

Conceiving Corporate Governance for an Asian Environment

4th Conference of the EU-Asia Corporate Governance Dialogue Series

CORPORATE GOVERNANCE IN A CHANGING ENVIRONMENT

7 July 2017

1. **The financialized stock corporation**

- a. Value transferred to the financial system
- b. Corrupted role of management
- c. Companies defending themselves from corporate law

2. **Real environment of Asian companies**

- a. Most private firms in Asia are family-run.
- b. Many of the remaining firms are state-run.

3. **Solutions using systems theory and technology**

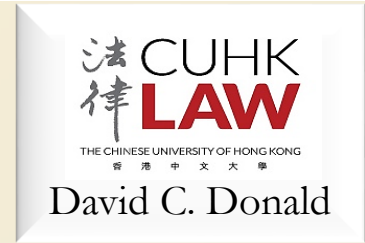
- a. Conceive both company and user as system
- b. De-emphasize empty vessel agency
- c. Decrease dependence on the share of stock

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FINANCIALIZED COMPANIES

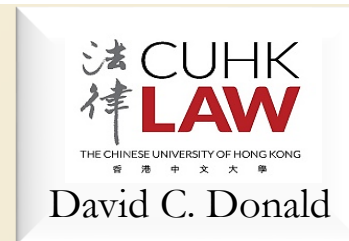
(View from the West)

Stock corporations are made for finance



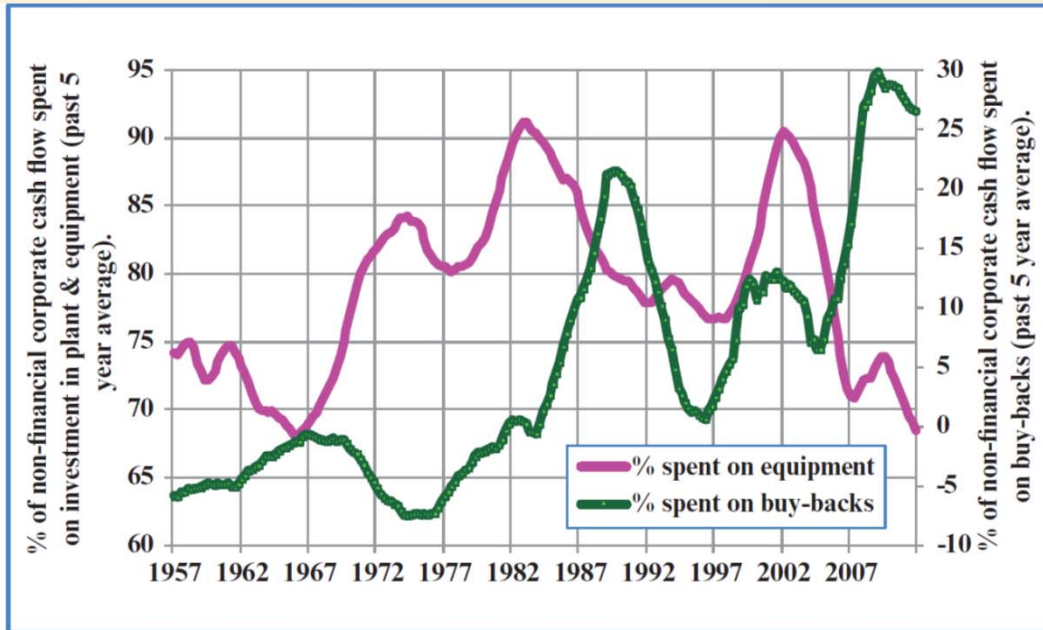
- **Capital Accumulation:** The modern stock corporation form arose in conjunction with expensive projects like railroads as a means of collecting finance for large projects.
- **Legitimate interests:** The corporation is understood mainly as a ‘nexus of contracts’ in which economic return can be pursued through entrepreneurial activity.
- **Conflict of Interests:** Measured as individual interest that is contrary to profit for shareholders, such as Henry Ford’s decision to favor employees through low dividends.
- **Financial exceptionalism:** Motivations arising from connection with or accepted views of financial professionals or financial rationality are generally considered not to conflict with the good of the company.

