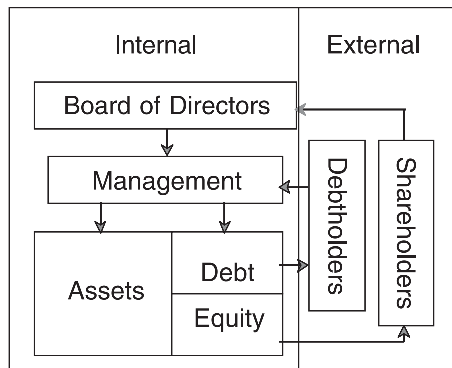

Fig. 1. Corporate governance and the balance sheet model of the firm. Adapted from PowerPoint slides accompanying Ross et al. (2005).

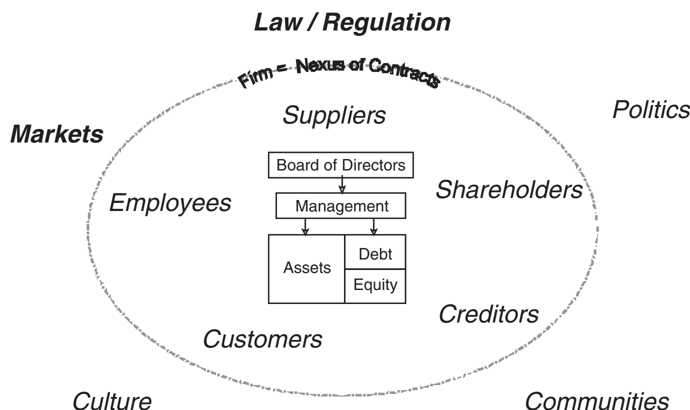

Fig. 2. Corporate governance: beyond the balance sheet model.

As Shleifer and Vishny (1997) put it, the suppliers of finance use corporate governance to ensure that they will get a return on their investment. The diagram also captures the link between shareholders and the board. Shareholders, the residual claimants, elect board members and boards, as established in state law, owe a fiduciary obligation to shareholders.

Of course, firms are more than just boards, managers, shareholders, and debtholders. Fig. 2 provides a more comprehensive perspective of the firm and its corporate governance. The figure depicts other participants in the corporate structure in, including employees, suppliers, and customers. When added to participants outlined in Fig. 1, we have the nexus of contracts view of the firm, as articulated by Jensen and Meckling (1976).

By incorporating the community in which firms operate, the political environment, laws and regulations, and more generally the markets in which firms are involved, Fig. 2 also reflects a stakeholder perspective on the firm (see Jensen, 2001 and references therein).[3] This view captures the realities of the governance environment. For example, in the US, some states have stakeholder laws under which unsolicited takeover bids may be rejected if the takeover is expected to have adverse effects on the community in which the target firm operates. Similarly, early legislation, e.g., the Securities Act of 1933 and the Exchange Act of 1934, through more recent legal reforms, such as the Sarbanes–Oxley Act of 2002, demonstrate that law and politics have important influences on both corporate governance and the way that firms operate. In the figure, I **bold** "Markets" and "Law/Regulation," because these aspects of the environment are of particular interest to researchers and I focus on them in this paper.

Fig. 3 expands the basic framework further to examine a broader set of governance influences. Note that this broader perspective, consistent with the definition of Gillan and Starks (1998), incorporates elements that many may not traditionally view as being part of corporate governance structures per se. However, they are aspects of the environment that, at a minimum, affect corporate governance. The central Governance node splits into two broad classifications – Internal Governance and External Governance. From there, I outline what I see as some of the key components of each.

I divide Internal Governance into 5 basic categories: 1) The Board of Directors (and their role, structure, and incentives), 2) Managerial Incentives, 3) Capital Structure, 4) Bylaw and Charter

[3] My thanks to Jeff Coles for his insights in developing this figure.

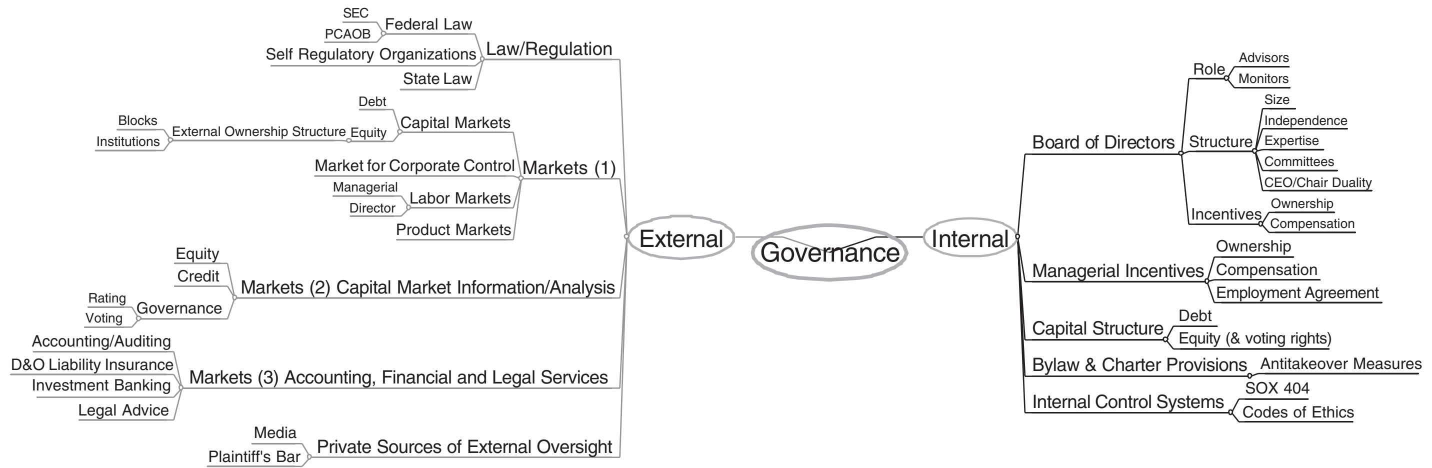

Fig. 3. Corporate governance: a broad framework.

Provisions (or antitakeover measures), and 5) Internal Control Systems. Similarly, I divide External Governance into 5 groups: 1) Law and Regulation, specifically federal law, self regulatory organizations, and state law; 2) Markets 1 (including capital markets, the market for corporate control, labor markets, and product markets); 3) Markets 2, emphasizing providers of capital market information (such as that provided by credit, equity, and governance analysts); 4) Markets 3 – focusing on accounting, financial and legal services from parties external to the firm (including auditing, directors' and officers' liability insurance, and investment banking advice); and 5) Private Sources of External Oversight, particularly the media and external lawsuits.

Obvious connections can be made between each of the governance elements, or nodes on the diagram. For example, the apex of Internal Governance, the Board of Directors, has a counterpart on the External node Markets (1) – specifically, the Labor Market for Directors. Similarly, under the Sarbanes–Oxley Act there is a direct connection between Law and Regulation under External Governance on the left-hand side of Fig. 3, and Internal Control Systems on the right. Some caveats are in order. First, it is difficult to represent such a multidimensional network of interrelationships in a one-dimensional diagram. Second, different readers may classify aspects of governance differently than me. For example, while I view Accounting and Auditing as part of the Market for External Services, others may consider this a Private Source of External Oversight. This leads to my final caveat. What I present here is just one view of the world. Nonetheless, it is a framework I find useful for thinking about governance issues.

3. Internal governance

3.1. Boards of directors

As discussed previously, many view boards of directors as the lynchpin of corporate governance. With a fiduciary obligation to shareholders, and the responsibility to provide strategic direction and monitoring, the board's role in governance is important. Traditionally, research on corporate boards has focused on links between board structure and firm value, governance choices, and investment and financing decisions (including the sale of the firm). While board size and the independence of the board from corporate management play central roles in the research to date (Rosenstein and Wyatt, 1990; Yermack, 1996), others examine board activity (Vafeas, 1999) and the structure and activity of board subcommittees (Klein, 1998, 2002; Deli and Gillan, 2000). In addition, several papers examine the role of CEO duality, i.e., where the CEO is also chairman of the board (Baliga et al., 1996; Brickley et al., 1997; Goyal and Park, 2002).

In addition, Hermalin and Weisbach (1988) and more recent work by Warther (1998), Adams and Ferreria (2003), Gillette et al. (2003), Harris and Raviv (2005), and Raheja (2005) examine theoretical aspects of board structure. In general, these papers model boards and their roles as monitors of, and advisors to, corporate management. Several of these papers also derive the optimal board size and independence. For review articles, see John and Senbet (1998) and Hermalin and Weisbach (2003).

