LACK OF PROPORTIONALITY BETWEEN OWNERSHIP AND CONTROL: OVERVIEW AND ISSUES FOR DISCUSSION

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At its meeting on 14 November 2007 the Steering Group on Corporate Governance agreed on a common position based on the OECD Principles of Corporate Governance about the issue of whether there should be proportionality between ownership and control (also known as one-share-one-vote) in listed companies.

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Proportionality between corporate ownership and control implies that any shareholder owns the same fraction of cash flow rights and voting rights. Securities-voting structures that depart from the principle of proportionality have sometimes caused concern: first, discrepancies between ownership and control can exacerbate the misalignment of the incentives of controlling and non-controlling shareholders; and, second, a separation of voting and cashflow rights may compromise the efficiency of markets for corporate ownership and control. The question facing authorities is whether these potential drawbacks actually manifest themselves and, if so, whether their economic costs are sufficiently large to justify regulation.

The debate about proportionality resurfaced recently when the European Commission commissioned a study examining the use of Proportionality-Limiting Measures (PLMs) in a number of EU and selected other countries with the purpose of establishing if a case can be made for harmonising regulation of such mechanisms. However, based on the study the European Commissioner for the Internal Market and Services, Charlie McCreevy, concluded there is no need for action at EU level on this issue.

The OECD Principles of Corporate Governance do not take positions on proportionality. They do, however, recommend against voting right discriminations within each class of shares and in favour of transparency and disclosure of disproportionate arrangements. Moreover, the Principles' recommendations on equitable treatment of shareholders militate against the abuse of non-controlling shareholders in consequence of disproportionality. The Principles' focus on overall economic outcomes could serve as an argument for regulating proportionality if non-trivial negative economic consequences were demonstrated.

A large number of mechanisms for separating voting rights from cash flow rights in listed companies are legally available in most OECD countries. Among the many options for leveraging voting rights, most jurisdictions and market places allow multiple share classes and virtually all accept the reliance on pyramidal or cascading shareholdings. Mechanisms for locking in control in most jurisdictions include voting right ceilings. In addition, a number of instruments that do not in themselves depart from proportionality can be used to bolster the effect of PLMs, including in most jurisdictions cross-shareholdings and shareholder agreements. In other words, proportionality cannot be addressed simply in terms of voting right differentiations of companies' common stock.

Empirical studies demonstrate that whereas PLMs are widely available in most countries the number of companies that actually avail themselves of such mechanisms is more limited. This is attributed to a number of factors including tax rules (e.g. the absence of pyramids in the United States), market pressures (e.g. the low incidence of voting right differentiation in the United Kingdom) and the varying scope for extracting private benefits across jurisdictions. Moreover, the mechanisms are to some extent substitutes and hence normally not applied conjointly.

There is neither a clear trend in the availability nor in the implementation of PLMs. Some transition economies have taken steps to suppress voting right differentiations in recent years as part of national reform efforts to improve corporate governance. Other OECD members (e.g. Finland and Italy) on the other hand have liberalised rules bearing on PLMs. Regarding the actual implementation of PLMs the clearest trend detected by cross-country studies is that dual-class capitalisation has become rarer over the last decade.

Studies of share prices indicate that non-controlling investors extract a discount, and hence obtain higher returns, in compensation for the presence of PLMs. These discounts appear vary according to the quality of legal and regulatory frameworks, reflecting the perceived risk of expropriation by the controlling shareholders.

Institutional investors and investor associations have been active participants in the recent debates over proportionality. They largely support unified voting structures in companies' common stock ("one-share-one-vote") and other measures to avoid disproportionate control, and several of their representative bodies have issued recommendations to this effect. However, these investors do nevertheless invest in companies featuring PLMs if offered sufficient value discounts. Their position seems based partly on a perception of missed opportunities relative to a situation without PLMs, partly on fears of falling victims to an excessive extraction of private benefits. Institutional investors' position on high-voting shares in some recent takeover bids could moreover indicate that they themselves have come to place an increasing value on influence.

Conclusions

- *There is nothing a priori onerous about separating ownership and control.* On the contrary, given the differences in expertise and resources of different economic agents doing so is often efficiency enhancing. However, those benefiting from a disproportionate degree of control may have incentives to seek private benefits at the cost of non-controlling shareholders. The latter can obtain full compensation through a value discount on the shares they purchase, but from a societal perspective this may represent market failure and a source of economic inefficiencies.

- *The cost of regulating proportionality would be considerable.* Simply ruling out voting right differentiation on companies' shares would neither be effective nor efficient. The number of alternative PLMs that can be used to a similar effect is such that incumbent owners could simply seek other routes to the same result. To effectively achieve proportionality a broad-based regulation targeting multiple elements of the corporate governance landscape, plus most likely also tax codes and new financial instruments, would be needed. The direct cost of such sweeping measures would include the deterrence of companies controlled by owner-entrepreneurs from seeking stock market listing. Indirect costs include the effects of the multi-faceted regulation on economic activities not related to PLMs. The cost of softer regulation such as comply-or-explain, while lower, could also be excessive.

- *Strengthening corporate governance frameworks is a better alternative.* If the source of inefficiencies is the spectre of excessive private benefits then the first-best solution is to discourage the extraction of such benefits. This point is illustrated by the fact that PLMs apparently make less of a difference to investors in countries with strong legal and regulatory frameworks, including in terms of disclosure and enforceable rights of non-controlling shareholders. Measures to regulate related party transactions and to encourage minority shareholder participation in shareholder meetings could be considered in this context. The OECD

Principles of Corporate Governance recommends corporate governance frameworks and practices that, if fully implemented, go a long way toward achieving this goal.

- *Specific problems can be dealt with through carefully targeted regulation*. Countries with weak corporate governance frameworks may be unable to discourage some forms of abuse and hence need to regulate certain forms of proportionality. Such regulation needs to be based on recognised principles of regulatory impact assessment, including cost-benefit analysis and a careful assessment of all available courses of regulatory action.

LACK OF PROPORTIONALITY BETWEEN OWNERSHIP AND CONTROL: OVERVIEW AND ISSUES FOR DISCUSSION

The purpose of the present document is to support a discussion of issues related to proportionality between voting and cashflow rights, taking as a starting point the consensus reflected in the OECD Principles of Corporate Governance (“the Principles”). This is in response to the decision of the Steering Group at its November 2006 meeting that following the conclusion of the EU fact finding study, a policy debate at the OECD would be appropriate. The exercise takes place in the context of the PWB 2007-2008 thematic studies of which two were foreseen.

The document takes six main directions: following a brief introduction it summarises the discussion about the pros and cons of proportionality that has taken place in some OECD countries; it identifies key parts of the Principles relevant to the proportionality discussion; it presents evidence of the availability and actual use of proportionality-limiting mechanisms (PLMs) in individual countries; it reviews empirical studies of the costs and impacts of departure from proportionality; it presents the position of institutional investors, who particularly in Europe have been active in the discussion; and, it ends with a discussion of the likely costs and benefits of moving toward proportionality.

1. Introduction

The so-called proportionality principle implies that any shareholder should own the same fraction of cash flow rights and voting rights – which is also commonly referred to as proportionality between ownership and control. Proportionality is perceived by many as being “logical” in the double sense that, first, shareholders as the residual claimants have the strongest interest in maximising firm value; and, second, voting power should match economic incentives. In addition, recent public debates about proportionality have also assumed an emotional dimension: the idea that each share entitles the owners to equal influence has intuitive appeal. It has lead to catchphrases such as “shareholder democracy” (somewhat imprecisely, as modern democracy would imply proportionality between influence and the number, rather than investments, of shareholders) based on assumed parallels between societal and corporate governance.

However, the starting point for any analysis of proportionality is necessarily that there is nothing *a priori* odious about the separation of the cashflow and ownership rights, or the private contractual processes that accompany them. The theories of finance and corporate governance are conditioned on the premise that assets and the ability to manage them efficiently are often not in the hands of the same people, in which case a degree of separation becomes optimal. The separation of ownership and managerial control, however, leads to a classic corporate governance issue: in consequence of the delegated authority managers may choose action that increases their private benefits at the expense of shareholder value (the "agency problem"). Shareholders can limit divergences from their interest by providing appropriate incentives or by monitoring the managers' actions, but they tend to refrain from doing so unless they possess the relevant information. In particular, small shareholders lack the incentive to oversee management since they themselves would carry the entire cost but would be entitled to a miniscule share of the benefits (the "incentive problem").

Corporate governance literature consequently posits that a certain degree of concentrated ownership (and in some cases control) is efficiency enhancing because it helps overcome the agency and incentive problems, as well as prevent the entrenchment of incumbent management. However, the concentration of ownership and control also enhances the scope for self-dealing and effective expropriation of the minority shareholders. This problem is compounded when the concentration of control is conditioned upon large discrepancies between voting and cashflow rights, because this exacerbates the misalignment of the incentives of controlling and non-controlling shareholders. This is one of the two main theoretical arguments against departing – or at least departing too much – from the proportionality principle.

The second main argument is that a separation of voting and cashflow rights may compromise the efficiency of markets for corporate ownership and control. Efficiency implies that these markets allocate corporate assets to those who are able to maximise their economic returns. However, if voting and cashflow rights are separate then the highest bid for the controlling shares may come from investors who expect to derive the greatest private benefits rather than maximise shareholder value. This aspect, however, falls outside the scope of the present paper which focuses on the direct link between proportionality and corporate governance.

In sum therefore, proportionality as an economic welfare enhancing proposition is not self evident. This is reflected in a large body of recent academic literature and indeed confirmed by the fact that many shareholders do not seem to require proportionality. Freedom of contract is at the heart of market-based systems and the burden of proof needs to be place on those who claim that it is not in the public interest.

2. The one-share-one-vote debate

In the United States the one-share-one-vote controversy started as early as 1925, when the issuance of non-voting common stock by some leading corporations led to widespread protests. The following year, New York Stock Exchange issued a position against departures from one-share-one-vote, citing the NYSE Listed Company Manual's reference to a "long-standing commitment to encourage high standards of corporate democracy"[1]. However, NASDAQ and AMEX chose not to follow a similar policy and in consequence effectively competed with NYSE by attracting companies with dual class shares. In the 1980s when a wave of corporate takeovers made a growing number of US companies review their control structures, in addition to defensive possibilities, the issue came back to the forefront, and NYSE eventually adopted a proposal permitting dual class structures for its listed companies.

[1] Loss, L. and J. Seligman (2003), *Securities Regulation*, 3rd edition, New York.

As an outcome the SEC proposed a rule prohibiting the listing on an exchange or the inclusion in NASDAQ of the equity securities of an issuer that "would have the effect of nullifying, restricting or disparately reducing the per share voting rights" of one or more classes of common stock of the issuer. The rule permitted IPOs of stock with disparate voting rights and the subsequent public offerings of lesser voting stock, as well as the issuance of stock with lesser voting rights in an acquisition. However, reducing the voting rights of already listed stocks was prohibited, as were voting right restrictions based on the length of time a shareholder had held stock and vote ceilings.[2] The US stock exchanges and NASDAQ in 1994 voluntarily adopted equivalent provisions as part of their own listing rules.

The European Commission – including in the context of the Financial Services Action Plan – has been asking itself how to achieve a more efficient, unified capital market and especially through developing a market for corporate control. Thus, the 2003 EU Takeover Directive attempted to outlaw corporate defences without prior shareholder approval and establish a breakthrough rule curbing the use of high-voting shares in foiling takeovers. However, most member countries have opted out of these provisions.

During the early discussions a proposal aimed among other things at imposing a board neutrality principle was rejected by the EU Parliament. The main reason for this was representatives of countries with mandatory "one share one vote" absence of voting right differentiations (plus, in some cases, the non-availability of "poison pills") feared that their national companies would be vulnerable to takeover bids with no means of defending themselves. Thus arose the demand for a levelling of the playing field in the EU capital markets by the removal of discrepancies in member state laws on specific control mechanisms (Rickford, 2006). The High Level Group of Company Law Experts ("Winter Group") was appointed to recommend a way to resolve the impasse. However, the ultimate Directive fell short of the Group's ambitions amid widespread protestations from businesses and national interest groups that "one size doesn't fit all" because of the use of alternative PLMs as well as large differences in ownership structures and concentration across Europe.

The latest major contribution to the debate was a study commissioned by the European Commission in 2007. This study avoided the takeover issue and instead examines the use of PLMs in a number of EU and selected other countries with the purpose of establishing if a case can be made, or not be made, for harmonising regulation of control-enhancing mechanisms.[3] However, in a subsequent development the European Commissioner for the Internal Market and Services, Charlie McCreevy, on 3 October 2007 made a public announcement that in his view "there is no need for action at EU level on this issue"[4]. This appears to have put the issue to rest, at least for now, within the EU.

3. Proportionality and the OECD Principles of Corporate Governance

The Principles of Corporate Governance provide a benchmark for assessing the relevance of the proportionality principle in the OECD area. On the one hand, the Principles are an aspirational document

[2] Ferrarini (2006).

