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Theoretical and Methodological Perspectives

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Introduction

As this book illustrates, corporate governance may be defined in many ways in different contexts. Some define the concept more broadly than others.[1] For example, one group of management scholars defined corporate governance in their work together 'as the determination of the broad uses to which organizational resources will be deployed and the resolution of conflicts among the myriad participants in organizations.'[2] Approaching things from a slightly different perspective, a pair of finance scholars offer that '[c]orporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.'[3]

Writ broadly, when we talk about corporate governance in this chapter, we are talking about the nature and effects of the relationships between and among corporate stakeholders (constituents), including principally the three internal constituents of the corporation: directors, officers, and shareholders – also known as stockholders (although come corporate governance scholars treat shareholders, especially non-controlling shareholders, as external stakeholders). Many theorists describe an inherent tension in corporate governance between the directors or officers, as managers of the corporation, and the shareholders, as owners of the corporation. Corporate governance also often includes the interaction of directors, officers, or shareholders with external stakeholders – creditors, employees/labor (although by some measures they are internal to the firm, they are not a formal part of the corporation's legal structure), advisors (e.g., lawyers, investment bankers, and accountants), suppliers, service providers, distributors, customers, clients, members of the community, and even government and other regulatory officials.

Scholars have advanced a number of theories to explain and predict the behavior of corporate stakeholders overall and in specific circumstances. These theories emanate from and are tested through the use of analytical methods; corporate governance theories foster new research methodologies, and research methodologies help identify the need for (and paths to) new theories. Analyses in the area of corporate governance take many forms and result in many different contributions to the literature. Variations occur across different states of incorporation and different fields of inquiry (e.g., law, economics, finance, management, accounting, psychology, sociology, and other academic, professional, and practical disciplines). For example, empirical research on corporate governance – research that tests hypotheses or answers questions and formulates, supports, or refutes theory through data analysis and testing (calculation, observation, experimentation) – is comparatively new in legal scholarship.

With all that in mind, this chapter sets out to do two relatively simple, yet important, things. First, it identifies and explains key theories of corporate governance. Next, it isolates and describes a variety of approaches taken by scholars in examining the interrelationships comprising and implicating corporate governance. In each case, the theories and methodologies are labeled, elucidated, and, as relevant, appraised. Relevant terms are noted and defined in context when possible.

My approach in the chapter is multidisciplinary, but I admit to bias that necessarily affects my choice of content and terminology. I am, by educational training and professional experience, a lawyer, and I therefore necessarily view the world primarily through the lens of US corporate and securities law – the principal US laws containing rules of corporate governance. However, I have incorporated the work of non-lawyers throughout the chapter.[4] In particular, the dominant theories come from economists. My objective is to cover theoretical and methodological perspectives on corporate governance from a variety of different perspectives, because I believe a multidisciplinary approach is necessary to a full understanding. Accordingly, as a whole, the material covered in this chapter is designed both to serve as a broad foundation for the matters addressed in subsequent chapters of this *Handbook* and to enable a more critical reading of the concepts addressed in those chapters.

Theoretical Perspectives

> A multitheoretic approach to corporate governance is essential for recognizing the many mechanisms and structures that might reasonably enhance organizational functioning.[5]

Corporate governance theories describe, explain, predict, interpret, and model the relationships between and among the three internal constituents of the corporation and, in some cases, other corporate stakeholders. They have evolved over time in response to and as drivers of, legal and societal changes.[6] Scholars find theories of the corporate firm challenging to construct and prove out in every case. This challenge also creates opportunity, however. The fact that multiple theories describe, explain, predict, interpret, and model the complex interrelationships that exist in the corporation make the corporation an intriguing puzzle.

Although a number of corporate governance theories exist, only a few are dominant in the literature. This portion of the chapter will describe in some detail a few key theories that do an effective job of describing, explaining, predicting, interpreting, or modeling the associations between and among corporate stakeholders. Then, several other theories will be mentioned briefly and related to their dominant context.

Separation of Ownership and Control

One often hears and sees references to the 'Berle & Means corporation,'[7] named for the theoretical work of Adolf A. Berle and Gardner C. Means published in 1932. These references are intended to convey a simple observation about the corporate form of business association: that it represents a structural (even if not always actual) separation of the ownership and control of a business association. Said another way, the corporate financial risk-taking generally is separated from corporate decision control and management.[8] Shareholders are the residual owners of the firm, and their welfare is considered to be the corporation's primary concern (which is referred to as shareholder primacy).[9] But, in actuality, shareholders have minimal management rights in the corporate structure. Under default corporate law rules, shareholders elect directors, are permitted to amend the corporation's bylaws, and have secondary approval rights (after action is taken by the board of directors) over fundamental – or basic – corporate changes (i.e., charter amendments, mergers, sales of all or substantially all of the corporation's assets, and the dissolution of the firm). The corporation is managed by or under the direction of its board of directors. Day-to-day management control of the corporation is vested in the corporate officers by the corporation's charter and bylaws and board resolutions. This structure allows and sometimes requires shareholders to be passive owners of the firm and can lead to manager-shareholder conflict (in particular if the directors or officers use their control to benefit themselves at the expense of the corporation's shareholder-owners).

The separation of ownership and control observed by Berle and Means describes well the overall structure of the corporation as a matter of statutory law – three distinct internal constituents with individualized roles, duties, and obligations. The typical US public corporation, which has widely dispersed individual and institutional ownership, is often touted as the best example of a Berle & Means corporation. Shareholders acquire and dispose of shares in faceless transactions in public securities markets. The shareholders do not nominate the directors they elect; in most cases, a committee of the corporation's board of directors selects the nominees. Most often, directors are elected by a mere plurality vote once a quorum of shareholders – typically those owning a majority of the outstanding common shares – is present at a meeting, in person or by proxy. And shareholders rarely use their statutory power to remove directors.[10] Although some officers may be (and often are) directors, since the adoption of the Sarbanes – Oxley Act in 2002 in the United States, most directors are 'independent,' in the sense that they are not officers of the corporation. State corporate law generally does not require that directors and officers own shares in the corporation they serve, and while some corporations do set requirements of that kind, the number of shares owned by US public company directors and officers typically does not constitute effective or actual control.

