Corporate Governance and the Current Crisis

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Two views of corporate governance

• Narrow view: Ensure firms are run in the interests of shareholders

• Broad view: Ensure firms are run so society’s resources are used efficiently
Narrow view

• Anglo-Saxon capitalism

• Based on Adam Smith’s “Invisible Hand”

• All agents should pursue their own interest
  – Individuals should maximize their utility
  – Firms should create wealth for shareholders
Narrow view (cont)

• Widely analyzed and understood

• Requires strong assumptions to be valid:
  – Perfect and complete markets
  – Symmetric information
  – Perfect competition
Broad view

• Narrow view follows from broad view provided these assumptions are satisfied

• But if markets are incomplete, or there is asymmetric information, or imperfect competition, it is not clear that running firms in the interests of shareholders is necessary or sufficient for efficiency
Broad view (cont.)

• With market failures alternative objective functions for firms may lead to a superior allocation of resources

• In many non-English speaking countries financial markets are more incomplete

• Objective functions of firms are quite different too
Firm priorities

Survey of managers:

Which of the following two would be the most prevalent view in your country?

(a) A company exists for the interest of all stakeholders

(b) Shareholder interest should be given the first priority
Figure 1: Whose Company Is It?

- **Japan**: 97% of all stakeholders, 3% shareholders.
- **Germany**: 83% of all stakeholders, 17% shareholders.
- **France**: 78% of all stakeholders, 22% shareholders.
- **United States**: 76% of all stakeholders, 24% shareholders.
- **United Kingdom**: 71% of all stakeholders, 29% shareholders.

Legend:
- Green bar: All stakeholders
- Light green bar: Shareholders
Firm priorities (cont.)

Survey of managers:

Which of the following two would be the most prevalent view in your country?

(a) Executives should maintain dividend payments, even if they must lay off a number of employees

(b) Executives should maintain stable employment, even if they must reduce dividends
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 (60), Dividends more important (40)
United States: Job Security more important (11), Dividends more important (89)
United Kingdom: Job Security more important (11), Dividends more important (89)
Governance and the crisis

• This last question suggests that in times of crisis there may be a significant difference in how shareholder and stakeholder firms react.

• Shareholder firms may be much more willing to fire workers and this can have important effects in terms of macroeconomic stability.

• We will focus on differences between the U.S. and France, Germany and Japan.
• How important are these differences?

• In the U.S. fear of unemployment for oneself and people in your immediate family is one of the main drivers of reductions in consumption

• In France and Germany fear of unemployment appears to be much less of a problem

• This can help explain the difference in views on stimulus packages and so forth between the U.S. and Europe
GDP growth rate evolution

Growth rate compared to previous quarter, annualized, seasonally adjusted

Source: OECD Stat Extracts
Unemployment Rates

France: 9.0% 6.0% 5.0% 4.0% 2.0%
Germany: 8.0% 7.0% 6.0% 5.0% 3.0%
US: 0.0% 1.0% 2.0%
Japan: 0.0% 1.0% 2.0% 3.0% 4.0%

Aug 08 Sep 08 Oct 08 Nov 08 Dec 08 Jan 09 Feb 09
Workforce reductions by country

Country-based effect on workforce reduction in the automotive industry
(% reduction of 2007 worldwide headcount over 2008-FY2009)
Workforce reductions by country

Country-based effect on FTE layoff in the automotive industry
(% reduction of 2007 worldwide headcount over 2008-FY2009)

- Germany
- Japan
- France
- USA

[Bar chart showing percentage reductions for various companies in different countries, with a weighted average line.]

Workforce reductions by country

Country-based effect on workforce reduction
(% reduction of 2007 worldwide headcount over 2008-FY2009)
Same dividend as previous year’s * Forecast for Toyota, PSA, Honda as of 03/31/3009
U.S. dividend changes

Dividend changes from previous year (number of firms)

- Dividend Increase
- Dividend Decrease
Comparison of dividend changes

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Number of firms</th>
<th>% omit</th>
<th>% incr.</th>
<th>% decre.</th>
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<td>2008</td>
<td>3118</td>
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<td>34</td>
<td>17</td>
<td>41</td>
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</table>
Workforce reduction methods

- % firing
- % temporary workers
- % buyout and early retirement
- % non replacement

Average Germany
Average Japan
Average France
Average US
## Workforce reduction methods

<table>
<thead>
<tr>
<th>Method</th>
<th>GERMANY</th>
<th>JAPAN</th>
<th>FRANCE</th>
<th>US</th>
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<tr>
<td>% firing</td>
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<td>% buyout and early retirement</td>
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<td>% non replacement</td>
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<td>90%</td>
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### Companies

