

International Comparison of Corporate Governance

基礎企業ガバナンス論

The move to “financial capitalism” and
the large corporate scandals under the
outsider model

4 November 2011

Review of the previous class

Two main models of corporate governance

- (1) The outsider model: prevalent in Anglo-Saxon countries such as the US and UK
- dispersed company ownership, no controlling shareholder (“widely-held firms”)
- almost all shares are held by *individual and institutional investors* (“outsiders”)
- larger free float
- the shares are held for financial gain

Review of the previous class

Two main models of corporate governance

- (2) The insider model: prevalent in continental European countries, Japan and South Korea
- concentrated company ownership, there is a *controlling shareholder* (usually a family) or a group of *stable shareholders* (“insiders”)
- keeping control via “dual-class shares” and/or “pyramid structures”
- smaller free float
- long-term nature of investments

Wallenberg Foundations

19% capital

41% votes

Investor AB

Class A

1 vote

40.8 % capital

87.3% votes

Investor AB

Class B

1/10 vote

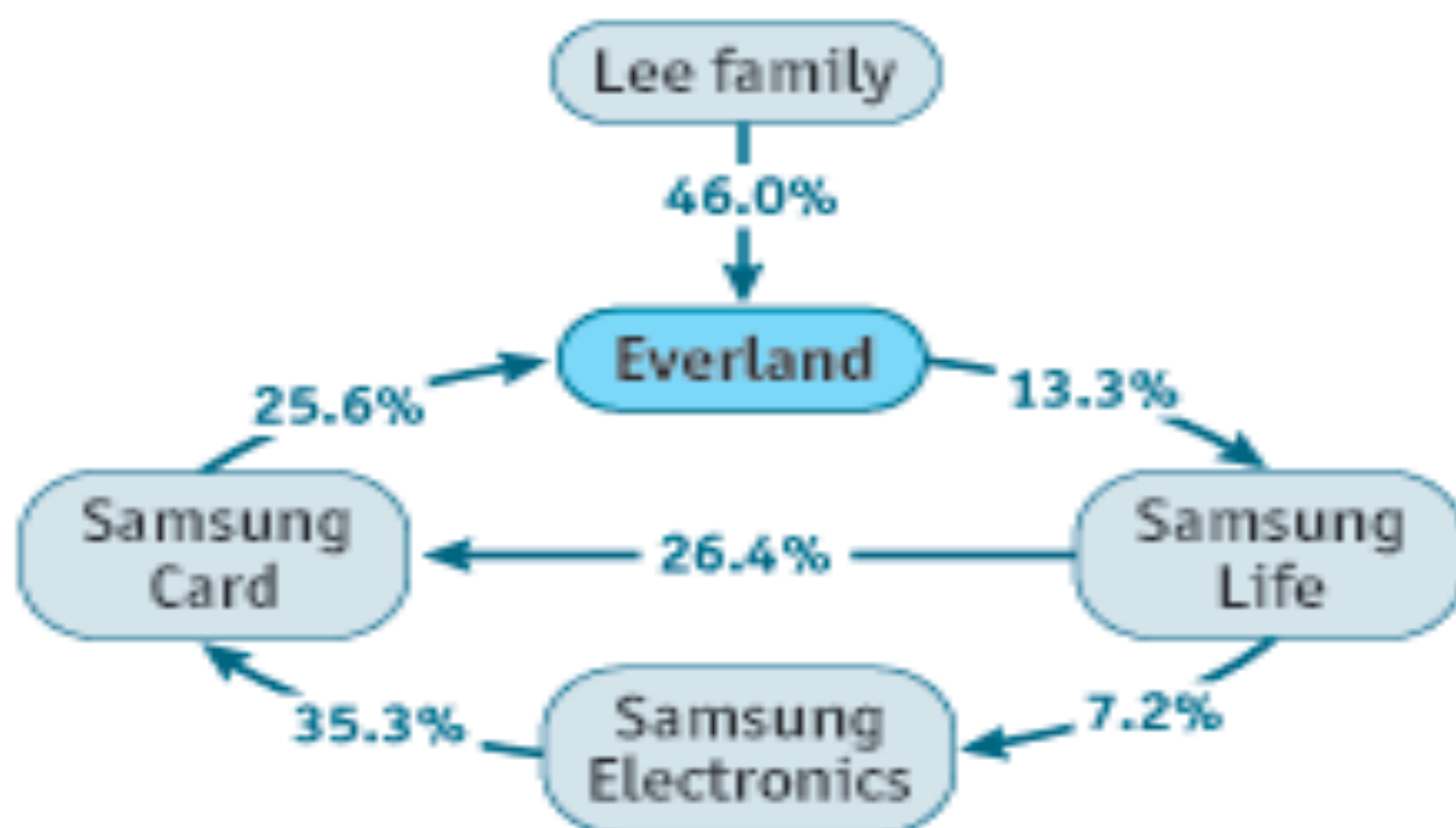
59.2 % capital

12.7 % votes

Control of 14 large listed firms making up 42% of the market capitalization on the Stockholm Stock Exchange

