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# Multiple faces of shareholder power in Asia: Complexity revealed

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# Multiple Faces of Shareholder Power in Asia: Complexity Revealed

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# Multiple Faces of Shareholder Power in Asia: Complexity Revealed

Dan W. Puchniak*

ABSTRACT:

This is a working draft Chapter for a forthcoming volume, The Research Handbook on Shareholder Power, edited by Randall Thomas and Jennifer Hill (United Kingdom: Edward Elgar). The Research Handbook is part of a joint project on Shareholder Power co-organized by Dan W. Puchniak and Randall Thomas, which is co-sponsored by NUS Law's Center for Law & Business and Vanderbilt Law School's Law and Business Program. The Chapter uses three distinct lenses (i.e., American, Asian, and jurisdiction-specific lenses) to reveal the multiple faces of shareholder power in Asia. It demonstrates that viewing shareholder power in Asia solely through the monolithic American-cum-global lens not only results in myopia, but terribly misleads. It explains why jurisdiction-specific (and not American or Asian) lenses are required to reveal the "external benefits of control" which appear to be critical for understanding the behavior of the most important shareholders in Asia's miracle economies — a fact that has been almost entirely overlooked. The Chapter concludes by suggesting that future research should use "jurisdiction-specific lenses" to gather and analyze local knowledge to understand the unique external private benefits of control that make shareholder power in Asia's leading economies incredibly diverse and complex — something that will require a book not another regression analysis

Key words: Comparative corporate law, shareholder power, Asian shareholders, private benefits of control, controlling shareholders,independent directors, proxy contests, hostile takeovers, shareholder litigation, culture and corporate governance

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During the industrial revolution, the United Kingdom managed to double the size of its economy in a little over fifty years—an astonishing feat that marked the beginning of more than a century of the West's domination of the world economy (Australian Government 2012). Even juxtaposed against this epoch-changing event, the last fifty years in Asia appears extraordinary. Starting in the 1950s, Japan engineered the first "economic growth miracle" in recorded human history: the Japanese economy doubled in size in under a decade (Spence 2011). Over the next fifty years, economic growth miracles sprung up throughout Asia, with many Asian economies repeating their growth miracles two or three times over. These sustained economic growth miracles rapidly transformed Asia's four tiger economies (Hong Kong, Singapore, South Korea and Taiwan). These economies have now joined (and, in some cases, surpassed) Japan as among the most wealthy, sophisticated and efficient economies in the world. China and India have more recently engineered their own economic growth miracles, transforming themselves into potentially the world's most important engines for economic growth (Australian Government 2012).

The result: the West's domination of the world economy is over. Asia's tiger economies now appear at the top of global rankings in terms of per capita GDP and economic efficiency. China is now poised to overtake the United States as the world's largest economy—a position the United States has held for over a century. By 2020, three of the world's four largest economies will be in Asia (China (1), Japan (3) and India (4)) (Jorgenson and Vu 2011). The shift in global economic power towards Asia is undeniable and can no longer be ignored.

The meteoric rise of Asian economies has seen the concurrent rise of Asian financial markets and companies. The first decade of the new millennium saw Asian financial markets take center stage in the global competition for shareholder capital. In 2010, Asian stock exchanges captured 66 percent of the capital raised globally through initial public offerings



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(IPOs), up from 12 percent in 1999 (Spears and Tsang 2010). Indeed, in three of the last six years, the Hong Kong Stock Exchange has attracted more fresh shareholder capital than either the New York Stock Exchange or London Stock Exchange, leading the world in capital raised through IPOs. Similarly, Asian companies can now claim to be the most powerful in the world. In 2013, for the first time, there were more Fortune Global 500 Companies in Asia than in either North America or Europe (*Fortune Magazine* 2013). In fact, there are now twice as many Fortune Global 500 Companies headquartered in Tokyo (47) and Beijing (41) than in New York (18) and London (18) (ibid.). Regardless of whether this century turns out to be "Asia's century", as many predict, what has already occurred in Asia provides a unique opportunity to evaluate whether the conventional wisdom about shareholder power, which has been derived primarily from America's corporate governance experience, has universal applicability. To spoil the surprise, it does not.

When viewed through the lens of American corporate governance, the face of shareholder power in Asia appears conspicuous for its absence. Replace the American lens with an Asian one, however, and the face of shareholder power in Asia is notable for its prominence. Replace the macro-Asian lens with a lens for each of Asia's miracle economies and the prominence of shareholder power in Asia remains, but its jurisdictional diversity is revealed.

This chapter uses these three lenses to reveal the multiple faces of shareholder power in Asia. The chapter demonstrates that viewing shareholder power in Asia solely through a monolithic American lens not only results in myopia, but terribly misleads. It also illuminates how *local* context, which is treated increasingly in comparative corporate law and governance scholarship as unimportant, is essential for understanding shareholder power and corporate governance comparatively in Asia (and, most likely, around the world).



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For decades, the lens of American corporate governance has been intensely focused on finding solutions to the principal corporate governance problem in the Berle and Means corporation: minimizing shareholder-manager agency costs (Cheffins 2011). This focus has brought to the fore corporate governance solutions which aim to empower dispersed shareholders vis-à-vis self-interested managers. Hostile takeovers have become a hallmark of American corporate governance by providing a market mechanism for transforming "*de jure* shareholder voice into a powerful *de facto* form of shareholder control" (Coates 1999). Independent directors have become a linchpin in American corporate governance by providing a watchdog for dispersed shareholders in corporate boardrooms (Gordon 2007). Shareholder litigation has become a pillar of American corporate governance by enlisting entrepreneurial attorneys to deliver compensation to injured dispersed shareholders and to deter managers from using their *de facto* control for their own self-interest (Cheffins and Black 2006). Proxy contests have, more recently, become a fixture of American corporate governance by providing a mechanism that amplifies the voice of dispersed shareholders by channeling it through institutional investors and shareholder activists (Gilson and Gordon 2013). In sum, the lens of American corporate governance sees empowering dispersed shareholders in order to minimize managerial agency costs as the key to good corporate governance. This view has been brought to a global perspective by prominent international organizations and the watershed law and finance literature which see the empowerment of dispersed shareholders in all countries, regardless of the local context, as critical (if not, required) for successful companies, financial markets and economies to develop (La Porta et al. 1998, 1999, 2000).

When viewed through this American-cum-global lens, shareholder power in Asia confuses. Asia's miracle economies have generally become known for disempowering, not empowering, dispersed shareholders—the opposite of what the American lens would predict.



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Indeed, non-existent markets for corporate control, insider dominated boards, anaemic shareholder litigation, and perfunctory shareholder meetings are corporate governance features for which Asia has become infamous. This gives rise to a vexing question: How has Asia produced world-leading companies, world-leading financial markets, and world-leading economies without American-style shareholder power?

Although the American lens provides few insights into this important question, it does have some utility. Increasingly, scholars gazing at Asia through an American lens have spotted some green shoots of American-style shareholder power on the rise. To name just a few, scholars have studied the rise of derivative actions in Japan and Korea (Puchniak and Nakahigashi 2012; Rho and Kim 2012), and the rise of independent directors in China (Clarke 2006; Yuan 2007). Governance scholars have also looked at the rise of shareholder activism in India (Varottil 2012). What these and other similar studies reveal, however, is that when American mechanisms for shareholder power are transplanted into Asia they tend to take on a unique localized form and produce unexpected consequences—so much so that they no longer seem "American-style" in practice.

