ON INVESTMENT PERFORMANCE, VALUE CREATION, MANAGEMENT AND CORPORATE GOVERNANCE: THE FRENCH CASE

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Abstract

This paper studies corporate governance, investment, value creation and their effects on corporate performance in some European countries and in particular in France. It accounts for specific aspects of investment performance, governance, management and entrepreneurship. Corporate governance systems can be identified by the degree of ownership and control and the identity of controlling shareholders. In outsider systems characterized by wide dispersed ownership as in the U.S and UK, the main specificity is the conflict of interest between strong managers and widely-dispersed weak shareholders. In insider systems characterized by concentrated ownership or control as in Germany and Japan, the main specificity is the conflict of interest between controlling shareholders (or blockholders) and weak minority shareholders. There are several models of corporate governance since each country has developed a variety of mechanisms to overcome agency problems arising from the separation of ownership and control. Some results are reported using a data base conceived by IPAG students.

Keywords: corporate governance, investment, performance, management, legal view

Introduction

Governments recognize the complementarities between sound macro-economic policies and sound micro-economic foundations in the determination of growth.

In fact, corporate governance affects the developments of capital markets and acts on the resource allocation process. It affects the behavior and performance of firms, entrepreneurship and the innovative activity.

With the globalization, corporate governance can affect the industrial competitiveness of countries and better corporate governance should affect corporate performance and lead to higher economic growth.

Corporate governance systems vary from one country to another and can be identified by the degree of ownership and control and the identity of controlling shareholders. In outsider systems, characterized by wide dispersed ownership as in the U.S and UK, the main specificity is the conflict of interest between strong managers and widely-dispersed weak shareholders.

In insider systems characterized by concentrated ownership or control as in Continental Europe, Germany and Japan, the main specificity is the conflict of interest between controlling shareholders (or blockholders) and weak minority shareholders.

The differences between corporate governance systems can be explained by countries' legal and environments, historical and cultural factors.

Bellalah (2003, 2004) provides an economic rationale for the reasons explaining why corporate governance matters and investigates the relationship between corporate governance, corporate performance and economic growth.

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The study of the specificities of corporate governance systems allows the identification of the key factors that shape the effectiveness of different corporate governance mechanisms and the key policy adjustments that are needed.

The analysis in Bellalah (2003) builds on previous work done by the OECD (1998) on the shareholder and stakeholders models and provides an assessment of the strengths, weaknesses and economic implications of different systems of corporate governance.

The paper presents also a survey of some results on the relationship between corporate governance, management, firm performance, investment, etc.

Section 1 studies corporate governance, investment and firm creation and their effects on firm performance. It studies corporate performance and governance with respect to management and entrepreneurship in France.

Section 2 develops a comparative analysis of corporate Governance systems with respect to the French case. Comparisons are done with respect to other countries.

Section 3 presents a legal view of Corporate Governance Systems and shows the importance of legal aspects in the determination of investments and performance in France. We report the results of a study done by IPAG students in end 2003 and beginning the year 2004.

Investment, corporate performance and the effects on firm profitability

1. The models of governance, management and firm creation

Management and corporate governance have been often regarded in the context of the "principal-agent" relationship when the owner of the firm is not the person who manages or controls it. There is a separation between the financing and the management decision or a separation between ownership and control (Berle and Means (1932)).

The effects of management and corporate governance on the firm behavior and economic performance depend on the definition of purpose of the firm. In economic literature, there are mainly two models of the corporation: the shareholder model and the stakeholder model.

1.1. The foundations of the models of management, governance and entrepreneurship

The objective of the firm is to maximize profits. Performance is appreciated by the market value of the firm. Managers and directors must ensure that the firm is run in the interests of shareholders. The principal-agent relationship arising from the separation of ownership and decision-making causes the firm's behavior to diverge from the profit-maximizing ideal. Since managers are not the owners of the firm, they can have other objectives such as maximizing their salaries or an attachment to particular investment objectives rather than maximizing the shareholder wealth.

The "agency" problem appears also as an asymmetric information problem since managers are better informed regarding the firm's actual and future cash-flows. As a consequence, managers have substantial residual control rights and discretion in the process of allocation of resources. In this setting, corporate governance deals with the limits on managers' discretion and accountability.

