

International Comparison of Corporate Governance (CG)

基礎企業ガバナンス論

Lecture #1: Two main models/types of CG

21 October 2011

From the previous classes

- I. What is a corporation, types of corporations (public and private), and the agency problem (information asymmetry, diverging interests of shareholders and managers)?
- II. What is a corporate scandal? “Illegal or unethical behavior by people acting within or on behalf of a corporation” (for example, accounting fraud, false information, insider trading, etc.)
- Reasons for the scandals: both greedy, immoral people and bad environment (giving them wrong incentives)
- Also, failure of the so-called “gatekeepers”

The so-called “gatekeepers”

- People and organizations that should protect the interests of investors and stakeholders against illegal or unethical behavior by managers and controlling shareholders

In particular:

- (1) Boards of directors
- (2) External auditors
- (3) Securities analysts
- (4) Credit rating agencies
- (5) The government

Comparison of CG in different countries to understand better the reasons for the scandals

Two main models/types of CG

- *I. The outsider model* (the Anglo-Saxon countries like US, UK, etc.)
- *II. The insider model* (Germany, the rest of continental Europe, Japan)
- Four criteria: (1) whether company ownership is dispersed or concentrated; (2) identity of the owners; (3) sources of corporate financing; (4) who controls the behavior of managers and how
- Pls. take a look at the handout

Comparison of the 2 systems

Table 1: Simplified comparison of Anglo-American and Rhineland systems

Anglo-American	<	Systems	>	Rhineland
Common law	<	Law	>	Civil law
Liberal	<	Market organisation	>	Co-ordinated
Diluted	<	Ownership structure	>	Concentrated
Equity	<	Corporate financing	>	Debt
High	<	Labour market turnover	>	Low
External	<	Acquisition of labour skills & innovation	>	Internal and incremental
Decentralised, company level	<	Collective bargaining	>	Centralised, sector level
Marginal	<	Institutionalised worker representation	>	Generalised

Source: TUAC 2005

(1) Company ownership: dispersed or concentrated? Part I

「アウトサイダー・モデル」: 株式所有の分散

I. The outsider model

- company ownership is dispersed among a large number of small shareholders (individuals and institutional investors)
不特定多数の小株主
- there is no “*controlling shareholder*” 支配的株主,
e.g. a shareholder holding more than 10-20% of the capital (or the voting rights 議決権)
- short-term nature of investments
投資の狙いは短期的な利益

(1) Company ownership: dispersed or concentrated? Part II

「インサイダー・モデル」: 株式所有の集中

II. The insider model

- company ownership is concentrated into the hands of one or several large shareholders
特定の大株主
- *there is a controlling shareholder*: usually a family
同族企業
- “**closely held firms**” (as opposed to “widely held firms”)
- long-term nature of investments 長期的な利益

The insider model: some examples I

- Most of the companies in continental Europe are “closely held”
- Usually the controlling owners (e.g. the families) play an important role in company management too
- For example, in Germany, the Porsche and Piech families own and control Porsche (and indirectly VW)



PORSCHE

The insider model: some examples II

Some other controlling families in Europe

- France: the Michelin family → Michelin



- Italy: the Agnelli family → Fiat



(2) Who are the owners? Part I

所有者(株主)の分類

「アウトサイダー・モデル」: 個人投資家、機関投資家

1. The outsider model

- the shares of most US and UK corporations are held by *individuals and institutional investors* (e.g. pension funds, hedge funds, and other collective investment vehicles)
- these shareholders don't have any other relationship to the company → ***“outsiders”***
- they hold company shares for financial gain

(2) Who are the owners? Part II

所有者(株主)の分類

「インサイダー・モデル」: 家族、金融機関(銀行、保険会社)、他の企業(例えば、同企業集団のメンバー)

II. The insider model

- the shares of most German and Japanese corporations are held by the *controlling families*, *financial institutions* (banks and insurance companies), and *other companies* (for example, members of the same business group)
- these are also called “***stable shareholders***”
安定株主 (or “insiders”)
- they hold company shares for long-term purposes

