

Corporate governance (22E00500) Syllabus & Intro

CEMS course and MSc-degree in accounting,
advanced studies

Autumn 2022

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Bianca in brief



- Assistant Professor in Financial Accounting, Aalto University School of Business
 - Doctorate from University of Oulu
 - For further information: <https://www.aalto.fi/en/departement-of-accounting-business-law/bianca-beyer>
 - Most recent and relevant papers:
 - **The smartest guys in the [board]room: Directors' intelligence, CEO compensation, and firm performance** (2020), WP, with Kallunki & Nilsson
 - **Paywatch - Directors' skin in the game and executive compensation** (2020), WP, with Kallunki, Nilsson & Rossi
 - **Are convicted CEOs paid differently? Evidence from unique Swedish data** (2018), WP, with Kallunki, Nilsson & Rossi
 - **How does carbon footprint information affect consumer choice? A field experiment** (2022), accepted as REP at the Journal of Accounting Research, with Chaskel, Euler, Gassen, Großkopf & Sellhorn
 - **Private firm transparency and public peers' information environment**, WP, with Flagmeier & Kosi
 - **Non-financial KPI in executive compensation contracts: Evidence from the CSR-Directive EU2014/95**, WP, with Lehmann & Timmermans
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Seppo in brief



- Professor in Accounting (Corporate Governance) at Aalto University School of Business
- Doctorate from Turku School of Economics (Finland) in 1996 on "Communication in the Share markets"
- For further information: <https://people.aalto.fi/seppo.ikaheimo>
- Most recent and relevant publications and papers:
 - Ikäheimo S. & Leino M. (2017) **Corporate governance in Finland: current state of art, challenges and opportunities**. In "Corporate Governance: new challenges and opportunities". Eds. Udo Braendle and Vincenzo Capizzi, Virtus, InterPress.
 - Ikäheimo S., Kallunki J.-P., Moilanen S. & Schiehl E. (2018) **Do White-Collar Employee Incentives Improve Firm Profitability?** Journal of Management Accounting Research, 30, 3: 95-115
 - Ikäheimo S. & Lumijärvi O.-P. (2018) **Perhe on paras? Perheomisteiset pörssiyritykset Suomessa**. Pörssisäätiö. (Family is best? Listed family-owned firms in Finland)
 - Moilanen S. & Ikäheimo S. (2019) **Managerial intentions for and employee perceptions of group-based incentives Social exchange theory-based interpretations**. Journal of Accounting & Organizational Change, 15(4), 605-625.
 - Mao Y., Myllymäki E.-R. & Ikäheimo S. (2022) **Does CEO IQ improve earnings persistence**. WP
 - Ikäheimo S., Lääkkölä A. & Puttonen V. (2022) **Capital flows and short-termism – evidence from European listed companies 1992-2020**. WP





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Syllabus of the course

Objectives

- This course is an **advanced course** which emphasizes the role of both **good and bad governance** in the **corporate success and in the society**
- The course underlines the **major problems of corporate governance** with
 - i. principle-agency,
 - ii. principal-principal and
 - iii. stewardship approachesand **how institutions** of corporate governance **are solutions** for these problems, **but sometimes these solutions are seeds for new problems.**
- The course aligns **theoretical thinking** with **empirical and practical solutions** within the field of corporate governance. The course offers the **diversity of solutions** and helps to understand the **country- and company specific practices** of corporate governance



Expected results – after the course, you will be able to...

- ...use the concepts of corporate governance in every-day thinking
- ...understand:
 - the role of governance quality in the corporate success
 - the relationship between the company management, board of directors and shareholders
 - the reasons for the variety in corporate governance practices both within one country and between countries and the recent trend of convergence in corporate governance practices;
 - the theoretical basis of the Board of Directors, Investor Relations, Executive Compensation, Internal Control and risk management, corporate governance regulation, and various roles of owners in corporate governance, and the logic how they work
 - how corporate governance bundles are constructed;
- ...evaluate the quality of corporate governance practices



...and have the ability to...

