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**CONNECTING THE DOTS – BRINGING EXTERNAL CORPORATE
GOVERNANCE INTO THE CORPORATE GOVERNANCE PUZZLE**

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Abstract: Corporate governance research has largely focused on internal governance mechanisms (i.e., the board of directors, controlling owners, and managerial incentives). However, much of this work ignores the role that external corporate governance practices play in preventing managers from engaging in activities detrimental to the welfare of shareholders, and the overall firm. In this essay, we first review and organize current research on external governance mechanisms and integrate this siloed body of work within the broader corporate governance equation. We explicitly focus on six external governance mechanisms: the legal environment, the market for corporate control, external auditors, stakeholder activism, rating organizations and the media. We discuss findings showing how external governance mechanisms act both as independent forces as well as in conjunction with internal corporate governance mechanisms. We conclude the review by mapping an agenda for future research on corporate governance that better integrates internal and external governance mechanisms. Our review suggests that studying different configurations of external and internal governance mechanisms will help us to better understand what factors and conditions lead to effective corporate governance.

Key words: Corporate governance; External corporate governance mechanisms; Configurations of governance practices

“The traditional shareholder value approach is too narrow a view for an economic analysis of corporate governance. I will [. . .] define corporate governance as the design of institutions that induce or force management to *internalize the welfare of stakeholders*.” Emphasis added. 2014 Economic Nobel Laureate Jean Tirole’s Presidential Address to the Econometric Society entitled “Corporate Governance” (subsequently published in *Econometrica*, 2001, p. 4).

“Governance refers to leadership systems, managerial control protocols, property rights, decision rights, and other practices that give organizations their authority and mandates for action.” McGahan (2014) call for the 2015 Annual Meeting of the Academy of Management on “Opening Governance.” <http://aom.org/annualmeeting/>

INTRODUCTION: WHAT IS CORPORATE GOVERNANCE?

Over the last few decades, the topic of corporate governance (CG) has attracted substantial interest from scholars and practitioners. Much of this attention has been the result of systemic corporate misconduct, such as the wave of scandals at companies like Enron and WorldCom around the turn of the century, increased shareholder activism, and the 2008 global financial crises. The academic literature on CG has quickly become a vast body of work that includes research from a number of different disciplines (Aguilera & Jackson, 2010; Bebchuk & Weisbach, 2010; Dalton, Hitt, Certo, & Dalton, 2007; Davis, 2005; Denis & McConnell, 2003; Filatotchev & Boyd, 2009; Tihanyi, Graffin, & George, 2014; Westphal & Zajac, 2013). This research, much of it coming from an agency and shareholder value maximizing perspective, has given us substantial insights about the internal mechanisms that firms put in place to hold their leaders accountable and ultimately enhance firm performance. However, it appears that we may need new approaches if we are going to better understand the increasingly complex puzzle of CG. This review essay seeks to reinvigorate CG research by examining the role of external CG as a key dimension in the overall governance system and to uncover the distinct underlying social processes through which these external mechanisms exert influence. To begin, in this introduction, we first develop a working definition of effective CG.

Interestingly, because CG is a socially constructed term that has evolved over time (Ocasio & Joseph, 2005), its definition differs widely depending on one's view of the world. This multiplicity of conceptualizations is well illustrated in the next five short definitions, each emphasizing different CG dimensions and their respective ultimate goals. Law and finance scholars define CG rather narrowly as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment (Shleifer & Vishny, 1997). Property rights scholars see CG as mechanisms supplying the complex set of constraints that shape the ex post bargaining over the quasi-rents generated by the firm (Zingales, 1998). The managerial perspective refers to governance as the set of "formal structures, informal structures, and processes that exist in oversight roles and responsibilities in the corporate context" (Hambrick, Werder, & Zajac, 2008, p. 381). The sociological view emphasizes its distributive nature and defines CG as a mechanism to allocate power and resource control among firm participants (Davis, 2005). Finally, from a broader stakeholder perspective, CG is described as the "structure of rights and responsibilities among the parties with a stake in the firm" (Aoki, 2001, p. 11). It views the purpose of CG as ensuring that executives respect the rights and interests of company stakeholders, as well as guarantee that stakeholders act responsibly with regard to the generation, protection, and distribution of wealth invested in the firm (Aguilera, Filatotchev, Gospel, & Jackson, 2008; Aguilera & Jackson, 2003; Garcia-Castro & Aguilera, 2015).

Given this array of perspectives, the first task is to identify the distinctive elements that compose effective CG. Our analysis of numerous CG definitions from a large spectrum of scholarly disciplines, policy forums (i.e., OECD, World Bank) as well as practitioner organizations (i.e., Institute of Directors, the Corporate Library) leads us to propose four key elements of effective CG. First, good governance should protect stakeholder rights and provide a

means to enforce those rights by monitoring executives and holding them accountable (Protection of Stakeholder Rights and Enforceability). Second, good governance is supposed to help mediate between the different interests and demands of various internal and external stakeholders (Management of Stakeholder Relationships). Third, good governance provides transparent information disclosure (Information Disclosure). Finally, good governance involves the provision of strategic and ethical guidance for the firm (Strategic and Ethical Guidance). Thus, we maintain that effective CG is an essential ingredient in corporate success, productive stakeholder relationships, and sustainable economic growth. For the sake of parsimony, our review and analysis focuses mostly on the U.S. context. Therefore, international differences and cross-national comparisons, while important, fall beyond the scope of our review.

In the next sections, we first discuss the governance puzzle and highlight the motivations for our focus on external CG mechanisms. Second, we conduct a comprehensive review of the existing literature concerning the six key external CG across multiple disciplinary fields. In order to analyze this extensive literature, we draw on an organizing conceptual framework that helps us delineate how external CG mechanisms might directly influence effective CG (see Figure 1). Third, we explore the interaction between internal and external CG mechanisms and show when the latter might indirectly help internal CG mechanisms become more effective. Finally, we conclude by discussing how to move forward and include a call for an increased focus on configurational approaches to governance.

THE CORPORATE GOVERNANCE PUZZLE

The governance literature has at times distinguished between internal and external CG mechanisms (Walsh & Seward, 1990). This distinction draws on whether the locus of action of a given governance mechanism emanates from within the firm or from outside the boundaries of

the firm. It is important to note that most research has historically focused primarily on internal governance mechanisms, and particularly on three mechanisms: board of directors¹, ownership and managerial incentives.

These three internal CG mechanisms share the logic that when effectively implemented, they should align managerial and shareholder interests and result in higher overall financial performance. In Table 1, we include some of the most relevant studies on boards, ownership, and managerial incentives as governance mechanisms. The influence of boards, particularly board independence, on firm performance has been of great interest to governance scholars for some time (Dalton et al., 2007; Finkelstein & Hambrick, 1996; Johnson, Daily, & Ellstrand, 1996). However, empirical research, mostly from an agency perspective, is equivocal as there is little systematic support for the proposed positive relationship between board independence and firm performance (Dalton, Daily, Ellstrand, & Johnson, 1998; Dalton et al., 2007).

The second internal governance mechanism, ownership and particularly ownership concentration, has also been the subject of extensive research. The main claim in the literature is that ownership concentration will grant owners the incentive and capacity to directly monitor and advise managers and the board. Yet, while some studies have documented an empirical relation between large shareholdings and corporate performance (Morck, Shleifer, & Vishny, 1988), a meta-analysis of the empirical literature shows that this relationship is negligible (Dalton, Daily, Certo, & Roengpitya, 2003). The third key internal governance mechanism highlighted in the literature is managerial incentives, operationalized as executive compensation and contingent pay. This internal mechanism has also received a lot of attention, with a renewed interest since

¹ Even though boards typically have a majority of independent directors who are also employed outside the firm, the corporate finance and managerial governance literatures conceptualize boards of directors as an internal mechanism, in part because directors represent the highest legal authority of the firm, they are compensated by the firm, and they are prominently associated with the firm.

the most recent financial crisis. Once again, empirical findings have been mixed and inconclusive. For example, empirical research and meta-analyses of the influence of executive equity-related incentives on financial performance fail to uncover consistently significant effects (see, for example, the surveys and commentaries of Bebchuk & Fried, 2005; Core, Guay, & Larcker, 2003; Daily, Dalton, & Rajagopalan, 2003; Dalton et al., 2007; Hall & Murphy, 2003; Tosi, Werner, Katz, & Gomez-Mejia, 2000). In conclusion, numerous studies across multiple disciplines have examined internal governance mechanisms, but their direct influence on firm social and financial performance is weak at best. We claim that this lack of empirical support may be due, in part, to depicting an incomplete picture of governance that neglects external governance forces, and hence suffers from unobserved heterogeneity and miss-specification. This is shown for example in Walls and Hoffman's (2013) exploration of boards' experience and environmental performance. In addition, we suggest that it is imperative to pay greater attention to the inter-dependencies between internal and external CG mechanisms.

Insert Table 1 and Figure 1 here

In contrast to the extensive research on internal CG, our knowledge of external governance mechanisms is much more limited, particularly from a holistic perspective that examines both their *direct* impact on effective CG as well as their *indirect impact* through other CG mechanisms. External CG mechanisms are those that operate from outside the nucleus of the firm. Walsh and Seward (1990) were among the first to make this distinction in discussing the efficiencies of internal and external corporate control mechanisms. Their seminal article focused on board monitoring and executive compensation as vital internal mechanisms, and the market

for corporate control as an important external mechanism. They argued that external control mechanisms were likely to be activated by internal control failure. In a similar vein, Daily, Dalton, and Cannella (2003, p. 373) stated that “internal mechanisms include an effectively structured board, compensation contracts that encourage a shareholder-orientation, and concentrated ownership holdings that lead to active monitoring of executives. The market for corporate control serves as an external mechanism that is typically activated when internal mechanisms for controlling managerial opportunism have failed.”

In this review, we depart from where these authors left this conversation on the balance between internal and external CG mechanisms and seek to move the field forward in two ways. First, while quite prominent among financial economists and legal scholars, the market for corporate control is not the only or necessarily the most important external CG mechanism. There are in fact a number of external governance mechanisms that originate outside the focal firm, which help to ensure that executives respect the rights and interests of company stakeholders, guarantee that stakeholders engage in fruitful relationships, provide financial transparency, and offer overall strategic guidance. Their relative salience depends on multiple contingencies but they have the capacity to impact firms’ governance directly and can also influence the effectiveness of internal governance mechanisms.

Second, as we suggested, the lack of conclusive findings on the direct link between internal governance mechanisms and firm performance may very well be due to poor identification—that is, because each of these governance constructs captures different realities for each firm within a unique governance environment (Aguilera et al., 2008). We therefore join the call for a more “holistic approach” to CG research in which the interdependencies of governance mechanisms are examined to understand their effectiveness (Aguilera et al., 2008;

Filatotchev & Boyd, 2009; Misangyi & Acharya, 2014; Tosi, 2008; Walls, Berrone, & Phan, 2012).

Following recent trends including the rise of institutional investors and shareholder primacy, the passage of the 2002 Sarbanes-Oxley Act, the advent of the financial crises and subsequent 2010 Dodd-Frank Act, increasing globalization and media pressures, and advances in information and communication technology, research has paid more attention to the influence that external mechanisms have on governance decisions and opportunistic behavior. An excellent example in this respect is the work by Coffee (2006) who acknowledges the role that external parties such as attorneys, analysts and rating agencies play in shaping governance decisions. On his book's very first page, Coffee states: "[A]ll boards of directors are prisoners of their gatekeepers. No board of directors—no matter how able and well-intentioned its members are—can outperform its professional advisors. Only if the board's agents properly advise and warn it, can the board function effectively." In other words, internal governance mechanisms such as the board of directors do not operate in isolation, and external factors play an essential role in determining directly and indirectly the effectiveness of a firm's governance.

We consider six key external governance mechanisms that have attracted recent attention in the literature: the legal system, the market for control, external auditors, stakeholder activists, rating organizations, and the media. A promising stream of literature has developed discussing the individual influence of each of these external governance mechanisms on CG effectiveness. Figure 1 shows how each of the six external CG mechanisms leads to more effective governance. The arrows in the figure show which of the four CG objectives each external mechanism is most likely to affect. Underneath each of the external CG mechanisms, we have included a brief reference to the underlying theoretical processes by which a particular external mechanism is

most likely to affect governance related objectives.

The legal system in which firms are embedded, and specifically corporate law, has long been considered a mechanism that formally and normatively defines the nature of firm relationships (Roe, 1994). The market for corporate control has historically received the greatest attention of the external mechanisms, especially in the finance and accounting literatures, where it has been associated with better protection of shareholder rights. In addition, increasing attention has been given to the role of rating organizations (including analysts) and the media in reducing information asymmetry and sanctioning inappropriate or illegitimate firm actions (Aspara, Pajunen, Tikkanen, & Tainio, 2014; Bednar, 2012; Daines, Gow, & Larcker, 2010; Dyck & Zingales, 2002). Similarly, stakeholder activism has gained prominence with the rise of institutional investors, proxy advisor agencies, socially engaged stakeholders, and celebrity shareholder activists (Aguilera & Desender, 2012; Becht, Franks, Mayer, & Rossi, 2010; Clark & Crawford, 2012; Davis & Thompson, 1994; Goranova & Ryan, 2014). Finally, external auditors are considered an integral part of the CG puzzle, particularly as it relates to information disclosure (Carcello, Hermanson, Neal, & Riley, 2002; Desender, Aguilera, Crespi, & Garcia-cestona, 2013; Hay, Knechel, & Wong, 2006).

An important motivation for this review article is our observation that research on CG has tended to narrowly focus on internal governance mechanisms (often a single one), while disregarding external governance mechanisms which might play a significant role in protecting stakeholder rights, managing stakeholder relationships, offering information disclosure and providing guidance. Hence, there is a need for both, greater clarity about which external governance mechanisms may help achieve the different elements of effective CG, and for better insights into how they will do so.

A central question that we seek to answer is: *what is the role of external corporate governance mechanisms in ensuring effective CG, both directly as well as through their impact on internal corporate mechanisms?* We believe that governance research needs to more fully examine the relationships between external and internal governance mechanisms, by moving beyond “one size fits all” prescriptions and toward a “bundle” perspective that accounts simultaneously for both internal and external mechanisms. We argue that while internal governance mechanisms are likely to discipline managers directly, they are often activated in complementarity to external governance mechanisms. For example, an internal control mechanism such as the board of directors may be activated and its effect amplified by the existence of an external mechanism, such as legal provisions, negative press, or pressure from ratings agencies. The current challenge with the external CG mechanisms that we have identified is that they are studied in silos as opposed to being conceptualized as an integral part of a complex CG puzzle.

Conceptual Framework

To examine and organize this extensive yet fragmented literature of external CG, we propose an organizing framework based on the four main theoretical perspectives where CG research lies: agency theory, institutional theory, resource dependency theory and team production theory. We deliberately do not draw explicitly on the stakeholder perspective (Freeman, 1984) to clearly differentiate between external forces influencing governance and individual stakeholders.² We briefly summarize each theoretical perspective below in order to

² Our conceptualization of external governance mechanisms is substantially different from an analysis of different stakeholders to the firm. While some of the external governance mechanisms that we describe involve actors that could be considered stakeholders (e.g. journalists, shareholder activists etc.), not all stakeholders play a governance role. In particular, we are interested in mechanisms which facilitate effective CG and that can lead to the imposition of sanctions for actions that would go against the general firm interest. In this sense, while many key stakeholders, such as clients, providers, or employees, undoubtedly can exert direct firm pressure; this is typically done for reasons that are focused solely on the interests of that particular stakeholder. Furthermore, only stakeholder

identify their underlying logical processes which we will utilize to discuss how each external CG mechanism influences effective CG directly, and through internal CG mechanisms. Table 2 summarizes the key concepts and processes for each theory.