In this prototypical corporation with dispersed shareholdings, it is rational for shareholders to *not* monitor managers (i.e., to free-ride on others). However, the same is not true for corporations with concentrated share ownership. In these latter corporations, it is rational for shareholders to monitor managers. The Berle & Means model does not effectively describe these corporations because there is an integration of ownership and control. One example is the archetypal close corporation in the United States – which typically comprises, in addition to the founder, an overlapping group of the founder's family, friends, and other close associates as shareholders, directors, and officers. Here, the shareholder is an owner-operator. Substantially the same group of people both own and control the corporation, even though all three internal constituents of the corporation continue to exist as a matter of corporate law and structure.

The Berle & Means depiction of the corporation also does not always well describe corporate structures and ownership patterns in other parts of the world.[11] In fact, the dispersed passive ownership model prevalent in the United States only exists as a dominant structure in the United States and the United Kingdom. This model is sometimes referred to as an outsider system of corporate governance. In countries like Brazil and Germany, for example, insiders and families have historically owned and controlled most corporations. These types of models are sometimes called insider systems of corporate governance. In Germany, this evolved into banks and other corporations becoming the principal corporate shareholders. In each case, these dominant shareholders owned controlling positions in the corporation, resulting in no actual separation of ownership and control. Similarly, in Japan, corporations historically were owned and controlled by family groups known as *zaibatsu* and now by cross-ownership groups (including as shareholders, for example, firms from the same industry or from the corporation's supply and distribution chain) called *keiretsu*. Bank lenders in Japan also often are owners of the corporations to which they lend. In these ownership structures, public investors are relegated to a minority position. More detail is provided on these and other alternative ownership structures later in this book. In discussing the theoretical observations of Berle & Means, however, it is important to note that the potential for corporate governance conflict in controlling shareholder (insider) corporate governance models like these is *not* typically between managers and shareholders but, instead, between majority shareholders and minority shareholders. Controlling shareholders may, for example, appropriate assets from the corporation for their own benefit, either to an affiliated firm (e.g., through tunneling) or to themselves.

Agency

Observations about the nature of conflict created by corporate structures motivated theorists to pursue additional work on the relationships that exist in the corporate form of business organization. Economists led the charge, focusing on the agency and agencylike relationships represented by stakeholders in the corporate structure. Michael C. Jensen and William H. Meckling generally are the earliest scholars credited with propounding the agency theory of the corporation, but work in this area has been ongoing since the publication of their seminal paper, *The Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*[12] in 1976. In their paper, 'Jensen and Meckling … proposed agency theory as an explanation of how the public corporation could exist, given the assumption that managers are self-interested, and a context in which those managers do not bear the full wealth effects of their decisions.'[13]

At its core, agency theory assumes that all individuals act in their own interests with the objective of maximizing their personal welfare. As a result, there are inherent costs associated with a structure in which one individual (the principal) delegates or entrusts the management and control of his assets or affairs to another (the agent), especially where the agent is armed with more information than the principal (known as information asymmetry). These costs are labeled 'agency costs' and comprise all negative effects of the delegation of management and control, including those associated with 'shirking' by the agent, i.e., costs resulting from the agent acting in a manner that is inconsistent with the interests of the principal (moral hazard often referred to as residual loss), and those incurred by the principal in overseeing the agent's activities to prevent shirking (often referred to as monitoring costs), as well as those incurred by the agent to reduce the potential for shirking (often referred to as bonding costs). Jensen and Meckling modeled these agency costs and showed, for example, that principals will not bear an unlimited amount of monitoring costs (ceasing to bear those costs when the marginal return on the last dollar spent equals the marginal cost).

Although the directors and officers of a corporation are not agents of the corporation's shareholders as a matter of law (since an agency relationship arises from an association of mutual consent in which one person consents that another act in his stead and on his behalf, and the other consents to act in the stead and on behalf of the one), agency theory, as applied to the corporate form, treats directors and officers as agents to whom the assets of shareholders have been entrusted. Structures and attributes of corporate governance (including decision-making by independent directors, legal and contractual incentives to align director and officer financial interest in the corporation with those of shareholders, fiduciary duties of care and loyalty, and derivative litigation) are designed to address the key possible manifestations of shirking, which include self-interested and disloyal decision-making, as well as negligent, reckless, or intentional mismanagement. The market for corporate control (i.e., the threat of a change in control of the corporation through a proxy contest or tender offer, neither of which involve action by corporation's directors or officers), if unimpeded, also allows shareholders and investors in the market to constrain opportunistic director and officer actions.

Agency theory reflects some basic attributes of the corporation and accurately explains and predicts certain observed behaviors of corporate officers and directors. Indeed, corporate directors and officers have been found liable for insider trading, for making corporate decisions for their own profit rather than for the benefit of the corporation and its shareholders, and for exercising inadequate care in managing the corporation. Each of these transgressions represents a type of shirking that corporate law recognizes as involving actual or possible breaches of fiduciary duty.