Recent empirical work focuses on the evolution of board structure over time, and changes in board structure post-Sarbanes–Oxley (SOX). For example, Chhaochharia and Grinstein (2005a,b) focus on recent changes in board structure, finding that board size and independence have increased since SOX. Coles et al. (2005b) and Linck et al. (2005a,b) focus on board changes over time, and on the costs associated with board changes resulting from the new

regulations. Boone et al. (2005) track the evolution of board structure from IPO, and Lehn et al. (2005) examine board evolution for firms surviving since the 1930s. In general, these studies conclude that board size and structure are endogenously determined.

Other recent work focuses on board characteristics. Ferris et al. (2003) find that busy boards do not harm shareholder wealth, while Fich and Shivdasani (in press) suggest that the board's ability to monitor is compromised at firms with several busy directors. Conyon and Muldoon (2004) and Larcker et al. (2005) study board interlocks, with the latter suggesting that "cozy" board relationships limit effective monitoring.

In addition, board actions and expertise are attracting increased attention. Agrawal and Chadha (2005) report that financial expertise on boards limits the likelihood of accounting restatements. Anderson et al. (2005) report that the market attaches more credibility to earnings announcements when boards and audit committees are both independent and active. Building on the work of Booth and Deli (1999) and Krozner and Strahan (2001), Güner et al. (2005) find that the presence of commercial bankers on boards is associated with the size of loans, while the presence of investment bankers on boards is associated with more frequent outside financings, and larger public debt issues. However, the authors find that the presence of financial experts does not necessarily improve shareholder value.

In a similar spirit, in this issue, **Brick et al. (2006-this issue)** examine board characteristics and CEO compensation. The primary focus of the analysis is on the link between board and CEO pay, while controlling for CEO, firm, and governance characteristics (including CEO age, tenure, ownership, board size and independence, among others). The authors argue and find that excess compensation paid to directors is associated with excess CEO compensation. Although the authors suggest that unobserved firm complexity may contribute to this result, they find that excess compensation is associated with poor future performance. Consequently, **Brick et al. (2006-this issue)** interpret their findings as suggesting "cronyism" or mutual back-scratching. That is, excess compensation for directors compromises their independence and leads to overpayment of CEOs.

Focusing on Chinese firms, **Chen et al. (2006-this issue)** study the links between corporate fraud, board structure, and ownership structure in the context of enforcement actions of the Chinese Securities Regulatory Commission (CSRC). In their univariate analyses, the authors find that board characteristics and ownership structure differ between fraud and no-fraud firms. However, in a multivariate analysis, while Chinese firm's board characteristics are important in distinguishing between fraud and no-fraud firms, the type of owner is less so. The authors conclude that the proportion of outside directors, the number of board meetings, and the tenure of the board chair are associated with the incidence of fraud.

Taking a different perspective, **Berry et al. (2006-this issue)** examine the evolution of board and other governance structures in young firms after they undertake IPOs. In particular, the authors examine how board structure (including board independence and venture capitalist (VC) representation), CEO ownership, VC ownership, CEO incentive pay, and unaffiliated blockholdings change for up to 11 years after the IPO. The authors find that board independence and the proportion of board seats held by VC's increase as CEO ownership declines (a result that is concentrated in those firms that survive the authors' 11-year sample period). The authors suggest that as one governance mechanism designed to control agency costs weakens (CEO ownership) others (board structures) strengthen to fill the void.

Also of note, although I emphasize elements of board structure in this discussion, the papers by **Brick et al. (2006-this issue)** and **Berry et al. (2006-this issue)** also focus on CEO compensation a governance mechanism that other papers in the Special Issue also address.

3.2. Managerial incentives

Compensation policies chosen by boards can play an important role in aligning the interests of owners and managers. Indeed, during the 1990s, academics and practitioners alike argued in favor of equity-based compensation (particularly stock options) as a mechanism for aligning the incentives of mangers and shareholders (e.g. Jensen, 1993). Review papers pertaining to compensation include Murphy (1999), Bebchuk and Fried (2003), Core et al. (2003) and Core et al. (2004). Classic empirical work focusing incentives from ownership include Morck et al. (1988), Demsetz and Lehn (1985), and McConnell and Servaes (1990).

Despite the increased use of option-based compensation during the 1990s, concerns regarding its efficacy abound. In particular, perceptions of a disconnect between pay and performance, the creation of perverse incentives, or managerial excess continue to attract headlines in the press and calls for compensation reform. Recent academic work focuses on related issues. For example, stock options expensing (Carter and Lynch, 2003), the ongoing debate over repricing or replacing underwater options (Acharya et al., 2000; Brenner et al., 2000; Carter and Lynch, 2001; Chen, 2004; Chance et al., 2000; Chidambaran and Prabhala, 2003; Coles et al., in press; Ferri, 2005a; Rogers, 2005), and measuring incentives (Jensen and Murphy, 1990; Haubrick, 1994; Core and Guay, 1999; Guay, 1999). Others examine shareholder oversight of compensation by focusing on shareholder voting on compensation-related proxy proposals (Bethel and Gillan, 2002; Ferri et al., 2005b; Morgan and Poulsen, 2001; Morgan et al., in press).

More recently, Agrawal and Chadha (2005), Burns and Kedia (in press), Johnson et al. (2003), and Peng and Roell (2003) study the association between option-based compensation and the propensity of firms to restate earnings, commit fraud, or be subject to class action lawsuits. In general, these papers find that higher incentives are associated with increased likelihood of these outcomes. Adding to this line of inquiry, **Denis et al. (2006-this issue)** ask: Is there is a dark side to incentive compensation? Put simply, their answer is yes. After controlling for other elements of compensation and possible determinants of fraud, the authors find a positive association between option use and the likelihood of fraud allegations. Using a matched sample procedure, the authors report a positive association between measures of option intensity and class action lawsuits for securities fraud. Expanding the analysis to include ownership structure, they find the link between option use and alleged fraud is stronger in firms with high outside block ownership and institutional ownership. The authors' interpretation is that the incentive to engage in fraudulent activity is exacerbated by the presence of block and institutional owners who may also benefit from the fraud.

Also focusing on compensation issues, **Aggarwal and Samwick (2006-this issue)** develop a model and empirically analyze the relations between incentives from compensation, investment, and firm performance. The authors' optimal contracting model shows that the relationship between firm performance and managerial incentives, by itself, cannot determine whether managers receive private benefits of investment, as in theories of managerial entrenchment. As an alternative, they estimate the joint relationships between incentives and firm performance *and* between incentives and investment. They derive the result that investment and incentives are positively related. Moreover, they find that firm performance is increasing in incentives at all levels of incentives. The authors interpret their findings as being inconsistent with theories of overinvestment based on managers having private benefits of investment. Rather, the results support a view that managers have private costs of investment and, more generally, are consistent with models of underinvestment.

3.3. Capital structure

A number of papers examine multiple classes of stock, which typically entail different voting and cash-flow rights, and corporate performance. For example, Gompers et al. (2004) and Zingales (1995). My primary focus here, however, is on governance and debt. Over two decades of research suggests that debt can act as a self-enforcing governance mechanism; that is, issuing debt holds managers' feet to the fire by forcing them to generate cash to meet interest and principle obligations. Thus, debt mitigates the potential agency costs of free cash flow (Grossman and Hart, 1982; Jensen, 1986, 1993). The counter-arguments are that most firms can easily meet interest payments and firms typically rely on internal financing (Allen and Gale, 2000). Shleifer and Vishny (1997) discuss the role of debt in governance, and John and John (1993) provide an in-depth analysis of the link between capital structure and compensation.

Recent empirical work on corporate governance and capital structure focuses on the association between governance and the cost of debt. For example, Klock et al. (2005) find that increased use of antitakeover measures is associated with lower costs of debt financing. Similarly, Cremers et al. (2004) report that the presence of institutional blockholders is associated with lower yields, particularly in the presence of multiple antitakeover measures.

In this issue, **Bryan et al. (2006-this issue)** emphasize the link between compensation and the agency costs of debt. The authors note that, although contracting theory predicts that greater equity-based compensation decreases the agency problems of equity, it may exacerbate the agency problems of debt. They observe that while the agency costs of debt, which include underinvestment, asset substitution, and financial distress became less likely during the 1990s, firms became more difficult to monitor, and thus the agency costs of equity rose. The authors suggest that the net effect of these changes explains why more firms used equity-based compensation in the latter 1990s, and why the proportion of options in the compensation mix increased throughout the 1990s.

