

The Berle-Means Corporation in the 21st Century

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Partial and Preliminary Draft of

October 24, 2008

Prepared for the U Penn Law School Seminar

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I. Introduction

Ever since Berle and Means' revelation about the extent to which ownership of shares of large US corporations was dispersed, scholars of corporate law have debated the desirability of this pattern. A simple economic rationalisation is that as the scale of industrial enterprise—and its associated capital requirements—grows, a point is reached at which the reduction in risk-bearing and liquidity costs achieved by dispersed ownership more than offsets the consequent increase in managerial agency costs. Whilst this rationalisation is framed at the level of the firm, the ubiquity of dispersed ownership in the US lead many scholars to extrapolate that there was a deterministic, or 'natural', relationship between economic development and the dispersion of stock ownership at the level of the economy as a whole.

This latter view was challenged by evidence from other jurisdictions, made available in robust form in the 1990s, that dispersed stock ownership was not the norm internationally. There then followed a vigorous debate about the respective merits of dispersed and concentrated stock ownership at the level of a 'system' of corporate governance. As the dust begins to settle on that debate, two stylised facts emerge that we consider to be particularly salient. First, in every jurisdiction there are at least a few firms that have dispersed stock ownership. Secondly, in only two jurisdictions—the US and the UK—is it the case that all, or almost all, public firms exhibit this pattern of ownership. It is plausible to interpret these observations as follows. On the one hand, the trade-off between risk-bearing and agency costs may depend on a range of firm or industry-specific factors (such as financial versus human capital intensiveness, propensity to innovate, and level of competitiveness in the industry). Thus not all firms might be expected to move towards dispersed stock ownership: rather, a mixed equilibrium in which some are dispersed and some remain concentrated, might be expected. On the other hand, various aspects of the regulatory environment may bias the development of national systems either in favour or

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We are grateful to Richard Nolan and Ed Rock for helpful discussions. The usual disclaimers apply.

against a norm of dispersed ownership, leading to a starker division between ‘systems’ than firm-level optimization might alone dictate.

It is plausible that a transition from concentrated to dispersed ownership may, at the firm level, be blocked by path dependencies in the ownership structure. (Bebchuk and Roe, 1999). The implication is that, without some form of exogenous intervention, firms subject to concentrated ownership will not, if left to their own devices, unwind this structure in all cases where there may be cost advantages to doing so. In other words, an excessive level of blockholding (at the firm level) may result. This is consistent with a review of history in the US and UK, which strongly implicates legal and regulatory choices—intentionally or not—in the development of generally dispersed stock ownership. In the US, the New Deal of the 30s broke up the power of financial institutions and pushed companies towards dispersed ownership (Roe, 1994). In the UK, a series of policies strongly supportive of private pensions—including, most importantly, a staggeringly large tax bias in favour of institutional rather than individual stock holding—lead to the rise of powerful institutional investors who kept managers—and each other—in check (Bank and Cheffins, 2006). Nowhere else was the system of corporate governance perturbed sufficiently for firms to leave the basin of attraction of concentrated ownership in significant numbers. Consequently, such jurisdictions exhibit a lack of political demand for legal institutions which control the particular varieties of agency costs associated with generally dispersed stock ownership. However, just as this implies that laws may facilitate the dispersal of stock ownership, the oblique links between legal cause and governance effects imply that such regulation might introduce a countervailing bias—towards too *much* dispersal. Many observers therefore arrive at a position of agnosticism as between the merits of different ownership patterns.

As the twenty-first century begins to unfold, this bifurcation of ‘systems’ of corporate governance, categorised at the national level, is being called into question by the increasing globalization of international capital and product markets. Firms have unprecedented opportunities to reincorporate or cross-list in other jurisdictions, allowing them to opt into legal and institutional frameworks based around dispersed stock ownership, even when the nation(s) in which their physical plant is located lack such institutions. Private equity firms are helping to break down the firm-level path dependencies that might previously have hindered companies from taking up such opportunities, as they have incentives to select a jurisdiction for listing, when they exit, which will maximise the value of the firm (see Armour, 2005). The upshot from these developments will be that a class of ‘metropolitan corporations’ organised on the Berle-Means pattern, with dispersed stock ownership and a listing (or incorporation) in either New York or London, will emerge.¹ These two jurisdictions, having been pressed through ‘frozen accidents’ of regulation to develop generalised systems of corporate governance based around dispersed stock ownership, are likely to have significant comparative advantage over other contenders for firms of this variety.

This paper’s enquiry is concerned with the pattern of the governance constraints which will be imposed on these Berle-Means corporations in the 21st century. The argument is structured as follows. After a brief review in Section II of the history of thinking about the Berle-Means corporation in comparative context, Section III then gives an overview of the differences between the UK and US systems. Contrary to widely-held beliefs, the mechanisms employed in the US and the UK to keep managerial agency costs in check are widely different. The US

¹ We do not mean to imply that there will be an inexorable global trend towards this form of organisation: rather that simply *for some firms* whose physical and current legal location is outside the UK and the US, this is likely to prove an attractive option. At the same time, private equity firms can also acting to concentrate the ownership of domestic firms in these jurisdictions for which dispersed stock ownership is not appropriate, with the most valuable exit under such circumstances being a secondary or tertiary sale (Cheffins and Armour, 2007).

approach, which may be characterised as ‘law-oriented’ uses the retail investor as its regulatory heuristic. Such investors are assumed to be passive, and likely to be ill-informed contributors to corporate governance. Three key features of the regime flow from this. First, extensive disclosure obligations are imposed by federal securities laws, which are designed to ensure that US public firms keep their shareholders informed. This facilitates shareholder exit in the case of underperformance; for firms wishing to raise capital again in the future from public markets, this is a significant constraint. In particular, the provision of information also helps to police managerial agency costs by requiring that self-dealing transactions be disclosed. Secondly, a corollary of the focus on retail investors is, a (relative) lack of control rights for shareholders, and a concentration of power in the board, which may be rationalised as an efficient division of labour when investors are numerous, highly dispersed, and ill-informed. Thirdly, a consequence of the lack of use of governance-oriented mechanisms of controlling managerial agency costs, is that there is aggressive enforcement (both by public and private actors) of the legal rules mandating disclosure. As a consequence of the strong enforcement mechanisms, US courts specialising in corporate law have become adept at regulating self-dealing transactions.

In contrast, the UK’s approach, which may be termed ‘governance-oriented,’ has primarily been focused on the provision of control rights to institutional investors. Compared with the US, there is consequently greater control in the hands of shareholders, especially over generic matters relating to corporate governance. Such investors specialise in buying and selling investments—as such, they are likely to find it worthwhile to develop expertise in *generic* issues relating to corporate governance: matters such as requisitioning meetings, removing directors, controlling directors’ actions during hostile takeovers, veto rights for self-dealing, and voting rights to control executive compensation. In contrast, there has traditionally been far less emphasis on the protection of the retail investor, issuer disclosure, and judicial regulation of self-dealing. Legal enforcement rates have consequently been much lower. In one aspect, however, the UK’s disclosure regime has developed more strongly than in the US, however: that of shareholder (as opposed to issuer) disclosure. The trade-off from having more powerful shareholders is the risk of inter-shareholder opportunism, and the UK’s disclosure (and regulatory) regime is oriented more towards this than its US counterpart as a result.

In section IV, we explain these patterns in terms of historical political economy. The origins of the US system lie in populist hostility towards financial institutions (Roe, 1994). Fear of powerful national banks can be traced back to the hostility towards a national bank prior to the Civil War (Brands, 2006). The reforms of the early twentieth century merely cemented further the pre-existing fragmentation of US banking (Roe, 1994). As a corollary of the lack of large-scale finance available from banks, large US firms had been turning to capital markets for debt finance since the late nineteenth century, and by the early twentieth century, had begun to raise significant amounts of equity finance in a similar fashion. By the 1930s, retail shareholding was already a large-scale phenomenon (Coffee, 2001) meaning that there was widespread political support for the New Deal legislation, a system designed around the retail investor in the Berle-Means corporation.

In Britain, too, banks’ importance in the financing of large firms was constrained early on. The limitation they faced in the UK was not so much political as one of market sentiment. A disastrous banking collapse in 1878, precipitated by mixing illiquid investments with supposedly liquid deposit accounts, left many in the banking community with a deep aversion to illiquid investments (Collins and Baker, 2003). Debt, preferably short-term and secured over assets, was the investment of choice for these institutions. Thus, as in the US (and contrary to the experience in continental Europe) UK banks never became significant holders of equity in their investee firms. From the 1950s onwards, a powerful tax bias lead retail investors to sell and institutional investors to buy shares (Hannah, 1976; Bank and Cheffins, 2006; Armour and Skeel, 2007), with

the result that by the mid-1970s, the majority of shares in domestic UK listed companies were owned by institutions.

Section V explores why changing ownership patterns make the present U.S. and U.K. regulatory patterns ill-suited for the emerging class of metropolitan firms, which are characterized both by the separation of ownership and control and by ownership that is concentrated in institutional investors located throughout the world. In the U.S., circa 1950, institutions owned less than 10 percent of the market capitalization of public firms; circa 1980, under 30 percent. Today institutional ownership amounts of well over 60 percent of total market capitalization. For the largest firm, institutional ownership is even greater, approaching 70 percent. This shift in ownership has reduced coordination and other collective action costs. It has helped facilitate the rise of activist hedge funds (Brav et al, 2007; Klein and Zur, 2007) and has given rise to more general demands for a greater shareholder role in corporate governance.

The relevant ownership changes in the U.K. relate to the nature of the institutional owners. Foreign institutions are becoming increasingly large shareholders in U.K. public firms. Domestic U.K. institutional ownership peaked at approximately 60 percent in the mid-1990s. It has decreased to approximately 45 percent today. Over the same period, foreign institutional ownership increased from less than 20 percent to approximately 40 percent. Moreover, the “style” of institutional owners is becoming more diverse: not just the traditional pension funds or insurance companies but mutual funds, hedge funds, the proprietary ownership and trading divisions of investment banks. This ownership shift will undercut the U.K. corporate governance system, in which geographic proximity (the City of London) and investor heterogeneity supported repeat-play interactions and reputation effects which fostered collective shareholder governance and “light touch” regulation by the market regulators.

Thus ownership patterns in both the U.S. and the U.K. have moved to “diffuse concentrated separated” ownership, the characteristic of metropolitan firms. The “market float” dominates insider blocks, so ownership is “separated.” The owners are institutions rather than individuals, so ownership is “concentrated” rather than “dispersed.” Yet these institutions are diverse in objectives and geographically diverse as well, so that ownership is in many respects “diffuse.” Large public firms in other jurisdictions are evolving in this direction from a tradition of concentrated non-separated ownership but the ultimate destination will be similar, the metropolitan firm.

In Section VI we develop some of the implications. The most important is that neither the U.S. nor the U.K. regulatory pattern will work very well for the metropolitan firm. The U.S. model constrains too sharply the possibilities of shareholder governance and thus substitutes higher cost mechanisms (like hard-to-calibrate high-powered incentives) to constrain managerial agency costs. There is insufficient disclosure of ownership interest and activity by substantial shareholders despite newly-developing ways to synthesize voting influence and economic participation. The U.K. model on the other hand lacks sufficient private and public enforcement capabilities. As institutional owners become more diverse and international, reputation effects will work much less well to constrain opportunistic behavior vis-à-vis other institutions in governance cooperation. Regulators will have diminished capacity to identify, understand, and address in “light touch” ways patterns of concerning behavior.

We discuss briefly some of the regulatory patterns that would fit better with the governance needs of the metropolitan firm and the possibilities of regulatory convergence. What are the hallmarks of the regulatory system that may emerge? Turning to our hazy crystal ball, it seems that metropolitan firms ought to be subject to extensive, and credibly enforced, disclosure regulation (above the historical level in the UK); at the same time they will also likely to find their managers being held on a short governance leash by institutional investors (that is, with stronger governance entitlements than are currently granted to US shareholders); moreover, their

(more-empowered) shareholders will find themselves subject to increasing disclosure obligations designed to mitigate intra-shareholder opportunism problems and a developing code of practices that would be unacceptable.

II. The Berle-Means Corporation in Comparative Context

1. What is the 'Berle-Means Corporation'?

In 1932, *The Modern Corporation and Private Property* heralded the arrival of managerial capitalism in the US.² It made the groundbreaking observation that the 'ownership' of large US corporations had become separated from their control. The authors' pioneering empirical research showed that in many large American corporations, there was no single shareholder—or even group of shareholders—who owned a sufficient percentage of the shares as to be characterised as 'controlling' the firm. In such firms, the authors reasoned, the effective locus of control in fact lay with the directors, and their hired managers, to whom the shareholders as a collective had notionally delegated the power to run the firm. Since then, the authors' names have come to be associated with the phenomenon to which they drew attention: corporations in which no single stockholder or group of stockholders holds a sufficiently large stake as to exercise meaningful control over the managers' conduct.