But agency theory is not a full and accurate descriptor of the corporate form in either the owner-operator context – e.g., for close corporations (where there are few, if any, standardized agency relationships among the internal corporate constituents, since they occupy roles as both investors and managers) – or in a controlling shareholder context (where the main threat is the controlling shareholder's opportunism, not that of directors or officers).[14] Moreover, agency theory sometimes inaccurately describes and predicts actual behavior, since not all directors and officers are self-interested welfare maximizers. And finally, agency theory focuses on only a few (the internal three) of the many stakeholders in the corporate firm, treating shareholders as the center of attention. This model of corporate governance exhibits, reflects and supports shareholder primacy. However, the legal rules of corporate governance rarely afford shareholders control over corporate policies and affairs, manifesting instead a system of director primacy or managerialism, in which directors or officers control the corporation's decision-making and destiny, with little opportunity for shareholder monitoring. In any event, agency theory concentrates on the investor-manager dichotomy, leaving relationships between and among the broader set of corporate stakeholders (e.g., creditors, employees/labor, and others) to supplemental and competing theories of corporate governance.

Nexus of Contracts

An important alternative theory of the firm is contractarian theory. As this branch of theory observes, the corporate firm can be conceptualized as a nexus of contracts – an interconnected network of explicit and implicit agreements (not necessarily legally binding contracts) among those who constitute and interact with the corporation (i.e., internal and external corporate stakeholders).[15] The contractarian view of the firm is rooted in the work of economist Ronald Coase on transaction cost theory.[16] The firm exists because the coordination of explicit and implicit contracts that it provides is more efficient than producing the same goods or providing the same services by contracting for each of the needed components of the business in the market.[17]

Yet, the basic contractarian theory does not explain *how* the corporation coordinates the many arrangements that make up the corporation. The work of Stephen Bainbridge completes this picture by linking Coasian observations back to the control structure evidenced in agency theory. He posits that the board of directors of the corporation, as the constituent group of the corporation charged with managing or controlling management of the corporation, *is* the nexus of the contracts that constitute the corporation – the core of a web of interconnected arrangements – holding the web together, filling gaps in the contractual framework, and coordinating the use of the component contractual relationships in the operation of the corporation's business.[18] This idea evidences director primacy and is consistent with the separation of ownership and control. Accordingly, while it may describe the prototypical US public company well, it is not an accurate conception of many close corporations and majority-shareholder-controlled entities.

Team Production

Corporate governance also may be described as a problem of team 'production.'[19] The team production theory, like the nexus of contracts theory, views the corporation as a cohesive group consisting of the internal and external stakeholders of the corporation. All of these constituents supply resources to the firm that are subject to opportunistic appropriation.

> The mediating hierarchy model consequently suggests that the public corporation can be viewed most usefully not as a nexus of implicit and explicit contracts, but as a nexus of firm-specific investments made by many and varied individuals who give up control over those resources to a decision-making process in hopes of sharing in the benefits that can flow from team production.[20]

The team production model reflects elements of shareholder primacy, managerialism, and director primacy. Although directors, as managers of the corporation, coordinate and reconcile the activities and relationships of team members, group members typically work out their own arrangements. Margaret Blair and Lynn Stout popularized this theory of corporate governance with their 1999 article, *A Team Production Theory of Corporate Law*, in which they classified the directors' role as that of mediating hierarchs rather than agents.[21]

Blair and Stout themselves note one weakness of their theory – that their model primarily describes US public companies. But another criticism of the team production model is that it does not fully account for corporate governance rules that place shareholder interests ahead of those of other corporate stakeholders and directors in the role of agents.[22] These criticisms essentially attack the fact that team production theory (like contractarian notions of the corporation) is principally a theory of the aggregate group, whereas agency cost theory, together with the predicate separation of ownership from control, explains the dominance of certain players in key relationships within the group.

Other Corporate Governance Theories

The dominant theories of corporate governance described above represent only an important sampling. There are, of course multiple additional theories, general and specific. For example, stewardship theory, like agency theory, examines the investor-manager dichotomy that results from the separation of ownership and control. Stewardship theory, however, characterizes management less as opportunists and more as compliant, cooperative trustees of the shareholder's assets and affairs.

> Whereas agency theorists view executives and directors as self-serving and opportunistic, steward-

> ship theorists describe them as frequently having interests that are isomorphic with those of shareholders. This is not to say that stewardship theorists adopt a view of executives and directors as altruistic; rather, they recognize that there are many situations in which executives conclude that serving shareholders' interests also serves their own interests.[23]

Specific conceptions of the corporation also give rise to or employ other theories of corporate governance. Corporate social responsibility (CSR) provides a good example. Like the nexus of contracts and team production theories, CSR recognizes the important role of other stakeholders in the corporation. CSR incorporates and extends a broad field of study exploring the relationship of the corporation to society. In particular, its proponents defend and promote the operation of the corporation for public benefit. CSR is not a theory: rather, a large number of theories (instrumental economic, political, social integrative, and ethical) describe and explain the various interactions of the corporation and society that are elements of CSR.[24] These theories, most of which would be described by scholars as communitarian, rather than contractarian, corporate governance theories,[25] describe the role of the corporation in society in numerous ways: as a source of wealth, a source of power, a citizen, a dependent or servant, a moral being, etc. In general, instrumental economic theory supports CSR to the extent that CSR leads to wealth maximization for shareholders or the firm; i.e., CSR is a means to an economic end. Political theory encompassing CSR explains how socially responsible behavior derives from and reifies the corporation's societal power and position. In the main, as it relates to CSR, social integrative theory argues that the corporation's reliance on society requires that it behave in a socially responsible manner, while ethical theory emphasizing CSR focuses on the corporation as a normative member of society (having roots in cooperative stakeholder management and philosophy). Subsequent chapters in this book focus on or reference some of these theories.

The list of theories applicable to corporate governance issues could consume numerous additional pages. But this brief description conveys enough information to enable an evaluation of a broad range of contentions about corporate governance in varying contexts. In addition, the theoretical perspectives described here allow us to identify, categorize, characterize, and critique various research methodologies applicable in corporate governance research. These research methodologies both reflect and assess corporate governance theories.