3.4. Bylaw and charter provisions

The Bylaw and Charter Provisions depicted in Fig. 3 pertain to those governance features that serve as potential barriers to the market for corporate control. For example, poison pills (or shareholder rights plans) allow firms to issue additional shares to all shareholders other than a hostile blockholder seeking control of the company after a pre-determined ownership threshold has been reached. The pill, if triggered, dilutes both the potential acquirer's voting power and the economic value of their investment in the target firm. Thus, if they swallow the pill, they are poisoned economically. Other provisions include staggered, or classified, boards whereby only some board members are up for election in a given year. In the event of a proxy contest for board seats, a dissident must win elections over successive years to gain voting control of the board, and thus the firm.[4] The argument in favor of such features is that they force potential bidders to negotiate with incumbent boards and ensure that shareholders receive higher premia. The tension, of course, is that such mechanisms may undermine the market for corporate control, entrenching management. For an earlier, more detailed overview, see Jarrell et al. (1988).

Early empirical work suggests that antitakeover measures (ATMs), on average, entrench managers, given the negative abnormal returns surrounding their adoption (Malatesta and

[4] For more recent work, see Danielson and Karpoff (1998), Gillan et al. (2003), and Gompers et al. (2003).

Walkling, 1988; Reingaert, 1988). However, Brickley et al. (1994) find that market reactions depend on board structure. In particular, they find that independent (shareholder-oriented) boards are associated with positive market reactions to ATM adoption, whereas less independent (management-oriented) boards are associated with negative reactions.

Recently, papers by Daines and Klausner (2001), Field and Karpoff (2002), Bebchuk and Cohen (2005), Bebchuk et al. (2003), and Gompers et al. (2003) have raised concerns about the use of antitakeover measures. The results of several of these papers suggest that increased use of antitakeover measures is associated with poor performance. Similarly, Core et al. (in press) document that firms with more antitakeover provisions have poor future operating performance. Of note, however, is the caveat made by many of these authors that their findings are indicative of associations between governance and performance, rather than of causation.

In focusing on poison pills, **Danielson and Karpoff (2006-this issue)** ask the question: Do pills poison operating performance? The authors' focus is on companies that adopt poison pills prior to widespread implementation of state laws affording firms antitakeover protections. The findings suggest that firms experience modest operating performance *improvements* during the 5-year period after pill adoption. Moreover, these improvements occur for wide range of firms, and are unrelated to specific adoption years or whether firms invest heavily in R&D. The authors also examine the performance implications of other antitakeover measures, with particular emphasis on firms that have both poison pills and classified boards – a combination viewed by legal scholars as a particularly potent antitakeover defense (Bebchuk and Cohen, 2005) – and find that performance changes are unrelated to board structure. On balance, the authors conclude that their evidence is at odds with the widely held view that poison pills negatively affect firm performance.

4. External governance[5]

As discussed earlier, firms do not operate in a vacuum, but rather under legal constraints. Firms are exposed to market forces and are subject to other sources of oversight. I discuss each of these in turn.

4.1. Law/Regulation

Aspects of the legal and regulatory environment are integrally related to corporate governance, and a large body of research studies the link between governance, law, and finance. For example, papers examine the impact of state law changes (particularly laws allowing firms to adopt antitakeover measures) on shareholder wealth and the labor market for directors (Szewczyk and Tsetsekos, 1992; Coles and Hoi, 2004). Taking a different tack, Comment and Schwert (1995) focus on takeover probabilities following firm and state adoption of antitakeover provisions, and conclude that such provisions do not preclude takeovers. More recent work emphasizes governance and wealth changes following the implementation of Sarbanes–Oxley and new listing standards. Linck et al. (2005a,b) examine board structure, whereas Chhaochharia and Grinstein (2005a,b) focus on wealth effects, and Leuz et al. (2005) examine firms that voluntarily deregistered with the SEC pre- and post-Sarbanes–Oxley. Others,

[5] The reader will note my omission of internal control systems. There is relatively little finance work on this issue. For excellent discussions of governance and accounting systems, see Bushman and Smith (2001) and Bushman et al. (2004).

notably Karpoff et al. (2005) focus on the legal consequences of corporate crime. The authors report that, counter to the widespread view that corporate crime is lightly disciplined, firms and individuals have been subject to heavy fines, prison sentences, and reputation penalties.

There is also a broad literature, starting with La Porta et al. (1997) focusing on corporate governance and how it relates to the legal protections afforded shareholders and creditors. Indeed, the authors suggest that legal differences account for differences in the breadth and depth of financial markets, and in the ability of firms to access external finance. The work by La Porta et al. is the basis of a growing literature on international governance, a review of which can be found in Denis and McConnell (2003).

In an interesting addition to this area, **Daouk et al. (2006-this issue)** examine the link between capital market governance (CMG) and several key measures of market performance. Using detailed data from individual stock exchanges, the authors develop a composite index that captures three dimensions of security laws: the degree of earnings opacity, the enforcement of insider trading laws, and the effect of removing short selling restrictions. Of note are the findings that improvements in the CMG index are associated with *decreases* in the cost-of-equity, *increases* in market liquidity, and *increases* in market pricing efficiency. The results are consistent across the components of the CMG index and alternative market performance measures.

4.2. Markets 1: capital, control, labor, and product markets

4.2.1. Capital markets

In this section, I discuss the importance of ownership structure to corporate governance. I first examine recent evidence on the monitoring role of institutional investors, and then focus on the role of blockholders. With regard to institutional investor monitoring, Hartzell and Starks (2003) suggest that concentrated institutional ownership moderates executive compensation. However, others have argued that institutional investors may be subject to potential conflicts of interest when it comes to monitoring corporate management. For example, Woidtke (2002) suggests some institutions that are able to monitor are subject to conflicts of interest with other shareholders, and thus their monitoring role is potentially compromised. More recently, Davis and Kim (in press) report that, although mutual funds are no more likely to vote with management of client versus non-client firms, there is a positive relation between business ties and the propensity of mutual funds to vote in favor of management proposals.

Other papers focus on the importance of block ownership to effective corporate governance. Bethel et al. (1998) report that active blockholders lead to enhanced shareholder value. Holderness (2003), in a survey of the literature, concludes that while blockholders have incentives to monitor management, they might also consume corporate resources. Studies of block ownership often use hand-collected data from proxy statements. Others rely on data from CDA Spectrum (now Thomson Financial) or Compact Disclosure. However, Anderson and Lee (1997a,b) and Bhagat et al. (2004) identify significant problems with the CDA/Spectrum data and question its use.

In this issue, **Dlugosz et al. (2006-this issue)** highlight that the blockholder data in Compact Disclosure has many mistakes and biases, which can be only partially fixed. In a representative application (examining the link between firm value and block ownership), the authors show that using uncorrected blockholder data as a dependent variable leads to increased standard errors of coefficient estimates, but does not cause bias. However, using block ownership as an independent variable can result in economically significant errors-in-variables biases. The

authors conclude that if the blockholder effect is the key independent variable, it is necessary to work with clean block data, and they provide guidance on how to do this.[6] Finally, in a valuable contribution to other researchers interested in using blockholdings, the authors have made the cleaned data available online.[7]

4.2.2. The market for corporate control

In many regards the market for corporate control is the ultimate corporate governance mechanism. As managers compete in the product market, assets (companies) go to the highest value use and thus inefficient managers are disciplined. However, the market for corporate control may be double-edged in that it also provides a means by which inefficient managers may indulge in empire building through ill-advised acquisitions (Bittlingmayer, 2000). (Bittlingmayer (2000), Bruner (2004), Holmstrom and Kaplan (2001), and Weston et al. (2004) provide more detailed discussions on the market for corporate control.)

Although no papers in the special issue directly focus on this area, interesting recent papers examine the association between aspects of governance and the market for corporate control. For example, Gompers et al. (2003) report that firms with many antitakeover protections tend to be more acquisitive. Hartzell et al. (2004) report that, on average, CEOs of firms that are acquired receive compensation in line with what they would have earned had they remained in the CEO position. However, the authors also find that when the target CEO receives extraordinary treatment, acquisition premia are lower. Chen et al. (2005), Gaspar et al. (2005), and Qiu (2004) provide evidence that institutional investors monitor corporate acquisition activity. In general, these papers find that certain types of institutional investors are associated with better acquisitions or the withdrawal of bad bids.