It appears that, ironically, the intense search to find similarities in the manifestations of American-style shareholder power in Asia has resulted primarily in identifying differences. In addition, it should not be forgotten that a few green shoots of modified "American-style" shareholder power does not change the fact that Asia's enormous economic success occurred (and, generally, still occurs) in a corporate governance environment largely devoid of American-style shareholder power. As such, the question remains: How have Asian companies, financial markets and economies become world leaders in the absence of American-style shareholder power?

Replace the American lens with a lens that looks at corporate governance in Asia on its own terms and a critical feature is revealed that brings at least part of the answer to this



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question into focus: in each of Asia's leading economies a single or small group of block shareholders controls the corporate governance in most large public companies through their voting rights (La Porta et al. 1999; Claessens et al., 2000; Huang, 2012; Varottil, 2012). From this perspective, when viewed through an Asian lens, shareholders in Asia wield an enormous amount of power—a fact the American lens obscures. Indeed, the power that these block shareholders wield directly over corporate governance often appears greater than the power that shareholders in America wield indirectly through hostile takeovers, independent directors, shareholder litigation, proxy battles, or any other means.

The idea that shareholder power may be more of a force in Asia than America turns the comparative corporate governance universe on its head. After all, America has long been vaunted as the global bastion for shareholder primacy and power, while Asia has largely been lambasted for its penchant for shareholder disempowerment. In addition to exposing the frailties in this conventional wisdom, the realization that powerful block shareholders dominate corporate governance in Asia's miracle economies provides at least three other valuable insights.

First, it helps explain why many American-style mechanisms for shareholder power have gained little traction in Asia. Put simply, Asia's block shareholders inherently have power over corporate governance through their direct voting rights. They do not require American mechanisms, which are designed primarily to overcome the collective action problems of dispersed shareholders, as they do not have such problems to begin with. Obviously, hostile takeovers and proxy battles fade in importance in an environment where companies are dominated by large block shareholders who have *de facto* corporate control.

Second, it helps explain why some American mechanisms for shareholder power tend to produce unexpected results when transplanted into Asia. For example, in Asia's controlling shareholder environment independent directors are often transformed from being watchdogs



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for dispersed shareholders into a mechanism for amplifying the block shareholder's controlling power or a signaling device for "good" corporate governance with no real bite (Clarke 2006; Lawley 2007; Yuan 2007; Song 2008; Pritchard 2012).

Third, as Gilson has observed, in a controlling block shareholder environment the focus of corporate governance shifts from minimizing managerial agency costs to minimizing private benefits of control (Gilson 2006). This valuable insight, combined with the realization that Asia's miracle economies are dominated by powerful block shareholders, suggests that analyzing the role of private benefits of control in Asia—an area which has too often been overlooked—is critical for understanding shareholder power in Asia's miracle economies.

The insight that understanding private benefits of control is critical for understanding shareholder power in Asia, however, exposes the limitations of a *single* Asian lens. Although Asia's miracle economies are broadly similar in that they are each dominated by powerful block shareholders, these shareholders have *diverse* and *local* characteristics which impact uniquely on the types of benefits of control that drive them. Indeed, the diversity of Asia's most powerful shareholders is remarkable: from the state as the most powerful shareholder in China, to the quasi-state sovereign wealth fund and wealthy families as the most powerful shareholders in Singapore, to corporate shareholding networks dominated by lifetime employees (and previously strongly influenced by main banks) as the most powerful shareholders in Japan. This diversity suggests that the only way to accurately understand shareholder power in Asia is through multiple jurisdiction-specific lenses—not one monolithic lens for all of Asia. Indeed, when multiple jurisdiction-specific lenses are employed it becomes clear that Asia's most powerful shareholders are each driven by a unique matrix of *external* benefits of control. These matrices vary from jurisdiction to jurisdiction, within each jurisdiction, and over time: complexity revealed.[1]

[1] See section IV, for a detailed explanation of the differences between internal and external benefits of control.



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A detailed examination of the unique matrices of *external* benefits of control that drive Asia's diverse groups of powerful controlling block shareholders and the institutional and regulatory constraints upon them is, unfortunately, more suitable for a book than a book chapter. Indeed, this author is in the early stages of writing a book on this very topic. Within the constraints of this chapter, however, what will be demonstrated is that recognizing and understanding the *diverse* and *local* characteristics of Asia's most powerful shareholders is critical for understanding shareholder power and corporate governance in Asia. In particular, this chapter will explore how such diversity results in a variety of unique and local *external* benefits of control (e.g., political gains, cultural contingent psychic benefits and institutional financial benefits) which may drive the expression of shareholder power, and how it is regulated, in unique localized ways. In a sense, this chapter's multiple jurisdiction-specific lenses illuminate an inconvenient truth: there is no such thing as shareholder power *in Asia*. Rather, there are multiple faces of shareholder power in Asia and to understand them properly requires *local*—not American, Asian, or universal—knowledge.

The balance of this chapter will proceed as follows. Section I examines how the American lens has come to be defined by the managerial agency costs problem and explains how, in this environment, corporate governance mechanisms that aim to empower dispersed shareholders vis-à-vis self-interested managers have become the primary litmus test for "good" corporate governance. Section II explores how the American lens has gone global and examines how Asia, when viewed through this American-cum-global lens, appears to have an absence of shareholder power—resulting in a number of erroneous conclusions about shareholder power and corporate governance in Asia's miracle economies. Section III illuminates a critical feature that becomes visible when Asia's miracle economies are viewed on their own terms: a single or small group of block shareholders control, through their voting rights, the corporate governance in each of Asia's miracle economies. It then explains why



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this insight makes an analysis of *internal* and *external* benefits of control critical for understanding shareholder power in Asia. Section IV replaces the macro-Asian lens with multiple jurisdiction-specific lenses which reveals how understanding the *diverse* and *local* nature of *external* benefits of control in Asia's miracle economies is critical for properly understanding the role of shareholder power and corporate governance in Asia. Section V concludes by suggesting that the key to understanding shareholder power in Asia is local, jurisdiction-specific, knowledge. This is a marked departure from the lust for grand universal theories which has become a driving force in comparative corporate governance scholarship (Puchniak 2012).

## I. THE AMERICAN LENS: NARROWLY FOCUSED ON EMPOWERING DISPERSED SHAREHOLDERS TO MINIMIZE MANAGERIAL AGENCY COSTS

In 1932, law professor Adolf Berle and economist Gardiner Means made the ground-breaking observation that in the largest American corporations a new condition had developed: "[T]here are no dominant owners and control is maintained in large measure apart from ownership" (Berle and Means 1933: 117). This observation cast the lens through which American corporate governance has been primarily viewed ever since—one in which dispersed shareholders collectively own America's largest corporations but individually lack sufficiently sizable stakes to influence the directors and executives who effectively control them (Cheffins and Bank 2009). In such an environment, the risk that directors and executives will either shirk their responsibilities or use their *de facto* corporate control to serve their self-interests (i.e., the risk of "managerial agency costs") looms large. As a result, for decades, the lens of American corporate governance has focused primarily on finding mechanisms to minimize the managerial agency costs that arise from the inherent lack of



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power that dispersed shareholders have over the directors and executives who effectively control America's largest corporations (Cheffins 2011).