2. What are the Normative Implications?

Scholars have been debating the normative implications of Berle and Means' findings since 1932. Berle and Means themselves did not view the separation of ownership and control as a benign development. Rather, they were concerned that this heralded the rise of a 'managerialist' form of capitalism, under which vast resources were marshalled at the hands of a few corporate managers, unchecked by due political process. This perspective echoed in the work of many scholars writing over the next 40 years.³

Until the 1970s, however, no robust economic theory of the firm, or of its financing, had been developed. In the 1970s, however, economists began to rationalize dispersed equity ownership as involving a tradeoff between the costs of managerial agency—the principal object of concern for Berle and Means—and economies in risk-bearing.⁴ Widely dispersed shareholders are able better to diversify their risk-bearing, and so permit firms to lower the risk-bearing component of their cost of equity capital. However, this came at the price of a lowering in their ability to co-ordinate and monitor managers. The central goal of corporate law was thus seen as the amelioration of the agency costs to which this gave rise. For many US scholars at this time, the separation of ownership and control was viewed as the result of economic determinism—a trade-off, to be sure, but one that was presumptively optimal owing to its universal acceptance.

This perception was shaken by evidence from other countries, which came to be available in robust form only by the early 1990s. A series of international studies exploded the myth of the universality of the Berle-Means corporation.⁵ On the contrary, it appeared that dispersed stock ownership was in fact the exception, rather than the norm, internationally. This was at a time in which German and Japanese companies were perceived to be outperforming their US counterparts, leading some to ask whether, in addition to being distinctive, dispersed ownership was also a competitive disadvantage.

At the same time, the LBO boom of the 1980s posed a clear challenge to the domestic ubiquity of the dispersed ownership paradigm. Many former public companies were purchased by private

² ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

³ Refs e.g. Galbraith

⁴ See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, ___-___ (1976); FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991), 40-72.

⁵ See, e.g., Julian Franks and Colin Mayer, *Capital Markets and Corporate Control: A Study of France, Germany and the UK*, ___ Econ. Policy 189 (1990).

equity bidders, thereby transforming them from dispersed to concentrated ownership, leading some to argue that private equity's superior ability to control managerial agency costs lent it outright economic advantages.⁶ Explanations for the Berle-Means corporation's success in the US were sought not in economic determinism, but in the contingencies of domestic politics.⁷

But by the end of the 1990s, the pendulum had swung back again. The American economy was booming, and doubts about the economic utility of diffuse ownership disappeared. Some argued that the march of globalization would force other countries to open up their domestic product and capital markets to forces of competition in a way that would render the competitive weaknesses of their systems of corporate governance all too apparent.⁸ Comparative discussion shifted from how the US had been held back in developing diffuse ownership, to how other jurisdictions had been held back in failing to do so.⁹ Others, however, were content to remain agnostic as to the economic (dis)advantages of one form of ownership or the other.¹⁰

3. How Prevalent is Dispersed Stock Ownership?

The exact incidence of ownership patterns according with the Berle-Means paradigm, both at different points in time, and across different countries, is controversial. Quite apart from the considerable difficulties of data availability and comparability, the issue is complicated especially by the fluidity of the notion of 'effective control', the application of which is likely to be highly context-specific. As a result, a range of different indicators of ownership dispersal in publicly-traded firms have been employed in the literature—as they were by Berle and Means themselves.¹¹

One of the most influential recent studies, that of La Porta, Lopes-de-Silanes, and Shleifer in 1999, focuses on the 20 publicly-traded companies with the largest market capitalization at the end of 1995, in each of 27 developed countries.¹² The results show that, around the world, the UK, Japan, and US, followed by Australia, Ireland, and Switzerland, have the highest proportion of such firms without a 20% blockholder.¹³ However, when a more restrictive test, reporting the proportion of the 20 largest firms not having a 10% blockholder, is applied, the UK and US are clear international outliers.¹⁴ Another study by Faccio and Lang, investigating the ultimate ownership of all publicly-traded Western European corporations, reported that the UK and Ireland had far fewer firms with 20% blockholders than was the case in any other jurisdiction sampled.¹⁵ Similar results emerge from the ECGI's *Control of Corporate*

⁶ Michael C. Jensen, *The Eclipse of the Public Corporation*, 67 Harv. Bus. Rev. 61 (1989).

⁷ Bernard S. Black, *Shareholder Passivity Reexamined*, 89 Mich. L. Rev. 250 (1990); MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994).

⁸ See Henry B. Hansmann and Reinier A. Kraakman, *The End of History for Corporate Law*, Geo. L.J. (2000).

⁹ See La Porta et al (1997); Bebchuk (1999); Rene M. Stulz, *The Limits of Financial Globalization*, 60 J. Fin. 1595, ___-___.

¹⁰ See Carlin and Mayer (2000).

¹¹ See discussion in BERLE & MEANS, *supra* note 2, ___-___; MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE (2003), ___-___; PETER A. GOUREVITCH & JAMES J. SHINN, POLITICAL POWER AND CORPORATE CONTROL: THE NEW GLOBAL POLITICS OF CORPORATE GOVERNANCE (2005), 17-20;

¹² Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. Fin. 471 (1999).

¹³ *Ibid.*, 492 (Proportions of the largest 20 firms reported as not having a 20% blockholder are: UK: 100%, Japan 90%, US 80%, Australia 65%, Ireland 65%, Switzerland 60%; average for sample countries: 36%).

¹⁴ *Ibid.*, 493. See Table 1, *infra*.

¹⁵ Mara Faccio and Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations*, 65 J. Fin. Econ. 365, 379-380 (2002).

Europe project, which collated data on blockholdings required to be disclosed in the EU and US for all publicly-traded companies.¹⁶ The median largest voting block reported in UK companies was a 9.9% stake; this was less than half the size of the next smallest European median, 20%, in France, and less than a quarter of the size in many European countries.¹⁷ By comparison, the median largest voting block for NYSE listed firms was 5.4%, and 8.6% for NASDAQ.¹⁸

A somewhat more nuanced finding is reported by Holderness in a recent study.¹⁹ He compiles a representative sample of all publicly-traded US firms, and then compares this with firm-level data (all from 1995) from other jurisdictions, controlling for size, age, and industry. Once these factors are taken into account, the US is no longer an international outlier. Rather, as measured by the incidence of blockholding, and the size of blocks, approximately one-third of a sample of 22 developed and developing countries have more dispersed ownership in publicly-traded firms than the US.²⁰ The UK and Japan are clear outliers with the most dispersed ownership in Holderness' results.²¹ The disparity between these findings and the earlier studies may stem from the fact that dispersion increases with firm size.²² The US has the world's largest economy, the largest stock market capitalisation, and the largest number of publicly-traded firms (see Table 1). It is highly plausible that, towards the top end of the size distribution of US listed firms, there are more publicly-traded firms with diffuse ownership than anywhere else.

[Table 1 about here]

To summarise this section, the share ownership of the largest UK and US firms is more dispersed than in most other venues for listing worldwide. If we shift our attention from the largest firms to the population of listed firms as a whole, the US is no longer an international outlier, but the UK and Japan are. However, the US (and to a lesser extent, the UK and Japan) has a far larger stock market capitalisation and population of listed firms than elsewhere. As larger firms are more likely to have more dispersed ownership, the foregoing implies that the largest part of the world's population of 'Berle-Means corporations' is likely to be found in the US and the UK, [and, to a lesser extent, Japan].

4. What Causes Stock Ownership to be Dispersed or Concentrated?

The realisation in the early 1990s that dispersed ownership was not the international norm heralded the start of a still-ongoing programme of research directed towards explaining the different patterns of stock ownership worldwide. Whilst the comparative evidence means simple economic determinism is no longer convincing, more subtle economic accounts have been offered to explain the pattern. Just as size affects ownership structure, it is plausible that industrial and technological concerns may also be salient factors. We might term this the 'Coasean' view.²³ Dispersed equity finance is plausibly better suited to the exploitation of emergent technologies, in

¹⁶ FABRIZIO BARCA & MARCO BECHT (EDS.), *THE CONTROL OF CORPORATE EUROPE* (2001).

¹⁷ Marco Becht and Colin Mayer, *Introduction*, in BARCA & BECHT (EDS.), *supra* note 16, ___-___. The study does not, however, report findings for Ireland.

¹⁸ *Ibid.*

¹⁹ Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, working paper, Boston College (2006), forthcoming *Rev. Fin. Stud.*

²⁰ *Ibid.*, 44 (Table 4).

²¹ *Ibid.*, 43 (Figure 2), 44 (Table 4).

²² *Ibid.*, 19. On the link between size and ownership dispersion, see Harold Demsetz and Kenneth Lehn, *The Structure of Corporate Ownership: Causes and Consequences*, 93 *J. Pol. Econ.* 1155, ___-___ (1985).

²³ See GOUREVITCH & SHINN, *supra* note xx, 30-37.

regard to which continuation or liquidation decisions must be made rapidly.²⁴ On the other hand, a blockholder ownership structure may offer advantages for production in which employees must be persuaded to make firm-specific human capital investments, as a blockholder owner can commit more credibly to implicit or explicit contracts with employees regarding future returns on these investments.²⁵ Moreover, less reliance on equity markets invites greater reliance on bank finance, which also may have comparative advantages in relation to industries which employ relatively high levels of physical assets, rendering debt finance a suitable investment strategy.²⁶

The Coasean account is, however, rendered less plausible by the apparent global bias towards concentrated ownership. A complementary economic explanation points to path dependencies in this ownership structure.²⁷ [explain benign path dependency theory as well] Concentrated blockholders derive many rents from their controlling positions. If they sold their shares to dispersed owners, no shareholders would be able to capture such rents, and the blockholders would not be fully compensated for their loss of benefits. Thus we might expect a pronounced reluctance to sell on the part of blockholders. This would occur even if it were socially inefficient for control to be concentrated. Thus the economic theories suggest that, on the one hand, diversity in ownership structures may complement industrial structure, but on the other hand, there may be a bias towards blockholding brought on by path dependencies.

A second type of explanation for variance, focusing on the role of regulation, has been even more prominent in the literature. Broadly speaking, the claims in this tradition assert that the differing incidence of Berle-Means corporations across jurisdictions is associated with differences in the legal regulation of corporate governance. Within the regulatory perspective, there are strong differences over (i) the *scope* of relevant regulation—which legal rules are thought to be of significance in determining ownership structure; and (ii) whether law is *endogenous*—that is, whether law is a cause of dispersed ownership, or a symptom of something else.

On the one hand, La Porta, Lopes-de-Silanes, Shleifer, and Vishny report that the degree of dispersion of ownership amongst the largest firms in countries around the world is correlated with the degree of protection of outside investors from expropriation by managers.²⁸ They reason that ‘weak’ shareholder protection is associated with reduced willingness to invest money in the hands of managers. Moreover, they argue that the strength of shareholder protection is correlated with ‘legal origins’—namely, the civil or common law derivation of a legal system. This is thought to determine, exogenously, the content of the shareholder protection laws that in turn drive ownership structure. However, this position has been substantially undermined by historical case studies showing that ownership dispersal preceded shareholder-friendly regulation in both the UK and US,²⁹ and by new studies demonstrating that the correlations are not robust across different periods of time or measurements of legal protection,³⁰ and may even be an artefact of coding error.³¹ [Enforcement?]

²⁴ See Carline and Mayer (2000). It may also be more attractive for entrepreneurs seeking venture capital finance *ex ante*, as dispersed ownership means that, after an IPO, they may regain control of their firm: Black and Gilson 1998 JFE.

²⁵ Carlin and Mayer, *ibid.*; PETER A. HALL & DAVID SOSKICE (EDS.), *VARIETIES OF CAPITALISM* (2001).

²⁶ See Franklin Allen, Laura Bartiloro, and Oskar Kowalewski, *Does Economic Structure Determine Financial Structure?*, working paper, Wharton Business School (2006).

²⁷ Lucian Ayre Bebchuk and Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 *Stanf. L. Rev.* 127 (1999).

²⁸ Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny, *Legal Determinants of External Finance*, 52 *J. Fin.* 1131 (1997).

²⁹ Cheffins (2001); Coffee (2001).

³⁰ Jackson and Roe (2006); Armour *et al* (2007).

³¹ Spamann (2006).

A second, ‘political’, line of argument also focuses on regulation, but views this as the product of political forces that also shape corporate governance.³² A key feature of a generalised political account is that regulation is both endogenous and path-dependent.³³ That is, regulation to some degree reflects the political agenda, which may in turn be affected by the distribution of surplus under existing regulatory structures. This, however, leaves important questions unanswered. If the separation of ownership from control precedes regulatory measures that cement it, how does it come about?³⁴

In order to shed light on these regulatory theories, we turn now to an examination of the US and UK, the jurisdictions in which, as we have seen, the Berle-Means corporation is most prevalent. In Section III, we examine the question of the *scope* of the relevant regulation that responds to the problem of managerial agency costs in each jurisdiction. In Section IV, we then situate this in historical context, by asking how this regulation emerged.