4.2.3. Labor markets

The finance literature on labor markets focuses on CEOs, board members, and members of senior executive teams. Classic papers, such as Fama and Jensen (1983) and Jensen and Meckling (1976) argue that labor market forces and reputation concerns have a disciplining effect on both managers and board members. Solid performance by CEOs or board members has the potential to lead to better opportunities for the individuals going forward. For example, CEOs may be offered a position at a larger or more prestigious firm or more board seats in the future. At the same time, poor performance may be associated with termination and subsequent difficulties obtaining new positions, either as an executive officer or board member.

Early empirical work, including Coughlan and Schmidt (1984), Murphy (1999), and Warner et al. (1988), provides a broad perspective on the association between firm performance and the labor market for CEOs. These studies find that good performance is positively associated with CEO compensation, whereas poor performance increases the likelihood of termination or CEO turnover. Indeed, numerous studies focus on the associations between CEO turnover, governance, and organizational form. For example, Goyal and Park (2002) find that the sensitivity of CEO turnover to firm performance is significantly lower when the CEO and chair positions are co-located. More recently, Berry et al. (in press) report that CEO turnover in diversified firms is insensitive to both accounting and stock-price performance, but that CEO turnover in focused firms is sensitive to firm performance. In related work examining succession

[6] For Compact Disclosure data outside the base sample (1996–2001), the authors suggest that winsorizing the data can reduce about half the bias in representative applications.

[7] http://www.finance.wharton.upenn.edu/~metrick/data.htm or on WRDS.

planning, Naveen (in press) reports that a firm's propensity to promote an internal candidate to the CEO position is related to firm size, diversification, and industry structure. Further, succession planning is associated with a higher probability of inside and voluntary succession, and a lower probability of forced succession.

Taken together, these papers suggest that governance and organizational structure are associated with the employment relationship and the labor market for executives. Adding to this literature, **Agrawal et al. (2006-this issue)** argue that outsiders are chosen for CEO positions only if they are markedly better than the best insider – that is, they are handicapped in the selection process. The rationale for handicapping is that it provides incentives for insiders to work hard to win (Chan, 1996). Handicapping implies that firms are more likely to appoint an insider to the CEO position when insiders are comparable to each other, when outsiders are less comparable to insiders, and when there are multiple inside candidates. The authors find evidence consistent with their hypotheses and argue that outsiders are indeed handicapped.

Other papers examine the labor market for directors, Brickley et al. (1999) report that the likelihood of a retired CEO serving on his own board two years after departure or serving as an outside director on other boards is positively related to the individual's performance while CEO. Srinivasan (2005) reports that outside directors at firms that restate their financials experience high turnover and hold fewer directorships after the event. Similarly, Harford (2003) finds that in firms that are taken over, target firm directors are rarely retained and hold fewer directorships in the future than a control group. Moreover, Yermack (2004) finds that outside directors receive positive performance incentives from compensation, turnover, and opportunities to join new boards. A common theme in all of these studies is that reputation is important in the labor market for directors.

In focusing on directorships held by sitting CEOs, Booth and Deli (1996) report that CEOs of firms with high growth opportunities hold fewer board seats than firms consisting primarily of assets in place. In their study, they find little evidence to suggest that outside directorships held by CEOs represent unchecked perquisite consumption. Perry and Peyer (2005) offer a different perspective in their examination of the wealth effects associated with executives accepting outside directorships. Specifically, they report that when insiders accept outside board seats and agency costs are low, shareholders benefit. However, when agency costs are high and insiders accept board seats in other firms, the market reacts negatively, suggesting that the costs to shareholders of having executives accumulate board seats outweigh the benefits.

Conyon and Read (2006-this issue) ask two important questions related to the labor market for directors: First, why do firms allow their executives to accept outside directorships? Second, do outside directorships enhance shareholder value? The authors develop an intuitive model of the costs and benefits to the home firm of executives sitting on other corporate boards. Central to the model is an assumption that accepting outside directorships alters the CEO's effect on the value of the home firm. The potential benefit to the home firm is that the manager's quality may be enhanced. The costs include the opportunity cost of the CEO's time. Of note is the authors' finding that executives will choose to spend more time on external directorships than is optimal for their home firm.

4.2.4. Product markets

A number of papers focus on product market competition and its relation to different aspects of corporate governance, including compensation structure and CEO turnover.[8] Previous work

[8] Several papers have examined links between product market competition and capital structure, e.g., Chevalier (1995), Phillips (1995), and Zingales (1998b).

offering theoretical perspectives on the link between product market competition, managerial incentives, and executive compensation include Aggarwal and Samwick (1999), Hermalin (1992), Kedia (1998), and Sharfstein (1988), amongst others. These papers' conclusions are ambiguous. A recent theoretical paper by de Bettignies and Baggs (2005), however, finds that product market competition directly and unambiguously lowers the shareholders' marginal cost of inducing managerial effort. Several papers including Aggarwal and Samwick (1999), de Bettignies and Baggs (2005), De Fond and Park (1999), Karuna (2005), and Kedia (1998) provide empirical evidence concerning these relations. Of these, Karuna (2005) and de Bettignies and Baggs (2005) conclude that increased competition is associated with stronger contractual incentives for employees. A general overview of the link between governance and competition can be found in Allen and Gale (2000).

With regard to product market competition and CEO turnover, Parrino (1997) reports that poor CEOs are easier to identify and less costly to replace in industries comprised by similar firms than in heterogeneous industries. He finds that the likelihoods of forced turnover and intra-industry appointments increase with industry homogeneity. De Fond and Park (1999) report that the frequency of CEO turnover is greater in more competitive industries, and that relative performance evaluation measures are closely related to turnover in industries with intense competition. Similarly, Fee and Hadlock (2000) find that turnover for newspaper industry executives other than the CEO is prevalent in competitive environments and in the face of strong performance by competitor firms. The potential link between product market competition and the labor market for executives as measured by employee turnover again highlights the interconnected nature of governance systems.

4.3. Markets 2: capital market information and analysis

There are a number of papers examining the links between capital market information providers and different aspects of corporate governance. For example, Chung and Jo (1996) argue that securities analysts reduce agency costs by monitoring corporate management and providing information about firms to the market. Oversight can also come from other market participants – notably those offering governance analysis and voting recommendations to institutional investors. In this area, Bethel and Gillan (2002), Morgan and Poulsen (2001), and Morgan et al. (in press) provide evidence that negative voting recommendations from governance analysts are associated with significantly lower levels of voting support. Thus, some service-oriented entities have the potential to act as both information providers and monitors of corporate management.

4.4. Markets 3: the market for services

Less research exists, however, that investigates the relation between the market for services and corporate governance. One interesting, but nascent area (primarily due to limited data availability) is the link between director and officer (D&O) liability insurance and corporate governance. Early work in this area, Bhagat et al. (1987), reports that the adoption of D&O coverage appears to enhance shareholder wealth. However, papers focusing explicitly on the pricing of D&O insurance in the U.S. are rare, as firms are generally not required to disclose detailed information about their insurance coverage.[9] A notable exception is Chalmers et al.

[9] Firms incorporated in New York have higher disclosure standards for D&O insurance.

(2002) who, using proprietary data for a sample of IPO firms, find that the 3-year post IPO performance is negatively related to the amount of insurance coverage purchased concurrent with the IPO. The authors suggest this finding is indicative of opportunistic behavior of management. These results are broadly consistent with papers examining this issue in Canada, where firms are required to disclose information on D&O insurance. Indeed, Core (1997) reports that Canadian firms with higher inside ownership are less likely to purchase coverage, and if they do, they carry lower limits than firms with low levels of inside ownership. Moreover, Core (2000) finds that D&O insurance premiums are higher for firms with weaker governance, and premiums are positively associated with the probability of litigation risk.

Recent work also focuses on the relationship between firms and their external auditor. In particular, whether or not payments from firms to external auditors for non-audit services compromise the integrity of the audit process, as some critics suggest was the case with Arthur Andersen and Enron. Investigating this issue, Frankel et al. (2002) conclude that payment for non-audit services can compromise auditor independence. Specifically, the authors report that the ratio of non-audit to total audit fees is positively related to discretionary accruals (a proxy often used for earnings management). However, Larcker and Richardson (2004) suggest that such results are concentrated in firms with weak governance, and further, that auditors' reputation concerns play a key governance role in limiting unusual accounting choices by client firms.[10] Given the increased availability of audit fee data since the passage of SOX, I expect that researchers in both accounting and finance will continue to investigate the oversight role of auditors and its connection to other aspects of governance.