- ...work **independently** writing **analytical essays** based on given material and apply it empirically
- ...work **effectively in a team** in order to contribute appropriately to the production of a group output, report and presentation
- ...**participate** in class-room, group and one-to-one **discussion**
- ...use **scientific argumentation** skills in the discussions
- ...**write** a short **research report** based on academic papers and empirical material and write a group report

Social skills and
self-competence

Scientific skills



Timetable of the course

Unit	Content	Readings
24.10.2022 9am–12pm	Getting organized, Introduction to corporate governance and Basic concepts of corporate governance	
26.10.2022 9am-12pm	Basic concepts and Institutions of corporate governance	Roe, 2004
31.10.2022 9am-12pm	Diversity of corporate governance internationally and between firms	Diary 1: Aquilera et al., 2008
2.11.2022 9am-12pm	Corporate governance bundle, case work	Diary 2: Garcia-Castro et al., 2013
21, 23, 28, 30.11.2022 9am-12pm / 8am-12 pm	Themes will be specified with the students and includes student presentations, guest lectures and lectures by Bianca and Seppo	will be included, topics for Diaries 3-8



Lecture 1: October 24 Monday

Bianca and Seppo

Getting organized and Introduction to the corporate governance

Key points:

- Organizing the course work
- The origin of corporate governance

Learning outcomes:

- Commit to the rules of the game in the course
- Understand the origin of corporate governance



Lecture 2: October 26 Wednesday (1/2)

Bianca and Seppo

Basic concepts and the institutions of corporate governance

Key points:

- Principal-Agency theory, stakeholder and stewardship theories
- Institutions of corporate governance
- The role of each institution in mitigating and causing agency problems

Learning outcomes:

- Basic understanding of theoretical perspectives and the key concepts of agent, principal and information asymmetry
- Basic understanding of each of the corporate governance institutions



Lecture 2: October 26 Wednesday (2/2)

Structure of the lecture:

- Lecture by Bianca and Seppo on the nature of corporate governance

Pre-reading:

- Roe M.J., 2004, The institutions of corporate governance. Harvard Law School, Discussion Paper 488 (only pages 1-16)



Lecture 3: October 31 Monday (1/3)

Bianca and Seppo

Corporate governance bundle

Key points:

- The diversity of corporate governance internationally and between companies
- The divergence of international practices of corporate governance and their historical development
- The role of history and organizational environment on the effectiveness of corporate governance bundles
- The recent convergence of corporate governance practices and the role of codes in the convergence



Lecture 3: October 31 Monday (2/3)

Learning outcomes:

- Understand the major differences in practices between countries, industries and companies from the perspective of corporate governance bundle
- Understand the historical reasons for these differences
- Understand the need and mechanisms for recent convergence of corporate governance practices



Lecture 3: October 31 Monday (3/3)

Structure of the lecture:

- Lecture by Bianca and Seppo on the history of corporate governance path dependence and corporate governance bundle

Pre-reading:

- Aguilera R.V., Filatotchev I., Gospel H. & Jackson G., 2008, An Organizational Approach to Comparative Corporate Governance: Costs, Contingencies, and Complementarities. *Organization Science*, 19:3, 475-492. ([Diary 1](#))



Lecture 4: November 2, Wednesday

Structure of the lecture:

- Discussion on the corporate governance bundle
- Case work on the corporate governance bundle

Pre-reading:

- Garcia-Castro R., Aguilera R.V. & Ariño M.A. (2013) Bundles of Firm Corporate Governance Practices: A Fuzzy Set Analysis. *Corporate Governance: An International Review*, 21, 390-407.
(Diary 2)



Lecture 5-8: November 21, 23, 28 and 30: Topics will be defined with students!

