Communication, Consensus and Control*

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Abstract

We investigate properties of shareholder-value maximizing corporate boards in situations where both the management and the board have expertise (or private information) relevant for the collective decision facing the corporation. We suppose that the board cannot directly monitor management in a way that eliminates distortions arising out of managerial agency. This creates a trade-off between improving information sharing and reducing distortions in decision-making, leading shareholders to often design a board that is imperfectly aligned with both shareholders and management. Indeed, even when management has complete control over decision-making and the board only has an advisory role, the optimal board may be designed to provide "bad" advice to management in order to limit the ex-post costs of managerial agency. We establish our results by investigating the relationship between shareholder value maximization and the possibility of generating ex-post consensus between management and the board. We also show that the optimal board will be able to generate shareholder consensus and investigate how this is affected by the transparency of board-management deliberations. These results add to our understanding of corporate governance as an instrument that facilitates efficient (and strategic) information transmission within the firm.

JEL classification: C7, D2, D7, D8, G3, L2.

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