Available online at www.sciencedirect.com
ScienceDirect
Procedia Social and Behavioral Sciences 2 (2010) 6875–6882
Procedia
Social and Behavioral Sciences

Selected Papers of Beijing Forum 2007

Harmonious Corporate Governance

Randall Morck

Professor, University of Alberta

Bernard Yeung

Professor, New York University[i]

Abstract

Corporate governance matters because how well corporations utilize the people's savings matters. Many developed economies mandate that corporations be run for their public shareholders. This is not because shareholders are superior to employees, bankers, bondholders, customers, suppliers, or anyone else. Rather, it is because poor governance usually harms public shareholders before it harms others. Well engineered disclosure rules make corporations transparent, so poor governance quickly depresses share prices, alarming shareholders who demand corrective measures. Ideally, all this happens before the problem grows large enough to harm employees, customers, or other stakeholders. Governing corporations for shareholders really amounts to 'using' shareholders as early warning alarms and automatic correction mechanisms. But sound government policies are necessary, for this works if corporations are rendered transparent and public shareholders are empowered to force changes. Other stakeholders cannot fulfill this role as well because shareholders' wealth is most directly tied to the firm's economic efficiency.

1. Introduction

The wealth modern corporations generate is key to the high standards of living enjoyed by the citizens of developed economies. Consequently, much attention is rightly focused on how well a country's great corporations are managed. In recent years, this concern calls for improved 'corporate governance'. But the concern itself is far older than these words. After virtually every major stock market decline of the past four centuries, concerns about the quality of decision-making by top corporate executives arise in one form or another.[ii]

These concerns are legitimate, for modern economies entrust corporations with the task of using the people's savings to build productive capital assets that meet the needs of the economy. If top corporate managers routinely squander the nation's savings on foolish or self-aggrandizing ventures, the welfare of the whole people is compromised. But if top corporate managers typically invest the public's savings wisely and productively, the overall wealth of the nation grows. Good corporate governance is often framed in terms of fairness to shareholders, but its real importance is to the harmonious prosperity of the economy.

In Western legal tradition, a 'corporation' is an 'artificial individual', for the very word descends from the Latin 'corpus', meaning 'person' or 'body'. The corporation was invented by Dutch merchants at the beginning of the 17th century to undertake ventures too grand in scope, scale, and duration to be accomplished by a single person or

1877-0428 © 2010 Beijing Forum. Published by Elsevier Ltd. Open access under CC BY-NC-ND license.
doi:10.1016/j.sbspro.2010.05.038

even a single wealthy family.[iii] Its purpose was, and remains, to organize large numbers of individuals in a cooperative venture capable of mobilizing savings no real person could command alone.

The ‘body’ of a corporation thus comprises many real people: its workers, mangers, suppliers, customers, bondholders, bankers, and shareholders. Recent commentators on corporate governance have taken to calling these ‘stakeholders’, though an older term ‘claimants’ is perhaps more accurate, for each has a certain ‘claim’ to a portion of the revenues the corporation generates. Workers claim wages, managers claim salaries and bonuses, suppliers claim payment for the inputs they provide, customers claim products promised them, bankers and bondholders claim interest due, shareholders claim dividends, and so on. This older term perhaps better justifies expanding the list to include the government, which claims taxes on the corporation’s income, and the community at large, which demands ethical conduct by the corporation.

To advance their well-being, and the greater good, all these stakeholders must act in harmony. But harmony is not equality. Just as the foot can not demand a place upon the shoulders for the sake of equality with the head, the different stakeholders that compose the artificial person of a corporation should not be treated precisely equally. In fact, economic theory and evidence show that harmonious prosperity is best sustained if differences between different stakeholders are respected.

2. Harmony in Variety

In most developed economies, the law requires that corporations be run in the best interests of their shareholders. There are many exceptions to this, of course. Germany requires a balance between shareholders and workers, but *de facto* gives banks a dominant role; and Canada’s Supreme Court recently ruled that corporations be run in the best interest of the artificial person of the corporation itself.

