Grading sheet re-exam CG Feb 2017

1. Asset specificity is of importance in the transaction cost theory explanation why there is a corporate governance problem. Explain. (6p)

Asset specificity create dependency in a relationship, which would be of no concern if 1. No opportunism exist (3) and/or everyone had all information, i.e., bounded rationality (3). With one of these conditions not fulfilled, the relationship needs to be controlled.

2. What reasons are there for using an Internal managerial labour market? (8p)

Labor shortage, firm-specific skills, control, custom, motivation –work hard (2p for each, max 8p)

3. Socialized ownership is very important today. Describe it and pinpoint some of its advantages and disadvantages. (9p)

Socialized ownership could imply ownership through pension fund and the like. It implies that the investor put its money in a fund, that puts the money at the stock market, buying shares in corporations. (3)

Advantages: Huge risk money supply to firms, if fast moving, contribute to liquidity on the market, if guided by good analysts, good buying behavior, bring knowledge to the market price (3)

Disadvantages: Huge investments make the lock in to the investment, they can through voting rights influence the corporation, themselves being hired managers could make them prone to support non-capitalstic principles, for example sustainability, put power through the voting right in hands of organizations that do not invest in information and theory, i.e., competence in influencing the corporation. (3)

4. Give arguments for the presence of employees at the board of directors. (6p)

They can be residual claimants (for example bankruptcy), thus have to control the investments (2), if controlling, they can restrict change of the corporation, which will constitute incentives for firm-specific investments (team production) (2), they add to diversity at the board, for example gender, ethnicity, and different positional experience (2)

Alternative answers: institutional norm/pressure, insight what is going on in the firm, to show that they care about the employees' perspectives (1-2 p depending on how well augmented for)

5. Describe the goal orientation of family firms and compare it to the corporation with large separation between ownership and control. (6p)

Non-financial goals, including a consideration of the family in decisions, supporting the family. (2-3)

Examples of goals: long-term perspective, generational transfer, autonomy, control, loyalty, belongingness, status. (1 per each)

Compared to financial goals in the corporation with large separation between ownership and control.

6. What are the potential <u>negative</u> consequences of organizations conforming to institutional pressure. Use an example of recent changes in norms of corporate governance to explain the "costs" of adopting dominating institutional logic for corporations. (8p)

The key drawback of conforming to institutional pressure is the loss of efficiency. The norm of what is considered "good" corporate governance applies to every corporation, however it may not necessarily match the governance needs to each corporations, resulting in inefficiency. In other words corporations may engage in practices that are do not improve processes within the firm. An example of such can be the appointment of independent directors purely for legitimacy reasons. When directors are there just to communicate to investors "good" practices without bringing needed competence on the board. Another example is to exercise monitoring due to legitimacy pressure, harming corporate processes and limiting management from doing their job – instead of developing the company they need to engage in additional reporting slowing down the decision-making process and efficiency. Students may come up with different examples, the red thread should be to show that the process adapted to conform to the norm is not efficient from business process perspective.

7. Why is effective delegation of decision-making power to managers important for corporations? (7p)

The key point is the separation between ownership and control, which assumes that capital holders delegate the decision-making power to the management, is an effective form of organization because: (2-3)

1. *Access to capital – opportunity to grow. When comparing with private firms, driven by owner-managers they have financial capital mainly limited to one individual (or debt), while corporations with can generate more equity financing through attracting multiple investors putting their capital in the future growth of the firm. (2 p)*
2. *Managerial talent – in privately held firms, managers-owners need to possess considerably wealth to start their business – however they may not necessarily be the most competent managers to drive development of their corporations. Due to separation between security ownership and control corporations can select managers on the basis of their talent not capital they own, thus selecting and retaining the most competent individuals. (2p)*
3. *Diversification or effective management of risks. Risk taking is necessary for the development and growth, thus the allocation of risks to those who can bare them at the lowest costs can create benefits for corporate form of business activity. In corporations shareholders bare the residual risks, while managers who undertake*

decisions are not driven back or becoming risk averse due to large capital investment. Yet the costs of risks is minimal for shareholders since they can diversify their risks through investing in multiple corporations consequently the minimization of risks creates opportunities to more risk taking and development of a corporation.   (2p)

A good discussion of the balance between monitoring and development can give additionally 2-3 p. However, the student can maximum get 5 p if not mentioning any of the three point above, and maximum a total of 7 p.