The opportunistic behavior of managers can reduce the amount of resources that investors are willing to put up ex-ante to finance the firm. This represents the "hold-up" problem discussed in Grossman and Hart (1986) and Williamson (1975) among others.

In the shareholder model, an effective corporate governance framework must minimize the agency costs and hold-up problems. It is possible to align the interests and objectives of managers with those of shareholders by aligning directly managers interests with those of shareholders using executive compensation plans, stock options, direct monitoring by boards, etc (for more details about the countries that belong to each category and an exhaustive survey of the literature, the reader can refer to Bellalah (2004)). Another method consists in enhancing the rights of shareholders through legal protection and enforcement of shareholder rights and prohibitions against insider-dealing. A final method consists in using indirect means of corporate control like capital markets and markets for corporate control and managerial labor markets.

The dominant organizational form of the firm is one characterized by concentrated ownership because ownership concentration allows resolving the monitoring problem. Since the benefits from monitoring are shared with all stockholders, some of them have an incentive to "free ride" when the ownership is not concentrated.

Thereby, the main problem of corporate governance in this context is to develop reforms that retain the benefits of monitoring provided by concentrated ownership and encouraging at the same time the flow of external funds to corporations.

1.2. The foundations of the stakeholder model in management decisions

The stakeholder model considers a broader view of the firm by incorporating all the stakeholders such as employees, suppliers, customers, creditors and the society at large. In this context, corporations must fulfill wider objectives and have responsibilities to parties other than shareholders. In this context, the implications of corporate governance on economic performance must account for the incentives and disincentives faced by all stakeholders who contribute to firm performance. Blair (1995) defines stakeholders as actors who have contributed firm-specific assets.

In this context, corporate governance must look for the appropriate mechanisms that elicit firm specific investments on the part of different stakeholders and must develop active cooperation amongst stakeholders in creating wealth.

When an opportunistic behavior exists, the principal-agent problem can lead to under investment problems. For example, suppliers and distributors can under invest in firm specific investments such as distribution networks. In this context, corporate governance becomes a problem of searching for the appropriate mechanisms that reduce the scope of opportunism and expropriation and lead to efficient resource allocation. Blair (1995) views corporate governance as a set of institutional arrangements for governing the relationships among stakeholders that contribute firm specific assets. The stockholder model is criticized because managers can use "stakeholder" reasons to justify poor company performance.

2. A comparative analysis of management and governance models and their importance in explaining the performance of firms

2.1. Outsider management, governance systems and performance

'Outsider' systems as in the US and UK are characterized by widely dispersed share ownership and high turnover. These systems tend to place a stronger emphasis on the protection of minority investors. The absence of concentration ownership may discourage active corporate governance. Regulation in this system provides adequate shareholder protection and allows investors to assume the risk-reward tradeoff with an equal access to information. In theory, shareholders have the power to select members of the board and to vote upon key issues facing the company, but in practice this is limited by the fragmentation of ownership. The strong protection of minority shareholders and transparency characterize the outsider system. The board of directors plays a major role in the corporate governance framework. The board is responsible for monitoring managerial performance and preventing conflicts of interests. The board is also responsible for reviewing key executive and board remuneration. The board must have some degree of independence from management in outsider systems. However, this independence poses a problem in reality when the board can become entrenched.

Outsider corporate governance systems are also characterized as a market based system and a “disclosure-centered” system. The corporate governance framework in 'outsider' systems favors the use of public capital markets. Capital markets influence the behavior of key parties. Firstly, minority investors are afforded a high degree of protection in securities law. Secondly, the monitoring of management is based on the discipline of capital markets. This assumes liquid stock markets and an adequate disclosure of information. An effective corporate governance framework can limit the scope for managerial discretion. The market for corporate control can represent a more effective disciplinary device than either the board of directors or the monitoring by institutional investors.

2.2. Insider governance models

'Insider' systems are characterized by concentrated ownership or voting power and several inter-firm relationships and corporate holdings. Examples include Europe (except UK), Japan and Korea among others. These dominant features in the insider systems are banks, holding companies, and familial control. Insider systems reveal close relationships with banks, cross-shareholdings and pyramidal structures of corporate holdings. Shareholders can extend their control at relatively low cost by resorting to cross-holdings, pyramiding, proxy votes, dual-class shares, etc.