4.5. Private sources of external oversight

The two private sources of external oversight detailed in Fig. 3 are the media, and plaintiffs' bar – or lawsuits. The media clearly plays an important role in reporting on corporate America and its corporate governance. For example, Bethany Mclean of *Fortune Magazine* is credited with revealing problems at Enron. Finance researchers have also examined the corporate governance role of the media. Notably, Dyck and Zingales (2002) focus on how the media pressures corporate managers and directors to behave in a "socially acceptable" manner. In doing so, they conclude that the media affects corporate policies toward the environment and the extent to which corporate resources are diverted to the advantage of controlling shareholders.

More recently, Malmendier and Tate (2005) examine CEOs who are subject to media attention. Specifically, they define "superstar" CEOs as those who receive prestigious awards from the business press. The authors find that such CEOs subsequently underperform, compared to both the overall market and a sample of hypothetical award winners – those with matching firm and CEO characteristics. They also find that award-winning CEOs are compensated more after receiving awards, and they spend more time on activities external to the firm (including outside directorships and writing books). These effects are strongest in poorly governed firms. The implication is that CEOs basking in the limelight may be indicative of broader governance problems at such firms.

Litigation is also an important element of the governance environment. As noted in Section 3.2, several recent papers examine the association between alleged fraud and compensation. Other papers focus on the antecedents and consequences of alleged fraud and litigation,

[10] See also Antle et al. (2002), Ashbaugh et al. (2003) Firms incorporated in New York have higher disclosure standards for D&O insurance (2003).

including Coles et al. (1998), Cox and Thomas (2005), Li (2005), Mohan (2005), Wang (2004a,b), and **Denis et al. (2006-this issue)**. The papers studying what happens after alleged fraud offer conflicting results. For example, Agrawal et al. (1999) find little evidence of CEO or board turnover surrounding allegations of fraud. However, focusing on a more recent time period, Farber (2005) finds that firms charged with fraud by the SEC tend to have poor governance relative to a control group, and that the average governance of the fraud firms improves during the following 3 years. Similarly, Ferris et al. (2005) report that board structures improve following derivative lawsuits. Finally, Haslem (2005) examines a broad range of suits including antitrust, breach of contract, labor-related, patent infringement, and shareholder class actions. He reports that going to court appears to dominate settling litigation from a shareholder wealth perspective (even when the firm loses). In addition, he finds that firms with weak governance tend to settle quickly, and that the market reaction to settlements is more negative where agency costs are likely greater. On balance, these findings suggest that oversight by both the media and those seeking to sue public firms may provide a rich agenda for further work.

5. A broad perspective on the issues

Recent work increasingly focuses on multiple governance mechanisms. For example, Gompers et al. (2003) examine the relation between 24 different antitakeover measures and firm performance, amongst other issues. Danielson and Karpoff (1998) examine both antitakeover measures and board independence. Similarly, Gillan et al. (2003) study the relation between industry characteristics and board size, independence, board committee structure, and the use of antitakeover provisions. **Black et al. (2006-this issue)** adopt a similar approach in examining governance practices at Korean firms. The authors study several different dimensions of governance including regulation, shareholder rights, board structure, board procedures, disclosure practices, and ownership structure. The authors find that Korean firms' corporate governance practices are strongly influenced by regulatory considerations, particularly for larger firms because they are subject to more stringent rules. However, the authors also find that industry factors, firm size, and firm risk are associated with firm governance structures. Of note are findings that larger and riskier firms tend to be better governed. Finally, the authors also find that governance is sticky; that is, firms alter their governance structures slowly in response to economic factors.

6. Discussion and conclusion

It is worth noting some common characteristics of the papers in the special issue. First, each adds to our understanding of one or more specific governance issues. Second, in a manner consistent with contemporaneous governance research, the papers in the issue increasingly focus on multiple aspects of corporate governance. I expect that focusing on broader definitions of what constitutes corporate governance, and the consideration of multiple governance mechanisms and how they interact will become more important as governance research evolves. Third, the papers in this issue, and governance research more generally, fall into one of three broad classifications: performance as a function of governance (e.g., Tobin's Q as a function of board structure), governance as a function of governance (e.g., CEO pay in relation to ownership structure), and increasingly, the impact of governance on performance (explaining variation in governance structures as a function of firm and industry characteristics).

At the same time, however, traditional empirical research is increasingly under attack from critiques of endogeneity. Indeed, there have been recent calls from many researchers including Coles et al. (2003), Zingales (2000) and Himmelberg (2003) amongst others, to further develop structural models or quantitative theories of the firm to guide empirical work. These critiques do not suggest that empirical research is without merit – quite the contrary. Rather, the study of empirical regularities and associations combined with traditional theoretical modeling and the development of structural models will pave the way forward. Such calls for new approaches do, however, highlight that researchers must continue to be careful with their experimental design – particularly with regard to issues of endogeneity and omitted variable biases. To that end, focusing on natural experiments, including regulatory shocks (such as those resulting from the passage of Sarbanes–Oxley) is one way to frame research questions in an attempt to mitigate some of these endogeneity concerns. Further, careful modeling of transactional events (e.g., mergers and acquisitions, CEO turnover, etc.) and how they relate to governance characteristics will continue to be a staple of governance research.

The papers in this issue provide important contributions to our knowledge of corporate governance and provide a strong foundation on which future researchers can build. With recent governance failures and the ensuing regulatory reforms, the U.S. corporate governance landscape has changed dramatically during the past few years. As regulatory reforms take hold and new regulations evolve, information on these changes will become available and we will have the potential to ask new questions and explore unresolved issues. As a result, it is an exciting time for governance researchers. I eagerly await the next wave of governance research that will add to our understanding of governance systems.

References

Acharya, V.V., John, K., Sundaram, R.K., 2000. Contract renegotiation and the optimality of resetting executive stock options. Journal of Financial Economics 57, 65–101.

Adams, R., Ferreria, D., 2003. A Theory of Corporate Boards, Working Paper. SITE-Stockholm School of Economics.

Adams, R., Mehran, H., 2003. Is corporate governance different for bank holding companies? FRBNY Economic Policy Review 9 (1), 123–142.

Aggarwal, R., Samwick, A., 1999. Executive compensation, strategic competition, and relative performance evaluation: theory and evidence. Journal of Finance 54, 1999–2043.

Aggarwal, R., Samwick, 2006. Empire-builders and shirkers: investment, firm performance, and managerial incentives. Journal of Corporate Finance 12, 489–515. doi:10.1016/j.jcorpfin.2006.01.001 (this issue).

Agrawal, A., Chadha, S., 2006. Corporate governance and accounting scandals. Journal of Law and Economics 48, 371–406.

Agrawal, A., Knoeber, C.R., Tsoulouhas, T., 2006. Are outsiders handicapped in CEO successions? Journal of Corporate Finance 12, 619–644. doi:10.1016/j.jcorpfin.2004.04.005 (this issue).

Agrawal, A., Jaffe, J.F., Karpoff, J.M., 1999. Management turnover and governance changes following the revelation of fraud. Journal of Law and Economics 42, 309–342.

Allen, F., Gale, D., 2000. Governance and competition. In: Vives, X. (Ed.), Corporate Governance: Theoretical and Empirical Perspectives. Cambridge University Press.

Anderson, R.C., Lee, D.S., 1997a. Ownership studies: the data source does matter. Journal of Financial and Quantitative Analysis 32, 311–329.

Anderson, R.C., Lee, D.S., 1997b. Field guide for research using ownership data. Journal of Financial and Quantitative Analysis 32, 1–11 (supplement).

Anderson, K.L., Deli, D.N., Gillan, S.L., 2005. Boards of Directors, Audit Committees, and the Information Content of Earnings. Working Paper. Arizona State University.

Antle, R., Gordon, E., Narayanmoorthy, G., Zhui, L., 2002. The Joint Determination of Audit Fees, Non-Audit Fees, and Abnormal Accruals. Working Paper. Yale School of Management.

Ashbaugh, H., LaFond, R., Mayhew, B.W., 2003. Do non-audit services compromise auditor independence? Further evidence. Accounting Review 78 (3), 611–639.

Baliga, B.R., Moyer, R.C., Rao, R.S., 1996. CEO duality and firm performance: what's the fuss? Strategic Management Journal 17, 41–53.

Bebchuk, L.A., Cohen, A., 2005. The costs of entrenched boards. Journal of Financial Economics 78 (2), 409–433.

Bebchuk, L., Fried, J., 2003. Executive compensation as an agency problem. Journal of Economic Perspectives 17, 71–92.

