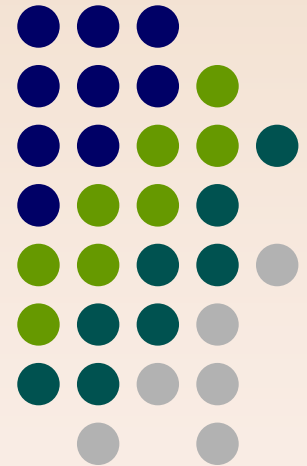


# The Elusive Quest for Global Governance Standards

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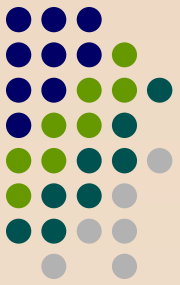
Lucian Bebchuk and Assaf Hamdani

Sloan Foundation Corporate Governance  
Research Conference, March 2009

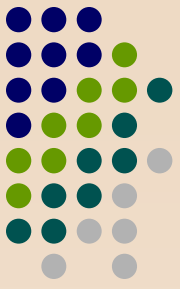


# Main Points

- Companies with dispersed ownership (NCS companies) vs. companies with a controlling shareholder (CS companies): Governance arrangements that are beneficial for one type of companies are often irrelevant or even counter-productive for the other type.
- While the difference between CS and NCS firms has been recognized, it has not been reflected in the design and use of governance metrics.
- Any global single governance metric is bound to miss the mark in either cross-firm comparisons or cross-country comparisons.
- The influential global metrics extensively used by scholars and shareholder advisers -- the Corporate Governance Quotient (CGQ), the Anti-Director Rights Index, and the Anti-Self-Dealing Index -- are inadequate for assessing governance around the world.
- Going forward, the quest for global governance standards should be replaced by an effort to develop separate methodologies for assessing governance in CS and NCS companies.
- We identify the key features that these separate methodologies should include.



# Demand for Global Metrics

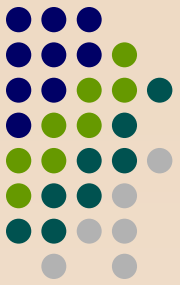


- Widespread recognition that adequate investor protection is important, and
- Globalization of capital markets

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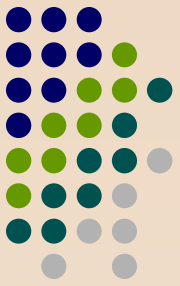
- Interest by researchers, policymakers, and investors in cross-country and cross-firm comparisons of governance.

# Supply of Global Metrics:



- The Anti-Director Rights Index and the Anti-Self-Dealing Index:
  - Applied in over 100 studies
- Riskmetrics's CGQ system:
  - Widely used by investors and public firms; growing use by academics.

# Some Fundamental Differences between CS and NCS companies (1)



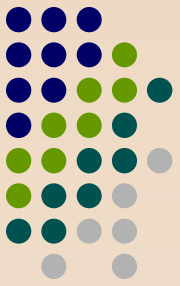
## Contestability of Control:

- Control is contestable in NCS companies but not in CS companies.

## Implications:

- Rules governing control contest are important for investor protection in NCS companies but largely irrelevant for investors in CS companies.

# Some Fundamental Differences between CS and NCS Companies (2)



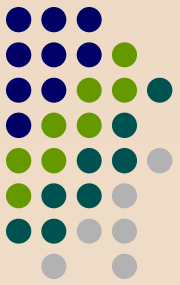
## Nature of agency problems:

- The insiders from whom public investors need protection are controlling shareholders in CS companies and managers in NCS companies.

## Implications:

- Rules that increase the power of the majority of shareholders vis-à-vis the board might protect shareholders in NCS companies but are unlikely to do so in CS companies.
- Rules that give power to minority of shareholders are more likely to be beneficial for public investors in CS companies than in NCS companies.