[3] European Commission (2007), Report on the Proportionality Principle in the European Union, 18 May 2007, produced jointly with International Shareholder Services, Shearman and Sterling LLP and the European Corporate Governance Institute.

[4] The text of Commissioner McCreevy's speech is available on the Commission's website: http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/592&format=PDF&aged=0&language=EN&guiLanguage=en.

based on consensus across a number of diverse jurisdictions and hence limited in terms of recommendations on the pros and cons of specific regulatory choices. On the other hand, variations in proportionality give rise to a number of interlocking issues and judgements that ultimately affect the coherence of the entire system of corporate governance.

This section focuses on three aspects of proportionality and the guidance that can be derived from the Principles on each of them: (1) Are departures from proportionality, on any particular kinds of PLMs, directly in conflict with (parts of) the Principles? (2) What other values espoused by the Principles, e.g. regarding key ownership functions and equitable treatment of shareholders, are likely to be affected by departures from proportionality? (3) To what extend do the Principles concern wider economic benefits that could be enhanced, or endangered, by proportionality?

3.1 Recommendations covering proportionality

The Principles in the main do not pronounce themselves on regulating voting rights. The annotations to Chapter III (The Equitable Treatment of Shareholders) make a general statement to the effect that *"[t]he Principles do not take a position on the concept of 'one share one vote'".* This part of the annotation further states that *"[t]he optimal capital structure of the firm is best decided by the management and the board, subject to the approval of the shareholders"* – which is essentially a position in favour of the freedom of contract.

The Principles deal with different classes of shares: "*Within any series of a class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected*". (Principle III.A.1) The first sentence recognises the division of shares into classes with different rights. This could arguably have ramifications for the use of some of the PLMs surveyed in the previous section, including double-voting shares whose voting rights depend on the holding period, but the Steering Group's 2007 "Methodology" recommends that to assess whether the Principles are fully implemented one needs to assess not only practices themselves but also the degree to which they are "*transparent, non-discriminatory, included in company charters and/or approved by shareholders*".[5]

The last sentence in principle III.A.1 bears, among other things, on the introduction or unification of dual-class shares. The Annotations further state that *"[p]roposals to change the voting rights of different series and classes of shares should be submitted for approval at general shareholders meetings by a specified majority of voting shares in the affected categories".* This provision, which is reflected in many countries' company laws, suggests a measure of minority protection by demanding the consent of not only the majority of the voting capital but equally of each category of shareholder directly affected. Equally, holders of any special class of shares would also need to consent to any reduction of their rights.

Of some further relevance is principle II.A.4, according to which basic shareholder rights should include the right to *"participate and vote in general shareholder meetings"*. Interpreted strictly this could be read as a recommendation against non-voting shares. However, the Methodology take the position that *"the existence of such classes of shares* [without voting rights] *does not imply that the principle is not implemented since the Principles do foresee different classes of shares and is not prescriptive about the*

[5] *OECD Methodology for Assessing the Implementation of the OECD Principles of Corporate Governance* (2007), pp. 62-63.

respective rights". The Methodology does, nevertheless, go on to opine that *"where such share classes are widespread and classes with voting rights very restricted… the structure could contribute to the underdevelopment of corporate governance standards and might be closely associated with the non-implementation of other principles".*

The previous point about transparency and disclosure is further compounded by no less than two additional stipulations of the Principles. Chapter V (Disclosure and Transparency), principleV.A.3 states *"[d]isclosure should include, but not be limited to, material information on: … Major share ownership and voting rights".* This provision extends beyond voting right-differentiation to include any form of PLMs, including pyramidal structures and cross-ownership. The Annotations to Chapter V posit that *"[t]he right to such information should also extend to information about the structure of a group of companies and intra-group relations. Such disclosures should make transparent the objectives, nature and structure of the group… Such disclosure might include data on major shareholders and others that, directly or indirectly, control or may control the company through special voting rights, shareholder agreements, the ownership of controlling or large blocks of shares, significant cross shareholding relationships and cross guarantees."*

Chapter II (The Rights of Shareholders and key Ownership Functions), principle II.D states that *"[c]apital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate with their equity ownership should be disclosed."* Like the previous point, the Annotations to II.D makes direct reference to control mechanisms other than vote limitations: "*Pyramid structures, cross shareholdings with limited or multiple voting rights can be used to diminish the capability of non-controlling shareholders to influence corporate policy… Voting caps redistribute control and may affect the incentives for shareholder participation in shareholder meetings… Shareholders can reasonably expect that all such capital structures and arrangements be disclosed*". Particularly strong wording is applied in the Methodology's treatment of pyramidal structures (principle II.D): "*Control is particularly opaque in such groups, in part because private companies about which little is known are integral to the pyramid… Cross shareholdings between companies are also common, but are frequently limited by law… Transparency is often poor in this area.*"

In sum, the Principles to not advocate one-share-one-vote or even use it as a benchmark for corporate governance practices. They do, however, recognise that complex voting structures need to be accompanied by a number of other measures to promote good corporate governance. Therefore they make repeated reference to a need for transparency and disclosure regarding PLMs. And, a number of the detailed recommendations in the Principles can be instrumental in avoiding the potential negative consequences of separating ownership from control. Some of these recommendations are reviewed below.

3.2 Proportionality in the broader context of the Principles

As mentioned in section 1, some of the main general concerns related to PLMs is the effect they might have on the relationship between, on the one hand, shareholders and company management and, on the other, controlling and non-controlling shareholders. The rights of shareholders vis-à-vis boards and the equitable treatment of shareholders are an essential focus of Chapters II and III of the Principles. Some of the provisions in Chapter II concerning the need to avoid board entrenchment could, if interpreted strictly, be taken to bear on the advisability of PLMs. However, both the annotations and the Methodology identify as their primary aim to prevent the denial of shareholders' contractual and legal rights.

3.2.1 The Equitable Treatment of Shareholders

Chapter III states as part of its overarching principle that "*the corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders*". This is of obvious importance in relation to instruments such as PLMs that have as their main purpose to boost the influence of some shareholders relative to others and deals with potential behaviour to the detriment of others.

More concretely, principle III.A.2 posits that "*minority shareholders should be protected from abusive action by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress*". In addressing concerns that a highly concentrated ownership or control could, in some cases, lead to expropriation of the non-controlling shareholders this is a central provision. Equally relevant are the annotations to this principle which note that "*the potential for abuse is market where the legal system allows, and the market accepts, controlling shareholders to exercise a level of control which does not correspond to the level of risk that they assume as owner through exploiting legal devices to separate ownership from control, such as pyramid structures or multiple voting rights. Such abuse may be carried out in various ways, including the extraction of direct private benefits via high pay and bonuses for employed family members and associates, inappropriate related party transactions, systematic bias in business decisions and changes in the capital structure… favouring the controlling shareholder*".

Related with the previous point, principle III.B further states *"insider trading and abusive self-dealing should be prohibited".* Such practices may of course take place in perfectly proportional systems, but additional concerns can arise where management is entrenched and/or protected by concentration of votes.

Finally, provisions in Chapter VI ("The Responsibilities of the Board") are directly relevant in this context. Principle VI.A addresses the issue of board members' duties of care and loyalty, which imply obligations toward all shareholders to act "in the interest of the company". The duty to protect non-controlling shareholders is brought over even more clearly in the text of principle VI.B, which posits that *"where board decisions may affect different shareholder groups different, the board should treat all shareholders fairly"*. This provision essentially establishes that even if the interests of controlling and non-controlling shareholders are not aligned it should be a board duty to see that control is not used to the detriment of any one group. The annotations further stress this point, observing that *"this principle is particularly important to establish in the presence of controlling shareholders that de facto may be able to select all board members".* Again, while this is relevant in the context of PLMs it is not limited to the proportionality discussion; a highly concentrated ownership in a one-share-one-vote system would, for instance, give rise to similar concerns.

3.2.2 The Principles and the public interest

The Principles further recognise the authorities' need to regulate in the public interest, which is among the conceptual underpinnings of Chapter I ("Ensuring the Basis for an Effective Corporate Governance Framework"). In particular, principle I.A posits that "the corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets". The annotations to this principle further offer "...policy makers should remain focussed on ultimate economic outcomes and when considering policy options they will need to undertake analysis of the impact on key variables that affect the functioning of markets…"

The implication of this for the proportionality discussion is that, in addition to safeguarding basic tenets of sound corporate governance such as board oversight and non-discrimination among shareholders, authorities may need to take action that are not motivated by the concerns of individual corporate shareholders or stakeholders. This will for instance be the case if they detect market failures, the correction of which yields greater welfare than the associated regulatory costs [for a discussion of this, see *Towards better regulation in corporate governance: Experience in implementing Regulatory Impact Assessment (2007)*]. Again, in the language of the Principles authorities are invited to do so if they are convinced that issuing laws or regulation will promote "overall economic performance".

4. Separating voting from cash flow rights: a survey of mechanisms

Economic literature traditionally identifies two main channels through which corporate investors may decouple the cash flows and voting rights of shares, including the leveraging of voting power and mechanisms to "lock in" control. The most commonly used such mechanisms are listed below. Not covered by the present section are a number of company-internal arrangements that can in some circumstances also be employed to leverage the control of certain shareholders. For instance, the ongoing discussions in the United States about corporate proxies and the voting arrangements at general meetings (e.g. majority versus plurality vote) may have important ramifications for the allocation of control rights in US companies. In addition, a number of marketed financial instruments are increasingly available that can be used by investors, including incumbent management, to hedge their financial interest in a company while retaining voting rights.

Leveraging of voting power. The two main types PLMs used to bolster the voting powers of individuals, hence creating controlling shareholders, are differentiated voting rights on company shares and multi-firm structures. Mechanisms include:

- *Differentiated voting rights.* The most straightforward – and, as the case may be, transparent – way of leveraging voting power is to stipulate differential voting rights in the corporate charter or bylaws. Companies have gone about this in a number of ways, including dual-class share structures and, in addition to common stock, issuing non-voting shares or preference shares without or with limited voting rights. The latter is a borderline case: preference shares have common characteristics with debt as well as equity, and in most jurisdictions they assume voting rights if the issuers fail to honour their preference commitments.

- *Multi-firm structures.* Voting rights can be separated from cash-flow rights even with a single class of shares by creating a set of cascading shareholdings or a pyramidal hierarchy in which higher-tier companies own shares in lower-tier companies. Pyramids are complementary to dual-class share structures insofar as almost any pyramidal control structure can be reproduced through dual (or, rather, multiple) share classes. However, for complex control structures, the controlling shareholders may prefer pyramids since the underlying shares tend to be more liquid than stocks split into several classes. (In the remainder of this paper the word "pyramid" is used jointly to denote truly pyramidal structures and cascading shareholdings.)

Lock-in mechanisms. The other main category of PLMs consists of instruments that lock in control – that is cut off, or in some cases bolster, the voting rights of common stock. A clear-cut lock-in mechanism is voting right ceilings prohibiting shareholders from voting about a certain threshold irrespective of the number of voting shares they hold.[6] Secondly, a type of lock-in mechanism that confers greater voting right on selected shareholders is priority shares, which grant their holders extraordinary power over specific types of corporate decisions. This type of lock-in mechanism, when held by the state, is commonly referred to as a "golden share". Finally, company bylaws or national legislation may contain supermajority provisions according to which a simple majority is insufficient to approve certain major corporate changes[7].

***Related or complementary instruments*.** Other instruments, while not themselves sources of disproportionality, may either compound the effect of PLMs or produce some of the same corporate governance consequences as PLMs. One example is cross-shareholdings, which can be used to leverage the effectiveness of PLMs and, in consequence, are often an integral part of pyramidal structures. A second such instrument is shareholder agreements that, while their effects can be replicated by shareholders acting in concert of their own accord, nevertheless add an element of certainty to voting coalitions. A recent study concluded that such arrangement may have begun to crowd out pyramidal control structures in the case of Italy (Bianchi and Bianco, 2006). Where entrenched management is an issue the use of ownership limits – which do not in themselves affect the balance between control and cash flow rights – may be used to shield managers from shareholder control.

4.1 Trends in legislative and regulatory frameworks with respect to proportionality

A significant number of OECD governments have taken steps in recent decades to improve their frameworks for corporate ownership and control. The most comprehensive cross-country survey of longer trends provides an overview of the changes related to three PLMs in 30 European countries since 1990 (Goergen et al., 2005)[8]. Based on a detailed corporate governance database[9], they review among other things the legislation affecting three mechanisms for separating ownership and control, namely voting caps, non-voting shares and dual-class share structures. The authors appear to conclude that while trends are mixed, the overall tendency is for (European) countries to have become more restrictive toward the use of PLMs. However, the evidence they provide is open to alternative interpretations.