Corporate governance has been finely adjusted to financial industry needs



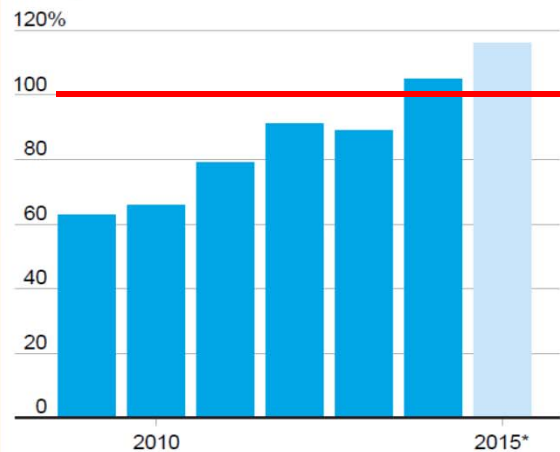
- **Disposable companies:** Corporate objects have been eliminated and structural changes facilitated for fast realization of assets.
- **Glass house companies:** Disclosure has been increased regularly in nearly every way possible to facilitate investment.
- **Limited law:** Law evolved so that litigating company strategy (business judgement) is impossible, only conflicted action contrary to current value is actionable successfully.
- **Finance over business in bankruptcy:** Law changes so that the close out netting of claims from derivatives receives priority over investments in productive assets.

Share buybacks exceed replace investment



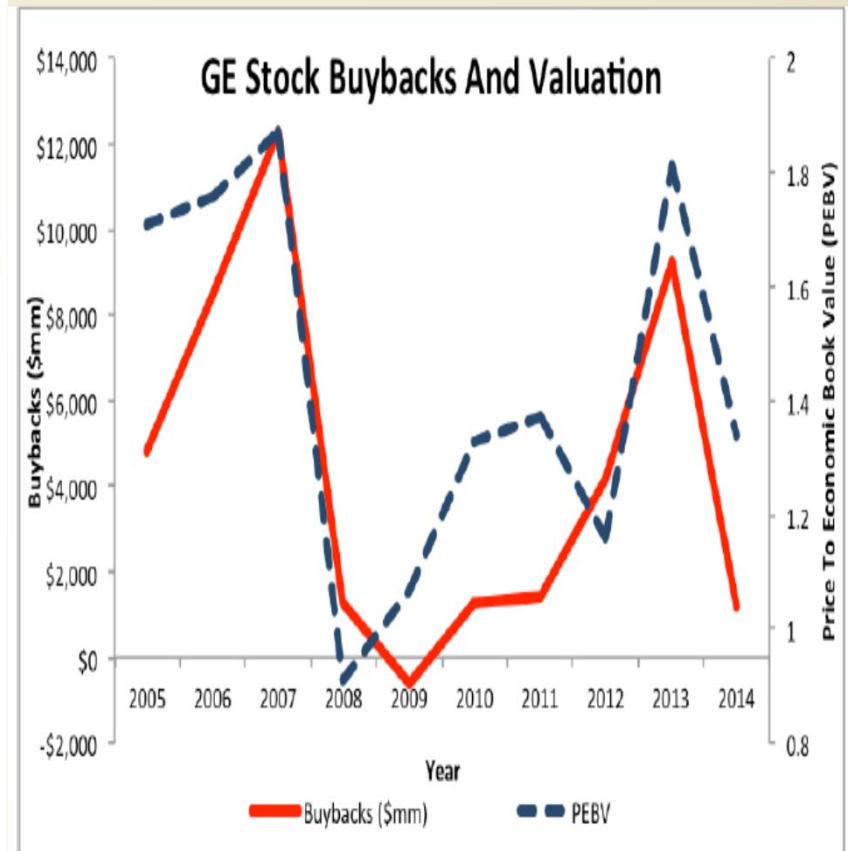
In 2015, US companies returned \$885 billion to shareholders, which was “113% of their capital spending spending, compared with 60% in 2000 and 38% in 1990.” Reuters

