A Comparative Theory of Corporate Governance

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Corporate Governance in Perspective: Diversity or Convergence
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US View of Corporate Governance

• Firms sole objective should be to create wealth for shareholders

• Corporations in Japan and many other countries do not do this so the conclusion is they have poor corporate governance
Standard Corporate Governance Mechanisms

• Effective Board of Directors with sufficient outsiders
• Management compensation aligned with shareholders’ interests (e.g. stock options)
• Market for corporate control (hostile takeovers)
• Intervention by banks
Corporate Governance in Japan

• By and large these mechanisms are not applicable in Japan

• E.g. Toyota
  – Board of directors: 60 people with 1 outsider
  – Managers paid much less than in the US and traditionally have not had stock options
  – No hostile takeovers in Japan
  – ¥3.5-¥4.0 Trillion cash holdings so banks have little influence
Corporate Governance in Japan (cont)

• According to standard view Toyota should be a poorly run firm and should have produced low returns for shareholders
Corporate Governance in Japan (cont)

• BUT IT IS VERY SUCCESSFUL!

• In the long run it has performed better for shareholders than Ford, GM and even the S&P 500
Stakeholder Capitalism

• Why is the standard US view so wrong here?

• It ignores alternative forms of capitalism such as stakeholder capitalism

• Stakeholder capitalism is where companies pursue the interests of many stakeholders such as employees as well as shareholders
Figure 1: Whose Company Is It?

<table>
<thead>
<tr>
<th></th>
<th>All stakeholders</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>97</td>
<td>3</td>
</tr>
<tr>
<td>Germany</td>
<td>83</td>
<td>17</td>
</tr>
<tr>
<td>France</td>
<td>78</td>
<td>22</td>
</tr>
<tr>
<td>United States</td>
<td>76</td>
<td>24</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>71</td>
<td>29</td>
</tr>
</tbody>
</table>
Figure 2: Job Security or Dividends?

- Japan: Job Security more important (97), Dividends more important (3)
- Germany: Job Security more important (59), Dividends more important (41)
- France: Job Security more important (40), Dividends more important (11)
- United States: Job Security more important (89), Dividends more important (11)
- United Kingdom: Job Security more important (89), Dividends more important (11)
Stakeholder Capitalism (cont)

• Stakeholder capitalism has not been analyzed nearly as much as Anglo-Saxon capitalism

• Aoki (1990; Journal of Economic Literature) contains an excellent overview of the work he and others have done on comparing Japanese (J-mode) firms and US (H-mode) firms.
Results in our paper

• In an imperfect world stakeholder capitalism can do better than Anglo-Saxon capitalism

• J-mode firms are based on consensus and cooperation while H-mode firms have the manager tell everybody what to do
A comparison

- The J-mode allows the efficient allocation to be implemented because the effect of requiring consensus and cooperation is that decisions are made for the long run.

- The H-mode does not allow the efficient allocation to be implemented – top managers have too much power and abuse it.
Employment

• An important characteristic of the Japanese system is lifetime employment and an inflexible labor market

• With Anglo-Saxon capitalism these are undesirable but with stakeholder capitalism they are an advantage and make consensus easier to achieve
Income distribution

• What happens if there is a bad shock to a J-mode firm?

• In order to maintain cooperation it may be necessary to keep wages and employment high even if this means cutting returns to shareholders such as dividends

• This is the opposite of what happens in an H-mode firm
Concluding remarks

• Anglo-Saxon capitalism is only one form of capitalism – there are potentially many others

• Stakeholder capitalism can be superior if there are imperfections

• Stakeholder capitalism needs to be much more extensively studied
Concluding remarks (cont)

• Important not to attribute the effects of bubble collapse to corporate governance