Insert Table 2 about here

Traditionally, empirical research on CG has been rooted in agency theory which tends to take an insider view of governance, claiming that by managing the inherent conflicts between shareholders and managers, firms will operate more efficiently and perform better (Dalton et al., 2007). Research from an agency perspective asserts that managers and other corporate insiders have different objectives than outside investors and will act in their self-interest whenever they have the opportunity to do so, usually at the expense of the outside investors (Jensen & Meckling, 1976). Key assumptions within agency theory are managerial self-interest, bounded rationality, risk aversion, and information asymmetry between principal and agent (Eisenhardt, 1989). The agency perspective proposes that the following underlying processes can help to achieve effective CG: monitoring of agents, contractual relations, incentives, and signaling. According to this view, without effective governance mechanisms in place, company insiders might adopt suboptimal strategies, manipulate performance measures, resist takeovers, and expropriate value (Shleifer & Vishny, 1997).

The basic assumption of institutional theory is that institutions bring stability and meaning to social and economic behavior (North, 1990; Scott, 1995). This is achieved mostly because there are certain rules of the game that are taken for granted as legitimate. Specifically,

activism and the media would likely emerge from a traditional stakeholder analysis, as the legal framework and the market for corporate control represent broader institutions, while external auditors and governance rating agencies are professional firms specialized in reducing information asymmetries firm insiders and outsiders.

as stated by DiMaggio and Powell, institutions provide “a context in which individual efforts to deal rationally with uncertainty and constraints often lead to homogeneity in structure, culture and output” (1983, p. 147). This homogeneity or isomorphism is a product of legitimacy as opposed to efficiency. Suchman defines legitimation as “a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions” (1995, p. 574). From this perspective, the processes underlying CG are related to firm conformity to a set of legitimate institutional logics whether this is done through coercive, normative or mimetic isomorphism (Scott, 1995). A related institutional process is when organizations adopt practices for symbolic reasons as opposed to fully internalizing them, what has been labeled de-coupling (Westphal, Gulati, & Shortell, 1997; Westphal & Zajac, 2013). Finally, another significant process salient within this perspective is the social control function of reputation, where firms avoid behaviors that may be perceived as illegitimate to prevent reputational damage (Bednar, Love, & Kraatz, forthcoming).

Resource Dependency Theory (RDT) defines organizations as encompassing diverse groups of actors with varying and competing interests. These competing interests along with demands from the external environment create interdependence between firms (Pfeffer & Salancik, 1978). The RDT perspective implies that a major purpose of CG is to reach a consensus in the mutual interdependencies between internal and external stakeholder relationships by effectively distributing the power and allocating the asymmetric resources. Pfeffer and Salancik (1978) conjectured that the internal groups best capable of managing an organization’s most pressing external dependencies would gain the most power and control over the organization. Thus, firms respond strategically to allocate resources in order to manage environmental uncertainty and stakeholder interests (Hillman & Dalziel, 2003; Hillman, Withers,

& Collins, 2009). Recent studies extend the original idea of RDT and look at situations in which corporations need to manage more diverse demands mobilized through employee ownership (Blasi, Freeman, Mackin, & Kruse, 2010) and social movements (Briscoe & Safford, 2008).

Finally, almost as a reaction to agency theory and to the logic of shareholder primacy is the team production model (Lan & Heracleous, 2010). Team production theory suggests that the corporation embodies a number of stakeholders who collectively invest firm-specific resources, but jointly relinquish control over those resources to a board of directors for their own benefit in order to solve ex-ante the problem of coordinating efforts and shirking within the team and prevent ex-post free riding among contributing members (Blair & Stout, 1999; Rajan & Zingales, 2000). Klein, Mahoney, McGajan, and Pitelis (2012) clarify that stakeholder claims are proportionate to their respective involvement in the organization. Yet, the board of directors is assigned the role of mediating hierarch—a body who balances the often competing stakeholder claims and interests that contribute to the team production process, makes decisions on the allocation of team surpluses, and is ultimately legally in control of a corporation’s assets and key strategic decisions (Blair & Stout, 2001, p. 404). CG is understood as a collective action process where stakeholders define internal goals and delegate the coordination and control function to a neutral third party.

Even though each of these theoretical perspectives has a distinct logic, they all offer a unique organizational process by which external CG mechanisms might be able to influence the four objectives effective CG: protect stakeholder rights, manage stakeholder relations, provide information disclosure and offer strategic and ethical guidance.

EXTERNAL GOVERNANCE MECHANISMS: DIRECT IMPACT ON GOVERNANCE EFFECTIVENESS

This section is devoted to defining and reviewing literature on our six external corporate governance mechanisms. Table 3 (panels A-F) provides an overview of the most significant studies for each of the six external governance mechanisms: legal system, corporate control, external auditors, governance ratings, stakeholder activism and media. It is important to note that many of these studies imply that governance effectiveness is reflected primarily in financial performance, which we believe opens the door for future work that measures governance effectiveness in an expanded way that is consistent with the objectives that we outlined earlier. We discuss and synthesize this inter-disciplinary body of work by highlighting the salient organizational processes that guide each external CG mechanism towards effective CG (as summarized in Table 4) and provide guidance for future research.

Insert Tables 3 and 4 about here

Legal System

The legal system refers to the set of structures and processes used for interpreting and enforcing the existing law. It establishes how property rights are defined and protected, and includes regulatory institutions overseeing norms and rules that firms must comply with. The legal system must be accompanied by institutional means to enforce it. In addition to the legally enforced laws and regulations, “soft laws” are also part of the legal system—these are principles and norms that are enacted by the stock exchange commissions, interest groups or the larger society to exert influence on firm governance (e.g., the comply or explain codes of governance, codes of ethics, sustainability reporting, etc.). The legal system tends to be somewhat fluid because it can change according to the political and economic environment (Aguilera, Goyer, &

Kabbach-Castro, 2013). Although there is a rich literature that compares legal systems across different countries (Armour, Deakin, Lele, & Siems, 2009; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998), in this review we focus on the U.S. common law legal system, which is characterized by strong reliance on jurisprudence and case law.

Scholars have typically focused on how corporate law defines firms' corporate governance in terms of the legal personality, limited liability, transferable shares, management-board relationships and the ownership structure of the firm (Hansmann & Kraakman, 2004). To begin with, there are two legal choices that are likely to have a great influence in the organization's governance: (1) under what legal regime the organization forms, and (2) where firms chose to incorporate. Firms might take the form of a general partnership, limited partnership, limited liability partnership (LLP), limited liability company (LLC), or an incorporated entity, including a closely-held corporation, a publicly-held corporation, or new forms such as a benefit corporation, low-profit LLC, or blended-purpose firm. The law grants distinct rights and responsibilities to partners in a general partnership or LLP, limited partners in a limited partnership, managers and members in an LLC, or directors or shareholders in a corporation.

In terms of where to register a firm or business entity, we know that over fifty-percent of the Fortune 500 companies are incorporated in Delaware, as are over sixty-percent of high-technology companies. While academic debates once looked at whether Delaware courts tended to favor directors and managers at the expense of shareholders (i.e. the so-called "race to the bottom" theory), others argue that the expertise of Delaware courts and the attention Delaware pays to keeping its corporate law up-to-date and flexible explains Delaware's predominance as a place to incorporate (Romano, 1993). Yet, firms may also list in a foreign stock exchange not

only to access foreign capital but to gain legitimation from foreign investors (Bell, Filatotchev, & Aguilera, 2014; Coffee, 1999) or to avoid disclosure and taxes, as we have seen in the recent inversion debate (Dharmapala, 2008).

In the U.S., the publicly traded firm is the most highly regulated because it lies at the intersection of state corporate law and federal securities law. State corporate law gives most of the proactive rights and powers to the board of directors in a way endorsing the team production logic. It protects directors against liability for business decisions that end badly, given the business judgment rule, and offers exculpatory provisions in most articles of incorporation for breaches of the fiduciary duty of care. The law also grants shareholders three important rights: the right to vote in the annual meeting, the right to introduce shareholder proposals in the annual meeting, and the right to sue the corporation's directors and officers for breaches of their duty of loyalty, or for lack of full disclosure under federal securities law. These rights enable the principals' capacity to act within the agency logic.

When it comes to firm governance, legal norms, mostly enforced by the courts and stock exchanges, are a key external mechanism delineating the rights and responsibilities of different interest groups within and around the firm (Aguilera & Cuervo-Cazurra, 2004; Fligstein & Choo, 2005; Kraakman et al., 2004). The legal system defines almost every dimension of the firm's governance structure such as the purpose of the business entity, who owns it, what its stakeholders can and cannot do, and ultimately how the power and resources are distributed within the firm. The organizational processes within institutional theory help explain many of the symbolic and substantive legal adoptions. For example, bankruptcy and liquidation regulation stipulates how firms will proceed when they fail, including the prioritization of who gets paid first depending on the legitimation of different stakeholders. Another example stems from the

fact that the courts and society view the incorporated firm as a separate “legal person” with legitimate purposes beyond wealth maximization (Davis, 2013; Walls & Triandis, 2014). The Hobby Lobby case of June 2013 (*Burwell v. Hobby Lobby*) illustrates a legal opinion which expands outside the manager-shareholder relationship and reaches into the shareholder-employee relationship.

Based on our definition and description of the legal system, this external CG mechanism clearly shapes every dimension of governance effectiveness as we have identified (see Figure 1). First, it legally establishes and enforces the rights and responsibilities of different stakeholders and the protection of their interests. Second, it regulates relationships between parties with a stake in the firm, particularly as it refers to capturing and distributing firm wealth. Third, the legal system mandates the disclosure of financial and non-financial information, which is relevant for both existing and potential stakeholders. Finally, formal legal rules defining the purpose of the business entity (i.e., corporate law and individual statutes of incorporation) as well as legally binding contracts such as a family business constitution or shareholder agreements set specific guidelines on what the purpose of the firm is and how to operate following those principles.

A central question that research on the legal system aims to address is “who owns the corporation.” An important view, linked to agency theory, portrays public corporations as bundles of assets collectively owned by shareholders (principals) who hire directors and officers (agents) to manage those assets on their behalf. In this dominant perspective, shareholder interests are the central consideration of corporations and legal systems need to focus on reducing agency costs by keeping directors and managers faithful to shareholders' interests (Hansmann & Kraakman, 2001). This is done by deploying the law to hold stakeholders

accountable (i.e., monitoring), by setting the appropriate legal bounds for incentives and contractual expectations, and by enforcing them. A complementary view is the RDT in that regulation stipulates who has the capacity to reduce environmental dependency and uncertainty. The legal system defines what stakeholders have the ability to obtain critical resources from the environment and to regulate inter-corporate relations (Hillman et al., 2009).

More recently however, other theoretical processes have been used to argue that the corporation legally exists to serve purposes beyond simply enhancing shareholder value (Lan & Heracleous, 2010). For example, the team production model suggests that the legal requirement that public corporations be managed under the supervision of a board of directors has evolved not to reduce agency costs, but to protect the enterprise-specific investments of all the members of the corporate "team," including shareholders, managers, rank and file employees, and possibly other groups, such as creditors (Blair & Stout, 1999). In other words, the corporation should be managed to further the interests of the corporation itself and must meet the needs of a wider range of constituents to do so.

Relatedly, a significant body of research has drawn on institutional theory to show how the legal system can enhance CG through the provision of institutional norms and coercive isomorphism (Edelman & Suchman, 1997; Morgan & Quack, 2010). In this view, the legal system explicitly coerces corporations to comply with a specific regulation, but it also implicitly leads corporations to conform to normative and cognitive guidance underpinning the legal system (Edelman & Suchman, 1997; Greenwood, Oliver, Sahlin, & Suddaby, 2008). For instance, Edelman (1990, 1992) has shown that a governance practice that is initially adopted by legal enforcement eventually becomes taken-for-granted as the practice enhances efficiency and meets social expectations.

In sum, the legal system is a broad CG mechanism with many different layers shaping most dimensions of how firms are governed. There are multiple strategic governance choices that firms make which are directly driven by the strength and texture of regulation such as where to incorporate, how to organize the firm for tax and state planning purposes, who is liable, how to close the firm, how to grow the firm, etc. Changes in regulation, especially when this is unanticipated, provide interesting testing grounds for future lines of research.

Market for Corporate Control

When firms underperform, they face an increased risk that they will be taken over by outside ownership, a mechanism that is known as the market for corporate control. The market for corporate control is based on the logic that markets operate in part to discipline managers and boards (Dalton et al., 2007; Fama & Jensen, 1983; Haleblan, Devers, McNamara, Carpenter, & Davison, 2009; Walsh & Seward, 1990). This CG mechanism is activated when managers make poor strategic decisions, whether that be because of incompetence, self-interest, shirking of responsibilities, malfeasance, or some other reason, and as a result, the firm's assets are undervalued in the equity market. When the stock price declines due to corporate assets that are devalued, the firm is more susceptible to takeover (Hawley & Williams, 2000). Under these circumstances, other management teams or investors may target the firm in a hostile takeover, and make changes to the firm management and strategies in an effort to increase the depressed stock price and enhance the overall firm value (Bebchuk & Fried, 2005).

Research examining this mechanism has historically been strongly embedded in agency theory. The effectiveness of the market for corporate control is based on managerial incentives. Particularly, the threat of takeovers acts as a strong motivator for executives to manage the firm's assets in the best interests of shareholders rather than in their own self-interest, to avoid potential

job loss and damage to managerial reputation (Bednar et al., forthcoming; Cowen & Marcel, 2011). In theory, the market for corporate control allows a firm's assets to be reallocated in more productive ways (Jensen, 1984). For instance, an acquiring firm can engage in revenue improvement, cost reduction, vertical integration or diversification and thus improve the profitability of a target firm by combining business lines and sharing tangible and intangible resources between two companies (Larcker & Tayan, 2011). In addition to hostile takeovers, the market for corporate control includes other plausible actions such as voluntary mergers, leveraged buyouts, stockholder buyouts, spin-offs, split-ups, divestitures, asset sales, and liquidations (Dalton et al., 2007).

Yet, our review of the literature shows that this external governance mechanism is not without challenges, and multiple boundary conditions have been identified. Previous studies on acquirers' performance (Fuller, Netter, & Stegemoller, 2002; King, Dalton, Daily, & Covin, 2004; Moeller, Schlingemann, & Stulz, 2005; Tuch & O'Sullivan, 2007) conclude that on average, the takeovers have little to no impact on shareholder wealth in the short run, and produce mostly negative returns in the long run, at least for acquiring firms. This effect can be attributed to several factors. First, the assessment of what the target would be worth in the acquirer's control is inherently difficult, and is impacted by information asymmetries between insiders and outsiders. Second, managers may adopt anti-takeover practices, including poison pills (Davis, 1991; Davis & Greve, 1997), greenmail (Kosnik, 1990), dual-class shares or defensive changes in asset and ownership structure (Gompers, Ishii, & Metrick, 2010), and corporate charter antitakeover amendments (Dalton et al., 2007; Mahoney, Sundaramurthy, & Mahoney, 1997; Sundaramurthy, 2000; Walsh & Seward, 1990) that can entrench management and raise the acquirer's takeover cost. Furthermore, while in theory the market for corporate

control suggests relative ease in the change of ownership between different parties, in practice, takeovers are a very expensive solution (Williamson, 1970) that involves search costs, bidding and other transaction costs, and the cost of inducing reluctant shareholders. Such additional costs further weaken the strength of this governance mechanism. Moreover, the market for corporate control is unlikely to provide a source of discipline in firms with controlling shareholders or private firms.

