Corporate Governance in Other Countries

Franklin Allen
University of Pennsylvania

Innovation and Regulation in Financial Markets
Federal Reserve Bank of Philadelphia
Policy Forum
November 30, 2007
Introduction

• Which of the following views is the prevalent one in your country?

(a) A company exists for the interest of all stakeholders

(b) Shareholder interest should be given the first priority
Figure 1: Whose Company Is It?

- **Japan**: 97% stake owned by all stakeholders, 3% by shareholders.
- **Germany**: 83% stake owned by all stakeholders, 17% by shareholders.
- **France**: 78% stake owned by all stakeholders, 22% by shareholders.
- **United States**: 76% stake owned by all stakeholders, 24% by shareholders.
- **United Kingdom**: 71% stake owned by all stakeholders, 29% by shareholders.

Countries are listed in order of decreasing stake held by all stakeholders.
Also which of the following two would be the most prevalent view in your country?

(a) Executives should maintain dividend payments, even if they must lay off a number of employees

(b) Executives should maintain stable employment, even if they must reduce dividends
Figure 2: Job Security or Dividends?

- **Japan**: 97% Job Security, 3% Dividends
- **Germany**: 59% Job Security, 41% Dividends
- **France**: 60% Job Security, 40% Dividends
- **United States**: 11% Job Security, 89% Dividends
- **United Kingdom**: 11% Job Security, 89% Dividends
In practice…

Germany

- Codetermination: In large firms workers’ representatives have half the seats on the Supervisory Board

- Workers’ interests are represented in the decision making process
In practice…(cont.)

China

- Has introduced mandatory representation of workers on company’s supervisory board

- Too soon to say how it will work in practice
In practice…(cont.)

France

- Firms with an enterprise council must allow workers’ representatives to attend board meetings

- This changes the nature of decision making by the board and gives workers some weight
In practice…(cont.)

Japan

- Legally firms are run in shareholders’ interest and workers are not represented on the board

- BUT …“It would be irresponsible to run Japanese companies primarily in the interests of shareholders” (Chairman of Toyota, 2001)
Other examples in brief

Mandatory co-determination
- Netherlands, Luxembourg, Sweden, Denmark

Voluntary co-determination: Finland
- Voluntary codetermination with workers’ representatives on the board
- 300 companies have introduced it
(also Switzerland and Ireland)
To sum up…

• Great heterogeneity of firms’ objectives across countries

• Stakeholder interests seem to be important in many countries

• But standard corporate governance literature on firms as maximizers of shareholder value
  – That is what firms do in US and UK
What **should** firms do?

- Presumably, they should be run to ensure society’s resources are used efficiently

- What is the best system?

- Well, it depends on the world we are in
Best system?

• In an Arrow-Debreu world with
  – Perfect and complete markets
  – Symmetric information
  – Perfect competition

• Then, maximizing shareholder value achieves efficiency
Best system? (cont.)

- But if we go away from it
  - Incomplete markets
  - Asymmetric information
  - Imperfect competition

- Then, it is not clear that running firms in the interests of shareholders is necessary or sufficient for efficiency

- Allen and Gale (2000) show that altering the objectives of firms can lead to efficiency gains

- Tirole (2001) argues that having diffuse objective functions in stakeholder systems is problematic
Positive analysis

• Allen, Carletti and Marquez (2007)

• How to model stakeholder firms?
  • When they want to assure continuity to their employees
  • When they compete imperfectly

• What is the effect of adopting stakeholder concerns on market value?

• Do firms want to be stakeholder-oriented?
A model of stakeholder capitalism

- One-period economy to start with
- Duopoly with linear demand and constant marginal cost of production $c$ per unit
- Bertrand competition with differentiated products
Two-period model

• A second period is added identical to the first

• But there is a shock to marginal costs in period 1

• A firm operates in period 2 only if profits in period 1 are positive

• Standard shareholder solution
Stakeholder governance

Stakeholder firm problem

Max \quad \text{Profits period 1}
\quad + \quad \text{Expected profits period 2}
\quad - \quad \text{Prob bankruptcy} \times K_i

- Firms take account of the costs employees and suppliers would bear in case of bankruptcy

- $K_i$ is a deadweight cost is the key point
Stakeholder capitalism (cont.)

Result 1
A concern for stakeholders leads firms to set higher prices than in shareholder societies

- Stakeholder societies are further away from perfect competition than shareholder societies
Stakeholder capitalism (cont.)

Result 2

Provided $K_i$ is not too large stakeholder firms have higher first-period expected profits than shareholder firms

- Price above monopoly price otherwise
Stakeholder capitalism (cont.)

Result 3
Stakeholder firms can have higher overall market value than shareholder firms

- Stakeholder concerns soften competition

- Stakeholder firms survive more
Extensions

• Will firms choose to voluntarily adopt stakeholder concerns?

• What is the effect of competition between stakeholder and profit-maximizing firms?

• Cournot vs. Bertrand competition
Concluding Remarks

Stakeholder societies can have

• Higher firm value
• Stakeholders are more secure

But

• Prices are higher

• An important remaining issue is whether stakeholder societies can Pareto dominate shareholder societies and vice-versa