Bebchuk, L.A., Coates IV, J.C., Subramanian, G., 2003. The power of takeover defenses, working paper, Harvard Law School and NBER.

Becht, M., Bolton, P., Roëll, A., 2003. Corporate governance and control. In: Constantinides, G., Harris, M., Stulz, R. (Eds.), Chapter in the Economics of Finance. North-Holland.

Berry, T.K., Bizjak, J.M., Lemmon, M.L., Lalitha N., in press. Organizational complexity and CEO labor markets: evidence from diversified firms. Journal of Corporate Finance.

Berry, T., Fields Paige, L., Wilkins, M.S., 2006. The interaction among multiple governance mechanisms in young newly public firms. Journal of Corporate Finance 12, 449–466. doi:10.1016/j.jcorpfin.2005.08.003 (this issue).

Bethel, J.E., Liebeskind, J.P., Opler, T., 1998. Block share purchases and corporate performance. Journal of Finance 53, 605–634.

Bethel, J.E., Gillan, S.L., 2002. The impact of the institutional and regulatory environment on shareholder voting. Financial Management 31 (4), 29–54.

Bhagat, S., Brickley, J.A., Coles, J.L., 1987. Managerial indemnification and liability insurance: the effect on shareholder wealth. Journal of Risk and Insurance 54, 722–736.

Bhagat, S., Black, B.S., Blair, M.M., 2004. Relational investing and firm performance. Journal of Financial Research 27, 1–30.

Bittlingmayer, G., 2000, The market for corporate control (including takeovers). In: Bouckaert, B., De Gaest, G. (eds.), Encyclopedia of Law and Economics, University of Ghent and Edward Elgar.

Black, B.S., 1998. Shareholder activism and corporate governance in the United States. In: Newman, P. (Ed.), The New Palgrave Dictionary of Economics and the Law.

Black, B.S., Jang, H., Woochan, K., 2006. Predicting firms' corporate governance choices: evidence from Korea. Journal of Corporate Finance 12, 660–691. doi:10.1016/j.jcorpfin.2005.08.001 (this issue).

Boone, A.L., Field, L.C., Karpoff, J.M., Raheja, C.G., 2005. The Determinants of Corporate Board Size and Composition: An Empirical Analysis. Working Paper. Washington University.

Booth, J., Deli, D.N., 1996. Factors affecting the number of outside directorships held by CEOs. Journal of Financial Economics 40, 81–104.

Booth, J., Deli, D.N., 1999. On executives of financial institutions as outside directors. Journal of Corporate Finance 5, 227–250.

Brenner, M., Sundaram, R.K., Yermack, D., 2000. Altering the terms of executive stock options. Journal of Financial Economics 57, 103–128.

Brick, I.E., Palmon, O., Wald, J., 2006. CEO compensation, director compensation, and firm performance: evidence of cronyism? Journal of Corporate Finance 12, 403–423. doi:10.1016/j.jcorpfin.2005.08.005 (this issue).

Brickley, J.A., Coles, J.L., Terry, R.L., 1994. Outside directors and the adoption of poison pills. Journal of Financial Economics 35 (3), 371–390.

Brickley, J.A., Coles, J.L., Jarrell, G., 1997. Leadership structure: separating the CEO ad Chairman of the board. Journal of Corporate Finance 3 (3), 189–220.

Brickley, J., Linck, J., Coles, J.L., 1999. What happens to CEOs after they retire? New evidence on career concerns, horizon problems, and CEO incentives. Journal of Financial Economics 52, 341–377.

Bruner, R., 2004. Applied Mergers and Acquisitions. John Wiley and Sons, New York.

Bryan, S., Nash, R., Patel, A., 2006. Can the agency costs of debt and equity explain the changes in executive compensation during the 1990s? Journal of Corporate Finance 12, 516–535. doi:10.1016/j.jcorpfin.2005.09.001 (this issue).

Burns, N., Kedia, S., in press. The impact of performance-based compensation on misreporting. Journal of Financial Economics.

Bushman, R., Smith, A., 2001. Financial accounting information and corporate governance. Journal of Accounting and Economics 32, 237–333.

Bushman, R., Qi, C., Engel, E., Smith, A., 2004. Financial accounting information, organizational complexity and corporate governance systems. Journal of Accounting and Economics 37 (2), 167–201.

Carter, M.E., Lynch, L.J., 2001. An examination of executive stock option repricing. Journal of Financial Economics 61, 207–225.

Carter, M.E., Lynch, L.J., 2003. The consequences of the FASB's 1998 proposal on accounting for stock option repricing. Journal of Accounting and Economics 35, 51–72.

Chalmers, J.M.R., Dann, L.Y., Harford, J., 2002. Managerial opportunism? Evidence from directors' and officers' insurance purchases. Journal of Finance 57 (2), 609–636.

Chan, W., 1996. External recruitment versus internal promotion. Journal of Labor Economics 14, 555–570.

Chance, D.M., Kumar, R., Todd, R.B., 2000. The 'repricing' of executive stock options. Journal of Financial Economics 57, 129–154.

Chen, M.A., 2004. Executive option repricing, incentives, and retention. Journal of Finance 59, 1167–1200.

Chen, F., Gao, G., Rui, 2006. Ownership structure, corporate governance, and fraud: evidence from China. Journal of Corporate Finance 12, 424–448. doi:10.1016/j.jcorpfin.2005.09.002 (this issue).

Chen, X., Harford, J., Li, K., 2005. Monitoring: Which Institutions Matter? Working Paper. University of British Columbia.

Chevalier, J., 1995. Capital structure and product market competition. Empirical evidence from the supermarket industry. American Economic Review 85, 206–256.

Chhaochharia, V., Grinstein, Y., 2005a. The Transformation of US Corporate Boards: 1997–2003. Working Paper. Cornell University.

Chhaochharia, V., Grinstein, Y., 2005b. Corporate Governance and Firm Value: The Impact of the 2002 Governance Rules. Working Paper. Cornell University.

Chidambaran, N.K., Prabhala, N.R., 2003. Executive stock option repricing, internal governance mechanisms, and management turnover. Journal of Financial Economics 69, 153–189.

Chung, K.H., Jo, H., 1996. The impact of security analyst's monitoring and marketing functions on the market value of firms. Journal of Financial and Quantitative Analysis 31 (4), 493–512.

Claessens, S., Fan, J., 2002. Corporate governance in Asia: a survey. International Review of Finance 3 (2), 71–103.

Coles, J.L., Hoi, S., 2004. New evidence on the market for directors: board membership and Pennsylvania Senate Bill 1310. Journal of Finance 58, 197–230.

Coles, J.L., Bhagat, S., Bizjak, J., 1998. The shareholder wealth implications of corporate lawsuits. Financial Management 27, 5–27.

Coles, J.L., Lemmon, M.L., Meschke, J.F., 2003. Structural Models and Endogeneity in Corporate Finance: The Link Between Managerial Ownership and Corporate Performance. Working Paper. Arizona State University.

Coles, J.L. Daniel, N.D., Naveen, L., in press. Executive compensation and managerial risk-taking. Journal of Financial Economics.

Coles, J.L., Daniel, N., Naveen, L., 2005. Boards: Does One Size Fit All? Working Paper. Arizona State University.

Comment, R., Schwert, G.W., 1995. Poison or placebo? Evidence on the deterrence and wealth effects of modern antitakeover measures. Journal of Financial Economics 39 (1), 3–43.

Conyon, M.J., Muldoon, M.R., 2004. The Small World Network Structure of Boards of Directors. Working Paper. The University of Pennsylvania.

Conyon, M.J., Read, L., 2006. A model of the supply of executives for outside directorships. Journal of Corporate Finance 12, 645–659. doi:10.1016/j.jcorpfin.2005.08.004 (this issue).

Core, J., 1997. On the corporate demand for directors' and officers' insurance. Journal of Risk and Insurance 64, 63–87.

Core, J., 2000. The directors' and officers' insurance premium: an outside assessment of the effectiveness of corporate governance. Journal of Law, Economics, and Organization 16, 449–477.

Core, J., Guay, W., 1999. The use of equity grants to manage optimal equity incentive levels. Journal of Accounting and Economics 28, 151–184.

Core, J., Guay, W., Larcker, D., 2003. Executive equity compensation and incentives: a survey. Economic Policy Review 9 (1), 27–50.

Core, J., Guay, W., Rusticus, T., in press. Does weak governance cause weak stock returns? An examination of firm operating performance and investors' expectations. Journal of Finance.

Core, J.E., Guay, W.R., Thomas, R.S., 2004. Is U.S. CEO compensation inefficient pay without performance? Vanderbilt Law and Economics Research Paper No. 05-05.