Buybacks and dividends as a percentage of net income

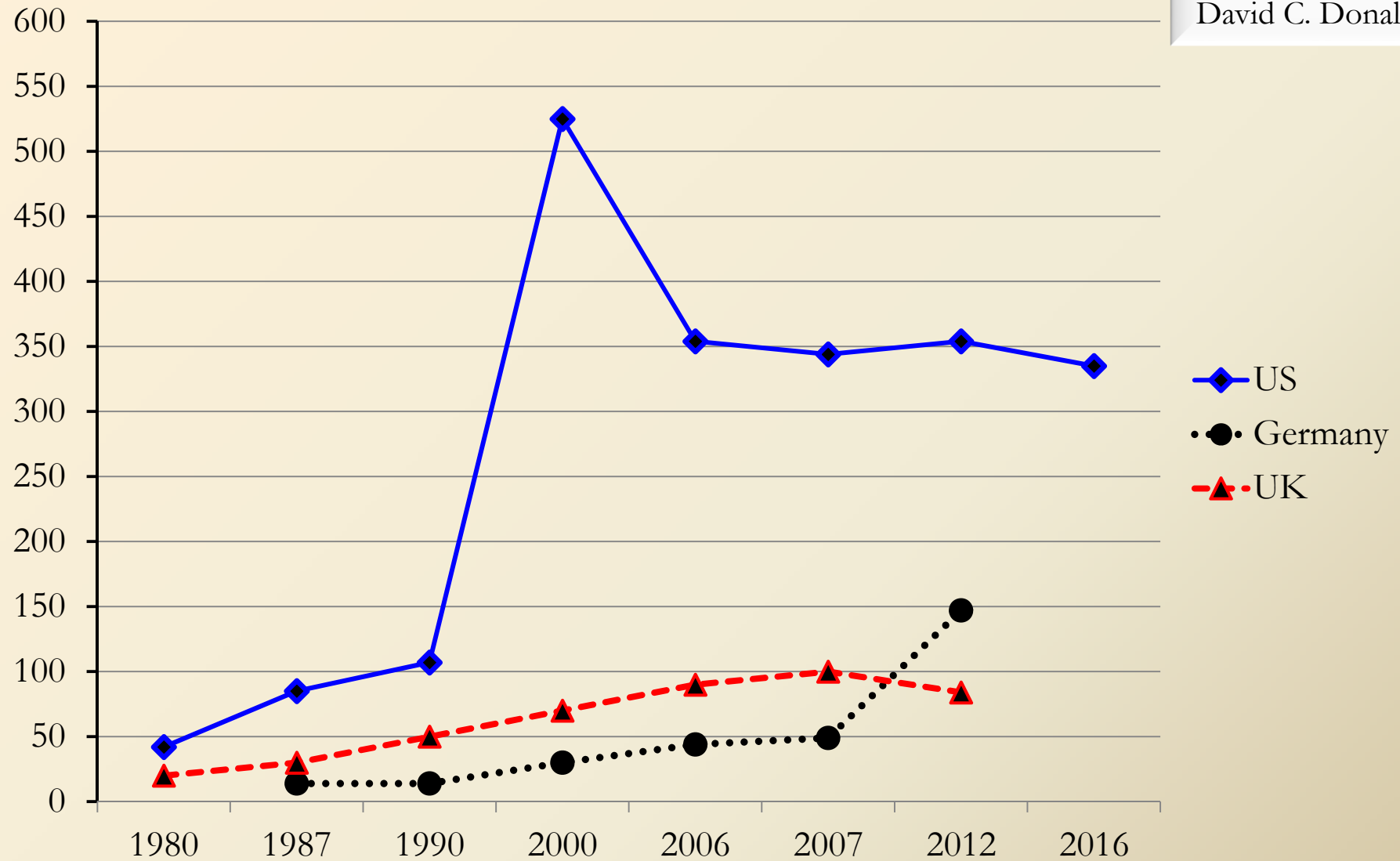


Note: Aggregate number for 3,297 publicly traded non-financial companies analyzed by Reuters
 *2015 data for 613 companies that have reported

Sources: Thomson Reuters data, regulatory filings



Ratio of Executive Pay to Average Salary



Sources: US data: AFL-CIO, 2008 Trends in CEO Pay, from <http://www.aflcio.org/corporatewatch/paywatch>. No figure available for 1987. German Data: Schwalbach (2009: 125-26). No figure available for 1980.

Productive activity forced to protect itself

- **Avoid voting rights:** After 2000, many of the most successful companies (e.g., Google, Facebook, LinkedIn and Alibaba) have used defensive, dual class shareholding structures to avoid short-term influence by financial investors.
- **Super-majority protection:** Tesla has specific provisions in its constitution preventing investors from taking major actions. Most other companies stagger boards to achieve similar protection.
- **Bribing investors to conduct research:** Companies like Apple with traditional governance have been forced to borrow tens of billions (borrow, so as to lower tax impact) in order to buy-back their own shares to appease institutional investors and prop share price.
- **Juicing for immediate value:** Companies doing less well, like DuPont, have been broken up and wrung out to create a quick cash spurt for consumption of institutional investors.
- **Obsolete corporate governance?** Core powers around which corporate law has been built are being phased out of real operations to enable corporations to survive.