III. Two Varieties of Dispersed Ownership

1. Regulatory vs Governance Mechanisms and Shareholder Types

The UK and US are, as we have seen, the two jurisdictions in which stock ownership in listed firms is most widely dispersed. This dispersal means that a fundamental concern for corporate law is the amelioration of managerial agency costs. These are the costs of separation between managers exercising control over the firm’s decision-making, and shareholders who are in receipt of the residual returns from the carrying on of the business activities.³⁵ A variety of techniques exist in corporate governance for ameliorating managerial agency costs.³⁶ Broadly speaking, we may divide these according to whether they rely on *regulatory* or *governance* mechanisms.³⁷ Regulatory mechanisms subject managers to legal constraints on their scope for self-interested behavior. Governance mechanisms, on the other hand, exert control over managers through the terms of their relationship with the firm and its shareholders—most obviously, by giving decision-making power to shareholders in certain circumstances.

To work effectively, each of these varieties of control mechanisms requires enforcement. In the case of regulatory mechanisms, this will involve a third-party agency, usually a court or regulator, to assess managerial conduct. In the case of governance mechanisms, the assessment is made not by an external agency, but by the shareholders, or in some instances independent directors appointed to act on their behalf. This is sometimes referred to as a difference between ‘third-party’ and ‘second-party’ enforcement.³⁸ In the language of incomplete contracts theory, it relates to the difference between court enforcement of a contract, and reliance on property rights to structure a renegotiation. The label attached matters less than the point that the different types of control mechanisms are axiomatically associated with different types of enforcer.

It is important not to overstate the extent to which governance mechanisms may substitute for regulatory mechanisms. We do not mean to say that a system that relies on

³² The pioneer of this view was Mark Roe: see ROE, *supra* note xx; ROE, *supra* note xx.

³³ GOUREVITCH & SHINN, *supra* note xx, 57-59; [Rajan and Zingales; Bebchuk et al].

³⁴ See Cheffins, *supra* note xx, xxx; Marco Becht and J. Bradford DeLong, *Why Has There Been So Little Block Holding in America?*, in RANDALL K. MORCK (ED.), *A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD*, 613, 618-620 (2005).

³⁵ Michael C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305., ___-___; see also FRANK H. EASTERBROOK AND DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991), 171-174.

³⁶ For a comparative overview, see REINIER KRAAKMAN *ET AL.*, *THE ANATOMY OF CORPORATE LAW* (2003), 23-28.

³⁷ See *ibid.*, 23 (distinguishing ‘regulatory’ and ‘governance’ strategies).

³⁸ See, e.g., ROBERT ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBOURS SETTLE DISPUTES* (1991).

governance mechanisms need have no recourse at all to third-party dispute resolution. The point is rather that such recourse can be much more limited. Where governance mechanisms are used, courts need only decide questions of the allocation of decisional rights, and need not concern themselves with substantive issues. This corresponds to the ‘property rights’ view of the firm in economic theory, in which (legal) allocation of entitlement to control physical assets is used as a means of generating bargaining power in renegotiations between contracting parties.³⁹ All third-party decision-makers need do is to specify the circumstances under which one party or other has control of the assets; the substantive content of contract renegotiation is a matter for the parties.

There are characteristic differences in the necessary conditions for success when relying on each of these two types of enforcer. The first such difference concerns information requirements. Third-party enforcement requires that the information upon which an enforcement action is taken be independently *verified* to the decision-maker, whereas second-party enforcement requires only that it be *observable* to the party with the decision rights. The second concerns the incentives of the enforcer. Third-party enforcers typically have no financial stake in the outcome, whereas shareholders do. This might be thought to give the shareholders more high-powered incentives. However, this interacts with the third dimension, which encompasses collective decision-making. Where shareholders are numerous and dispersed, they will be less effective at monitoring (because of free-rider problems) and decision-making regarding enforcement. It also intersects a fourth issue, which is the risk of intra-shareholder opportunism. Powerful shareholder governance entitlements bring with them the concern that one group of shareholders may hijack the decision-making agenda to their private benefit, and to the detriment of others. Third-party enforcers are unlikely to pose such a risk.

In the corporate governance systems of most developed nations around the world, governance mechanisms are probably more significant in controlling managerial agency costs than are regulatory mechanisms. As we have seen, in most countries, the stock ownership of most major corporations tends to be concentrated in the hands of one or more controlling blockholders. Such a shareholder is well-positioned to appoint and control the managers, using governance rights.⁴⁰ Conversely, many commentators have tended to assume that if a company’s stock ownership is widely dispersed, as described by Berle and Means, then governance mechanisms are less effective at controlling managers, because of the information and decision-making constraints with which shareholders will have to contend in exercising their entitlements. On this view, whilst governance may work for controlling shareholders, dispersed shareholders, being passive, need something else—likely regulatory mechanisms—to help them control managers.

In our view, a simple binary categorization is probably too stark. It does not necessarily follow that in the absence of a controlling shareholder, governance mechanisms cannot be more effective than regulatory strategies.⁴¹ Rather, much may depend on the degree of dispersion and the identity of the shareholders. In particular, we might imagine that if shareholders are predominantly *retail* investors, then they are likely to hold very small individual stakes, thus rendering overall ownership highly diffuse, and also to lack the coordination and sophistication necessary to make effective governance decisions. On the other hand, if shareholders are predominantly *institutional* investors, then we might expect them (as compared to retail investors)

³⁹ See OLIVER HART, FIRMS, CONTRACTS, AND FINANCIAL STRUCTURE (1995), ___-___; Edward B. Rock and Michael L. Wachter, *Islands of Conscious Power: Law, Norms and the Self-Governing Corporation*, 149 U. Pa. L. Rev. 1619 (2001).

⁴⁰ Indeed, under these circumstances, the concern is not so much that the managers may take actions that are contrary to the interests of the shareholders as a whole, but rather that the controlling shareholder may procure the managers to take steps that are contrary to the interests of other shareholders.

⁴¹ We do not imply here that either type of mechanism will operate perfectly: rather, we are engaged in an exercise of comparative efficiency between second- or third-best solutions.

to hold larger stakes in the firms in which they invest, to be more sophisticated, and better able to co-ordinate with one another. In short, institutional investors may be able to use governance mechanisms to control managers even in the absence of a controlling shareholder. Thus the absence of a controlling blockholder need not necessarily imply a turn to regulatory mechanisms to control managers. We might predict that a system in which institutional shareholders predominate would, *ceteris paribus*, be associated with less regulatory, and more governance, mechanisms than a system in which retail investors predominate.

This is not the only dimension across which we would expect to see differences. A second concerns the differing informational requirements of regulatory and governance mechanisms. Recall that governance mechanisms work on the basis of observable information. If institutional shareholders are able to observe poor managerial performance, then they can control managers by the threat of removal very effectively, without needing to verify this to an external agency. No-one other than the sophisticated shareholder—or coalition of shareholders—and the manager need be aware of the information. On the other hand, regulatory mechanisms have greater informational demands, because outcomes must be verified to a third party. The upshot is that we would expect greater reliance on regulatory mechanisms to be associated with greater information disclosure obligations imposed upon firms and managers.

We would also predict a third dimension of difference between retail and institutional systems. Whilst institutions may be better able to exercise governance rights than retail investors because of their lower decision-making costs, more powerful shareholders bring with them a greater risk of intra-shareholder opportunism. That is, a concern that one group of shareholders may form a coalition to expropriate minority investors. Thus a system relying on governance by powerful (institutional) shareholders may need to respond more effectively to concerns of intra-shareholder conflict.

Finally, it is worth observing that reputational constraints are likely to do more work in a system based on governance than one based on regulatory mechanisms. Governance mechanisms work better, we have suggested, in the hands of institutional investors, and are likely to be associated with lower formal disclosure obligations. Institutional shareholders are more likely to interact with one another on a repeated basis, so giving rise to the possibility of meaningful reputational sanctions (e.g. for intra-shareholder opportunism), than are retail investors.⁴² In particular, if regulatory mechanisms are not developed to respond to managerial agency costs, then they may not readily be available to respond to intra-shareholder opportunism, and in this context, reputational constraints may have to do the work.

[Table 2 about here]

A comparison between the US and the UK systems of corporate governance helps to illustrate each of these points. As we have seen, both have strongly dispersed share ownership, as compared to the rest of the world. Yet until quite recently, a much greater proportion of outstanding shares in UK publicly-traded companies have been in the hands of institutional investors, than in the US. Correspondingly, US levels of retail ownership have been much higher. This corresponds to differences in the mechanisms employed to control managerial agency costs, along each of the dimensions we discussed above. Table 2 summarises these points, which the rest of this section will elaborate in more detail.

2. Predominant Shareholder Types

⁴² See Barak D. Richman, *Firms, Courts, and Reputation Mechanisms: Towards a Positive Theory of Private Ordering*, 104 Colum. L. Rev. 2328 (2004).

It is well-known that institutional share ownership has been growing rapidly in the US in recent years. However, in the UK, levels of institutional ownership have been far higher for far longer. This point is illustrated clearly in Figures 1 and 2, which use official data sources to show the changes in levels of institutional, versus individual, ownership in the two countries over time.

[Figure 1 about here]

[Figure 2 about here]

3. Shareholder Governance Mechanisms in the UK

Consistent with our account, shareholders in UK companies have greater governance entitlements than do their counterparts in the US. Here we offer a brief overview of those which we consider to be most salient in controlling UK managers.

1. Board Vulnerability

It is a mandatory rule of UK company law that an ordinary resolution—that is, a simple majority of those shareholders present and voting—of the general meeting is able to remove directors at any time.⁴³ This negates the effect of ‘staggered board’ provisions, commonly used by US managers to entrench themselves against the possibility of shareholder removal.⁴⁴ Default rules of UK company law also give shareholders the right to nominate and appoint directors.⁴⁵ Whilst this is not protected by a mandatory rule, any attempt to entrench a board by removing these rights would be ineffective given the shareholders’ overriding power to remove directors: shareholders could credibly threaten to remove immediately any director with whom they are not content. Moreover, the shareholders have the power to modify the company’s constitution, including the provisions on election of directors.⁴⁶

Not only can UK shareholders fire managers at a shareholders’ meeting, but they can also requisition a meeting for the purpose. Shareholders together holding more than 10% of a company’s voting rights may require the holding of a general meeting, and require proposed resolutions to be circulated to shareholders at the company’s expense.⁴⁷ A recent study of UK and US shareholder proposals and meeting requisitions found that whereas US shareholder proposals cover a diverse range of issues, UK proposals and meeting requisitions focus very closely on

⁴³ Companies Act 2006 § 168(1). However, it appears that rates of CEO turnover are only slightly higher overall in the UK than the US: see Mark L. Defond and Mingyi Hung, *Investor Protection and Corporate Governance: Evidence from Worldwide CEO Turnover*, 42 J. Acc’t. Res. 269, 283 (2004) (CEO turnover rates over period 1996-2002, 14% for US firms and 16% for UK firms).

⁴⁴ Under a staggered board provision, only a proportion of the board may be removed at any given annual meeting, so that it will typically take two to three years to wrest control of the board following a takeover: see Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Further Findings and a Reply to Symposium Participants*, 55 STAN. L. REV. 885 (2002). The default rule for appointments in UK companies is in fact a 3-year staggered board (see, e.g., Companies Act 1985, Table A, SI 1985/805 (‘1985 Table A’), Art. 74), but this is subject to the exercise of the mandatory removal power.

⁴⁵ See 1985 Table A, Arts. 76-78. These provisions are found in the model articles of association (equivalent to a corporate charter or bylaws in the US), which apply to the extent that they are not expressly excluded: Companies Act 2006, § 20(1).

⁴⁶ Companies Act 2006 § 21.

⁴⁷ Companies Act 2006 §§ 303-305. Moreover, shareholders in holding more than 5% of the voting rights in public companies may require resolutions to be put onto the agenda for the AGM, and circulated to shareholders in advance, also at the company’s expense (Companies Act 2006 §§ 338-339).

applications to remove or elect specific directors, and in a significant number of cases, the entire board.⁴⁸

Insofar as voting at meetings is concerned, it is a mandatory rule of UK company law that resolutions are passed by a majority of the votes cast in the meeting.⁴⁹ Whilst the same basic rule applies under Delaware law, it does not extend to the appointment of directors.⁵⁰ In contrast, for the appointment of directors the standard Delaware rule is so-called ‘plurality’ voting, under which the directors are elected who receive the largest number of votes in favour. This means that it is not possible to vote ‘against’ a particular director, and that directors may be appointed even if they do not receive a majority of the votes.

In addition to the foregoing, the UK’s regulatory environment also restricts managers’ ability to entrench themselves with generous termination payments.⁵¹ The Combined Code on Corporate Governance provides that directors’ notice periods should not ordinarily be longer than one year,⁵² and under the companies legislation, any notice period greater than two years must be pre-approved by the shareholders.⁵³ Moreover, publicly-traded UK companies have since 2002 been required to send shareholders each year a directors’ remuneration report—including details of notice periods and termination payments—on which a precatory shareholder vote must be taken at the AGM.⁵⁴ Empirical studies suggest that the introduction of these precatory resolutions in the UK have had a restraining impact on executive pay.⁵⁵

Non-voting and dual-class stock, another well-known entrenchment device, whilst not prohibited by the UK Listing Rules, are strongly discouraged by the London Stock Exchange and the investment community.⁵⁶ As a result, they are relatively rare.⁵⁷ A recent study commissioned

⁴⁸ Bonnie Buchanan and Tina Yang, A Comparative Analysis of Shareholder Activism in the US and UK: Evidence from Shareholder Proposals, paper prepared for Oxford/Yale conference on UK-US corporate governance (2007), 44-45 (82% of UK shareholder proposals/meeting requisitions are concerned with removing or electing specific directors; only 30% of US shareholder proposals relate to board issues, and of these only 6% seek appointment of a particular director).

