CORPORATE GOVERNANCE: AN INTERNATIONAL OUTLOOK

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CHAPTER 1

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CORPORATE GOVERNANCE: DOES IT STILL MATTER?

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1. Introduction

Over the last decade, corporate governance has received growing attention by policy makers, investors and rating agencies, especially in response to corporate scandals such as World Com, Enron, Arthur Andersen, Adelphia Communications, and Parmalat group. Subsequently, several corporate governance reforms were introduced around the world, in order to strengthen shareholders rights, as well as to restore market trust in the governance of public corporations. For example, in 2002 the US enacted the Sarbanes-Oxley (SOX) Act with the aim of improving governance practices inside public corporations by increasing board independence, disclosure, monitoring, and auditing mechanisms. A year later, the New York Stock Exchange (NYSE) and NASDAQ introduced new corporate governance rules by requiring that all listed companies must have a majority of independent directors, on the assumption that increased board independence leads to better management monitoring and better performance.[1]

Corporate governance (hereafter CG) deals with a set of internal and external mechanisms through which corporations are structured, managed, directed and owned.[2] A corporation represents a distinct legal entity, owned by its shareholders and managed by a board of directors. Shareholders provide equity capital, and therefore are the owners of the company. A public company (or listed company) is defined as a corporation whose shares are quoted on a stock exchange market. In a metaphoric sense, Gompers et al. (2003) view corporations as "republics": "The ultimate authority rests with voters (shareholders). These voters elect representatives (directors), who delegate most decisions to bureaucrats (managers)".[3] The authors distinguish between two extreme governance-mechanisms:

a "democracy" (in which shareholders have the power and can easily replace directors);

a "dictatorship" (in which managers have extensive power and may strongly restrict the shareholders' right to replace the company's directors).

[1] For more details on the new corporate governance rules introduced by the SOX Act and NYSE-NASDAQ, see: Finegold at al. (2007); Coles et al. (2008). In particular, Finegold et al. (2007) review 105 studies published over the period 1989-2005, in order to investigate the relationship between the key requirements introduced by US reforms and firm performance.
[2] For an extensive and well organized review of internal and external corporate governance mechanisms, see: Gillan (2006); Denis et al. (2003).
[3] See Gompers et al. (2003), p. 107.

In a corporation, shareholders have a limited liability: their risk is limited to the amount of capital supplied to the firm, and they are not directly liable for the company's obligations. Shareholders are not required to be actively involved in the management of the firm. They have the right a) to elect a board of directors to manage the corporation on their behalf, and b) to receive dividends (if any). Shareholders also hold a residual claim on the firm's equity. The board makes major strategic decisions (such as issuing new shares, distributing dividends, changing corporate bylaws, dissolving or selling the company, initiating a merger with or acquiring another company. The board leaves the day-to-day running of the company to its managers appointed by the board.

If shareholders do not agree with board decisions they may initiate actions against directors ("shareholder activism") or leave the company by selling their shares ("exit or voice" dilemma[4]). Shareholder activism is particularly evident in the case of institutional investor shareholdings (pension funds, venture capitalists and private equity investors, for example), which represent key elements in improving CG in companies (Braendle and Kostyuk 2007).[5] Indeed, several studies have documented the beneficial role played by institutional investors in helping to achieve a more efficient monitoring and governance of companies, to the benefit of all their stakeholders (Cumming and Zambelli 2009, Cao and Lerner 2009, Tirole 2001).[6]

Historically, shareholders' rights have been given greater protection in Common Law countries, such as the US., where listed firms are typically characterized by a widely dispersed ownership structure (La Porta et al. 1999), so individual shareholders hold a very small portion of total equity capital. On the contrary, the ownership structure of many listed firms in Europe is typically concentrated in the hands of few shareholders, mainly represented by wealthy families (Van der Elst 2008, Faccio and Lang 2002).[7] In the latter contexts, it is essential to establish mechanisms to protect investors' rights, as well as to strengthen minority

[4] Each State specifically regulates the extent to which shareholders may undertake actions against directors. Gehlbach (2006) introduced a new theoretical model to analyze the "exit or voice" dilemma, which was originally studied by Hirshman (1970).