Methodological Perspectives

To advance the study of corporate governance, researchers will need to advance beyond establishing and protecting our own fortresses of research. … [I]ndividual research efforts that do not genuinely embrace the full scope of tools available to us as researchers will result in continued won battles, with little progress toward ending the war.[26]

Research is the way we test and expand knowledge. It is a process of inquiry, investigation, and assessment.[27] Researchers gather, process, examine, and analyze facts, data, and other information. In academic work, the manifest product of research is scholarship (or, in some cases, creative activity). Scholarship uses different research methods (techniques, processes) that are founded on different methodologies (principles, rationales).

Corporate governance research methods and methodologies, like the theories they foster and support (or refute), emanate from diverse fields of study (including – individually and in combination – law, economics, finance, accounting, management, psychology, sociology, anthropology, political science, and philosophy) and involve the use of distinctive analytical techniques and tools.[28] Researchers in different fields may describe the different types of methods and methodologies they use in different ways. These various taxonomies make it difficult for newcomers to understand the corporate governance research landscape and for scholars to communicate about research design and efficacy. To help disentangle this labeling mess, the discussion of corporate governance methods and methodologies in this chapter is divided into those used in legal corporate governance scholarship (which is somewhat *sui generis*) and those used in the corporate governance scholarship produced in other disciplines. In writing about lawyers who teach and perform research in business school programs, one commentator notes that:

> A fundamental dichotomy exists between the methodologies used for legal research and publishing by faculty holding Juris Doctor (J.D.) degrees as compared with that which is customary for faculty typically holding the degree of research doctorate (Ph.D.). For example, non-law faculty, chairs, or deans may not always differentiate between the normative legal research conducted by law faculty and the quantitative research typically conducted by faculty from social science disciplines. This difference, which is not always settled or discussed in business schools, 'makes legal scholars different in the eyes of other business school disciplines, and difference in this regard proves no ad-

> vantage.'[29]

These divergent corporate governance methods and methodologies reflect historical differences in the purpose of legal scholarship (i.e., to describe, interpret, and prescribe law and legal rules) and the people for whom it was written (e.g., other law academics, lawyers, and judges). Yet legal scholarship is becoming more quantitative and multidisciplinary in response to calls for practical research output that informs both lawyers and those in other disciplines.

Research Methods and Methodologies in Legal Scholarship

Defining the unique methods and methodologies of legal corporate governance scholarship is no simple affair given the various ways in which legal scholarship is categorized. Some legal scholars separate their overall scholarship into functional classifications related to law, without reference to research methodologies. They may describe legal scholarship as theoretical (assessing or positing theoretical principles), policy-oriented (evaluating or suggesting the guiding principles underlying law and legal rules), and doctrinal (examining or recommending specific laws or legal rules). These categories may overlap in individual scholarly works. The research methods employed to create this scholarship have traditionally been non-empirical, but in recent years, some corporate law scholars have begun to use empirical methods.

As a result, many legal scholars divide the corporate governance research world into two camps, based on these two research methods. For them, the world is separated into conventional (or what some call theoretical or traditional) and empirical legal scholarship.

> Scholars employing a wide range of theoretical approaches … have employed different perspectives to try to generalize about the origins, current state, and future of corporate law. These pieces are provocative and illuminating, but they rarely seek to test the theories developed against empirical evidence. Legal empiricists, on the other hand, have generally eschewed 'big theory' and focused their efforts on narrower, testable hypotheses. Their articles look more like those published in economics and finance journals, and that is often where they are found.[30]

Conventional non-empirical corporate governance legal research identifies and examines law (statutory and decisional), other legally relevant rules (derived from governmental and non-governmental regulatory bodies, corporate charters, bylaws, and contractual covenants between or among corporate constituents), and extant legal (and sometimes other) treatises and scholarship. (In this work, the law and rules serve as primary information sources, and treatises and scholarship are classified as secondary sources.) The examination is typically *not* quantitative (i.e., it does not use mathematical or statistical analysis). It does not consist of testing, relying instead on textual analysis and theory-based, policy-oriented, or experiential reasoning. Its objective may be descriptive (positive), interpretive, or normative. The power and value of this kind of scholarship derives from both (a) the precise selection of relevant information from law, rules, and scholarship for examination and (b) the quality (logical, rhetorical, etc.) of the arguments made by the author on the basis of that information. The approach embodied in legal scholarship is founded in traditional legal education and consistent with *stare decisis*, a common law principle holding that judges must respect legal precedent – prior binding judicial opinions – in making their decisions (i.e., law created by judges is consistent with and builds on past law). Conventional legal scholarship typically is published in law reviews and journals affiliated with law schools, which are not peer-reviewed publications.

As a general matter, legal scholarship is published in student-edited law reviews and journals, rather than peer-reviewed journals. There are benefits (e.g., extension of the educational mission, potentially faster publication cycles) and detriments (e.g., uneven selection criteria and editing) associated with this publication process. Moreover, because of its reliance on and integration with prior work, legal scholarship tends to be heavily footnoted. Footnotes may include citation to relevant sources of law, analysis, and reasoning, but also may include additional textual exposition and information. Source citations are formatted in one of several specialized legal citation styles, the most common of which is Bluebook format.[31]

Traditional legal corporate governance research has been subject to criticism on various grounds. Corporate governance scholars from other fields, many of whom do not understand the legal and scholarly tradition represented in conventional legal research, may view it legal scholarship as having limited utility in resolving corporate governance (and other legal) questions.[32] Certainly, legal and non-legal scholars alike find traditional legal research difficult to evaluate.[33] Moreover, conventional legal scholarship is not always a reliable means of identifying and evaluating the practical consequences of law and legal rules.[34] In fact, conventional legal scholarship has been criticized for being too abstract and disconnected from the practice of law.[35]

Empirical legal research resolves some of these concerns in that it enables a more comprehensive (and potentially more trustworthy) assessment of the effects of law on society through quantitative measurement and qualitative tools that allow for richer positive observations. Empirical legal corporate governance scholarship uses a variety of the empirical research methods evidenced in non-law scholarship (described below), including especially event studies. Although legal empiricists often use quantitative methods, they may also include qualitative or behavioral elements in their work. Largely because legal scholars typically have little academic or experiential training in econometrics or other empirical analytical methods, the quality of the chosen empirical methods or the resulting analyses can be uneven.[36] To address this criticism, many legal empiricists work with economics, finance, and other scholars as co-authors to provide the requisite training and experience for a particular project. Some of this work are published in law reviews, and some are published in peer-reviewed journals.