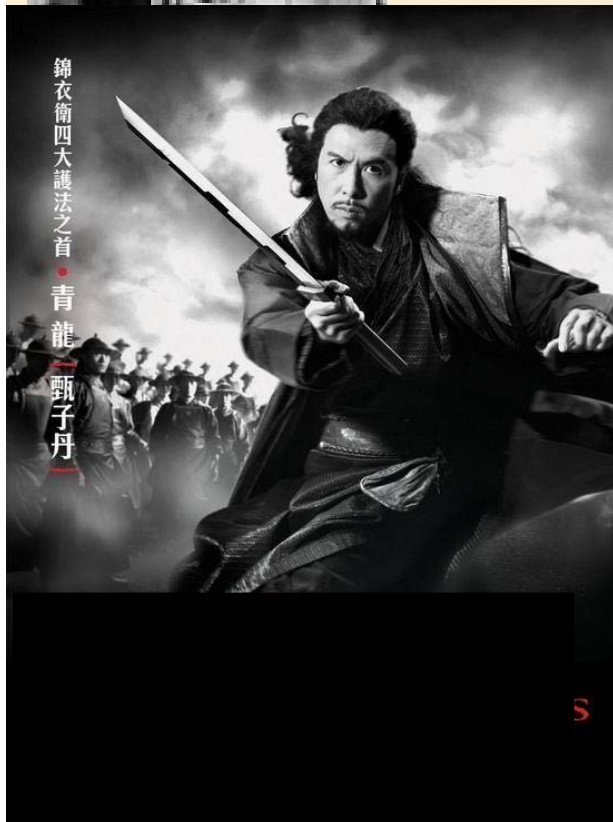
The role of academics: Once upon a time in corporate governance



Management
Meet your Match!



ve action problems
s weaken this right.



ing their shares to
and the incentive to

Takeovers do not seem to benefit corporate participants

$$gc + gs + gg > ga + cf + cl ?$$

Where:

- gc = medium-term gains to bidder from takeover
- gs = gains to target shareholders accepting offer
- gg = gains to target's governance
- ga = gains to financial intermediaries acting as arbitrageurs
- cf = costs of financial advice
- cl = costs of legal advice

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ASIAN ENVIRONMENTS *(Are They Really Inferior?)*

“Family firms tunnel funds and extract rents.
They need to evolve toward dispersed holdings”



David C. Donald

Some Leading Family Firms

- Wal-Mart Stores, Inc. - United States
- Volkswagen AG - Germany
- Berkshire Hathaway, Inc. - United States
- Ford Motor Company - United States
- Cargill, Incorporated - United States
- Koch Industries Inc. - United States
- Bayerische Motoren Werke AG (BMW) - Germany
- Arcelor Mittal - Luxembourg
- Reliance Industries Limited - India
- Peugeot SA - France
- Comcast Corp. - United States
- The Long & Foster Companies - United States
- Roche Holding AG (Roche Group) - Switzerland

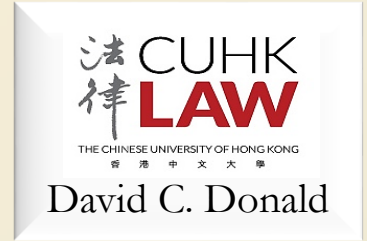


Some Leading Asian Family Firms

- Reliance Industries Limited - India
- Formosa Petrochemical Corp – Taiwan
- Lotte Shopping - South Korea
- Suntory Holdings Ltd. - Japan
- PT Astra International Tbk - Indonesia
- Doosan Heavy Industry & Construction Co – South Korea
- CJ Corp. - South Korea
- Hindalco Industries Ltd. - India
- Formosa Chemicals & Fibre Corporation – Taiwan
- Bharti Airtel Ltd (fka Bharti Tele-Ventures Ltd) - India
- Sun Art Retail Group Ltd - Hong Kong
- Vedanta Resources plc - India
- Nan Ya Plastics Corp. – Taiwan
- Chow Tai Fook Jewellery Group Ltd. – Hong Kong
- Sun Hung Kai Properties Ltd. – Hong Kong