Finally, takeover corrections of managerial failure have the disadvantage of being *ex-post* corrections, whereas other mechanisms may be *ex-ante* or deterring disciplining devices. When the market for corporate control becomes active, it serves as evidence of the failure of other governance mechanisms (Dalton et al., 2007) but it may not prevent performance failure due to *ex-ante* managerial shirking behaviors. Moreover, the market for corporate control has more long-term negative effects on many other stakeholders, such as bondholders, employees and suppliers of the acquired firm (Billett, King, & Mauer, 2004; Karceski, Ongena, & Smith, 2005; Shleifer & Summers, 1988). Thus, while the market for corporate control potentially disciplines poor management and minimizes agency costs, the actions taken after the acquisition can create subsequent problems. Given its substantial impact on many stakeholders, the market for corporate control itself has been subject to significant scrutiny and criticism from labor unions, the media, and other prominent stakeholders. Shleifer and Vishny (1997) are also “skeptical that it alone can solve the problem of corporate governance.”

While there are limitations to the market for corporate control, recently there has been renewed interest on the direct impact of this external mechanism on CG, linked to (exogenous) changes in the business combinations laws that made takeover more difficult in some states. There is some evidence that when managers are insulated from takeovers by antitakeover laws,

worker wages rise, fewer old plants are destroyed and fewer new plants are created while the overall productivity and profitability of the firm tend to decline (Bertrand & Mullainathan, 2003). Others have found that while firms in non-competitive industries experience a significant drop in operating performance after the passage of antitakeover laws, firms in competitive industries experience no significant effect, in line with the notion that competition mitigates managerial slack (Giroud & Mueller, 2011). Such studies suggest that the market for corporate control can be effective in some cases and they provide nice examples of authors using exogenous shocks that affect the take-over market to evaluate the effectiveness of this mechanism. Future research should continue to employ these methods to test for other boundary conditions (beyond competitive intensity) and linkages with other governance mechanisms. Furthermore, since much of the recent M&A activity has been characterized by cross-border acquisitions, future research on the nature of the international market for corporate control in general (Bris, Brisley, & Cabolis, 2008), and in cross-border acquisitions initiated by emerging market bidders (Martynova & Renneboog, 2008) seems to be especially promising.

External Auditing

The purpose of the external audit is to express an opinion indicating that reasonable assurance has been obtained that (1) the financial statements as a whole are free from material misstatement, whether due to fraud or error, and that (2) they are fairly presented in accordance with the relevant accounting standards. By issuing such opinions, external auditors enhance the degree of confidence that intended users can place in the financial statements. As such, external auditors are considered an integral part of the CG puzzle (Desender et al., 2013) because they enhance the quality of accounting information disclosure and reduce asymmetries of information

between the insiders of the firm and all other stakeholders, which in turn limits the managers' ability to manipulate information and extract undue wealth.

The literature on external auditing as an external governance mechanism draws from multiple theoretical perspectives. Most often, it builds on agency theory, and theorizes that external auditing contributes to more effective governance through a reduction in the information asymmetry between principal and agents. In addition, other theoretical perspectives can also heighten our understanding of how external auditors might play a significant governance role. For example, institutional theory suggests that certification by an external auditor enhances firms' legitimacy. Research from this perspective has shown how institutional environments influence accounting policies and procedures in firms by changing social expectations (Bebchuk & Fried, 2004; Covalleski, Dirsmith, & Michelman, 1993). Furthermore, the institutional environment can help shape the jurisdictional disputes of accounting professionals (Covalleski, Dirsmith, & Rittenberg, 2003).

The resource dependence view highlights the auditors' dependence on critical information from within the firm (especially from directors). As such, the board interaction with external auditors may lead to better audit planning (Cohen, Krishnamoorthy, & Wright, 2007). Following a wave of corporate scandals in the U.S., the Sarbanes-Oxley Act of 2002 has strongly emphasized the importance of auditor independence as a key element to restore investors' confidence. As a result of these scandals and new legislation, increased concern for reputation and fear of litigation have both been amplified, which is likely to positively influence the extent to which external auditors can serve as an effective governance mechanism.

Two auditor characteristics have been extensively studied: the level and nature of external audit fees and the size of the audit firm (because the number of big auditor firms has changed

over time from 8 to 4, we refer to large audit firms as Big N) (Hay et al., 2006). While an extensive literature has developed around the determinants of these audit characteristics (for an detailed overview of auditing research, see meta-analysis by Hay et al., 2006), our focus here is on studies that have explored the direct governance role of external auditors. In terms of a direct effect on governance effectiveness (Figure 1), large unlisted and listed companies around the world are required by law to have an external audit. Smaller unlisted firms may voluntarily decide to audit their financial statements to increase their legitimacy. Several studies point to the benefits of voluntary external audits for private firms, such as lower interest rates (Blackwell, Noland, & Winters, 1998), greater access to credit (Allee & Yohn, 2009; Hope, Thomas, & Vyas, 2011) and a greater likelihood of credit upgrades (Lennox & Pittman, 2011). These findings suggest that the presence of an external auditor sends a strong and credible signal to important external constituents.

In terms of the auditor choice, Big N auditors are argued to deliver higher audit quality. First, Big N auditors are expected to have stronger incentives to offer greater audit effort. These incentives arise from having more reputational capital to protect (DeAngelo, 1981), higher litigation risk, and greater regulatory scrutiny. Second, Big N auditors are expected to be more competent. Their large size allows them to attract and retain higher quality audit inputs, particularly with respect to human resources and expertise (Dopuch & Simunic, 1982). In addition, Big N auditors' large customer base makes them less financially dependent on any given client, thus increasing their independence. Empirically, the overwhelming majority of the literature finds evidence consistent with Big N auditors providing higher audit quality than non-Big N auditors. For example, there is strong evidence that Big N auditors are associated with higher quality audit outputs, such as a lower likelihood of fraud (Lennox & Pittman, 2010), a

higher likelihood of receiving going concern opinions (Chan & Wu, 2011), lower earnings management (Becker, Defond, Jiambalvo, & Subramanyam, 1998; Francis, Maydew, & Sparks, 1999; Kim, Chung, & Firth, 2003), improved management forecasts (Ball, Jayaraman, & Shivakumar, 2012), and timelier 8-K filings (Schwartz & Soo, 1996). There is also evidence that Big N auditors are associated with higher quality audit inputs, such as more audit effort as reflected in higher audit fees (Ireland & Lennox, 2002).

Corporate governance research has only recently started to unravel the potential impact of other CG mechanisms on auditor judgments. Future research would benefit from a more in-depth understanding of how external auditors assess the CG characteristics of firms to determine their audit scope. Given that external auditors are independent and need to determine the amount of evidence that is sufficient to formulate an opinion, they can potentially provide a different perspective on which governance features lead to higher risk of accounting manipulation. In this vein, Cohen et al. (2007) found that the roles of the board (monitoring versus advisory) influence auditors' planning judgments with respect to control risk assessments and the planned scope of audit tests. Another area for future research stems from the fact that much of the prior literature has strongly focused on the Anglo-American firms (Hay et al., 2006). Future research could therefore investigate how local institutional environments might affect the governance role of external auditors.

Rating Organizations

A number of organizations specialize in rating various aspects of the focal firm and can act as external governance mechanisms. In this review, we focus on two in particular: financial analysts and CG rating agencies. These two external bodies use mostly publicly available information to rank firms in terms of their financial and governance performance, respectively.

Multiple theoretical lenses can and have been used to discuss the effect of these rating organizations. The agency logic suggests that ratings have the potential to reduce information asymmetries between managers and shareholders by offering better information about expected performance and firm governance practices. Better information on relative performance measures may work as a strong incentive for managers to meet expectations, while the relative governance measures may deter the adoption of suboptimal governance practices. Similarly, the RDT logic suggests that relative rankings might minimize environmental dependencies and uncertainty as they bring new information on firms' financial and governance performance. On the other hand, institutional theory highlights the legitimating role that these ratings may serve when they are taken for granted. Ratings may induce normative isomorphism as firms converge on certain accepted practices and in some cases, may even lead to symbolic responses where firms change outward appearances without engaging in substantive change (Westphal & Graebner, 2010). Finally, different ratings might offer metrics for stakeholders to calculate where they stand in the team production effort and whether their firm is working with relative effectiveness.

There is a large literature on financial analysts from multiple disciplines that is beyond the scope of this essay. In general, security analyst recommendations are thought to provide valuable information about firms to stakeholders (Chen & Crossland, 2014) and are greatly influential to investors, firm reputation and access to capital (Westphal & Clement, 2008). Security analysts serve as legitimate external evaluators whose ratings (and forecasts) can be seen as certifications of CEO ability and evaluations of their corporate strategies (Benner, 2010; Wiersema & Zhang, 2011). If corporate activities are perceived as illegitimate or do not fit in pre-conceived and well known categories, the value of a corporation tends to be underestimated

by analysts in what has been called the ‘illegitimacy discount’ (Zuckerman, 1999). In addition to reducing information asymmetry between corporations and stakeholders, negative analyst ratings can have severe organizational consequences such as put pressure on the board of directors to dismiss the CEO (Wiersema & Zhang, 2011). Some studies demonstrate that behavioral dynamics, as well as resource dependence considerations (Hayward & Boeker, 1998) may raise questions about the efficacy of analysts as an external governance mechanism.

While analysts have been a subject of study for many years, more recently we have seen the development of CG indexes that strive to measure the quality of CG in a single metric (Aguilera & Desender, 2012; Bebchuk & Hamdani, 2009). Corporate governance rating agencies (such as Risk Metrics/ Institutional Shareholder Services, Governance Metrics International, and The Corporate Library) play an increasingly important role in the governance equation. Their impact on governance effectiveness is mainly directed towards providing information regarding the governance arrangements of the firms that they assess. Most CG rankings and indices keep a uniform scale for assessing a firm’s governance, which allows firms and their stakeholders to get a sense of the firm’s relative governance quality. As a result CG ratings can pressure firms to make governance changes. The providers of these ratings make strong claims regarding the ratings’ value in predicting future outcomes, such as accounting restatements, shareholder suits, operating performance, and stock returns³.

Daines et al. (2010) argue that there are several reasons to believe that commercial governance ratings might grant reliable and valid measures for the construct of CG. First, firms selling ratings appear to be a commercial success, which suggests the possibility that the ratings are useful to their customers. Second, commercial ratings use quantitative algorithms that

³ ISS claims that its ratings “identify the worst corporate offenders” and that “there is no doubt that [its] ratings could have helped some investment managers avoid the gigantic losses experienced during the corporate scandal era defined by meltdowns at Enron, Global Crossing and WorldCom.”

presumably capture their extensive expertise regarding the relationship between governance choices and firm performance. Their rating algorithms are flexible and are revised each year to “take into account market trends.” Finally, commercial firms employ large, rich databases from multiple data sources. Daines et al. (2010) consider governance ratings from three primary CG rating firms: ISS Corporate Governance Quotient (CGQ), Governance Metrics International (GMI), and The Corporate Library’s TCL rating, to examine whether commercially available CG rankings offer useful (new) information to shareholders. They conclude that commercial ratings do not predict governance-related outcomes with the precision or strength necessary to support the bold claims made by most of these firms. While CG ratings bundle CG information into a single measure that allows investors to better understand the firm’s CG arrangement and compare it to other firms, it does not seem to provide substantial new information to the market.

Recently, research has examined whether the position in CG ratings is linked to shareholder voting or the presence of institutional investors. While Daines et al. (2010) find little or no relation between the governance ratings with either their voting recommendations or the actual votes by shareholders on proxy proposals, Aggarwal, Erel, Ferreira, and Matos (2011) uncover that firms’ CG rating improve after the arrival of institutional investors. One interpretation of these weak effects of governance ratings on firm performance and other outcomes is that the governance ratings contain a large amount of measurement error. Some support for this interpretation is found in the surprisingly small correlations among the ratings (Daines et al., 2010). In this line of work, it appears that distinguishing effective governance from ineffective has proven to be quite difficult, especially given the great variety of CG mechanisms (and combinations thereof) employed by firms. Governance arrangements that are optimal for investor protection in companies without a controlling shareholder could be

suboptimal for companies with such a controller and vice versa. In this line, Bebchuk and Hamdani (2009) suggest that optimal governance is generally not one-size-fits-all and hence, a uniform scoring standard could lead to faulty rankings.

Future research in this area could further examine the impact of CG ratings on other firm outcomes, such as accounting restatements, earnings management or shareholder suits.

Researchers have ample opportunity to explore contingencies which may provide insight into the conditions when governance ratings may be especially relevant. For example, firms that have a controlling shareholder and those that do not, face different governance problems and so ratings may affect them in different ways. Khanna (2009) suggests that country characteristics in addition to other firm-level characteristics may influence optimal CG. This supports the idea that just as the quest for a single global governance rating standard will be difficult, finding universal effects of governance ratings will also be less fruitful than a more contextualized approach.

Stakeholder Activism

Stakeholder activism, as a broad term, reflects the external pressure from stakeholders to influence company policy and practices. Often activists use a minority ownership position to actively influence company policy and practices (Sjöström, 2008), although stakeholders with no ownership stake in the firm can also exert significant pressure on firms (de Bakker, den Hond, King, & Weber, 2013). Stakeholder activism is a type of social movement where various parties contend with firms to try to enact change (Davis & Thompson, 1994; King & Pearce, 2010). Stakeholder activists vary widely from fearless defenders of long-term investors to short-term profit maximization seekers to social activists with non-financial agendas.

There are two key motivations to engage in activism: financially-motivated (to increase shareholder value) and socially motivated (to divest from conflict zones, adopt CSR practices,

etc.) (Judge, Gaur, & Muller-Kahle, 2010). The motivation of stakeholder activism is tied to its proponents, who can range from corporate gadflies such as Carl Icahn or Gerald Armstrong, to institutional investors including pension funds and hedge funds, to proxy advisors (i.e., Institutional Shareholder Services), and social activist investors (i.e., CERES, Global Environmental Fund, Trillion Asset Management). Following this distinction, two streams of literature on stakeholder activism co-exist. On one hand, the financial activism stream embraces shareholder primacy and treats activism that deviates from concerns with shareholder value or governance as irrelevant or frivolous (Gillan & Starks, 2007; Thomas & Cotter, 2007). On the other hand, the stakeholder-centered social activism stream (Sjöström, 2008; Tkac, 2006) focuses on stakeholder activists raising social issues in annual shareholder meetings and corporate boardrooms (Rehbein, Waddock, & Graves, 2004; Vogel, 2004). Goranova and Ryan (2014) provide an excellent overview of the antecedents and outcomes of both streams of activism.

There exist multiple tactics for stakeholders to exercise pressure on management and the board to change or introduce new practices and strategic directions. These tactics include letter writing, proxy battles, litigation, publicity campaigns, dialogue with corporate management or the board, asking questions at general annual meetings, and by filing formal shareholder proposals. Financial activists are typically dissatisfied with a perceived mismanagement of resources or ineffective governance practices. Thus, short-term oriented hedge funds tend to apply pressure to the board to try and influence strategic issues such as the sale of the company, share buy-backs, or operational shake-ups. In terms of overall governance reforms, the main initiatives have been: acceptable use of poison pills, ability to change corporate charters and by-laws, changes in corporate voting rules, role and power of proxy advisors, and how and when hedge funds can disclose their corporate rebuilding. Specific governance practices that have been

targeted as conduits of poor governance are eliminating staggered boards, increasing the presence of independent directors, being able to nominate their own directors to the board (proxy access), say on pay votes (Larcker, McCall, & Ormazabal, 2013) and the abolition of supermajority requirements (Foley, Goldsmith-Pinkham, Greenstein, & Zwick, 2014).

In recent years, the most engaged players in the activism landscape have been activist hedge funds (Bebchuk & Weisbach, 2010). Brav, Jiang, Partnoy, and Thomas (2008) find that although activist hedge funds seldom seek control and are largely non-confrontational, they tend to propose strategic, operational, and financial remedies and attain success or partial success in two-thirds of the cases. Similarly, Becht et al. (2010) drawing on privately obtained data from Hermes show that activism can lead to changes in the company's strategy, by refocusing on the core business and returning cash to shareholders, as well as changes of the chief executive officer (CEO) or chairman. The study suggests that financial institutions can increase in value not just by buying and selling securities strategically but also by creating value inside of firms by providing monitoring services. The authors note that legal rules in the U.K. give shareholders much more power than U.S. shareholders and that the nature of legal rules on the influence of shareholder activism is an important question for the future.