The insider model: an additional explanation

- In continental Europe and Japan: many companies may seem “widely held” (i.e. the ownership is dispersed) but actually belong to the insider model because they have a *de facto* controlling owner or a coalition of “stable shareholders”
- One reason: deviations from the “one share – one vote” rule are quite common
- Many companies have “dual-class shares” or “multiple-voting-right shares” 種類株
- For instance, each of **A shares** carries one vote, and each of **B shares** (for “insiders”) ten votes

The insider model: some examples

A. Keeping control via dual-class shares

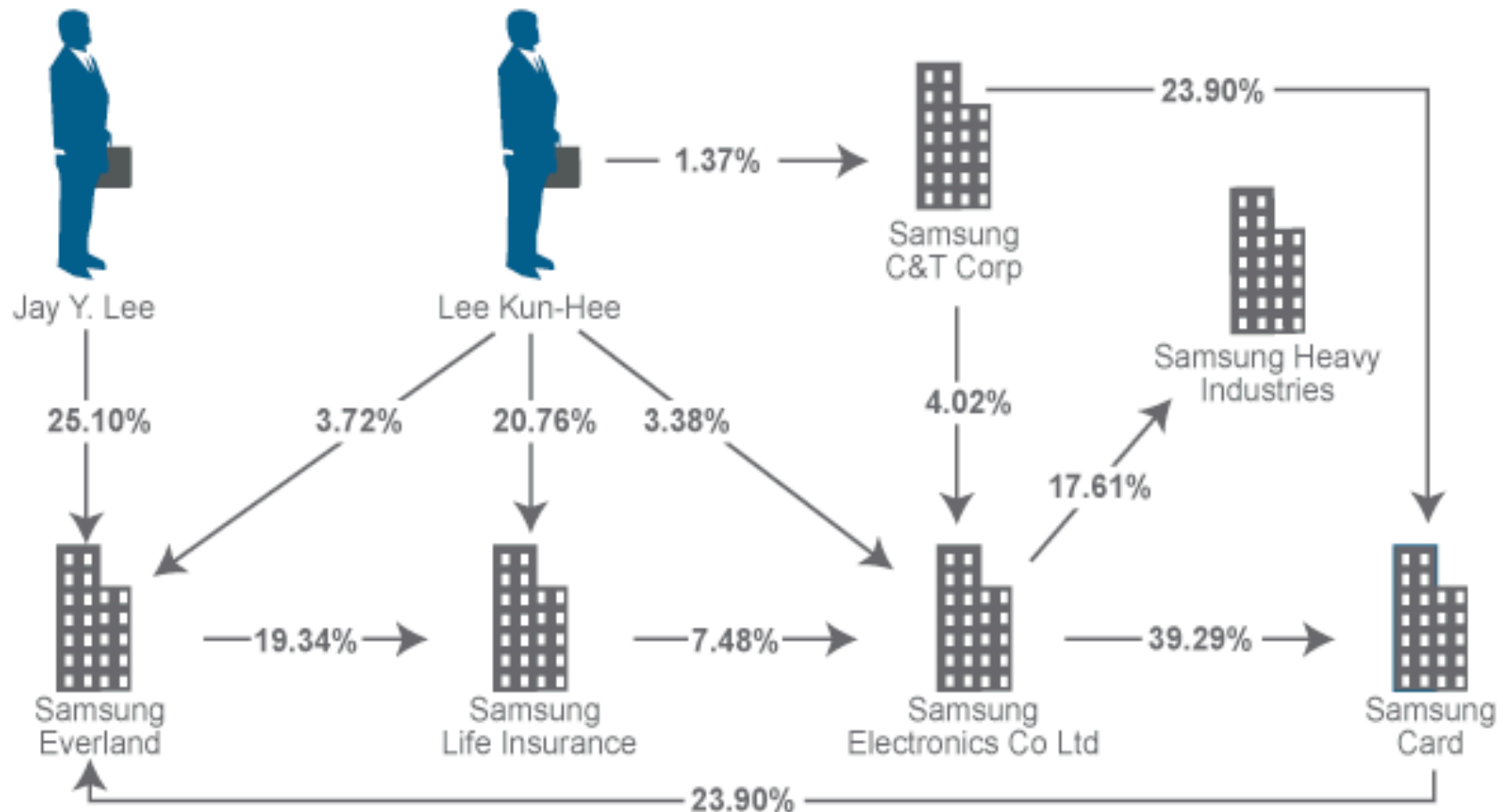
- Porsche: the 2 families hold only 10% of the capital but 100% of the voting rights
- VW: the Lower Saxony government holds 20.1%, which gives it veto power because no other shareholder can have more than 20% of the votes (according to *the Volkswagen law*)