[5] The shareholdings of institutional investors is increasing sharply in Europe and in the US. For more information on these trends, see Braendle and Kostyuk (2007), Kostyuk et al. (2007), Kruse (2007). A recent review on Institutional Investor Activism in Europe and in the US is developed by Santella et al. (2008).

[6] Institutional investors holding a large percentage of company's equity have a strong incentive to be actively involved in the management of the company, closely monitoring managers' activity, as well as voicing their opinion (Chung et al. 2005).

[7] Ownership concentration is particularly evident in Italy. For more information on the ownership structure of Italian listed firms see, among others: Mengoli et. al (2009), Bigelli et al. (2008), Belcredi and Rigamonti (2008), Belcredi and Caprio (2004).

shareholder rights so as to prevent, or at least minimize, potential opportunistic behaviors by directors, managers and dominant shareholders. The main rationale underlying CG reforms is based upon the assumption of a positive causal relationship between shareholders' rights and firm performance. Therefore, better corporate governance rules (especially with reference to the board structure, shareholders' rights and investors' protection) may improve the efficient management of companies, resulting in improved operating and financial performance.

La Porta, Lopez and de-Silanes, Shleifer and Vishny –LLSV- (1997, 1998) provided an empirical foundation for a line of research that emphasized the crucial role in CG of the legal environment and regulatory system, known as the "law matters view" (see also Shleifer 2008). They showed that different legal systems (especially with reference to the Common Law and Civil Law affiliation) exerted enormous influence on shareholders' protection, as well as corporate governance practices. Despite subsequent criticism by legal and economics scholars[8], their studies provided evidence that Common Law countries better protect investors and minority shareholders (La Porta et al. 1998) and better shareholder protection leads to higher firm performance (La Porta et al. 2002). Given this important link, and the performance goal underlying recent CG reforms, several questions arise:

- Does CG really matter?;
- How can we measure good corporate governance?;
- Do changes in CG matter?

The empirical evidence has not uniformly supported a positive relationship between shareholders' rights, corporate governance and firm performance. The purpose of this chapter is to answer the above questions by evaluating the most recent literature and thus to shed some light on the linkage between CG and performance. The rest of this chapter is structured as follows. Section 2 reviews corporate governance mechanisms. Section 3 focuses on the relationship between corporate governance and firm performance. Section 4 provides concluding remarks.

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[8] To review the main criticism surrounding the seminal studies by La Porta et al. (1997-1998) see, among others, Spamann (2008), Van der Elst (2008), Martynova and Renneboog (2007). Other recent studies suggest new corporate governance indexes in order to implement cross-country comparison: Martynova and Renneboog (2007, 2008), Kauffman et al. (2007), Cornellius (2005), Cools (2005). Recently, several rating system of corporate governance have been developed in order to enable companies, investors and analysts to better assess the quality of companies' governance: Donker and Zahir (2008); Doidge et al. (2007).

2. Corporate governance system

For the purpose of this chapter, we define corporate governance (CG) as the field in economics that investigates how corporations are owned, directed and controlled. CG refers to the entire set of legal provisions, organizational and institutional arrangements, cultural and ethical values that affect the activities of a company, as well as those that safeguard the interests of its stakeholders (shareholders, suppliers, creditors, and employees). [9] CG deals with the following questions: Who controls the corporation and how is that control exercised? Who has the power to make decisions and under which principles or guidelines are these decisions made? How can we guarantee that managers and directors act in the best interest of shareholders?

The basic role of CG, then, is to suggest (and sometimes impose) appropriate incentive mechanisms to motivate directors and managers (agents) to act in the best interest of the shareholders (principals), as well as to guarantee an efficient management of the company in order to improve its performance to the benefit of all their shareholders (principal-agent dilemma[10]).