In insider systems, cash flow rights and control rights are aligned. This gives majority shareholders the incentive and the power to monitor management. When ownership is dispersed and voting power is concentrated, controlling blockholders have an incentive to engage in active monitoring. Shleifer and Vishny (1997) show that ownership concentration and voting power concentration can become detrimental because small investors can avoid holding shares and the flow of external capital to firms is impeded. The problem of rent extraction by controlling shareholders is that it raises the cost of capital since minority shareholders demand a premium on shares issued.

One of the consequences of rent extraction in insider systems is the lack of opportunities for risk diversification as a consequence of illiquid markets. Concentrated ownership can increase the incentives for monitoring and encourage more long-term relationships amongst stakeholders. Even if capital markets are less developed in insider systems, the long-term nature of relationships can encourage a greater investment in firm-specific assets.

Long-term relations with banks and financial institutions, which can affect the performance of the corporate sector because the available financing to firms affects the cost of capital, can also characterize insider corporate governance systems. In insider systems, debt/equity ratios are typically higher. Thadden (1995) shows that the long-term relationships with banks can also reduce biases that might favor investments that generate improvements in performance.

The role of financial institutions in financing failing companies makes a distinction between different corporate governance systems. Asymmetric information problems are important in the refinancing of failing firms. Mayers (1996) shows that restructuring of poorly performing firms is an important feature of the Japanese financial system. He states that UK (and US) financial institutions intervene too late in corporate restructuring.

In addition, insider systems are characterized by long-term relationships between the contractual partners of the firm. These long-term relations are important in high technology industries or activities with high asset specificity. Ownership by one corporation in another reduces transaction costs and 'hold-up' problems related to opportunistic behavior. Complex patterns of ownership and cross-shareholdings allow insiders to exercise control over a group with a small share of the total outstanding equity of the firm.

2.3. Relative performances of bank-based and market-based governance models

Corporate finance and governance systems can be defined by the degree to which securities markets compete with intermediaries (typically banks) to provide external finance to firms. In addition, the nature of the ties between financiers and firms, and the degree of influence and monitoring on a firm's decisions of financiers are important characteristics of corporate governance systems. For example, securities markets in the United States and the United Kingdom have been much more important in funds' provisions to firms than in Germany and Japan. In this respect, the debate has mainly focused on the way to provide external finance and the respective advantages of each system. In theory, a large amount of literature has compared debt contract versus equity contract for solving agency problems (Shleifer and Vishny, 1997).

Thereby, policy makers and economists have generally compared the relative merits of bank-based and market-based systems. On one hand, the "bankers" generally argued that securities markets are an ineffective device for exerting corporate control. Second, liquid equity markets may facilitate takeovers, which may be socially inefficient (Schleifer and Summers, 1988). Third, more liquidity may reduce incentives to undertake careful corporate governance. Fourth, markets will typically induce "free-rider" problems where an outsider expends lots of resources to get information while others have an incentive to wait for results. Opinions differ, however, on the importance of stock markets in stimulating the acquisition of information. In effect, well functioning stock markets can reveal very quickly information through price changes (Stiglitz, 1985, 1994). Finally, corporate control can be influenced by stock market development. Among others, Diamond and Verrechia (1982) and Jensen and Murphy (1990) have shown that stock market development may reduce the principal-agent problem. Moreover, Laffont and Tirole (1987) and Scharfstein (19880 argue that take-over threats induce managers to maximize the value of the firm or a firm's equity price. Thus, well-functioning stock markets that ease corporate take-overs can mitigate the principal-agent problem. Stiglitz, however, claims that outsiders will be reluctant to take over firms because they have worse information about firms than owners. Then, the corporate control of market is only efficient under specific conditions.