Non-voting shares, a mechanism on which few jurisdictions had restrictions already in 1990, were permitted by an additional two countries between 1990 and 2004. None in the same period banned this type of equity. The use of dual share classes, on the other hand, was abolished by law in five European countries between 1990 and 2004. However, with one exception (Germany) this reflects a tightening of national practices in new and candidate EU countries, many of which felt under pressure to take action following corporate governance excesses in the aftermath of their conversions to a market economy. As for voting caps, these have been outlawed in four European countries between 1990 and 2004. Again, transition economies figure prominently (two of the four). The changes appear to have been motivated largely by a desire to stimulate national markets for corporate control.

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[6] Another example is the use of depository certificates (common only in the Netherlands) to separate completely cash-flow from voting rights.

[7] Super-majority provisions are technically PLMs as they limit, under some circumstances, the voting rights of large shareholdings. However, their governance effect is mostly opposite to that of other PLMs as their main purpose is to prevent the abuse of a concentrated control.

[8] The main focus of this study is on takeover regulation. However, it also reviews a limited number of PLMs.

[9] The so-called Martynova-Renneboog Corporate Governance Database is based on a questionnaire sent to national legal specialists. The database is not currently in the public domain.

A small number of OECD member countries have undertaken more recent action for bearing on PLMs. In Korea, changes in the Fair Trade Act were enacted in 2005, aimed to curb “excessive cross-shareholdings” in the chaebol sector. A consequence of the changes was that companies with more than Won 6,000 billion (US$6 billion) in assets were prohibited from investing more than 25% of their net assets in other companies, including their own units. Like some of the cases mentioned above this seems to be largely a reactive move by authorities in an economy still influenced by the aftermath of the financial crisis of the late 1990s. However, in 2007 the restrictions on cross-shareholdings were eased. The amount threshold was raised to Won 10,000 billion and the share of net assets that can be invested was raised to 40%[10].

A comprehensive liberalisation of corporate law was enacted in Italy in 2004. Changes to the country’s Civil Code implied that non-listed companies enjoyed an important boost to their freedom of contract, including in areas such as the issuance of voting shares and the use of vote caps. For listed companies, that change was somewhat less significant, but they were granted greater freedoms to design the precise rights of “limited voting shares” (related to non-voting shares or preference shares in other jurisdictions). Conversely, the ban on dual-class share structures remained in place for all categories of companies (Ventoruzzo, 2006).

Finally, in Finland a 2006 revision of the Companies Act abolished previous limitations on the differentiation of the voting rights of dual-class shares (to 1:20). The Finnish authorities stated that they could see no rationale for limiting the flexibility of companies and investors to decide on the optimal ownership and control structure, and that they did not want one basic law for listed companies and another for non-listed ones[11].

4.2 The availability of PLMs in OECD countries

No source of comprehensive corporate governance information covers all of the PLMs listed above for all OECD countries. However, the Steering Group’s own OECD Corporate Governance and Law Database, to which delegates have submitted information and subsequent updates [for a documentation of the database, see *Summary of the Comparative Company Law Database (2002)*] , allows a cross-country comparison of the rules bearing on voting right differentiations plus certain other mechanisms (Table 1). In the case of cross shareholdings, the entry “Restricted” normally implies that this mechanism is allowed but subject to rules regarding the amount of shares that can be cross-held. The remainder of this section is based, first, on this information and secondly on data provided by European Commission (2007a) and other public sources.

Multiple-class shares are available to listed companies in 19 OECD countries. Of the 11 countries that restrict this practice, 9 are located in Continental Europe (Austria, Belgium, Czech Republic, Germany, Italy, Luxembourg, Poland, Portugal and Spain) and two on the Pacific Rim (Australia, Korea). Conversely, in North America, the Nordic countries, Japan, United Kingdom, New Zealand, Turkey and a small number of Central European countries the use of multiple-class shares is legally allowed. The position of some countries in this respect is not entirely clear. For instance, in Japan under the Corporation Act a company may not have more than one voting right per share. However, the Act permits companies to

[10] Financial Times, 28 February 2005, “South Korea vows to press ahead with reforms” and International Financial Law Review, June 2007, “Monopolies”.

[11] Based on a presentation by the Finnish delegate to the Steering Group in April 2007.

adopt a “unit” share system, pursuant to which a company may specify in its articles of incorporation the number of shares that will constitute one unit, with each unite being entitled to one voting right.

Non-voting preference shares are the most widely available PLMs among the ones sampled in Table 1 (though, overall, it probably ranks second behind pyramid holdings). Only three countries prohibit such instruments, namely Denmark, Netherlands and Sweden – in all cases reflecting general provisions in corporate law to the effect that all shares must carry votes. In most other countries non-voting preference shares are treated as a hybrid of ownership and debt instruments, which generally obtains voting rights only in extreme circumstances such as neglect of the preferential rights or bankruptcy proceedings against the issuer. In some countries securities regulation and listing rules actually prohibit issuers from granting voting rights to preference shares except for narrowly defined special circumstances.

Other non-voting shares may be issued by listed companies in less than half of all OECD countries. It follows from Table 1 that the 17 countries that do not allow such shares are mostly the ones that prohibit either multiple-class/differentiated voting right shares or non-voting preference shares[12]. In addition, [two] countries which allow some form of differentiation of their common stock ban non-voting shares, namely [the Slovak Republic and] Turkey. Two countries, Australia and Italy, allow the issuance of non-voting shares even though multiple-class shares are not permitted.

Voting right ceilings can be used by listed companies in 20 OECD countries and prohibited or severely limited in seven (the status of the other three member countries cannot be ascertained from the database). The seven countries where companies do not generally have access to the mechanism are Germany, Italy, Japan, Korea, Luxembourg, Turkey and the United States. In the case of Germany a frequently quoted exception to the rule was until recently the voting right ceilings, by specific legislation, in Volkswagen AG. However, in October 2007 the European Court of Justice held that the so-called *Volkswagen Gesetz* constituted a restriction on the free movement of capital, effectively nullifying the law. In the United States the use of voting right ceilings is prevented by the listing requirements of stock exchanges. Companies are, however, mostly allowed to retain vote ceilings in place prior to the promulgation of the relevant rules.[13]

Cross-shareholdings in listed companies are in themselves not prohibited anywhere in the OECD area. However, in most countries restrictions are placed on the magnitude, or voting arrangements, of cross-held positions in order to avoid bypassing the fundamental maxim that firms should not own themselves and give underpinning to the idea of equity capital. The corporate laws of a large number of Continental European countries limit to 10% the amount of corporate capital that can be cross-held – and in the case of Italy an even stricter limit of 2% applies if both companies are listed. Other countries have slightly more lenient restrictions. Hungarian law sets a higher threshold at 25% capital ownership, beyond which the investee is to be considered as an affiliate and hence barred from owning shares in the investing company. And, in Germany, Korea and Japan cross-shareholdings beyond certain percentages of capital lead to caps or other limitations on voting rights.

[12] Some definitional problems relate to the relative positions of Switzerland and the Netherlands. The Swiss “participation certificates” may in practice be equivalent to the Dutch “certificates of deposit”, which are not considered as non-voting shares.

[13] According to European Commission (2007b), p. 315, “US public issuers with pre-existing voting right ceilings (i.e. such voting rights ceilings had pre-existed and been permitted under the then-existing listing requirements prior to the promulgation of the relevant [rules]) would generally be permitted to retain those ceilings”.

Table 1. Selected PLMs: laws, regulations and listing requirements

	Multiple-class shares allowed?	Non-voting preference shares?	Other shares without voting rights?	Voting right ceilings?	Cross share-holdings?
Australia	No	Yes	Yes	Yes	Yes
Austria	No	Yes	No	Yes	Yes
Belgium	No	Yes	No	Yes	Restricted
Canada	Yes	Yes	Yes	Yes	Yes
Czech Rep.	No	Yes	No	Yes	Yes
Denmark	Yes	No	No	Yes	Restricted
Finland	Yes	Yes	Yes	Yes	Restricted
France	Yes	Yes	Yes	Yes	Restricted
Germany	No	Yes	No	No	Restricted
Greece	Yes[14]	Yes	No	Yes	Yes[15]
Hungary	Yes	Yes	No	Yes	Restricted
Ireland	Yes	Yes	Yes	Yes	Yes
Italy	No[16]	Yes	Yes	No	Restricted
Japan	Yes[17]	Yes	Yes	No	Restricted
Korea	No	Yes	No	No[18]	Restricted
Luxembourg	No	Yes	No	No[19]	Yes
Mexico[20]	Yes	Yes	Yes	..	..
Netherlands	Yes	No	No	Yes	Restricted
New Zealand	Yes	Yes	Yes	..	Yes
Norway	Yes	Yes	Yes	Yes	Yes
Poland	No	Yes	No	Yes	Yes
Portugal	No	Yes	No	Yes	Yes
Slovak Rep.	..	..	..	Yes	Yes
Spain	No	Yes	No	Yes	Restricted

[14] European Commission (2007b) and OECD Corporate Governance and Company Law Database differ on this point. The indication in the table is based on the Database.

[15] Restrictions pertain to cross shareholdings that are so large that the invested company could be considered as a subsidiary.

[16] Italian joint stock companies are not allowed to issue multiple voting rights shares. There is no formal rule against limited voting right shares, but opinions differ as to whether issuing such stock would be regarded as a circumvention of the prohibition of multiple voting rights.

[17] In principle no share may represent more than one vote. However, an effect equivalent to multiple-voting right shares is obtained by dividing company stocks into classes and specifying in the articles of association how many “units” within each class are needed to constitute one vote.

[18] One exception is the election of auditors, where a 3% voting right cap applies.

[19] Voting rights can, however, be capped through shareholder agreements. It is not yet clear whether the validity of such agreements would be upheld by the courts.

[20] Authorisation from the Banking and Securities National Commission is required.

Sweden	Yes	No	No	Yes	Yes
Switzerland[21]	Yes	Yes	Yes[22]	Yes	Yes
Turkey	Yes	Yes	No	No	Yes
U.K.	Yes	Yes	Yes	Yes	Yes
U.S.[23]	Yes	Yes[24]	Yes	No[25]	Yes[26]

Source: OECD Corporate Governance and Company Law Database and European Commission (2007b).

Among the PLMs and related measures that are not covered by the database, European Commission (2007a) indicates that the most commonly available (at least within Europe) may be pyramid structures and shareholder agreements. In all the 19 nations surveyed by this study (16 European countries[27] plus Australia, Japan and the United States) listed companies have the right to engage in pyramidal structures and enter into shareholder agreements. However, in the case of pyramids stock market rules may act as a limiting factor in some countries. For instance, in Italy securities regulation prohibits "multi-layer listing" – that is, listing of companies whose main asset or revenues are or derive from shares held in another listed company. In the United Kingdom listing rules effectively limit the degree of ownership of listed by non-listed companies.

Other mechanisms that are commonly available across the 19 countries covered by the study are supermajority provisions (17 countries) and priority shares (12 countries). (As alluded to earlier, supermajority provisions are technically PLMs although they are in practice often used to protect non-controlling shareholders.) No country actually prohibits supermajority provisions, but the legal situation surrounding this PLM in France and Ireland is perceived by the authors as unclear. In the case of priority shares, Finland, Greece, Hungary, Poland and Spain have outright restrictions whereas the legal situation in Italy and Luxembourg is characterised as unclear. What is perhaps most interesting with a view to the following sections of the present paper is the fact that among European countries voting right differentiation figures among the less frequently available PLMs. Ten of the 19 countries in the sample allow multiple-class shares, and only eight of them allow non-voting shares – three of which non-European countries.

5 Proportionality in practice: evidence across countries

While the previous section demonstrated that most PLMs are widely "available" in OECD countries, in the sense of not being prevented by company law or listing requirements, this does not necessarily imply that they are widely used. Factors that could limit controlling shareholders' incentives to rely on such

[21] The articles of incorporation may provide that the voting right is determined according to the number of shares owned by each shareholder irrespective of the par value.

[22] The articles of incorporation may provide for the issuance of "participation certificates" which grant no voting rights. These certificates may be listed on the stock market.

[23] Based on Delaware law and the listing requirements of the main US stock exchanges.

[24] The listing of non-voting shares is in some cases subject to restrictions.

[25] Prohibited through listing requirements and marketplace rules. However, pre-existent voting right caps are generally grandfathered.

[26] Cross shareholdings exceeding 5% of any class of publicly registered voting securities must be disclosed.

[27] The European countries are Belgium, Denmark, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Hungary, Netherlands, Poland, Spain, Sweden and United Kingdom.

mechanisms include, first, market pressures expressed through pricing (e.g. significant discounts on stock carrying less than proportional voting rights), or explicit or implicit standards of market conduct. Secondly, a comparatively restrictive interpretation by courts of law and regulatory bodies in some countries of the rights to extract private benefits from corporate control may weaken incentives to use PLMs. Third, formally unrelated legislation and regulation (e.g. corporate tax codes) may militate against the use of some forms of control mechanisms.

5.1 Disproportionally around the world: a review of cross-country studies

A rich empirical literature has surveyed the effects of concentrations of corporate ownership in various countries. In most countries around the world corporate ownership is characterised by the presence of large shareholders who have substantial influence over corporate decisions (La Porta *et al*., 1998, Claessens et al. 20002, and Faccio and Lang, 2002). The main exception appears to be the United States where dispersed ownership is prevalent, although blockholders are not entirely absent (Becht *et al.* 2003). However, most studies focus on measures of ownership concentration – or, at most, aggregate measures of control and do not establish the relative roles of concentrated ownership and PLMs.