These deviations from the standard model of shareholder interests are thought by many, especially those critical of market economies, to be ‘progressive’ or ‘egalitarian’, but they are not. The German system has its roots in World War II, when Adolf Hitler sought to seize control of all major German corporations without nationalizing them (which would have been socialist). His solution was to sever the duty of corporate managers to shareholders in the name of workers’ rights, but relegate real corporate control to banks. Once Nazis were put in charge of the major labor unions and banks, Hitler’s control over Germany’s great corporations was secured without any socialist nationalizations.[iv]

Ignorant of the Nazi pedigree of the German model, ‘progressive’ reformers in a few US states, starting with Pennsylvania, rewrote their laws to require that corporations be run in the ‘balanced interests of all stakeholders’. Canada’s recent revision of its laws probably owes more to its confused Common Law judges setting confused precedents than to deep thinking.[v] But such changes are rare, for the most part, once such standards are in place, they are difficult to change. Germany still operates under corporate governance rules established by the Nazis, and Italy continues to operate under rules mainly established by Mussolini.[vi] Correctly setting the balance of rights and duties across different classes of stakeholders is important, and important to get right the first time because errors are difficult to correct.

Equality of stakeholders is often couched in ethical terms. Equality is desirable, so it is claimed that equal treatment of all stakeholder must also be ethical. But one is not born a shareholder, rather than a bondholder or a banker. Nor is one born a worker, rather than a customer. The economic roles people play when they interact with a corporation are largely voluntary. Even the poor and uneducated, via their pension funds and insurance funds, may end up being workers for one corporation and shareholders in others. Ethics can hardly justify augmenting workers’ rights over shareholders’ if this destroys the value of pensioners’ savings.

But economic logic can easily clear up this confusion. The different stakeholders play very different roles in the corporation, and the laws and regulations that govern corporations best serve the economy as a whole by clarifying these roles.

3. Shareholder Safeguarding Harmony

The United Kingdom and United States, except for Pennsylvania and its imitators, demand that corporations be run in the interests of their shareholders. This sounds like the law is favoring shareholders, perhaps because they were historically wealthier and more powerful than workers or other stakeholders-though bankers and bondholders are hardly weak and vulnerable. In fact, the law is not favoring shareholders. Rather the law is cynically 'using' them.

Shareholders are different from other stakeholders, for their claim on the corporation's wealth is 'residual'. This means that the corporation is legally required to pay its workers, suppliers, creditors, and taxes first. Only after all other stakeholders' claims are satisfied may the corporation pay any dividends to its shareholders. Because of this, a corporation's shareholders are sometimes called its 'residual claimants'.

Shareholders' status as residual claimants makes them far more sensitive to poor governance than the other stakeholders are. If a corporation starts performing badly, it must cut its dividends to shareholders first, sending its share price plummeting. Even rumors that a corporation's revenues are falling, and that it might someday have to cut its dividends, are enough to depress its share price sharply. Poor governance, even the slightest hint of mismanagement, hurts the shareholders within minutes of the news spreading via wire services, news media stories, and financial analysts' pronouncements.

The other stakeholders, in contrast, are more insulated from governance problems. It often takes years of mismanagement before a corporation is so dysfunctional that it can not pay workers' wages, suppliers' bills, bank interest payments, or taxes.

The reason centuries of experience in the Western world led to laws requiring that corporations be run in the interests of their shareholders is not that shareholders are more worthy than all others, but that they are more sensitive to mismanagement. We use shareholders as an 'early warning alarm' system to sound sirens when a corporation's governance becomes questionable. Any other system disconnects that warning system, and so puts the other stakeholders in uncertain peril.

A brief analogy with mining safety is useful here. Before modern technology allowed air quality underground to be monitored closely, miners throughout the Western world always took canaries, small yellow song birds, with them into mines. Canaries are more sensitive to poor air quality than are humans, so miners knew that a silent canary was a danger signal to flee the mine Sensible governance of a medieval mine arguably implied running the mine in the interests of the canaries, and this is roughly what was done. As long as the canaries sang happily, the miners were safe and the mine productive. No-one argued that canaries were more important than miners; they were just more sensitive signals of trouble. Consequently, everyone listened carefully to the canaries.

4. Harmony through Clarity

Modern economies use shareholders in a similar fashion-as sensitive alarm systems that alert others to governance problems. This alarm system works best if corporations are as transparent to their shareholders as possible. Otherwise, false rumors can cause unnecessary share price fluctuations and suppressed bad news can keep share prices from falling as they should.