⁴⁹ Companies Act 2006 §§ 282-283.

⁵⁰ DGCL § 216.

⁵¹ Exercise of the summary removal power by the shareholders will constitute a repudiation of an executive director’s service contract: see Companies Act 2006 § 168(5)(a). See also *Southern Foundries v Shirlaw* [1940] AC 701.

⁵² Financial Reporting Council, The Combined Code on Corporate Governance June 2006 (‘Combined Code 2006’) (2006), ¶ B.1.6. In both jurisdictions, executive compensation is usually determined in the first instance by a remuneration committee comprised of outside (‘non-executive’ in the UK parlance) directors. On the UK position, see Combined Code 2006, ¶¶ B.2.1-2.3. On the US position, see [...]

⁵³ Companies Act 2006 § 188.

⁵⁴ Companies Act 2006 §§ 420-421, 439; Companies Act 1985 Sch 7A, ¶¶ 3(4), 5(1). These provisions were introduced from 1 August 2002 by the Directors’ Remuneration Report Regulations 2002, SI 2002/1986. See generally, Freshfields Bruckhaus Deringer, *Directors’ Remuneration Report Regulations: Checklist, Commentary and Related Best Practice* (2007).

⁵⁵ See Sudhakar Balachandran, Fabrizio Ferri, and David Maber, *Solving the Executive Compensation Problem through Shareholder Votes? Evidence from the UK*, working paper Columbia Business School/Harvard Business School (2007) (compared to control group in US, UK executives’ pay packages since 2002 exhibit greater downwards sensitivity—that is, poor performance is associated with less pay); Kym Sheehan, *Is the Outrage Constraint an Effective Constraint on Executive Remuneration? Evidence from the UK and Preliminary Results from Australia*, working paper University of Melbourne Centre for Corporate Law and Securities Regulation (2007) (UK companies revise total executive remuneration downwards following larger than average negative votes in precatory resolution).

⁵⁶ See Julian Franks, Colin Mayer, and Stefano Rossi, *Spending Less Time with the Family: The Decline of Family Ownership in the UK*, NBER Working Paper No 10628 (2004), 1-2.

⁵⁷ See, e.g., ‘Error Deprives Schroders of FTSE 100 Place’, *Financial Times*, March 15, 2007 (‘Unusually for a UK company, Schroders has voting and non-voting shares.’)

from Deminor, a proxy voting consultancy, by the Association of British Insurers, reported that as of 2004, 88% of large listed UK companies conformed strictly to the ‘one share, one vote’ principle.⁵⁸

2. Shareholder Choice in Takeovers

The board’s vulnerability to removal by shareholders is coupled with firm restrictions on their range of responses to takeover challenges. The UK’s Takeover Code imposes a ‘no frustrating action’ principle upon the managers of a target company, that prohibits them from taking, once a bid is launched or anticipated, any actions that might have the consequence of frustrating its success, without first obtaining the consent of their shareholders.⁵⁹ It is widely believed that the threat of hostile takeovers can act as a check on managerial agency costs. In line with this, the likelihood of a publicly-traded UK firm being a takeover target, particularly of a hostile bid, appears to increase if its performance worsens.⁶⁰ Moreover, hostile bids appear to be more likely to occur, and if made, more likely to succeed, in the UK than in the US.⁶¹

Defenders of the US ‘board choice’ model sometimes claim that it is a way of delegating to managers a set of decisions shareholders may not be well-placed to make.⁶² It permits incumbent directors either to reject unwanted offers, or to negotiate a higher price for their firm, thus benefiting target shareholders. The extent to which this is useful likely depends on the types of shareholder involved. Retail investors may benefit from delegating these questions to management; institutional investors are quite capable of rejecting a bid if they feel it is not going to create sufficient value, as notoriously occurred in NASDAQ’s bid for London Stock Exchange plc.⁶³ Interestingly, the empirical literature shows no appreciable difference in bid premia for target shareholders in US and UK firms.⁶⁴

3. Control over Significant Corporate Transactions

Another aspect of the governance mechanisms employed in the UK to control managerial agency costs is the role played by shareholder approval in relation to certain categories of corporate transaction—namely, those involving either a risk of conflict of interest, or those which are of significant magnitude in relation to the size of the company.⁶⁵ The most wide-ranging of the

⁵⁸ Deminor, *Application of the One Share – One Vote Principle in Europe* (2005), 17. Whilst in the region of 5% of UK companies still have some non-voting stock in issue (*ibid.*), the proportion has been declining over time, and those that remain are legacy issues, as opposed to new issues (Franks *et al.*, *supra* note 56, 21-22).

⁵⁹ City Code, GP 7 and Rule 21. See also John Armour and David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation*, 95 *Geo. L.J.* 1727, 1734-1738 (2007).

⁶⁰ Julian Franks, Colin Mayer, and Luc Renneboog, *Who Disciplines Management in Poorly Performing Companies?*, 10 *J. Fin. Intermed.* 209, ___-___. However, target management are very likely to be replaced following a successful takeover, regardless of whether or not it is friendly, and of the firm’s performance, suggesting that, as a disciplinary mechanism, the takeover bid is very unfocused: Julian Franks and Colin Mayer, ‘Hostile Takeovers in the UK and the Correction of Managerial Failure’ 40 *Journal of Financial Economics* 163 (1996); see also Franks *et al.*, *supra* note xx, 233-234.

⁶¹ Armour and Skeel, *supra* note 59, 1738.

⁶² See, e.g., Marcel Kahan & Edward B. Rock, *Corporate Constitutionalism: Antitakeover Charter Provisions as Precommitment*, 152 *U. PA. L. REV.* 473 (2003).

⁶³ Newspaper reports

⁶⁴ See Armour and Skeel, *supra* note 59, 1740n. (reviewing literature).

⁶⁵ UK Listing Rules, LR 10, 11. In addition, the UK’s general companies legislation requires that for certain transactions to which the counterparty is either a director or their associate (including companies in which they hold controlling shareholdings), shareholder approval must be sought. Most significantly, this

relevant provisions are located in the UK Listing Rules, and are regarded by UK institutional shareholders as an important mechanism of control over corporate boards.⁶⁶ These require, in relation to significant transactions, that details of all transactions of a value between 5-25% of the company's business ('Class 2 transactions') must be disclosed to shareholders.⁶⁷ For transactions in excess of a 25% threshold ('Class 1 transactions'), the disclosure must be supplemented by a stockholder vote on the transaction.⁶⁸ And for transactions with any 'related party' (extensively defined),⁶⁹ disclosure must be supplemented by a stockholder vote, excluding the votes of the related party and their associates.⁷⁰

4. Control over Seasoned Equity Issues

Another distinguishing feature of the UK corporate governance environment is the strong focus on shareholder's pre-emption rights regarding seasoned equity issues. Such rights are applied as default rules to all companies under company law,⁷¹ and supplemented by provisions in the Listing Rules for firms listed on the UK Official List,⁷² although their application may be waived *ex post* by shareholder authorisation.⁷³

Most obviously, pre-emption rights are seen as protection for shareholders from the risk of dilution associated with an open offer. However, they also appear to play a more significant governance role in the UK, by providing a focal point around which shareholders can centre monitoring and engagement with the company. A discounted rights issue creates a threat of dilution for investors who do not subscribe. On the other hand, investors who do subscribe have an initial monopoly over the new investment. The amount at stake will depend on the terms of the issue and the reasons the company is seeking further finance. Thus there will typically be dialogue between a company and its major institutional investors the period prior to a rights issue.⁷⁴ For this reason, rights issues are strongly correlated with managerial turnover. Two

encompasses substantial property transactions (Companies Act 2006 §§ 190-196) and corporate loans or similar transactions with directors (*ibid.*, §§ 197-214).

⁶⁶ See GEOFF P. STAPLEDON, *INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE*, 130-131 (1996).

⁶⁷ LR 10.4.1. A series of different ratio tests, relating to assets, consideration, and profits, are applied cumulatively; LR 10.2.

⁶⁸ LR 10.5.1.

⁶⁹ LR 11.1.4. The definition includes not only directors and significant shareholders (>10% voting rights), but any 'person exercising significant influence' or any 'associate' (extensively defined) of the foregoing categories.

⁷⁰ LR 11.1.7.

⁷¹ Companies Act 2006 §§ 560-577.

⁷² LR 9.3.11-12. Moreover, shares may not be issued at a discount of more than 10% to their current market price unless as a rights issue or specifically approved by shareholders: LR 9.5.10. The protection for investors found in the Listing Rules is stronger than under the Companies Act: see Eilís Ferran, *Legal Capital Rules and Modern Securities Markets—the Case for Reform, as Illustrated by the UK Equity Markets*, in KLAUS HOPT AND EDDY WYMEERSCH (eds.), *CAPITAL MARKETS AND COMPANY LAW*, 115, 131-33 (2003).

⁷³ Companies Act 2006 §§ 570-571; LR 9.3.12(1). The grant of such a waiver is, however, subject to a well-established set of voting guidelines adhered to by institutional investors in the UK. For the latest version, see PRE-EMPTION GROUP, *DISAPPLYING PRE-EMPTION RIGHTS: A STATEMENT OF PRINCIPLES* (2006), available at <http://www.pre-emptiongroup.org.uk/documents/pdf/DisapplyingPre-EmptionRightsStatementofPrinciples.pdf> (consent will be granted uncontroversially for issues amounting to less than 5% of ordinary share capital in any given year; where issue amounts to more than 7.5% of the ordinary capital, a business case for waiver must be made: *ibid.*, principles 8-9, 14-15).

⁷⁴ STAPLEDON, *supra* note xx, 129-130; Paul Myners, *Pre-Emption Rights: A Final Report*, URN 05/679 (2005).

studies have documented a strong positive relation between rights issues by UK listed firms and managerial change.⁷⁵ Indeed, in a comparison with a number of other ‘disciplinary mechanisms’ in the UK—including hostile takeovers—rights issues are most strongly associated with managerial turnover in underperforming firms.⁷⁶

It might be thought that shareholder control over seasoned equity issues might lead managers to be conservative with dividend payments, in order to bolster their financial position against the need to raise finance by seasoned equity. As in the US, dividend payments in the UK are ordinarily determined in the first instance by a board recommendation, followed by a shareholder vote.⁷⁷ However, given UK boards’ vulnerability to removal by shareholders, and their inability to take defensive action against a takeover, such a strategy would be short-sighted.⁷⁸ Historically, low dividend yields were the classic precursor to a hostile takeover;⁷⁹ correspondingly, dividend growth in UK stocks has generally been higher than in their US counterparts.⁸⁰

4. Restraints on *Intra*-Shareholder Agency Costs

As we have seen, UK shareholders have greater powers than their US counterparts to control managers using governance mechanisms. With this, however, comes a risk that shareholders may use this power opportunistically. In particular, there is a concern that shareholders having a block of shares with sufficient voting power to influence outcomes might act in a way that benefits themselves, at the expense of other shareholders. This concern becomes greater if the blockholder’s voting power is, by whatever means, greater than their economic stake in the firm.⁸¹ Recently, the advent of derivatives have worsened the potential for this sort of problem, as blockholders may now be able to hedge their position completely, so as to have voting rights but no economic interest in the firm.⁸² Similarly, stock lending facilitates the assembly of a voting position at the time of a general meeting which, because the price of the ‘lending’ agreement is fixed prior to the meeting, means that the ‘borrower’ does not bear any economic consequences associated with the exercise of their voting rights.⁸³

As in the US, the basic starting point in UK corporate law regarding shareholder voting is that a shareholder may vote as he or she pleases.⁸⁴ However, there are a number of dimensions over which the UK corporate governance environment acts to control such opportunism, which are, as predicted, stronger than the corresponding controls in the US. We now review these briefly.

⁷⁵ Franks *et al.*, *supra* note 60, 234-235; David Hillier, Scott C. Linn and Patrick McColgan, *Equity Issuance, CEO Turnover and Corporate Governance*, 11 *Eur. Fin. Manag’t.* 515 (2005).

⁷⁶ Franks *et al.*, *supra* note 60, 226, 244-46.

⁷⁷ See, e.g., Table A 1985, Art. 102.

⁷⁸ See Brian R. Cheffins, *Dividends as a Substitute for Corporate Law: The Separation of Ownership and Control in the United Kingdom*, 63 *Wash. & Lee L. Rev.* 1273 (2006).

⁷⁹ See Armour and Skeel, *supra* note 59, 1756-1758.

⁸⁰ See Elroy Dimson and Paul Marsh, *UK Financial Market Returns, 1955-2000*, 74 *J. Bus.* 1, 22-26 (2001) (Real dividend growth for UK stocks higher than in US over this period).