In this context, it makes sense that many of the mechanisms that have come to define American corporate governance aim to empower dispersed shareholders vis-à-vis managers in large public companies. Hostile takeovers, at least in theory, perform this function by ensuring that managers who do not exercise their *de facto* control in a way that maximizes shareholder value will be displaced by a hostile acquirer—effectively reasserting the control of dispersed shareholders *ex post* when managers indulge in agency costs producing behavior *ex ante*. Such an *ex post* expression of dispersed shareholder power provides a credible *ex ante* threat for all managers to avoid agency costs producing behavior in the future. Developments in American corporate governance (e.g., the widespread adoption of poison pills, staggered boards and state-based anti-takeover legislation) illustrate the complexity of putting the theory of empowering dispersed shareholders through hostile takeovers into practice. Even in the face of such complexity, however, it is clear that hostile takeovers have remained a focal point of American corporate governance because of their *potential* to reduce managerial agency costs by utilizing free-market forces to effectively empower dispersed shareholders.

Independent directors have similarly become a linchpin in American corporate governance based largely on the belief that they can effectively minimize managerial agency costs in dispersedly held public companies. The emergence of this belief has accompanied a shift in the role that directors are expected to play in America's large public companies: from trusted advisors to the CEO in the 1950s, to active monitors of management today (Gordon 2007).

For directors to effectively fulfill their role as managerial monitors, independence is key. This has been recognized in stock exchange listing rules, federal legislation and



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Delaware jurisprudence, which have all reinforced the prominence of independent directors as managerial monitors in America's large public companies. The result has been an increase in the representation of independent directors on the boards of public companies, from 20 percent in the 1950s, to 75 percent by the mid-2000s (Gordon 2007). Indeed, this illustrates how the idea of independent directors as powerful watchdogs on behalf of dispersed shareholders has become entrenched in American corporate governance.

Shareholder litigation has similarly become a pillar of American corporate governance based on the rationale that it can be an effective mechanism for empowering dispersed shareholders. As Cheffins and Black have noted, in the United States both class actions and derivative suits are "well-established devices for solving collective action problems that otherwise discourage shareholders owning a small percentage of shares from launching proceedings against directors" (Cheffins and Black 2006: 1393). The ability of class actions and derivative suits to enhance the power of dispersed shareholders is bolstered by the high-powered economic incentives that the American legal system provides entrepreneurial attorneys who normally drive such actions. In addition, the United States stands out among major jurisdictions in not requiring plaintiffs to pay some portion of the defendant's legal expenses in unsuccessful cases, further improving the litigation environment for dispersed shareholders (ibid.). In sum, the American system of shareholder litigation is tailored towards providing dispersed shareholders with mechanisms for holding directors and executives accountable when they abuse their *de facto* control.

Finally, proxy contests have also become a fixture of American corporate governance by amplifying the power of dispersed shareholders in large public corporations (Gilson and Gordon 2013). In spite of the fact that under United States law proxy proposals are nonbinding, there is growing evidence that they have been effective in driving management towards acting in the interests of shareholders. This is evident from the impact that proxy



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contests have had on a number of pro-shareholder corporate governance initiatives (e.g., the removal of the poison pill and staggered boards and linking executive pay with performance). Indeed, empirical evidence has shown that approximately 40 percent of proxy proposals that win a majority vote end up being implemented by management (Renneboog and Szilagyi 2010).

The emergence of proxy contests as a powerful tool for dispersed shareholders is intrinsically linked to the rise of institutional investors as a powerful voice in America's large public corporations. With institutional investors now collectively controlling a majority of shareholder votes in many of America's largest public corporations, they can credibly threaten to align themselves in order to challenge management in proxy contests. This threat, combined with the emergence of shareholder activists that have made a business model out of driving institutional investors to act, have made proxy contests an important mechanism for empowering dispersed shareholders in order to limit managerial agency costs (Gilson and Gordon 2013).

In sum, the lens of American corporate governance has been shaped primarily by the fundamental problem that Berle and Means observed eighty years ago: large public corporations are owned by dispersed shareholders but effectively controlled by directors and senior executives. The disempowerment of shareholders that axiomatically flows from being dispersed has been addressed in American corporate governance primarily through mechanisms that aim to empower dispersed shareholders vis-à-vis self-interested managers—hostile takeovers, independent directors, shareholder litigation and proxy contests loom large.

Before moving on, it should be noted that there is a growing body of research suggesting that it is no longer accurate to view America's large public corporations solely through the Berle and Means lens (Cheffins and Bank 2009). This research has insightfully revealed that there are a significant number of large public corporations in the United States



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that have either a large dominant shareholder or institutional shareholders who can collectively speak with a controlling voice. Although this research highlights a diversity among America's large public corporations that has too often been overlooked, the fact remains that in the United States "the typical very large firm lacks a shareholder owning a dominant stake" (Cheffins and Bank 2009: 467). In other words, the fundamental observation made by Berle and Means still holds true for the bulk of America's largest public corporations.

Much more importantly in the context of this chapter, however, there is little dispute that the lens which has been used to understand American corporate governance and the mechanisms that have come to define it, have been built primarily on the *assumption* that the Berle and Means corporation is the dominant form taken by America's largest public companies. As a result, corporate governance mechanisms that aim to empower dispersed shareholders vis-à-vis self-interested managers have come to be viewed in the United States as critical (if not, required) for good corporate governance—a view that has now gone global (Cheffins 2012).

## II. ASIA'S ECONOMIC MIRACLES VIEWED THROUGH THE AMERICAN LENS: MYOPIA REVEALED

In the 1990s, corporate governance scholarship shifted from being focused primarily on American corporate governance to focusing on comparing the corporate governance systems of leading economies around the world (Cheffins 2012). The intellectual lens used for this comparative analysis was influenced substantially by the economic climate of the time. The 1990s saw the indisputable rise of the United States as the sole global economic superpower, while the economic fortunes of Japan and Germany—which were seen as possible



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challengers to America's economic hegemony a decade earlier—were in steep decline. In this environment, the American lens became the perspective from which all other systems of corporate governance were primarily viewed (Puchniak 2007a). This development resulted in American corporate governance emerging as the *de facto* gold standard for "good" corporate governance around the world.

In this context, somewhat ironically, the dispersed nature of shareholding in America's large public corporations came to be viewed as a primary reason for its economic success—not the bane of its existence as Berle and Means had suggested. Research by leading scholars claimed that dispersed shareholding was intrinsically linked to the development of successful financial markets and economies. At the same time, it became evident that the United States and United Kingdom stood out as the only countries in the world whose public corporations were dominated by dispersed shareholders (Puchniak 2007a). This fact buttressed the view that dispersed shareholding was the "optimally efficient" endpoint in the global evolution of corporate governance (Gilson 2006). After all, throughout the 1990s, the New York Stock Exchange and London Stock Exchange were unparalleled among global financial markets and America's economic hegemony was unchallenged. The only question that remained was: Why were the United States and United Kingdom able to develop "optimally efficient" dispersed shareholding systems, while other countries failed to do so?

The most influential answer to this question was put forward by the now familiar "law and finance" literature (La Porta et al. 1998, 1999, 2000). This body of watershed research suggested that the answer lay primarily in the strong legal protections that the United States and United Kingdom provided for minority shareholders. Specifically, this literature empirically linked strong legal protections for minority shareholders to the development of dispersed shareholding and successful financial markets and economies. In short, it suggested



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that the key to America's economic success lay in the strong legal protections provided to minority shareholders, which were essential for its "optimally efficient" system of dispersed shareholding to develop.

The specific "law and finance" theory strongly supported the broader idea that empowering dispersed shareholders lay at the core of successful corporations, financial markets and economies. This idea, which was built on America's corporate governance experience, became widely accepted around the world and has evolved into much more than an academic musing. It has influenced a slew of corporate governance reforms around the world—from corporate governance reforms imposed by the International Monetary Fund and World Bank in response to financial crises, to European Commission directives aimed at improving corporate governance in the EU, to countless domestic codes of "good" corporate governance and corporate law reforms around the world.