B. Keeping control via pyramid structures

- Fiat: a partnership called “Giovanni Agnelli & C” → 2.3% direct interest in Fiat and all ordinary shares of *a holding company*, which, together with the partnership, owns 69.8% of IFIL (a company listed on the Torino SE) → 30.4% of Fiat

Samsung: keeping control via cross-shareholdings

Samsung Group cross-shareholdings



Source: Samsung Companies



(3) Sources of corporate financing: Part I

会社はどこから資金を調達しているのか

「アウトサイダー・モデル」: 自己資本、資本市場

1. The outsider model: companies use as main sources of financing

- their own capital
- funds raised from the capital market (by issuing shares, bonds, and other financial instruments)
- this is possible in part because the US and UK shareholders invest a large part of their financial assets in the capital market
- Example: private pensions such as *the 401(k) plans* and public pension funds like *CalPERS (The California Public Employees Retirement System)*

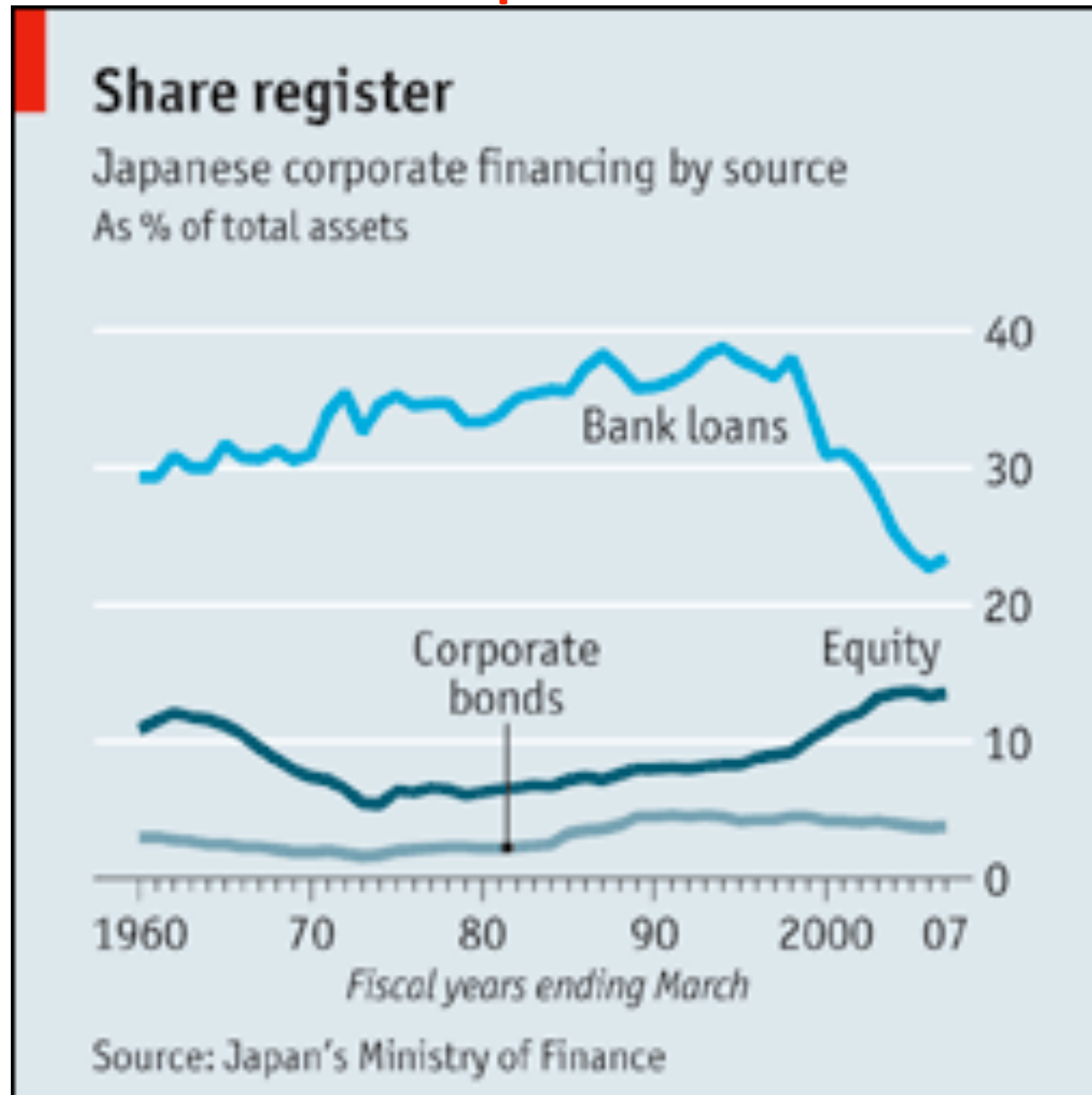
(3) Sources of corporate financing: Part II