The market reaction to shareholder activism has been equivocal. It is reported to be positive (Brav et al., 2008; Cuñat, Gine, & Guadalupe, 2012; Greenwood & Schor, 2009; A. Klein & Zur, 2009; A. Klein & Zur, 2011), negative (Bizjak & Marquette, 1998; Cai & Walkling, 2011), and insignificant (Agrawal, 2012; Becht et al., 2010; Gillan & Starks, 2000). In addition to influencing firms' financial performance, Stevens, Steensma, Harrison, and Cochran (2005) find that shareholder activism is related to the adoption and internalization of ethics codes by financial executives. Several studies also find that shareholder activism enforces managerial

discipline and raises the likelihood that the CEOs of targeted firms will lose their jobs (Brav et al., 2008; Del Guercio, Seery, & Woidtke, 2008).

There are multiple studies examining how shareholders as organized groups are influencing the social and environmental governance dimensions of companies (Lee & Lounsbury, 2011; O'Rourke, 2003; Rehbein et al., 2004). Proffitt and Spicer (2006) show that organizations such as the Interfaith Center on Corporate Responsibility (ICCR) have helped to legitimize the introduction of shareholder proposals on issues surrounding international human rights and labor standards and have been able to mobilize public pension funds. Labor unions have also become successful in pushing workers' interests even at the detriment of shareholder value maximizing goals (Agrawal, 2012). It can be argued however that shareholder resolutions represent the tip of the iceberg when it comes to changing behavior on environmental, social, governance or ethical issues, and that the most critical shareholder engagement occurs through behind-the-scenes dialogue (Goodman, Hebb, & Hoepner, 2014; Logsdon & Van Buren, 2008). The combination of public, private and interactive stakeholder engagement tactics in the realm of socially responsible investing is nicely illustrated by Guay, Doh and Sinclair's (2004) research on the growing activist influence of non-governmental organizations (NGOs).

In addition to shareholders, other stakeholders such as employees, customers, and communities can attempt to influence corporate activities. For example, employee advocacy groups have been shown to influence the adoption of certain worker benefits (Briscoe & Safford, 2008). Boycotts or protests are a widely used tactic for stakeholder activists to draw attention to perceived injustices and to give voice to groups not represented in official channels of decision-making in corporations (King, 2008). Stakeholder activists in this vein can directly threaten to constrain corporations from obtaining resources and disrupt corporate operations. Research in

this area suggests that protests against a target corporation can spill over and indirectly affect other firms in the same industry and even outside the original target zone (Haveman, Rao, & Paruchuri, 2007; Yue, Rao, & Ingram, 2013). Although stakeholder activists can directly influence changes in corporate governance structures or other firm outcomes, they can also induce indirect changes by influencing the evaluations of rating organizations. For example, anti-sweatshop movements affected corporate reputation and CSR ratings of U.S. firms (Bartley & Child, 2011).

A current research question is whether stakeholder activism is ultimately good for all stakeholders and for the corporation as a whole. In other words, corporate agitators might have short-term profit aspirations at the expense of longer term stakeholders such as employees and bondholders. In the legal community, there is also a heated debate on whether hedge fund activism generates long term company value (see Bebchuk and Martin Lipton blog at Harvard Law School Forum on Corporate Governance and Financial Regulation). Future research that addresses these issues of which stakeholders are likely to benefit from activism would greatly enhance our understanding of this external CG mechanism.

Media

The media is another important external constituent that in some cases may act as a type of external control mechanism. The term media includes various channels of communication (newspaper, television, radio, blogs, etc.) and those journalists who provide content for these channels. The media is often referred to as an information intermediary because of its ability to distribute information to varied constituencies (Bushee, Core, Guay, & Hamm, 2010). There is a vast body of work in the communication and journalism literatures about the role that the media plays in setting the agenda for what the public cares about (McCombs & Shaw, 1972) and at

times, shaping how the public thinks about certain issues (McCombs, Shaw, & Weaver, 2013). However, in this review, we are focused on studies that have conceptualized the media as playing a governance role of some kind (Dyck & Zingales, 2002).

When we think of the media playing a governance role, we refer to the ability of the media to exert influence and control on managers and firms to make decisions and adopt practices that are consistent with widely accepted principles of good governance (Bednar, 2012). Most studies that touch on the governance role of the media have focused on the news media, and its role in disseminating information to a broad spectrum of individuals and stakeholders. Because the media (and increasingly so, social media) can broadly disseminate information, it is thought to exert a monitoring role in that the threat of negative press can deter managers from acting in self-interested ways for fear of their reputational damage (Dyck, Volchkova, & Zingales, 2008). In addition to this monitoring role, the media can promote effective governance by increasing transparency and reducing information asymmetries between management and stakeholders.

In their study on the role of the media in promoting strategic change, Bednar, Boivie, and Prince (2013) outline three different ways that the media may influence organizational actions that may help us better understand how the media might function in a governance role. First, the media simply reports on events that occur within the corporate landscape. By reporting on events that may not otherwise be widely known, the media can shine a light on certain issues that stakeholders may not otherwise be aware of. It is also important to note that while the media may attempt to be objective in their reporting of events, they exert influence by choosing which events to cover and by shaping the way in which those events are reported. Second, the media provides a platform to publicize the views of external stakeholders. Activist investors, environmental groups, protestors, and other stakeholders who may not typically have a strong

voice in enacting organizational change, can be given increased voice by using the media (Andrews & Caren, 2010). Work on the effect of protests on stock market reactions demonstrates that media coverage can significantly amplify the effect of relatively small groups of individuals (King, 2008; King & Soule, 2007). Finally, members of the press can exercise influence by uncovering new information through independent investigation. This role of the media is often referred to as its watchdog role and can be seen in instances where reporters uncover fraud or wrongdoing that is occurring in a particular organization. For example, the work of reporter Bethany McLean was instrumental in triggering the series of events that eventually led to the downfall of Enron (Healy & Palepu, 2003).

Much of the research on the influence of the media and in particular, its disciplining or governance role has come from accounting and finance scholars. For example, research shows that the news media can reduce information asymmetry between managers and external constituents (Bushee et al., 2010; Liu & McConnell, 2013), and in some cases the media can actually serve as a watchdog by monitoring the actions of top managers (Miller, 2006). Such a view is consistent with agency theory's focus on information asymmetry and the incentive effects of managerial reputation. Some of these studies demonstrate that firms do make substantial changes in response to negative press coverage, such as when firms make changes to their governance structures after being identified as one of BusinessWeek's worst boards (Joe, Louis, & Robinson, 2009). On the other hand, others have claimed that while the press reacts to perceived lapses in governance, such as reporting about exceptionally high executive compensation, its actual impact on subsequent practices is actually quite limited (Core, Guay, & Larcker, 2008).

In the management literature, studies tend to focus on the media as a “propagator of legitimacy.” Such research is consistent with institutional theory’s claims that firms seek after legitimacy. From this perspective, the media acts as a carrier of institutional norms. Much of this work focuses on the positive benefits that accrue to firms and leaders through increased media attention. For example, small firms gain legitimacy when they are covered in the press, which can ultimately affect the firm’s stock price at IPO (Pollock & Rindova, 2003). Positive media coverage is seen as a valuable resource because of its potential to enhance the firm’s reputation (Deephouse, 2000). Further, positive coverage can also facilitate the creation of firm and CEO celebrities (Hayward, Rindova, & Pollock, 2004; Rindova, Pollock, & Hayward, 2006; Wade, Porac, Pollock, & Graffin, 2006).

However, more recently, management scholars have begun to focus more on the potential for the media to play a governance role even though in many cases, this work does not specifically label the media’s role as one of governance. For example, Wiesenfeld, Wurthmann, and Hambrick (2008) point out that the media acts as a type of social arbiter, by using its platform and wide reach to make assessments of individuals and organizations. In this role, the media acts as a type of referee that encourages appropriate behavior while stigmatizing those who act in inappropriate ways. Recent work has also demonstrated that the effect of the media on organizational action is contingent on firm characteristics, including the makeup of the board (Bednar et al., 2013). In this way, the media not only serves as a governance mechanism but may also influence the effectiveness of other more traditional governance mechanisms.

Good progress has been made in understanding the media’s governance role, and we have evidence that media coverage can affect managerial decision making in some circumstances. However, it is also clear that the media’s governance role is somewhat limited and will not

influence all firms in the same way. For example, firms and managers may attempt to neutralize external pressure from the media by making changes that are largely symbolic (Bednar, 2012) or by engaging in social influence tactics towards journalists in order to affect the favorability of subsequent press reports (Westphal & Deephouse, 2011; Westphal, Park, McDonald, & Hayward, 2012). Future research further uncovering the circumstances under which media coverage is most likely to have an impact would be helpful.

Another area that requires scholarly attention stems from the fact that much of the prior research has focused on the impact of print media on organizational outcomes. However, with the rise of new channels of information, including social media and various other internet channels, it is imperative to study how information disseminated via various channels impacts organizational action in different ways.

Presence of Multiple External Corporate Governance Mechanisms

Interestingly, external CG mechanisms often co-exist and tend to reinforce each other in a complementary fashion, although this is not always the case. In Table 5, we present these studies in the form of an interaction table showing that there is scarce research examining combined external CG mechanisms (shadow sections). Below we discuss the five cells where there exists some research.

First, the legal system and market for corporate control are complementary, which is nicely supported by Bertrand and Mullainathan (2003). When antitakeover laws insulate managers from takeovers, overall firm productivity and profitability tend to decline. Recently, Burkart, Gromb, Mueller, and Panunzi (2014) developed a theoretical model to better understand the complementary role of legal investor protection for the efficiency of the market for corporate control when bidders are financially constrained.

Second, external auditors may interact with the legal system. Yet, the logic behind this relationship is not always straight forward. On the one hand, Francis, Schipper, and Vincent (2002) show empirically that countries with weak legal environments demand, in general, lower quality audits than do strong legal environment countries. Coffee (2006) adds to this logic that legal liability threats are necessary to promote gatekeeper effectiveness. On the other hand, there is some evidence that external auditors fill a void in weak legal environments (Choi & Wong, 2007). Even if the legal liability risk for auditors is reduced, Big N auditors may have strong reputational concerns, which may be amplified by the media. As such, audit reputational concerns may substitute for weak legal liability.

Third, there is a complementary relationship between stakeholder activism and the market for corporate control. Goranova and Ryan (2014) propose this link between shareholder engagement and the effectiveness of the market for corporate control by arguing that by reducing managerial entrenchment, activism could precipitate activity in the market for corporate control. On this point, Greenwood and Schor (2009) demonstrate that firms targeted by activists are more at risk to be acquired. They argue that the combination of hedge funds' short investment horizons and their large positions in target firms makes M&A the only attractive exit option. Their results suggest that hedge funds may be better suited to identify undervalued targets and prompt a takeover, than to engage in long-term CG or operating issues.

Fourth, the media has been found to influence the audit opinion. Joe (2003) used an experiment to examine why auditors are more likely to issue going-concern opinions when the client has been the subject of negative press coverage prior to the date of the audit opinion. She finds that negative press coverage increases auditors' perception of a client's bankruptcy

probability and this, in turn, leads auditors to modify the audit opinion, even if no new information is presented.

Finally, we know that stakeholder activists may seek to target the firm's corporate image and reputation, and to do so they often rely on the media to broadcast illegitimate corporate behaviors and challenge dominant corporate images (Gamson, Croteau, Hoynes, & Sasson, 1992). The media offers a channel through which stakeholder activists can exert more direct pressure on corporations (Dyck & Zingales, 2002; King, 2008). In this line of work, it would be helpful to explore how the media both mediates and moderates the effect of other more traditional governance mechanisms.

CONNECTING THE DOTS: HOW EXTERNAL CORPORATE GOVERNANCE ENHANCES THE EFFECTIVENESS OF INTERNAL CORPORATE GOVERNANCE

In the previous section, we have reviewed and discussed the direct effects of six of the most prominent external governance mechanisms on CG effectiveness. In this section, we turn to the handful of studies that combine internal and external governance mechanisms as summarized in the columns 2-4 in Table 5. Our emphasis is in uncovering the organizational processes that occur when external CG mechanisms combine with the three most commonly studied internal mechanisms: the board of directors, ownership structure and executive compensation. By showing when external governance mechanisms might enable internal mechanisms to become more effective, we hope to begin to offer a better picture on how CG practices interact by either substituting or complementing each other to form bundles of governance practices (Bell et al., 2014; Briscoe, Chin, & Hambrick, 2014; Misangyi & Acharya, 2014; Ward, Brown, & Rodriguez, 2009). As you can see in Table 5, while there are some studies that have examined potential interactions between certain internal and external mechanisms, we are unable to make

strong assertions about the strength and robustness of these relationships. In Table 6, we highlight the relationships that we believe are most promising and discuss them below. Table 6 is inevitably somewhat speculative given the lack of research in these particular areas. But we believe that future research should pay particular attention to areas where we have proposed a strong or moderate relationship in Table 6 and where there are few corresponding studies in Table 5.

Insert Tables 5 and 6 about here

Legal System

As shown in Table 6, we suggest that the legal system has a strong influence on all three internal governance mechanisms. The legal system helps to set up the formal and informal rules of the game (North, 1990) under which governance operates. Thus, the legal system acts as a largely complementary mechanism that defines how boards, owners, and incentive systems can operate. Moreover, there is no doubt that regulatory responses to managerial misconduct and the 2008 financial crises in the United States (e.g., the Sarbanes-Oxley Act of 2002 and Dodd-Frank Act of 2010 respectively) have shaken firm governance at many levels, but particularly in how it grants shareholders' wider rights, expects greater board oversight responsibilities, and defines the contours of executive compensation.

First, the law determines the nature of shareholder rights. Typically, shareholders vote in the annual meeting to elect directors, ratify the auditor, and vote on any shareholder or board proposals, such as amending the charter or by-laws, and more recently, advisory say-on-pay proposals. The law also gives shareholders the right to vote at special meetings concerning

merger proposals or a sale of the company. There are several points where the law grants diverse rights and opportunities to shareholders when it comes to the vote. First, not all companies have a one share-one vote structure. Some corporations grant differentiated voting power to different classes of shareholders. Second, the voting quorum necessary to elect the members of the board of directors varies by company. For example, until recently, a plurality was all that was necessary but many companies have been changing their charter to require that directors be elected with a majority. Moreover, better protection of minority shareholders allows publicly traded firms with controlling owners to rely more readily on the capital market for financing than on bank debt or venture capitalists.

A fruitful line of research within the legal perspective is seen in the shift from country level analysis of minority shareholder protection (La Porta et al., 1998) to firm level analysis of shareholder rights. This research examines how firms are governed by multiple levels of legislation such as company level by-laws or company charters, state corporate laws, and federal securities legislation and regulation, as well as stock exchange requirements. For example, studies have found that legal rules promoting stronger shareholder rights are correlated with higher firm profitability and higher sales growth (Bebchuk, Cohen, & Ferrell, 2009; Gompers, Ishii, & Metrick, 2003).