CG involves the design and adoption of a set of mechanisms through which outside investors (shareholders and other suppliers of funds) may protect themselves by ensuring a satisfactory return on their investments (Shleifer and Vishny 1997).[11] These mechanisms tend to fall into 2 main categories (Figure 1.1.1):

a) External mechanisms, which refer to CG mechanisms provided by the external environment in which a firm operates (the takeover market and the regulatory environment);

b) Internal mechanisms, which refer to the whole set of incentive arrangements that are internal to the firm: board of directors, management system, board compensation (such as stock options mechanisms), and ownership and capital structure of a company. Among these elements, the board structure represents a crucial factor for an efficient corporate governance system.

9 A review of the legal foundations of corporate governance is provided in Shleifer (2008).
10 See, among others: Jensen and Meckling (1976).
11 An extensive review of literature on CG mechanisms is provided by Denis et al. (2003) and Gillan (2006).

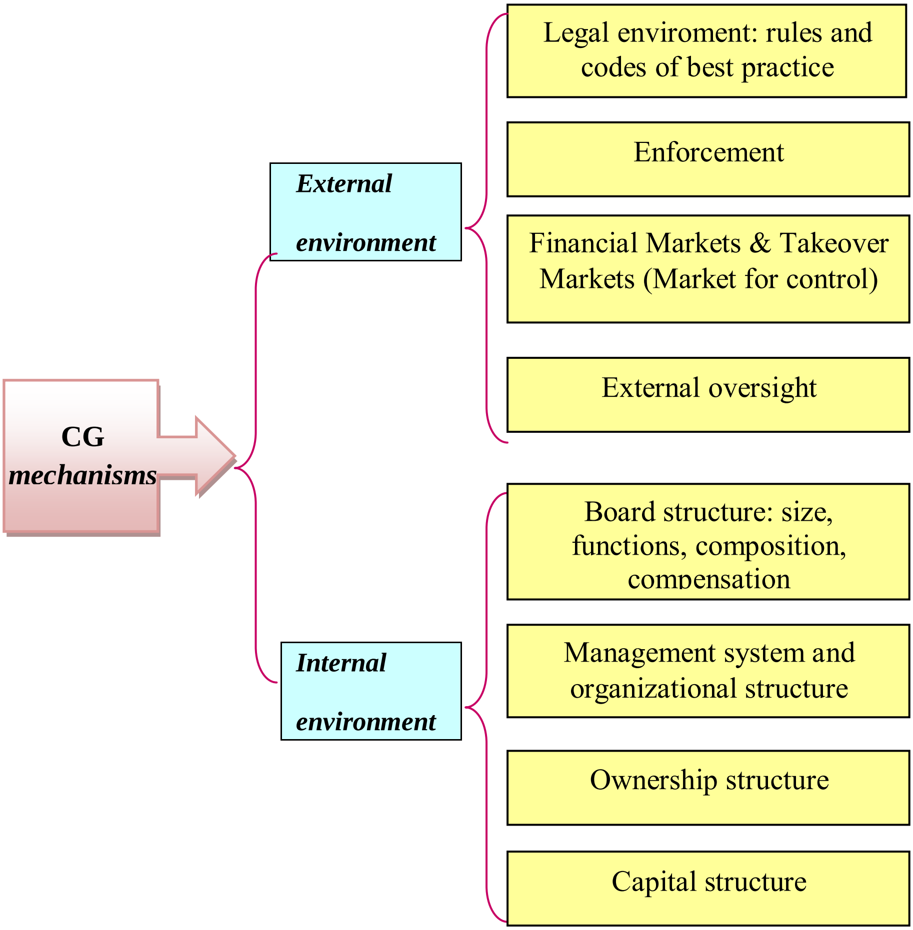

Figure 1.1.1 - Internal and External CG mechanisms

Source: Elaborated from Denis and McConnell (2003), Gillan (2006).

As emphasized by Denis et al. (2003), two main bodies of the literature on CG have developed. A first line of studies focused on:

a) internal CG mechanisms (among which the board and the ownership structure play a crucial role);

b) external control by the takeover market.

