1

Introduction

1.1 Motivation

Lately the corporate governance practices of contemporary corporations have met with considerable interest. The corporate governance research and discussion have their origin in the 1930s, when Berle/Means [1932] observed and addressed the increasing separation of ownership and control of firms. This development was caused by significant corporate law reforms taking hold around the turn of the 19^{th} century.[1] The reforms enhanced the rights of corporate boards to govern without unanimous consent of shareholders in exchange for statutory benefits like appraisal rights.[2] Although the aim of the reforms was to make corporate governance more efficient, they were and still are also causing problems. They have watered down shareholder inspection rights,[3] which lead Cook [1894] to the drastic statement that these corporate law changes allow managers to turn firms into "efficient instruments of fraud, speculation, plunder and illegal gain."[4] Consequently, in the following years researchers have argued over the positive and negative effects of the separation of ownership and control on the firm and its performance.

A significant advance in the discussion was the development of the new institutional economics and the financial agency theory by Jensen/Meckling [1976] and Fama [1980], which allowed an institutional approach of the issue. These theoretical frameworks raised a multitude of arguments for different, even contradicting effects of the corporate governance structure on the firm. The empirical evidence on the separation's effect as well as that on the corporate governance mechanisms have not reached a consensus. Thus more and more studies have tried to achieve an explanation by further developing the research question from the simple separation to a precise consideration

[1] See Winkler [2004, p. 112].
[2] See Horwitz [1985, pp. 200-202].
[3] See Machen Jr. [1908, pp. 892-894].
[4] Cook [1894, p. 894].

of ownership and control structure. Aspects of the ownership structure like the owner's identity have become important. Especially management or institutional investors have attracted attention as owner types, since they are directly involved in the agency conflict and their special characteristics and utility functions are assumed to cause different effects.

The increasing academic discussion has also found recognition in the business world. The agency problems caused by the control loss of the shareholders led to the development and implementation of corporate governance systems to protect the rights and the equitable treatment of shareholders. The corporate governance structure defines the rules and procedures for making decisions on corporate affairs. It also provides the structure through which the company objectives are set, as well as the means of attaining and monitoring the performance of those objectives. Thus corporate governance systems increase the transparency and diminish the information asymmetry. This reduces the agency costs by limiting the space for opportunistic behavior and easing monitoring actions. Another way to reduce the agency conflict is the alignment of interest impacting especially the managerial remuneration systems, for example in form of performance-based managerial remuneration or stock option plans.

In the last decade corporate governance has been even receiving greater attention in both, developed and developing countries, as a result of the increasing recognition of its positive effect on both, the firm's economic performance and its access to capital. In the "Global Investor Opinion Survey" of over 200 institutional investors, first undertaken in 2000 and updated in 2002, McKinsey & Company (ed.) [2002] found that the majority of respondents still put corporate governance on a par with or above financial indicators when evaluating investment decisions.[5] 77% of the respondents would pay a premium for well-governed companies, which varies from 13% for North America up to even 30% for Eastern Europe or Africa.[6]

Furthermore, numerous high-profile cases of corporate governance failure as that of Enron Corporation have focused the minds of governments, companies, investors and the general public on the threat posed to the integrity of financial markets. Corporate governance practices may serve as a prevention of business failures or frauds. In response many countries have implemented governance-related reforms that have been welcomed by investors. The most prominent example is the Organisation for Economic Co-operation and Development (OECD) who revised its Principles of Corporate Governance in 2004.

---

[5] For more detailed information see Figure A.1 in Appendix A.1, p. 217. More than 60% of investors state that governance considerations might lead them to avoid individual companies with poor governance and with a third avoiding even whole countries. See Figure A.2 in Appendix A.1, p. 218.

[6] For more detailed information see Figure A.3 and Figure A.4 in Appendix A.1, pp. 218 and 219.