*Where is
China?*

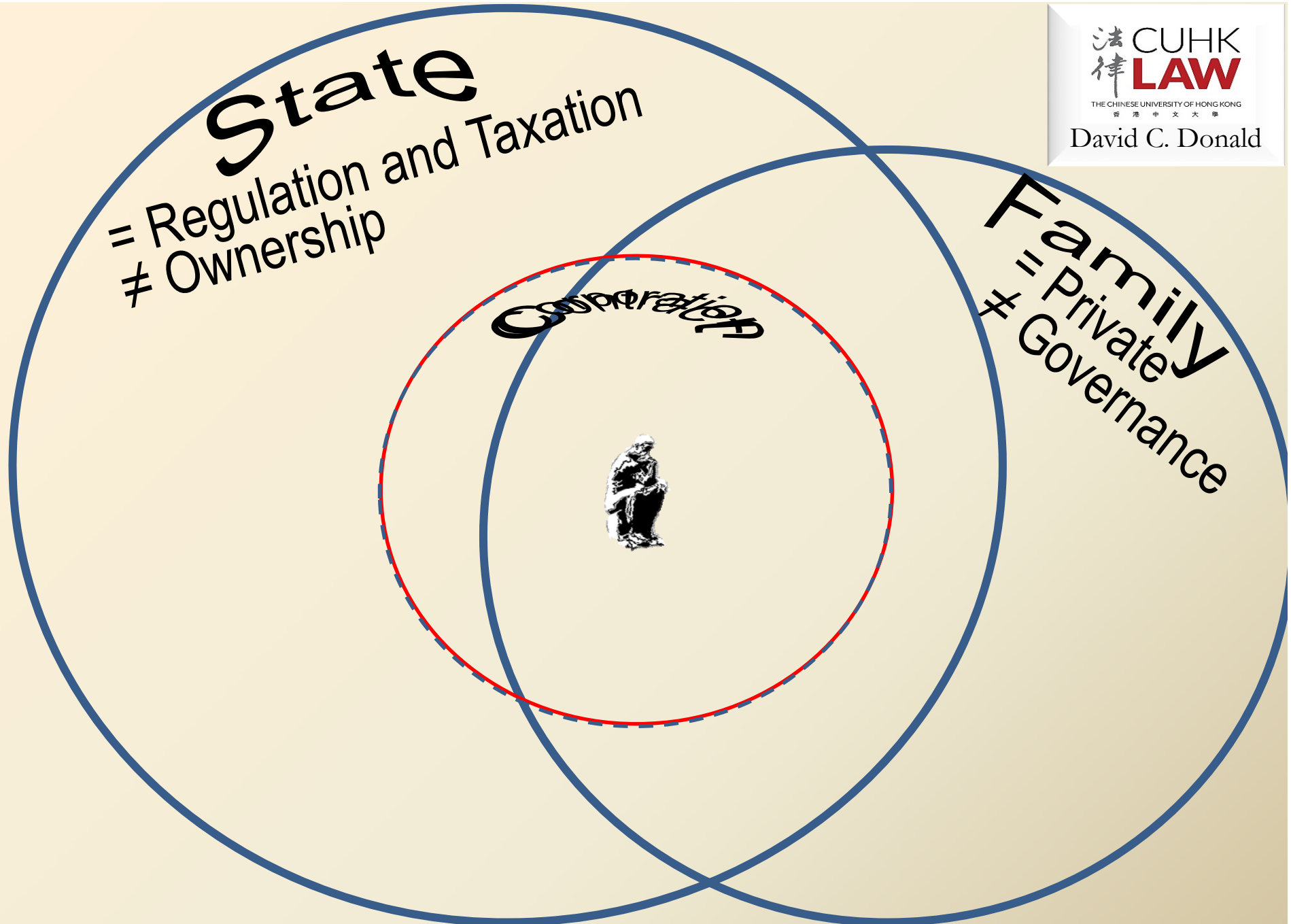
China's State Owned Firms



- Sinopec – ranked 2 in Fortune 500
- China National Petroleum – 4 in Fortune 500
- State Grid – 7 in Fortune 500
- Industrial and Commercial Bank of China – 18 in Fortune 500
- China Construction Bank – 29 in Fortune 500
- Agricultural Bank of China – 36 in Fortune 500
- China State Construction Engineering – 37 in Fortune 500
- Bank of China – 45 in Fortune 500
- China Mobile Communications – 55 in Fortune 500
- SAIC Motors – 60 in Fortune 500
- China Railway Engineering – 70 in Fortune 500
- China National Offshore Oil – 72 in Fortune 500
- Noble Group – 77 in Fortune 500