For shareholders to fulfill their social duty as canaries, firms must publish timely and correct financial data, a competitive and independent business news sector must earn profits by checking its facts and spreading truthful information, and the law must let shareholders take corrective measures when problems become evident. Each of these three points deserves the attention of political leaders.

Poorly performing managers understandably wish to keep their firm's problems secret or to release false news of high profits. This sort of behavior is deeply destructive, for it undermines the usefulness of shareholders as protectors of workers and other stakeholders. The timely release of truthful and complete financial data to the public is essential not merely for the sake of shareholders, but to let shareholders fulfill their social purpose as early warning alarms for incompetence or venality in corporate boardrooms.[vii]

Of course, the burden of producing this information falls on all corporations, not just the ill run ones, so the government must find a middle way-disclosure rules that do not overly burden well-governed corporations, but that have sufficient strength to expose ill-governed corporations quickly and accurately.

Every successful modern economy has business newspapers, or at least business sections in general newspapers, that boost sales and thus earn profits by exposing problems in other businesses. Much research in economic history ties the development of mass circulation newspapers in the late 19th to the exposure of systemic corruption in Western countries' big businesses, and to widespread political support for the leaders who effectively reduced corruption. The critical development appears to have been new technology that greatly cut the price of paper by allowing its cheap mass production from wood pulp.[viii]

Again, corporations and real individuals must have some expectation of privacy. Corporations need to protect cutting edge research secrets from competitors' eyes, and CEOs cannot be hounded by business reporters acting like paparazzi chasing movie stars. The challenge for governments is to find an optimal balance between individuals' rights to privacy and societies' right to timely and true alarm signals from well-informed shareholders.

Finally, shareholders need the power to do something if corporate governance worsens sharply. One possibility is to let shareholders vote to fire underperforming top corporate executives in shareholder meetings. But this response can fail if insiders—the underperforming top managers, their families, or other allies—control large enough blocks of stock. Another possibility is to let angry shareholders sue under-performing top managers for damages, but this can be too costly to small shareholders. Yet another option is to design a financial system that allows corporate takeovers, so that well-governed corporations can buy ill-governed corporations, fire the latter's underperforming top managers, and replace them with better talent.

Regardless of the corrective mechanism used, shareholder power cannot be too easily triggered, for well-run corporations sometimes suffer bad luck; and replacing their top mangers might only create confusion when clear thinking is most needed. But protestations by top managers that shareholder power is too dangerous must also be filtered through the knowledge that the general prosperity might well be advanced if certain great corporations were run by better qualified top executives. The right balance thus requires thoughtful government policy. Ideally, an omnipresent threat of shareholders firing poor corporate top managers should induce the latter to quit voluntarily, or improve their performance. Shareholder power, properly constituted, need actually be exercised only rarely.

5. Balancing Risk and Reward

Most shareholders become shareholders by investing their savings in stock markets, hoping to increase their wealth in order to live comfortably in retirement.[ix] But the social purpose of shareholders is to monitor share price fluctuations and support corrective action when corporate governance problems emerge. These price fluctuations expose shareholders to the chance that their savings might be worth much more someday, but also to the risk that they might be worth much less.

Corporations have found that shareholders, like other people, usually dislike risk. Consequently, corporations pay their shareholders present or future dividends large enough to constitute an offsetting reward. This *risk premium* is higher for stocks that expose shareholders to greater uncertainty.

In contrast, bankers and bondholders usually get their interest payments on time, so they are willing to accept lower rewards for advancing money to the firm. The same is true of customers who pay in advance-they usually get timely delivery of the goods they buy-or suppliers who ship inputs in advance-they are usually paid on time too. Unless the corporation is very ill-governed, or unusually unlucky, these and other stakeholders should never doubt that their claims will be honored. Moreover, a well governed corporation should limit its exposure to bad luck-it should never hire workers it likely cannot pay, take out loans it cannot repay, or enter contracts with customers or suppliers that it cannot honor.

If bad decisions (or bad luck) do depress revenues, top corporate executives are duty-bound to honor the claims bankers, bondholders, customers, suppliers, and other stakeholders-even if this means sacrificing shareholders' dividends now and/or in the future. This shielding of the other stakeholders during bad times justifies the corporation paying shareholders a higher percentage return each year during good times. This risk premium is why shareholders typically earn higher average returns on their investments than do bankers, bondholders, or the providers of trade credit. But again, this does not reflect any unfairness. Shareholders are paid more because they also risk more.