Perhaps more importantly, over the last two decades, this idea has transformed mechanisms for empowering dispersed shareholders, which have become synonymous with American corporate governance, into key indicia for measuring "good" corporate governance around the world. Specifically, hostile takeovers, which only a few decades ago were narrowly embraced by "some American academics and highflying investment bankers on Wall Street, [have become] widely embraced by mainstream governments, academics and corporate governance pundits around the world [as] a prerequisite for an efficient system of corporate governance" (Puchniak 2008a: 197). Independent directors, which in the 1950s were an idiosyncrasy even on American corporate boards, have become a benchmark for good corporate governance around the world. High-powered mechanisms for minority shareholder litigation, which have traditionally been seen as a unique (and often deleterious) form of American corporate governance, have taken center stage on Asian and European corporate governance reform agendas. Vigorous proxy contests, which only more recently



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have come to play a critical role in amplifying dispersed shareholder voice in America's large public companies, are emerging as a global litmus test for "good" corporate governance.

In sum, these mechanisms for empowering dispersed shareholders have become synonymous with American corporate governance and in the process have emerged as indicia for "good" corporate governance around the world. This has been driven largely by the assumption that if countries adopt American mechanisms for shareholder power, dispersed shareholding and economic success will follow. In this context, the conventional wisdom has become that American mechanisms for empowering dispersed shareholders are essential (if not, required) for successful companies, financial markets and economies to develop. The American lens for understanding shareholder power has gone global.

Viewed through this American-cum-global lens, the success of Asia's leading companies, financial markets and economies confuses. The American mechanisms for empowering dispersed shareholders have been deemed essential for success. Yet, Asia's leading companies, financial markets and economies have achieved success, at a level that has transformed the global economy, largely in the absence of American-style shareholder power. The American lens fails to explain this world-changing phenomenon. On the contrary, it suggests that it should not have occurred at all.

An obvious starting point for accurately explaining Asia's enormous success without American-style shareholder power would be to abandon the American lens and look afresh at the role that shareholders and other stakeholders have played in Asia's miracle economies—not to search myopically for American mechanisms for empowering dispersed shareholders in Asia. Indeed, this is the approach taken in sections III and IV of this chapter. Unfortunately, however, most leading corporate governance scholars and policymakers have failed to take this approach (Lin and Milhaupt 2013). Instead, they continue to view shareholder power in Asia through an American lens. As a result, at least two erroneous



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conclusions about shareholder power and corporate governance in Asia's miracle economies have emerged.

First, when shareholder power in Asia is viewed through an American lens, corporate governance in Asia's miracle economies appears exceptionally "poor". It is fairly obvious, however, that to reach such a conclusion requires strained logic that borders on a tautology: American mechanisms for empowering dispersed shareholders are tantamount to "good" corporate governance; therefore, "good" corporate governance requires American mechanisms for empowering dispersed shareholders. As thin as this logic may be, it often forms the basis for the widely-held, but erroneous, view that Asia's miracle economies uniformly have "poor" corporate governance because they lack American mechanisms for empowering dispersed shareholders.

A striking example of this can be seen in GovernanceMetrics International's global corporate governance ratings, which provide a yearly ranking of the quality of corporate governance in 38 of the world's most important economies ("the GMI Ranking") (GMI 2010). The GMI Ranking considers a myriad of factors in calculating each economy's score for "good" corporate governance. The availability of hostile takeovers, the influence of independent directors, and minority shareholder rights, however, play a weighty role (ibid.). In essence, the GMI Ranking relies heavily on the American lens for assessing shareholder power as a way to distinguish "good" from "bad" corporate governance. It assumes that the American mechanisms for empowering dispersed shareholders are indicia of "good" corporate governance around the world—a view that surely influences the corporate governance advice that GMI provides to its institutional clients who manage $15 trillion (Daines et al. 2010).[2]

[2] Bebchuk and Hamdani have made a similar observation regarding RiskMetrics's highly influential Corporate Governance Quotient (CGQ) (Bebchuk and Hamdani 2009).



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The yearly results of the GMI Ranking are predictable: the United States and United Kingdom consistently rank at the top, while Asia's miracle economies consistently rank at the bottom (e.g., GMI 2010). In fact, in 2010, not a single Asian miracle economy received even a passing grade in the GMI Ranking, China and Japan ranked 33 and 34 respectively out of 38 economies and, adding insult to injury, all of Asia's miracle economies (except for Singapore and India) ranked below Greece (ibid.). The rankings confirmed what we should already know: American mechanisms for shareholder power loom large in American corporate governance but play a limited role in the corporate governance of Asia's miracle economies. To erroneously conclude from this, however, that corporate governance in Asia's miracle economies is exceptionally "poor" is grossly myopic. It turns a blind eye to any possibility that "good" corporate governance may occur in the absence of American mechanisms for shareholder power.

Second, many scholars and policymakers justify using an American lens to view shareholder power in Asia by essentially recasting Asia's success without American-style shareholder power as a *transitory stage* on the path towards economic development (Puchniak 2007a, 2008a). As the theory goes, Asia's miracle economies have been able to develop successfully without American-style shareholder power. After they reach development, however, shareholding in large public companies will become dispersed and American-style shareholder power will be required to minimize managerial agency costs.

Although this theory may provide a rationalization for the obsessive search for American-style shareholder power in Asia, history has proved it wrong. Over the past several decades, Japan and Asia's four tiger economies have all achieved economic development. None of them, however, have developed a corporate governance system defined by American mechanisms for shareholder power. In other words, economic development does not axiomatically require or lead to the development of American-style shareholder power.



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Indeed, Asia's tiger economies are now demonstrating that *developed* economies cannot only exist, but indeed thrive—sometimes at levels that significantly outperform the United States and United Kingdom—in the absence of corporate governance systems defined by American mechanisms for shareholder power. A short history lesson should suffice.

To start, it is uncontroversial that Japan's post-war economic boom (1950s–1980s) was both miraculous and devoid of any evidence of American-style shareholder power (Puchniak 2008b). In four post-war decades, Japan transformed itself from a country decimated by war to having a GNP per person in 1988 that was higher than that of the United States (Ito 1992). In the process, Japan created world-leading companies and financial markets, and achieved economic growth rates that significantly exceeded any others in recorded human history (Spence 2011).

It is also well known that Japan's post-war economic miracle transpired in a corporate governance environment where American mechanisms for shareholder power played a *de minimis* role (Puchniak 2008b). Japan's market for corporate control was moribund (Puchniak 2008a). Japan's corporate boards were dominated by lifetime employees (Puchniak 2008b). Its minority shareholder lawsuits were scarce and uniformly unsuccessful (Puchniak and Nakahigashi 2012). Its shareholder meetings were curt rubberstamping affairs that were more suited for *Yakuza* shakedowns than dispersed shareholder voice (West 1999). In short, Japan, circa-1988, provided indisputable evidence of enormous success without American-style shareholder power. At that time, it was generally assumed that if any evolution were to occur it would be America "evolving" towards Japan's unique system of corporate governance that was defined by mechanisms that *disempowered* shareholders, not the other way around.