Coughlan, A.T., Schmidt, R.M., 1985. Executive compensation, management turnover, and firm performance. Journal of Accounting and Economics 7, 43–66.

Cox, J.D., Thomas, R.S., 2005. SEC Enforcement Actions for Financial Fraud and Private Litigation: An Empirical Enquiry. Working Paper. Vanderbilt Law School.

Cremers, M., Nair, V.B., Wei, C., 2004. The congruence of shareholder and bondholder governance, NYU. Law and Economics Research Paper, vol. 04-007.

Daines, R., Klausner, M.D., 2001. Do IPO charters maximize firm value? Antitakeover protection in IPOs. Journal of Law, Economics and Organization 17, 83–120.

Danielson, M.G., Karpoff, J.M., 1998. On the uses of corporate governance provisions. Journal of Corporate Finance 4 (4), 347–371.

Danielson, M.G., Karpoff, J.M., 2006. Do pills poison operating performance? Journal of Corporate Finance 12, 536–559. doi:10.1016/j.jcorpfin.2005.10.001 (this issue).

Daouk, H., Lee, C.M.C., Ng, D.T., 2006. Capital market governance: how do security laws affect market performance? Journal of Corporate Finance 12, 560–593. doi:10.1016/j.jcorpfin.2005.03.003 (this issue).

Davis, Kim, E.H., in press. Would mutual funds bite the hand that feeds them? Business ties and proxy voting. Journal of Financial Economics.

de Bettignies, J.-E., Baggs, J., 2005. Product Market Competition and Agency Costs. Working Paper. University of British Columbia.

De Fond, M., Park, C., 1999. The effect of competition on CEO turnover. Journal of Accounting and Economics 27, 35–56.

Deli, D.N., Gillan, S.L., 2000. On the demand for independent and active audit committees. Journal of Corporate Finance 6 (2), 427–445.

Demsetz, H., Lehn, K., 1985. The structure of corporate ownership: causes and consequences. Journal of Political Economy 93, 1155–1177.

Denis, D., 2001. Twenty-five years of corporate governance research... and counting. Review of Financial Economics 10, 191–212.

Denis, D., McConnell, J.J., 2003. International corporate governance. Journal of Financial and Quantitative Analysis 38, 1–36.

Denis, D.J., Hanouna, P., Sarin, A., 2006. Is there a dark side to incentive compensation? Journal of Corporate Finance 12, 467–488. doi:10.1016/j.jcorpfin.2005.08.006 (this issue).

Dlugosz, J., Fahlenbrach, R., Gompers, P., Metrick, A., 2006. Large blocks of stock: prevalence, size, and measurement. Journal of Corporate Finance 12, 594–618. doi:10.1016/j.jcorpfin.2005.04.002 (this issue).

Dyck, A., Zingales, L., 2002. The corporate governance role of the media. The Right to Tell: The Role of Media in Development. Oxford University Press, New York.

Fama, E.F., Jensen, M.C., 1983. Separation of ownership and control. Journal of Law and Economics 26, 301–326.

Farber, D.B., 2005. Restoring trust after fraud: does corporate governance matter? Accounting Review 80, 539–561.

Fee, T., Hadlock, C., 2000. Management turnover and product market competition: empirical evidence from the U.S. newspaper industry. Journal of Business, 205–243.

Ferri, F., 2005. Structure of Option Repricings: Determinants and Consequences. Working Paper. Harvard University.

Ferri, F., Markarian, G., Sandino, T., 2005. Stock Options Expensing: Evidence from Shareholder Votes. Working Paper. Harvard University.

Ferris, S.P., Jagannathan, M., Pritchard, A.C., 2003. Too busy to mind the business. Monitoring by directors with multiple board appointments. Journal of Finance 58 (3), 1087–1112.

Ferris, S.P., Lawless, R.M., Makhija, A.K., 2005. Derivative Lawsuits as a Corporate Governance Mechanism: Empirical Eevidence on Board Changes Surrounding Filings. Working Paper. University of Missouri-Columbia.

Fich, E., Shivdasani, A., in press. Are busy boards effective monitors? in press Journal of Finance.

Field, L., Karpoff, J., 2002. Takeover defenses at IPO firms. Journal of Finance 57, 1857–1889.

Frankel, R.M., Johnson, M.F., Nelson, K.K., 2002. The relationship between auditors' fees for non-audit services and earnings quality. Accounting Review 77, 71–105.

Gaspar, J., Massa, M., Matos, P., 2005. Shareholder investment horizon and the market for corporate control. Journal of Financial Economics 76 (1), 135–165.

Gillan, S.L., Starks, L.T., 1998. A survey of shareholder activism: motivation and empirical evidence. Contemporary Finance Digest 2 (3), 10–34.

Gillan, S.L., Starks, L.T., 2003. Corporate governance, corporate ownership, and the role of institutional investors: a global perspective. Journal of Applied Finance 13 (2), 4–22.

Gillan, S.L., Hartzell, J.C., Starks, L.T., 2003. Explaining Corporate Governance: Boards, Bylaws and Charter Provisions. Working Paper. Arizona State University.

Gillette, A.B., Noe, T.H., Rebello, M.J., 2003. Corporate board composition, protocols, and voting behavior: experimental evidence. Journal of Finance 58 (5), 1997–2032.

Gompers, P.A., Ishii, J.L., Metrick, A., 2003. Corporate governance and equity prices. Quarterly Journal of Economics 118, 107–155.
Gompers, P.A., Ishii, J.L., Metrick, A., 2004. Incentives Versus Control: An Analysis of U.S. Dual Class Companies. Working Paper. Harvard University.
Goyal, V.K., Park, C.W., 2002. Board leadership structure and CEO turnover. Journal of Corporate Finance 8, 49–66.
Grossman, S.J., Hart, O.D., 1982. Corporate financial structure and managerial incentives. In: McCall, J.J. (Ed.), The Economics of Information and Uncertainty. University of Chicago Press, Chicago, IL.
Guay, W., 1999. The sensitivity of CEO wealth to equity risk: an analysis of the magnitude and determinants. Journal of Financial Economics 53, 43–78.
Güner, A.B., Malmendier, U., Tate, G., 2005. The Impact of Board with Financial Expertise on Corporate Policies. Working Paper. Stanford University.
Harford, J., 2003. Takeover bids and target directors' incentives: the impact of a bid on directors' wealth and board seats. Journal of Financial Economics 69 (1), 51–83.
Harris, M., Raviv, A., 2005. A Theory of Board Control and Size. Working Paper. University of Chicago.
Hartzell, J., Starks, L., 2003. Institutional investors and executive compensation. Journal of Finance 58, 2351–2374.
Hartzell, J.C., Ofek, E., Yermack, D., 2004. What's in it for me? Personal benefits for CEOs whose firms are acquired. Review of Financial Studies 17, 37–61.
Haslem, B., 2005. Managerial opportunism during corporate litigation. Journal of Finance 60 (4), 2013–2041.
Haubrick, J.G., 1994. Risk aversion, performance pay, and the principal-agent problem. Journal of Political Economy 102 (2), 258–276.
Hermalin, B., 1992. The effects of competition on executive behavior. Rand Journal of Economics 23, 350–365.
Hermalin, B., Weisbach, M., 1988. The determinants of board composition. Rand Journal of Economics 19 (4), 589–606.
Hermalin, B., Weisbach, M., 2003. Boards of directors as an endogenously determined institution: a survey of the economic literature. Economic Policy Review 9, 7–26.
Himmelberg, C., 2003. Measuring the real effects of corporate governance, unpublished manuscript. Federal Reserve Bank of New York.
Holderness, C.G., 2003. A survey of blockholders and corporate control. FRBNY Economic Policy Review 9 (1), 52–64.
Holmstrom, B., Kaplan, S.N., 2001. Corporate governance and merger activity in the United States: making sense of the 1980s and 1990s. Journal of Economic Perspectives 15 (2), 121–144.
Jarrell, G.A., Brickley, J.A., Netter, J.M., 1988. The market for corporate control: the empirical evidence since 1980. Journal of Economic Perspectives 2 (1), 49–68.
Jensen, M.C., 1986. Agency costs of free cash flow, corporate finance, and takeovers. American Economic Review 76, 323–329.
Jensen, M.C., 1993. The modern industrial revolution, exit, and the failure of internal control systems. Journal of Finance 48, 831–880.
Jensen, M.C., 2001. Value maximization, stakeholder theory, and the corporate objective function. In: Chew, D.H., Gillan, S. L. (Eds.), Corporate Governance at the Crossroads: A Book of Readings, D.H. Chew and S.L. Gillan (Editors), McGraw-Hill, New York, 2005.
Jensen, M.C., Meckling, W., 1976. Theory of the firm: managerial behavior, agency costs, and capital structure. Journal of Financial Economics 3, 305–360.
Jensen, M.C., Murphy, K., 1990. Performance pay and top-management incentives. Journal of Political Economy 98, 225–264.
John, K., John, T.A., 1993. Top management compensation and capital structure. Journal of Finance 48 (3), 949–974.
John, K., Senbet, L.W., 1998. Corporate governance and board effectiveness. Journal of Banking and Finance 22 (4), 371–403.
Johnson, S., Ryan, H.E., Tian, Y.S., 2003. Executive Compensation and Corporate Fraud. Working Paper. Louisiana State University.
Karpoff, J., 1998. The Impact of Shareholder Activism on Target Companies: A Survey of Empirical Findings. Working Paper. University of Washington.
Karpoff, J.M., Lee, D.S., Mahajan, A., Martin, G.S., 2005. Penalizing Corporate Misconduct: Empirical Evidence. Working Paper. University of Washington.
Karuna, C., 2005. The Effect of Industry Product Market Competition on Managerial Incentives and Pay. Working Paper. University of California, Irvine.