On the other hand, "marketers" have mainly centered their criticisms on the problems created by power banks. First, banks as debt issuers have an inherent bias toward prudence (Allen and Gale, 1999), so that bank can significantly reduce corporate innovation (especially in case of high technologies). In particular, Sahman (1990), Porter (1992) claim that the US system appears to be better at funding emerging companies and new (often high technology) business activities than German and Japanese systems. Franck and Mayer (1992) outline that such a comparative may explain the predominance of high technology firms in internet and communication technologies, and biotechnology. As pointed out by Porter (1992), liquidity of US capital markets allows better reallocation of capital from low to high growth sectors. Wurgler (1999) shows that countries with stock markets that impound more firm-specific information into individual stock price do have a better allocation of resources. In addition, state ownership companies have a poor allocation of capital. The literature also suggests some other link between institutional structures and corporate governance. On one hand, the literature suggests a relation between the institutional structures of countries and the type of activities that are undertaken in these countries. The first strand is based on information theories (see Allen and Gale, 1993, 1999). The second strand focuses on commitment theories: concentrated ownership is associated with activities that involve investments by other stakeholders and dispersed ownership with the adoption of new technologies that could be resisted by other stakeholders. The third strand relies on control theories.

Second, banks have a powerful position as active monitors (for example in Germany and Japan). They may therefore exercise influence through their control of the firm's access to external funds. Their large shareholder status insures that they have both the incentive and the ability to directly monitor management through their presence on the board and the vote they can exercise at the general meeting. In this case, the major problem is "who monitors the monitors?". Therefore, bankers can act in their own interests. In effect, bankers may become captured by firms or collude with firms against other creditors (Black and Moersch, 1999; Wenger and Kaserer, 1998). However, bank-based systems may partly overcome these issues. For example, according to Aoki (1996), the main bank in Japan may administer three types of monitoring: ex-ante, interim and ex-post. On one hand, banks can monitor ex-ante investment decisions by examining loan applications.

On the other hand, interim monitoring concerns performance of the on-going business and projects carried out by company. Finally, ex-post monitoring involves evaluating the financial performance of the company and intervening in the management of the firm when the firm is in distress.

3. On investment, performance and the legal view of governance

The legal approach of corporate governance is a natural extension of the work of Jensen and Meckling (1976). Jensen and Meckling consider financial claims as contracts between investors and firms. These contracts give shareholders and creditors claims to the cash-flows of firms. Research by Grossman, Hart and Moore (Hart, 1995) extends previous work and distinguish between the contractual and residual control rights of investors. In this respect, financial instruments are not defined in terms of cash-flows but rather in terms of rights they provide to their holders. Both approaches outline the importance of investor's rights and their protection. In addition, as noted by Levine (1998), the "legal-based view" as opposed to the "economics and law" tradition, builds on this financial services view. La Porta, Lopez-de-Silanes, Schleifer and Vishny (hereafter, LLSV, 1999) argue that, "in the end, the rights create finance". The legal view is based on the incentives for investors to give their money to managers when both the theory and the evidence suggest that managers have strong incentives to deviate for the optimal profit-maximizing behavior and may expropriate much of the rent. Two sets of explanations have traditionally competed in the literature. The first set merely relies on firms' and managers' reputation. Investors are gullible and get taken this reputation. The second set explains that investors provide external financing to firms because they receive control rights in exchange. In particular, the legal protection of shareholders becomes the key factor. As pointed out by Hart (1995), external financing is a contract between the firm (or the legal entity) and the investors or financiers. In this respect, Schleifer and Vishny (1997) argue that what explains (much of) differences in corporate governance systems stems from varying legal environments (shareholders rights, creditor rights, legal enforcement) and ownership concentration. Their works starts from legal families and the difference between Common Law versus Civil Law. But "what is special about legal families?"

The literature is based upon two explanations: the judicial explanation (Coffee, 2000; Johnson et al., 2000) which underlines the difference in the legal philosophies using the organization of the legal system and, the political explanation which is based on the differences in political history (Rajan and Zingales, 1999; see further). Contrary to the "Economics and Law" tradition which is based on the theory on financial contracting, (financial contracts take place between sophisticated issuers and sophisticated investors) most regulations of financial markets are necessary. LLSV (1998) discuss a set of key legal rules protecting shareholders and creditors as well as legal enforcement efficiency and accounting standards. Classifying countries by legal origin, they document the prevalence of these rules in 49 countries around the world and find evidence of significant legal framework. In particular, they show that Common Law countries have the strongest protection of outside investors – both shareholders and creditors – whereas the Civil French law has the weakest protection. German Civil law and Scandinavian Civil law fall in between. LLSV (2000) argue that the legal approach is more appealing to understand corporate governance than the usual distinction between bank-centered and market-centered financial systems. In particular, LLSV (2000) show that large differences among countries in ownership concentration in publicly traded firms, breadth and depth of financial capital markets, dividend policies and access of firms to external finance, are explained by how well investors (shareholders and creditors) are protected by law from expropriation by the managers and controlling shareholder firms. In addition, civil law countries are more interventionist than Common Law countries. LLSV (1997) also found evidence of higher valuation of firms in countries with better protection of minority shareholders, and weaker evidence of the benefits of higher cash flow ownership by controlling shareholders for corporate valuation. LLSV (1999) examine patterns of control in the largest firms from each of 27 wealthy economies. The data show that countries with poor investor protection typically exhibit more concentrated control of firms than do countries with good investor protection.