Then, in 1989, the bubble burst. Japan's success without American-style shareholder power was quickly forgotten. A chorus of corporate governance experts claimed that it was inevitable that American mechanisms for empowering dispersed shareholders would emerge



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as a defining force in Japan (Puchniak 2007a, 2008a). This was the genesis of the claim that success without American-style shareholder power was a *transitory stage* and that evolutionary forces would axiomatically lead Japan (which has often served erroneously as a proxy for Asia) to develop a corporate governance system defined by American mechanisms for shareholder power.

Indeed, the legions of experts who have claimed that American mechanisms for shareholder power would inevitably come to define Japanese corporate governance had reasons to be confident. As a result of reforms undertaken during the Allied Occupation (1945–1952), Japan's corporate law had strong legal protections for minority shareholders that had lay moribund for decades and, at least empirically, the shareholding in Japan's large public companies was (and still is) as widely dispersed as in the United States and United Kingdom—a fact that is often overlooked (Puchniak 2008b; Franks et al. 2014). Ultimately, however, in spite of incessant post-bubble predictions that Japan would inevitably develop a system of corporate governance defined by American mechanisms for shareholder power, a quarter of a century has passed and such a system has failed to emerge.[3]

Even after a quarter of a century of erroneous predictions, however, claims that American mechanisms for shareholder power will inevitably emerge as a dominant force in Japanese corporate governance have not completely ceased. This is because although Japan is still the world's third largest economy, with legions of world-class companies, and one of the highest standards of living in the world, its decades of slow economic growth have left the door open to questions about whether it may ultimately need to adopt American-style shareholder power. In addition, the rise of foreign institutional investors in Japan is putting

[3] Examples of such failures are: the failure of every attempted hostile takeover since the bubble burst (Puchniak 2008a); maintaining lifetime employee controlled boards in spite of a major corporate law reform to promote them (Puchniak 2008b); the rise of derivative actions but the realization that they are driven mainly by social activists and not wealth maximizing shareholder plaintiffs (Puchniak and Nakahigashi 2012); and, hedge-fund activists trying, but failing, to break Japan's "community firm" model (Buchanan et al. 2012).



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pressure on its corporate governance system to evolve. Even in the midst of this pressure, however, a system of corporate governance defined by American mechanisms for shareholder power has failed to develop (Buchanan et al. 2012).

Over the last few decades, however, while critics have obsessively searched for evidence of the rise of American-style shareholder power in Japan (and more recently in China), Asia's tiger economies have achieved a level of economic development roughly equivalent to, and in some cases exceeding, Japan and the United States—a fact that has been almost entirely overlooked.

Singapore's GDP per person is now significantly higher than that of the United States and Singapore regularly tops global rankings in terms of economic competitiveness and the efficiency of its corporate regulatory environment (Wee and Puchniak 2012). Hong Kong's GDP per person now also tops the United States and its stock exchange has led the world in IPOs in three of the last six years. Both South Korea and Taiwan have now also achieved GDPs per person equivalent to most developed Western countries and in the process have produced world-leading companies in several important industries.

None of the tiger economies, however, have developed corporate governance systems in which the American mechanisms for empowering dispersed shareholders have played a defining role. On the contrary, the tiger economies have achieved economic development and are thriving, yet the Berle and Means corporation and American-style shareholder power have, at best, played a marginal role.

In sum, there is scant evidence to suggest that the success of Asia's developed economies, which has occurred without American-style shareholder power, is a transitory stage on the path towards economic development—a lesson that should not be forgotten as China and India continue to develop. On the contrary, the emergence of dispersed shareholders, accompanied by mechanisms that provide them with a strong voice, is largely



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absent in all of Asia's developed (and developing) miracle economies. This is the opposite of what America's corporate governance experience would lead one to predict.

It should now be clear that using the American lens to examine shareholder power in Asia's miracle economies confuses. The near obsessive search for American mechanisms for shareholder power in Asia, however, has had some utility. Although none of Asia's miracle economies have developed anything resembling American-style shareholder power, many attempts have been made to transplant American mechanisms for empowering dispersed shareholders into Asia's miracle economies. For example, the rise of derivative actions in Japan and Korea, independent directors in China and shareholder activism in India have all been cited as attempts to transplant American mechanisms for shareholder power to Asia (Clarke 2006; Yuan 2007; Varottil 2011; Puchniak and Nakahigashi 2012; Rho and Kim 2012; Varottil 2012). What these and other similar observations reveal, however, is that when American mechanisms for shareholder power are transplanted into Asia they tend to take on a unique localized form and produce unexpected consequences—so much so that they no longer seem "American-style" in practice.

This obsession with viewing Asia through an American lens has come at a price. For Japan and China, which over the last two decades have respectively been the focal points in Asia for comparative corporate governance, a detailed comparative literature has developed on the potential emergence of hostile takeovers, independent directors, derivative actions and shareholder activism. Putting the American lens aside, this literature appears curious as none of these American mechanisms for shareholder power have been a defining force in any of Asia's miracle economies. In other words, we have developed a detailed understanding of how American mechanisms for shareholder power have failed to gain traction, had marginal influence or produced limited and often unexpected results in two out of seven of Asia's miracle economies. In short, we have missed the mark.



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Conversely, there has yet to be a detailed comparative analysis of the forces that drive the significant block shareholders in Asia's miracle economies—which, as explained below, is the crux of shareholder power in Asia. Such an analysis appears to have significant value as major block shareholders control the vast majority of the largest public companies in Asia's miracle economies. In other words, in the obsessive search for American-style shareholder power, the true essence of shareholder power in Asia has been largely ignored. Now that the acute myopia caused by the American lens has been revealed, the remainder of this chapter will attempt to provide an overview of shareholder power in Asia on its own terms.

## III. THE ASIAN LENS: SHAREHOLDER POWER IN ASIA REVEALED

If we put aside the American lens and look afresh at the corporate governance landscape in Asia, a critical feature is revealed: in all of Asia's miracle economies, except for Japan, public companies typically have a single shareholder that holds a large enough block of shares to exert effective control over the company. In other words, in all of Asia's miracle economies, except for Japan, most public companies have a concentrated shareholder structure (La Porta et al. 1999; Claessens et al. 2000; Huang 2012; Varottil 2012). Based on this observation, at least at first blush, it would appear to make sense to have two lenses for examining shareholder power in Asia: one for Japan, and one for all of Asia's other miracle economies.

Based on a purely empirical analysis, the shareholding structure of Japan's large public companies stands out, not only in Asia, but also in comparison to almost all other countries in the world. Indeed, post-war Japan has been distinct from most other countries as the vast majority of its large public companies have traditionally not had a single shareholder with a block of shares large enough to exert effective control. In fact, according to the most



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common empirical measures for shareholder dispersion, only shareholders in the United States and United Kingdom are as dispersed as in Japan—with Japanese shareholders in large public companies appearing even more dispersed on some measures (La Porta et al. 1999; Claessens et al. 2000; Aoki 2010; Franks et al. 2014). Perhaps, the Berle and Means corporation has made its way to Asia after all.

Before jumping to this conclusion, however, it is important to remember that the defining feature of the Berle and Means corporation is the functional separation of ownership and control—which does not arise axiomatically from dispersed shareholding. Indeed, in the case of post-war Japan, dispersed shareholding has not resulted in a *functional* separation of ownership and control. Lifetime employee manager-directors, who have dominated the boards of large corporations in post-war Japan, have never held more than a *de minimis* percentage of their company's shares (i.e. empirically there has always been a technical separation of ownership and control in large corporations in post-war Japan) (Franks et al. 2014).