6. Successful Failure

Sometimes, corporations get into such deep problems that, even if they cut their dividend payments entirely, they still cannot honor their promises to their workers, bankers, bondholders, customers, suppliers, or other stakeholders. The fates of the various stakeholders of such imprudently ill-governed (or profoundly unlucky) corporations are then determined by a country's bankruptcy law.

Bankruptcy laws are thus usefully thought of as extensions of countries' corporate governance laws-to protect stakeholders' rights when that protection is truly needed. Indeed, the main economic purposes of bankruptcy laws is to sort out the claims of stakeholders when all of them cannot be satisfied, and to determined how the corporation should be governed thenceforth.

How well a country's bankruptcy law achieves these dual goals is of first order importance to its general prosperity.[x] How a country deals with its business failures can be a critical element of its overall economic success.

First, blame must be determined. If the corporation's misfortunes are truly due to bad luck alone, its current top managers can be left in charge. But if their errors caused the corporation's problems, they need to be replaced before they can do more harm. The selection of a CEO under normal circumstances should be left to the shareholders; but in bankruptcy the shareholders become irrelevant, for they have lost their entire investment and are essentially 'out of the picture'. The other stakeholders must take charge, for the alarm system failed, or was not heeded, and the other stakeholders' claims are now at risk.

Sometimes the present and future claims of the various stakeholders can best be satisfied by letting the corporation continue in business-under new management if necessary. In such a ‘reorganization’ the different stakeholders renegotiate their claims, accepting less money or delayed payments to accommodate the corporation's diminished ability to pay. The relative rights of different stakeholders also come into play, for the workers might prefer that the firm continue under familiar top mangers, while other stakeholders might be less forgiving of those managers' past errors.

But sometimes the corporation is damaged beyond repair. If so, the stakeholders’ claims can best be satisfied by ‘liquidation’—a speedy auction to sell all the corporation’s assets to other companies. This raises money to compensate the stakeholders for their dishonored claims on the defunct corporation, even as it puts that corporation's assets back to work as quickly as possible in other corporations, renewing their contribution to the general prosperity. Again, the stakeholders' rights come into play, for the money raised by this auction must be divided among the different stakeholders.

Here, governments must manage an even more delicate balance. When a corporation is even minimally financially healthy, empowering stakeholders other than shareholders with corporate governance rights is pointless, and even harmful if this disconnects the early warning alarm system shareholders would otherwise provide. But if the corporation is unable to honor its promises to any of its various other stakeholders, or even just at serious risk of this, shareholders should cease to be the sole focus of corporate governance. If bankruptcy is certain, shareholders should lose all influence, and the distressed corporation should be run in the interests of its other stakeholders.

If the firm is bankrupt, the workers, bankers, bondholders, customers, suppliers, and tax collectors whose claims are at risk cannot all be satisfied. Consequently, the rights of different stakeholders against each other must be determined. A government concerned that workers are more vulnerable than bankers or bondholders might give employees stronger rights in bankruptcies. Another government, concerned about the stability of its banking system, might assign the highest priority in corporate bankruptcy proceedings to bankers.

There is considerable variation across countries in the rights accorded different stakeholders in bankruptcies, the only situation in which stakeholder rights really matter. China, like other countries, needs to give the distribution of stakeholder rights in bankruptcies serious reflection, so that it accommodates the needs of the economy under changing circumstances. But this flexibility needs to be build-in ahead of any crisis, for countries cannot change their bankruptcy laws willy-nilly, lest this further magnify stakeholders' doubts about their claims at the most inauspicious of times.

China’s socialist heritage can perhaps best be preserved within a market economy framework by providing workers very strong rights in corporate bankruptcies, and this may also be socially desirable to a country striving to expand its middle-income population. The offsetting social costs-a less stable banking system or the risk that customers and suppliers will avoid businesses rumored to be in trouble-may be worth paying.

7. Learning from Others' Errors

Despite the compelling logic that stakeholders should be the dominant voices in the governance of firms in or near bankruptcy, and that shareholders should retain primacy otherwise, many corporations and many countries have experimented with other arrangements. The full wealth of historical experimentation is not yet fully analyzed, but such studies as have emerged attest to the validity of running financially healthy firms 'for their shareholders'. It may 'sound good' for politicians to demand that corporations be run in the interests of not just shareholders, but of all their stakeholders; but this is unsound economic policy.