Comparing the growth performances of a sample of industrialized and developed countries, Levine (1998) has shown that the legal view is much more appropriate than the dichotomy of bank-based and market-based. Kugler (1999) argues that good shareholder protection is one determinant of liquid securities' markets. Therefore, when expropriation of minority shareholders is constrained by laws, investors anticipate high returns and are ready to pay more for shares, which in turn induces controlling shareholders to reduce their stakes and / or give and up control.

Demirguç-Kunt and Maksimovic (1998) examine whether the underdevelopment of legal and financial systems does prevent firms in some countries from investing in growth opportunities that may be profitable. Thus, they show the link between financial markets and institutions and a firm's ability to obtain debt and equity financing. Data show evidence that an active stock market and a well-developed legal system are important in facilitating a firms' growth. Second, there is no evidence that firms use external financing differently if they are in countries classified as bank-based or market-based (using the development of their banking sector relative to their securities markets). Beck, Levine and Loayza (1997) show that the legal origin variables help explain cross-country differences in creditor rights, enforcement quality and accounting standards. In addition, the component of financial development defined by general characteristics of the legal and accounting framework is positively associated with growth. Rajan and Zingales (1997) examine the mechanisms through which financial development affects economic growth. In particular, they study whether industries that are more dependent on external grow relatively faster in countries that essentially have developed financial market and institutions. Data support evidence that industries depending more on external finance grow relatively faster in economies with a higher level of financial development. Second, industries that generate cash flow from operations grow relatively faster in economies with underdeveloped financial systems. Beck and Levine (2000) show that there is evidence neither for the bank-based nor the market-based hypothesis. Second, empirical evidence shows that countries that are heavily dependent on external finance grow faster in economies with a higher level of overall financial development and with better protection of outside investors. Levine (1998) shows that the legal rights of creditors and the ability to enforce those rights are strongly tied to the ratio of bank credit to the private sector. The legal origin has a profound impact on bank development. Empirical evidence also suggests that the components of banking development, defined by legal environment or creditors rights and the efficiency of contract enforcement is positively and robustly correlated with long-run rates of economic development.

However, legal differences may not explain all existing corporate governance schemes or the predominance of a type of financial system. In this respect, Rajan and Zingales (2001) develop a theory based on the politics of financial development. They claim that a Common Law system allows for more contractual and legal innovation. Hence, it is more conducive to financial development. But they argue that the greater financial development in Common Law countries is not because laws are better in those countries. Because of the decentralization that accompanies Common Law, it makes it easier for financial markets to develop in spite of political opposition and makes it difficult to reverse this development when political changes occur.

4. Investment, performance and the importance of the legal view of governance

4.1. Investment and shareholders' and creditors' rights and legal enforcement

We focus on shareholders rights, creditor rights and legal enforcement. We also include ownership concentration.

Shareholders rights are one of the distinct elements between insiders and outsiders systems. We study seven measures of shareholders protection and an aggregate measure (anti director rights). The first –one share / one vote – provides the basis for an alignment of management incentives with the interests of shareholders. Only Greece and Japan require that ordinary shares offer the equivalent of one vote per share.

Some voting provisions can result in a distortion of the voting mechanism in favor of managers or of dominant shareholders at the expense of minority shareholders. Two measures capture these effects. One is the prohibition of voting by proxy through the mail. Although many of the English Common Law countries, as well as France and Norway, allow proxy voting, most Civil Law countries prohibit it. The second is a requirement that shareholders intending to vote in a shareholder meeting deposit their shares with the company or with a designated financial intermediary several days prior to the meeting. All the English Common Law and Scandinavian Civil Law countries carry the requirement that shares be blocked prior to the general meeting.