Lifetime employee manager-directors, however, have been the "functional owners" of most large Japanese corporations as they have effectively controlled the voting power in their companies through the stable/cross-shareholding networks that have traditionally dominated the shareholding landscape in post-war Japan (Puchniak 2008b; Buchanan et al. 2012). These stable/cross-shareholding networks were traditionally centered around main banks and/or linked together through *keiretsu* groups (Aoki et al. 1994; Shishido 2000). Although each individual shareholder in these networks typically holds less than 5 percent of a company's shares, collectively these stable/cross-shareholders (who are all typically large corporations controlled by lifetime employee manager-directors) normally hold a large enough block of shares to ensure that lifetime employee manager-directors functionally control the voting rights in most of Japan's public companies (for more details, see section IV below) (Puchniak



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2007a).[4] In this sense, Japan's public companies have had a shareholding structure which is *functionally* the same as Asia's other miracle economies: there is a powerful block shareholder (in Japan's case, the stable/cross-shareholding networks that are dominated by lifetime employee manager-directors) that owns a large enough stake in most public companies to exert effective control. The Berle and Means corporation has not found a home in Asia after all.

With this observation, a remarkable similarity among Asia's miracle economies is revealed: in each of them a single or small group of block shareholders, through their voting rights, effectively control the corporate governance in most large public companies. This observation reveals a dramatically different picture of shareholder power in Asia than the one seen through the American lens. Rather than Asia's miracle economies being described in terms of their failure to empower dispersed shareholders, they appear as economies defined by block shareholders wielding an enormous amount of power.

In fact, the power that these block shareholders wield directly over corporate governance often appears greater than the power that shareholders in America wield indirectly through hostile takeovers, independent directors, shareholder litigation, proxy battles, or any other means. The idea that shareholder power may be more of a force in Asia than America turns the comparative corporate governance universe on its head. After all, America, not Asia, has long been viewed as the Mecca for shareholder power. In addition to exposing the erroneous nature of this conventional wisdom, the realization that powerful block shareholders dominate corporate governance in Asia's miracle economies provides at least three other valuable insights.

First, it helps explain why some American mechanisms for shareholder power have gained little traction in Asia. Put simply, Asia's block shareholders inherently have power

[4] It should, however, be noted that the strength of stable/cross-shareholders' control rights and the influence that main banks have traditionally had over stable-shareholders has declined significantly in the last two decades.



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over corporate governance through their direct voting rights. They do not require American mechanisms, which are designed primarily to overcome the collective action problems of dispersed shareholders, as they do not have such problems to begin with. Obviously, in a company where more than 50 percent of the shares are controlled by block shareholders a hostile takeover is impossible—as any takeover that occurs would be, by definition, friendly. Essentially the same is true for proxy contests, which also become functionally moot in companies with large block shareholders.

Thus, the ubiquitous block shareholding structure, which is revealed when shareholder power is viewed through an Asian lens, helps explain why both hostile takeovers and proxy battles have been rare and largely unsuccessful in Asia's miracle economies. The only partial exception to this has been in Japan, where the mirage of dispersed shareholding (as explained above), exacerbated by some more recent unwinding of stable cross-shareholding networks, led to a spike in hostile takeover *attempts* and proxy battles. Ultimately, however, all of Japan's hostile takeover attempts have failed and its proxy battles have been largely unsuccessful. This demonstrates that, even in their diminished state, Japan's stable/cross-shareholders remain strong enough to exert effective control (Puchniak 2008a; Buchanan et al. 2012).

Second, it helps explain why American mechanisms for shareholder power tend to produce unexpected consequences when transplanted into Asia. A clear example of this is the role that independent directors have played in Asia's miracle economies. In 2001, Singapore implemented a corporate governance comply-or-explain regime that suggested at least a third of the directors on boards of listed companies should be independent. Although more than 98 percent of listed companies "complied" with this requirement, the effectiveness of these independent directors has been questioned because the definition for independence did not (until last year) require independence from controlling shareholders (Tjio 2011; Tan et al.



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2013). This led to speculation that independent directors may have ironically been used to reinforce block shareholder power—a consequence that runs counter to the idea of the American-style independent director acting as a watchdog for dispersed minority shareholders.

In a similar vein, in 2002, Japan reformed its corporate law to provide large companies with the *option* of adopting an "American-style" board with sub-committees controlled by outside directors (Puchniak 2003). Since this amendment, less than 3 percent of listed companies have adopted the "American-style" board and in the few that have it appears that the outside directors have sometimes served to reinforce *keiretsu* and cross-shareholding links—again, a result that runs counter to the idea of the American-style independent director (Lawley 2007; Puchniak 2008a; Goto 2013). Continuing this trend, in early 2003, China implemented rules requiring that independent directors comprise at least one-third of the boards of listed companies. Most commentators have been skeptical about their utility because of the fear that these "independent" directors will be puppets of the government, which is also China's primary block shareholder—again, a result that does not fit with the idea of the American-style watchdog independent director (Clarke 2006; Yuan 2007; Huang 2012). In sum, these examples illustrate how examining the effect of block shareholding structures in Asia's miracle economies can reveal why transplanted American mechanisms for shareholder power tend to produce unexpected consequences—a fact that is obscured when Asia is viewed through the American Berle and Means lens.

Third, as Gilson has observed, in a controlling block shareholder environment the focus of corporate governance should shift from minimizing managerial agency costs to minimizing private benefits of control (Gilson 2006). This valuable insight, combined with the realization that Asia's miracle economies are dominated by controlling block shareholders, suggests that analysing the role of private benefits of control in Asia is critical



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for understanding shareholder power in Asia's miracle economies. This insight, however, exposes the limitations of the macro-Asian lens because (as explained in detail below) there is good reason to believe that the character of private benefits of control (in particular, *external* private benefits of control) and their effect on corporate governance will differ from jurisdiction to jurisdiction, and even within each jurisdiction, over time. Thus, to properly understand the role of private benefits of control in Asia's miracle economies requires a lens for each of Asia's miracle economies—a point that will be made clear in section IV below.

## IV. JURISDICTION-SPECIFIC LENSES: ASIA'S MULTIPLE FACES REVEALED

Although the American lens views controlling shareholder structures as the inefficient consequence of failing to provide adequate mechanisms for empowering dispersed shareholders, as Gilson has pointed out, there are compelling reasons to believe that controlling shareholder structures can be efficient (Gilson 2006). This idea flows from the observation that controlling shareholders do not suffer from the collective action problem that so bedevils dispersed shareholders. Indeed, large block shareholders have a strong economic incentive to either monitor managers effectively or to manage the company itself. In addition, as a result of the block shareholder's proximity to management and ready access to information, they can often discover problems quickly and effect changes swiftly using their controlling power. From this perspective, as Gilson notes, "a controlling shareholder may police the management of public corporations better than the standard panoply of market-oriented techniques employed when shareholdings are widely held" (Gilson 2006: 1651). This observation goes a long way towards providing a possible answer to the question of how Asia has produced world-leading companies, world-leading financial markets and world-leading economies without American-style shareholder power.



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Unfortunately, however, this answer is far from complete. Although controlling shareholders provide an efficient mechanism for minimizing the risk of managerial agency costs, they introduce a new risk: private benefits of control (i.e. benefits that the controlling shareholder receives as a result of their controlling power, which are not provided to the minority shareholders). A common example of private benefits of control is when a controlling shareholder causes the company to sell a piece of its property, at below market value, to a company the controlling shareholder wholly owns. In such a case, the private benefit that the controlling shareholder receives increases proportionally as the percentage of the controlling shareholder's equity stake in the company decreases. In this common example, the controlling shareholder can be seen to have used her controlling power to extract a financial benefit from the company that was greater than the proportion of her equity stake.

