The Insider View vs. Outsider View of Corporate Governance

National models of Corporate Governance

- 2 categories of corporate governance systems
  - Outsider model – separation between the owners of the company (shareholders) and the people who manage the business
    ▪ AKA Anglo-Saxon/market model
  - Insider model – minimal separation between ownership and control
    ▪ AKA bank-based/institutionally-based model
- Issue with categorizing – no 2 countries are the same, so no 2 systems of corporate governance can be the same
  - System of corporate governance in a country is determined by (Solomon, 2007, p. 181)
    ▪ Internal factors – corporate ownership structure, the state of the economy, the legal system, government policies, culture and history
    ▪ External influences – extent of capital inflows from abroad, the global economic climate and cross-border institutional investment
    ▪ E.g. US is prescriptive in its corporate governance while Australia is descriptive in our code
    ▪ E.g. US don’t consider social ties while Australia does
  - Categorizing looks at the extremities – but what about the middle? Countries that exhibit both insider and outsider system characteristics
    ▪ E.g. BRIC countries and emerging countries

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The Insider Model

Ownership and control
- Governance of the corporation is largely driven by insider control
  - i.e. corporation is controlled by individuals/groups that function within an organisation
- Shareholders are often also the managers
• E.g. in Germany and Japan, banks play a significant ownership and management role many companies (they aren’t just providers of finance)
• .:. agency problem isn’t really an issue because the owners are often the managers too

• Some rely on trusted business relationship and state guidance
  o E.g. Keiatsu (Japan) and Chaebol (Korea)
• Some involve substantive state control
  o E.g. to protect itself from unsolicited takeovers and strong competitors, the French business has developed a complex network of cross-shareholding known as `verrouillage’

Wide concept of the firm
• Purpose of the firm – a wide and more holistic interpretation is taken of what the firm represents
  o i.e. it does not exist just to create shareholder value
• The firm is considered to be an autonomous economic and social entity

Dual board system
• 2 boards and a two-tier model
  o Management board – deals with the specific business, legal and operational dealings of the company and is comprised solely of executive management
  o Supervisory board – supervises the management and made up of shareholders and employees (half-half)
• Implementation of the board structure varies country-by-country
• Shareholders and employees can impact managerial decision making
  o Common to see representatives of employees on the respective boards of companies
  o .:. a series of relationships drive the corporation rather than one governing body

Corporate control
• Limited use of external executives and directors
  o This is changing in some companies – e.g. Swiss multinational companies
  o But there is continued resistance in other companies – e.g. Siemens
• Note: it is difficult to generalize about legal systems because they evolve overtime and are based on historical, cultural and political themes of countries
• Legal and professional environment of corporate control
  o Fewer minority shareholders in insider system means less investor protection
    • Larger shareholders have sufficient representation on the board, and .:. control management to ensure that their interests are being met
  o Corporate governance guidance is not that well-established
• External market for corporate control
  o i.e. how do we influence behaviour of people in the organisation (revolves around the threat of takeover changing behaviour)
    • If the company is not efficient, and another organisation thinks they can make them more efficient, the company is a takeover target
If you’re a takeover target, companies will immediately try to operate more efficiently

- Lack of a robust external market
- Takeovers and acquisitions rarely occur because
  - Tightly held shareholdings – shares are tightly held by few large investors so there is a significant degree of company cross-shareholdings
  - Investors with long-term objectives – investors usually have a long-term strategy of being closely involved with the company’s management and strategic directions so short-term capital gains aren’t a priority
  - There is often an implicit contractual agreement between management and various company stakeholders, which gives extra support to the company
  - Societal norms – in some countries (particularly Japan), there is a cultural hesitation to engage in such predatory activity

### Key risks

- **Minimal separation between ownership and control**
  - In family-established and family-controlled companies, interests of minority shareholders may not be respected
  - That coupled with less liquid financial markets and reduced investor protection laws can disincentivize potential shareholders from taking a stake in a company
- **State intrusion into company affairs**
  - If the state has an explicit or implicit stake in the company, management practices of the company may be driven by political objectives of the gov.
    - State-induced practices may be at the cost of the individual company and its shareholders
  - Intrusion by the state can be a disincentive for wider investment in a company
- **Non-specialisation of management**
  - i.e. promoters double up as managers and/or banks intrude in the management process without industry specific expertise
  - Having different stakeholders all playing a part in setting company policy can lead to a multitude of conflicting corporate goals
  - Consensus position might not be the one that provides the best result for the company and its shareholders