<table>
<thead>
<tr>
<th>Company</th>
<th>GERMANY</th>
<th>JAPAN</th>
<th>FRANCE</th>
<th>US</th>
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<tbody>
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<td>Volkswagen</td>
<td>100%</td>
<td>0%</td>
<td>100%</td>
<td>100%</td>
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<tr>
<td>Daimler</td>
<td>90%</td>
<td>100%</td>
<td>90%</td>
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<td>BMW</td>
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<td>90%</td>
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<td>Continental</td>
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<td>Toyota</td>
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<tr>
<td>Honda</td>
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<td>50%</td>
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<tr>
<td>Nissan</td>
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<td>40%</td>
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<tr>
<td>Suzuki</td>
<td>30%</td>
<td>30%</td>
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<tr>
<td>Mazda</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
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<tr>
<td>Mitsubishi</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Bridgestone</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Toshiba</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
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<tr>
<td>Peugeot SA</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Renault</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
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<tr>
<td>Michelin</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>GM</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Ford</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Goodyear</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
</tr>
</tbody>
</table>
Domestic vs. Abroad

% workforce reduction in home country

Germany

Japan

France

USA

Volkswagen
Daimler
BMW
Porsche AG
Continental
Toyota
Honda
Nissan
Suzuki
Mazda
Subaru
Mitsubishi
Bridgestone
Panasonic
Toshiba
Sharp Corp.
NEC
SONY
Peugeot SA
Renault
Michelin
SEB
Philips
Electrolux
GM
Ford
Firing of Full-time workers by Region

- **Home country**
- **Abroad**
- **US**

### Regions
- **GERMANY**
- **JAPAN**
- **FRANCE**
- **US**

### Countries
- **US**
  - VW: 60%
  - Daimler: 70%
  - BMW: 80%
  - Porsche AG: 90%
  - Toyota: 100%
  - Honda: 100%
  - Nissan: 100%
  - Suzuki: 100%
  - Mazda: 100%
  - Subaru: 100%
  - Mitsubishi: 100%
  - Peugeot SA: 100%
  - Renault: 100%
  - GM: 100%
  - Ford: 100%

- **FRANCE**
- **JAPAN**
- **GERMANY**

### Notes
- The chart shows the percentage of full-time workers fired in each country, categorized by region.
Employee Board Representation

- Among the Japanese companies researched, 53% of the board members are inside directors who hold management positions in the company, and 22% of the external (non-executive) directors are former employees.

- Inside directors are appointed or promoted from among senior employees. CEO has the authority – sometimes exclusive authority – over executive personnel issues, and the decision will be approved by board members and proposed to shareholder meeting.

- Shareholders have the right to vote on elections to the board of directors (Article 329 of the Corporate Law), and appointment of CEO could also be delegated to shareholder meeting (precedent).

<table>
<thead>
<tr>
<th>Company</th>
<th>Internal</th>
<th>External</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Toyota</td>
<td>29</td>
<td>10 (6)</td>
<td>39</td>
</tr>
<tr>
<td>Honda</td>
<td>21</td>
<td>7 (2)</td>
<td>28</td>
</tr>
<tr>
<td>Nissan</td>
<td>7</td>
<td>6(0)</td>
<td>13</td>
</tr>
<tr>
<td>Suzuki</td>
<td>10</td>
<td>5(0)</td>
<td>15</td>
</tr>
<tr>
<td>Mazda</td>
<td>10</td>
<td>5(0)</td>
<td>15</td>
</tr>
<tr>
<td>Subaru</td>
<td>8</td>
<td>4(1)</td>
<td>12</td>
</tr>
<tr>
<td>Mitsubishi</td>
<td>9</td>
<td>8(2)</td>
<td>17</td>
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<tr>
<td>Bridgestone</td>
<td>10</td>
<td>6(0)</td>
<td>16</td>
</tr>
<tr>
<td>Panasonic</td>
<td>14</td>
<td>12(5)</td>
<td>26</td>
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<tr>
<td>Hitachi</td>
<td>8</td>
<td>11 (6)</td>
<td>19</td>
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<tr>
<td>Toshiba</td>
<td>9</td>
<td>5(1)</td>
<td>14</td>
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<tr>
<td>Sharp Corp.</td>
<td>10</td>
<td>7(0)</td>
<td>17</td>
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<tr>
<td>SONY</td>
<td>3</td>
<td>12(0)</td>
<td>15</td>
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<tr>
<td>NEC</td>
<td>7</td>
<td>15(2)</td>
<td>22</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>155</strong></td>
<td><strong>113(25)</strong></td>
<td><strong>294</strong></td>
</tr>
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</table>