La Porta *et al.* (1998) surveyed publicly traded "large" companies in a number of countries including 23 OECD members. It found that while almost a third of the companies in their sample were family-controlled (at end-1995), the reliance on voting right differentiations of company stock in most countries was insignificant. The authors calculated the share of an average company's stocks that an investor would have to purchase to obtain 20% control and found that only in four countries is this share at or below 15%, namely in Sweden, Switzerland, Denmark and the Netherlands. Given the large number of countries and stock markets that allow voting right differentiation, they concluded that "companies obviously do not use anything like the opportunities for high and low voting shares".

The study further surveyed the control mechanisms in companies with controlling owners (defined as holding at least 20% of the voting rights) and concluded that pyramidal structures are a preferred instrument in many OECD countries. In 26% of the entire sample (of controlled companies) involved pyramid or cascading holdings, ranging from 79% in Belgium and 53% in Sweden to zero in the United States and United Kingdom. Cross-holdings were not found in most of the companies surveyed, the main exceptions being Germany (20%) and Austria (15%). The fact that Japan does not figure prominently is attributed by the authors to the fact that, while cross-holdings are common in corporate Japan, there are few cases of controlling owners individually holding more than 20% of the votes.

Applying a similar methodology, Claessens *et al.* (2000) examined a large sample of East and Southeast Asian corporations (end-fiscal year 1996) in which at least one blockholder has more than 5% of the voting rights, and calculated the ratios of control to cash-flow rights for these owners. By far the strongest separation of ownership and control was found in the case of Japan where voting rights were on average boosted by 40 percentage points through PLMs. This is attributed to the prevalence of pyramidal structures and cross-shareholdings and is apparently most pronounced in companies with a non-trivial ownership by financial institutions. As cross-holdings have been reduced in Japan over the last decade (at least until recently) the difference between ownership and control might have narrowed since the data was sampled.

In Korea where family control and cross-holdings are also prevalent, Claessens *et al. (op. cit.)* found that while ownership is in many cases highly concentrated, a more limited separation of ownership from control (around 15 percentage points) was the rule. Later studies, however, indicated that the discrepancies could be somewhat bigger. Black *et al.* (2005) – based on a slightly different methodology excluding several PLMs but including "affiliate" ownership by relatives and employees of the controlling shareholder – arrived at a separation of ownership and control of about 17 percentage points (mean of sample) in 2001. Joh (2003), based on data from the mid-1990s, arrived at a mean separation of ownership and control concentration of just under 21 percentage points for all Korean companies and (consistent with Claessens *et al.*) 15 percentage points for publicly traded firms. Interestingly, this study also looked specifically into the *chaebol* sector. Consistent with a later study by Kim *et al.* (2006) it found an average ownership-control separation of more than 40 percentage points in *chaebol*-affiliated companies.

5.2 Individual PLMs in Europe and elsewhere

A much more comprehensive mapping of the implementation of PLMs in large listed companies is available for European countries thanks to a stocktaking by European Commission (2007a) together with earlier work by Deminor (2005) (Table 2). The table is further supplemented with US and Canadian evidence derived from Gompers *et al.* (2007) and Amoako-Adu and Smith (2001). It appears from the table that, in Europe and North America as well, only a minority of the listed companies make use of the PLMs that are legally available to them.

One of the more striking national examples of non-application of PLMs is the United Kingdom, where, as seen from Table 1, few such mechanisms are not legally available to companies. Apart from non-voting preference shares, which are widely used, very few UK listed companies separate voting from cash-flow rights. The main reason for this appears to be that "investing institutions and the London Stock Exchange have discouraged the issuance of non-voting shares and other devices for discriminating against different shareholders" (Brennan and Franks, 1997)[28]. Most of the few companies that still had non-voting shares cancelled them at the beginning of the 1990s.

The United States is another example where the freedom of contract generally applies regarding PLMs but most companies, subject to market or other pressures, choose not to implement them. Only an estimated 6% of listed companies have shares with multiple voting rights, and the number is apparently dropping as many dual-class capitalisations that were put in place as takeover defences in the 1980s are being unified. Several studies have argued that ownership in the United States is so widely dispersed (studies commonly find a largest voting block in listed companies of around 5% of the votes) that PLMs would in most cases be insufficient to obtain actual corporate control (e.g. Becht, 2001).

Another well-publicised characteristic of US corporate ownership and control is the absence of pyramidal and cascading shareholdings. This is due to the double taxation of inter-corporate dividends, which was introduced in the 1930s with one of its purposes being "to render economically unviable certain corporate structures which were believed to facilitate governance problems, tax avoidance and highly concentrated corporate control" (Morck, 2003). Moreover, in the US Section 8 of the Clayton Act prohibits interlocking directorates, and has effectively prevented the creation of the kinds of corporate pyramids and cross shareholdings that are common in much of the rest of the world

Apart from the United Kingdom and United States, in another 16 OECD countries companies are free to issue shares with dual or multiple voting rights. However, most of them do not avail themselves of this option. In only two of the countries in Table 2 – Sweden and France – have more than half of the large listed companies issued multiple-class shares. This could reflect a general preference for PLMs in these

[28]Another more general factor at play is the fact that the London Listing Rules prevent the extraction of private benefits by controlling shareholders (Listing Rule 3.12, Financial Services Authority, London 2000, as quoted by Rickford (2006)).

countries, because the reliance on other mechanisms such as pyramids, cross-shareholdings and, in the case of France, vote ceilings is also internationally high.

In six of the countries in Table 2 listed companies cannot issue multiple-class voting shares, namely Belgium, Germany, Italy, Poland[29], Portugal and Spain. Alternative mechanisms, however, are used. This appears to be the case in Belgium and Italy which, together with Sweden, have the highest incidence of pyramidal structures in the sample. That said, it would appear that the survey on which Table 2 is based applied a relatively inclusive definition of pyramids, including in some cases chain-ownership of subsidiaries without outside shareholder participation, and hence should be taken as a high-end estimate[30]. Moreover, pyramids are reportedly losing importance in both Belgium and Italy. In Belgium, studies have found evidence of controlling shareholders are beginning to convert lower-level companies in the pyramids into closely-held affiliates (Becht, Chapelle and Renneboog, 2001). There is an internationally high incidence of shareholder agreements in Italy – which may be due to the aforementioned substitution of shareholder agreements for pyramids, but perhaps also reflects a regulatory requirement to register such agreements) – and to a lesser extent Belgium.

[29] In Poland this follows legal change in 2001. Pre-existent multiple voting rights shares have retained their rights, but cannot be traded in regulated markets.

[30] The Steering Group Chair, Marcello Bianchi, in a letter to the Secretariat told that based on a stricter definition pyramids are found in about 25% of the listed companies in Italy.

Table 2. The existence of PLMs in the top-20 listed companies in selected OECD countries (percentage share within group)

	Multiple-class shares	Non-voting preference	Pyramid structures	Vote ceilings	Cross shareholdings	Shareholder agreements
Belgium	0	0	40	0	0	25
Canada[31]	11	..	..	..	..	..
Denmark	25	0	0	10	0	0
Finland	40	0	0	10	0	5
France	55	0	20	20	10	15
Germany	0	20	15	5	10	0
Greece	0	5	15	10	0	5
Hungary	5	5	35	20	0	5
Ireland	0	30	0	5	0	0
Italy	0	30	45	10	0	40
Netherlands	10	5	30	0	0	0
Poland	20	0	10	20	0	0
Portugal[32]	0	0	..	75	..	..
Spain	0	0	20	30	0	5
Sweden	80	0	65	5	25	5
Switzerland[33]	12	6	..	35	..	..
United Kingdom	5	50	0	10	0	5
United States[34]	6	..	0	..	..	..

Source: European Commission (2007), Deminor (2005), Amoako-Adu and Smith (2001), and Gompers *et al.* (2007).

Corporate Germany deploys a number of different PLMs, none of which can be characterised as an "instrument of choice". Preference shares, pyramids, vote ceilings and cross-shareholdings all occur but not to an internationally large extent. One additional source of concentration of voting power proposed by Becht and Böhmer (2001) is the importance of proxy voting by banks at German shareholder meetings, which among other things has the potential to add voting power to existing voting blocks. Subsequent changes to the company law may have weakened this channel of influence (e.g. by requesting that custodians obtain the permission to vote shares) as has a more general disengagement by German banks from their own stock ownership to save capital[35].

[31] Amoako-Adu and Smith (2001) report 148 dual-share class firms listed on Toronto Stock Exchange in 1998. Data from the World Federation of Exchanges gives the total number of listed companies by TSX Group at end-1998 to 1,433.

[32] Limited sample including four enterprises (Deminor, 2005).

[33] Limited sample including 17 enterprises (Deminor, 2005).

[34] Based on a 2002 sample of 6345 enterprises (Gompers *et al*., 2007).

[35] This disengagement was also made possible by changes to the tax law that reduced taxation of capital gains on long held shares.

Finally, in the other economies without recourse to multiple-class shares vote ceilings appear to be an instrument of choice. This is the case in Spain (30% of the large companies have vote caps), in Portugal (75%, but based on a tiny sample – see footnote) and to a lesser extent in Poland (20%).

5.3 The direction of change: a diminishing role for dual-class shares?

Studies of changes in the actual application of PLMs are few and far between. The most ambitious attempt known to the Secretariat is Pajuste (2005) which surveys the number of dual-class listed firms in a small number of European countries (Denmark, Finland, Germany, Italy, Norway, Sweden and Switzerland) over the last decade. This study finds, first, that the fraction of dual class listed companies in the surveyed countries declined from 41% in 1995 to 22% in 2001 (Table 3). None of the individual countries in the sample deviates from the general trend. This is attributed to a large degree to share-class unifications within the already listed shares, the economics of which are discussed further in a later section.

The decline reflects not only unifications but a drop in the listing of new companies with dual-class equity. As some countries no longer, or only under special circumstances, allow dual-class shares a decline on average would have been expected, and the 2002 figures need to be interpreted with care as there were few new listings this year. However, in 1999 and 2000 (the last years with a significant number of IPOs) the proportion of companies with dual-class shares had dropped on average to around 10% from 22% in 1996. The decline is found across countries, including the ones where dual-class shares are traditionally widely used.

Table 3. Dual-class firms in per cent of total listed firms and newly listed companies

	Total listed companies		**Newly listed companies**	
	1995	2001	1996	2002
Denmark	60%	37%	33%	0%
Finland	46%	24%	0%	0%
Germany*	24%	12%	5%	0%
Italy*	41%	35%	0%	0%
Norway	24%	7%	10%	0%
Sweden	61%	46%	59%	29%
Switzerland	47%	26%	50%	0%
Average	**41%**	**22%**	**22%**	**4%**

Source: Pajuste (2005).

* In the case of Germany: includes non-voting preference shares; in the case of Italy: includes non-voting shares.

These findings could be taken as one indication of the gradual corporate governance convergence that Goergen *et al.* (2005) as mentioned above discussed. Pajuste (2005) speculates that "the costs of dual-class share structures have increased in recent years due to investor focus on better corporate governance practices. The increasing costs of dual-class share structures put a considerable burden on companies that need to raise new equity capital and hence care about their share price, liquidity and investors recognition."

5.4 The price of disproportionate control

Empirical studies are generally not able to establish unambiguous estimates of the "value" of corporate control. In companies employing PLMs the controlling shares, or share classes, may not even be listed, or if they are they are usually not actively traded. For instance, Gompers et al. (2007) found that 85% of all US multiple-class shares have at least one untraded class of common stock. It follows that researchers are mostly limited to either studying the stock market valuation of "outside equity", or else examining the one-off events when control structures change or controlling blocks are traded. Both research strategies have been pursued and have spawned two complementary strands of empirical literature.

The literature review produced by Adams and Ferreira (2007) provides a good overview of the findings of each of these lines of research, which for the purpose of the present paper do not have to be listed in any great detail. As regards the first category of studies (largely pioneered by Claessens et al., 2002) the consensus finding from a relatively small number of studies of share pricing in United States, Western Europe and East Asia is that the presence of PLMs does lead to a discount on the market valuation of the listed shares of the companies concerned. Empirical estimates are notoriously difficult to compare due to differences in modelling strategies.[36] Adams and Ferreira synthesise the findings into an average pricing effect of the presence of PLMs, regardless of the magnitude of the disproportionality. They conclude that the discount on share prices in consequence of disproportionality between ownership and control is generally in the range from 3 to 14 per cent. Some studies further find an extra impact of "large" discrepancies between ownership and control – effectively implying a non-linearity according to which a certain degree of disproportionality may be harmless, or even positive, for share prices whereas more serious decoupling of ownership and control does lead to a pricing discount.