Features supportive of minority shareholder representation include the possibility of cumulative voting, in which shareholders are permitted to cast all their votes for one candidate, or for a proportional representation on the board. Except for the United States, Canada, Spain and Japan, such protections are not common in the OECD countries. In addition, some countries give minority shareholders (defined as shareholders who own less than 10 per cent of capital) additional legal rights, such as the right to challenge managers' decisions in court. Only English Common-law countries and Japan give such rights.

The sixth measure – preemptive rights to new issues – is a standing provision giving existing shareholders the option to be first in line to purchase new issues of stocks. It can be seen as a preemptive measure that prevents the dilution of the voting power of existing shareholders, which might come about by measure that prevents dilution of the voting power of existing shareholders. About half of the listed OECD countries offer this right, with the European countries more heavily represented here.

The seventh measure – percentage of share capital for an extraordinary meeting - captures the idea that minority rights are more fully represented when it is possible to call a shareholder meeting at the request of shareholders controlling only a minority percentage of capital. This percentage varies considerably among OECD countries and legal origin. In particular, German Civil Law requires less percentage of share capital than other countries.

Finally, a summary index – anti director rights - is given by counting the number of times these indicators support minority shareholders rights with the index receiving an additional point if the percentage of share capital to call an extraordinary meeting lies at or below the median of ten percent. Common Law countries have the best protection of shareholders whereas French Civil Law has the weakest protection. German Civil Law and Scandinavian countries fall in between.

Creditors rights are often more effective than shareholders rights "since default is reasonably straightforward violation of a debt contract that a court can verify" (Schleifer and Vishny, 1997). However, bankruptcy provisions and creditor rights can influence the efficiency with which managers use the resources at their disposal. Thereby a strong bankruptcy policy may elicit more efficient decision-making. When firms experience financial distress and fail to make promised payments to creditor, two possibilities are generally available for creditors: liquidation and reorganization. Creditors' rights may depend on their seniority. This may help them to repossess collateral. Aside from affecting the efficiency of the firm through the effect on managers' willingness to maximize firm value, bankruptcy may also affect the willingness of managers to undertake high potential and high return projects. In addition, once a firm has entered into a situation of financial distress, liquidation errors become a key criterion for judging the efficiency of bankruptcy code (Franks and Torous, 1996). To the extent that a bankruptcy code provides greater protection to the firm, the risk of deferred liquidation rises but the risk of premature liquidation falls. Finally, the bankruptcy code may also be judged on the extent to which it minimizes other costs: the explicit costs of legal and accounting fees, the cost to stakeholders such as employees, suppliers, customers and the state, and the cost of re-negotiation.

Data, however, do not capture all these effects. We use four measures of creditors' rights (La Porta et al., 1998) and an aggregate one (Creditor Right). The first, "No automatic stay on assets" equals one if an automatic stay on the assets of the firm is not required during the reorganization procedure. The second, "Secured creditors first paid" referred to the seniority' right (see below) and equals one when secured creditors are ranked first from the disposition of the assets of a bankrupt firm. The third, "Restrictions for going into reorganization", equals one when restrictions (creditors consent) are imposed in the reorganization process. The fourth, "management does not stay during reorganization" equals one when a civil person or the creditors do the operation of the business during reorganization.

Data on creditor rights show different patterns across OECD countries. In two-thirds of the listed OECD countries, an automatic stay on assets is required in the reorganization procedures, preventing secured creditors from repossessing their collateral. These provisions protect the interests of managers and other creditors at the expense of secured creditors. Only the United Kingdom, New Zealand, Belgium, Spain, Austria, Germany and Denmark do not impose such a requirement.

Debtor, creditor and investor rights are of little consequence without enforcement. In most countries, market regulators enforce laws and regulations, in part by courts and in part by market participants themselves. In this respect, we use five measures of legal enforcement. We do not take into consideration accounting standards (see La Porta et al., 1998). In effect, this measure is based on annual reports from 1990 and does not include the harmonization procedure in the European Union and in the International Accounting standards or US GAAP (Germany, 1998).