%   53%     38%     100%
Employee Directors

Presence of employee directors on board: effect on FTE layoff
(% reduction of 2007 worldwide headcount over 2008-FY2009)

- Peugeot SA
- GM
- Ford
- Renault
- Volkswagen
- Daimler
- BMW
- Porsche AG
- Toyota
- Honda
- Nissan
- Suzuki
- Mazda
- Mitsubishi

weighted average
Employee Directors

Presence of employee directors on board: effect on FTE layoff
(% reduction of 2007 worldwide headcount over 2008-FY2009)

No Employee Directors  Employee Director

<table>
<thead>
<tr>
<th>Company</th>
<th>% Reduction</th>
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<tbody>
<tr>
<td>Peugeot SA</td>
<td>-10%</td>
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<tr>
<td>Michelin</td>
<td>-15%</td>
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<tr>
<td>GM</td>
<td>-20%</td>
</tr>
<tr>
<td>Ford</td>
<td>-10%</td>
</tr>
<tr>
<td>Goodyear</td>
<td>-5%</td>
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<tr>
<td>SEB</td>
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<tr>
<td>Electrolux</td>
<td>5%</td>
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<tr>
<td>Whirlpool</td>
<td>10%</td>
</tr>
<tr>
<td>Renault</td>
<td>0%</td>
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<tr>
<td>Volkswagen</td>
<td>0%</td>
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<tr>
<td>Daimler</td>
<td>0%</td>
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<tr>
<td>BMW</td>
<td>0%</td>
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<tr>
<td>Porsche AG</td>
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<td>Continental</td>
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<td>SONY</td>
<td>0%</td>
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<tr>
<td>NEC</td>
<td>0%</td>
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</tbody>
</table>

(weighted average)
RESTRICTIONS ON DISMISSALS
ULTIMA RATIO PRINCIPLE

• Termination of the employment contract must represent the last possible means (last resort).
• A dismissal may not be pronounced until all reasonable measures or possibilities of reaching an understanding have been exhausted.
  – Reduction in Overtime, Reduced Pay
  – Transfers within the company
  – Non-renewal of Fixed-term Contracts
  – Solicitation of Voluntary Retirement, Early Retirement
  – Outplacement support
Doctrine on Abusive Dismissals

• Established by case law in 1979
• Later incorporated by Labor Contract Law
  – “a dismissal shall be considered an abuse of the right to dismiss and therefore null and void if it is not based on objectively reasonable grounds and may not be recognized as socially acceptable”

**Four Requirements**

1. Business necessity
   – risk of bankruptcy
2. Ultima ratio
3. Objective and reasonable selection standards
4. Consultation with the labor union
   – explain the necessity of the dismissal, its timing, scale and method, and consult with them concerning the dismissals in good faith
Political concerns on “Haken-Giri”

• 5 Jan 2009, Chief cabinet secretary Kawamura
  – "Companies should utilize large internal reserves to maintain employment (for temporary workers). Their attitude to increase temps is one of the causes of current labor crisis."

• 5 Jan 2009, Labor Minister Masuzoe
  – "Personally I am against temping for manufacturing sector. It’s time to make a bold policy shift."

• 6 Jan 2009, Prime Minister Aso
  – "Regular employment is best."
  – "Banning temping could also be harmful for workers."
  – "We should also consider global competitiveness."

• Labor Ministry (MHLW) 's bureau of stable employment
  – "Japan's social safety net has failed to keep up with changes in the labor market. We must build a safety net that suits this more deregulated working environment."
Criticism towards administration

• M. Abe, professor at Dokkyo University
  – “This recession has opened the nation’s eyes to its growing social inequalities. There is a whole population of workers who are outside the traditional support net.”

• JAMA (Japan Automobile Manufacturers Association)
  – "We have to further shift production overseas if dispatching agencies were to be regulated."

• Canon
  – We have underestimated the difficulties faced by the laid-off temporary workers in the current economic downturn and would offer them more aid, including help in staying longer in their apartments.

• M. Yuasa, leader of "New Year's Haken Tent Village"
  – “The Tent City was not simply charity. It is a campaign to enable workers to get out of the downward spiral into poverty, which forces them to accept the degradation of their work conditions, and create a healthy labor market that allows workers to say No to these attacks”
Concluding remarks

• Anglo-Saxon system works well in booms but has undesirable macroeconomic spillovers in times of crisis

• Globalization has led to the U.S. becoming a dumping ground for some firms’ unemployment

• Stakeholder system works well in downturns and avoids spillovers

• A full evaluation of stakeholder governance is needed