A second line of research refers to the legal environment, emphasizing the importance of the legal environment for the efficacy of the corporate governance system ("Law matters" principle). The "Law matters" view was originally introduced by La Porta et al. studies (1997, 1998, 2000) who started a growing body of studies aimed at comparing the different legal systems across countries. First, they argued that the level of investor protection and enforcement are the most important key-drivers for the development of an efficient corporate governance system.

Second, they showed that countries providing poor investor protection generally come from a Civil Law background and are characterized by high levels of ownership concentration and inefficient equity markets. The rationale underlying this evidence may be simplified as follows: if the legal system does not protect the owners (investors) from management opportunistic misbehaviors, then owners will tend to become the controllers.

Third, La Porta et al.(2002) argued that firms operating in countries characterized by higher levels of investor protection tend to perform better, in terms of Tobin's Q ratio (which represents the ratio between the market value of a firm and its total assets value[12]).

3. Does corporate governance matter for firm performance? The never-ending debate

Is there a positive relationship between shareholders rights and firm performance?

Agency theory, conventional wisdom on CG and policy makers around the world argue that CG affects firm performance. CG is supposed to lead to a more efficient decision making process. The basic idea is that good CG practices imply high investor protection and effective monitoring of managers to prevent the misuse of corporate resources by directors, managers and majority shareholders. This should lead to a more efficient allocation of resources and therefore to better long term firm performance. Good CG is not only supposed to increase firm value and performance, but also to lower the cost of raising capital and reduce the probability of having opportunistic and fraudulent behavior by managers and directors -principal agent problem- (Jensen and Meckling 1976). Agency theory

[12] In the empirical literature, Tobin's Q ratio has often been used as an indicator of a company's future growth potential or future performance (Dushnitsky and Lenox 2006), as well as an indicator of a company's intangible assets (Simmon and Sullivan 1993). Tobin's Q is measured as the market value of equity plus the book value of debt divided by the replacement value of assets. The denominator (the replacement value of assets) is difficult to estimate, due to a lack of available data. Therefore, scholars generally tend to use an approximation of Tobin's Q, by considering the book value of assets instead of their replacement cost (see for example Bozec and Laurin 2008, Garay and Gonzalez 2008).

also predicts that the perceived quality of CG should positively influence the firm's share-price.[13]

Despite theoretical predictions, the empirical evidence does not unambiguously support the view that good CG implies higher firm performance. Mixed and even contrasted results exist. The following sections review the most recent empirical literature on this matter.[14]

3.1 Assessing the corporate governance impact through surveys and indexes

3.1.1 McKinsey & Company Opinion Survey

In 2002, a survey developed by McKinsey & Company in Asia showed that the majority of professional investors (78%) were willing to pay a 20-25% premium for companies characterized by better corporate governance practices (McKinsey & Company, 2002). The survey highlighted several policy implications on what matters in CG, as well as a series of priorities for policy makers and regulators around the world: improving shareholders' rights, enhancing the disclosure, monitoring and independence of board, strengthen the enforcement system (in line with Enriquez 2002, Enriquez and Volpin 2007).

Subsequent studies attempted to evaluate the relationship between CG quality and firm performance in a more rigorous manner by proposing different CG indexes, in the spirit of La Porta et al. (1997-1998). However, assessing the quality of CG through a global index is not easy and it might be the result of a subjective judgment, especially with reference to whether certain CG provisions should be included or not. Moreover, one should not focus on the effect of a single governance provision, analyzed in isolation, without considering the potential influence on shareholder value played by other governance arrangements. It might then be helpful to look at the entire set of corporate governance principles published by the Organisation for Economic Co-operation and Development (OECD) as Campos et al. (2002) and Nam and Nam (2005) did[15], or to look at the

[13] A recent review of the theoretical literature on agency theory and its implication for corporate governance is provided in: Biswas and Bhuiyan (2008). See also Fama (1980).
[14] A more detailed review of the empirical evidence investigating the linkage between the quality of CG and firm performance is provided by: Shepherd et al. (2008), Bhagat and Bolton (2008), Lehen et al. (2007), Buccirossi and Spagnolo (2007), Brennan (2006). A review of the mixed empirical evidence on the relationship between CG and firm performance is developed by: Donker and Zahir (2008).
[15] The OECD corporate governance principles were originally developed in 1999 and updated in 2004 in response to recent well known corporate scandals. These principles mainly refer to the following areas: shareholder protection and equitable treatment (in

governance provisions monitored by the Investor Responsibility Research Center (IRRC) for institutional investors and academics interested in corporate governance issues (as Gompers et al. 2003 and Bebchuk et al. 2009 did).[16]