- Quality of corporate governance
- Board of directors
- Investor relations
- Executive compensation
- Ownership
- Audit
- Risk management
- Internal audit
- ESG and corporate governance
- Gender equality and corporate governance
- Start-up corporate governance
- Detailed analysis of a special case/own ideas



Examples of group presentations

1. Corporate governance bundle: Case Country
2. Corporate governance bundle: Comparative case analysis
3. Excessive executive compensation
4. Fair executive compensations
5. Say on pay in EU – pros and cons
6. Regulating executive compensation in financial service industry
7. Active ownership
8. Concentrated ownership: pros & cons
9. Venture capital and corporate governance
10. Risk management – recent development / comparative analysis
11. Internal Audit – recent development
12. Investor Relations: Accounting perspective
13. Investor Relations: Communication perspective
14. Board of directors – monitoring vs. advising
15. Regulating board of directors
16. Developing board work
17. Sustainability and corporate governance
18. Quality of corporate governance – does it exist?
19. Gender equality topics
20. Corporate governance scandals: Case Company
21. Other? Own idea? Special case?



Assessment (maximum 100 points)

- max **20** points **learning diaries**
 - max **15** points **group presentation**
 - max **20** points **group report**
 - max **5** points **peer assessment (group report)**
 - max **40** points **final written exam**
-
- Opportunity for upgrade based on classroom activities



Course delivery (1/2)

- Interactive teaching by Bianca and Seppo
 - case analysis
 - guest lectures
 - group/individual presentations by students
- Learning Diary
 - individual company is analyzed based on pre-readings
 - each student selects one (publicly quoted) company for detailed analysis for their diaries



Course delivery (2/2)

- During the lectures we will use students' companies as illustrative cases on the discussed topic
 - With these case companies, students bring practice into the lectures
- Students' reports and presentations offer an opportunity to go deeper in specific topics



Diaries (max 20 points) (1/5)

Students write a personal report (diary) based on the pre-readings, analyzing their case company

- Students may write **maximum 4 diaries** maximum (out of 8 possible time slots)
- Important: instead of simply repeating what the authors (of the pre-reading) say, it is essential to
 - try and explain in one's own words what the main issues are
 - apply the learned content from the pre-readings by analyzing one's case company



Diaries (2/5)

The following perspectives should be considered:

- What were the main issues in the pre-readings? (max 1 page)
- How does your case company look like from the perspective of this material? (max 1 page)
- How does this relate to your earlier knowledge?
- Did some issues remain unclear?/What would you like to know more about?
- Do you disagree with something that is said? Why?

Important: Also, present 1 question which you would like us to address during the lecture.



Diaries (3/5)

Formal requirements

- The diary should be 3 pages (5 pages **maximum**) each
- Font: Times New Roman, font size 12 point
- Spacing: 1,5 lines

Deadlines

- diaries 1 and 2: October 28th at noon (12:00 pm)
- diaries 3 to 8: November 17th at noon (12:00 pm)



Diaries (4/5)

Pre-readings for diaries:

- Diary 1: Aquilera et al., 2008 (*Bundles*)
 - Diary 2: Garcia-Castro et al., 2013 (*Bundles*)
 - Diary 3: Agarwal et al., 2016 (*IR*)
 - Diary 4: Connelly et al., 2010 (*Ownership*)
 - Diary 5: Fernandes et al., 2013 (*Executive compensation*)
 - Diary 6: Hermalin & Weisbach, 2003 (*Board of Directors*)
 - Diary 7: Kaplan & Mikes, 2016 (*Risk management*)
 - Diary 8: Renders et al., 2010 (*Quality of corporate governance*)
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Diaries (5/5)

- Diaries will be graded, returned and discussed during the lecture in which the respective topic is discussed.
- Each diary is graded as follows:
 - 5 points (Excellent)
 - 4 points (Very good)
 - 3 points (Good)
 - 2 points (Satisfactory)
 - 1 point (Acceptable)



Classroom activities

- The classroom activity will be comprehensively evaluated
- It may have a positive effect on your grade
- In class participation, critical and constructive thinking and high-quality argumentation are highly respected



Group presentation and report (max 35 points) (1/5)

- In **groups of 4 people**, you will work on a corporate governance topic you have selected (see slides 16/17)
- **Presentation** (max 15 points)
 - You will present the results during the lecturers according to the agreed time schedule.
- **Report** (max 20 points)
 - You will prepare a report of about 15 pages (20 pages max!)
 - The final version of your report must be returned no later than December 4th, at 6 pm