The realization that controlling shareholders reduce the risk of managerial agency costs, but create the new risk of private benefits of control, suggests that a proper understanding of shareholder power in Asia's miracle economies requires an examination of private benefits of control. In essence, in Asia's controlling shareholder environment, the lens of inquiry for examining shareholder power must shift from focusing on managerial agency costs to focusing on private benefits of control. If private benefits of control were as straightforward in the real world as in the example above, it may be appropriate to view all of Asia's miracle economies as having one primary corporate governance problem (i.e. private benefits of control) which could be addressed by a single set of solutions. In other words, a single lens for all of Asia's miracle economies would suffice.

Unfortunately, however, in Asia's miracle economies (and, likely everywhere else) the reality of private benefits of control is far more complex—a fact that the literature has largely overlooked. Most often, the concept of private benefits of control is defined in



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extremely narrow terms as "the nonproportional flow of real resources *from the company* to the controlling shareholder" (Gilson 2006: 1663, emphasis added). This conventional understanding of private benefits of control assumes that the incentive for shareholders to maintain and exercise a controlling block of shares is the financial benefits of control that they can extract *from the company*. As the theory goes, without such benefits shareholders will not hold a controlling block as it imposes "costs in illiquidity and lack of diversification on the controlling shareholder, in addition to the actual cost of monitoring" (Gilson 2006: 1664).

Based on this conventional understanding of private benefits of control, the goal of corporate governance in Asia's miracle economies should be to minimize the private benefits that controlling block shareholders *extract from companies* (i.e. to minimize what is defined in this chapter as "*internal private* benefits of control"). This conventional understanding, however, overlooks an entire universe of potentially powerful benefits that controlling shareholders may receive as a result of their control which are derived from sources *external to the company* and may, in *some* cases, even produce residual benefits for minority shareholders (i.e. what is defined in this chapter as "*external* benefits of control"). These *external* benefits of control—which have been almost completely overlooked in the literature—loom large in Asia's miracle economies and explain why a single lens for accurately understanding shareholder power in all of Asia's miracle economies will not suffice.

*External* benefits of control differ from *internal private* benefits of control in four important ways. First, the types of external benefits of control available to controlling shareholders may vary among jurisdictions depending on each jurisdiction's unique economic, political and institutional environment, while there is only one type of internal private benefit of control in all jurisdictions (i.e., financial benefits tunneled out of the



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company). Second, external benefits of control may only be available to some controlling shareholders within a single jurisdiction, while internal private benefits of control are generally available to all controlling shareholders within a single jurisdiction. Third, external benefits of control can provide controlling shareholders with direct financial and/or non-financial psychic benefits which may be culturally contingent, while internal private benefits of control provide solely pecuniary benefits and generally remain consistent across cultures. Fourth, external benefits of control may incentivize controlling shareholders to act in ways that either reduce or enhance minority shareholder value, while internal private benefits of control generally only serve to reduce minority shareholder value through wealth tunneling. When external benefits of control *enhance* minority shareholder value the benefits are no longer "private" as they are shared with the minority shareholders (which is why the term "external benefits of control" rather than "external *private* benefits of control" is used in this chapter).

These four distinguishing features of *external* benefits of control loom large in Asia's miracle economies. They have resulted in the emergence of powerful controlling shareholders being driven by *diverse* and *local external* benefits of control that are unique to each jurisdiction and that in some cases enhance overall shareholder value (including value for the minority shareholders) and in other cases erode it. As such, ultimately, the only way to understand the most powerful controlling shareholders in Asia's miracle economies is to examine the unique local *external* benefits of control that are important drivers of their behavior. This is why multiple jurisdiction-specific lenses are required to accurately understand shareholder power in Asia's miracle economies. Within the scope of this chapter, a brief analysis of the unique *external* benefits of control in China (Asia's largest economy), Japan (Asia's largest developed economy) and Singapore (Asia's wealthiest economy) will make this point clear.



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To start, a brief comparison of China, Singapore and Japan clearly illustrates how the types of external benefits of control may vary significantly based on a jurisdiction's economic, political and institutional environment and may only be available to some controlling shareholders within a single jurisdiction. In China, two-thirds of the largest corporations are state-owned enterprises ("SOEs"). In 2003, the Chinese government created the State-Owned Assets Supervision and Administration Commission ("SASAC"), as a ministry-level agency, to act as the controlling shareholder for most of the largest SOEs (Lin and Milhaupt 2013). By 2006, SASAC controlled 155 Chinese companies with revenues of $1.06 trillion and is now commonly referred to as "the world's largest controlling shareholder" (Marcos Aguiar et al. 2007; Lin and Milhaupt 2013).

Lin and Milhaupt, in their detailed analysis of SASAC, have noted that the regulators and politicians who control SASAC "reap private benefits of control not shared with ordinary financial investors, in the form of political influence, opportunities for patronage or corruption, and national prestige" (Lin and Milhaupt 2013: 744). They go on to find that the objective of SASAC is "to maximize a range of benefits extending from state revenues to technological prowess, and from soft power abroad to regime survival at home" (Lin and Milhaupt 2013: 746). As such, in China, it is clear that political external benefits of control provide the most compelling reason for why SASAC maintains its block shareholdings and dictates significantly how it exercises them. In addition, many of these political external benefits of control appear to drive corporate behavior that often has more to do with the personal interests of the political figures controlling SASAC than the companies that SASAC controls. In sum, China's unique economic, political and institutional environment has produced idiosyncratic, largely political, external benefits of control that define shareholder power in China's most powerful companies—something unseen through the monolithic Asian lens.



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In Singapore, most listed companies have a powerful controlling shareholder, which is normally either Singapore's state holding company ("Temasek") or a wealthy Singaporean family (Lan and Varottil 2015). At first blush, as the Singapore Ministry of Finance is Temasek's sole shareholder, it may appear that Temasek and SASAC are driven by similar types of political external benefits of control. In addition, similar to SASAC, Temasek is the controlling shareholder of many of Singapore's largest listed companies and is by far Singapore's most powerful *single* controlling shareholder—the listed companies it controls (which are normally referred to in Singapore as Government Linked Companies or GLCs) collectively account for 37 percent of Singapore's total stock market capitalization (Tan et al. forthcoming 2015).

In reality, however, SASAC and Temasek differ significantly in terms of the incentives that drive them and the manner in which they exert their controlling shareholder power. From the outset, the Singapore government was aware of the risks of political interference in the corporate governance of GLCs. As a result, it developed a highly visible and well-tailored regulatory regime to explicitly prevent politics from influencing the corporate governance of GLCs. This regulatory regime has been largely successful as GLCs "are professionally managed with limited interference from the government" and have performed exceptionally well for decades (Tan et al. forthcoming 2015).

This is not to say that political external benefits of control do not play a role in Singapore's GLCs. To the contrary, they are at the core of the Singapore GLC model. However, Singapore's unique economic, political and institutional environment—including its almost entirely overlooked highly contested post-independence democratic elections—have inextricably intertwined the strong economic performance of GLCs to the political legitimacy of the People's Action Party (PAP), which has governed Singapore since its independence. As such, it is in the PAP's self-interest to ensure that GLCs are managed in a



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commercially effective manner to maximize their long-term value—which, based on empirical evidence, appears to have been done successfully (Tan et al. forthcoming 2015).