⁸¹ See Lucian Ayre Bebchuk, Reinier Kraakman, and George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, in RANDALL C. MORCK (ed.), *CONCENTRATED CORPORATE OWNERSHIP*, 445 (2000).

⁸² Henry C. Hu and Bernard S. Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 *So. Cal. LR* 811 (2006).

⁸³ *Ibid.*; Marcel Kahan and Edward B. Rock, ‘The Hanging Chads of Corporate Voting’, U Penn Inst for Law & Econ Research Paper No 07-18, NYU Law and Economics Research Paper No 07-29.

⁸⁴ See, e.g., *N.W. Transportation Co v Beatty* (1887) 12 App Cas 589; *Burland v Earle* [1902] AC 83.

1. Restraints on Blockholding and Non-voting Shares

The first set of restrictions act to constrain the ability of UK blockholders to aggregate voting power—whether directly, through a large block of shares, or indirectly, through pyramid structures. The most significant restriction is perhaps the Takeover Code’s ‘mandatory bid’ rule. This requires that any person, or group of persons acting together in concert,⁸⁵ who acquires an interest in a company’s shares carrying more than 30% of the voting rights must make a bid to acquire control of the rest of the shares (voting and non-voting).⁸⁶ The purpose of the mandatory bid rule is to promote equality of treatment amongst shareholders—that is, to ensure that who wish to sell to a bidder are able to do so at the best price offered.⁸⁷ However, it has the effect, which does not appear to have been intended at the time of its introduction,⁸⁸ of limiting the extent of control block formation in British companies. Consequently, the distribution of the largest blockholdings in British companies is curtailed at just under 30%.⁸⁹ To be sure, a voting block of less than 30% is often sufficient to ensure practical control in many publicly-traded firms,⁹⁰ but the mandatory bid rule nevertheless imposes an upper bound on majority shareholder power in a given firm. In addition, the hostility of UK investors to non-voting shares means that blockholders are greatly restricted in their ability to use these to enhance their control.⁹¹

In addition to these outright restrictions, there were for over 25 years restrictions on the *speed* with which a purchaser could build up a stake in a company. The Substantial Acquisitions Rules (‘SARs’), which were imposed by the Takeover Panel from 1980 until 2006, prohibited a buyer (or a group of buyers acting in concert) from acquiring more than 10% of a company’s voting rights if his aggregate holding would thereby amount to between 15% and 30%.⁹² The SARs were originally introduced following concerns that ‘dawn raids’ (what in the US would be termed a ‘street sweep’) on the market,⁹³ whereby just under the 30% threshold would be bought in a very short space of time, would deny some shareholders the opportunity to sell their shares at a potentially favourable price.⁹⁴ They were abolished in 2006, following the Takeover Panel’s

⁸⁵ A group of shareholders will be ‘acting in concert’ where they co-operate, pursuant to an agreement or understanding (which may be formal or informal) to obtain or consolidate control of a company (Takeover Code, C1). ‘Control’ is taken to mean simply the holding of shares carrying more than 30% of the voting rights (*ibid.*, C6).

⁸⁶ Takeover Code, Rule 9.1.

⁸⁷ A mandatory bid must offer each shareholder the best cash price that the bidder has paid for shares in the target company acquired on the open market during the 12 months prior to the bid (*ibid.*, Rule 9.5(a)).

⁸⁸ The origins of the mandatory bid rule are described in Armour and Skeel, *supra* note 59, 1763-64.

⁸⁹ See, e.g., Marco Becht and Colin Mayer, *Introduction*, in FABRIZIO BARCA AND MARCO BECHT (EDS.), *THE CONTROL OF CORPORATE EUROPE*, 1, 26 (2001); Marc Goergen and Luc Renneboog, *Strong Managers and Passive Institutional Investors in the UK*, in BARCA AND BECHT (eds.), 259, 268 (2001).

⁹⁰ US poison pill triggers are often set at 15%, or even 10% [cite?].

⁹¹ See *supra*, text to notes 56-58.

⁹² SAR 1. There were exceptions if the purchaser (i) acquired a block from an existing blockholder; (ii) had announced a firm intention to make a bid; or (iii) made the acquisition pursuant to a tender offer (SAR 2). Once the 30% threshold was reached, the purchaser would trigger the obligation to make a mandatory bid under Rule 9 of the Takeover Code.

⁹³ See, ‘Secret Buyer’s £100m Gold Shares Deal’, *The Times*, 7 February 1980, 1; ‘Inquiry on Buying of Gold Shares Sought’, *The Times*, 12 February 1980, 1; ‘“Dawn Raid” on Revertex Shares’, *The Times*, 26 April 1980, 19; ‘“Dawn Raid” Nets Pergamon 29.5pc in BPC’, *The Times*, 19 July 1980, 17.

⁹⁴ See ‘City Puts Ban on “Dawn Raids” Pending new Code of Conduct’, *The Times*, 8 August, 1980, 13 (ban on acquisition of more than 15%); ‘Sun Sets on the Dawn Raiders’, *The Times*, 10 December 1980, 23; ‘Watchdog Curbs Quick-Fire Raiders’, *The Times*, 25 September 1981, 17.

conclusion that investors are now less likely to sell into a market raid, given that if they wait, stock value is likely to appreciate following the acquisition of a toehold.⁹⁵

2. Disclosure of Blockholdings

Accurate and timely disclosure of share ownership positions—in particular, of economic and voting positions—allows investors to be aware *ex ante* of the potential risks they face regarding the actions of other shareholders, and also *ex post* of the likely motivation behind shareholder votes. As such, it would allow the market to price the expected impact of a particular blockholder's conduct into securities more rapidly. It also allows other shareholders to take countervailing positions where they wish to prevent a particular investor from expropriating assets.

In both the UK and US, shareholders with significant holdings of voting shares are required to disclose their interest to the company, and to have this entered into a publicly-available register. These provisions were first introduced in the late 1960s, and contain many similarities.⁹⁶ In both jurisdictions, the scope of the provisions has been expanded to include two or more purchasers acting in concert, and subsequent changes in a block that has crossed the disclosure threshold must also be notified.⁹⁷ Moreover, both have less restrictive provisions for investment managers. However, the UK provision has, since 1989, been more restrictive than a 13D filing in the US, because it is triggered at a threshold of 3%, rather than 5%, and must be made within 2 days, as opposed to the 10 days permitted in the US.⁹⁸ This difference pales into insignificance, however, when attention is paid to the disclosure requirements imposed by the UK's Takeover Code during an offer period.⁹⁹ Under these, declared bidders, and any other person owning or controlling more than 1% of any class of relevant securities in the target must disclose all dealings in the target within 1 day.¹⁰⁰

Moreover, in addition to these automatic, or reactive, disclosure requirements, UK companies have a power to request information proactively concerning beneficial interests in their shares from any persons they reasonably believe may have, or have had, such an interest.¹⁰¹ There are powerful sanctions for non-compliance with such a request. Not only does this constitute a criminal offence, but the company may also impose restrictions on voting, entitlement to receive dividends, or ability to transfer the shares.¹⁰² Such proactive requests are commonly used by UK companies to maintain an understanding of their shareholder body.

In recent years, the dramatic growth of derivative contracts referenced to equity securities has increased the possibilities for the creation of synthetic equivalents to pyramid ownership structures. One possibility, termed 'empty voting' by Hu and Black, involves hedging out the economic interest in shares, leaving the shareholder with bare control rights, and perverse incentives as regards voting. Whilst US regulators have struggled to respond to this phenomenon, the UK's Takeover Panel has, since May 2006 required disclosure of dealings in long equity

⁹⁵ See Panel on Takeovers and Mergers, Proposed Abolition of the Rules Governing Substantial Acquisitions of Shares, PCP2005/4, 8-9 (2005).

⁹⁶ See Companies Act 1967, § 33; Williams Act 1968 [...]

⁹⁷ FSA, DTR 5; SEC Rule 13d-1, 13d-2.

⁹⁸ Companies Act 1989, § 134. See now FSA, DTR 5.

⁹⁹ ;An offer period begins when there has been an announcement as to an actual or potential takeover.

¹⁰⁰ Takeover Code, rule 4. Moreover, bidders may not sell any stock in the target without the permission of the Takeover Panel, and with 24 hours public notice that a sale may occur.

¹⁰¹ Companies Act 2006 § 793. Information received following such a request must be disclosed by the company (*ibid.*, §§ 808-811). Moreover, an exercise of this power can be requisitioned by a 10% shareholder: *ibid.*, § 803.

¹⁰² *Ibid.*, §§ 794-798.

swaps in the same fashion as regards the underlying securities.¹⁰³ Even more expansively, the UK's Financial Services Authority is currently consulting over whether such derivative disclosure requirements should be extended to equalize with the general block disclosure rules outside takeover situations.¹⁰⁴

3. Regulation of Non-public Information

[To follow: Insider dealing/market abuse regime in UK covers coordination between investors expecting to use governance rights in a way that will affect stock price. Not so covered in US]

4. Control of Voting

Intra-shareholder agency problems may manifest themselves through voting in a variety of ways. The most obvious is where a blockholder uses their votes to procure or ratify a transaction that benefits itself at the expense of the company. Mechanisms responding to this problem have been present in UK company law since its inception in the nineteenth century. On the one hand, directors of a UK company owe duties solely to the company, and if they act partially in favour of an appointing shareholder, they will breach these duties.¹⁰⁵ Moreover, they owe a duty to act fairly as between different classes of shareholder.¹⁰⁶

On the other hand, whilst shareholders owe no *duties* by virtue of their position as shareholders,¹⁰⁷ they may be subjected to *disabilities* that restrain their ability to vote in a way that harms the interests of other shareholders. The most fundamental of these is that resolutions passed in general meeting must be passed in good faith in the interests of the company as a whole.¹⁰⁸ That is, the members of the majority voting in favour of the resolution must subjectively believe that the measure in question is for the furtherance of the interests of the company as a whole, as opposed to their sectional interests. This standard is ordinarily not very difficult to satisfy, requiring simply the existence of some plausible business purpose,¹⁰⁹ but majority shareholders will not be permitted to use their votes to pass a transaction benefiting themselves sectionally at the expense of the company.¹¹⁰

Challenging such a transaction under the foregoing rules requires *ex post* litigation; far more effective in protecting UK shareholders from blockholder expropriation is the *ex ante* restriction on related party transactions imposed by the Listing Rules. Any transactions, in excess of a *de minimis* threshold, between a company or any of its subsidiaries and a 'related party'

¹⁰³ See TAKEOVER PANEL, DEALINGS IN DERIVATIVES AND OPTIONS: OUTLINE PROPOSALS, PCP 2005/1 (2005); TAKEOVER PANEL, CONSOLIDATED AMENDMENTS TO THE TAKEOVER CODE EFFECTIVE ON 20 MAY 2006 (2006).

¹⁰⁴ See FSA, DISCLOSURE OF CONTRACTS FOR DIFFERENCE: CONSULTATION AND DRAFT HANDBOOK TEXT, CP07/20 (2007).

¹⁰⁵ *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187, 220-222.

¹⁰⁶ *Mutual Life Insurance Co of New York v Rank Organisation Ltd* [1985] BCLC 11, 21-22; *Re BSB Holdings (No 2)* [1996] 1 BCLC 155, 246-249. This principle is now codified as Companies Act 2006 s 172(1)(f).

¹⁰⁷ *Kuwait Asia Bank*, *supra* n 105, 217-220.

¹⁰⁸ *Allen v Gold Reefs of West Africa* [1900] 1 Ch 656, 671; *British America Nickel Corporation Ltd v MJ O'Brien Ltd* [1927] AC 369, 371-373; *Peters' American Delicacy Co Ltd v Heath* (1939) 61 CLR 457, 511-513; *Re Holders Investment Trust Ltd* [1971] 2 All ER 289, 291; *Re BSB Holdings (No 2)*, *supra* n 106, 234; *Redwood Master Fund Ltd v TD Bank Europe Ltd* [2006] 1 BCLC 149 at [105]-[106]. There is considerable debate over the scope of the types of resolution to which this rule applies. At its narrowest, it applies only to resolutions concerned with alterations of the company's constitution; at its broadest, it applies to all types of shareholder resolution: see *Re BSB Holdings (No 2)*, *supra* n 106, 234.

¹⁰⁹ See *Greenhalgh v Arderne Cinemas* [1951] Ch 286.

¹¹⁰ Discuss fraud on minority caselaw.

(extensively defined),¹¹¹ must be preceded by disclosure and conditional on a stockholder vote, from which the votes of the related party and their associates are excluded.¹¹²

A second way in which intra-shareholder agency problems may occur in relation to voting occurs through strategic manipulation of the voting process. In this regard, long periods between the record dates at which entitlements to vote are determined and the actual meetings lend themselves to abuse. A shareholder at the record date may vote even if they are no longer actually a shareholder at the date of the meeting.¹¹³ Whilst the foregoing mechanisms—in particular, the related party transactions rules—would ameliorate the perverse incentives which might result, the structure of the UK system acts to make this type of voting arbitrage much more difficult in any event.