Research Methods and Methodologies in Other Scholarship

Non-law corporate governance scholarship (including principally work in finance, economics, management, and accounting) comprises predominantly empirical research.[37] This empirical corporate governance research typically is published in peer-reviewed journals and may be quantitative, qualitative, or behavioral. Quantitative corporate governance research tends to be best at showing what is happening in a particular research area, while qualitative and behavioral research often can help offer important details on why. Behavioral research in corporate governance is distinguishable from quantitative and qualitative research less by its method than by the assumptions that underlie the research. For our purposes here, the following distinction is applicable: quantitative and qualitative corporate governance literature assumes that principles and agents are rational economic actors, while behavioral literature relaxes that assumption.

These and other differences make the world of corporate governance scholarship rich and varied. Different methods and methodologies represent more than a difference in approach; they represent distinct, valid, and valuable ways to get information and solve the puzzles that corporate governance presents. As a result, an individual researcher may use more than one method to test a hypothesis or answer a research question. Alternatively, a researcher may engage in a formal or informal collaborative narrative process with other researchers. By sequencing or combining their efforts, researchers may help develop an enhanced, rich knowledge of a particular area.[38]

Corporate governance scholarship other than legal scholarship typically is published in peer-reviewed field-specific journals. Although there is some variation in the format of these published works, many follow certain standard formatting norms. Journals may require different citation formats, but many use the Chicago, American Psychological Association, or American Language Association styles.

Quantitative Empirical Research

Most of the empirical work on corporate governance issues is quantitative and features econometric (mathematical or statistical) analysis of data sets consisting of pre-existing (archival) and hand-collected information.[39] (Research using archival data sets often is referred to as an archival study.) Quantitative corporate governance research focuses on the outcomes of stakeholder action. Typically, researchers are looking for a relationship between corporate director or officer conduct and firm performance. There are also numerous studies that look at the relationship between individual corporate governance characteristics (e.g., board composition or institutional ownership) and either firm value or firm choices. These studies identify the correlation between and among the relevant independent and dependent variables and assess causal relationships.

Event studies, in which researchers look for market price reactions to specific corporate events involving public companies, have become particularly popular.[40] The components of an event study illustrate both its conceptual simplicity and its operational complexity.

> In order to conduct an event study, the researcher first defines the event under investigation. Events are usually announcements of various corporate, legal, or regulatory action or proposed action. Examples of events that have been studied are takeovers, equity offerings, change in state of incorporation, adoption of antitakeover provisions, filing of lawsuits against corporations, deaths of corporate executives, and product recalls. After defining the event the researcher searches for the first public announcement of the event. Identification of the first public announcement of the event is critical since, under the semi-strong form of the efficient-market hypothesis, the impact of the event on the value of the firm would occur on the announcement date. …
>
> After defining the event and announcement period, stock returns are measured for this period. …
>
> Calculation of the third component is more complicated. Although it is straightforward to measure the actual return for the announcement period, determination of the impact of the event itself on the

> share price is less so. To measure this impact, the *expected return* must be subtracted from the actual announcement-period return. …
>
> … The unexpected announcement period return, also known as the *abnormal return*, is computed as the actual return minus the estimated expected return. This abnormal return is the estimated impact of the event on the share value.
>
> The fourth and final step is to compute the statistical significance of this abnormal return.[41]

The popularity of event studies is understandable. Public filings and press announcements (as well as public company stock prices) are freely available, stock price changes are ill-understood, and the practical knowledge gained from stock price movements can be very useful to a wide variety of corporate governance decision-makers, including lawmakers, regulators, judges, lawyers, investment bankers, and (of course) corporate managers.[42]

Critiques of the different types of quantitative corporate governance research are many and varied. In a 2003 article introducing a special topic forum for the *Academy of Management Review*, three corporate governance scholars articulated 'a number of potential barriers to moving corporate governance research forward.'[43] These barriers exist largely in quantitative corporate governance research and include: a dearth of primary, process-oriented data; an over-reliance on agency theory; and a single-minded approach, with a narrowly defined theoretical and disciplinary focus.[44]

In addition, quantitative empirical research in corporate governance scholarship tends to suffer from endogeneity problems (where one variable is caused by another within the research model) and omitted-variable biases (caused by the lack of an independent variable that should have been included in the model).[45] For example, if a researcher finds a correlation between board independence and operating performance, it may be difficult to determine whether firms with more independent boards perform better or whether better-performing firms seek independent boards. This is a classic endogeneity problem. The central issue is the difficulty in determining causality. Similarly, where an independent variable (known information at the outset of the analysis) is correlated with another independent variable that is not included in the model (either by design or because the data is unavailable), it may be difficult to ascertain whether the included or the omitted variable is responsible for influencing the dependent variable (the data that is generated in the study). So, a study may show that certain corporate governance provisions or structures are correlated with firm performance. But those provisions or structures may, themselves, be correlated with data not in the model, e.g., the industries in which the firms operate, board or ownership composition, or other firm attributes. It then could be these firm attributes, not the provisions or structures included in the model, that are influencing firm performance.

