Comments on “Comparative Institutional Analysis of Corporate Governance” (Masahiko Aoki) and “A Comparative Theory of Corporate Governance” (Franklin Allen and Douglas Gale)

Takeo Hoshi

Graduate School of International Relations and Pacific Studies (UCSD), and RIETI

Corporate governance as an institution for various stakeholders

- Deviation from the Arrow-Debreu model → shareholders dominated governance no longer optimal → stakeholder capitalism can be superior (Allen and Gale)
- Aoki also stresses the variety of observed corporate governance arrangements → no arrangement is absolutely superior to the others regardless of the conditions
- Set an important research agenda → suggest useful frameworks to advance the research

Comparative Institutional Analysis (Aoki)

- Conceptualize corporate governance as “a set of self-enforcing rules (formal or informal) that regulates action choices of the players (the manager, the investor, and the worker) contingent on evolving states
- Corporate governance as a stable equilibrium of the game
- Observed variety of corporate governance arrangements can be understood as multiple equilibria which cannot be Pareto-ranked.

CIA (continued)

- The equilibrium in the corporate governance game may be supported by the equilibrium outcomes of another (e.g., social, political) game (linked games)
- Institutional complementarities makes corporate governance arrangements “robust”

Understanding various corporate governance arrangements by CIA

- Exclusive property rights to owner/manager
- Co-determination between manager and worker
- Relational contingent governance
  - The main bank system
  - Holding company structure
  - Venture capital financing
  - State-owned enterprises
  - Banking regulation
- Silicon Valley model (venture capital governance with tournament)

Allen and Gale models as CIA

- In the sense that Allen and Gale try to come up with models for different types of corporate governance as different equilibria, their analysis belongs to CIA
- In these simple models, the multiple equilibria can often be Pareto-ranked
- Management by consensus eliminates the problem of short-termism
- Long-term employment and inflexible secondary labor market increase the benefits of management by consensus

Comments

- I also believe theoretical modeling of the stakeholder view of corporate governance is important (complete agreement with the authors of these papers)
- The stakeholder view is more general in the sense that it includes the shareholder view as a special case
- Important contribution that all of us should read
- My comments are mostly agenda for the future research that these papers implicitly suggest than criticism of the papers

Comment 1: Is this really Japan? (a) consensus or young manager?

- In the simplest model of Allen and Gale, decision by consensus is equivalent with decision by a young manager
- One can change a model slightly to show the governance mechanism that selects more young managers than old tend to exhibit less rent-seeking decisions
- Japanese firms are not known for having young managers; Required consensus between young and old generations at Japanese firms is also questionable

Is it really Japan? (b) continued employment of managers or workers?

- In the model that shows complementarity between management by consensus and long-term employment, the manager is more likely to retain the job in Japan
- If we assume instead
  - Workers are more likely to retain the jobs; more costly to fire the workers
  - Pursuing shareholders’ interest requires firing workers (more often than rent-seeking)
- The result is reversed: long-term employment reduces the benefits of management by consensus

More research on what the essential elements of corporate governance

- Empirical research on what are really essential in the corporate governance (in Japan and elsewhere)
- Will help the efforts of establishing theoretical foundation (so many parameters to characterize "corporate governance")

Comparative corporate governance: international or intra-national

- Both Aoki and Allen-Gale papers show the corporate governance arrangement may differ even within a country
  - The degree that workers' skill is "essential" may differ from industry to industry
  - Some firms may be managed by consensus of managers while others run just by old guys
- Studies on intra-national differences in corporate governance arrangements can reveal how those factors that vary with in a country influence the corporate governance

Comparative corporate governance: international or intra-national (cont'd)

- International comparison must be controlled for the difference in the intra-national distributions of firms
- How much of the US-Japan difference in the corporate governance is due to the different distribution of firms (by industry or by production system)? How much is really due to the difference in corporate laws, social system, history, etc.?

Is a system with strong complementarity really robust?

- True it may be difficult to change only one element when other complementary ones stay the same
- But a change in one element certainly reduces the viability of other complementary ones
- System may be robust to small shocks but may change drastically following a sufficiently big shock
- Importance of looking at the period when the system changed
  - For Japan, immediate post-war period, and now?