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BOOK REVIEW

Igor Filatotchev and Mike Wright (eds): the life cycle of corporate governance

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This book contains 14 contributions demonstrating applications of the firm theory of the life cycle to the analysis of corporate governance problems. It is an interesting and innovative approach to a theme dominated by the narrow and static perspectives of the literature published in the last decade. The debate about the meaning and political and economic consequences of corporate governance systems has been influenced by the agency perspective of the firm. We can confirm this statement with reference to the position of Hart (1995), where he explains that "corporate governance issues arise in an organisation whenever ...an agency problem, or conflict of interests involving members of the organization" is present, or the frequently quoted Shleifer and Vishny (1997) survey, in which they state that "corporate governance is an agency perspective sometimes referred to as separation of ownership and control". The normative conclusion that results from this framework is the "maximisation of shareholder value" as a means to obtain superior economic performance not only for a particular corporation but also for the economy as whole.

The "stakeholder perspective" of corporate governance (usually seen as an alternative approach to governance problems) deals also with social justice, and as social cohesion within a nation is a requirement for international competitiveness, those making such a claim argue that companies which draw on the experience of all of their stakeholders will be more efficient than those that focus only on the shareholder interests and experience (see for example Kelly et al. 1997). The theoretical argument is that physical assets in which shareholders invest are not the only ones that create value in the corporation. Other stakeholders, such as

A. Fortunato (✉)
Faculty of Economics, University of Coimbra, Avenida Dias da Silva,
165, 3004-512 Coimbra, Portugal
E-mail: adelino.fortunato@netvisao.pt

employees (who invest in human capital) or creditors also bear some firm-specific risk and should be accorded "residual claimant" status alongside with shareholders (Blair 1995).

The limitations of both arguments can be found in their reliance on neoclassical theory for understanding economic performance, namely the individual nature of the resource allocation process and incentive systems. Production and innovation processes generate returns not only by individual investments in human and physical resources, but also by integration of these resources in an organizational learning process (O'Sullivan 2001). The investments that make assets firm specific imply organizational and collective learning and change over time in response to evolving opportunities and threats of the competitive environment. In this broad context, corporate governance is also concerned with all the social institutions that shape the process of resource allocation in corporate enterprises.

Besides the focus on agency theory, approaches to corporate governance have focused on large, mature firms, neglecting the economic relevance of young and small ones that face profit constraints. Small family firms, start-ups or "threshold firms" need to find the essential resources and knowledge for growth, and this means the opportunity to face agency problems. Thus corporate governance must be viewed as a dynamic process, changing with different stages of the firm's life cycle, accommodating shifts in ownership structure, differing balances between external and internal stakeholders, monitoring and control functions and strategic behavior for assuring growth and survival. To be comprehensive, the analysis of corporate governance needs to combine the agency's problems with firm strategy over the life cycle and with economic and institutional dynamics.

It is good to see a book addressing some of the concerns just mentioned. In the first chapter, the editors introduce the life cycle approach of corporate governance and then the book is organized in two main subject areas. The first group of nine essays studies the relation between Governance and Life-cycle Stages of firm development. Mayer (Chapter 2) examines Venture Capital as one stage in the transition from ownership and control by the founders until the stage of dispersed ownership of quoted firms. Zahara and Hayton (Chapter 3) observe the evolution of the board composition of 416 US high technology new ventures, detecting growing outside representation and diversity in educational and functional backgrounds of directors from the start-up to the adolescent phase. Chapter 4 contains a study of 1,464 US family firms developed by Schulze, Lubatkin and Dino, relating the use of debt with ownership dispersion among directors. They find a U-shaped curve relationship resulting from a wedge between the interests of those family members who run the firm and the interests of the other family owners, revealing agency problems between the controlling and other minority shareholders.