The first measure - the efficiency of the judicial system[1] – provides an assessment of the "efficiency and integrity of the legal environment as it affects business, particularly foreign firms. Except for Greece, Italy, Portugal and Spain, OECD countries score high for these variables.

4.2. Investment, ownership concentration and performance

General assessment on ownership concentration

Some corporate governance systems reveal a widely dispersed ownership (outsider systems) and others show a concentrated ownership (insider systems). The controlling shareholder may be an individual, family holding, bloc alliance or financial institution and or corporations acting through holding companies or via cross shareholdings. As it appears in most papers on corporate governance, two basic conflicts concern the controlling manager and 'outside" widely dispersed shareholders and the conflict between 'inside' controlling shareholders and outside minority shareholders. This latter relationship is found in OECD and non-OECD countries.

Structure of corporate ownership

The ownership structure also differs when comparing the importance of banks as shareholders of firms and the nature of the firms. On one hand, Prowse (1997) claims that the aggregate shareholding pattern does not seem to bear out the traditional distinction between a market-centered system and a bank-centered system. Thereby, in terms of the weight of the financial sector in aggregate holdings, the United Kingdom (respectively the United States) is closer to Japan (respectively Germany). On the whole, the role of banks, as direct owners, differs substantially across countries in the OECD area. In Germany, proxy voting, pyramiding voting pacts and other devices confers an advantageous position of banks. But Edwards and Mibler (2000) show that the German corporate governance system is based on high ownership concentration rather than a special role of banks.

[1] This measure must be interpreted with caution as it represents an average of scores for the period 1980 to 1983.

Firm performance and ownership concentration

One of the main issues to the debate surrounding corporate governance practices is whether or not owner-controlled firms are more profitable than manager-controlled firms. Several empirical studies reveal the beneficial effects of enhanced monitoring as a result of higher ownership concentration. Gugler (1999) provides a comprehensive survey of empirical studies of the effects of ownership concentration on corporate performance. The majority of studies from the US and UK show that "owner-controlled" firms significantly outperform "manager-controlled" firms. The proxies used for performance of the firm are the net income/net worth, rate of return on equity or Tobin's Q, or the riskiness of returns. Shleifer and Vishny (1998) among others find that at low levels of concentration, performance increases as concentration increases, but then decreases as concentration levels keep increasing. Nevertheless, the result of the comparisons between the performance of owner-controlled firms and manager-controlled firms may depend on several factors such as the initial levels of ownership concentration, the life-cycle model of the firm, the effects of product market competition on managerial behavior, etc.

The board structure, management and performance

The board of directors plays a major role in the corporate governance framework, the determination of investment and performance. The board is responsible for monitoring managerial performance and preventing conflicts of interests. The board is also responsible for reviewing key executive and board remuneration. The board of management must have some degree of independence for management in outsider systems. However, this independence poses a problem in reality when the board can become entrenched. This is typically the case when board members are compensated for their activities and are at the same time responsible for overseeing executive board and remuneration. In theory, the board should represent the interests of shareholders, but in practice, they become part of the management. Therefore, the board is often regarded as a relatively weak monitoring device.

The results of the study done by IPAG students and research center

For French firms, performance is determined mainly by the specific features of governance, the skills of managers and the amount of investments. The study which covers more than 60 firms shows that value creation in small business firms is explained by the same factors as for well known firms. The amount of investment seems to be related to the firm performance. We plan to extend the empirical study to other countries in comparisons to the French case.

Conclusion

The degree of business autonomy and the company's cost of capital may be substantially influenced by the capital structure of the company law. In particular, rapidly developing financial instruments are offering a wide range of flexibility in this respect, which has to be weighted against the proper protection and fair treatment of all different categories of claimants.

An efficient allocation of capital may require a free transferability of shares. In this case, present and potential investors have an incentive to insure that the ownership and control structures of the company are transparent. Less transparency may increase the costs of buying and selling the company's share.

Most of OECD countries do not impose restrictions on how much an individual owner can hold in a publicly listed company or the amounts held by different categories of owner. But the "regulatory framework" imposes restrictions on cross-shareholdings in most French and German Civil Law countries.

Investment, performance and governance seem to be related for small firms and in particular in France. In fact, the empirical study done at IPAG, shows that good management and skills explain higher investment amounts, better performance and value creation.

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