In both jurisdictions, only registered shareholders are entitled to vote at meetings.¹¹⁴ Under Delaware law, the board may set a ‘record date’ up to 60 days before the meeting, at which point entitlements to vote will be determined from the register.¹¹⁵ In the UK, on the other hand, record dates are no longer than 48 hours before the meeting.¹¹⁶ The effect of the very short record date in the UK is to make it much more difficult to ‘capture’ votes through transactions immediately around the record date.

The UK’s regulatory environment has also started to respond to the particular issues raised by stock lending in this context.¹¹⁷ A stock ‘lending’ transaction is technically a sale and resale. The resale price may be fixed under the terms of the lending agreement,¹¹⁸ so the borrower need not bear the economic consequences associated with voting in a way adverse to the issuer’s interests. The Bank of England has since 1990 chaired a committee of trade associations, known as the Securities Lending and Repo Committee, which has since April 1994 produced a code of guidance to market participants as regards stock lending.¹¹⁹ This makes clear that ‘securities should not be borrowed solely for the purpose of exercising the voting rights’ at a shareholders’ meeting.¹²⁰

[Discuss appraisal remedy? Is this used in relation to US public companies? UK equivalent provision (‘unfair prejudice’ petition) is not used in relation to publicly-traded companies]

¹¹¹ LR 11.1.4. The definition includes not only directors and significant shareholders (>10% voting rights), but any ‘person exercising significant influence’ or any ‘associate’ (extensively defined) of the foregoing categories.

¹¹² LR 11.1.7.

¹¹³ See Hu and Black, *supra* note 82, 832-835; Kahan and Rock, *supra* note 83, 27-31.

¹¹⁴ UK Companies Act 2006, § 327; DGCL § 219(c).

¹¹⁵ DGCL § 213(a) (record date may not be more than 60 days or less than 10 days before a stockholder meeting).

¹¹⁶ This is a mandatory rule for uncertificated securities: see Uncertificated Securities Regulations 2001, SI 2001/3755, Reg. 41, first introduced in 1995. For ordinary securities, this is a matter for the company’s constitution, but publicly-traded companies typically align the position with that which will apply for their uncertificated securities: see, e.g., BP plc, Memorandum and Articles of Association, Art. 60(D) (48 hours prior to meeting). This reflects long-standing commercial practice preceding the introduction of the mandatory rule in 1995.

¹¹⁷ As appears to have occurred in the case of Laxey Partners’ activism in relation to British Land plc in 2002: see Hu and Black, *supra* note 82, at 816-817.

¹¹⁸ See, e.g., MARK C. FAULKNER, AN INTRODUCTION TO SECURITIES LENDING, 9 (2004).

¹¹⁹ See Bank of England, Securities Lending and Repo Committee, <http://www.bankofengland.co.uk/markets/gilts/slr.htm>.

¹²⁰ SECURITIES LENDING AND REPO COMMITTEE, SECURITIES BORROWING AND LENDING CODE OF GUIDANCE (2004), 17.

Thus we see that in the UK, there are greater constraints on intra-shareholder agency costs in publicly-traded firms than exist in the US. Blockholdings are subject to restrictions on absolute size, and were for many years subject to restrictions on the speed at which they could be accumulated. Blockholders are also required to disclose their interests in both jurisdictions, but in the UK the basic disclosure threshold is set at a lower level, disclosure is required much more rapidly, and extraordinary transparency obligations are imposed during a takeover situation. Finally, both jurisdictions have difficulty to implement *ex post* review standards for egregiously manipulative self-interested voting, but the UK supplements this with an *ex ante* approval requirement, excluding the self-interested votes, for any related party transaction. Moreover, the UK's short record dates and code of conduct on stock lending go some way to ameliorating concerns that have recently emerged concerning vote arbitrage through 'record date capture'.

5. Disclosure Obligations

The third dimension across which we have predicted differences in dispersed ownership systems according to predominant shareholder type is disclosure. Here we are referring to requirements imposed on firms regarding prospectus and continuing disclosure. The UK's disclosure regime has historically been much less onerous in this regard than that which has been operant in the US since 1934. In particular, until December 2006, there was no general liability in the UK for misleading statements or omissions that might affect secondary trading.¹²¹ This is consistent with the view that in an environment in which the principal investors are institutions relying on governance mechanisms to control managers, the information standard required is observability, rather than verifiability.

[This section will be expanded].

UK institutions were, until recently, able to rely on selective disclosure.

6. Enforcement Mechanisms

1. Formal Enforcement

The final dimension of difference concerns enforcement mechanisms. In a corporate governance system in which retail investors predominate, greater reliance is made on regulatory, as opposed to governance, mechanisms to control managerial agency costs. To be effective, regulatory mechanisms—that is, third-party intervention—must be supported by credible threats of enforcement. Conversely, where the predominant investor type is institutional, greater reliance is placed on governance mechanisms to control managerial agency costs. By their nature, these do not require the same degree of third-party enforcement; rather they simply require a credible threat of intervention by investors following underperformance. We would therefore expect, all other things being equal, to see more third-party enforcement occurring in the US than the UK.

This pattern is indeed observed, as regards formal enforcement by both private actors and public agencies. Consider first private litigation. In the US, fiduciary duty law suits are used as means of controlling egregious managerial misbehavior, and private litigation is facilitated by funding and procedural rules. A recent empirical study compares the incidence of private

¹²¹ Financial Services and Markets Act 2000 § 90A (inserted by Companies Act 2006) (liability for false or misleading statements, or material omissions, in respect of continuing disclosure obligations). There might additionally be liability at common law for deceit (*Derry v Peek* (1889) 14 App Cas 337) or for negligent misstatement, although in the latter case, it seems likely that liability for prospectus misstatements would be limited to initial subscribers, as opposed to subsequent purchasers (*Al-Nakib Investments Ltd v Longcroft* [1990] 1 WLR 1390).

litigation of corporate law claims in the US and UK.¹²² Over the period 2000-2006, US publicly-traded companies have an approximately 1/250 chance of one or more of their directors being subject to a lawsuit of this type generating one or more opinion, and 1/500 chance of being subject to a lawsuit that is not struck out at the first hearing.¹²³ In contrast, over the period 2004-2006, no UK publicly-traded company was subject to a private lawsuit launched against its directors for breaches of corporate law duties that resulted in an opinion, and only one such claim was ever filed during this period, approximating to odds of 1/10,000.¹²⁴ Similarly, private enforcement of securities law violations is frequent in the US,¹²⁵ whereas in the UK there are only one or two reported instances in which such claims have been brought since the early 1980s.¹²⁶

This relative dearth of *ex post* enforcement in the UK is not limited to private actions. As regards enforcement by public agencies, the US SEC brings far more enforcement lawsuits and imposes far higher aggregate penalties than does the UK's FSA, even controlling for the US' larger market capitalization.¹²⁷ To be sure, the UK's Takeover Panel does engage on a large scale with corporate actors, taking on average 368 cases a year over the period 1969-2006.¹²⁸ However, most of these interventions are of an *ex ante* variety: the Panel reviews information disclosure and advises parties about compliance in real time during an actual or potential takeover situation. The Panel imposes *ex post* sanctions much less frequently, on average in 6 cases a year over the same period.¹²⁹ Similarly, the UK's Financial Reporting Council, which oversees the quality of financial statements produced by publicly-traded UK companies, has only brought *ex post* court proceedings in 3 cases since 1991.¹³⁰

This is not to say that third party enforcement is likely never to occur in the UK. Indeed, even in a system in which governance mechanisms are the principal constraints on managers, there will need to be institutions supporting the allocation of decisional rights that allow such governance mechanisms to function—or, in economists' language, 'property rights need to be enforced'. UK courts do hear such actions.¹³¹ Such rules require less information to be presented to the court, and do not require the decision-maker to have significant business expertise.¹³²

¹²² John Armour, Bernard S. Black, Brian R. Cheffins and Richard Nolan, *Private Enforcement of Corporate Law: An Empirical Comparison of the US and UK*, working paper (2007).

¹²³ However, the deterrent value of these lawsuits is perhaps questionable. In only 7 cases since 1981 have US outside directors had to pay out from their own pockets, as opposed to the suit being covered by their D&O insurance: see Bernard S. Black, Brian R. Cheffins and Michael Klausner, *Outside Director Liability*, 58 *Stanf. L. Rev.* 1055, ____ - ____ (2006).

¹²⁴ Armour *et al.*, *supra* note 122.

¹²⁵ *Ibid.*

¹²⁶ John Armour, *Enforcement Strategies in UK Company Law: A Roadmap and Empirical Assessment*, working paper, 14 (2007) (two instances since 1980).

¹²⁷ John C. Coffee, *Law and the Market: The Impact of Enforcement*, working paper, Columbia Law School (2007).

¹²⁸ Armour, *supra* note 126, 27.

¹²⁹ *Ibid.*, 29.

¹³⁰ Data on FRC enforcement activity compiled from FRC Annual Reports, 1991-2006.

¹³¹ See, e.g., *Mornington v Easier plc* [2005] EWHC 2578 (Ch) (shareholder seeking court requisitioned meeting to prevent incumbents frustrating attempts to requisition EGM to remove board of AIM-listed company); *Might SA v Redbus Interhouse plc* [2003] EWHC 3514 (Ch) (28.5% shareholder of company listed on LSE main list requisitioning meeting to remove board; seeking injunction restraining incumbents from Chairing meeting); *PNC Telecom plc v Thomas* [2002] EWHC 2848 (Ch) (17.6% shareholder requisitioning meeting to remove board of company listed on LSE main list: whether service of notice of requisition by fax effective).

¹³² See Michael J. Whincop, *Painting the Corporate Cathedral: The Protection of Entitlements in Corporate Law*, 19 *Oxf. J. Leg. Stud.* 19 (1999); Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 *Calif. L. Rev.* 393 (2003).

However, in other contexts—such as the control of inter-shareholder agency costs, for example—more intensive third-party enforcement may be required. The problem is how to do this in an environment where less information is available and courts and regulatory agencies have less experience of dealing with such matters directly. In short, regulatory institutions developed in the context of controlling managerial agency costs may create positive externalities in other fields; conversely, their absence may mean that substitutes need to be developed.

2. Reputation and Ostracism

The most powerful substitute for *ex post* formal enforcement which we see in the UK consists of reputation-based mechanisms. In short, parties who breach the rules are threatened with ostracism from the London markets.

It is well-known that where a group of parties have repeated interactions, sanctions taking the form of threats to withdraw the benefits of future interactions from non-cooperating parties can act as substitutes for external legal enforcement.¹³³ Such mechanisms require a shared understanding amongst parties as to what constitutes ‘sanctionable’ conduct, and a means of discovering and disseminating information about breaches.¹³⁴ The regulatory agencies in the UK perform this function. All of the principal agencies—the Takeover Panel (responsible for application, ‘adjudication’ and enforcement of the Takeover Code), the Financial Services Authority (responsible for prospectus and circular scrutiny, enforcement of the Listing Rules, and sanction of , and the Financial Reporting Council—list the threat of censure amongst their armoury of potential sanctions, and exercise it periodically.¹³⁵ The Takeover Panel, which was the pioneer in this regard, provides a very good illustration. The Panel was established in 1968 in response to widely-perceived problems occurring in relation to bidder and target tactics during the takeover wave of the late 1960s. Its guiding code of principles, the *City Code on Takeovers and Mergers*, drew on and developed an earlier set of best practice guidelines, the *Notes on the Amalgamation of British Businesses*, which had been promulgated in 1959 by a working party chaired by the Bank of England. The existence and promulgation of the *Notes* satisfied the first of the preconditions we have articulated above for the operation of reputational sanctions—namely, a shared statement of what constituted sanctionable conduct. However, what was lacking was a disinterested, and therefore credible, mechanism for the identification and transmission of information about breaches. Until an independent advisory and investigative body—the Takeover Panel—was established, this condition was lacking.

However, merely ‘naming and shaming’ is not enough to sustain desired conduct. Individuals may still derive private benefits from cooperating with the shamed party. Indeed, the Takeover Panel’s first year (1968-9), in which its sole sanction was public censure, was widely perceived to be a failure because of several flagrant breaches of its orders by recalcitrant parties. To overcome this problem, the Panel in 1969 co-opted the relevant trade and professional associations of stockbrokers, investment banks, insurance companies, mutual fund managers, and

¹³³ It is one of the “folk theorems” of game theory that in the context of an indefinitely repeated game, there are multiple possible equilibria, some of which will induce co-operative behaviour in individual rounds. See, e.g. DOUGLAS G. BAIRD, ROBERT H. GERTNER & RANDALL C. PICKER, *GAME THEORY AND THE LAW*, at 172-173 (1994); ERIC RASMUSEN, *GAMES AND INFORMATION*, at 123-126 (2nd ed. 1994).

¹³⁴ Otherwise there are significant potential problems relating to false accusations being launched in order to gain private advantage against competitors.

¹³⁵ The Takeover Panel has issued approximately 1.2 public censures *per annum* relating to breaches of the Takeover Code during the period 1987-2006 (Armour, *supra* note 126, 29). The Financial Reporting Council has issued approximately 4.8 such censures *per annum* over the period 1991-2007 in relation to financial statements published by UK publicly-traded companies (FRC Annual Reports, 1991-2007). [Add FSA data].

the London Stock Exchange itself. This was an alliance of reputation-pooling organisations, who had a shared interest in the reputation of the takeover system as a whole. Each agreed to impose sanctions, including the possibility of exclusion, on any member attracting an adverse ruling from the Panel. This model was derived from that already used by the London Stock Exchange to enforce its listing rules, and by the Bank of England in banking standards. A similar structure was subsequently adopted when other Self-Regulatory Organisations ('SROs') were set up in the City of London during the 1980s.