Chapters 5, 6 and 7 examine the characteristics of external investors by means of Initial Public Offerings (IPOs). Filatotchev, Wrick and Arbeck investigate the evolution of 293 entrepreneurial firms in the UK and find that boards of the Venture Capital IPOs are more independent than other IPOs, and Venture Capital syndicates invest in relatively more risky firms. Espenlaub, Goergen and Khurshed try to analyze the question whether the presence of Venture Capital backing and the lock-in agreements of Venture Capitalists act as strategic complements or substitutes to the lock-in agreements of the directors and other shareholders. Using a sample of IPOs issued in the UK during 1992–1998, they find that a major part of cases use the lock-ins of Venture Capitalists and other shareholders as strategic complements to maximize the positive valuation effects of third-party certification, signalling and monitoring. Goergen and Renneboog examine a sample of German and UK firms and conclude that there is no relationship between the dilution of original ownership resulting from IPOs and long run performance.

Chapters 8, 9 and 10 examine peculiar problems of corporate governance in mature firms. Haynes, Thompson and Wright use a sample of 500 quoted firms in the UK and conclude that manager decisions about downsizing and divestment must be encouraged by share based mechanisms. Toms and Filatotchev investigate the financial constraints to retrenchment and turnaround, showing that managers of large firms often face a trade off between competitive high fixed sunk investments impossible (or difficult) to sell in the event of a crisis, and no competitive ones, permitting only normal profit levels. Weir, Laing and Wright try to find the determinants of a company's decision to change from publicly quoted to private control (PTP), confirming that PTPs have higher board shareholdings and higher institutional shareholdings than other acquisitions. This conclusion is compatible with the financial incentive hypothesis, which states that the greater the internal shareholdings, the greater the financial incentive to take a company private and thus increase personal wealth of managers.

A second group of papers treats the relationship between Industrial and Institutional Life Cycles. Toms and Wright (Chapter 11) compare the differences between UK and USA, usually seen as the most representative countries of the market-based system. The main differences lie in the different roles of economic institutions in the process of industrialization in the period following the Industrial Revolution. Conglomerate growth was a consequence of regulatory restrictions resulting from the concentration of USA large-scale firms threatening accountability and efficiency by means of monopoly power and anti-competitive practices. By contrast, moderate-sized industries and firms forced British capital abroad and left domestic entrepreneurs dependent upon network and alliance type of capitalism. Consequently, UK firms performed badly during the 1959–1980 period, importing the American managerial, multi-divisional, large-scale model of industry, but became well placed from 1980, adapting to the shareholder capitalism.

Pye and Colville show, in Chapter 12, the confluence of micro- and macro-level governance issues, analyzing the roles of cultural heritage and board strategy against age in the definition of corporate maturity and life cycle. The intention of Gispert, de Jong, Kabir and Rennboog in Chapter 13 is to examine whether differences in corporate governance systems of Belgium, Netherlands and UK lead to differences in industrial performance, taking into account the control concentration and board structure characteristics of a matched sample of firms. The main idea is to confront the market based system of UK, with the Continental European governance system associated with the French style of Belgium and with the German style of the Netherlands. They conclude that country-specific corporate governance features are more important in determining firm performance than the stylized facts of the different corporate governance systems in the international context. This means that it is necessary to include country-specific factors as additional explanatory variables of corporate performance.

Finally, Jones and Mygind in Chapter 14 investigate the development of specific patterns of ownership structures and dynamics over the life cycle of the Baltic companies. They analyze both starting and final ownership configurations for sample enterprises created by transition processes from central planning to market economy, trying to understand the dynamic period of adjustment in governance structures. Important institutional features influencing this process include the privatization method (which may favor managers, concentrated foreign investors or diversified external ownership), the weak financial system (limited financing from banks, absence of stock exchange and venture capital) and embryonic governance institutions for security property rights. They find that, in spite of important differences in institutional development and privatization process, similar governance cycles appear in Estonia, Latvia and Lithuania. However, the ownership structures adjustment is faster in Estonia as a consequence of the fast institutional change, namely of the financial system.

> From my point of view the type of research opened by this book needs articulation with more empirical comparative institutional analysis of different corporate governance systems all over the world. The cases studied by the majority of the revised contributions were applied to the firms of UK and the USA, two countries usually included in the market-based system. The life cycle approach needs to be confronted with institutional diversity to test the general predictions about firm and corporate governance evolution (so many times influenced by the Anglo-American institutional characteristics) in various historical and cultural fields. This is the main challenge to this promising line of investigation.

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