Kedia, S., 1998. Product Market Competition and Top Management Compensation. Working Paper. Rutgers University.
Klein, A., 1998. Firm performance and board committee structure. Journal of Law and Economics, 137–165.
Klein, A., 2002. Economic determinants of audit committee independence. Accounting Review 77, 435–452.
Klock, M.S., Mansi, S.A., Maxwell, W.F., 2005. Does corporate governance matter to bondholders? Journal of Financial and Quantitative Analysis 40 (4), 639–719.
Kroszner, R., Strahan, P., 2001. Bankers on boards: monitoring, conflicts of interest, and lender liability. Journal of Financial Economics 62, 415–452.
La Porta, R., Lopez-de-Silanes, F., Shleifer, A., Vishny, R., 1997. Legal determinants of external finance. Journal of Finance 52, 1131–1150.
Larcker, D.F., Richardson, S.A., 2004. Fees paid to audit firms, accrual choice, and corporate governance. Journal of Accounting Research 42 (3), 625–658.
Larcker, D.F., Richardson, S.A., Seary, A., Tuna, A.I., 2005. Back Door Links Between Executives and Executive Compensation. Working Paper. The University of Pennsylvania.
Lehn, K., Patro, S., Zhao, M., 2005. Determinants of the Size and Structure of Corporate Boards: 1935–2000. Working Paper. University of Pittsburgh.
Leuz, C., Triantis, A.J., Yue Wang, T., 2005. Why Do Firms Go Dark? Causes and Consequences of Voluntary SEC Deregistrations. Working Paper. University of Maryland.
Li, S., 2005. Corporate Fraud and Costly Monitoring: An Empirical Analysis of a Simultaneous System with Partial Observability. Working Paper. Wilfrid Laurier University.
Linck, J.S., Netter, J., Yang, T., 2005a. The Determinants of Board Structure. Working Paper. University of Georgia.
Linck, J.S., Netter, J., Yang, T., 2005b. Effects and Unintended Consequences of the Sarbanes Oxley Act on Corporate Boards. Working Paper. University of Georgia.
McConnell, J., Servaes, H., 1990. Additional evidence on equity ownership and corporate value. Journal of Financial Economics 27, 595–612.
Macey, J.R., O'Hara, M., 2003. The corporate governance of banks. FRBNY Economic Policy Review 9 (1), 91–107.
Malatesta, P.H., Walkling, R.A., 1988. Poison pill securities: stockholder wealth, profitability, and ownership structure. Journal of Financial Economics 20, 347–376.
Malmendier, U., Tate, G.A., 2005. Superstar CEOs. Working Paper. Stanford University.
Mohan, S., 2005. Corporate Governance, Monitoring and Litigation as Substitutes to Solve Agency Problems. Working Paper. The University of Texas at Austin.
Morck, R., Shleifer, A., Vishny, R., 1988. Management ownership and market valuation: an empirical analysis. Journal of Financial Economics 20, 293–315.
Morgan, A., Poulsen, A., 2001. Linking pay to performance – compensation proposals in the S&P 500. Journal of Financial Economics 62 (3), 489–523.
Morgan, A., Poulsen A., Wolf, J., in press. The evolution of shareholder voting for executive compensation schemes. Journal of Corporate Finance.
Murphy, K., 1999. Executive compensation. In: Ashenfelter, O., Card, D. Handbook of Labor Economics vol. 3. North-Holland, Amsterdam.
Naveen, L., in press. Organizational complexity and succession planning. Journal of Financial and Quantitative Analysis.
Parrino, R., 1997. CEO turnover and outside succession a cross-sectional analysis. Journal of Financial Economics 46 (2), 165–197.
Peng, L., Roell, A., 2003, Executive pay, earnings manipulation and shareholder litigation. Unpublished paper (Baruch College, NY and Princeton University, NJ).
Perry, T., Peyer, U., 2005. Board seat accumulation by executives: a shareholder's perspective. Journal of Finance 60, 2083–2123.
Phillips, G., 1995. Increased debt and product market competition. Journal of Financial Economics 37, 189–238.
Qiu, L., 2004. Which Institutional Investors Monitor? Evidence from Acquisition Activity. Working Paper. Brown University.
Raheja, C., 2005. Determinants of board size and composition: a theory of corporate boards. Journal of Financial and Quantitative Analysis 40 (2), 283–306.
Reingaert, M., 1988. The effect of poison pill securities on shareholder wealth. Journal of Financial Economics 20, 377–417.
Rogers, D., 2005. Managerial risk taking incentives and executive stock option repricing: evidence from the US casino industry. Financial Management 34 (1), 95–121.

Rosenstein, S., Wyatt, J.G., 1990. Outside directors, board independence and shareholder wealth. Journal of Financial Economics 26, 175–191.

Ross, S.A., Westerfield, R.W., Jaffe, J., 2005. Corporate Finance, 7th edition. McGraw Hill Irwin, New York.

Scharfstein, D., 1988. Product market competition and managerial slack. Rand Journal of Economics 19, 147–155.

Shleifer, A., Vishny, R., 1997. A survey of corporate governance. Journal of Finance 52, 737–775.

Srinivasan, S., 2005. Consequences of financial reporting failure for outside directors: evidence from accounting restatements and audit committee members. Journal of Accounting Research 43 (2), 291–334.

Szewczyk, S.H., Tsetsekos, G.P., 1992. State intervention in the market for corporate control: the case of Pennsylvania Senate Bill 1310. Journal of Financial Economics 31 (1), 3–23.

Vafeas, N., 1999. Board meeting frequency and firm performance. Journal of Financial Economics 53 (1), 113–142.

Wang, Y., 2004a. Securities Fraud: An Economic Analysis. Working Paper. University of Maryland.

Wang, Y., 2004b. Investment, Shareholder Monitoring, and the Economics of Securities Fraud. Working Paper. University of Maryland.

Warner, J.B., Watts, R., Wruck, K., 1988. Stock prices and top management changes. Journal of Financial Economics 20, 461–492.

Warther, V.A., 1998. Board effectiveness and board dissent: a model of the board's relationship to management and shareholders. Journal of Corporate Finance 4, 53–70.

Weston, J.F., Mitchell, M.L., Mulherin, J.H., 2004. Takeovers, Restructuring, and Corporate Governance. 4th edition. Pearson Prentice Hall, New Jersey.

Woidtke, T., 2002. Agents watching agents? Evidence from pension fund ownership and firms value. Journal of Financial Economics 63 (1), 99–131.

Yermack, D., 1996. Higher market valuation of companies with a small board of directors. Journal of Financial Economics 40 (2), 185–213.

Yermack, D., 2004. Remuneration, retention, and reputation incentives for outside directors. Journal of Finance 59, 2281–2308.

Zingales, L., 1995. What determines the value of corporate votes. Quarterly Journal of Economics 110, 1047–1073.

Zingales, L., 1998a. Corporate governance. In: Newman, P. (Ed.), The New Palgrave Dictionary of Economics and the Law.

Zingales, L., 1998b. Survival of the fittest or the fattest? Exit and financing in the trucking industry. Journal of Finance 53, 905–938.

Zingales, L., 2000. In search of new foundations. Journal of Finance 55, 1623–1653.