Workers can acquire strong corporate governance rights-for example, in some US corporations, workers own substantial stock in their own companies. Over the past several decades, workers have accumulated enough shares in enough companies that employee-governed firms can be meaningfully compared with otherwise-similar firms to test for systematic differences in corporate strategies and performance. Employee-governed firms perform worse, grow more slowly, take fewer risks, have shorter-term planning horizons, and (unsurprisingly) pay their workers more[xi]. While paying workers generously might be fine, slow growth and excessive aversion to risk taking are probably undesirable strategies if rapid job creation and fast economy-level growth are the government's objectives.

In yet other US firms, top managers successfully insulate themselves from shareholder pressure in various ways. Top managers, left to run things for themselves, appear to have deleterious effect of corporate strategies and performance too. Top manager-run firms perform poorly, waste money on profitless investments, and avoid even prudent risk taking.[xii]

In many Asian and European countries, as well as Canada and Latin America, handfuls of powerful families control huge groups of firms, and these corporations end up governed in the interests of these controlling shareholders alone, not in the interests of shareholders in general.[xiii] This leads to a variety of economy-level performance deficits-notably depressed *per capita* GDP growth.[xiv]

Postwar Japanese 'keiretsu' business groups allegedly gave paramount corporate governance power over many of its greatest corporations to their banks.[xv] This too is empirically linked to excessive risk avoidance in the short term and weak performance in the longer term, corporate strategies thought by some to underlie Japan's prolonged economic slowdown in the 1990s.[xvi]

In each case, the common theme is stakeholders who care little about how efficiently the corporation is run as long as their 'claims' are safe. Given the opportunity, they distort corporate decision making to benefit themselves at the expense of the overall efficient operation of the firm. The corporation's existing workers run the firm to safeguard their jobs until they are due to retire. The care less about creating new jobs (growth) or about investing in cutting edge technology. Bankers care about the firm's ability to meet its current interest bills, not about its long-run productivity. Current workers dislike new technologies that might make their skills obsolete.

In contrast, public shareholders gain whenever the stock prices rises and lose whenever it falls. If corporations are transparent enough that these price fluctuations are at least loosely tied to real changes in the corporation's expected profits, the shareholders have a clear economic interest in the corporation being run as efficiently as possible and for the long run.

This is also what the country as a whole requires. A corporation is, by definition, run most efficiently when it converts the cheapest possible inputs into the most valuable possible outputs. This difference in value, the firm's profit, measures both how well the top managers are governing the corporation and how well they are using the nation's savings and resources. Sound government policy thus encourages firms to maximize their profits so as to avoid waste.

Sound government policy on corporate disclosure makes corporations transparent to their shareholders so stock prices mirror real value. How this is best done accomplished remains a point of genuine debate, for every country's stock markets still experience occasional episodes of 'irrational exuberance'.[xvii] If these episodes are the exception, rather than the rule, stock prices can still serve as useful (though imperfect) barometers of the quality of corporate governance, and shareholders can still serve as useful canaries.

Of course, if corporations are sufficiently opaque to make stock prices meaningless, this alarm system no longer serves a useful purpose. In such a situation, allocation of capital by central planners might preferable to allocation of capital in response to share price signals. But central planning induces well-known inefficiencies that kept many socialist countries very poor for many years. Market economies work better if their governments carefully devise transparency rules and governance regimes that draft shareholders to serve the people as a whole. If desired, socialist characteristics can be preserved by protecting workers' rights more strongly than those of other stakeholders in bankrupt or near bankrupt corporations, when workers' wellbeing is most genuinely at risk.

8. Conclusions

Corporate governance matters because corporations allocate the nation's savings and resources into some undertakings and not others. The quality of these allocation decisions affects the fortunes of the corporation, and the overall quality of such decisions across the economy affects the general level of prosperity.

Our best current understanding of the economics underlying corporate decision-making suggests that top corporate managers be instructed to act in the interests of their public shareholders. This is because public shareholders are hurt first in even slightly misgoverned corporations. Their outcry can serve as a warning that 'all is not well'. By empowering shareholders to fire underperforming top managers, the state can establish a mechanism that automatically detects and corrects governance problems. Corporate governance laws and regulations seek to engineer this system so it operates at minimal cost in well-governed corporations and with maximal accuracy in ill-governed corporations.

