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When Should Control Be Shared?

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Abstract

A common pattern of control in firms is for management to retain a broad set of rights, while the remaining stakeholders' contracts provide them with targeted veto rights over specific classes of decisions. We explain this pattern of control sharing as an efficient organizational response that balances the need to encourage management to account for stakeholders' interests against the need to prevent self-interested stakeholders from blocking valuable proposals. Enforceable obligations of good faith and fair dealing play an essential role in facilitating undivided management control of many decisions. With these legal protections (but not without them), shared control is more likely when the parties are more symmetrically informed and hence better able to bargain to efficient decisions.

Keywords: Contract theory, control rights, ownership rights, shared control.

JEL Classification: D23, K12.

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