Claessens *et al.'s* original study further attempted to quantify the effects of control concentration in different economy-specific circumstances. It concluded that the size of value discounts depends on, among other things, the quality of banking systems, the legal and juridical protection of individual shareholders and the degree of financial disclosure required. In other words, the quality of corporate governance frameworks seems to play an important role. Further support for this point was provided by Ben-Amar and André (2006) which examined the value creation in mergers and acquisitions. The study is interesting because it focuses on Canada – which, as indicated earlier has a relatively high number of PLMs for a country considered as being within the "Anglo-American" model of corporate governance. The authors find no evidence of separation of ownership and control having a significant impact on value creation, and conclude that "in an environment with good legal and extra-legal institutions protecting minority shareholders… and where firms need to maintain good relationships with the investment community to facilitate future cash raising and maintain lower cost of capital, added controls may not be warranted or may add extra costs without benefits" Ben-Amar and André (2006).

As regards "events studies" the findings (also) vary greatly – apparently because the "events" they concern, including within individual data samples of researchers, are triggered by vastly different considerations. It is often not clear whether price responses to, say, share unifications reflect the unification *per se* or other information conveyed as part of the announcement, such as changes in management or strategies. At one extreme Bigelli *et al.* (2006), surveying Italian share unifications between 1982 and

[36] Some studies test the influence of share prices of a wedge between, or ratio of, the respective percentages of ownership and control in the hands of the dominant shareholder. Others model the effect of concentrated control and add a correction term, or dummy, insofar as control is increased through PLMs.

2005, concluded that announcements usually are associated with price increases for non-voting shares and declines for voting shares. While this may make some arithmetical sense in a country there the price differential between voting and non-voting shares is among the highest in the world (e.g. Nenova, 2003) one must ask oneself why the voting shareholders agree to the unification. The authors conclude that unifications have been used by controlling shareholders to transfer wealth from other owners to themselves by purchasing non-voting shares ahead of the unification announcement. A conclusion that offers itself is that in a jurisdiction or stock market that cannot protect minority and non-voting shareholders from such expropriation even the uncompensated unification of share classes may not be in the interest of the apparent beneficiaries.

The studies of the value of superior voting shares, as would be expected, are methodologically related to those dealing with discounts on non-controlling stock prices. A large number of researchers have looked into this issue in individual OECD countries and generally (though not invariably) attached a significant positive value to superior voting rights. The perhaps most frequently quoted study in this line of research is Nenova (2003), which provides measures of the value of the voting rights of the control block group in a sample of 661 companies in 18 countries in 1997[37]. The author finds average voting premiums in her sample varying from around zero in the Scandinavian countries, to around 10% in Germany and the United Kingdom, to close to a third in France and Italy.

One of the main studies of transfers of control blocks is Dyck and Zingales (2002), which review 412 control transactions in 39 countries between 1990 and 2000[38]. The authors find an average control premium of 14%, and further report major variations across countries. The control premium is found to be negative in Japan (one may speculate that this reflects the special circumstances under which control transactions occur in this economy) and as high as 65% in Brazil. This study confirms Nenova's finding of generally low control premiums in the Scandinavian countries, but attributes similarly low premiums to France and the United Kingdom. The two studies generally agree on the main factors influencing control premiums. Both conclude that better accounting disclosure rules, better protection of minority investors and a higher quality of law enforcement are negatively related to the value of corporate control. Dyck and Zingales further find evidence that structural indicators other than legal ones, such as product market competition, financial market development and public attitudes can also reduce the average control premium.

6. PLMs from the perspective of institutional investors

6.1 Corporate governance codes developed by investors

Some other corporate governance codes by, inter alia, investor groups are considerably more prescriptive in regards of one-share-one-vote than the OECD Principles. A recent stocktaking counted 35 such recommendations or best-practice documents for the EU countries alone.[39] These codes have been developed mostly by institutional investors, but also by shareholder associations and securities traders. In

[37] The sample includes 14 OECD countries plus Hong Kong (China), South Africa, Brazil and Chile.

[38] Two thirds of the countries in their sample are OECD members. The remainder are largely from South America and South East Asia.

[39] Most of these codes are purely voluntary, but some are issued in concert with self-regulating bodies, including as part of "comply or explain" arrangements. An overview of the European codes was provided by European Commission (2002).

essence they span from non-prescriptive advice to corporate boards to recommendations regarding investors' portfolio allocation as a function of the investee company's corporate governance arrangements.

Table 4 provides an overview of recommendations by international investor organisations. Four bodies have published corporate governance codes, all of which do to some extent support one-share-one-vote and proportionality more broadly. The ICGN Global Corporate Governance Principles, which formally endorse and build upon the OECD Principles, nevertheless take a somewhat different position on proportionality. The recommendation that ordinary shares should "feature one vote for one share" goes beyond the Principles' language on individual share classes (principle III.A.1) and further seeks to establish a "comply or explain" requirement. Moreover, ICGN's Global Share Voting Principles contain a provision that goes beyond the OECD Principles. The recommendation that individual investors' voting rights should be unrelated to the size of their holdings amounts to an express position against the use of voting caps.

Among the other international bodies surveyed, the Euroshareholders' Corporate Governance Guidelines go the furthest toward an unqualified endorsement of one-share-one-vote. According to this code, voting in proportion to one's ownership of the capital is a basic right of shareholders. EASD's Corporate Governance Principles appear slightly less prescriptive. Whilst also advocating the avoidance of deviations from one-share-one-vote they stress a need for transparency and disclosure, and speak out against voting-right differentiation within each share class, where proportionality cannot be achieved. The Equity Advisory Group of IIF, focusing on corporate governance in emerging markets, has opined that the adherence to one-share-one-vote for new issues of stock should be a top priority. The Group further recommends the eventual elimination of certain kinds of voting right differentiation (super-voting and non-voting shares).

Table 4. Corporate governance codes by international investor groups

Corporate governance code	Recommendation on proportionality
International Corporate Governance Network (ICGN): *Statement on Global Corporate Governance Principles*, 2005.	"Corporations' ordinary shares should feature one vote for each share… Divergence from a 'one-share, one-vote' standard which gives certain shareholders power disproportionate to their equity ownership should be both disclosed and justified." (Section 4.3)
ICGN: *Global Share Voting Principles*, 1998.	"The same voting rights should attach to shares regardless of how much equity a shareholder holds". (Principle 1)
European Shareholders Group: *Euroshareholders Corporate Governance Guidelines*, 2000.	"The principle of 'one share, one vote' is the basis of the right to vote. Shareholders should have a right to vote at general meetings in proportion to the issued shareholder capital." (Section II)
European Association of Securities Dealers: *Corporate Governance Principles and Recommendations*, 2000.	"Deviations from 'one-share-one-vote' should be avoided and, where they exist, must be disclosed". (Principle III) "Deviations… such as multiple vote shares, voting caps, the use of multiple legal devices, the use of cross-holdings, as well as overly complicated statutory provisions are discouraged. If they exist they must not apply within a single class of shares; must be simple and easy to understand; and must be disclosed and explained. Ownership cascades… and significant shareholder agreements should be disclosed." (Annotations)
Institute of International Finance: *Policies for Corporate Governance and Transparency in Emerging Markets*, 2002.[40]	"[A] top priority is to limit new issues to 'one share, one vote'. One-share, one-vote capital structures are the simplest and ensure the most accountability because influence is proportional to ownership… A best practice for existing issues would be to eliminate eventually all shares with super-voting rights as well as nonvoting shares." (Section on Minority Shareholder Protection)

Source: OECD Secretariat based on the respective organisations' websites.

For the purpose of the present paper six codes of corporate governance proposed by national investor groups were studied (Table 5), as well as two statements by individual institutional investors (Hermes and TIAA-CREF). From the table appears that these codes are as strongly supportive of one-share-one-vote as the international ones, but that – perhaps unsurprisingly – rather than outlining general principles some tend to focus on the avoidance of some of the PLMs most commonly found in their domestic corporate sectors. For instance, two of the three Scandinavian codes (Denmark and Norway) come out strongly against voting right differentiation – in the case of Norway even in the form of a blanket recommendation against different share classes. The Swedish Shareholders' Association is more circumspect in its recommendation that each share should be accompanied by one vote. This does not appear to preclude super-voting shares and the text is further tempered by the observation that this recommendation applies "in principle".

[40] The recommendation was produced by the IIF Equity Advisory Group, which consists largely of representatives of institutional investors.

Table 5. Corporate governance codes in individual OECD countries

Corporate governance code	Recommendation on proportionality
Australian Investment and Financial Services Association (IFSA): *Corporate Governance Guide for Fund Managers and Corporations*, 2002.	"IFSA strongly supports the principle of 'one share, one vote'… Voting rights are a valuable shareholder right that should be managed with the same care and diligence as any other asset." (Section 10.2)
Danish Shareholders' Association: *Guidelines on Good Management of a Listed Company*, 2000.	"Limitations on voting rights should be limited to a minimum… and shares with disproportional voting rights should be abandoned" (Section 1 on AGMs)
French Financial Investment Management Association (AFG): *Recommendations on Corporate Governance*, version 2004.[41]	"Double or multiple votes may be used to compensate the loyalty of certain shareholders. But, being in favour of one-share-one-vote, AFG considers that the practice… may allow minority shareholders to control a company and is susceptible to abuse. AFG thus hopes that this practice will be abandoned." (Section I.B.3)
Norwegian Corporate Governance Board: *The Norwegian Code of Practice for Corporate Governance*, 2006.[42]	"The company should have only one class of shares." (Section 4, first point)
Swedish Shareholders' Association: *Corporate Governance Policy*, 2001.	"The Swedish Shareholders' Association's attitude in principle is that every share in the company should be accompanied by one vote." (Section 1.1.1)
UK Pension Investments Research Consultants (PIRC): *Shareholder Voting Guidelines*, 1999.	"Dual share structures with different voting rights are disadvantageous to many shareholders and should be reformed." (Part V)[43]
Hermes: *Corporate Governance Principles*, 2006.	"All shares of a company should generally carry one vote… Divergence from [one-share-one-vote] gives certain shareholders voting power disproportionate to their equity ownership, [which] is undesirable as it disadvantages some of the other shareholders." (Section 2.3)
TIAA-CREF: *Policy Statement on Corporate Governance*, 2007.	"The one-share, one-vote principle should apply to all publicly traded companies to ensure that shareholders' voting power is aligned with their economic interest. Voting caps and super voting rights should be eliminated." (Section 8)

Source: OECD Secretariat based on the respective organisations' websites.

The French AFG recommendations (the "Hellebuyck Commission") recognise the argument of the French authorities that double voting shares may have their use in rewarding loyalty. The Commission nevertheless declares itself in favour of one-share-one-vote on account that differentiated voting rights are susceptible to abuse. The Australian Investment and Financial Services Association's Corporate

[41] The recommendations of the so-called Hellebuyck Commission. Unofficial translation by the OECD Secretariat.

[42] The NCGB includes industry and stock market officials, but has a majority of investor representatives.

[43] As quoted by Fremond and Capaul (2003).

Governance Guide strongly supports one-share-one-vote and opines that voting rights should be thought of, and managed, like an asset. The UK Pension and Investment Research Consultants, who act as advisors to municipal and other public pension funds, speak out against dual share structures with different voting rights and recommend that they be "reformed".

Two individual institutional investors have both published positions on corporate governance in recent years which advocate the one-share-one-vote principle. Hermes opines that a voting power disproportionate to equity ownership "disadvantages some of the other shareholders" (a proposition discussed in detail in the following sections). TIIA-CREF – who, being domiciled in the United States, may be less concerned with multiple-class shares than European investors – proposes specific limitations on voting caps and super voting rights.

6.2 Arguments for and against institutional investors' position

Institutional investors' consistent argumentation in favour of proportionality and, in particular, an end to voting right differentiation has sometimes led to counter-accusations. Some have said that these investors simply seek a mandated share unification that could unduly favour the reduced-voting right shares which they currently hold – and which had been bought at a lower price, in full knowledge of the limitations. However, additional theoretical and practical arguments in favour of the institutional investors' argument have been brought forward, some of which are reviewed in this section.

As mentioned in the introductory section, one of the main arguments in favour of PLMs is the principal-agent problem: to ensure that corporate managers maximise the interest of all owners, shareholders need to engage in a process of monitoring that can be both time-consuming, costly and demand an expertise that they do not necessarily possess. PLMs help provide individual shareholders with the ability to engage in such monitoring, but at the same time enhances the scope for extracting private benefits to the detriment of the non-controlling shareholders. In consequence, any value discount on non-controlling stock will reflect investors' assessment of the net value of the expected benefits of enhanced monitoring and the costs of private benefit extraction.

However, investors are not a homogenous group. The cost of private benefit extraction may *ceteris paribus* apply equally to different investor groups, but the perceived benefits of monitoring by a third party will normally differ. Well informed and resourceful investors will normally attach less value to such monitoring than small shareholders, so if market pricing of non-controlling shares reflects an average of investors' preference then these shares may be priced to highly in the eyes of the former. In the words of Lee (2006), "the main beneficiaries of dual-class structures are small shareholders and founding families, not institutional investors. This is because, unlike small shareholders, institutions can do their own monitoring". A further consequence of this line of thinking would be that institutional investors can be thought of as competing with controlling shareholders for small investors' placements. The two alternatives available to a small shareholder concerned with monitoring is investing via an institutional intermediary or investing directly in a company that has a controlling shareholder.