Group presentation and report (2/5)

- Presentation guidelines:
 - Be properly prepared, use clear English
 - Understandability and clarity are important
 - Combine (abstract) theories with real world examples
- The total time for each presentation is **30 minutes**.
 - the maximum time for presentation is 20 minutes
 - the rest of the time is devoted to class-room discussion
- The presentation should **generate perspectives and ideas** and **combine theory with practice**



Group presentation and report (3/5)

- Report – formal requirements:
 - Font: Times New Roman, size 12
 - Spacing: 1,5 lines



Group presentation and report (4/5)

Aspects important for both the report and the presentation:

- The **quality of content**, i.e. both academic and practical relevance of the content is appreciated
- The **structure** follows the logic of the flow of the storyline
- The **clarity of argumentation** supports the understandability of the presented statements
- The capability to **integrate the topic to the broader setting** of corporate governance bundle
- The depth of analysis indicates with the **criticalness and shortcomings of theory and practice**



Group presentation and report (5/5)

The presentations/reports are graded according to the following scale:

- 14-15/18-20 points Excellent
- 12-13/16-17 points Very Good
- 10-11/13-15 points Good
- 8-9/11-12 points Satisfactory
- 1-7/1-10 points Acceptable



Peer assessment (max 5 points)

- Each student will get one report assigned for peer assessment
 - That means each report will get 4 peer assessments
 - The assessment is done according to the rubric in the MyCourses workshop tool
 - You either get 5 points or less for the peer assessment

(more information about the rubric will be found when the peer assessment is opened)



Exam (max 40 points)

- The exam will consist of 6 questions
 - students may answer to **4 of them**
 - If 5 questions are answered, the **best** answer will be eliminated in grading
- The exam covers
 - all the reading material, lecture material, possible mini cases, guest lectures, student presentations and student reports
 - Some of the questions require the ability to apply knowledge to evaluate and solve an empirical case

(more information about the implementation of exam tba)



Required readings (1/2)

- Agarwal V., Taffler R.J., Bellotti X. & Nash E.A., 2016, Investor relations, information asymmetry and market value. *Accounting and Business Research*, 46, 31-50. (diary)
- Aguilera R.V., Filatotchev I., Gospel H. & Jackson G., 2008, An Organizational Approach to Comparative Corporate Governance: Costs, Contingencies, and Complementarities. *Organization Science*, 19:3, 475-492. (diary)
- Connelly B.L., Hoskisson R.E., Tihanyi L. & Certo S.T. 2010, Ownership as a form of corporate governance. *Journal of Management Studies*, 47, 1561-1589. (diary)
- Garcia-Castro R., Aguilera R.V. & Ariño M.A. (2013) Bundles of Firm Corporate Governance Practices: A Fuzzy Set Analysis. *Corporate Governance: An International Review*, 21, 390-407. (diary)



Required readings (2/2)

- Fernandes N., Ferreira M.A. & Murphy K.J. Frydman C. & Jenter D., 2013. Are U.S: CEOs Payed More ? New International Evidence. Review of Financial Studies, 26:2, 323-367. (diary)
- Hermalin B.E. & Weisbach M.S., 2003. Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature. Economic Policy Review, 9, 7-26. (diary)
- Mikes A. & Kaplan R. 2013, Towards a Contingency Theory of Enterprise Risk Management. Harvard Business School, Working Paper 13-063. (diary)
- Renders A., Gaeremynck A. & Sercu P., 2010, Corporate-governance ratings and company performance: A cross-European study. Corporate Governance: An International Review, 18, 87-106. (diary)
- Roe M.J., 2004, The institutions of corporate governance. Harvard Law School, Discussion Paper 488, only pages 1-16
- In addition, all lecture material, group presentations and group reports



Case company selection for your diaries and topic selection

Individually:

- Select a company for your own analysis in the diaries and for your report (in case you want to use them for this purpose)

As groups of 4 students:

