

Comment on Jackson—
Miyajima Paper

by Juro Teranishi

“Determinants of the evolution of
corporate governance system”

Jackson-Miyajima paper

- Issue

the future of the corporate governance system in Japan

- Conclusion

hybridization (diversification)

- Why ?

political factor (regulation)

efficiency

---- seems to be desirable to take a third factor (institutional infrastructure) into consideration

Three determinants of the evolution of corporate governance

- Government regulation and political process
 - (i) Hoshi-Kashyap(2001)
 - (ii) Rajan-Zingales (2002)
- Comparative efficiency
 - (i) Aoki and others
- Institutional infrastructure
 - (i) La Porta-Lopez de Silanes-Shleifer-vishney (1998),
Modigliani-Perotti(1998)---- legal origin
 - (ii) principle of institution design

 - ((iii) education ?)

The effect of government regulation

Deregulation is necessary but does not seem to be sufficient. (The concept of modernization of financial system was too naive.)

(i) Japan after mid-1980s

---- still high share of bank deposits and bank loan, and cross-shareholding among non-financial firms

(i) East Asia after 1980s (McKinnon-Shaw)

---- The larger the firms, The higher is the dependence on bank borrowings

Ratio of debts to total assets of firms by
size(%,2002)

	1 Bott om 25%	2	3	4 Top 25%	No. of sample firms
Indonesia	25	41	53	53	160
Korea	38	41	49	58	989
Malaysia	27	36	41	45	602
Philippine	17	32	36	52	98
Taiwan	37	41	47	51	272
Thailand	38	39	46	56	191

Comparative efficiency

Comparative efficiency is an important determinant of the evolution of corporate governance system, but so far results based on it are inconclusive.

- Efficiency

- (i) allocational efficiency

- bank --- bank directors have information about transaction balance of firms --- firm-level efficiency

- market --- stock market can accommodate diversity of opinion about new technology and industry among investors --- industry-level efficiency

- (ii) organizational efficiency

- bank --- agency costs reduction by main bank (reciprocal monitoring)

- market --- cost saving through shareholder's direct monitoring (board system and shareholder meeting)

- Institutional competition
 - (i) Convergence through Darwinian process (survival of the fittest)
 - (ii) Co-existence of different systems (incomplete specialization based on comparative advantage; eg. Information processing (Aoki))
- Empirical results----inconclusive
 - controversy about the Hoshi-Kahyap-Sharfstein analysis
 - allocation of bank lendings and stocks among industries (Teranishi and Takei)

Institutional infrastructure (1) legal origin

Relationship between country's legal origin and investor protection; Investor protection = shareholder right + creditor right + enforcement

(i) common law countries (UK, US)

--- strong investor protection

(ii) civil law countries (France, Germany, Scandinavian)

--- weak investor protection

La-Porta, Lopes-de-Silanes, Shleifer and Vishney (1997) --- common law countries have higher rate of external financing (larger equity markets and larger aggregate liabilities) than civil law countries.

---- Their analysis dose not touch upon the issue of bank dominance vs. capital market dominance.

La-Porta, Lopes-de-Silanes, Shleifer and Vishney (1998) --- investor right is negatively related to the concentration of ownership of shares in large public companies.

Modigliani and Perotti (1998) --- weak investor right hampers the development of security markets and leads to dominance of bank lending.

----- Legal environment seems to be less irrelevant to the characteristics of Japan and East Asia.

Classification of East Asian countries by La Porta et al.

- Common law ---- Malaysia, Singapore, Thailand
- Civil law (i) French-type ---- Philippines
(ii) German-type ---- Japan, South Korea, Taiwan

	Rule of law (enforcement)	Shareholder right (anti- director right)	Creditor right
Common law origin	6.46	3.39	3.11
Civil law origin (French)	6.05	1.76	1.58
Japan	8.98	3.0	2.0
East Asia	6.09	2.86	2.71

Institutional infrastructure (2)

principle of institution design

- Two dimensions of economic efficiency
 - (i) allocational efficiency
 - (ii) organizational efficiency
- Existing literature is concerned only with comparison with respect to a given dimension
- Comparison between two dimensions matters
- A hypothesis: trade-off between the two dimensions
 - Japan and East Asia; organizational
 - Anglo-American; allocational

	Japan and East Asia --- organizational	Anglo-American ---allocational
ownership	Family ownership (low agency costs)	Public company
labor	Internal market (firm-specific skill)	Open market
finance	Bank loan (main bank monitoring of firms)	Capital market

Trade-off between allocational and organizational efficiency

- More public company --- higher agency costs, but more efficient mobilization of savings and low level of exploitation of minority shareholders
- More open labor market --- lower investment in firm-specific skill, but more efficient allocation of standardized labor
- More reliance on capital market --- higher costs in information processing of firms, but more efficient choice of new industries and technology

Conclusion

- Importance of institutional infrastructure.
- Trade-off between allocational efficiency and organizational efficiency matters.
- The possibility of convergence to A-model by Japan and East Asian countries seems to be low