# Some Fundamental Differences between CS and NCS Companies (3)



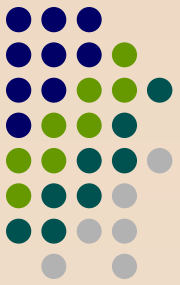
## Existence of collective action problems:

- Collective action problems significantly impede the ability of a shareholder majority to exercise its powers in NCS companies but not in CS companies.

## Implications:

- Rules that enable the majority of shareholders to overcome collective action problems are important for NCS companies but commonly irrelevant for CS companies.

# Example: Rules Governing the Ability of a Majority of Shareholders to Replace the Board



## **CGQ system:**

- \* Seven provisions out of fifty-five focus on features of the company's poison pill and takeover defenses.
- \* But among CS firms with a majority controller, these arrangements are irrelevant.

## **The Anti-Director Rights Index:**

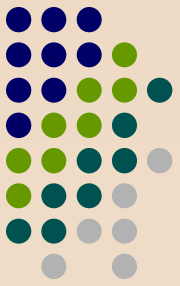
- \* Three out of six components focus on the ability of the majority of shareholders to exercise their voting power: shareholders' rights to call a special meeting, to vote by mail, and to vote without depositing shares.
- \* But for CS firms with a majority controller, these arrangements are irrelevant.

## **The Anti-Self-Dealing Index:**

- \* No weight given to such arrangements.
- \* OK for assessing investor protection in CS firms, but misses something of importance for investors in NCS firms.

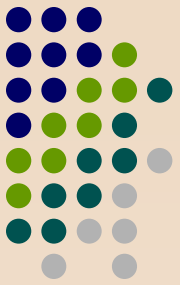


# Going Forward: Cross-Firm Comparisons



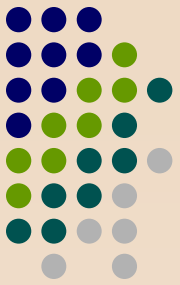
- Need to have a separate methodology for assessing investor protection in CS firms and a separate methodology for assessing investor protection in NCS firms.
- Any assessment methodology that applies a single metric to firms regardless of ownership structure will miss the mark with respect to CS companies, NCS companies, or both types of firms.

# Going Forward: Cross-Country Comparisons



- How well a country protects public investors in NCS companies does not determine how well it protects public investors in CS companies, and vice versa.
- Need to keep separate scores (and not blend them together) for:
  - How well a country protects public investors in NCS companies (the country's NCS score);
  - How well a country protects investors in CS companies (the country's CS score).
- This is important for:
  - Cross-country comparisons of average investor protections in public companies when countries have different proportions of CS and NCS companies.
  - Using the right country control in comparisons of firms around the world.
  - Studying political economy impediments to reforms and prospects for reform.

# CS Methodology



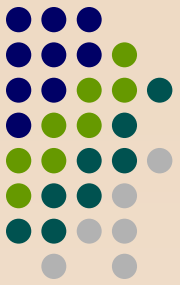
## For use in:

- Assessing governance in CS firms.
- Assessing how a country protects public investors in CS firms.

## Should:

- Give relatively less weight to arrangements governing:
  - control contents
  - voting procedures (except for votes where the minority has power to shape outcome)
- View more positively:
  - arrangements insulating directors from the majority of shareholders
  - arrangements enabling a minority of shareholders to block majority wishes.
- Pay closer attention to:
  - self-dealing, taking of corporate opportunities, and freezeouts
  - separation of cash flow and voting rights
  - director independence from the controller (and not only management)

# NCS Methodology



## For use in:

- Assessing governance in NCS firms.
- Assessing how a country protects investors in NCS firms.

## Should:

- Give significant weight to rules governing control contests.
- Give significant weight to rules governing shareholder voting procedures.
- Give significant weight to the rules governing the scope of shareholder power to intervene.
- Give significant weight to executive compensation.

# Conclusion

- The quest for a global governance metric should be replaced with an effort to design separate CS and NCS methodologies.
- By identifying the key elements that should and should not be included in each of these separate methodologies, our work provides researchers, policymakers, and investors with a useful framework for evaluating governance of public companies around the world.