Event studies have been singled out for critical treatment in a number of ways. For one thing, it can be difficult to identify the date of the relevant 'event' being studied. In general, researchers desire to find the earliest date on which information is released to the public. That may be done through a public filing (e.g., a proxy statement) or a news release, or both. Finding the actual date on which the public knew the material information at issue may be more challenging than it appears.

Also, the value of event studies depends on market efficiency – more specifically, the semi-strong version of the efficient capital market hypothesis. If stock prices are not efficiently responsive to the dissemination of information, then event studies do not have much informative value. Stock price movements may not give us high-quality information for this and other reasons; market price changes may not be accurate indicators of future firm performance, shareholder value, or other measurements of wealth.

In addition, an event study may be conducted using various parameters, some of which may negatively impact the explanatory power of the study. For example, long-window event studies require the researcher to identify and filter out possible effects of other intervening events that may impact stock prices. The use of shorter announcement periods may not cure this problem. For example, when two different events are announced in the same press release, it may be difficult to determine which is the influencing event. In general, however, small samples and long announcement periods may weaken the explanatory power of event studies. 'A researcher can increase the power of an event study by increasing the sample size, narrowing the public announcement to as short a time-frame as possible, or both.'[46] On the other hand, short announcement periods may result in exaggerated, incomplete, or otherwise inefficient market effects (e.g., shareholder overreactions to news), especially where the events being studied are complex or infrequent.[47] As a result, some studies measure and report both short-term and long-term effects. In these cases, the researchers measure the short-term effects as an implication of value and the long-term effects as a measure of actual value.

Qualitative Empirical Research

Qualitative empirical research involves the use of reasoning and judgment in the analysis of non-quantifiable information. Qualitative corporate governance researchers study human interactions and social processes (e.g., decision-making, elements of organizational or group culture) in specific contexts, including the corporate boardroom and executive suite. Their research may involve the analysis of information obtained through interviews, questionnaires or surveys, focus groups, reviews of historical documents (including correspondence and other communications), and direct participant observation captured in journal entries (or diaries). Study designs in qualitative corporate governance research range from ethnographies (cultural examinations), to phenomenological research (experiential assessments), to approaches rooted in grounded theory (methods centered on theory formation and confirmation).[48] Qualitative research can be a flexible tool in answering corporate governance questions because it allows the researcher to focus specific questions on targeted populations from which relevant archival or documentary data may not be available.

Qualitative corporate governance research is subject to various criticisms akin to those leveled against traditional legal research on corporate governance issues.[49] Qualitative research is difficult to evaluate because of its individualized nature. The data or information on which the analysis is based may not be objective, precise, or directly comparable or may otherwise be flawed. Survey data, for example, may exhibit a self-reporting bias that makes the results less valuable than third-party observations of actual conduct. In addition, the findings of qualitative corporate governance research run the risk of being anecdotal; they may not be representative or generalizable, especially when sample sizes are small or sample cases are subjectively selected (or otherwise potentially biased). Also, qualitative corporate governance research may assume or rely on an underlying common and static corporate governance environment that does not, in reality, exist. The subjects of interviews, questionnaires, focus groups, and observational studies may have been involved in and engaged with very different corporate governance environments over a period of time. This may be difficult to tease out in the data gathering. Of course, a researcher may ameliorate some of these drawbacks by designing his or her study to avoid various pitfalls or by limiting the claims he or she makes to those that do not implicate the related weaknesses.

Behavioral Empirical Research

Behavioral corporate governance research is often characterized as a form of quantitative or qualitative empirical research rather than its own type of corporate governance research. It has distinctive characteristics, however, and its use supports a significant and growing interest in behavioral and behavior-related theories of corporate governance.[50]

> Behavioral analysis of the law is increasingly standing on its own as a field of inquiry outside law and economics scholarship. Legal scholars now feel comfortable enough to apply findings on human and social cognitive and emotional biases, which are central to behavioral analysis, without framing the analysis in economic terms. Corporate law scholars have applied understandings about real, personal human traits such as trust and sensitivity to dismantle the self-interested actor model of the individual.[51]

Behavioral corporate governance research distinctively features documentation of realtime observations of, or laboratory experiments involving, the dynamics of corporate governance (e.g., stakeholder interactions and processes, rather than measures of performance or outcomes), as well as other quantitative (statistical or mathematical analysis) and qualitative (data gathering through interviews, questionnaires, etc.) methods. Behavioral studies of corporate governance may identify and report the operation of various factors (e.g., cognitive biases, heuristics, social pressures, bounded rationality, satisficing, routinized decision-making, politicized negotiations, decision-making under uncertainty, risk assessment, pressures toward group conformity, emotion, and affect) that explain deviations from the wealth maximization norm that underlies the dominant economic theories of corporate governance described earlier in this chapter.[52] Behavioral corporate governance research ranges across many disciplines, and the type of method and study design may vary based on the researcher or the subject.[53] For example, one pair of accounting scholars note that

> Experimental research on earnings management and accounting choice includes two types of studies: (1) individual judgment and decision making studies, or *behavioral research*, where the primary

> focus is on manipulation of the environment and observation of behavior of experienced participants who have learned about their incentives in the field and (2) multiperson studies, or *experimental economics research*, where participants are given incentives and allowed to interact.[54]

Dissatisfaction with the explanatory and predictive power of other forms of quantitative and qualitative empirical research over the past 10 years has led corporate governance scholars to call for more behavioral corporate governance research.[55] Of especial interest is research on corporate board processes. This work is understandably handicapped by a lack of researcher access to the boardroom.

