informed investors. These investors may be better able to help distressed firms as well. Still, there are serious questions about the effectiveness of these investors, largely because their toughness is in doubt. As Charkham (1994) has shown, German banks are large public institutions that effectively control themselves. There is little evidence from either Japan or Germany that banks are very tough in corporate governance. Finally, at least in Germany, large-investor-oriented governance system discourages small investors from participating in financial markets. In sum, despite a great deal of controversy, we do not believe that either the theory or the evidence tells us which of the three principal corporate governance systems is the best. In this regard, we are not surprised to see political and economic pressures for the three systems to move toward each other, as exemplified by the growing popularity of large shareholders in the United States, the emergence of public debt markets in Japan, and the increasing bank-bashing in Germany.

At the same time, in thinking about the evolution of governance in transition economies, it is difficult to believe that either significant legal protection of investors or takeovers are likely to play a key role. In all likelihood, then, unless Eastern Europe is stuck with insider domination and no private external finance at all (a risk in Russia), it will move toward governance by banks and large shareholders. The early evidence from the Czech Republic (van Wijnbergen and Mancini (1995)) and Russia (Blasi and Shleifer (1996)) indeed suggests that large shareholders, which in the Czech Republic are often bank-controlled mutual funds, play a central role in corporate governance. It would be extremely fortunate if transition economies managed to approach the corporate governance systems of Germany and Japan, particularly in the dimension of the legal protection of investors. But this does not imply that the United States should move in the same direction as well.

VIII. Conclusion

In the course of surveying the research on corporate governance, we try to convey a particular structure of this field. Corporate governance deals with the agency problem: the separation of management and finance. The fundamental question of corporate governance is how to assure financiers that they get a return on their financial investment. We begin this survey by showing that the agency problem is serious: the opportunities for managers to abscond with financiers' funds, or to squander them on pet projects, are plentiful and well-documented.

We then describe several broad approaches to corporate governance. We begin by considering the possibility of financing based on reputations of managers, or on excessively optimistic expectations of investors about the likelihood of getting their money back. We argue that such financing without governance is unlikely to be the whole story. We then discuss legal protection of investors and concentration of ownership as complementary approaches to governance. We argue that legal protection of investor rights is one essential element of corporate governance. Concentrated ownership—through large
share holdings, takeovers, and bank finance—is also a nearly universal method of control that helps investors get their money back. Although large investors can be very effective in solving the agency problem, they may also inefficiently redistribute wealth from other investors to themselves.

Successful corporate governance systems, such as those of the United States, Germany, and Japan, combine significant legal protection of at least some investors with an important role for large investors. This combination separates them from governance systems in most other countries, which provide extremely limited legal protection of investors, and are stuck with family and insider-dominated firms receiving little external financing. At the same time, we do not believe that the available evidence tells us which one of the successful governance systems is the best.

In writing this survey, we face a variety of still open questions. In conclusion, we simply raise some of them. While the literature in some cases expresses opinions about these questions, we are skeptical that at the moment persuasive answers are available.

First, given the large impact of executives’ actions on values of firms, why aren’t very high powered incentive contracts used more often in the United States and elsewhere in the world? Is their use limited by optimal design of incentives, by fear of self-dealing, or by distributive politics?

Second, what is the nature of legal protection of investors that underlies corporate governance systems in various countries? How do corporate laws differ, and how does enforcement of these laws vary across countries? Although a lot has been written about law and corporate governance in the United States, much less is written (in English) about the rest of the world, including other wealthy economies. Yet legal rules appear to play a key role in corporate governance.

Third, are the costs and benefits of concentrated ownership significant? In particular, do large investors effectively expropriate other investors and stakeholders? Are they tough enough toward managers? Resistance to large investors has driven the evolution of corporate governance in the United States, yet they dominate corporate governance in other countries. We need to know a great deal more about these questions to objectively compare the successful corporate governance systems.

Fourth, do companies in developing countries actually raise substantial equity finance? Who are the buyers of this equity? If they are dispersed shareholders, why are they buying the equity despite the apparent absence of minority protections? What are the real protections of shareholders in most countries anyway? We were surprised to find very little information on equity finance outside the United States.

Finally, and perhaps most generally, what are the political dynamics of corporate governance? Do political and economic forces move corporate governance toward greater efficiency or, alternatively, do powerful interest groups, such as the managers in the United States or the banks in Germany, preserve inefficient governance systems? How effective is the political and economic marketplace in delivering efficient governance? While our survey has de-
scribed some evidence in this area from the United States, our understanding of the politics of corporate governance around the world remains extremely limited.

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