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A NEW VIEW OF CORPORATE GOVERNANCE AND CORPORATE FINANCE



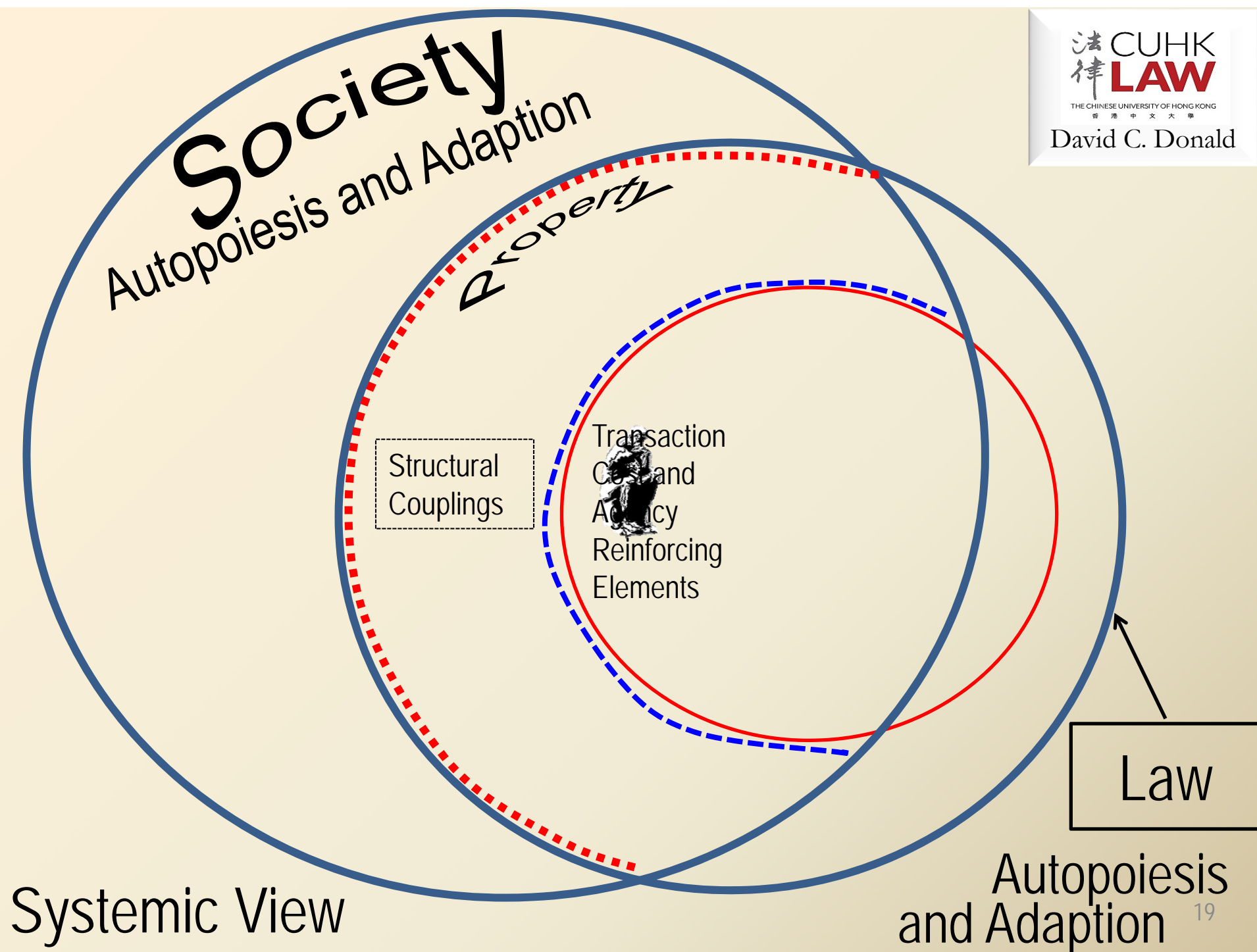
State

= Regulation and Taxation
≠ Ownership

Family
= Private
≠ Governance

Finance,
Professions
and Equitable
Considerations

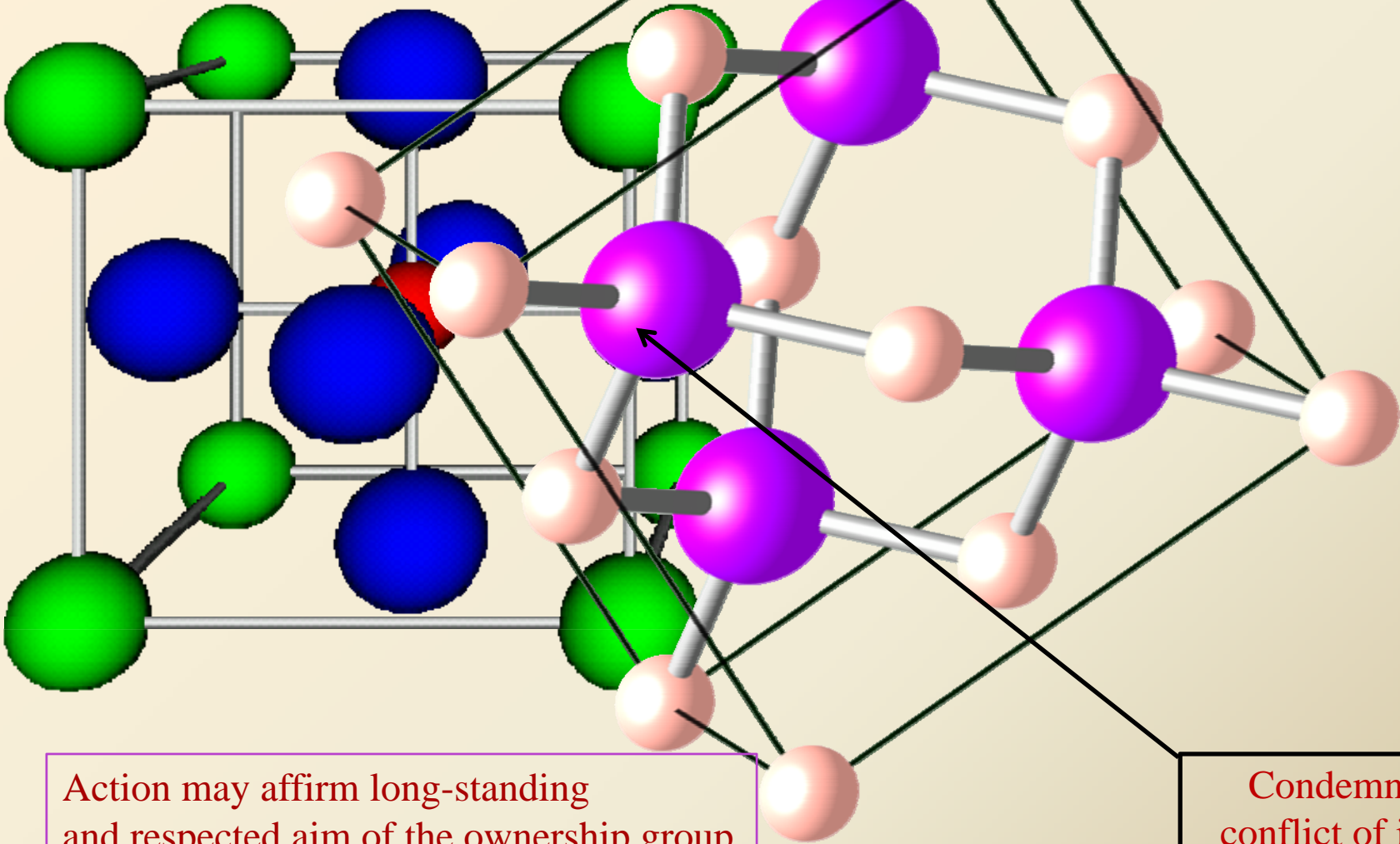




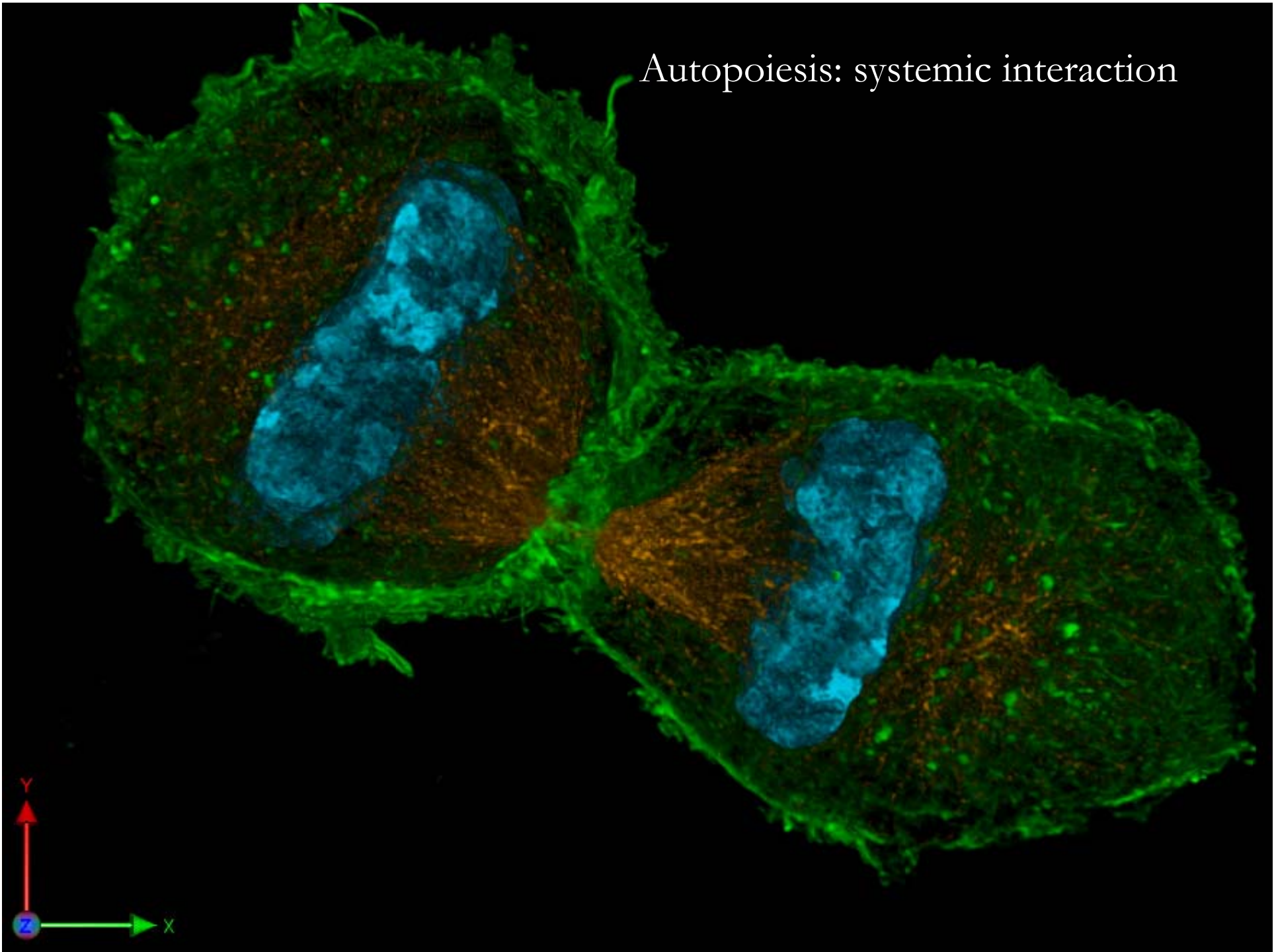
Systemic View

Autopoiesis and Adaption 19

Current corporate rules create a distorted picture



Autopoiesis: systemic interaction