3.1.2 Gompers, Ishii and Metrick (2003) index

As anticipated, Gompers et al. (2003) viewed corporations as "republics" which can operate within two main governance models: a democracy and a dictatorship. In order to investigate the relationship between shareholders' rights and firm performance, they analyzed the governance models adopted by 1500 firms during the 1990s and then constructed an aggregate governance index (known as the GIM index) based on 24 distinct governance provisions published by the IRRC organization. In particular, they investigated the correlation between the IRRC provisions (included in an aggregate corporate governance index) and firm's stock returns. In order to develop the GIM index they adopted the following methodology: for each firm they added one point for every governance provision that limited shareholders' rights.[17] As shown in Figure 1.1.2, the GIM index varies from 1 to 24: the highest score refers to the highest management power, or the weakest shareholder rights protection; the lowest score instead represents the lowest management power. They also identified two extreme portfolios:

a) Dictatorship Portfolio, with the highest management power and weakest investor protection;

b) Democracy Portfolio, characterized by the lowest management power and strongest investor protection.

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terms of a transparent and dispersed ownership structure; meeting notifications, anti-takeover provisions); board structure (in terms independent directors, written board guidelines); disclosure (in terms of transparent and timely disclosure); efficient auditing system (in terms of independent auditors); efficient enforcement. Campos et al. (2002) developed a score of good CG driven from the OECD principles. See OECD (1999-2004), available at: http://www.oecd.org/dataoecd/32/18/31557724.pdf

[16] The IRRC monitors 24 governance provisions that might affect shareholder value. For more details on the specific content of these provisions, see: Gompers et al. (2003).

[17] To view the specific governance provisions included into the GIM index, see Gompers et al. (2003).

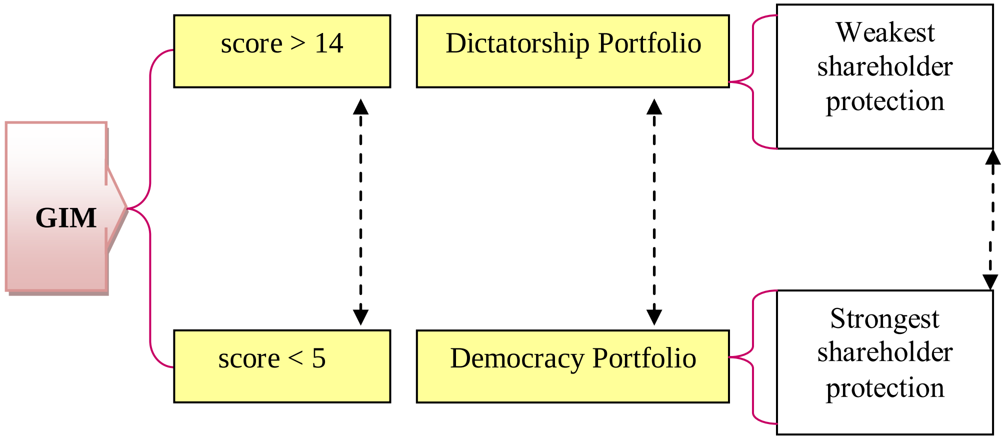

Figure 1.1.2 - The GIM index

Source: Elaborated from Gompers, Ishii and Metrick (2003)

Gompers et al. (2003) found that firms with weaker shareholder rights (implying a higher index) were less profitable both in terms of stock returns and Tobin's Q. In particular, they identified a significant negative correlation between the GIM index and stock returns during the 1990s. By contrast, the Democracy Portfolio (represented by firms with the strongest shareholder protection) outperformed the Dictatorship Portfolio (represented by firms with the weakest shareholder rights) by 8.5% per year over the 1990s. The authors also found a statistically significant negative correlation between their GIM index and firm performance (as measured by the Tobin's Q ratio, as well as the sales growth), implying that the higher the GIM score the worse the performance.