Second, the legal environment is likely to influence the relative importance of the board within the CG puzzle. The legal environment can affect the individual incentives and ability of directors to fulfill a monitoring role and can influence the risk of replacement when directors are at fault (Marcel & Cowen, 2014). Firms emphasizing the protection of shareholder rights tend to have a greater role preserved for the board of directors. The fiduciary duties of the board may empower the board to engage in more monitoring. Similarly, the ease of director liability suits

and the probability of legal enforcement may also work as an incentive for managers. In this line, Marcel and Cowen (2014) study director turnover following events of corporate fraud. Their findings are consistent with the view that boards initiate director departures to repair organizational legitimacy by signaling a willingness to remedy governance weaknesses. In addition, changes in regulation have the potential to impact monitoring behavior. For example, after the passage of the Sarbanes-Oxley Act, directors in the US have had greater incentives to monitor due to higher risks of large fines and prison sentences in the case of accounting crimes (Adams, 2012). On the other hand, the Sarbanes-Oxley Act also requires higher levels of independence and financial expertise on the audit committee and explicitly assigns its oversight over internal controls, thus enhancing their ability to perform a monitoring role (Finegold, Benson, & Hecht, 2007). Legal differences, often contingent on where the firm is incorporated, are vital to understand the function and importance of the board of directors. For example, boards in private firms are unlikely to play an equal role to boards in publicly traded firms.

Third, as a response to a controversial debate on seemingly "excessive" executive pay and the mismatch between pay and performance among publicly-traded firms, in 2010, the U.S. adopted the "say on pay" vote, obliging listed firms to conduct an advisory shareholder vote on the compensation of their top executives. This provision is likely to lead to a reconsideration of the design of executive compensation. In addition, norms might also partially determine both the level of pay and the relative importance of executive compensation as a mechanism to keep managers in line (Piketty & Saez, 2003). Therefore, we believe that the legal system works as a moderate activator of executive compensation, as its impact is far stronger on the effectiveness of the board of directors and ownership.

Market for Corporate Control

The market for corporate control has the potential to play an important role in firms with dispersed ownership but it may play a lesser role in firms with controlling shareholders. In firms with dispersed ownership, managers and board members are most directly affected by the risk of being taken over. The market for corporate control may incentivize both directors and managers to work hard and avoid opportunistic behavior in an effort to prevent replacement and reputational loss.

The market for corporate control can also directly influence certain kinds of compensation arrangements. For example, when the market for corporate control is more active, executives may demand golden parachutes and other similar arrangements that lessen the financial loss of losing one's job due to a takeover. Agrawal and Knoeber (1998) demonstrate that takeover threat has two opposing effects on compensation. The first is a competition effect in the market for managers, which results in less capability for managers to extract higher wages. The second is a risk effect, which leads, in contrast, to increased compensation as higher takeover threat is likely to result in an increased probability of firm-specific human capital loss or implicitly deferred compensation. This in turn makes managers demand higher pay to counterbalance the increased risk. This suggests that there may be both substitution and complementary effects of the market for corporate control and managerial incentives. Again, the exogenous change in the market for corporate control provides an opportunity to examine adjustments in the design of executive compensation.

Some studies have examined how executive compensation incentives may vary when interacting with the market for corporate control, depending on the stage of the M&A period (Bodolica & Spraggon, 2009). In the pre-acquisition period, shareholders may want to recruit skilled executives who are able to initiate and complete a risky M&A deal. Thus, the adoption of

compensation protection devices before an acquisition may reduce the need for long-term incentive plans in monitoring executive actions. Since acquisitions often result in turnover of the target firm's executives and board along with significant losses of important knowledge resources (Cannella & Hambrick, 1993; Harford, 2003; Krug & Hegarty, 2001), executive compensation packages may be used primarily to increase the risk-seeking behavior of executives and to retain scarce leadership, thus satisfying shareholders' expectations prior to an acquisition (Wulf & Singh, 2011). Future work exploring how different types of executive compensation are contingent on the market for corporate control to discipline managers appears to be a fruitful area for scholars to investigate.

External Auditor

While we have discussed how external auditors can serve as an external governance mechanism directly, they are likely to strengthen the governance role of the board of directors. The external auditor generally meets with the board to gather further information about the business and the quality of internal control systems. Through these meetings, directors who engage in monitoring can provide information and express concerns about records, documentation, internal control weaknesses and other matters that are relevant to the preparation and fair presentation of the financial statements (AU section 380). The external auditor considers this qualitative information to plan and conduct the audit, which consecutively determines the audit fee. Empirical research has shown support for the positive relationship between board independence (as well as audit committee independence) and audit fees in the U.S. (Abbott, Parker, Peters, & Raghunandan, 2003; Carcello et al., 2002), providing some evidence that external auditors allow boards to become more effective in their monitoring efforts.

Recently, Desender, Aguilera, López-Puertas Lamy, and Crespi (forthcoming) demonstrate that this influence of external auditors on board monitoring may be especially important in settings where the level of board independence is low or where the monitoring role has not been emphasized. Interestingly, this stream of literature offers a new approach to capturing monitoring effort. For example, while board independence does not necessarily capture monitoring behavior, its impact on the audit scope may provide a clearer signal of board monitoring effort. Research also shows that when boards do not have the incentives or the capacity to monitor management, external auditors become a substitute for effective boards (Desender et al., 2013). Moreover, it has been suggested that ownership concentration may act as a partial substitute to external auditing. Hope, Langli, and Thomas (2012) argue that given monitoring by large shareholders, agency costs are lower and, as a result, auditors supply less effort and there is less demand for a Big N auditor.

To better understand the relevance of external auditors on boards, changes in the auditing requirement such as Sarbanes-Oxley or the change in audit regulation in the UK which, starting in 2004, no longer required private firms to audit their accounts offer unique research opportunities. To illustrate, Lennox and Pittman (2011) find that companies who after 2004 voluntarily submit to an audit receive upgrades to their credit ratings. In contrast, companies that no longer submit to an audit suffer credit rating downgrades. It would be interesting to examine the relationship between board characteristics and firm outcomes, such as earnings management or earnings restatements for firms that kept the external audit (on a voluntary basis) compared to those which dropped the external auditor. It would also be fascinating to study whether and how the Sarbanes-Oxley Act has altered the relationship between boards and external auditors, and in turn, its effect on the quality of financial statements.

Rating Organizations

Rating agencies are likely to exert direct influence on both the boards and executive compensation. Board structure and the design of compensation schemes are central to most CG ratings. CG ratings may induce changes in board composition (e.g., board independence, CEO duality) and executive compensation (vesting periods, transparency, linkages to corporate performance) as firms strive to gain legitimacy by becoming similar to industry peers, and avoid loss of reputation.

The threat of downgrades from rating organizations may also serve as a complementary mechanism that exerts some pressure on boards to perform their duties well. For example, negative analyst evaluations can induce a corporation to make changes to the firm's governance structure including increases in formal board independence (Westphal & Graebner, 2010). However, reciprocity between executives and analysts along with tactics such as impression management and earnings management may reduce the effects of such downgrades on actual monitoring behavior (Washburn & Bromiley, 2014; Westphal & Clement, 2008). Yet, even though changes in overall board features may turn out to be more symbolic than substantive (Bednar, 2012; Fiss & Zajac, 2004), it potentially reinforces the position of independent directors to perform a monitoring role. With regards to an effect on ownership, even though shareholder rights are also typically evaluated by rating organizations, it may be more difficult (and costly) to modify limitations on shareholder rights. We therefore expect the influence on ownership to be weak, while the overall impact on the effectiveness of the board and executive compensation is likely to be moderate.

Stakeholder Activism

Although stakeholder activism's effect on targeted firms' performance is fairly equivocal, activists have been increasingly successful in enhancing firm governance effectiveness by activating internal CG mechanisms (Ertimur, Ferri, & Stubben, 2010; Thomas & Cotter, 2007). The strongest effect is on owners. Stakeholder activism allows shareholders to exercise their power as owners of the company to influence firm behavior. While large owners may be able to directly influence management, activism strongly enhances minority shareholders' ability. In some cases, activism may be directed against other large shareholders, not against directors. Stakeholder activism tends to be found in firms with certain types of ownership. In particular, firms with low managerial ownership (Bizjak & Marquette, 1998; Faleye, 2004), institutional ownership (Bizjak & Marquette, 1998; Brav et al., 2008; Renneboog & Szilagyi, 2011), large owners (Bizjak & Marquette, 1998; Faleye, 2004), and high executive compensation (Ertimur, Ferri, & Muslu, 2011) are more likely to attract activism.

Second, the relationship between stakeholder activism and board effectiveness is more mixed. While some work finds that independent boards attract shareholder activism (Ertimur et al., 2011; Prevost & Rao, 2000), other studies report that the relationship is unclear (Bizjak & Marquette, 1998; Renneboog & Szilagyi, 2011). Finally, the link between shareholder activism and executive compensation has been extensively researched. Ertimur et al. (2011) find that executive pay proposals and "vote no" campaigns are related to a reduction in excessive executive pay. Ferri and Sandino (2009) uncover that firms that are targeted with proposals to expense stock options are more likely to announce voluntary expensing. Furthermore, shareholder activism constrains CEO pay increases, particularly when proposals receive a shareholder majority vote. Brav et al. (2008) report that hedge fund activism has a positive impact on pay-for-performance, while Klein and Zur (2009) show that hedge funds rarely

demand reductions in CEO compensation, but often succeed at gaining board representation. Larcker, McCall, Ormazabal, and Tayan (2012) examine the influence of third-party proxy advisory firms' voting recommendations on shareholder proposal voting outcomes, particularly say-on-pay votes. They reveal that 70% of companies reported that their compensation programs were influenced by the guidance received from or by the policies of proxy advisory firms.

As we discussed above, activism could precipitate activity in the market for corporate control by reducing managerial entrenchment. At the same time, activism related to shareholder rights issues, such as rescinding poison pills (Bizjak & Marquette, 1998) or declassifying boards of directors (Guo, Kruse, & Nohel, 2008), for example, could make firms more attractive takeover targets. Firms that are consistently targeted for their anti-takeover provisions are subsequently more likely to be acquired (Del Guercio & Hawkins, 1999; Greenwood & Schor, 2009). While these studies focus on financial activism by shareholders, there is almost no research on how other stakeholder activists may influence and work in tandem with the three internal governance mechanisms. This is an apparent opportunity for future research.

Media

In general, the media is likely to have moderate effects on internal corporate governance mechanisms, and it may interact with these mechanisms to influence governance effectiveness and other important firm outcomes. Research finds that negative media coverage has a stronger effect on strategic change in the presence of an independent board (Bednar et al., 2013). This suggests that there may be complementarities between the board and the media such that the threat of negative press could motivate the board to govern the firm more effectively or at least to take a more active role. This complementary effect is in addition to any direct effects that the media may have on changes in composition of the board (Bednar, 2012).

With regards to ownership, it does seem likely that various ownership arrangements could be portrayed differently in the media and that the media may interact with ownership to influence various firm outcomes. Journalism scholars have long been concerned about ownership concentration in media firms and its impact on subsequent reporting. However, this potential relationship has not received significant attention in the management literature. Similarly, the media is likely to report on what are perceived to be egregious pay packages (Core et al., 2008). In theory, the resulting pressure from the media could potentially put an upper-bound on executive compensation, but empirical work has shown that negative media coverage of executive compensation tends to change the form of subsequent pay rather than absolute levels (Bednar, 2012; Core et al., 2008). However, increasingly the media can give voice to activists who are dissatisfied with executive pay and provide a platform for their voices to be heard.

DISCUSSION AND DIRECTIONS FOR FUTURE RESEARCH

Thus far in this review, we developed a working definition of effective corporate governance and described the underlying theoretical processes that relate six prominent external governance mechanisms with effective governance. Then, we reviewed research on the direct effects of each of these and discussed how these six external mechanisms are likely to influence the more commonly studied internal governance mechanisms. Building from this foundation, we believe that researchers who study CG have an exciting opportunity to better understand external CG mechanisms and their role in the CG puzzle. In particular, we propose that future research on external governance mechanisms will benefit from three important considerations: the adoption of configurational approaches, new methodological opportunities, and incorporating behavioral theoretical perspectives. We discuss each of them below.

A Configurational Approach

Revised Theoretical Foundation. Much of the governance work from an agency perspective has equated governance effectiveness with shareholder wealth maximization. Yet, mounting evidence of weak relationships between ‘good’ corporate governance practices and firm performance suggests that CG research may benefit from a somewhat different, wider approach. In this review, we suggested that it is imperative to understand governance effectiveness beyond shareholder value maximization and instead, that it may be helpful to conceptualize governance effectiveness in relation to the four objectives that we identified at the beginning of this review (protection of rights, enabler of relationships, disclosure and guidance). In addition, one reason for the mixed empirical results related to the effectiveness of various governance mechanisms may be that the governance literature has historically tended to examine the (average) effect of a single governance practice on firm financial performance.

A growing literature has sought to develop a configurational approach to CG by identifying distinct, internally consistent sets of practices that influence firms and their environments, and by exploring how these practices interact by substituting or complementing each other as related ‘bundles’ of practices (Bell et al., 2014; Misangyi & Acharya, 2014). A configurational approach consists of looking at multiple patterns of practices or characteristics that tend to occur together, and examining the effects of such patterns on firm outcomes (Fiss, 2007; Meyer, Tsui, & Hinings, 1993). This line of research has stressed that the simultaneous activation of several CG mechanisms is important in limiting managerial opportunism (Aguilera et al., 2008; Hoskisson, Hitt, Johnson, & Grossman, 2002; Rediker & Seth, 1995; Walsh & Seward, 1990).

From our discussion of the direct effects of external governance mechanisms and our analysis of how each of them may interact with internal governance mechanisms, it should be

clear that not all mechanisms play an equal part in the CG puzzle, and that their contribution depends on other governance mechanisms. The relationships proposed in Table 6 give us some clues about what internal and external mechanisms are likely to work together to improve governance effectiveness but it is almost impossible to assign degrees of confidence. For example, we would expect that a weak legal system would be associated with weak board monitoring and weak managerial incentives. Yet, we are likely to see bundles of strong internal governance mechanisms when the legal system is also strong. We may also see situations where configurations of external mechanisms work together to affect firm governance because although some of the external mechanisms may not activate internal mechanisms when used in isolation, the combination of multiple external mechanisms may affect the firm when considered together. For example, while stakeholder activism may not often influence board decisions directly, activists may have more influence when their activism is coupled with extensive media coverage and poor governance ratings that are likely to make boards more responsive to their demands. Similarly, the media could also amplify the effect of CG ratings on the level and mix of executive compensation. Thus, we may see configurations that include active boards, active stakeholders and high levels of media scrutiny. These examples illustrate that external mechanisms play a complementary role to internal mechanisms by activating their use, yet they have typically not been studied in combination.

Such examples are admittedly somewhat speculative and extensive theoretical and empirical work needs to be done to determine which governance practices tend to occur together and to investigate how different configurations of internal and external governance mechanisms influence firm outcomes. But we strongly believe that efforts to develop theoretical foundations that better help to explain when and how different mechanisms will influence strategic decisions

and firm outcomes will prove to be especially beneficial. Using a configurational logic moves governance research beyond “one size fits all” prescriptions and toward a perspective that can account simultaneously for both internal and external mechanisms. The number of potential combinations of CG practices, and hence their complementarities, is extensive and complex to resolve. This is particularly true when we think of internal and external governance mechanisms working in tandem. Thus, an important objective of future research should be to move beyond examining the effects of single governance mechanisms and to identify different configurations of effective firm level CG.

Configurational Contingencies and Multi-Level Analysis. Recent work in the management literature has started down this path of using a configurational logic to examine what bundles of governance practices may be associated with increased firm performance. For example, García-Castro, Aguilera, and Ariño (2013) and Misangyi and Acharya (2014) identified several groupings of governance practices that were associated with increased financial performance, as well as practices associated with lower firm performance. Misangyi and Acharya (2014) point out that configurations can include groupings of internal mechanisms, groupings of external mechanisms, or groupings that include both internal and external mechanisms. Bell et al. (2014) use a similar approach to uncover patterns in governance practices and contextual factors that are associated with increased perceived value of foreign IPOs in the U.S.