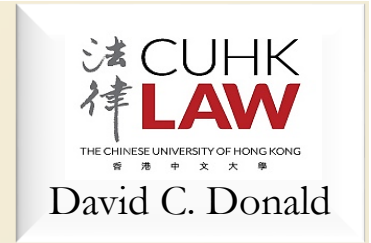




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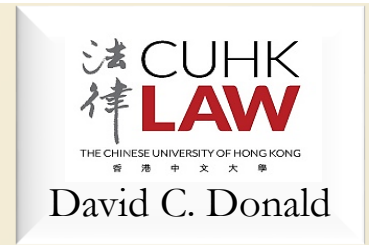
SUMMARY

Build “structural couplings” between network and company into corporate law



- **Current Western model is highly problematic:** Corporations are bled dry, share price does not reflect value activity, and successful companies reject investor power.
- **Asian companies are not chimpanzees:** An evolution toward dispersed shareholding is a myth and controlling shareholders are the norm, yet there is prosperity.
- **Companies should be conceived as systems:** Groups of people enter into and use companies; repressing this truth is highly inefficient.
- **Corporate finance should be tied to return:** Existing data and the ability to use it should allow us to move beyond the crude form of return from ownership shares.

Thank you!



FIN

David C. Donald webpage:

<http://www.law.cuhk.edu.hk/people/donald-david-c.php>

Papers:

http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=334405