Despite the documented negative correlation between the 24 IRRC governance provisions included in the GIM index and firm-performance, a few important questions remained unsolved.

1. Is it possible to imply a causal relationship between governance and performance, so that bad performance is caused by bad governance provisions or vice versa? Although Gompers et al. (2003) found a high correlation, they could not identify a causal relationship between their GIM index and firm performance due to potential endogeneity problems: CG provisions adopted by a firm might be endogenous and therefore it is difficult to assess "what causes what". As a result, alternative interpretations might be possible. For example: a) a reverse causal relationship between governance and performance may exist, so that firms

with better performance might choose to adopt better governance arrangements; b) a negative correlation between the GIM index and performance might be time specific (as Core et al. 2006 showed); c) other unobservable factors could affect simultaneously firm performance and corporate governance. As a result, Gompers et al. (2003) called for additional research in corporate governance in order to properly address the endogeneity issue, as well as to give a more definitive interpretation on the causality of the relationship between CG and performance.

2. Among the 24 IRRC governance provisions included in the GIM index, which arrangements have the most relevance for shareholder value?

3. Is CG more important for countries with strong investor protection or not?

Notwithstanding the above unresolved questions, the work by Gompers et al.(2003) represented an important step forward for the subsequent corporate governance research and practice. It provided a foundation for several studies that adopted their governance index as a proxy for firms' governance quality (see for example: Amit and Villalonga 2006, Core et al. 2006, Yermack 2006, Cremer and Nair 2005). Bebchuk et al. (2009) identified the IRRC provisions that matter the most, Bhagat and Bolton (2008) addressed the endogeneity issue mentioned above, while Garay and Gonzalez (2008) and Nam and Nam (2005) identified for which countries CG seems to be more important. These studies are analyzed in the following sections.

3.1.3 Bebchuk, Cohen and Farrel (2009) index

Bebchuk et al. (2009) further developed the GIM index by looking inside the IRRC "black box" in order to identify the IRRC governance provisions that really matter for shareholder value. Among the 24 IRRC CG arrangements, they identified 6 key-provisions that involved an entrenchment effect and that could have a substantial impact on shareholder value over the period 1990-2003.[18] For the purpose of this review, an entrenchment involves an abuse of a dominant position by the controllers of a company (directors, or controlling shareholders) that could damage firm value by diverting firm resources to satisfy their own interests to the detriment of shareholders, as well as deterring outside investors.[19]

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[18] See Bebchuk et al. (2009) for information about the specific entrenching governance provisions.

[19] For a recent review of studies focused on the Entrenchment effect see, among others: Bozec and Laurin (2008); Filatotchev et al. (2001).

Bebchuk et al. (2009) constructed an index based on these 6 entrenching arrangements, which they called the "Entrenchment Index" (also known as the BCF index). This index varies, from 0 to 6, according to the number of the entrenching provisions adopted by each specific firm (Figure 1.1.3).

Bebchuk et al. (2009) found a significantly negative correlation between their Entrenchment Index and firm performance (in terms of firm's stock returns) over the 1990-2003 period, implying that the presence of entrenching provisions is associated with a decline in a firm's stock returns. Therefore, if one implemented a strategy of buying firms with a low Entrenchment score and, at the same time, sold firms with a high Entrenchment Index, he or she would have obtained significantly abnormal returns.