Roundabout

Shareholdings in Samsung Group companies
2009, %



Source: Samsung

Additional terms

- trust banks 信託銀行
- ADRs (American depositary receipts) 米国預託証券
- holding companies 持株会社
- business groups (“zaibatsu”, “keiretsu”, “chaebol”) 財閥、系列(企業集團)
- free float: the proportion of shares that excludes shares held by owners owning more than 5% of all shares and/or by insiders 浮動株比率
- treasury stock: shares held by the issuing company as a result of share buybacks 金庫株

Large corporate scandals under the outsider model

- Examples: Enron and Worldcom (2001-2002), Bear Stearns and Lehmann Brothers (2008)
- The scandals resulted from a certain way of behavior by top managers: (1) overstating earnings and hiding debt (or losses), (2) using SPEs to hide debt (losses); (3) borrowing huge amounts of money to achieve short-term growth of profits and share prices

What explains the timing?

- Bubbles in the US asset markets → the dotcom bubble in the second half of 1990s, the housing bubble in 2003-2007
- Were there less scandals before?

What has changed since 1990s? Part I

- *I. Managers' incentives became closely linked to short-term profits and the short-term movements of share prices*

Before: "managerial capitalism" (1930s-1970s)

- Berle and Means (1932) about the dispersion of ownership → separation of ownership and control
- (1) Managers sought higher sales growth, larger market share and bigger size of their companies
- **(2) Their remuneration was based more on salary, rather than performance-related bonuses**
- (3) They could not be changed (fired) very often

What has changed since 1990s? Part II

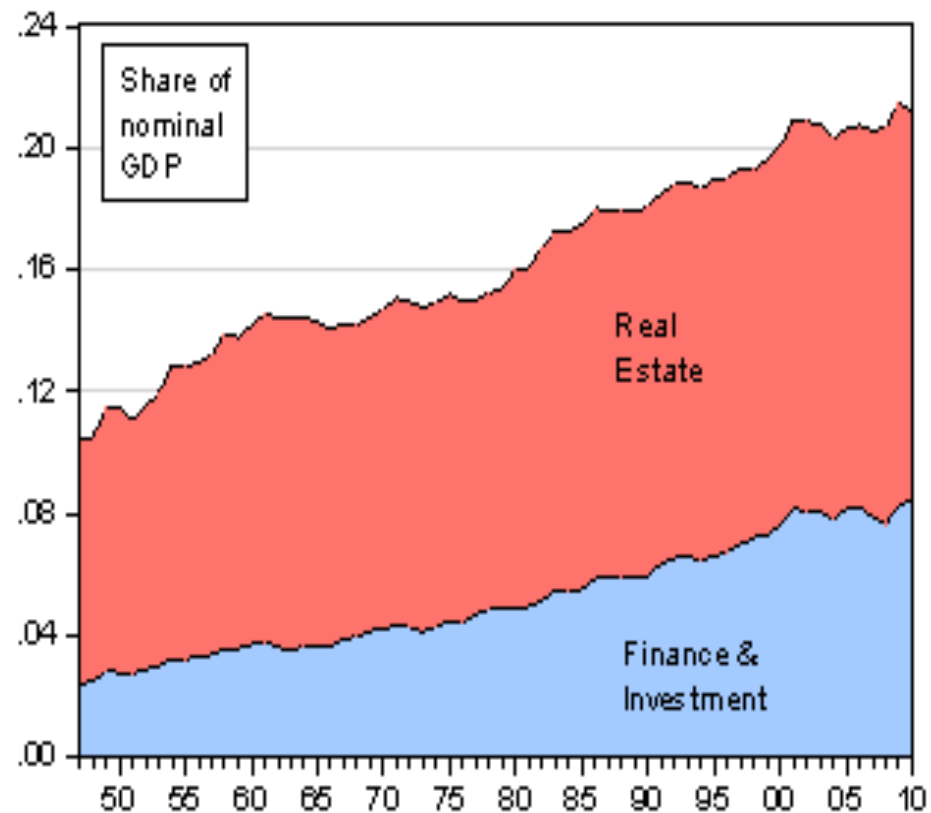
1980s-1990s: the move from “managerial” to “financial (or casino) capitalism”

- (1) Managers became more focused on short-term profits and the short-term movements of share prices
- **(2) Their remuneration became more equity based**
- *Payment in shares or stock options (reference to “the agency problem”)*
- In 2007, the average American CEO received 475 times the average wage, compared with 25 times in the mid-1970s
- (3) They could be changed (fired) more often especially as a result of a steady decline of quarterly share prices

The FIRE sector as percentage of GDP



And a dominant role for finance



Source: BEA

What has changed since 1990s? Part III

II. “Gatekeepers’ failure”, or failure of the so-called “reputational intermediaries”

- The system of checks of managerial behavior did not work (because of a bad collusion between the management and the gatekeepers)

Main gatekeepers

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

The primacy of shareholder value (株主価値重視経営)

- *The move to “financial capitalism” also meant that companies should try to deliver more benefits (value) to their shareholders*
- The “shareholder vs. stakeholder value” debate
- Company performance started to be judged by a number of short-term financial indicators showing to what extent the company delivers value to its shareholders
- The third assignment: financial indicators such as dividend yield, ROE, ROA, net profit ratio, etc.