Arguments for assigning top corporate executives a more general duty to balance the interests of all stakeholders-workers, managers, bankers, bondholders, customers, suppliers, etc.-misunderstand this logic, and risk short-circuiting the early-warning alarm and automatic course-correction system shareholders provide. If shareholders no longer provide these services, other stakeholders are needlessly put at risk and the stock market fails to fulfill one of its most important social purposes.

Top managers' duty should shift from shareholders to other stakeholders in a corporation in or near bankruptcy. Since healthy corporations always pay all they owe to their workers, managers, bankers, bondholders, customers, suppliers, and other stakeholders, these stakeholders are safe and only public shareholders are hurt by governance mistakes. But corporations in or near bankruptcy may not be able to pay all their stakeholders' claims, putting some in genuine financial peril. Bankruptcy laws balance the often conflicting interests of these stakeholders when their rights matter most. Clarifying the rights of all the firm's various stakeholders is indeed an important matter for government policy, but it matters mainly in bankruptcy. Consequently, stakeholder rights need to be engineered to come into effect as bankruptcy looms. But in the normal course of events for a healthy corporation, the general welfare is best served if corporations are run in the interests of their public shareholders.

Different countries and sub-national jurisdictions have experimented with different arrangements of stakeholder rights, and no system is perfect. Legally mandating that top corporate executives act for workers, creditors, bankers, or other stakeholders causes problems. These arise because these stakeholders are more likely than shareholder to have objectives discordant to the overall harmonious efficiency of the economy, and thus do not provide the useful early warning alarm that shareholders offer. Harmonious prosperity is best served by recognizing the different positions of shareholders and other stakeholders, and by mandating that firms be run for their public shareholders under normal conditions, and for their full spectrum of stakeholders if bankruptcy looms.

References

Durnev, Artyom, Randall Morck and Bernard Yeung. 2004. Value Enhancing Capital Budgeting and Firm-Specific Stock Returns Variatio. *Journal of Finance* 59(1) 65-105.

Dyck, Alexander, Natalya Volchkova, and Luigi Zingales. 2007. Corporate Governance Role of the Media: Evidence from Russia. *Journal of Finance* forthcoming.

Faleye, Olubunmi, Vikas Mehrotra and Randall Morck. 2006. When Labor has a Voice in Corporate Governance. *Journal of Financial and Quantitative Analysis* 41 489-510.

Forbes, Kevin.1986. Limited Liability and the Development of the Business Corporation. *Journal of Law, Economics, & Organization* 2(1) 163-177.

Gentzkow, Matthew, Edward Glaeser, and Claudia Goldin. 2004. The Rise of the Fourth Estate: How Newspapers Became Informative and Why It Mattered. NBER Working Paper no. 10791.

Jensen, Michael. 1986. Agency costs of free cash flow, corporate finance, and takeovers. *American Economic Review* 76(2) 323-329.

Jin, Li, and Stewart Myers. 2006. R-squared Around the World: New Theory and New Tests. *Journal of Financial Economics* 79(2)257-92.

John, Kose, Lubomir Litov, and Bernard Yueng. 2007. Corporate Governance and Managerial Risk Taking: Theory and Evidence. *Journal of Finance* forthcoming.

Kindleberger, Charles. 1978. *Manias, Panics, and Crashes*: A History of Financial Crises. John Wiley & Sons.

La Porta, Rafael, Florencio López-de-Silanes, and Andrei Shleifer. 1999. Corporate Ownership Around the World. *Journal of Finance* 54, 471-517.

Morck, Randall, Andrei Shleifer and Robert Vishny. 1988. Management Ownership and Market Valuation: An Empirical Analysis. *Journal of Financial Economics* 20(1/2) 293-315.

Morck, Randall, Masao Nakamura, and Anil Shivdasani. 2000. Banks, Ownership Structure, and Firm Value in Japan. *Journal of Business* 73(4) 539-68, Oct.

Morck, Randall and Masao Nakamura. 1999. Banks and Corporate Control in Japan *Journal of Finance* 54(1) 319-340.

