CORPORATE GOVERNANCE: NEXT STOP?

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"*Corporate Governance: Theory and Practice*", the annual conference by Virtus Interpress, is always a cornerstone to depict the state of the art on this critical topic. The 2022 edition makes no exception: the width and deepness of the topics as investigated by the accepted papers are proof, as these proceedings demonstrate. Nevertheless, there are some "fils rouge" that cross fertilize research and practices on corporate governance. Hereafter we challenge to illustrate them to stimulate forthcoming research, regulation and practices, for the next editions of the conference.

1. What is corporate governance?

The titles of the presented papers provide several insights into what corporate governance includes. Here are some keywords: gender diversity, remuneration fairness and transparency, board composition, ESG, social capital, disclosure, non-financial reporting, sustainability, firm identity, (corporate) well-being, governance risk-premium. At first sight, the corporate governance box seems to be large enough to become an "all-you-can-eat" research cluster! Indeed, this is not the case, particularly if we side the above question with the followings: what *was* corporate governance? Even more: what *will be* corporate governance?

According to ECB, "The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation — such as the board, managers, shareholders and other stakeholders — and lays down the rules and procedures for decision-making" (European Central Bank [ECB], 2004, p. 219). ECB glossary cites OECD. Shorter is ICAEW definition: "Corporate governance is the system by which companies are directed and controlled" (ICAEW, n.d.). Both definitions are large indeed so that you may include all the keywords of the conference as cited above.

A different perspective is given by Zingales (1997). He moves by defining governance as follows: "In spirit of Williamson (1985), I define a governance system as the complex set of constraints that shape the ex-post bargaining over the quasi-rents generated in the course of a relationship", and he continues: "A main role in this system is certainly played by the initial contract. But the contract will be incomplete, in the sense that it will not fully specify the definition of surplus in every possible contingency" (Zingales, 1997, p. 3). Finally, he concludes: "corporate governance is simply the governance of a particular organizational form — a corporation" and "*I define corporate governance as the complex set of constraints that shape the ex-post bargaining over the quasi rents generated by firms*" (Zingales, 1997, p. 3). Zingales' acumen lets us focus on the key underpinnings of corporate governance: the (agency) contracts and their incompleteness. Indeed, this framework gives us a more dynamic approach to corporate governance, by minimizing both the risk arising from too wide definitions and the one related to short-term critical issues (e.g., sustainability). In fact, under this approach, contingent topics remain relevant but miss to bind the entire concept of corporate governance to a specific time frame (i.e., to search for continuous updates). Last but not least, Zingales' proposal is compliant with the emerging research on the economics of corporate governance. In fact, the governance of agency relations is an expensive activity, while the control of agency costs is proof of its efficiency.

While past research on corporate governance was mainly concerned with the identification of its components along with the mechanics melting them, it is highly probable that in the forthcoming years the economics of corporate governance solutions will be investigated more and more. This will be also useful to regulators to prevent the adoption of regulating framework which may be toward superior equity and fairness, indeed, but completely out of any economic equilibrium. This was the case, for instance, of the auditor rotation rules, which suffered a lot from missing concerns on the trade-off of cost and benefits (i.e., agency costs) which may arise from any solution.

2. Corporate governance and the nature of the firm

The nature of the firm is probably one of the most complicated puzzles in economics and finance with no definitive solutions, so far. One possible solution sources from Jensen and Meckling (1976), who suggest the firm to be "*a nexus of contracts*". Zingales' (1997) proposal is fully compliant with this concept and it contributes to considering corporate governance as part of the nature of the firm; i.e., no firm may exist without any governance. In fact, we must distinguish the "nexus" from the "*patchwork of contracts*": the former building-up firms, the latter making relationships. This is also the reason why firms require decisions to craft the corporate governance in the most efficient way: relationships do not require them. Fitting the governance to the firm's nature has important consequences for research in business economics and as well as for Regulators and business people.

First of all, we must always have in mind that the reason for a firm's existence roots in its distinctive elements. Accordingly, the massive standardization of the corporate governance solutions is inconsistent with the nature of the firm. In fact, it is against the endogenous/firm-specific components of the firm, which cannot be standardized at all. This is the reason why regulations aiming to standardize strongly the corporate governance are probably against the firm survival and most of the sound entrepreneurial spirits. Making a comparison with concepts from finance: you must distinguish systematic from firm-specific risk, but cannot ignore the firm-specific consequences (e.g., in leverage decision making). Forthcoming research in corporate governance should clarify whether it refers to distinctive elements of the nature of the firms or to more systematic components to standardize.