While these studies represent a tremendous start, they also point us towards many opportunities to advance the governance literature forward with a configurational logic. A configurational approach to governance requires that we stop neglecting various contexts, at the firm, industry and societal level, in which certain governance mechanisms are most likely to

have an effect (Filatotchev, 2008). Part of this neglect may stem from an overreliance on agency theory as the basis for much of extant governance work. For example, Aguilera and Jackson (2003) posit that the ‘under-contextualized’ approach of agency theory remains restricted to two actors (managers and shareholders) and fails to consider other aspects of the organizational context that impact agency problems, such as diverse task environments, the life-cycle of organizations, or institutional context of CG.”

Thus, configurational approaches require that we consider firm-level characteristics (e.g., size, age, risk or performance), industry-level characteristics (e.g., the intensity of competition), or country-level characteristics that may determine the impact of various governance mechanisms. We must also take into account how differences between private and family firms, entrepreneurial businesses, non-governmental organizations, or public and private partnerships affect the incidence and effectiveness of different governance mechanisms. In addition, as firms evolve over time (e.g., they move through the life cycles, expand into new markets, need additional external funding), they face new governance challenges and conflicts. As such, a dynamic approach to governance may provide a better understanding of the effectiveness of governance mechanisms and when they really play a key role since configurations that are effective at one point in time may be largely ineffective at another.

Asymmetric Relationships and Opportunity Structures. While the presence of some external and internal governance might lead to a given firm outcome, it does not imply that the non-existence of those governance systems will lead to the negation of the outcome. Configurational relationships are not symmetrical. It is also important to take into account the opportunity structure. That is, configurations which might be effective for one particular governance objective, may be less effective for a different objective. Such contextualized

thinking is akin to research on social activism in corporate settings that has proposed the idea of “opportunity structures,” which are the set of characteristics that make a firm more or less attractive as potential targets for activist pressure (Briscoe et al., 2014). To properly incorporate configurational approaches to governance, we must isolate the set of characteristics that make a firm more or less likely to be influenced by internal and external governance mechanisms. The following are some illustrations: while the legal system has a crucial role in protecting stakeholder rights, influencing the management of stakeholders and requiring minimum information disclosure in almost all firms, ratings organizations are unlikely to play a substantial role in most small firms. Similarly, the media and stakeholder activists may play a greater role in larger firms and are likely to become more relevant depending on the industries.

In sum, in addition to thinking more about context, a configurational approach will force governance researchers to take steps to build new theory. The recent configurational studies do a nice job of identifying patterns of governance practices and contextual factors that are associated with higher performance. But they are less clear about the theoretical reasons for why those configurations occur the way that they do, and they do not always adequately explain the theoretical processes through which those bundles affect the firm. Thus as research uncovers new configurations of governance mechanisms, such findings will provide opportunities for researchers to inductively develop new theoretical insights and explanations for why these configurations exist. Such theory building may help the literature to move beyond and/or enhance agency conceptualizations of governance.

Methodological Opportunities

While in theory, a configurational approach to governance that recognizes bundles of internal and external governance practices appears to be a useful path forward, there are a

number of methodological considerations that must be addressed if such an approach is to be used successfully. We focus here on three: data collection issues, dealing with endogeneity, and using Fuzzy Set/Qualitative Comparative Analysis (FS/QCA) methods.

Data Collection Issues: With regards to data collection issues, research on external governance mechanisms will surely benefit from the increased availability of data over the last several years. Many of these mechanisms can be studied using data that is readily available from a variety of commercial databases. For example, when studying the legal system, authors can obtain legal provisions at the firm level from the Investor Responsibility Research Center (IRRC). Similar data sources exist for each of the six mechanisms although some mechanisms (e.g. Audit Analytics for external auditors, Factiva or Lexis Nexis for the media, and Thompson Reuters SDC for the market for corporate control). Some of the data collected from these sources, such as media data, require additional processing through human or computer aided coding. However, what may be more challenging for researchers is to develop measures for the four different corporate governance objectives mentioned previously. Many of these objectives can be measured quite easily. For example, protection of shareholder rights has been measured using indices of various governance practices that are extracted from databases such as IRRC. But as we move beyond shareholders and begin to consider additional stakeholders, new data sources and new ways of measuring governance objectives may be necessary. For example, it is not immediately clear how to best measure the extent to which the firm is able to manage internal and external stakeholder relationships. In all likelihood, the appropriate measures will depend largely on the specific stakeholder group that is being considered.

Endogeneity is problematic not just for configurational approaches but also when determining the causal effects of any of the external mechanisms that we outlined in the paper.

While studies often treat governance mechanisms as exogenous variables, in reality, many governance structures are the result of unobserved choices made by the firm. If governance structures arise endogenously because economic actors choose them in response to the governance issues they face, we need to ask why that structure was chosen when we observe what appears to be a poor governance structure. One potentially fruitful opportunity for future research would be to conduct process-oriented field studies to uncover the thinking behind various governance choices, using first-hand empirical data collection methods, such as questionnaire surveys, interviews, and participant observations. However, since most of the literature has traditionally focused on archival data, we must also consider other means to reduce concerns about endogeneity.

Two potential sources of endogeneity stand out: unobservable heterogeneity (which arises if there are unobservable factors that affect both the dependent and explanatory variables) and simultaneity (which arises if the independent variables are a function of the dependent variable or expected values of the dependent variable). For instance, it seems plausible that higher firm profitability may reinforce CEO power, lead to more CEO related directors, attract more media attention, or cause the firm to face lower shareholder activism. This creates a non-random treatment problem, which leads to inconsistent estimates of the impact of governance mechanisms on firm profitability in our models, potentially leading to the rejection of true hypotheses or failure to reject false hypotheses (Wooldridge, 2010).

To evaluate the effectiveness of any governance mechanism individually, ideally we would like to randomly assign these mechanisms to our sample firms. A close alternative to random assignment stems from examining unexpected changes in governance that only affect a subset of firms (i.e., a natural experiment). For example, a number of studies have used the

passage of business combination (BC) laws, to create a natural experiment to increase our understanding of the market for corporate (Bertrand & Mullainathan, 2003). This difference-in-difference test provides a robust environment for evaluating cause and effect.

Several other approaches, including employing fixed effects, matching score models, instrumental variable approach, and regression discontinuity designs have been developed to address endogeneity concerns (Reeb, Sakakibara, & Mahmood, 2012). The fixed effects approach allows you to control for unobserved time-constant firm heterogeneity, and it allows you to relate within-firm changes in governance mechanisms to within-firm changes in our outcome variable. One challenge with models that include firm fixed effects is that they may lack power to detect a relationship. The matched sample approach essentially attempts to address the non-random treatment effect by creating a pseudo random sample. Applied to CG research, if we want to better understand the influence of any mechanism, for example stakeholder activism, it is important to account for the factors that predict being targeted by stakeholder activists. Ideally, we would compare the outcome of firms that are equally likely to be targeted, while some are and some others are not. A major strength of the matching approach is that it obliges us to explicitly identify those factors that drive the presence of one mechanism.

Another popular approach to dealing with endogeneity is to seek an exogenous proxy for the treatment or independent variable of interest (Larcker & Rusticus, 2010). This approach centers on finding an instrument (i.e., a variable that influences the independent variable but appears unlikely to affect the dependent variable except through its effect on the independent variable) (Wintoki, Linck, & Netter, 2012). Unfortunately, exogenous instruments are rare and difficult to find.

Finally, the regression discontinuity design provides an interesting methodology to gain better insight in the influence of CG mechanisms. This approach focuses on identifying an observable characteristic that defines how some firm becomes part of the treatment group and seeks to exploit the cut-off point. Essentially, the regression discontinuity method seeks to utilize the similarities of those firms just above and just below the cut-off point (Almond & Doyle, 2011). For example, Cuñat, Gine, and Guadalupe (2013) use a regression discontinuity design that compares the stock market reaction and other outcomes of Say on Pay proposals that pass by a small margin to those that fail by a small margin. These approaches are likely to shed new light on some of the mixed results found in the CG literature and may also help to better grasp the relationship between CG mechanisms.

Fuzzy Set/Qualitative Comparative Analysis (FS/QCA) method. While some simple configurational models can be tested with OLS, particularly if they involve two-way interactions, others will require unique methods such as Fuzzy Set/Qualitative Comparative Analysis (FS/QCA). FS/QCA takes the perspective that cases are constituted by combinations of theoretically relevant attributes (i.e., governance mechanisms), that the relationships between these attributes and the outcome of interest (i.e., firm profits) can be understood through the examination of subset relations (Ragin, 2000, 2008), and thus that the attributes and the outcome are “best understood in terms of set membership” (Fiss, 2007, p. 1183). Importantly, FS/QCA is intended not to isolate the net, independent effects of single explanatory factors on a particular outcome, but rather to identify the combinations of factors that bring about a particular outcome (Ragin, 2008). Thus, Fs/QCA is particularly appropriate when researchers want to demonstrate that a combination, or bundle, of factors work in concert with one another to be a sufficient cause for a firm outcome (Mahoney & Goertz, 2006), especially if the number of possible

combinations is too large to handle through the use of interaction terms. An important caveat to FS/QCA is that it looks at associations, and that it cannot rule out potential reverse causality among the relationships. QCA has been employed in recent governance work on configurations (Bell et al., 2014; Misangyi & Acharya, 2014).

Incorporating Behavioral Approaches

Despite the fact that much of the governance literature has been dominated by agency theory approaches, we have highlighted that other perspectives such as institutional theory, resource dependence theory, and team production theory have also been successfully used to understand governance effectiveness. In addition, there is a growing stream of work that takes a more behavioral view of corporate governance (Hambrick et al., 2008; Westphal & Zajac, 2013). We believe that the ideas laid forth in this review are applicable to this line of work. This behavioral perspective goes beyond the formal structures and policies that are at the heart of much governance research and explores how informal structures (i.e., networks, power dynamics, and symbolic management) and decision-making processes affect how firms are governed. Future research in this stream of work could benefit from incorporating various external governance mechanisms. For example, work on decision-making on boards finds evidence of group decision-making biases such as pluralistic ignorance, and group polarization that ultimately affect important firm outcomes (Westphal & Bednar, 2005; Zhu, 2013). It would be interesting to study in future research how external pressure from the media, auditors, rating agencies, or the threat of a takeover would potentially exacerbate these biases. Future research could also explore how scrutiny from external governance mechanisms might influence the spread of information and subsequent diffusion of practices through board interlocks or other network ties. There has also been substantial work on symbolic action in the field of CG with

studies showing that firms often conform to expectations in largely symbolic ways, whereby they gain the benefit of conformity without engaging in substantive action (Westphal & Zajac, 1998; Zajac & Westphal, 2004). It would be interesting to examine whether such actions are more or less effective depending on the type of external governance mechanism that is involved. We believe that the study of external governance mechanisms represents an exciting opportunity for behavioral scholars of CG.

In the same way that we advocate for multi-methods to solve empirical issues, we also encourage more theoretical integration in CG research. Part of the mixed results on the effectiveness of the most prominent internal governance mechanisms may be due to use of the agency perspective as the primary theoretical lens. The adoption of multiple theoretical perspectives may provide a better understanding of when and how different mechanisms contribute to more effective CG.

Conclusion

We have set out to bring external governance mechanisms more prominently into the overall corporate governance picture. After reviewing the existing literature on six key external mechanisms, we believe that despite an array of potential methodological challenges, the future of CG research is bright. However, we must move beyond the “usual suspects” that have been so extensively studied in past research and start to find new ways of looking at the governance problem and firm outcomes if we are going to find meaningful and useful governance solutions. We hope that this essay spurs research in this vein.

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Table 1: Selected Research on Internal Corporate Governance Mechanisms

Panel A: Board (Board Independence, CEO Duality, Board Ownership)

Studies: Author(s) (Journal; year)	Research Question	Key Variables	Sample & Methodology	Key Findings
Bhagat & Black (JCL, 2002)	Does board independence leads to higher firm value?	DV: Tobin Q, ROA, turnover ratio IV: Board independence (% of outside directors)	928 large U.S. public companies for 1988-1990 and 1991-1993.	Evidence that low-profitability firms increase the independence of their boards of directors. But there is no evidence that this strategy works. Firms with more independent boards do not perform better than other firms.
Dalton, Daily, Ellstrand, & Johnson (SMJ, 1998)	Is board composition (board independence and CEO duality) related to higher financial performance?	DV: Financial performance IV: Board independence, CEO duality	Meta-analyses of 54 empirical studies of board composition and 31 empirical studies of board leadership structure and their relationships to firm performance.	The results for the board composition/financial performance meta-analyses suggest no relationship of a meaningful level.
Brickley, Coles, & Jarrell (JCF, 1997)	Does CEO duality affect firm performance?	DV: Stock returns, ROE IV: CEO duality	661 firms from the 1989 Forbes survey of executive compensation (OLS and Event study)	There is no evidence that CEO duality is associated with inferior accounting and market returns. If anything, the opposite is the case.
Goyal & Park (JCF, 2002)	Does CEO duality affect a board's decision to dismiss an ineffective CEO?	DV: CEO turnover IV: CEO duality	CEO turnover (and non-turnover) sample from the ExecuComp database over the period 1992–1996.	The sensitivity of CEO turnover to performance is lower when titles are combined, consistent with the notion that the combination of titles is associated with increased power over the board.
Adams, Almeida, & Ferreira (RFS, 2005)	Do firms whose CEOs have more decision-making power experience more variability in performance?	DV: variability of Stock returns, Tobin Q ROA IV: CEO duality	Fortune 500 firms from 1992 to 1999	Evidence that CEOs also holding the chairman title hold greater influence over corporate decision making.
Morck, Shleifer, & Vishny (JFE, 1988)	How does Board Ownership affect Market Valuation?	DV: Tobin Q IV: Board Ownership	371 Fortune 500 firms from 1980 (OLS)	Tobin's Q rises as board ownership increases from 0% to 5%, falls as ownership rises further to 25%, and then continues to rise, although much more slowly, as board ownership rises beyond 25%. The results also apply individually to the ownership by the firm's top officers and its outside board members.
Hillman & Dalziel (AMR, 2003)	Integrating Agency and Resource Dependence Perspectives to explain the Boards of Directors - Firm Performance relationship	Conceptual paper		The study suggest a more parsimonious view of board functions and examine how best practices for each board function complement or contradict one another. The authors argue that that board capital affects both board monitoring and the provision of resources and that board incentives moderate these relationships.

Panel B: Ownership (concentration, type)

Studies: Author(s) (Journal; year)	Research Question	Key Variables	Sample & Methodology	Key Findings
Demsetz & Villalonga (JCF, 2001)	Is there a relation between the ownership structure and the performance?	DV: Tobin Q IV: the fraction of shares owned by the five largest shareholding interests, and the fraction of shares owned by management	223-firm random subsample of the sample in the original Demsetz and Lehn (1985) study	The results show no statistically significant relation between ownership structure and firm performance
Thomsen & Pedersen (SMJ, 2000)	What is the impact of ownership structure on company economic performance?	DV: market-to-book value, ROA IV: Ownership concentration and type	435 of the largest European companies over the 1990–1995 period.	The results show a positive effect of ownership concentration on shareholder value and profitability, but the effect levels off for high ownership shares. Furthermore, the identity of large owners—family, bank, institutional investor, government, and other companies—has important implications for corporate strategy and performance.
Anderson & Reeb (JF, 2003)	Is there a relation between founding-family ownership and firm performance?	DV: Tobin Q, ROA IV: Family firms dummy	Standard & Poor's 500 firms from 1992 through 1999.	Family firms perform better than nonfamily firms. Additional analysis reveals that the relation between family holdings and firm performance is nonlinear and that when family members serve as CEO, performance is better than with outside CEOs.
Aggarwal, Erel, Ferreira, & Matos (JFE, 2011)	Do institutional investors affect corporate governance?	DV: Corporate governance quality based on 41 attributes IV: institutional ownership (domestic and foreign)	23 countries during the period 2003–2008	Results show that firm-level governance is positively associated with international institutional investment. Changes in institutional ownership over time positively affect subsequent changes in firm-level governance, but the opposite is not true. Foreign institutions and institutions from countries with strong shareholder protection play a role in promoting governance improvements outside of the U.S.