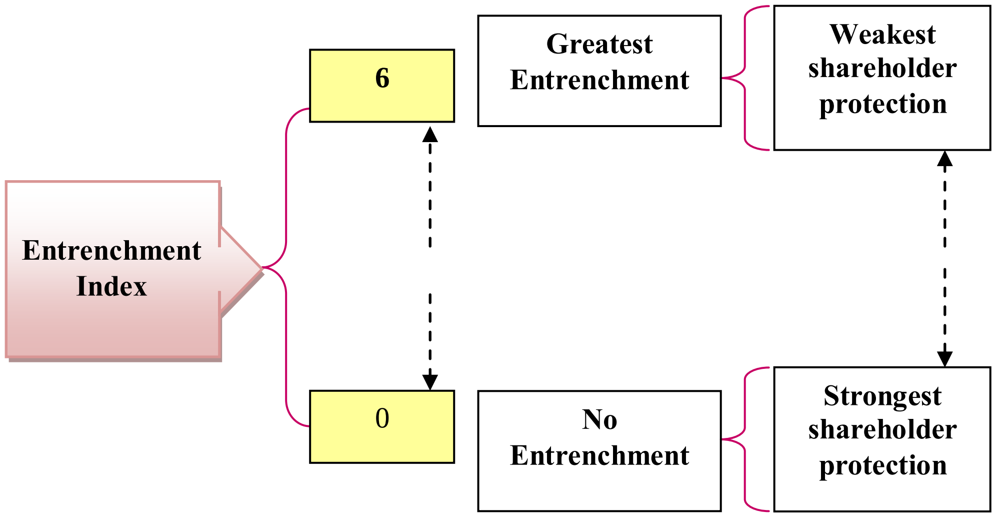

Figure 1.1.3 - The BCF index

Source: Elaborated from Bebchuk, Cohen and Farrel (2009).

The negative correlation between the Entrenchment Index and firm valuation did not imply that the entrenching provisions caused a lower firm value due to potential endogeneity problems not yet solved. The negative correlation between the Entrenchment index and firm performance documented by Bebchuck et al.(2005) could be the result of a firm choice so that low-value firms seek to adopt entrenching provisions.

Despite the unresolved endogeneity issues, the Bebchuck et al.(2005) findings have important policy implications, because they identified the governance provisions that really matter for shareholder value. Among the entire set of 24 IRRC governance arrangements, they showed the substantial relevance of only 6 provisions (the entrenching ones). These provisions are the most important driving forces behind the negative correlation between governance and firm valuation, originally documented by Gompers et al.(2003).

As highlighted by Bebchuck et al. (2005), future studies and policy makers should focus their attention on these provisions. Indeed, it would be useless to adopt broader indexes to assess the governance quality of a company by including a high number of CG arrangements (as most shareholder advisory firms suggest[20]).

[20] As documented in Brown and Caylor (2004), one of the most important shareholder advisory firms - the Institutional Shareholder Services (ISS) – developed a governance quality metric based on 61 provisions. The Governance International Metric has even developed an index that includes 600 governance provisions. Bebchuk et al. (2009) argue

The quality of governance could be evaluated more precisely by focusing on only the most relevant governance provisions, rather than considering broader indexes which might include provisions that do not matter at all.

3.2 For which countries does CG matter the most?

In line with OECD corporate governance principles, Nam and Nam (2005) implemented a governance survey and developed a CG index based on two CG components: a) shareholders rights (SHR) and b) board structure (B). They found that the overall CG scores are positively associated with firm performance (both in terms of Tobin's Q and return on assets). Secondly, Nam and Nam (2005) showed that the board of directors represents the most important component of CG, while shareholders' rights alone do not have a strong and significant influence on firm performance. Third, they found that CG seems to matter more for countries characterized by weaker investor legal protection, in line with Klappler and Love (2004).

Subsequently, Garay and Gonzalez (2008) further reinforced this view. They gathered information on CG practices in Venezuela, by considering only publicly available data. They investigated the impact of CG practices on firm performance, in terms of: dividend payout ratio, price to book value, and Tobin's Q ratio. They developed a CG index considering only 4 main components: information disclosure, composition and performance of board, ethics and conflict of interest, shareholders rights. In line with previous studies, they found a positive and significant correlation between their CG index and firm performance (measured by: Tobin's Q, price to book value and dividend payout ratio). They also showed that CG matters more in countries with weak investor protection, confirming the results previously documented by Nam and Nam (2005) and Klapper and Love (2004).