A smaller group of investors may have additional reasons for disapproving of PLMs. Even as the value discount on non-controlling shares affected by PLMs may make their returns financially attractive it is conceivable that "activist" investors could obtain even greater returns by taking stakes in companies with inoptimal governance arrangements and enhancing their efficiency. Objections to PLMs on these grounds would be based on a perceived denial of opportunities rather than insufficient return on the investments that actually take place. However, if PLMs are used to shield corporate insiders from efficiency enhancing governance change then they most likely also come at a cost to the national economy.

A survey of institutional investors' attitudes toward PLMs was prepared as part of the background to the European Commission's proportionality study. In the survey participated 445 institutional investors, domiciled in almost equal measure in the EU area and in the rest of the world, with total assets under management (AUM) exceeding € 4.9 trillion[44]. The largest single group of respondents were based in North America (93 investors), whereas the largest amount of AUM in any one country was held by the UK respondents (€ 2.2 trillion).

Among the more basic questions put to investors was how they "perceive" various kinds of control enhancing mechanisms (PLMs in the language of the present paper) in terms of negative or positive. Based on the responses (European Commission, 2007, Figure 5-5) it appears that institutional investors are largely indifferent regarding the use of preference shares and shareholder agreements – perhaps because the uptake of such mechanisms is perceived as more market-driven than other PLMs. The most negative assessment was given to golden shares and pyramidal structures, where the negative responses outweighed the positive ones by more than 70%[45]. In second and third places followed voting right ceilings (–68%) and multiple-voting class shares (–62%). Interestingly, respondents divided almost equally over whether to be positive or negative toward supermajority provisions – presumably reflecting this instrument's potential use as protector of either entrenched interests or minority shareholders.

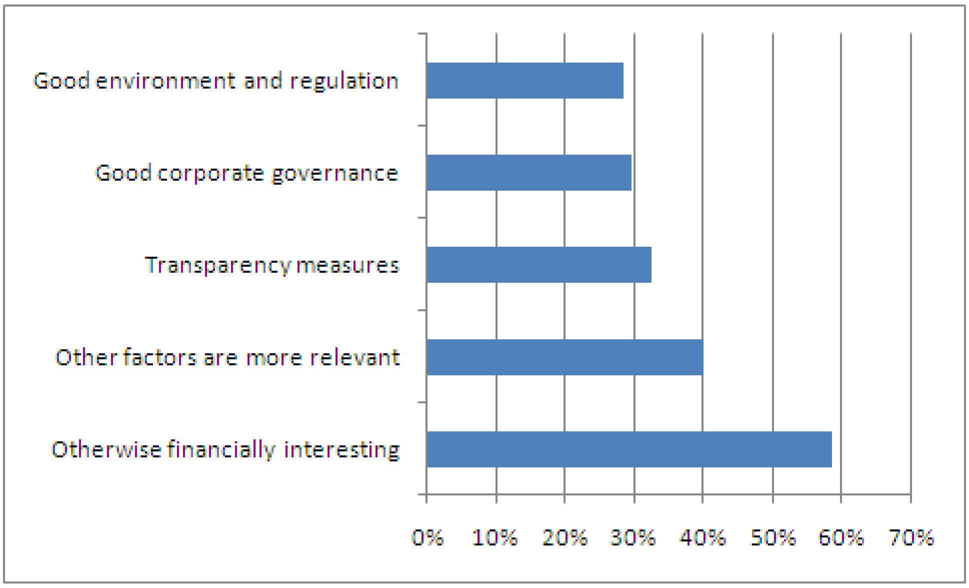
Further main findings from the survey are synthesised in Figures 1 and 2, namely the five main reasons institutional investors chose to – or not to – invest in companies featuring PLMs. (Investors were asked to choose between a number of reasons why they might ultimately decide to invest or not invest in a company; the percentages in the two figures are the share of respondents that "ticked" a given reason.) It appears from Figure 1 that a majority of the respondents are willing to consider investing in a company with non-proportional share voting structures if the company is "otherwise financially interesting"[46]. As regards the other top responses it may not be particularly illuminating to learn that investors consider "other factors", but interestingly factors three, four and five that may make institutional investors overcome their dislike for PLMs are transparency and generally good corporate governance in the invested company and the presence of a generally strong corporate environment and national regulation.

[44] The amount is a low-end estimate. It is based on the reporting by respondents to the questionnaire, more than a tenth of whom chose not to reveal their AUM. Addition caution is moreover called for when interpreting the survey results: the survey was sent to 7,792 investors, so the respondents only represent around 6% and could be subject to selection bias.

[45] The figures are calculated as the sum of the number of respondents who declared themselves "very positive" or "positive" minus the sum of those who declared themselves "very negative" or "negative", divided by the number of respondents.

[46] Strictly speaking, this does not follow from the response to a question about why, if at all, an institutional investor might invest in a company. However, the respondents were also given the option of responding that they never invest in a company featuring PLMs; a mere 8% did so.

Figure 1. Reasons for investing in a company featuring PLMs

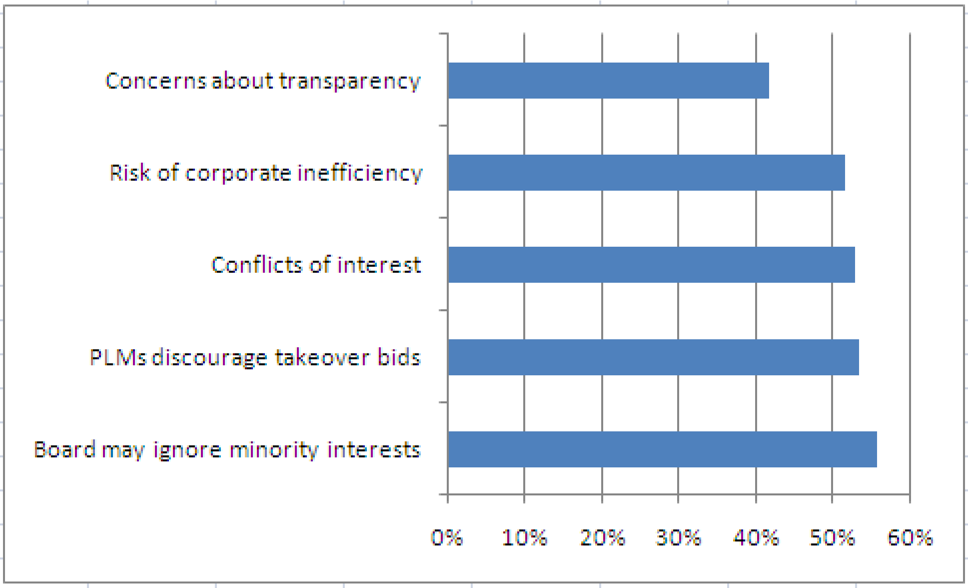


Source: European Commission (2007a)

The main reasons for not investing in companies with PLMs seem to concern the risk of principal-agent problems and board entrenchment (Figure 2). In first place, 56% of the respondents said that they have abstained/would abstain from a company over concerns that the "board may ignore minority shareholders' interests". Secondly, 53% mentioned the risk of "conflicts of interest for the board and significant shareholders". Both the first and the second point can be taken to indicate a combination of concerns about board entrenchment and expropriation by controlling shareholders. Another 53% cited concerns that PLMs would discourage takeover bids and thus hamper their potential positive impact on share prices. Further down the list came the risk of corporate inefficiencies as a result of the PLMs[47] and about the degree of transparency in companies whose incumbent controlling shareholders and/or management are shielded by such mechanisms.

[47] The point about corporate inefficiency in Figure 2 amalgamates two responses from the Commission study, one concerning "bad decision-making" on one about the "financial performance of the company".

Figure 2. Reasons for not investing in a company featuring PLMs



Source: European Commission (2007a).

In conclusion, institutional investors do, on the one hand, voice serious concerns about PLMs, on the other, they are obviously able to overcome these when certain criteria are fulfilled. Apart from the obvious ("high financial returns") the knowledge that the investee company operates at high standards of corporate governance and disclosure, and is domiciled in a jurisdiction with a strong regulatory environment, all serve to assuage the institutional investors' uneasiness about PLMs. Conversely, the main factors exacerbating institutional investors' concerns about PLMs apparently involve the spectre of entrenched management, self-dealing and (other) irregular corporate practices. In other words, investors may perceive a trade-off between the strength of external enforcement (whether through regulation or market mechanisms) and greater voting rights. According to this logic the positions in favour of one-share-one-vote may be interpreted as a call for credible disciplines on company insiders rather than an absolute demand.

7. Issues for lawmakers and regulators

An interesting observation from the previous sections is the fact that while most forms of PLMs are permitted in most OECD countries a relatively limited share of all listed companies avail themselves of these mechanisms. To some extent this is due to the fact that certain PLMs are unattractive for other reasons (a classic example is, again, the absence of pyramids in the United States) and that some instruments are available to affect influence (in the interest of entrenched boards, chiefly) that are not commonly classified as PLMs. But it also reflects the choice by company owners of control structures that are deemed optimal given the operating environment, corporate strategies and competitive situation in which companies find themselves.

Little systematic information is available on how and according to what criteria companies choose their securities-voting architectures. A recent study of dual-class US companies (Gompers *et al*., 2007) did seem to confirm some common perceptions. For example, the use of a family name as part of the company name significantly increases the probability of adopting a dual-class structure. Also, the study found that media companies (commonly thought to be susceptible to the extraction of non-pecuniary private benefits such as public recognition and political influence) are more likely than others to put in place such PLMs. Conversely, in many firms that issue multiple classes of shares, insiders do not own the majority of votes. There are also many firms in which insiders own the majority of votes, but also the majority of cash flow rights. Thus, the conjecture that PLMs are used purely for seizing control without proportional economic interest appears too simplistic (Adams and Ferreira, 2007).

Among the few studies examining the choice between alternative types of PLMs, Villalonga and Amit's (2006) study of a large number of Fortune 500 companies indicate that, first, young companies still controlled by the founder and his/her family are less likely to avail themselves of PLMs. Their control continues to rely on a concentrated ownership. Secondly, some of the main forms of PLMs appear to be substitutes. Companies might opt for dual class shares or pyramidal structures, but more rarely the two in combination. Conversely, voting agreements are found to be often used in conjunction with pyramids and the two mechanisms are considered by the authors as complementary tools for leveraging control.

7.1 Lack of proportionality: might regulation be justified?

While the disproportional ownership and control structures in listed companies apparently reflect the preference of companies and (most) shareholders, and hence may be considered as a consequence of the freedom of contract, the question arises whether it may nevertheless be contrary to the public interest. The study of Regulatory Impact Assessment currently before the Steering Group proposes that a so-called threshold test be applied to establish whether there is a potential need for regulatory intervention. (A decision to actually regulate would further depend on a cost-benefit analysis to establish whether the regulatory benefits outweigh the costs.) Four problems that might serve as a justification for regulation are [*Towards better regulation in corporate governance: Experience in implementing Regulatory Impact Assessment, (*2007)]: (1) market failure; (2) regulatory failure; (3) unacceptable hazards or risks; and (4) social goals other than those related to economic efficiency.

Of the four points, non-economic goals fall outside the scope of the present paper. True, the more emotional arguments regarding "shareholder democracy" may have been informed by such objectives. For instance, the governments of some OECD countries may have concerns about the use of PLMs to maintain, sometimes for generations, family or other core-shareholder control over major national enterprises. However, these considerations reflect a much wider set of distributional policies than can be reasonably addressed through corporate governance regulation.

Unacceptable risks are a concern that could, under some circumstances, justify regulation toward greater proportionality. Even if investors are well informed and have been fully compensated (through the value discounts demonstrated in section 5.4) for the risks perceived when buying the stock of companies featuring PLMs, negative events such as the more egregious examples of tunnelling and related-party transactions can trigger crises with unforeseeable effects. They may moreover be accompanied by considerable externalities. These usually work via the pricing of financial assets, involving steep, if mostly short-lived, increases in the cost of external finance, which may hit totally unrelated companies that happen to be in the same country – or considered by financial investors as being in the same risk class. Examples of corporate upsets leading to such "contagion" include the Parmalat scandal, which had as one of its outcomes a temporary virtual cessation of short-term credits to Italian corporations.