Reputational-pooling guilds and trade associations, using the threat of ostracism as a sanction, have had well-documented success in a number of different business contexts, both as substitutes for, and superior alternatives to, formal law.¹³⁶ In order to make denial of future business credible, they use an iterated sanction mechanism: members who breach the rules are ostracised, and one of the rules is rule that no member may deal with an ostracised member. Applied to the context of the UK's regulatory environment, a ruling from the Panel that a party had breached the Code could in sufficiently serious cases be relied upon to provoke, in the case of a professional, exclusion from the ability to continue to practice in London, or in the case of a firm, de-listing from the London Stock Exchange. A similar stance is now adopted by the FSA, which acts as a comprehensive gatekeeper both to individuals and firms operating in any investment related business (including most institutional investors and their fund managers), through the grant of 'fit and proper person' status, and to firms wishing to list on the main list, through the FSA's function as UK Listing Authority. Not only does this mechanism serve directly to police professionals and listed firms, but it also recruits them as gatekeepers for others. An example of this is found in the Takeover Panel's statement in relation to two financiers involved in numerous Code breaches in relation to an attempted takeover in 1991.¹³⁷

'In the Panel's view neither Mr Drummond nor Mr Prentice nor any company which is in practice, directly or indirectly, controlled by either or both of them is likely to comply with the standards of conduct for the time being expected in the United Kingdom concerning the practices of those involved in takeovers and mergers. Therefore ... persons or firms authorised to conduct investment business are prohibited from acting for Mr Drummond or Mr Prentice or companies which are ... controlled by either or both of them in connection with transactions regulated by the City Code ...'

By threatening sanctions for any regulated party who assists the ostracised financiers, it excludes the latter from any future participation in the takeover market. Thus the only type of party who is unlikely to be deterred by the threat of such sanctions is a true 'one-shot player', who derives a sufficiently large payoff from a single breach as never to have to return to the marketplace.

The UK's reliance on reputation and gatekeeper mechanisms means that its regulators have access to sanctions that are, as compared to *ex post* litigation, relatively disproportionate and relatively cheap to impose. Disproportionate in the sense that public censure or cold-shouldering cannot be tailored to fit the gravity of the breach to the same degree as can legal sanctions; cheap in the sense that no legal proceedings are required, simply a public announcement. Under such circumstances, it may be rational for an enforcement agency to expend a greater share of resources on detection of infringements, rather than sanctioning them. Once an infringement has been detected, the agency may offer to hold any censure in suspense, provided that the

¹³⁶ Avner Greif (11th century Maghribi traders—guild mechanisms substitute for formal law), Lisa Bernstein (diamond merchants; cotton and grain associations—guild mechanisms chosen in preference to formal law owing to superior dispute-resolution efficacy).

¹³⁷ PANEL ON TAKEOVERS AND MERGERS, MR ANDREW P. DRUMMOND AND MR ROBERT D. PRENTICE: RE DUNDEE FOOTBALL CLUB PLC, PANEL STATEMENT 1992/9, 15.

infringement is not repeated.¹³⁸ Thus the greater the level of prior infringements by any actor, the more credible the threat of sanction, and hence the more effective the deterrent. This account squares with the self-declared ‘compliance oriented’ enforcement culture at UK agencies such as the Takeover Panel, the FSA and the FRC.

[Summary para]

IV. How the Two Systems Evolved

1. Literature review

Which came first: law or ownership?

2. The UK

- Early period: until end of C19th.
 - Major industries were railways (first) (Kostal, 1994), public utilities. Manufacturing was much more small-scale; did not involve large amounts of outside capital (Cheffins, 2007).
 - UK firms were primarily financed with debt. This was, to a degree unusual in the C19th, public rather than private debt. (1) London market was most sophisticated in the world; spillover benefits from trading in govt bonds meant private bond finance could piggyback on this expertise; (2) British banks suffered a major liquidity scare in 1878 following collapse of City of Glasgow Bank, and were consequently uninterested in (relatively) illiquid investments such as equity (Collins and Baker, 2003).
- First half of C20th
 - At the beginning of this period, a few firms, amongst the railway industry, may have had significant proportions of outside equity and possibly dispersed stock ownership (Hannah, 2007).
 - During the first half of C20th, and esp the interwar period, there was significant merger activity (Hannah, 1974; Chandler, 1990). This resulted in significant issues of outside equity, which helped to disperse the ownership and control in the largest companies (Franks, Mayer and Rossi, 2005).
- WWII-1960s
 - Ownership dispersion was becoming more noticed after WWII. A number of features of the 1948 Companies Act responded to this. (1) Mandatory shr rights to requisition meeting, remove board; (2) Some (limited) increase in accounting and disclosure regulation.
 - Dividends were an important mechanism of corporate control in these early dispersed ownership firms—failure to pay sufficiently large dividends resulted in takeovers; paying them tied managers hands to the market (Cheffins, 2006).
 - From 1947-1997, there was no tax on dividend income for pension funds. Insurance companies, for much of this period, also enjoyed favourable tax treatment. In contrast, from 1947-1979, there were extremely high rates of marginal taxation on individual investment income. As a result, institutions substituted for individual shareholders at a dramatic pace (Bank and Cheffins, 2006).
 - Ownership dispersion was completed following the enormous takeover boom of the 1960s. This brought with it the advent of the Takeover Panel, the establishment,

¹³⁸ See Paul Fenn and Cento Veljanovski, *A Positive Economic Theory of Regulatory Enforcement*, 98 *Econ. J.* 1055 (1988).

operation, and direction of which was largely driven by the preferences of institutional investors. There was also, in 1967, the first blockholder disclosure rule (10% threshold).

- Incumbents try to entrench selves against hostile bids by using non-voting shares (Franks, Mayer, Rossi, 2005). However these are dismantled following pressure from institutional investors.
- 1970s-1980s
 - During the 1970s (i) the Panel introduced the mandatory bid rule; (ii) Institutions lobby LSE for introduction of significant transactions/related party transactions rules in Listing Rules; (iii) blockholder disclosure threshold lowered to 5%.
 - During the 1980s: (i) SIB (Securities and Investments Board) established in early 1980s as general oversight body for securities markets—modelled on successful Takeover Panel; staffed largely from institutions; (ii) Insider trading prohibition introduced, following extended lobbying from Panel; (iii) Institutions establish clear voting guidelines on various issues including pre-emption rights
 - ‘Big Bang’ 1986 opened London capital markets internationally.
- 1990s
 - Cadbury Code introduced in 1992 following institutional investor preferences. Follow-up reviews in 1995, 1998.
 - Tougher insider trading laws from 1993.
 - Financial Reporting Council established in 1991 to oversee financial statement disclosure; regulatory model again based on Panel/SIB.
 - 1997: dividend tax credit for institutions abolished. Decline in pension fund ownership begins.
 - Dramatic growth of equity derivatives market (CFDs/equity swaps) driven by high rates of stamp duty on equity trades; regulatory responses in terms of disclosure are necessitated.
- Overall picture
 - Growth until WWII was similar to many other jurisdictions: (1) ‘Economic imperative’: large-scale firms could capture risk-bearing benefits through dispersal of stock ownership; (2) ‘Path dependency’: legal institutions supporting dispersal were not present. (3) *Some* firms grew so quickly (by merger) they were forced to disperse. (4) This was similar to various other jurisdictions e.g. Canada (Morck, 2005). Moreover, dispersal was potentially unstable under these circumstances.
 - WWII onwards: (1) Tax bias meant institutions became much more significant; (2) Institutions became powerful lobbying force for greater shareholder protection; (3) Dispersed ownership, initially unstable, became stabilised. *Without the institutions this would probably not have happened*; (4) High levels of pension fund ownership constrained employee participation calls; (5) Self-regulation reduced political salience of issues re. employees.
 - Conclusion: key factors were mergers + institutional investors; driven by unintended consequences of tax policy in 1940s.

3. The US

- Early period: until end of C19th
 - Banks were fragmented owing to populist policies; did not become major owners in US stock markets (Roe, 1994; Brands, 2006).
 - Size of capital investment required by railroads lead to firms growing on a scale unseen anywhere else in the world (Chandler, 1990).

- Largely financed with publicly traded debt, but laid institutional framework for dispersed securities markets, which could subsequently be rolled out for equity as well (Coffee, 2001). But most large firms were blockholder-controlled around 1900.
- Early C20th
 - Why did the blockholding 'plutocratic' families sell out? (1) Mergers during 1897-1907 wave appear to be one plausible cause (Cheffins, 2004); (2) The extraordinary stock market rise during 1920s gave blockholders very rich pickings for selling out (Becht and DeLong, 2005); (3) US financial markets grew very rapidly during 1920s owing to pound's removal from gold standard (Ferguson, 2003).
 - Many of mechanisms for controlling agency costs were informal, reputation based, operated by Wall St community. But buyers were largely individuals, rather than institutions. This lead to an incentive and political mismatch.
 - After 1929, doubt cast on reputational mechanisms as means of safeguarding retail investors. Regulatory mechanisms introduced instead. Institutions arguably (Roe, 1994) prevented from developing as significant force in corporate governance. No facilities for large-scale pension investment.
- WWII-1980s
 - US-style shareholder activism (proxy fights, tender offers, corporate raiders) driven by individuals, rather than institutions.
 - Managers, unconstrained by institutions, are able to shape developments in corporate law in a way that favours them (lack of governance mechanisms).
 - This is not necessarily inefficient, given widely dispersed shareholders.

V: Two Systems and their Convergence in the Metropolitan Firm

1. The Argument Thus Far.

The stylized account of ownership structure throughout the world compares the diffuse ownership systems of the US and the UK with the concentrated ownership systems that prevail elsewhere in the world. The argument thus far has been that there are two important variants of diffuse ownership (meaning two variants of the Berle-Means corporation): retail systems and institutional systems, which differ critically on the cost barriers to collective shareholder action and thus on the appropriate mechanisms for the control of managerial agency costs. Separation of ownership and control through retail ownership means that individuals (as record holders and beneficial owners) are the voters. For such shareholders, however, passivity is the dominant strategy in the exercise of the reserve shareholder power. Separation through institutional ownership means that institutions, rather than individuals, are record holders and beneficial owners and thus are the voters. Individuals own portfolios, not stocks. Because institutions can act collectively at lower cost than individuals, passivity is not necessarily the dominant strategy. These diffuse ownership variants correspond in historically important ways to the United States and the United Kingdom, as previous sections have demonstrated.

Different forms of diffuse ownership will produce different regulatory regimes. Shareholder voting is of limited utility in the control of managerial agency costs in a retail system, which will look instead to intensive public and private enforcement of extensively elaborated legal duties. Extensive (and enforced) mandatory disclosure is a complementary element in the legal enforcement of these duties. Robust disclosure also facilitates non-legal enforcement of these duties: (1) directly, through the revelation of firm specific information, (2) indirectly, through stock market prices that impound information about agency costs and (3)

indirectly, though the support of stock market liquidity that reduces exit cost of dissatisfied retail investors .

By contrast, an institutional system seeks to control agency costs through a governance regime that empowers institutions as shareholders but subjects them to reputational constraints against intra-shareholder opportunism. The regime is supported by firm-level disclosure of two kinds: mandatory public disclosure of firm-specific information and selective private disclosure of firm-specific information. The regime is also supported by robust mandatory disclosure about shareholder behavior, particularly ownership levels and intentions, to help mitigate the risks of intra-shareholder opportunism. The institutional system will not come under pressure to elaborate legal duties to control agency costs; similarly, it will create a low-intensity enforcement regime.

An institutional system critically depends upon repeat play and various other observability conditions to sustain reputation. These reputation channels run in two directions: between the firm (through its officers and directors) and the institutions, and among the institutions themselves. Reputation sustains the low cost coordination among shareholders that supports a successful governance regime. Reputation also sustains the firm's willingness to reveal competitively-sensitive information selectively and privately to institutional holders. Such disclosure can make an institution a better governance actor but risks premature public release that would be costly to the firm. There are several elements that facilitate the creation and maintenance of reputation. (i) Geographic proximity of the institutions makes it easier for the actual agents who run the institutions to observe one another and decide whether trust is warranted. It also gives the regulator greater access to informal and formal mechanisms to enforce anti-opportunism rules. (ii) Similarity of the institutions, including the time horizon over which results are measured, makes it easier to evaluate whether behavior is cooperative or opportunistic and of course makes agreement easier on what measures to take. (iii) Frequently required shareholder approval plays an important role as well. It creates the necessary governance channel of course, but it also provides multiple learning opportunities as well as multiple occasions for institutions to observe one another's behavior. Greater skill in governance intervention by lead institution or group that is credibly non-opportunistic will lower the cost of cooperation .

