Contrary to Conventional Wisdom: Prof’s Corporate Governance Research Says, ‘LEAVE THE CEO ALONE’

by Mia Spilla Pavello

A s CEOs and their boards of directors continue to dig out from under the financial crisis of 2008, those interested in preventing a repeat of past mistakes might take a lesson from the recent research findings of Dr. Michael Rebollo, Ashish Nanda Smith Professor of Finance and Managerial Economics in the Nariman Board School of Management and author of numerous academic papers on a wide range of subjects, including corporate governance.

In “Optimal Corporate Governance and Compensation Policy in a Dynamic World,” a study he co-authored with Thomas H. Han of Said Business School and Balliol College, Oxford University, Rebollo describes the sometimes prickly relationship between chief executives and their boards, and argues in favor of curtailing the often middle-some ways of the latter.

“There’s a debate raging about how CEOs should be compensated and whether boards should be monitoring them closely all the time,” Rebollo says. In the research, published last year in The Review of Financial Studies (Vol. 25, Issue 2, pages 489-523), “we’re trying to make a very simple point,” Rebollo says, which is, if you want the manager to do a good job, one way to do that is to pay him in a manner that will give him the incentive to help the firm prosper. If you set up an expansive board to second-guess the manager, you’re wasting money, because they’re both trying to achieve the same goal. In fact, when the firm’s prospects are sufficiently bright, it is optimal for the board to leave the CEO alone.

“A lot of people who test governance theories still think a company’s not governed well if the board isn’t very active, and the point we’re making is that a lot of CEOs — like Jack Welch (formerly) of General Electric — who don’t have active boards, do a great job, which proves that if CEOs have the right incentives, the board may be best served by giving the CEO a free hand.”

Rebollo received a bachelor’s degree in economics from St. Stephen’s College at Delhi University in India and a PhD in finance from The University of Texas at Austin. His research interests range from corporate governance and corporate reputations, to corporate finance. And while many of his theories can shed light on current management practices, such is not the case with his more obvious research, which he says may take years to test because of the need for more data.

“The gap between what we do, in terms of research and practice, is wide,” he says. “In corporate finance research, for example, the best we can hope for right now is to understand what people are doing, why corporations are doing what they’re doing, and hopefully influence, in some general sense, what people should be thinking about when they make decisions. Corporate finance research has not developed formal tools that identify the correct decision. Therefore, our goal is to prompt decision-makers to take account of what should be important considerations and important trade-offs.

We’re trying to move the debates forward by getting people to think about things a little differently. But, the point is, those debates will last longer than my career.”

Michael Rebollo