- Select/invent up to 3 topics for your group work
- Write down:
 - Names and student numbers of all group members
 - For each student: Company names for diaries
 - 3 favorite topics, ranked by preference



Report and presentation time schedule (1/2) – meeting with Seppo (and Bianca)

- Students prepare a well-structured plan for the meeting
 - Title of the report (and presentation)
 - Structure of the report (and presentation)
 - Sales pitch of the topic
 - Key academic material
 - Key empirical material
 - Key learning points of report
 - Each group will have 20 minutes time
 - either on November 9th and 10th via Zoom.
 - Deadline to send the material: **8:00 am in the morning**
-



Report and presentation time schedule (2/2) – presentation and finalizing report

- Prepare a professional presentation and prepare your preliminary report (as if it would be your final one).
 - Return them no later than in the morning 8 am of your presentation day.
 - After your presentation, finalize your report and return it prior to deadline.
- In case you need additional advice for your presentation, ask Bianca and Seppo.





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Part 1: The origin of corporate governance

Corporate governance matters when ownership is separated from control

- *“Compensation practices at large financial institutions are one factor among many that contributed to the financial crisis that begun in 2007. High short-term profits led to generous bonus payments to employees without adequate regard to the longer-term risks they imposed in their firms. These perverse incentives amplified the excessive risk-taking that severely threatened the global financial system and left firms with fewer resources to absorb losses as risks materialized.”* Financial Stability Forum, 2 April, 2009.
- *“Inappropriate remuneration policies, practices and procedures were a contributory factor rather than a dominant factor behind the market crises.”* Financial Services Authority (Policy Statement 09/15)



Especially bad Corporate Governance seems to matter

- *“The collapse of the famed Enron Corporation has proven not only to have been a seminal business event, as rarely does a company as large and respected as Enron fail, but, along with several coincident corporate scandals, has proven a watershed moment in U.S. corporate scandals.”* Elson & Gyves (2003) *“The Enron failure and corporate governance reform”* in Wake Forest Law Review, 38, 855-884.
- *“These new claims pose further challenges to Volkswagen’s financial flexibility and competitive position and heighten Moody’s concerns about Volkswagen’s internal control and governance issues,”* said Yasmina Serghini-Douvin, the agency’s lead analyst for Volkswagen. Financial Times, November 4th, 2015.



Problems of corporate governance are old ones

- Capital needed for railways 1830s in the U.S. and in the U.K.
 - Publicly owned corporations emerged
 - Consequence: Separation of ownership and control

- Became common in the U.S. and U.K. and later elsewhere



Jensen & Meckling (1976) theorized the principle-agency relationship

- This study analyzed the separation of ownership and control from the perspective of principal-agency theory, where principal, i.e. owner, makes a contract with agency, i.e. manager, to give financing either to put it to productive use or to cash in the corporation
- The contract specifies what the manager does with the finance, and how the returns are divided between the owners and the managers
- This theory has guided most of the current corporate governance research as well as legislation and practical guidance, although corporate governance is much more than only an a-historical contractual relationship between the owners and the managers



Shareholder value or stakeholder value?

- Corporations are perceived as nexuses of contracts with various stakeholders
- If these contracts were complete then the only contract which remained open is the contract with owners. The role of owners is peculiar, although they are stakeholders, the return and risk of the contract is not pre-specified
- The owners receive the residual return after all other contractual obligations with other stakeholders have been met. As an outcome, the maximization of the present value of future residual return will maximize the value of the corporation to the shareholders AND to the society



The word corporate governance is a rather recent one

- The triggering point were the bad practices in the U.K. publicly owned companies in late 1980s and yearly 1990s
- To gain back trust and eliminate mal practices, in 1991 a first corporate governance committee lead by Sir Adrian Cadbury was founded, and it published the Cadbury report on the Financial Aspects of Corporate Governance in 1992



The importance of corporate governance has become global

- The world-wide privatization wave
- Mergers and takeovers
- Pension funds, mutual funds and active investors
- Deregulation and capital market integration
- Emerging market crises
- Scandals and failures at major corporations and banking industry