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that these approaches might be detrimental because they may put too much pressure on firms to change their governance models in order to improve their CG rating.

3.3 Endogeneity problems and the Bhagat and Bolton (2008) solution

The study by Gompers et al. (2003) called for new research to solve the endogeneity problem underlying the relationship between CG and performance. Considering the endogenous nature of corporate governance practices, Lehn et al. (2007) argued that the relationship between governance quality and firm performance could have been better evaluated by adopting a system of simultaneous equations.

Given the several CG indexes emphasized by the previous literature and the lack of consensus on how to measure governance quality, Bhagat and Bolton (2008) took into account different governance metrics: the GIM index by Gompers et al. (2003); the BCF index by Bebchuck et al. (2005); board independence; board ownership; CEO - chairman separation (also known as “CEO-board chair duality” or “CEO duality”[21]).

Bhagat and Bolton (2008) also considered different measures of performance (firm’s stock returns, Tobin’s Q and the operating firm performance, as measured by operating income before depreciation divided by total assets – ROA). In order to take into account the potential endogeneity of the relationship among governance, performance, ownership and capital structure, they developed a system of 4 simultaneous equations (Figure 1.1.4).

$$\begin{cases} P = f(G, O, C, z_1, e_1) \\ G = f(P, O, C, z_2, e_1) \\ O = f(G, P, C, z_3, e_1) \\ C = f(G, P, O, z_4, e_1) \end{cases}$$

Where:
P = performance
G = governance index (as measured by GIM and BCF index)
O = ownership structure
C = capital structure
Zi = vectors of control variables and instruments that could affect the dependent variables
ei = error terms related to unobservable factors

Figure 1.1.4 - A simplification of the Bhagat and Bolton (2008) Model

Source: Elaborated from Bhagat and Bolton (2008)

21 In the corporate governance literature, the “CEO duality” represents a separation of CEO and board chair roles so that the CEO and Chairman positions are held by two different persons. For more details on the implications of CEO-duality for firm performance see, among others, Braun and Sharma (2007).

Bhagat and Bolton (2008) found that better CG (in terms of the GIM index, the BCF indexes, and CEO – chair duality) is significantly positively associated with better operating performance (ROA). Contrary to what previous studies have shown, they did not find support for the view that better governance is associated with higher stock market returns and Tobin's Q. The authors interpreted the latter findings by arguing that stock market returns may be subject to investors' anticipation. In this case, if investors act in such a way to anticipate the effects of CG on firm performance, then long-term stock returns will not have a significant correlation with governance.

Bhagat and Bolton (2008) also found a significant negative relationship between board independence and operating performance. This finding could have important policy implications, especially with reference to the board-independence requirement introduced by several recent governance reforms in the U.S. (such as the SOX Act and the NYSE & NASDAQ listing requirements).

4. Concluding remarks

A comprehensive research on corporate governance requires an interdisciplinary approach, especially with a law and economics perspective.

Common wisdom and policy makers tend to assume that better corporate governance leads to better firm performance. However, in the literature there is no uniform empirical evidence to support this view. Nor is there a consensus on how to measure governance quality. Several studies found a positive correlation between better governance and firm performance. However, the endogenous nature of corporate governance practices casts some doubt on the supposed "causal relationship" between governance and performance. Lately, Bhagat and Bolton (2008) have addressed the endogenous nature underlying the relationship between corporate governance and firm performance and found strong support for the view that better CG involves better operating performance. Moreover, CG seems to matter more for countries characterized by poor investor protection.

A final question needs to be answered: Given the positive relationship between governance and performance, can we also imply that a positive change in CG leads to positive changes in firm performance? According to a recent study (Chidambaran et al. 2008) the answer seems to be negative. Therefore, imposing changes in governance regulations might be very expensive and not as effective as one could expect.

Overall, the empirical evidence shows that corporate governance matters for improving firm performance, but it does not seem to be the only key driver that matters. Another related question that needs to be answered is: what else matters? Shepherd et al. (2008) attempt to address this issue by focusing on the beneficial role of bank monitoring, but we shall wait for more empirical research to properly answer this question.[22]

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