Panel C: Managerial Incentives (Stock, options)

Studies: Author(s) (Journal; year)	Research Question	Key Variables	Sample & Methodology	Key Findings
McConnell & Servaes (JFE, 1990)	Is there a relation between Tobin's Q and the structure of equity ownership?	DV: Tobin Q IV: common stock owned by corporate insiders	sample of 1,173 firms for 1976 and 1,093 firms for 1986	Evidence of a positive relationship between increases in managerial ownership and firm performance as long as managerial ownership is less than 50 percent.
Mehran (JFE, 1995)	What is the relationship among executive compensation structure, ownership structure and control, and firm performance?	DV: Tobin Q, ROA IV: Compensation structure	153 randomly-selected manufacturing firms in 1979–1980	Firm performance is positively related to the percentage of equity held by managers and to the percentage of their compensation that is equity-based.
Ittner, Lambert, & Larcker (JAE, 2003)	What are the performance consequences of equity grants?	DV: Stock return, ROA IV: equity incentive residuals	Mail surveys of 217 new economy firms during 1999 and 2000	Exploratory performance tests indicate that lower than expected grants and/or existing holdings of options are associated with poorer performance in subsequent years.
Fahlenbrach & Stulz (JFE, 2011)	Is bank performance during the recent credit crisis related to CEO incentives before the crisis?	DV: buy-and-hold returns, stock volatility IV: Cash bonus/salary, Dollar gain from +1%, Equity risk (\$ and %), ownership	95 US listed banks (Compensation data of 2006)	There is some evidence that banks with CEOs whose incentives were better aligned with the interests of shareholders performed worse and no evidence that they performed better. Banks with higher option compensation and a larger fraction of compensation in cash bonuses for their CEOs did not perform worse during the crisis.
Harris & Bromiley (OS, 2007)	What is the influence of executive compensation and firm performance on financial misrepresentation	DV: accounting irregularities IV: Incentive compensation, relative performance	Sample of 919 financial restatements (accounting irregularities) between January 1997 and June 2002 identified by the U.S. Government Accountability Office (logit)	Empirical evidence provides support for both incentive and relative performance influences on financial statement misrepresentation

Table 2. A Multi-Theory Organizing Framework

	AGENCY THEORY (Jensen & Meckling, 1976)	INSTITUTIONAL THEORY (DiMaggio & Powell, 1983)	RESOURCE DEPENDENCY THEORY (Pfeffer & Salancik, 1978)	TEAM PRODUCTION THEORY (Blair & Stout, 1999)
KEY CONCEPTS	<ul style="list-style-type: none"> -Differing interests of principals and shareholders -Self-interest -Agency costs -Asymmetry of information -Bounded rationality -Risk aversion 	<ul style="list-style-type: none"> -Institutions bring meaning to social and economic behavior -Rules of the game become taken for granted -Conformity to institutional logics - Legitimacy 	<ul style="list-style-type: none"> -Firm must manage dependence on external environment -Interdependencies between firms -Asymmetric power/resource 	<ul style="list-style-type: none"> -Stakeholders invest resources but relinquish control to the board -Board of directors acts as a mediating hierarchy -Interests of the corporation are to be served
ORGANIZATIONAL PROCESSES	<ul style="list-style-type: none"> -Monitoring -Contracting -Incentives -Signaling 	<ul style="list-style-type: none"> -Coercive isomorphism -Mimetic isomorphism -Normative isomorphism -Decoupling: Symbolic Management -Social Control 	<ul style="list-style-type: none"> -Compliance -Power distribution -Resource allocation -Co-optation -Coalition -Vertical integration 	<ul style="list-style-type: none"> -Delegation to board - Collective action process -Coordinating interests - Dispute resolution

Table 3. External Corporate Governance Mechanisms

Panel A. Legal System

Studies: Author(s) (Journal; year)	Research Question	Key Variables	Sample & Methodology	Key Findings
La Porta et al. (JFE, 2000)	How important is Investor protection (legal approach) to understanding differences in corporate governance across countries?	Legal approach to corporate governance, compared to the more standard focus on the relative importance of banks and stock markets.	Conceptual study	LLSV argue that the legal approach is a more fruitful way to understand corporate governance and its reform than the conventional distinction between bank-centered and market-centered financial systems.
Leuz et al. (JAE, 2003)	Does investor protection explain earnings management across countries?	DV: Earnings Management IV: Investor protection, legal enforcement	Sample of 70,955 firm year observations for the fiscal years 1990 to 1999 across 31 countries and 8,616 non-financial firms	The findings reveal that earnings management decreases with investor protection, because strong protection limits insiders' ability to acquire private control benefits, which reduces their incentives to mask firm performance.
Crossland & Hambrick (SMJ, 2007, 2011)	Do nation-level institutions affect the degree to of managerial discretion?	DV: managerial discretion, variance in firm performance IV: individualism, tolerance of uncertainty, cultural looseness, dispersed firm ownership, a common-law legal origin, and employer flexibility.	Aggregate scores for 15 countries	Findings show that certain informal and formal national institutions—individualism, tolerance of uncertainty, cultural looseness, dispersed firm ownership, a common-law legal origin, and employer flexibility—are associated with the degree of managerial discretion available to CEOs of public firms in a country. In turn, country-level managerial discretion is associated with how much impact CEOs have on the performance of their firms.
Capron & Guillén (SMJ, 2009)	To what extent do corporate governance institutions prevalent in both the host and the target country of the merging firms enable or constrain the ability of the acquirer to reorganize the target?	DV: post-acquisition restructuring, asset deployment, redeployment of target resources to acquirer IV: Shareholder rights index, labor rights.	The data span 253 acquisitions undertaken by 190 acquirers located in 14 countries and targets in 27 countries.(OLS)	Stronger legal protection of shareholder rights in the acquirer country compared to the target country increases the acquirer's ability to restructure the target's assets and leverage the target's resources, while the protection of employee rights in the target country restricts the acquirer's ability to restructure the target's assets and redeploy resources to and from the target.
Schneper & Guillén (ASQ, 2004)	Are the interests of shareholders, workers, and banks are consistent with the practice of hostile takeovers.	DV: Hostile takeover IV: Shareholder rights, labor rights, banks' rights	Data on Hostile takeovers in 37 countries between 1988 and 1998.	Hostile takeovers increase in frequency with the extent to which shareholder rights are protected and decrease with the degree to which workers' and banks' rights are protected
Adams et al. (SMJ, 2011)	How do directors make decisions that involve	DV: Shareholder and stakeholder orientations,	Survey questionnaire send to all directors,	Findings show that directors' personal values and roles play an important part in their decisions. Directors and

	shareholders and other stakeholders?	IV: Personal values	CEOs, and vice CEOs of all publicly traded firms in Sweden in 2005.	CEOs are more pro-shareholder, the more they endorse entrepreneurial values, while employee representative directors exhibit a lower baseline level of shareholder orientation, they nonetheless often side with shareholders
Ioannou & Serafeim (JIBS, 2012)	What is the role of nation-level institutions as a driver of corporate social performance?	DV: corporate social performance IV: Political system (which includes Anti-self-dealing index)	Sample of 12,764 firm-year observations from 42 countries over the 2002–2008 period.	Findings show that the political system, followed by the labor and education system, and the cultural system are the most important NBS categories of institutions that impact CSP. Interestingly, the financial system appears to have a relatively less significant impact.

Panel B: Market for Corporate Control

Studies: Author(s) (Journal; year)	Research Question	Key Variables	Sample & Methodology	Key Findings
Fama & Jensen (JLE, 1983)	How could the problem caused by separation of ownership and control be solved?	DV: separation of ownership and control IV: governance in different forms of organizations	Theory paper that introduces the internal and external mechanism to solve agency problems	Separation of decision and risk-bearing functions is prevalent in part because of the benefits of its specialization but also because of effective governance structures to controlling the agency problems.
Davis & Stout (ASQ, 1992)	What firm's attributes are associated with takeover in the 1980s?	DV: firm's risk of becoming subject to a tender offer IV: Market to book, return on equity, size, age, type of ownership, Finance CEO, etc	Fortune 500 largest industrial firms between 1980 to 1990; event-history analysis	Large corporations were most likely to be taken over in the 1980s--greater organizational slack, age, and having a finance chief executive officer increased the risk of takeover.
King, Dalton, Daily, & Covin (SMJ, 2004)	What are the antecedents that predict post-acquisition performance?	DV: post-acquisition performance IV: Related acquisitions, Method of payment, Prior acquisition experience, etc.	93 empirical studies with 852 effect sizes and <i>n</i> size of 206,910; Meta-analysis	Acquiring firms generally received zero returns or negative returns beyond the day a merger or acquisition is announced
Bhagat, Dong, Hirshleifer, & Noah (JFE, 2005)	Whether and by how much tender offers are perceived by investors as improving combined equity value	DV: perceived value improvements IV: Related acquisitions, Method of payment, Pre-Williams Act, Post-March2000, etc.	327 tender offers in which the bidder and target were both listed on the NYSE or Amex during 1962–2001; Least squares regression	Combined bidder-target stock returns are higher for hostile offers, lower for equity offers, and lower for diversifying offers. Bidders on average pay fair prices.
Uhlenbruck, Hitt, & Semadeni (SMJ, 2006)	What is the potential acquisition benefit to a firm from other firm's new technologies and capabilities?	DV: abnormal returns IV: Type of acquisition (Offline–online, Online–online), Pre-March 2000.	1,029 acquisition events between 1995 and 2001 (363 cases online firms acquiring other online firms / 435 cases of online firms acquired by offline firms; Event study	Positive stock market returns accrue to firms using acquisitions for gaining knowledge and learning new capabilities.
Moeller, Schlingemann, &	How much did shareholders gain or lose in acquisition occurred from 1998-2001 compared to	DV: Average abnormal return IV: Acquisition	12,023 acquisitions by publicly listed U.S. acquirers from 1980 to	Acquiring firm shareholders lost 12 cents per dollar of their investment in the firm on the announcement of acquisitions from 1998 through 2001, compared to 1.6

Stulz (JF, 2005)	throughout the 1980s?	announcements	2001; Event study	cents per dollar spent throughout the 1980s.
Fuller, Netter, & Stegemoller (JF, 2002)	What is the impact of target and bid characteristics on the returns of acquirers?	DV: Abnormal Returns IV: Target Type and Method of Payment	539 acquirers making 3,135 bids, making five or more successful bids within three years between 1990 and 2000; Event study	Bidders gain negative returns when buying public targets and positive returns when buying private or subsidiary targets.
Bertrand & Mullainathan (JPE, 2003)	What goals do managers pursue when they are not closely monitored?	DV: worker wages, destruction of old plants, creation of new plants, productivity and profitability measures IV: regulatory change in takeover laws	224,188 plant-year observations from 1,000 US firms from 1976 and 1995	This paper finds that when managers are insulated from takeovers, worker wages (especially those of white-collar workers) rise. The destruction of old plants falls, but the creation of new plants also falls. Finally, overall productivity and profitability decline in response to these laws.
Hirsch (AJS, 1986)	What is the relationship between hostile takeovers and its linguistic framings?	DV: diffusion of hostile takeovers IV: linguistic frame of takeovers	the coverage of takeovers by three major business periodical, interview with 60 executives, and transcripts of congressional reports; historical, content analysis	The normative, linguistic framing of hostile takeovers facilitated takeover diffusion and legitimation

Panel C: External Auditor (Audit fees, Big N-Auditor)

Studies: Author(s) (Journal; year)	Research Question	Key Variables	Sample & Methodology	Key Findings
Simunic (JAR, 1980)	Is the audit industry competitive?	DV: audit fees/Total assets, (audit fees + cost of internal audit)/ Total assets IV: Big-8 auditor	397 publicly held corporations in the US, using a survey to obtain audit fees and related variables.	The hypothesis that price competition prevails throughout the market for audits of publicly held companies cannot be rejected. The results suggest that Big-8 firms enjoy scale economies which are passed on as lower prices to auditees.
Hope, Thomas, & Vyas (JIBS, 2011)	Does high-quality financial reporting (i.e., annual financial statements reviewed by an external auditor) ease external financing constraints?	DV: Financial constraints IV: Financial credibility (annual financial statements reviewed by an external auditor)	49,584 manufacturing and service firms from 71 countries around the world for 2002–2005, of which 46,429 are not publicly traded (using ordered probit and OLS)	Firms with greater financial reporting credibility (i.e., annual financial statements reviewed by an external auditor) experience significantly lower perceived problems in gaining access to external finance. Further, the impact of financial credibility in reducing financing constraints in the presence of a controlling owner is more pronounced in countries with weaker creditor rights.
Lennox & Pittman (TAR, 2011)	Are mandatory audits suppressing valuable information about the types of companies that would voluntarily choose to be audited?	DV: Credit rating IV: voluntary audit and switch of regime	5,139 private UK companies (OLS)	Firms attract upgrades to their credit ratings because they send a positive signal by submitting to an audit when this is no longer legally required. In contrast, companies that dispense with being audited suffer downgrades to their ratings because avoiding an audit sends a negative signal and removes its assurance value
Lennox & Pittman (CAR, 2010)	Are Big Five audits associated with a lower incidence of accounting fraud?	DV: Fraud IV: Big Five	US listed firms: fraud sample consists of 1,109 company-years. The control sample consists of 162,804 company-years from 1981 to 2001.	Big Five auditors were consistently associated with a lower incidence of accounting fraud, even in the years shortly prior to the sweeping corporate governance reforms. This finding is robust to controlling for the endogenous effects of screening by audit firms and selection by their clients.
Carcello, Hermanson, Neal, & Riley (CAR, 2002)	How do board characteristics (independence, diligence, and expertise) affect audit fees?	DV: Ln(audit fees) IV: % of non-executive board members, number of board meetings, average number of outside directorships	Fortune 1000 companies, from FY 1992-1993, using a survey to obtain audit fee data (OLS)	Evidence of significant positive relations between audit fees and board independence, diligence, and expertise.
O'Sullivan (BAR, 2000)	What is the impact of board composition and ownership structure on audit quality in the UK prior to the adoption of the Cadbury (1992)	DV: Ln(audit fees) IV: % of non-executives on the board, CEO duality, % of equity held by executive and non-	402 listed firms from the Times 1000 (UK) operating at the end of 1992 (OLS)	The results show that the proportion of non-executive directors has a positive impact on audit fees, while non-executive ownership and executive ownership affect audit fees negatively. CEO duality and external shareholder concentration has no significant effect

	recommendations.	executive directors, financial institutions and other outside investors		
Hope, Langli, & Thomas (AOS, 2012)	How does ownership structures and family relationships influence agency costs in private firms	DV: ln(audit fees), choice of Big-4 auditor IV: ownership concentration, family relationship between the major shareholder and the CEO	185,109 firm-year observations for non-listed Norwegian firms (2000-2007) (OLS, Logit)	Audit fees relate negatively to ownership concentration, to the portion of shares held by the CEO and number of board members related to the largest shareholder. Audit fees are positively associated with family relationships between the CEO and the major shareholder and the number of board members related to the CEO. The propensity to hire a Big 4 auditor increases as ownership concentration decreases, and the major shareholder's family influence on the board decreases.
Desender, Aguilera, Crespi, & Garcia-Cestona (SMJ, 2013)	Is the monitoring function of the board equally important in all firms, independent of their ownership structure?	DV: ln(audit fees) IV: % of non-executives on the board, % of equity held by the largest shareholder, shareholder type	242 listed firms from France and Spain pertaining to FY 2007 (OLS)	Findings show that while board independence and audit services are complementary when ownership is dispersed, this is not the case when ownership is concentrated. The relationship between board composition and external audit fees is also contingent upon the type of the controlling shareholder.