2. The Rise of Metropolitan firms

Our claim is that an increasingly large world-wide group of major public corporations that account for a significant fraction of world GDP will come to exhibit an ownership structure that combines elements of both the retail and the institutional models, what we call "metropolitan firms." We see this in the case of both the US and the UK. In the US, the ownership information we presented earlier show that institutions have an increasingly large ownership stake in public US firms. The scale economies of institutional investing mean that the fraction of institutional ownership is even higher in the largest firms. Shareholder passivity is no longer the dominant strategy and US institutional investors are bristling at the limits of the present system. For example, the recent clash over institutional access to the issuer proxy for the purpose of making director nominations demonstrates the ways in which the retail system may be out-moded. High levels of executive compensation may signal that managerial agency costs are not sufficiently controlled by the present system, yet the SEC was unwilling to move on a governance innovation that might help address it. It insisted on deal-killing disclosure about the nominator that is founded on tradition that assumes a retail investor in need of protection. (See Gordon (2007).

In the UK, institutional ownership has not changed in importance, but the nature of that ownership has changed. "Foreign" institutional investors and investors like hedge funds, foreign

and domestic, are jostling with traditional UK institutional investors (pension funds and life insurers) for ownership stakes. The geographic dispersion and diversity of these investors undercuts the conditions necessary to create and sustain reputation, on which the UK institutional system depends. Thus, upon reflection, there are two types of diffuse institutional ownership: “cohesive” and “dispersed.” The UK regulatory system works best in the case of *cohesive* institutional ownership in which reputation among shareholders is sustainable through the interaction of a complementary set of local arrangements and other local institutions and the regulator has ready access to important actors. But the emerging metropolitan firms will reflect *dispersed* institutional ownership, which will fit uneasily with UK-style governance and enforcement. A Hong Kong mutual fund, a German special situations hedge fund, a US public pension fund, a Chilean private pension fund, UK “market neutral” hedge fund, and a Swiss private equity fund will not necessarily all play by Association of Investment Trust Company rules.

Elsewhere in the world, diffusely-owned firms are already metropolitan firms, in the sense that their institutional owners are geographically dispersed and diverse.¹³⁹ Many concentrated ownership firms are likely to become metropolitan firms. As the scope of enterprise becomes world-wide, the increasing equity base of large firms means that blockholder control requires a growing equity stake that entails increasingly unattractive financial risks.¹⁴⁰ As the necessary equity stake increases, so do risk-bearing costs and the loss of liquidity. Diversification becomes increasingly infeasible. Compensatory pecuniary private benefits of control would require a scale that is inconsistent with increasing business complexity and size. Compensatory non-pecuniary benefits would have to reach remarkable levels in light of the increasing financial risks.¹⁴¹ This predicts for more ownership diffusion.¹⁴² Diffusion is almost certain to be institutionally based, if only because individuals regard themselves as less capable to make investment decisions across the international universe of companies and to handle trading and settlement systems outside their home countries.

¹³⁹ Cite to evidence.

¹⁴⁰ This is the result of institutional diffuse ownership as opposed to retail diffuse ownership. That is, if almost all shareholders are passive (as in a pure retail system), a would-be controller needs only a relatively small block that may even decrease as firm size increases. Someone who owned 5 percent of GM in the 1950s, for example, might in some sense be said to have “control.” But if the owners are institutions, then control is certain only at 50 percent, though “reliable” control should be feasible at a lower fraction, but that fraction will not necessarily decrease as firm size increases.

¹⁴¹ Gilson (2006) emphasizes the distinction between pecuniary and non-pecuniary benefits.

For concentrated ownership systems there is an analytically useful distinction between “controlling blockholder” regimes and “controlling controller” regimes, based on the different ratio between voting rights and cash flow rights. In a controlling blockholder regime, where the ratio is one, maintenance of control is linked to an ownership block whose value must generally increase in firm size. This presents the problems discussed in the text. In a controlling controller regime, exemplified by ownership pyramids or multiple class common, the ratio can be significantly less than one. In a controlling controller system if the ratio is allowed to decrease, the controller’s required equity investment need not increase in firm size. But given concerns about the likely inefficiencies of this form of organization because of the stark (and potentially increasing) incentives mismatch between the controller and the public equity suppliers, it seems improbable that this form of concentrated ownership system will be heralded as a governance solution for the largest world-wide firms.

¹⁴² The increase of ownership diffusion in firm size is consistent with LaPorta et al, who find, in a cross-country ownership survey of the 20 largest public firms (by market capitalization) in 27 countries, that the incidence of diffusely held firms increases as the ownership block criterion shifts from 10 percent to 20 percent, i.e., as the equity investment presumed necessary to retain control increases. (JF April 1999, pp. 492-93 Table II). Similarly, for “medium” public firms, they find fewer that are diffusely held, presumably because the necessary equity investment to retain control is smaller. (Id. at 494-95, Table III).

3. Will the rise of metropolitan firms produce a hybrid governance system?

The mismatch of the ownership structure of the metropolitan firm to the corporate governance systems of either the US or the UK suggests the desirability of reform and evolution. The optimal system looks to be a hybrid that combines elements of the two regimes, meaning elaborated legal duties, robust mandatory disclosure, strong shareholder governance rights, checks against intra-shareholder opportunism, and reasonably intense enforcement. The question is, if such a hybrid system is indeed more adaptive to the economically case of the metropolitan firm, how do we get there from here?

There are two modes of competitive pressure that might lead to change in the US or the UK, regulatory competition and yardstick competition. Regulatory competition works in the process of matching the demand side for better law with the supply side. There will be a growing group of firms moving from concentrated ownership to metropolitan ownership whose home country governance system is not best suited to a diffusely-owned firm. These firms may be able to improve their governance by opting into another country's system, either through a change in domicile and reincorporation or through cross-listing. Conceivably even firms now incorporated in the US or the UK, as the case may be, could seek to reincorporate or to cross-list. In certain respects each country is highly sensitive to the locational choice, as demonstrated by the debate over an apparent shift in initial public offerings from the NYSE/NASDAQ to the LSE/AIM market.

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Yardstick competition [citizens of Country B say, Country A has a better system; let's copy it. It's not a competition that occurs at the individual firm level, but rather mediated through politics.]

[more]

The barriers to change are of course formidable. We have earlier mentioned efficient path-dependency and inefficient path-dependency, each of which could operate in either country. The federal structure of the United States is a particular impediment to change. The SEC could not simply define a class of metropolitan firms and then oblige them to grant greater governance rights to their shareholders. Many of those rights are the subject of state law grant them declare that a particular governance regime

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UK may get there sooner, not so much because it has a unitary government, but because of the spur of the EU transparency directive, which forces much more robust disclosure regime, and because of increased enforcement activity that the FSA has already begun to undertake.

Table 1 : Stock Market and Firm Ownership Characteristics, Selected Countries

Country	GDP, 1995 (US\$bn)	Mkt cap, 1995 (US\$bn)	Population of listed firms, 1996	Proportion of largest 20 firms without 10% block, 1995	Median block size, all firms (%), 1995
Austria	239.56	32.51	106	0.05	63
Belgium	284.32	104.96	139	0.00	54
Finland	130.92	44.14	71	0.15	54
France	1570.26	522.05	686	0.30	63
Germany	2522.79	577.37	681	0.35	66
Hong Kong	144.23	303.71	561	0.10	49
Ireland	67.10	25.84	76	0.45	37
Italy	1126.04	209.52	244	0.15	65
Japan	5244.25	3667.29	2334	0.50	27
Norway	147.97	44.59	158	0.05	50
S Korea	517.19	181.96	760	0.40	37
Spain	595.75	197.79	357	0.15	52
Sweden	250.64	178.05	229	0.00	48
Switzerland	314.80	433.62	213	0.50	54
UK	1133.63	1407.74	2433	0.90	36
US	7342.30	6857.62	8479	0.80	50

Sources: GDP and market capitalization data are from the World Bank's *World Development Indicators* database; Population of listed firms is from dataset for 'What Works in Securities Laws' made available by Andrei Shleifer at <http://www.economics.harvard.edu/faculty/shleifer/dataset>; Proportion of largest 20 firms without 10% block is from La Porta *et al, supra* note 12, 493; Median block size is from Holderness, *supra* note 19, 44 (Table 4).

Table 2: Two Varieties of Dispersed Ownership

		US	UK
Shareholder characteristics	Complementary legal mechanisms		
Historically predominant shareholder type		Retail	Institutional
Ability to take governance decisions		Weaker	Stronger
Principal controls on managers		Regulatory	Governance
Potential for intra-shareholder opportunism		Lesser	Greater
Constraints on intra-shareholder actions		Weaker	Stronger
Information Requirements		Verifiable	Observable
Disclosure Obligations		Stronger	Weaker
Repeated interactions		Unlikely	Likely
Enforcement mechanisms		Formal	Informal

Figure 1: Share ownership patterns in the United States, 1950–2006¹⁴³

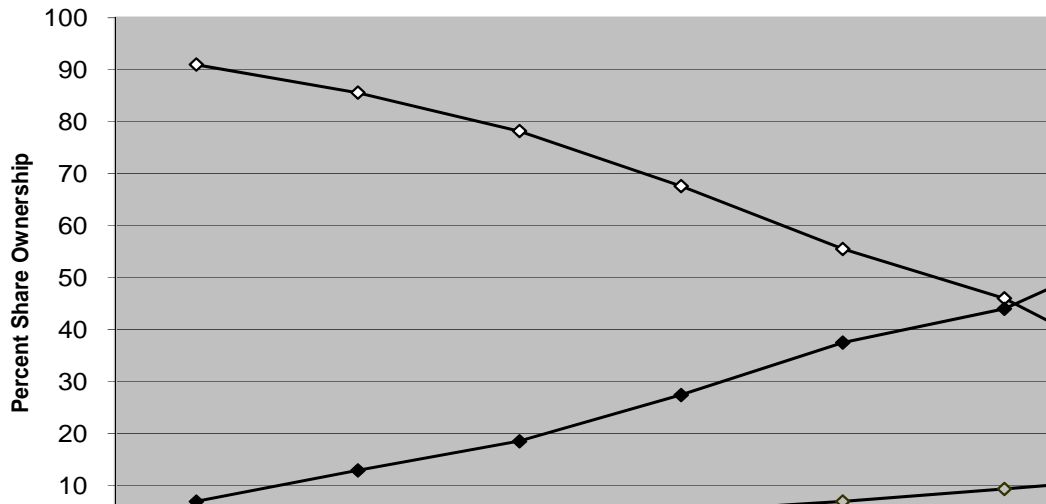
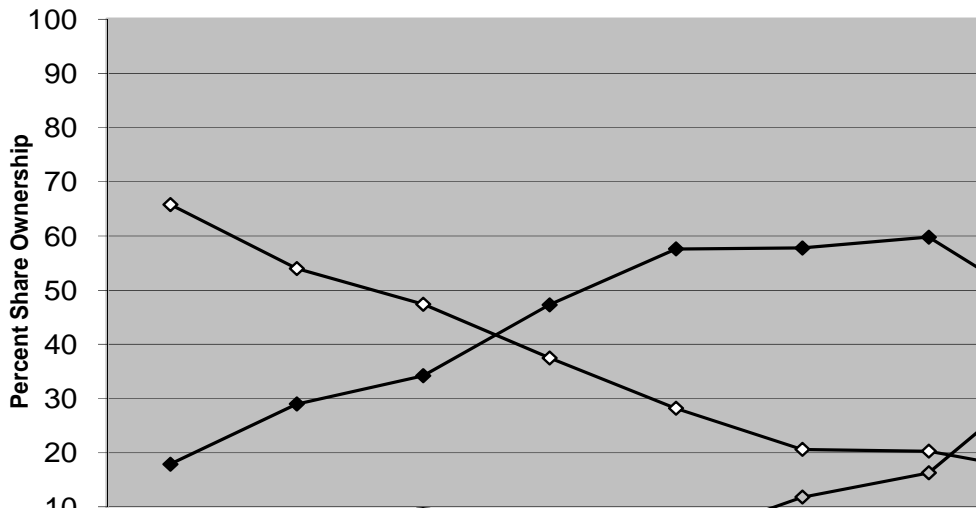


Figure 2: Share ownership patterns in the United Kingdom, 1957–2006¹⁴⁴



¹⁴³ BOARD OF GOVERNORS OF THE FED. RESERVE SYS., FLOW OF FUNDS ACCOUNTS IN THE UNITED STATES: ANNUAL FLOWS AND OUTSTANDINGS, 1945-1954; 1955-1964; 1965-1974; 1975-1984; 1985-1994; 1995–2006, at 82 tbl.L.213 (2007), available at <http://www.federalreserve.gov/releases/z1/Current/data.htm>. Figures are expressed as percentages of total holdings at market value.

¹⁴⁴ OFFICE FOR NAT'L STATISTICS, SHARE OWNERSHIP: A REPORT ON OWNERSHIP OF SHARES AS AT 31ST DECEMBER 2006, at 9 (2007); John Moyle, *The Pattern of Ordinary Share Ownership: 1957–1970*, at 6–7 (Univ. of Cambridge Dep't of Applied Econ., Occasional Paper No. 31, 1971).

