The Japanization of American Corporate Governance? Evidence of the Never-Ending History for Corporate Law

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The Flawed Convergence Debate

- The debate is premised on the assumption of a static American Model
- The American Model is assumed to be based on two features
  1. Shareholder primacy
  2. Dispersed shareholding
- Both 'American evolutionists' and path dependent theorist make this assumption
- The only disagreement is whether all countries will adopt the American Model
- This assumption is an error

The False Assumption of a Static American Model

- Hansmann and Kraakman
  - "the triumph of the shareholder-oriented model of the corporation over its principal competitors is now assured"
  - "most of corporate law" has already converged on the American Model
- LLS&V, Roe and Coffee provide path dependent explanations for what has constrained other countries from adopting the dispersed American Model
- Bainbridge
  - The debate "assumes that the U.S. model, towards which global systems are (or are not) converging, is one of shareholder primacy"
- Gilson
  - Formal change only occurs "as a last resort" because formal change requires "changing complimentary institutions" which is costly
- Japanese Law scholars
  - Write about Japan converging on the American Model – assuming that there is a static model
  - Milhaupt: "For the economic and political actors in these countries [Japan and other transitional economies but not the U.S.], it is not the end of history, but the beginning of time"
- Japanese legal reforms have sought to implement the 'American Model'
- The IMF and World Bank made this assumption in their response to the 1997 Asian Financial Crisis

The Convergence Debate is Fundamentally Flawed

- The American Model is <u>not</u> static – it has not finished evolving
- Since the 1980s, American corporate governance has developed a number of "un-American" governance mechanisms
  - Bank monitoring
  - Concentrated shareholding
  - An ineffective hostile takeovers regime
- The irony
  - The American Model no longer exists in America (never mind in other countries)
- This turns the convergence debate 'on its head'

Banks Play No Role?

- The Assumption
  - Banks play no role in the American Model
  - Gilson 2001: "…a large number of comparatively small banks that for practical purposes play no role in corporate governance"
  - Lack of bank monitoring used to distinguish the American Model
  - There is a path dependence story to explain banks' non-existence
- The Evolution
  - Baird and Rasmussen (2006) conclude that banks have become
    - "the principal mechanism" for replacing ineffective management in underperforming firms
    - The most important mechanism for monitoring companies throughout their entire life (not just post-bankruptcy)
    - A significantly more important governance mechanism than hostile takeovers
- Bank Influence has increased over the last three decades because of
  - Legal reforms, corporate culture and economics

American shareholding is dispersed?

- The Assumption
  - Gilson 2006
    - The literature has viewed "U.S./U.K.-style widely held distribution of stock ownership and control as the end point of corporate governance development; progress consisted of accelerating what selection would make inevitable"
  - LLS&V, Coffee and Roe assume the optimality of dispersed shareholding in their arguments
- The Evolution
  - Movement away from dispersed shareholding
  - 1970s: 70% of American stocks held by Individuals; 1994 only 48%
  - From 1980 to 1996 large institutional investors increased their share of the market from 30% to more than 50%
  - 34% of the S&P 500 companies have founder family equity ownership with average holdings of 18%
  - In 1998, there were 255 publicly traded US companies with dual class stock
  - Some of America's most prominent firms (e.g. Google and DreamWorks) have recently went public with a controlling shareholder structure
  - Gilson (2006) provides empirical evidence demonstrating efficient controlling/concentrated shareholding

Hostile Takeovers Drive American Corporate Governance?

- The Assumption
  - Coates (1999)
    - The mechanism that transforms "the limited *de jure* shareholder voice into a powerful *de facto* form of shareholder control"
  - Coffee (2001)
    - The market for corporate control is "the ultimate disciplinary mechanism" and hostile takeovers "its final guillotine"
  - Gilson (2001)
    - The commonly held view of the American model is that it is "catalyzed by the mechanism of hostile takeovers"

- The Evolution
  - Bebchuk
    - The staggered board and poison pill defense significantly insulated management from the threat of hostile takeovers
  - There were 92 hostile bids from 1995-2000 compared to 1032 hostile bids from 1985 to 1990
  - Baird & Rassmusen
    - American, "board member(s) rarely [worry] about the distant threat of a hostile takeover, but pay() attention when the business's banks come calling"

Adaptation (not Stagnation) has been America's Success

- Only one of the three changes is enough to demonstrate significant evolution
- That all three have occurred makes the endpoint assumption appear ridiculous
- The 1980s was a period of dramatic economic restructuring driven by hostile takeovers – which vested ultimate control in shareholders
- The 1990s was a period of sustained growth in which companies built on their restructuring gains by allowing directors' discretion
- Throughout this entire period banks increased their role as monitors
- American corporate governance continually evolves and constantly readjusts the balance of power between shareholders, directors and banks
- The evidence suggests that the secret to America's success is the adaptability of its corporate governance, not its adherence to a particular model
- This conclusion is only bold in the context of the flawed convergence debate

The Japanization of American Corporate Governance?

- *Japanization* not Americanization
- The defining features of the Japanese main bank model are
  - bank monitoring
  - an ineffective hostile takeovers regime
  - concentrated shareholding
- These are the features that have developed in American corporate governance
  - Indeed some of the similarities are striking
- Is American corporate governance converging on the Japanese main bank model?
- The short answer is: No – because there is no lifetime employment
- More importantly, the Japanese main bank model has also evolved
  - After a decade of resistance, it has changed to respond to problems created by the burst of the bubble
  - The crucial change was eliminating the 'no fail' bank policy – *not* 'Americanization'
  - The convergence debate fails to recognize this important change

The Conclusion

- The debate is fundamentally flawed because it is based on a false assumption
  - If corporate governance does not evolve towards a fixed endpoint, whether two models appear closer tells us little
- This flaw has important practical consequences
  - It obscures other important developments
  - Exporting the American Model is of little use if it is constantly evolving
- The lessons learned
  - America's success has been its ability to *adapt* – not to rigidly adhere to a static model
  - Japan's failure during the lost decade was its <u>resistance to adapt</u> its model to a dramatically changed environment after the bubble burst – not that it selected 'the wrong model'
  - <u>There is no magic</u> in the American, Japanese or any other corporate governance model
- The suggestion for future research
  - Forget models and focus on adaptation
  - What allows corporate governance systems to efficiently adapt to their ever-changing environments?