Second, we cannot forget that the nature of the firm is strictly related to one of its stakeholders. The firm sustainability is a direct consequence of the firm's ability to carry on sound and fair relations with its stakeholders. Clear empirical evidence of such a stakeholders-view of the corporate governance is provided by: 1) the value-chain relationships and the way they are governed (e.g., consortiums such as Airbus or the NASA suppliers); 2) the cooperating clusters of firms requiring rules, including leadership, to govern their relationships (e.g., SMEs network/clusters in Northern Italy). To the best of our knowledge, we must start to consider corporate governance as a tool to relate the firm efficiently to its stakeholders.

Third, the above discussion connects directly with another critical issue of the puzzle concerning the nature of the firm: its boundaries. It is well known that legal profiles suffer from designing the correct boundaries of the firm. In fact, since the seminal book by Barney and Ouchi (1986), it is well accepted the idea that several solutions (behind the corner ones of markets and hierarchies) can regulate the transactions among different economic agents. This includes markets as assisted by hierarchy (this is the above cited Airbus case) or hierarchies assisted by markets (as in the case of the NASA suppliers above), along with several other "pseudo"-hierarchies (as in the case of the Italian SMEs-networks). This explains the expansion of research efforts on corporate governance mechanisms governing the relation of the firms with the stakeholder and those within their own boundaries. The 2022 conference has a lot of innovation on this specific issue.

Based on the above points, Bertinetti and Mantovani (2009) propose to consider "the firm as a nexus of stakeholders carrying on transactions to be governed through agency contracts" (p. 426) (i.e., corporate governance). Accordingly, we introduce the concept of "incomplete governance" (i.e., in a very similar way as the "incomplete contracts" and the "incomplete markets"). We define the governance as incomplete when the uncertainty as to realize unfair results from "the ex-post bargaining over the quasi-rents generated in the course of a relationship" (Zingales, 1997, p. 3) is very high ex-ante. This will bias agent behaviour during negotiations as well as the resulting contracts.

3. The economics of corporate governance

Missing the costs from whichever corporate governance solution is a mistake. Nevertheless, you must also consider the other side of the coin: the benefits arising from controlling the agency costs. The economics of corporate governance is based on the ratio between benefits and costs as related to a specific corporate governance solution. This approach should be included in any discussion on corporate governance, to consider the attractivity of whatever proposed solution: the lower is the efficiency ratio (between benefits and costs), the lower the attractivity also is.

(Corporate) finance is probably the field of research where the economics of governance are considered the most, although recurring to indirect evidence and proxies. Mantovani and Moscato (2020), give evidence of the superior capability of some corporate governance solutions to increase debt capital and bank allowances for a company. In this paper, the increase in collected capital is chosen as a proxy for the agency cost reduction. Bertinetti and and Mantovani submitted and discussed into this year conference a paper investigating the impact of incomplete governance over the cost of capital. The empirical evidence for Italy shows a governance risk premium into the cost of equity capital at 39bp, while 81bp are shared with debt capital.

Sustainability and governance are souring research efforts and practices, particularly within the initiatives on ESG. From our perspective, it seems that the economics of corporate governance is the missing point of this investigation. The research of (supposed?) fairness makes it less relevant to consider the economic profile, with the resulting effect that those solutions get *UNsustainable*, particularly in the long run. The inconsistency of economic sustainability put at risk any result of the research efforts while missing the economics of governance makes it difficult to find investors funding the investments as required by corporate governance schemes.

This leads to the last "fil rouge" to consider: *measurement*. To the best of our knowledge, qualitative data are massively used in research on corporate governance. Probably, the lack of affordable measurement tools is at the root of this fact. Nevertheless, the risk of obtaining research results as biased from the abuse of qualitative-only data should be considered. This is a good reason to improve research efforts into the measurement of indicators for corporate governance. But there is more! The adoption of a concept of corporate governance based on Zingales (1997) and Bertinetti and Mantovani (2009) requires a multivariate approach, provided that several items contribute to the corporate governance nexus. We know that indicators proposed so far on corporate governance suffer from many limits, mainly related to the ways (and weights) the indicators are melted together toward a unique indicator. From this perspective, the 2022 conference presented an unprecedented number of papers on this topic.

A unique (and common) conclusion emerges, at this point: a lot of work on corporate governance is waiting for all of us in the forthcoming times. A good reason to schedule the next conferences.

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