A shortage of opportunities for access to relevant environments and information and the time-intensive and labor-intensive nature of behavioral research may limit not only the number but also the quality of behavioral studies that are conducted. Even apart from these barriers, behavioral corporate governance research has been criticized in many of the same ways that other empirical research has been criticized. For example, the results of behavioral studies may not be generalizable; behavioral research may be conducted in a single firm, limiting the explanatory and predictive power of the findings. And, like conventional legal research and qualitative empirical research, behavioral research is not yet well understood or used by some corporate governance scholars, making it hard to evaluate. However, many of these perceived and actual criticisms of behavioral research can be overcome by collaboration with researchers from other fields and back-grounds.[56]

Conclusion

Corporate governance theories, methods, and methodologies are multidisciplinary, multifaceted, and interrelated. Economic theory, especially agency theory, has held a dominant position in recent years. Similarly, empirical research methods – especially quantitative methods (and in particular event studies) – have predominated in all corporate governance research other than legal research. Yet, each theory and method has both strengths and weaknesses. Accordingly, an increasing number of scholars believe that theoretical and methodological work drawing from only one discipline or tradition has limited power and influence in advancing our understanding of corporate governance structures, attributes, processes, and dynamics.[57] These scholars read and use corporate governance literature that comes from various fields and from different theoretical and methodological perspectives. Their work also may be done collaboratively with scholars from other disciplines. This *Handbook*, itself, is an example. Consider these observations and look for examples as you read and reflect on the remaining chapters.

Notes

1 *See, generally*, Stuart L. Gillan, *Recent Developments in Corporate Governance: An Overview*, 12 J. Corp. Fin. 381, 382–385 (2006) (noting different definitions of ‘corporate governance’ and offering his own framework).

2 Catherine M. Daily et al., *Corporate Governance: Decades of Dialogue and Data*, 28 Acad. Mgt. Rev. 371 (2003).

3 Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. Fin. 737 (1997).

4 I must thank Rudy Santore, Josh White, Tracie Woidtke, and other colleagues in the College of Business Administration and from the Corporate Governance Center at The University of Tennessee, Knoxville, who helped ensure that I reflected in this chapter the insights and work of scholars in other disciplines. I also am grateful for the research assistance of Jonathan Thomaston (J.D., 2011, The University of Tennessee College of Law). All errors and omissions are, of course, my own.

5 Daily et al., *supra* note 2 at 372.

6 *See* David Millon, *Theories of the Corporation*, 1990 Duke. L.J. 201 (including a brief history of the theories of the corporation in the United States from the early years of the 19th century to the time of the article's publication).

7 Adolf A. Berle & Gardner C. Means, The Modern Corporation & Private Property (1932).

8 *See, generally*, Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J. Law & Econ. 301 (1983) (noting this dichotomy).

9 For a theoretical paper that supports an enhanced version of shareholder primacy, *see* Lucian Bebchuk, *The Case for Increasing Shareholder Power*, 118 Harv. L. Rev. 833 (2005).

10 *See* Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 Va. L. Rev. 675 (2007).

11 *See* Stijn Claessens et al., *Disentangling the Incentive and Entrenchment Effects of Large Shareholdings*, 57 J. Fin. 2741 (2002); Rafael La Porta et al., *Corporate Ownership around the World*, 54 J. Fin. 471 (1999).

12 Michael C. Jensen & William H. Meckling, *The Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. Fin. Econ. 305 (1976).

13 Daily et al., *supra* note 2, at 372.

14 *See* Andrei Shleifer & Robert W. Vishny, *Large Shareholders and Corporate Control*, 94 J. Polit. Econ. 461 (1986).

15 *See, generally*, Jensen & Meckling, *supra* note 12 (originating this term); *see also* Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. Polit. Econ. 288 (1980) (examining the separation of ownership and control in the context of the nexus of contracts theory of the firm); Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J. Law & Econ. 301 (1983) (same).

16 R.H. Coase, *The Nature of the Firm*, 4 Economica (n.s.) 386 (1937). For more on transaction cost theory and the organization of firms, see Oliver E. Williamson, *The Economics of Organization: The Transaction Cost Approach*, 87 Am. J. Sociology 548 (1981). Williamson articulates three levels of analysis in applying transaction cost theory to the theory of organizations: structural analysis, a role-based analysis, and an asset organization/allocation analysis. *Id*. at 549.

17 *See* Oliver E. Williamson, *The Modern Corporation: Origins, Evolution, Attributes*, 19 J. Econ. Literature 1537 (1981).

18 Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 Iowa L. Rev. 1 (2002).

19 *See* Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 Am. Econ. Rev. 777 (1972).

20 Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247, 285 (1999).

21 *Id*. at 280–281.

22 *See, e.g.*, Alan J. Meese, *The Team Production Theory of Corporate Law: A Critical Assessment*, 43 Wm.

& Mary L. Rev. 1629, 1635–1637 (2002).

23 Daily et al., *supra* note 2, at 372 (citations omitted).

24 *See* Elisabet Garriga & Domènec Melé, *Corporate Social Responsibility Theories: Mapping the Territory*, 53 J. Bus. Ethics 51 (2004). The summary in this paragraph relies largely on the categorizations developed in this article.

25 *See* Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 Cornell L. Rev. 856 (1997).

26 Daily et al., *supra* note 2, at 379–380.

27 For a good general book providing guidance on research, see Wayne Booth et al., The Craft of Research, 2nd edn (2003).

28 Hans van Ees et al., *Toward a Behavioral Theory of Boards and Corporate Governance*, 17 Corp. Gov.: Int'l Rev. 307, 308–310 (2009) (identifying and describing six separate 'research streams' in corporate governance).

29 David Monsma, *The Academic Equivalence of Science and Law: Normative Legal Scholarship in the Quantitative Domain of Social Science*, 23 T.M. Cooley L. Rev. 157, 159 (2006).