「インサイダー・モデル」: 自己資本、銀行融資

II. The insider model: companies use as main sources of financing

- their own capital
- bank loans
- the use of bank loans in the postwar era was facilitated by the “*main bank/ hausbank*” system
- continental European and Japanese firms have used to a lower degree funds raised from the capital market
- One reason: people in Europe and Japan have tended to keep their savings in cash or in bank deposits

Sources of corporate financing in Japan



(4) Who controls the managers and how: Part I

経営者が暴走しないように誰が監視しているのか？

「アウトサイダー・モデル」: 取締役会 (社外取締役)、資本市場 (敵対的買収の脅威)

1. The outsider model: the boards of directors composed of outsiders (independent directors), the capital market through the “threat-of-hostile-takeover” mechanism

- ordinary investors (outsiders) are expected to have more power because they can vote out the top management by using both their hands and feet (“voice” and “exit” 参加と退出)

Who controls the managers and how:

Part II

「インサイダー・モデル」: 支配的株主、主力銀行

II. The insider model: the controlling owners, the main banks

- the boards of directors are much weaker as they are usually composed of insiders (e.g. friends and members of the family; managers and employees from the same firm)
- the “hostile takeover” mechanism does not work
- the main banks can intervene in the case of a crisis → to bail out the company and replace the management
- Example: the bail-out of Mazda Motors by Sumitomo Bank in the 1970s

Conclusion: the two main models/types of CG

- There is no clear answer to the question “which model/type of CG is better?” Each one has its own merits and demerits
- Merits of the “insider model”:
 - (1) stable access to long-term investment funds
 - (2) a sense of stability and security for the management and employees (“the insiders”)

Conclusion: the two main models/ types of CG

- Demerits of the “insider model”:

- (1) loss-making, inefficient firms may be rescued by the banks or the government → perverse incentives of the managers and employees (*moral hazard*)
- (2) lack of transparency and accountability of the management → bad for outside investors and the general public

Questions for discussion

- Can you think about any other merits and demerits of the outsider/insider models?
- Pros and cons of family control of corporations
- Why have South Korean companies recently been doing better than the Japanese ones? Because they are family-owned, or for some other reasons?
- Pros and cons of “dual-class shares”
- Why has the “one share – one vote” rule been equated with “good CG”?

Assignment #2

(you can choose whether to submit for the class on 21 Oct. or the one on 4 Nov.)

Write a mini case study of a company of your choice

- does it have a dispersed or a concentrated ownership structure?
- does it belong to the outsider or insider model?
- (in the case of a concentrated structure/insider model) who are the large owners, or the “stable shareholders”?
- is there a controlling shareholder? If yes, who is he/she, and how much (percentage of capital/votes) does he/she control?
- how does he/she keep control? Are there any pyramid structures or dual-class shares?
- how big is the “free float” (%)?

E-mail me the file (up to one page in A4 format) until 9 am on 21 Oct. or 4 Nov. and prepare a short presentation on your mini case study.