Regulatory failure is to some extent "the other side of the coin" of market failure. By raising the spectre of excessive regulation it basically invites authorities to ask themselves if they may have over-regulated, imposing costs on the domestic economy that are unjustified by the hoped-for benefits. In the context of an essentially qualitative analysis such as threshold tests this is equivalent to assessing the benefits of the same regulation had it been initially absent. However, the analysis of regulatory failure also addresses the possibility of faulty rather than excessive regulation. In this sense it may be used in the way of incomplete law: flexibility is allowed but complementary actions such as transparency and minority rights protection might have been neglected [cf. *Towards better regulation in corporate governance: Experience in implementing Regulatory Impact Assessment, (*2007)]. Given the complexities of corporate governance regulation this is intuitively appealing, but in the context of RIA it is at the same time problematic as the act of replacing "faulty" regulatory framework with a stronger one involves a range of regulatory costs and hoped-for benefits. It is simpler to analyse the remedies of faulty regulation as action to correct market failure and evaluate the individual costs and benefits of such action.

7.1.1 Is there evidence of market failure?

The two most frequently quoted types of market failure that could lead to negative effects of – or in some cases arise in consequence of – disproportionality are asymmetric information and the presence of economic externalities. A third type of market failure would be a weak market for corporate control (e.g. stock markets without the depth and liquidity to price correctly the various types and classes of shares), but in the average OECD country this is not seen as a major concern.

7.1.1.1 Information asymmetries

The point about asymmetric information concerns, among other things, the relationship between the beneficiaries of PLMs and the non-controlling shareholders. If investors are fully informed then freedom of contact implies that shares that carry lower voting rights than those of a controlling group of shareholders will be purchased at a discounted price, the discount reflecting the value investors attach to the control rights that they forego. The most compelling argument against an inherent "unfairness" of shares without, or with limited, voting rights is that investors purchase them voluntarily. Such shares exist because companies offer them on terms that are acceptable to their buyers (Lee, 2006).

Provided that non-controlling shareholders hold rational expectations they anticipate the degree of opportunistic behaviour of the insiders and hence purchase the shares at a discount (Burkhart and Lee, 2007). Their ability to earn a fair rate of return depends on the quality of their predictions regarding the extraction by controlling minorities. For the same reason, any degree of uncertainty about the control structures of a company, the intentions of controlling owners and their ability to carry them out, minority share holder rights and the enforceability of legal and regulatory stipulations will all lead to a deepening of the discount.

From a purely private sector perspective, therefore, the issue of procedural fairness surrounding PLMs boils down to whether investors possess sufficient information about the voting right arrangements that pertain to the shares, and the company more generally, in which they are about to invest. The importance of this consideration is underlined by the OECD Principles which devote an entire chapter (Chapter V) to Disclosure and Transparency. Enhanced transparency around control instruments was also a centrepiece in the EU Takeover Directive, and it figures prominently in the securities regulation of many countries.

In practice, however, some problems present themselves. For instance, discretionary shifts in the control arrangements of a company, including block transfers and the withdrawal of key persons from the management, can drastically change the conditions under which the control discount was contracted. Unless the block-owner makes a credible commitment towards other shareholders – e.g. in the form of a change of control-clause in the articles of association – the spectre of sudden shifts in the controlling minority may impede efficient pricing of the non-controlling shares (Mülbert, 2006).

7.1.1.2 External effects

Even if information asymmetries can be fully overcome – and the implicit and explicit contracts between the controlling and non-controlling shareholders are consequently efficient – disproportionality may detract from overall economic efficiency because of externalities. Were this to occur it would be contrary to the recommendations of the Principles which state that corporate governance frameworks should be organised with a view to their "impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets".

The most important market imperfections that could lead to sub-optimal outcomes have to do with, one the one hand, the fact that the beneficiaries of PLMs may have to compensate the non-controlling shareholders there is no mechanism to make them compensate other economic agents for the damage potentially inflicted on them. The damage may include (in addition to the risk of systemic crises mentioned above) losses due to under-investment in consequence of large equity price discounts; and misallocation of capital due to insider control in company groups.

Underinvestment in consequence of large equity value discounts may not be a serious problem in all OECD countries for a couple of reasons. First, as shown in section 5.4, these discounts are sometimes of a magnitude that would not give policy makers cause for concerns. Conversely, in some developing and emerging economies much larger pricing effects of PLMs have been demonstrated – attributed by the authors of various empirical studies to fears of abusive extraction by the controlling shareholders amid weak legal and regulatory frameworks. This does not mean that regulators in OECD countries should necessarily be sanguine. For example, in a survey of a few cases of tunnelling Johnson *et al.* (2000) conclude that even in highly developed economies the diversion of corporate resources from the minority shareholders to the controlling shareholder can be substantial. The authors conclude that some legal systems may be more conducive to such practices than others.

Secondly, the importance of this problem depends on the degree of product market competition. A value discount in consequence of PLMs is mostly confined to the shares of the relevant company (although it can in some cases trigger reputation effects with more widely felt consequences) and if these put the company at a comparative disadvantage in raising capital then market disciplines should normally provide incentives to redress the issue. However, if competition is weak in consequence of slack regulatory frameworks and/or de facto monopoly then the higher cost of capital may persist and lead to underinvestment.

Regarding the possible misallocation of capital, several recent studies have found evidence that the rate of return on investment by companies in pyramids and other groups may be lower than in the corporate sector more generally. Holmén and Högfeldt (2005) studied Swedish pyramidal business groups (which face strong tax incentives to reinvest their earnings) and found evidence of a strong value discount not only on the companies at the bottom of the pyramids but also on the holding companies at the top level. They concluded that, whereas in the Swedish regulatory environment there is little scope for abusive extraction of private benefits the controlling owners do "systematically overinvest since they have access to a relatively inexpensive source of capital with lower and softer return requirements than the external capital markets". The authors concede that this problem may also arise in the absence of PLMs but argue that the problem is compounded by highly leveraged control over internal cash flows[48].

7.1.1.3 Macroeconomic benefits from PLMs?

Even as the risk of societal costs from strong concentration of corporate control – including through PLMs – are widely recognised, some mitigating factors have also been suggested. One of the conclusions offered by several of the "academic" commentators in the recent debate was that because of the trade-off between minority protection and effective board oversight, the impact of PLMs ("control-enhancing mechanisms" in EU documents) depends on the degree of concentration of ownership and control in national corporate sectors (Burkhardt and Lee, 2007). If, according to this argument, ownership is very dispersed (like in the United States) then allowing a degree of disproportionate control may be efficient because it enhances shareholder monitoring of boards. If blockholders who are distant from the management are both willing and able to monitor managers and influence corporate decisions then this might be advantageous to other shareholders[49]. The controlling blockholders could use their influence to enhance security benefits in the interest of all shareholders. Conversely, if ownership is already concentrated then the presence of PLMs may enhance dominant shareholders' chance of extracting private benefits at the expense of minority shareholders. The conclusion offers itself that PLMs may be economically inefficient in some cases but not in others and that, therefore, in the context of whether or not to mandate one-share-one-vote, "one size does not fit all". The European Commission (2007a) study, in particular, is not unsympathetic to this line of thought.

One may ask whether this argument does not rely excessively on a body of literature most of which (with a few notable exceptions) studied the effects of concentrated ownership and voting rights on corporate governance rather than the specifics of separating cashflow and control. If, for instance, an investor acquires an increased number of votes in a company solely through PLMs then his ability to monitor corporate managers increases, but, as his cashflow rights are unchanged, his incentives to do so will not necessarily strengthen. The case for "efficiency enhancing PLMs" is further weakened when one considers the fact that shareholders increasing their control through PLMs may in many cases be company "insiders" – for example being members of the corporate board themselves. Whereas the agency costs in the case of insider control is zero, if voting rights are separated from cash-flow rights the insiders have an incentive to convert securities benefits into private benefits – and the incentive to do so increases as a function of the degree of departure from proportionality.

A final argument against the notion of beneficial societal effects of PLMs would be that this intuition runs counter to the presence of value discounts on the shares of companies relying on PLMs that were documented in an earlier section. The discounts are assumed to encompass the contradictory pricing effects of, on the one hand, loss of control by the outsiders, on the other, the financial benefits of overcoming the incentive and entrenchment problems. Even in the corporate environments commonly considered as well-functioning the estimated discounts are positive or at best close to zero, which indicates that non-controlling investors on the whole consider PLMs as value destroying. This seems reconcilable with the "public interest" only if it indicates that the corporate insiders use their power to align corporate with societal objectives and misalign them with the interests of other shareholders. This may conceivably be the

[48] In the case of insider control, further support is found in Chirinko and Schaller (2003), which estimated that in Canadian firms company directors make their investment decisions based on a discount rate that is 3.5 to 4 percentage points less than the market rate.

[49] For an in-depth discussion, see Schleifer and Vishny (1997).

case with partially privatised enterprises and a few other firms close to public decision makers, but it hardly applies more generally.

7.1.2 Summing up

The case for limiting the use of PLMs in the individual interest of non-controlling shareholders is generally not strong. Investors are mostly sophisticated enough to assess the risks and expected losses that may arise from unconventional securities-voting structures, or rather from the combination of such structures and weak protection of non-controlling shareholders. The empirical evidence suggests that they extract a price for assuming these risks in the form of a discount on shares whose voting rights are curtailed through PLMs. One may not infer from the empirical studies that value discounts are necessarily always priced correctly, but in many cases the discounts are found to vary according to the degree of disproportional control as well as the quality of legal, regulatory and market disciplines in the country concerned. This could be taken as indications that, given freedom of contract, controlling and non-controlling shareholders are able to settle on an equilibrium price that reflects their relative preferences and a rational pricing of the value of control.

The use of PLMs to concentrate voting rights may create externalities that could potentially serve as justification for regulatory action. Allowances should be made for national differences, including notably the degree of concentration of corporate ownership, but even in countries with a dispersed ownership the indications are that PLMs may trigger a net overall efficiency loss through their misalignment of incentives of different shareholder groups. As corporate groups protected by PLMs "lock in" capital and stock markets assign values to shares according to the preference of controlling and non-controlling shareholders, hence affecting the allocation of productive resources, the ultimate outcome is often not economically efficient from the perspective of the host jurisdiction.

The twin questions then arise; first, whether the potential inefficiencies triggered by PLMs are sufficiently large to justify any kind of regulatory action, secondly, if that is deemed to be the case, what kind of intervention might be optimal. The following two sections address these issues. Section 7.2 examines the possible outcomes of direct regulation such as mandatory share unifications and other actions to limit the recourse to PLMs. Section 7.3 focuses on the options for indirect action aimed at avoiding and mitigating the negative outcomes of PLMs rather than abolishing the mechanisms themselves.

7.2 Is there a case for regulating proportionality?

The case for regulating proportionality would ultimately rest on the outcome of a full cost-benefit analysis along the lines proposed in *Towards better regulation in corporate governance: Experience in implementing Regulatory Impact Assessment (*2007) weighing the benefits suggested above against possible societal efficiency losses as well as compliance and regulatory costs and the compensation that might have to be paid to some shareholders in consequence of the move to proportionality. Such an analysis – which anyway might yield different results in different jurisdictions – is beyond the scope of the present paper. The sections below discuss in general terms some of the options that are available to policy makers and their likely consequences.

7.2.1 Likely consequences of mandatory one-share-one-vote

The degree of corporate control that incumbent owners may legally obtain or retain influences the choice between publicly traded and non-listed (in practice often closely-held) company ownership. Accordingly, regulatory constraints on the choice of security voting structures can have significant consequences for capital structure and ownership patterns. At one extreme, companies may choose not to go public. Many entrepreneurs tap into the equity markets only if they are granted some safeguards against losing control. Initially they may float only a minority stake, but as the capital needs of the company grow they tend to rely on PLMs. Accordingly, entrepreneurs may be reluctant to go public if, for instance, public capital markets impose strict corporate governance rules that impede their managerial autonomy (Boot *et al*., 2006). Insofar as this restricts the access to capital of new companies and companies with a particular growth potential it will hardly be in the public interest.

The alternative to the restricted-capital scenario could be even worse. Entrepreneurs might decide to rely on private-to-private equity capital – which may in some cases be a sound solution, but on a larger scale would counteract the economically sensible objective of developing deeper and more liquid markets for corporate control. Or, entrepreneurs may decide to migrate to markets with more accommodating regulations. One example of this taking place within one country was the apparent loss of market shares of NYSE to AMEX and NASDAQ due to the former's ban on dual-class shares until 1986 as mentioned in an earlier section[50]. With overseas listings becoming increasingly commonplace, the mandatory stock-voting rules could also make the change of corporate nationality gain pace. An important question is, of course, whether such developments are wholly undesirable, or they may serve the public interest by making poor performers leave the market.

7.2.2 Share class unifications

If authorities decide to impose one-share-one-vote (defined here as an end to voting right differentiation) through company law or listing requirements they are likely to face a number of practical problems. Insofar as unifications represent a sale of voting power form superior to inferior vote shareholders the issue of suitable compensation arises. A mandated unification needs to specify the terms of this trade (or, at least, establish a mechanism for doing so) as the parties can be safely assumed to disagree. For example, attempts at determining a "fair value" of the relative share classes based on the past pricing will run into the problem that the observed control premiums and discounts, as mentioned earlier, mostly relate to outside equity. There is no reliable measure of the value that the controlling shareholders attach to the private benefits from their investment and this problem complicates any procedure for mandated unification.