30 Randall S. Thomas, *The Increasing Role of Empirical Research in Corporate Law Scholarship*, 92 Geo. L.J. 981, 981–982 (2004) (book review).

31 *See* The Bluebook: *A Uniform System of Citation* (19th Ed. 2010).

32 *See* Michael McConville & Wing Hong Chui, *Research Methods for Law*, 18 (2007) ('[L]egal research, as taught in many law schools, is far too narrow in its outlook').

33 *See* Philip C. Kissam, *The Evaluation of Legal Scholarship*, 63 Wash. L. Rev. 221 (1988); Edward L. Rubin, *On Beyond Truth: A Theory for Evaluating Legal Scholarship*, 80 Calif. L. Rev. 889 (1992).

34 Marin Roger Scordato, *Reflections on the Nature of Legal Scholarship in the Post-Realist Era*, 48 Santa Clara L. Rev. 353, 410 (2008).

35 *See, e.g.*, Harry T. Edwards, *The Growing Disjunction between Legal Education and the Legal Profession*,

91 Mich. L. Rev. 34 (1992).

36 Scordato, *supra* note 33, at 420–422.

37 *See, generally*, Sanjai Bhagat & Roberta Romano, *Empirical Studies of Corporate Law, in* Handbook of Law and Economics, Vol. 2 (A. Mitchell Polinsky & Steven Shavell eds, 2007).

38 Henry L. Tosi, *Quo Vadis: Suggestions for Future Corporate Governance Research*, 12 J. Manage. Gov. 153, 163–164 (2008) (suggesting the use of laboratory and survey research methods as a complement to quantitative corporate governance research based on archival state sets).

39 *See* Oliver Marnet, *Behavior and Rationality in Corporate Governance*, 39 J. Econ. Issues 613, 613 (2005) (‘Empirical research on corporate governance typically investigates quantifiable relationships between measures of corporate performance and specific remedies to agency problems, including the number and independence of directors on a company board or board committees and the independence of external auditors.’ (citations omitted)).

40 For an excellent pair of articles on corporate law event studies, see Sanjai Bhagat & Roberta Romano, *Event Studies and the Law – Part I: Technique and Corporate Litigation*, 4 Amer. L. & Econ. Rev. 141 (2002) (earlier draft available at http://ssrn.com/abstract=268283) [hereinafter *Part I*] and Sanjai Bhagat & Roberta Romano Event Studies and the Law: *Part II – Empirical Studies of Corporate Law*, 4 Amer. L. & Econ. Rev. 380 (2002) (earlier draft available at http://ssrn.com/abstract=268285) [hereinafter *Part II*].

Event studies have had a major impact on corporate law. The explanation for this influence is straightforward. The objective of U.S. corporate law is furthering the interest of the owners of the firm, and the event study methodology, measuring the unexpected change in stock price due to new information about firm value, such as adoption of a new corporate law or a firm decision, provides a metric for identifying whether a specific corporate policy or action has the legal regime's desired beneficial impact on firm owners. Moreover, the event study literature serves as a helpful arbiter of corporate law debates because all sides hold the same normative conception of corporate law, shareholder wealth maximization. Bhagat & Romano, *Part II, supra*, at 381–382.

41 Bhagat & Romano, *Part I, supra* note 39, at 144–146.

42 Jonah B. Gelbach et al., Valid Inference in Single-Firm, Single-Event Studies, at 3, July 2009, *available at*http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1442222 (‘The popularity of event studies derives from their simple and elegant method of controlling for general market effects and other relevant covariates, there-

by isolating causal effects of events like a law's passage, corporate governance adoption, and so on.').

43 Daily et al., *supra* note 2, at 378.

44 *Id*. at 378–380.

45 *See* Gillan, *supra* note 1, at 396.

46 Bhagat & Romano, *Part I, supra* note 39, at 164.

47 *See, e.g*., Derek K. Oler et al., *The Danger of Misinterpreting Short-Window Event Study Findings in Strategic Management Research: An Empirical Illustration Using Horizontal Acquisitions*, 6 Strategic Org. 151 (2008).

48 *See* Lori J. Letts et al., *Guidelines for Critical Review Form: Qualitative Studies* (Version 2.0), 2007, pp. 2–3, *available at*http://www.srs-mcmaster.ca/Portals/20/pdf/ebp/qualguidelines_version2.0.pdf (describing these among other types of qualitative empirical research).

49 *See, e.g*., David Silverman, Qualitative Research: Theory, Method and Practice 360–362 (2004).

50 *See* Marnet, *supra* note 38, at 613–614.

51 Principles of Contemporary Corporate Governance 375 (J.J. Du Plessis et al., eds, 2005).

52 *See* Marnet, *supra* note 38, at 613–614; van Ees et al., *supra* note 28, at 311–313.

53 *See* van Ees et al., *supra* note 28, at 307 ('[B]ehavioral' studies of boards and corporate governance are scattered across disciplines and research traditions, and they apply different methodologies and assumptions'); *id*. at 311 (same).

54 Robert Libby & Nicholas Seybert, *Behavioral Studies of the Effects of Regulation on Earnings Management and Accounting Choice*, in Accounting, Organizations, and Institutions: Essays in Honor of Anthony Hopwood 290, 292 (Anthony G. Hopwood et al., eds., 2009).

55 *See* van Ees et al., *supra* note 28, at 307 ('[A] growing number of studies have emphasized the need to more closely study behavioral processes and dynamics in and around the boardroom to better understand conditions for effective corporate governance').

56 *See id*. at 315.

57 *See id*. at 311 ('[T]he idea that the different theories provide complementary perspectives, and that none of them can independently provide a full explanation, seems to have gained some ground in the field.').

- corporate governance
- research governance
- business law
- shareholders
- governance
- theories of governance
- agency theory

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