Thus, it appears that Singapore's unique economic, political and institutional environment has produced idiosyncratic political external benefits of control that are much different than those which have influenced SASAC in China. Indeed, somewhat ironically, in the case of Singapore the political external benefits of control have driven the government to design a system to keep politics out of the boardroom, which appears to have benefited all shareholders (including minority shareholders) in GLCs. In China, however, the evolution of SASAC seems to have created an institutional architecture that often promotes the use of its controlling power to capture immediate political external benefits of control without regard for its impact on the long-term wealth of the companies it controls. This illustrates how the types of external benefits of control and the corporate governance behavior that they drive differ significantly in China and Singapore. In addition, the political external benefits of control available to SASAC and Temasek are obviously not available to other controlling shareholders in China and Singapore respectively—illustrating how external benefits of control may be available to some controlling shareholders in a jurisdiction but not others.

As briefly explained in section III above, based on a purely empirical analysis, Japan's large public companies are among the most dispersed in the world. From shortly after the Allied Occupation until the present, however, Japan has had large blocks of stable-shareholders who are linked together through *keiretsu* and/or cross-shareholding networks and provide their support for lifetime employee manager-directors (Aoki et al. 1994; Shishido 2000; Buchanan et al. 2012). From the 1960s to 1980s, the by now well-known main bank system dominated the corporate governance of Japan's largest public corporations. Under this system, main banks were normally among the largest shareholders and primary controllers of the stable/cross shareholding networks. They were also ultimately responsible for monitoring



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the corporate management in their client companies. In return, the main banks received a myriad of financial incentives provided by the government for fulfilling their role as the main bank and profited from being viewed as a responsible main bank by players in the market. In other words, main banks received external financial benefits of control for playing the role of the coordinator and main monitor of the shareholder and *keiretsu* networks (Aoki et al. 1994; Puchniak 2007b). After the bubble burst in 1989, however, Japan's institutional and legal environment gradually changed. At the end of the 1990s, this change accelerated and cross-shareholdings, particularly in main banks, unwound significantly (Miyajima and Kuroki 2007). As a result of these institutional and legal changes, main banks no longer derived the same financial external benefits of control from being the largest shareholders in many cross-shareholder networks and consequently sold their shares—illustrating how external benefits of control may only be available to certain controlling shareholders in a market, can evolve over time, and may be contingent on a particular institutional environment.

Second, unlike internal private benefits of control, which are solely based on financial benefits, external benefits of control can involve non-financial psychic benefits. These non-financial external benefits of control are a largely unexplored area of controlling shareholder power. Indeed, the political external benefits of control in Singapore and China (discussed above) surely have a psychic element as political power is no doubt both ego driven and financially rewarding. More importantly, however, are likely the culturally contingent external benefits of control that may play a role in driving the behavior of controlling shareholders in Asia's miracle economies.

Indeed, some scholars have suggested that the prevalence in Singapore of public listed family-owned companies (which are far greater in number but tend to be smaller in size than listed GLCs) can be linked to the Confucian culture of Chinese entrepreneurs which uniquely drives them to maintain control and perpetuate the family name (Tan 2012). This may have



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some explanatory value for the prevalence of family controlled public companies in Singapore. It is unlikely, however, to provide a full explanation for why families have maintained control in many of Singapore's listed companies. Indeed, over the last 40 years of Singapore's miraculous economic growth, its shareholder market has become *more* concentrated and family-owned firms have remained dominant (Tan 2012; Lan and Varottil 2015). This has occurred during a period when Singapore has transformed into a global financial center known for its English speaking population, vibrant multiculturalism and increasingly Westernized society (Wee and Puchniak 2012). If Confucian culture is the primary driving force for families to maintain their controlling power in Singapore, then there should have been a marked decline of family-controlled companies over the last 40 years as the influence of Confucian culture has also declined—but, as we have seen, the opposite happened.

Rather than the broader nebulous concepts of "Asian values" or "Confucian culture," the more specific corporate cultures that exist in *each* of Asia's miracle economies may have more explanatory value. For example, the post-war evolution of the "community firm" in Japan, which has been defined by lifetime employee manager-directors may help explain the persistence of stable-block shareholding in Japan (Shishido 2000; Buchanan et al. 2012). After all, lifetime employees are linked together through a particular sub-culture in post-war Japan that has come to view the firm as the employee family rather than an organization for maximizing shareholder wealth. In this particular sub-culture it is easy to see how lifetime employee manager-directors may receive psychic external benefits of control when they support fellow lifetime employees in their stable/cross-shareholder networks. As lifetime employment has come under pressure and the post-war cultural concept of the "community firm" has weakened, a decrease in the psychic benefits for lifetime employee directors to support cross-shareholding networks may help explain some of their unwinding.



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There is no doubt that culturally contingent psychic external benefits of control play some role in driving the behavior of controlling shareholders in Asia's miracle economies and that these benefits evolve, as culture evolves, over time. Considerably more research, however, must be done in each of Asia's miracle economies to arrive at anything more than misleading cultural stereotypes. That being said, considering the enormous diversity among Asian cultures, it is extremely unlikely that culturally contingent psychic external benefits of control apply equally throughout all of Asia's miracle economies.

Third, unlike internal private benefits of control that come at the expense of minority shareholders, external benefits of control may sometimes drive the behavior of majority shareholders in a way that benefits minority shareholders. For example, in Singapore, listed companies in which Temasek is a controlling shareholder are more profitable than other public companies and command a 20 percent premium in their share price (Ramirez and Tan 2003; Tan et al. forthcoming 2015). In addition, even skeptics note how Temasek has also contributed to Singapore's overall economic success, which no doubt has been good for all shareholders in Singapore. Similarly, in China, some available empirical data suggests that SOEs, which SASAC controls, are more profitable than other large non-SOEs (Lin and Milhaupt 2013). Whether these potential increased profits will ultimately benefit minority shareholders or whether China will eventually reach Singapore's level of development, remains to be seen. It is clear, however, that China has been able to produce some of the most powerful companies in the world with a powerful controlling shareholder that is driven substantially by political external benefits of control. Also, during Japan's high growth era (1960s to 1980s) there is little doubt that its main banks, which were driven by financial external benefits of control, produced some of the greatest economic growth and international companies in the world.



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The point is not that external benefits of control are always beneficial for corporate governance—they are not. Politicians may maintain controlling stakes to inflate their egos at the company's expense. Families may hold onto controlling stakes to abide by their cultural proclivities for perpetuating the family name while forsaking profitability. The point is that, distinct from internal private benefits of control, external benefits of control may be positive or negative for minority shareholders depending on how they drive a particular controlling shareholder's behavior.

## V. SHAREHOLDER POWER IN ASIA: COMPLEXITY REVEALED

Ultimately, it is clear that external benefits of control are a critically important driver of the actions of some of the most powerful controlling shareholders in Asia's miracle economies. It is equally clear that the manner in which they do so is contingent on each jurisdiction's *local* economic, political and institutional environment and societal and business culture—which varies from jurisdiction to jurisdiction, among controlling shareholders within each jurisdiction, and over time. In addition, regulating external benefits of control is not a one-size-fits-all proposition, as some may be a boom and others a bust for corporate governance: complexity revealed.

In this context, *local*—not American, Asian, or universal—knowledge of the external benefits of control is required to properly understand shareholder power in the diversity of Asia's miracle economies. The challenge is now to gather this local knowledge and analyze it—something that will require a book not another regression analysis.[5]

[5] See Puchniak (2012) which comes to a similar conclusion based on a comparative analysis of the derivative action in Asia.



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