The terms of trade could be prescribed by law. But, in consequence of the said valuation problems a likely outcome would be that either superior or inferior vote shareholders would contest the valuation and take legal action. In addition, the redistribution effects of fixed-price schemes are predictable and can be undermined. As mentioned earlier Bigelli *et al.* (2006) demonstrate how controlling shareholders can exploit low compensation by purchasing inferior voting shares prior to unification. (This, however, hinges on an information advantage that should not usually be present in the case of regulatory change.) Also, wealth effects may be ambiguous when controlling shareholders hold superior and inferior voting sock and retain control after the unification (Hauser and Lauterbach, 2003).

Otherwise, the terms of unification can be determined either through an independent evaluation. However, in attempting to arrive at an economically efficient compensation an independent "evaluator" would face the uncertainties about private benefits mentioned above. At the same time he/she would have to hypothesise how the share unification will affect the security benefits. Conversely, authorities may let shareholders negotiate the compensation and coerce and agreement by making failure costly (Burkart and

[50] Loss and Seligman (*op cit.)*

Lee, 2006). This could be obtained by letting the law provide for a transition period and a default compensations rule, applicable if parties fail to reach an agreement. However, it would be notoriously difficult to design the different schemes in a way that did not affect the parties' bargaining positions, thereby influencing the outcome.

7.2.3 Alternative instruments for separating ownership and control

A prohibition of differential voting rights may obviously cause firms to shift from dual-class structures to other PLMs, notably pyramids and cascading holdings. As mentioned earlier the combination of listed and non-listed companies in pyramidal structures is prohibited in some jurisdictions, but regulators have less scope for discouraging ownership by one listed firm of another. Pyramids may, however, as the example of the United States shows be virtually eliminated by changes to the corporate tax code[51].

Pyramids – and cross-ownership – raise questions with respect the proportionality principle over and above those related to voting right differentiation as they represent deviations accomplished outside the corporate charter. (This also applies to the foundation ownerships that are widely used in the Netherlands.) Economic literature does attribute some corporate governance and wider economic benefits to pyramidal structures (e.g. an internal market for capital and labour), but they also tend to be more opaque and contribute to a less liquid markets for corporate control than voting-right differentiation in the common stock (Becht, 1999).

Moreover, the availability of "new" financial instruments such as certain types of derivatives can, as observed in an earlier section, be used to separate control from ownership almost regardless of the characteristics of the underlying shares. In consequence of such instruments the security-voting structure loses part of its relevance. And, if authorities were to impose statutory limitations on the PLMs available to controlling shareholders then presumably both the range of such instruments on offer and their usage would expand.

The impact of financial instruments such as share lending and equity derivatives on the markets for corporate control has attracted increasing attention, including in economic literature. Unsurprisingly, the debate to some extent reflects the fault lines the one about PLMs. On the one hand it is argued that vote trading may enhance controls over corporate boards by mitigating the free-rider problem among small investors (Christoffersen *et al*., 2006). On the other hand, the unbundling of cash flow and voting rights can result in inefficient takeover outcomes and allow control to be held by investors with distorted incentives (Hu and Black, 2006). The main concern here is that investors can hold votes in combination with derivative positions that are inversely related to the cash flow claims of their common shares, which has the potential to create conflicts of interest.

7.2.4 Regulation or comply-or-explain?

A recent proposal from the European Corporate Governance Forum (ECGF, 2007) suggests that regulators avoid broad-based rules making regarding proportionality[52]. Instead, the paper suggests, the

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[51] Ferrarini (2006). This, however, comes at the cost of many of the supposed efficiency gains that can be obtained from company/company ownership.

[52] The proposal was made by a Working Group on Proportionality, consisting of José Garrido Garcia, Klaus Hopt, Jonathan Rickford, Jan Schans Christensen, Jaap Winter and Eddy Wymeersch. The paper is available on

broader focus should be on imposing transparency and disclosure requirements and address a few types of PLM that could be the source of particular problems. Taking the last part first, the Forum suggests four kinds of practices should be areas of immediate concern for the EU Commission: (1) full board entrenchment; (2) the use of PLMs to further the interests of public or semi-public actors; (3) the use of market instruments to decouple voting rights and economic ownership (cf. the discussion above); and (4) the voting architecture in individual countries, including the role of intermediaries in acting on behalf of their clients.

On the overarching issue of transparency, the Forum made detailed recommendations some of which broadly consistent with the OECD Principles. However, the paper goes well beyond recommending that investors should have access to full information about securities-voting structures of the companies in which they invest. For example, companies with PLMs should be obliged to "provide for a reasoned explanation of the objectives and effects of the mechanisms applied". Individual shareholders who benefit to a non-trivial degree from PLMs should be required to "provide insight into the size and nature of their shareholdings and their policy on the exercise of the relevant powers".

What is more, the governments of EU member states should be required to provide annual information regarding application of disproportionate structures in the jurisdictions. Member states "could also be asked to explain to what extent their company laws or securities laws contain any countervailing measures addressing the concerns raised by the use of disproportionate mechanisms" and "indicate what measures they are considering where they find that the measures in place are not sufficiently effective". This proposal is likely to be read as a comply-or-explain agenda, effectively establishing proportionality as a benchmark, the deviations from which have to be justified by governments as well as investors and corporations[53].

7.2.4 Summing up

It would appear from the previous sections that there is no easy – let alone cheap – regulatory route to mandating proportionality. A mandatory conversion of multiple-class shares is, as evidenced from the experience of some OECD countries, indeed feasible. At the same time it is not unproblematic, especially as the relative value of different share classes is very difficult to establish. Compensating the "losers" may have to rely in large measure on the public purse, and failure to do so adequately could be a source of considerable market distortion with associated efficiency losses.

The challenge does not stop at the share class unification. The multitude of alternative PLMs, some of them with largely equivalent effect, is such that much more sweeping regulation would be needed to obtain proportionality. This would include corporate law (or tax law) changes to discourage pyramids; financial regulation to deal with emerging instruments, such as derivatives, for decoupling ownership and control; and much more detailed interventions into corporate governance to regulate voting and management agreements, voting procedures and countless more or less formal instruments that can be used to a similar effect as disproportionate ownership/control structures. The regulatory burden of would obviously be very heavy – in terms of administrative and compliance costs, but also due to the barriers to efficiency-

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the European Commission website: http://ec.europa.eu/internal_market/company/docs/ecgforum/workinggroup_proportionality_en.pdf.

[53] Similar allegations have already been made regarding the transparency provisions of the European Takeover Directive, which according to Hirte (2004) "takes up many of the issues that the Fifth Directive failed to harmonise" and effectively "establishes 'one-share-one-vote' as a European standard".

enhancing economic activities not related to PLMs that would arise as an unintended consequence. Alternatively, authorities could of course limit themselves to outlawing PLMs that appear particularly harmful (and, in the RIA context, whose elimination is thus easier to justify based on cost-benefit analysis). ECGF (2007) suggests that priority should be given to mechanisms that are particularly likely to lead to board entrenchment.

The idea of taking regulatory action to raise standards for transparency and disclosure is consistent with the Principles. For the general public, as well as individual investors, there is value in obtaining information about corporate control structures and, at the same time, the obligation to divulge such information may act as a disciplining factor on firms. At the same time, some caution is called for. Disclosure requirements come at a cost (an observation frequently voiced by critics of Sarbanes-Oxley), and a degree of confidentiality regarding corporate and financial strategies is legitimate and may be efficiency-enhancing.

7.3 Regulating the extraction of private benefits

If one accepts the notion that, on the one hand, there are potentially negative consequences of a lack of proportionality, but, on the other, mandating proportionality would be abortively costly – and in some cases hardly feasible – then an appealing option would seem to be regulatory action to curb the negative consequences. In the case of PLMs the drawbacks identified above include the extraction of private benefits to a degree which (whether or not they are perceived as abusive by the non-controlling shareholders) is societally inoptimal.

A strong corporate governance framework is one of the best safeguards against an excessive extraction of private benefits by controlling shareholders. In a best-case scenario, residual private benefits could actually be smaller than the efficiency-enhancing effect of the PLMs in overcoming agency and incentive costs. In this case the combined outcome of PLMs and adequate regulation will be an enhanced social outcome compared with a baseline scenario without PLMs. Following this logic, efforts to overcome the potential costs of PLMs through direct regulation are, in effect, second-best to enhancing the corporate governance frameworks and may even be motivated by the perceived difficulty in making a more concerted effort at improving the relevant legislation, regulation and implementation.

In the context of PLMs, at least three aspects appear of vital importance: (1) liquid and well-informed capital markets that are able to price correctly the likely disadvantage of PLMs to outside shareholders; (2) laws and regulations preventing extraction of private benefits from reaching socially unacceptable levels (including “ex-ante provisions” to protect minority shareholders, in the language of the Methodology); and (3) proper implementation mechanisms, including prompt and affordable legal recourse for all shareholders.

7.3.1 Market discipline and private benefits

The empirical evidence surveyed in previous is indicative of the importance of capital markets. Differences in share prices indicate that informed investors systematically discriminate between companies and markets according to the perceived severity of PLMs in place. At one extreme, PLMs are quite rare in the United Kingdom in the face of an expressed resistance to such mechanisms by main actors in the City of London. Clearly a strong price signal, including with regards to the potential market value of future share offerings, creates important incentives for companies to avoid excessive recourse to disproportional structures.

Some additional "disciplining" factors may apply. For instance, it may be overly simplistic to assume that the blockholders' degree of influence relies on their votes only. In practice the largest blockholders, even in the presence of PLMs, often control less than 50% of the voting stock and hence are dependent on their ability to mobilise support from other shareholders, which mitigates the scope for abusing their position. Among the arguments against holding excessively large control blocks are the disincentives to risk adverse investors of investing too large a fraction of their assets in one company, as well as the difficulty of liquidating an exceedingly large position (e.g. in consequence of deficient secondary market liquidity) in case of need.

Another potentially effective constraint on insider behaviour – which falls somewhat outside the scope of the present paper – is the market for corporate control. In addition to facilitating actual control transfers the mere possibility that an outsider challenges the insiders' control can have a disciplinary effect inducing insiders to abstain from self-serving actions that lower firm value[54]. Following Burkhart and Lee (2007), "*control contestability and partial ownership concentration are alternative mechanisms to mitigate the conflict between insiders and (outside) shareholders. It thus seems ideal to discipline insiders by using both mechanisms*".

The importance of laws and regulations, and their implementation, is also highlighted by studies of the share prices of companies with PLMs. As mentioned earlier the discounts investors extract when investing in non-controlling shares seem to vary systematically with their assessment the degree of protection offered them by legal and market frameworks, and their perception of the intentions of the controlling shareholders. For instance, in some of the Scandinavian countries where frequent recourse is made to multiple-class share structures, but legal and regulatory frameworks are believed to leave little scope for abusive extraction of private benefits, value discounts are generally very modest. Conversely, studies of countries with a comparatively limited legal protection of non-controlling shareholders – including emerging markets outside the OECD area – in some cases find truly massive discounts.

7.3.2 The OECD Principles and the extraction of private benefits

While the value of strong corporate governance frameworks is uncontested, it must be recognised that achieving this in practice can be a daunting task. In many countries, obtaining a corporate environment that limits the extraction of private benefits would require overhauling large bodies of law and regulations. If such action were considered only in order to deal with the – in most cases, presumably, relatively limited – cost of disproportionality then following the logic of regulatory impact assessment it is doubtful whether such action would be taken. It may in practice be less costly and more feasible to ban (certain) PLMs. However, certain minimum standards for corporate governance should not be compromised. The OECD Principles of Corporate Governance contains provisions that bear both directly and indirectly on the benefits extraction by controlling shareholders.

As discussed in a previous section, the OECD Principles provides a benchmark for assessing the relevance of the proportionality principle – including with regards to regulatory and other protection against the abuse of insider power and controlling shareholdings. The two principles that bear most directly on this issue are III.A.2 ("Minority shareholders should be protected from abusive action by, or in the interest of, controlling shareholders… and should have effective means of redress.")[55] and VI.B ("Where

[54] For instance, comprehensive restructuring carried out by incorporate corporate managements is attributed by Holmström and Kaplan, 2001) to the concurrent takeover threat.

[55] The phrase "minority shareholder" in the Principles corresponds to "non-controlling shareholder" in the terminology of the present paper.

board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.”).

Both outcome-oriented principles are necessarily defined very broadly. Some more concrete options for regulatory and other action are suggested by the Methodology, which posits that measures to protect minority shareholders may include, ex-ante, pre-emptive rights, qualified majorities for certain shareholder decisions and the ability of minority shareholders to convene a meeting of shareholders. Ex-post means of redress include derivative and class action suits and enforcement and investigation by the regulatory authorities. Principle VI.B is basically enforceable only through courts or arbitration instances that would need to establish standards for “fair” treatment. In countries with little or no jurisprudence in this area there may be considerable uncertainty about whether and to what extent fair treatment of non-controlling shareholders is indeed safeguarded.

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