Panel D: Rating Organizations

Studies: Author(s) (Journal; year)	Research Question	Key Variables	Sample & Methodology	Key Findings
Westphal & Graebner (AMJ, 2010)	How do corporate leaders manage the impressions of financial analysts about the conduct of their boards?	DV: Stock analyst appraisals IV: Dimensions of board, verbal impression management independence	Public U.S. companies with over \$100 million in revenues that were covered by at least one “sell-side” security analyst; archival and surveys data.	Negative stock analyst appraisals prompt corporate leaders to increase externally visible dimensions of board independence without actually increasing board control of management. increases in formal board independence, in combination with verbal impression management directed toward analysts, result in more favorable subsequent analyst appraisals of firms, despite a lack of effect on actual board control
Wiersema & Zhang (SMJ, 2011)	Do investment analysts provide certification as to the CEO's ability, or lack thereof, how does this affects board's evaluation of the CEO's efficacy	DV: CEO dismissal IV: Average analyst recommendation, Change in average analyst recommendation, Percentage of sell recommendations	S&P 500 companies for the 2000–2005 period	Negative analyst recommendations result in a higher probability of CEO dismissal
Gompers, Ishii, & Metrick (QJE, 2003)	Is there a relationship between shareholder rights and corporate performance?	DV: Firm performance IV: G-score of 24 anti-takeover measures	All companies covered in one of the six volumes of the IRRC: 1990, 1993, 1995, 1998 (about 1500 US listed firms)	Findings show that firms with stronger shareholder rights (i.e., higher G-index) had higher firm value, higher profits, higher sales growth, lower capital expenditures, and made fewer corporate acquisitions
Bebchuk, Cohen, & Ferrell (RFS, 2009)	which provisions, among a set of twenty-four governance provisions followed by the Investor Responsibility Research Center (IRRC), are correlated with firm value and stockholder returns	DV: Tobin Q, Abnormal stock returns IV: E-index	All companies covered in one of the six volumes of the IRRC: 1990, 1993, 1995, 1998, 1999 and 2002. (Between 1400 and 1800 US listed firms)	The authors put forward an entrenchment index (E-index) based on six provisions. Their findings show that increases in the level of the E-index are negatively related to Tobin's Q and abnormal returns.
Daines, Gow, & Larcker (JFE, 2010)	How good are commercial governance ratings?	DV: Accounting restatements, class action lawsuits, future operating performance, firm value, stock returns IV: ISS, GMI, TCL and AGR ratings	The primary sample consists of 2005 CGQ rankings for 5,059 firms, GMI rankings for 1,565 firms, TCL for 1,906 firms, and AGR rankings for 6,714 firms. There are 6,827 unique firms across the four commercial ratings (logit and OLS)	Commercial ratings do not predict governance-related outcomes. The findings reveal little evidence that the rankings are useful in predicting subsequent accounting restatements or shareholder litigation. In terms of future performance, AGR predicts future improvements in operating performance, TCL has a positive relation with future Tobin's Q, and AGR (and to a much lesser extent TCL and CGQ) has a positive relation with future alpha (excess stock price return). None of the ratings are able

				to predict the subsequent changes in a firm's cost of debt.
Johnson, Moorman, & Sorescu (RFS, 2009)	What is the long-term abnormal returns for portfolios sorted on governance characteristic	DV: Abnormal stock returns	all firms in the IRRC universe (except firms with dual-class shares) that have a governance index and stock returns from the Center for Research in Security Prices (similar to Gompers et al., 2003).	Using well-specified tests under this industry clustering, they find statistically zero long-term abnormal returns for portfolios sorted on governance.

Panel E. Stakeholder Activism

Studies: Author(s) (Journal; year)	Research Question	Key Variables	Sample & Methodology	Key Findings
Gillan & Starks (JFE, 2000)	How do other shareholders react to the type of proposal and the identity of the proposal sponsor (shareholder activist)?	DV: shareholder reaction through their votes and the change in stock price. IV: proposals sponsored by public pension funds, coordinated groups of investors, and individual investors	2042 shareholder proposals submitted at 452 companies over the 1987-1994 proxy sample period.(as reported by issues of the Investor Responsibility Research Center (IRRC) Corporate Governance Bulletin)	The voting analysis documents that sponsor identity, issue type, prior performance and time period are important influences on the voting outcome. Proposals sponsored by institutions or coordinated groups appear to act as substitutes gaining substantially more support than proposals sponsored by individuals. The nature of the stock market reaction, while typically small, varies according to the issue and the sponsor identity
Barber (JI, 2007)	Does CalPERS activism increased shareholder value?	DV: stock price IV: inclusion on the focus list	The sample includes all companies that made the “focus list” from 1992 to 2005	Only marginal increases are found in shareholder value on the day CalPERS announced that a company was on the list, indicating that the market expected only a moderate impact from CalPERS intervention. Over the long term, practically no excess positive returns are found.
Brav, Jiang, Partnoy, & Thomas (JF, 2008)	Which firms do activists target and how do those targets respond? How does the market react to the announcement of activism? How does activism impact firm performance?	DV: being targeted by a shareholder activist, abnormal market return, Executive Compensation and Turnover, Operational Performance IV: Type of Activism	A sample of 236 activist hedge funds and 1,059 hedge fund-target pairs for the period 2001 to 2006 (based on Schedule 13D filings).	Results show that activist hedge funds propose strategic, operational, and financial remedies and attain success or partial success in two-thirds of the cases. Hedge funds seldom seek control and in most cases are non-confrontational. The abnormal return around the announcement of activism is approximately 7%, with no reversal during the subsequent year. Target firms experience increases in payout, operating performance, and higher CEO turnover after activism.
Klein & Zur (JF, 2009)	The key objective is to examine recent confrontational activism campaigns by hedge funds and other private investors.	DV: being targeted by a shareholder activist, abnormal market return, Executive Turnover, Operational Performance IV: Type of Activism	The analyses focus on two samples of entrepreneurial activists. The first sample consists of 151 hedge fund activist campaigns conducted primarily between 2003 and 2005. The second sample contains 154 other entrepreneurial confrontational activist campaigns over the same time period.	Findings show that hedge funds achieved a 60 percent success rate in meeting their stated objectives. Almost three-quarters of the funds that pursued board representation were successful. All hedge funds that wanted the target company to repurchase stock, replace the CEO, or initiate a cash dividend were successful. And half (50 percent) were able to compel the company to alter its strategy, terminate a pending acquisition, or agree to a proposed merger. In addition, results show that that target companies exhibit abnormal returns around the announcement day of the investment but no subsequent improvement in operating performance.
Becht, Franks,	What is the contribution of	DV: abnormal returns to	The study is based on data made	Shareholder activism is predominantly executed through

Mayer, & Rossi (RFS, 2010)	activism to performance	shareholders IV: different categories of engagement objectives and different degrees of hostility	available by Hermes, the fund manager owned by the British Telecom Pension Scheme, on engagements with management in companies targeted by its UK Focus Fund.	private interventions that would be unobservable in studies purely relying on public information, as opposed to shareholder proposals at a company's annual meeting, or filings of proxy statements. Abnormal returns are largely associated with activists engagements rather than stock picking.
Stevens, Steensma, Harrison, & Cochran (SMJ, 2005)	What determines whether or not a financial executive relies on his/her firm's ethics codes when making decisions?	DV: Ethics code use in decision-making IV: Pressure from market stakeholders	a survey of 302 senior financial executives	Financial executives are more likely to integrate their company's ethics code into their strategic decision processes if they perceive pressure from market stakeholders to do so (suppliers, customers, shareholders, etc.);

Panel F. Media

Studies: Author(s) (Journal; year)	Research Question	Key Variables	Sample & Methodology	Key Findings
Core, Guay, & Larcker (JFE, 2008)	Does negative media coverage affect excess compensation?	DV: excess compensation; options exercised IV: Negative press coverage	2,052 firms from ExecuComp; Used computer aided context analysis to examine negative coverage in over 11,000 articles	Negative press is more likely following excess annual pay rather than raw pay. Little effect of negative coverage on CEO compensation and turnover.
Bushee, Core, Guay, & Hamm (JAR, 2010)	Does the media act as an information intermediary to reduce information asymmetry?	DV: Bid-ask spreads; market depth IV: amount of press initiated coverage; type of information and breadth of dissemination	1,182 NASDAQ firms from 1993 to 2004; Collected information on over 600,000 press articles	The press helps to reduce information problems around earnings announcements.
Wiesenfeld, Wurthmann, & Hambrick (AMR, 2008)	How does corporate failure lead to professional devaluation of executives?	DV: Professional devaluation IV: singling out; stigma diffusion; social arbitration	Theory paper that creates a process model of how executives become stigmatized	The media acts as a social arbiter that can stigmatize corporate leaders.
Dyck, Volchkova, & Zingales (JF, 2008)	How does media coverage affect corporate governance?	DV: Corporate governance violations IV: News coverage of governance event	98 corporate governance violations in Russia between 1998 and 2002	Investment funds lobbying efforts result in more coverage of governance violations while more press coverage increases the likelihood that governance violations will be overturned.
Bednar (AMJ, 2012)	How do symbolic changes in board structure affect media coverage?	DV: Positive press coverage IV: Change in board independence	250 S&P 500 firms from 2001 to 2005; Content analyzed coverage of CEOs and coverage of the firm	Increases in formal board independence result in more positive press coverage. More positive press coverage results in greater job security and guaranteed compensation for managers.
Bednar, Boivie, & Prince (OS, 2013)	Does negative media coverage affect the magnitude of strategic change	DV: Change in resource allocations IV: Negative press coverage	250 S&P 500 firms from 2001 to 2005; Used computer aided content analysis on over 42,000 articles	Negative media coverage associated with greater magnitude of strategic change. This effect is greater when the board is more independent.
Westphal & Deephouse (OS, 2011)	How do interpersonal relationships between CEOs and journalists affect the content of media reports?	DV: Negative statements about the firm, CEO, and strategy IV: Ingratiation behavior	Large-scale survey of CEOs and journalists. Approximately 2,000 CEO-journalist dyads included.	Increased ingratiation behavior by CEOs towards journalists results in less negative media coverage. Negative reporting about firms reduces journalists' access.
Westphal, Park,	How does impression	DV: Negative statements	Large-scale survey of 367 CEOs	Impression management from other CEOs is especially

McDonald, & Hayward (ASQ, 2012)	management toward journalists affect subsequent media coverage?	about the firm's leadership IV: Impression management by the focal CEO; Impression management by others on behalf of the focal CEO		effective at influencing the nature of coverage for a focal firm.
Johnson, Ellstrand, Dalton, & Dalton (SMJ, 2005)	How do board ratings published in the press affect stock price?	DV: abnormal stock returns IV: Board ranking	Sample of firms rated as 25 best or 25 worst boards by businessweek in 1996 and 1997	Firms on both the best and the worst list had positive abnormal returns although they were higher for the firms on the "best" list.
Miller (JAR, 2006)	What role does the press play in monitoring accounting fraud?	DV: amount of press coverage IV: various characteristics of the firm and the fraud	Firms in the SEC AAER (Accounting and Auditing Enforcement Release) database	The press rebroadcasts information from other sources related to fraud and by undertaking its own original investigation.

Table 4. Theoretical Perspectives, Organizational Processes and External Corporate Governance Mechanisms

	AGENCY THEORY	INSTITUTIONAL THEORY	RESOURCE DEPENDENCY THEORY	TEAM PRODUCTION THEORY
LEGAL SYSTEM	Monitoring Contracting	Institutional norms Coercive, normative and cognitive Isomorphism Legitimation	Reduce environmental uncertainty Capacity to obtain resources	Gives directors broad discretion to meet needs of various stakeholders Sets rules to manage team production challenges
CORPORATE CONTROL	Incentives - Potential job loss keeps managers in line Poor performance sends signal that firm may be taken over			
EXTERNAL AUDITING	Reduce information asymmetry by providing assurance about the quality of the financial statements	Provides a signal of legitimacy of financial statements Threat of negative signal deters bad behavior	Auditors' dependency on critical information from within the firm (especially management, directors and audit committee members) allows internal governance to improve when interacting with external auditors	Neutral third party that guarantees trust
RATINGS ORGANIZATIONS	Incentives - Potential reputation loss keeps managers in line Good governance focused on shareholders	Provide legitimacy to firms' governance; Normative isomorphism Symbolic responses Threat of negative signal deters bad behavior	Inter-firm comparisons	Good governance defined by broader set of stakeholders
STAKEHOLDER ACTIVISM	Push for governance structures that have the potential to reduce agency conflicts	Symbolic responses	Shareholder activism successful to the extent that it comprises a large enough group to affect firm's dependence on their support	Gives voice to entities that provide inputs into team production equation
MEDIA	Incentives - Potential reputation loss keeps managers in line Reduces information Asymmetry	Media acts as carrier of institutional norms Threat of negative signal deters bad behavior—social control mechanism	Media can be less effective because of dependence upon access to top executives	Reports on and occasionally used by entities that provide inputs into team production equation

Table 5: Selected Research on linkage between CG mechanisms and Firm performance – an overview

External CG Mechanisms/All	Board of Directors (internal)	Ownership (internal)	Incentives (internal)	Legal System (external)	Market for corporate control (external)	Auditor (external)	Rating Agencies (external)	Stakeholder Activism (external)	Media (external)
Legal System	Adams (2012); Aguilera (2005); Marcel & Cowen (2014)	Bell et al. (2014); Coffee (1999); La Porta et al. (2000)	Piketty & Saez (2003)	See Table 3A					
Market for Corporate Control	Brickley & James (1987); Cannella & Hambrick (1993); Fama & Jensen (1983); Krug & Hegarty (2001)	Caprio et al. (2011); Davis & Stout (1992); Gompers et al. (2010)	Agrawal & Knoeber (1998); Bodolica & Spraggon (2009)	Bertrand & Mullainathan, (2003); Burkart et al. (2014)	See Table 3B				
External Auditor	Abbott et al. (2003); Carcello et al. (2002); Cohen et al. (2007); Desender et al. (2013, forthcoming); Hope et al. (2012); O'Sullivan (2000);	Coffee (2006); Desender et al. (2013, forthcoming); Hope et al. (2012)	N/A	Francis et al. (2002); Choi & Wong (2007); Coffee (2006)	N/A	See Table 3C			
Rating Organizations	Westphal & Graebner (2010)	Aggarwal et al. (2011)	N/A	N/A	N/A	N/A	See Table 3D		
Stakeholder Activism	Brav et al. (2008); Gillan & Starks (2000); Klein & Zur (2009)	Bizjak & Marquette (1998); Ertimur et al., (2011); Prevost & Rao, (2000); Renneboog & Szilagyi (2011)	Brav et al. (2008); Ferri & Sandino (2009); Ertimur et al. (2011); Klein & Zur (2009)		Goranova & Ryan (2014); Greenwood & Schor (2009)	N/A	N/A	See Table 3E	
Media	Bednar (2012); Bednar et al. (2013)	Smith (1996)	Core et al. (2008)	N/A	N/A	Joe (2003)	N/A	Dyck & Zingales (2002); Gamson et al. (1992); King (2008)	See Table 3F

Note: highlighted in gray are studies that examine combined effects of external CG mechanisms. Table 6 expands on the governance bundles between internal and external CG mechanisms. N/A = none available to our knowledge.

Table 6. Proposed Theoretical Relationships Between External and Internal Corporate Governance Mechanisms

	Internal Corporate Governance Mechanisms		
External CG Mechanisms	Board of Directors	Ownership	Managerial Incentives
Legal System	STRONG	STRONG	MODERATE
Market for Corporate Control	MODERATE	WEAK	STRONG
External Auditor	MODERATE	WEAK	WEAK
Rating Organizations	MODERATE	WEAK	MODERATE
Stakeholder Activism	MODERATE	STRONG	MODERATE
Media	MODERATE	MODERATE	MODERATE

Figure 1: Direct relationship between external governance mechanisms and the main objectives of effective corporate governance