Morck, Randall, Bernard Yeung, and Wayne Yu. 2000. The Information Content of Stock Markets: Why Do Emerging Markets Have Synchronous Stock Price Movements? *Journal of Financial Economics* 58(1) 215-60.

Morck, Randall, Daniel Wolfenzon, Bernard Yeung. 2005. Corporate Governance, Economic Entrenchment and Growth. *Journal of Economic Literature* 43 657-722.

Morck, Randall and Bernard Yeung. 2006. Purifying Japan's Banks: Issues and Implications. *Asian Economic Papers* 5(1) 1-32.

Morck, Randall, David Stangeland, and Bernard Yeung. 2000. Inherited Wealth, Corporate Control, and Economic Growth The Canadian Disease? In Randall Morck, ed. *Concentrated Corporate Ownership*. National Bureau of Economic Research and the University of Chicago Press.

Rosenberg, Nathan and L. E. Birdzell, Jr. 1986. *How the West Grew Rich: The Economic Transformation of the Industrial World*. New York: Basic Books.

Shiller, Robert. 2000. *Irrational Exuberance*. Princeton University Press.

Temin, Peter. 2001. A Market Economy in the Early Roman Empire. *Journal of Roman Studies* 91 169-181.

Temin, Peter. 2004. Financial Intermediation in the Early Roman Empire. *Journal of Economic History* 64: 705-733.

Wurgler, Jeffrey. 2000. Financial Markets and the Allocation of Capital. *Journal of Financial Economics* 58(1) 187-214.

---

[i] Randall Morck is University Professor and Stephen Jarislowsky Distinguished Professor of Finance at the University of Alberta, Edmonton, Alberta, Canada T6G2R6; as well as a Research Associate with the National Bureau of Economic Research in Cambridge Mass.

Bernard Yeung is Dean and Stephen Riady Distinguished Professor of Finance, NUS Business School BIZ 2 Building, Level 6, 1 Business Link, Singapore 117592, Phone: 65 6516 3075, Fax: 65 6779 1365 E-mail: bizdean@nus.edu.sg, and Abraham Krasnoff Professor of Global Business, Professor of Economics and Professor of Management, Stern School of Business, New York University, New York NY 10012, and Honorary Professor and Co-Chair, Strategy Department, Guanghua School of Management, Peking University.

[ii] For a historical discussion of past centuries' stock market fluctuations, corporate governance problems, and regulatory responses, see Kindleberger (1976).

[iii] The first modern corporation was the *Dutch East Indies Company (Vereenigde Oostindische Compagnie* in Dutch, and thus abbreviated VOC), founded in 1602. It appears likely that legal entities much like modern corporations also played important roles in the economy of the Roman Empire, but much documentation was lost during the intervening Dark Ages.

[iv] For a detailed history of the development of the German Model of stakeholder rights, see Fohlin (2005).

[v] See Peoples v Wise ［2004］ 3 S.C.R. 461, 2004 SCC 68.

[vi] On the origin of Italian corporate governance standards, see Aganin and Volpin (2005).

[vii] For empirical evidence, see Morck et al. (2000), Wurgler (2000), Jin and Myers (200x), and many others.

[viii] See Gentzkow et al. (2004); also Dyck et al. (2007).

[ix] The stereotype that shareholders are wealthy tycoons retains validity in Latin America and parts of Asia, but in developed countries, especially the United States, the United Kingdom, and Japan, a corporation's shareholders are usually multitudes of small investors.

[x] On the importance of sorting out various claimants rights under different circumstances as a key institutional development, see Rosenberg and Birdzell (1986); on the role of limited liability in the historical development of the modern business corporation, see also Forbes (1986).

[xi] For statistical evidence on these comparisons, see Faleye et al. (2006)

[xii] For evidence on performance, see Morck et al. (1988) and the subsequent literature; on wasteful investment, see Jensen (1986) buttressed by Durnev et al. (2004); and on risk taking, see John et al. (2007)

[xiii] For a general survey, see La Porta et al. (1999). On Canada, see Morck, Stangeland, and Yeung (2000).

[xiv] For a survey of the empirical evidence supporting this, see Morck et al.

[xv] For statistical evidence on the role of Japanese banks in corporate governance, see Morck and Nakamura (1999) and Morck et al. (2000).

[xvi] See Morck and Yeung (2006) for discussion re. the plausibility of this possible link.

[xvii] Shiller (2000)