Corporate Governance and Ownership Structure

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Abstract: This paper reviews the theoretical and empirical literature on the relationship between corporate governance and ownership structure. From the agency perspective (Jensen and Meckling, 1976), the presence of large shareholders with greater controlling interest helps to mitigate conflicts of interests between manager and shareholders. The rent extraction model (Bebchuk, 1999a, 1999b), however, argue that large shareholdings can be motivated by private benefits of control which arise from significant control rights. Indeed, large controlling shareholders may extract benefits at the costs of minority shareholders. This problem becomes more severe when there is a deviation from the one-share-one-vote principle. Both theoretical models explain the motivation of individuals or organizations to forgo the benefits of diversification by concentrating their wealth in a single firm.

Keywords: Agency theory, corporate governance, private benefit of controls

INTRODUCTION

Most discussions on corporate governance and finance have focused on the corporate ownership structure. Indeed, the concept of ownership structure is the most important factor that determines the nature of the agency problem, which is the heart of corporate governance (Capulong et al., 2000). This is because ownership structure determines whether moral hazard problems are between managers and outside shareholders, or between controlling and minority shareholders.

The seminal study of Berle and Means (1932) notes the prevalence of widely held corporations in the U.S. and sets the image of the modern corporation as one operated by managers responsible to the shareholders. Their notion of diffuse ownership has also had profound influence on modern financial thinking as can be seen in the seminal contributions of Jensen and Meckling.

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11 The paper views corporate governance from the principal-agent or finance perspective (see Keasey, et al., 1997, pp. 3-5). Accordingly, corporate governance is defined as “the ways in which suppliers of finance to corporations assure themselves of getting return on their investment” (Shleifer and Vishny, 1997, p.737). In other words, corporate governance is “a set of mechanisms through which outside investors protect themselves against expropriation by the insiders” (La Porta et al., 2000, p.4).
(1976) and Grossman and Hart (1980). Much of the focus of extant studies is on conflict between diffuse shareholders and professional managers. In the mid-1980s, however, researchers began to realise that some U.S. public corporations had majority or large shareholders, many of whom were the managers or directors (e.g., Demsetz and Lehn, 1985; Holderness and Sheehan, 1988). Indeed, recent international evidence shows that the Berle and Means paradigm does not capture the reality of many corporations around the world. For example, La Porta et al. (1999) show that concentrated and dispersed ownership vary greatly across countries. For example, while dispersed ownership is prevalent in the U.S. and the U.K., blockholder controls are dominant in the countries of continental Europe.

The motivation of individuals or organisations to forgo the benefits of diversification by concentrating their wealth in a single firm can be explained by two agency relationship models: the principal-agent model (i.e., agency model) and the rent protection model. The agency model assumes that the level of ownership concentration in a firm determines the distribution of power between its managers and shareholders (Jensen and Meckling, 1976). As blockholder ownership increases, blockholders have a powerful incentive to monitor managers and therefore mitigate manager-shareholder agency conflicts (Grossman and Hart, 1980; Shleifer and Vishny, 1986). The concentration of shareholdings is thus the most direct way for outside shareholders to align their cash flow and control rights, especially in countries where legal shareholder protection is weak (Shleifer and Vishny, 1997). Alternatively, the rent protection model theorises that block ownership can be motivated by private benefits of control which arise from significant control rights (Bebchuk, 1999a, 1999b).

THE AGENCY MODEL

Concept of Agency Problems

The development of modern corporations is based primarily on the concept of sharing risks and capital by shareholders. In corporations owned by dispersed shareholders, however, it is difficult for control of the firm’s assets and management to be shared. As diverse ownership structures require delegation of control to the hands of a few professional managers, owner-manager conflict of interest becomes an unavoidable characteristic of widely-held corporations. The separation of ownership and control provides opportunities for managers to pursue their own interests at the cost of shareholders.

The differences in managerial and shareholder interests have been long recognised, indeed since Adam Smith’s (1776) *The Wealth of Nations*. Smith found that the management of early joint stock companies may not act in the best interests of the shareholders and also that they were negligent in many of their activities. A century and a half later, Berle and Means (1932) also raise critical warnings on the dangers of the separation of ownership from control. They underline that agency problems can severely affect firm performance.

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The concept of separation of ownership and control is the starting point for modern agency theory. The theory deals with agency relationships which arise when one self-interested individual (i.e., the principal) delegates some decision-making authority to another self interested individual (i.e., the agent). This delegation of authority exposes agents to risks for which they are not fully compensated, giving them incentives to seek additional compensation through non-compensatory means such as free-riding or shirking (Jensen and Meckling, 1976). It also creates information asymmetries that make it possible for agents to engage in activities that could threaten the wealth of owners. If both agents and principals are assumed to be utility maximisers, there is reason to believe that the agent will not always behave in the best interests of the principal. As decision-making authority is delegated by the principal to an agent, the agents use this power to maximise their self interest at the expense of principals. The problems due to this divergence of interest are referred to as the agency problem.

Jensen and Meckling (1976) define agency costs as the sum of the monitoring expenditures by the principal, the bonding expenditure by the agent, and the residual loss. Monitoring expenditures are paid by the principal to limit the aberrant activities of the agent. These expenditures potentially include payments to auditors to inspect the company's accounts, costs of providing information to financial analysts, rating agencies, independent directors on the board and so on (Farinha, 2003). Bonding costs are created by the agent either to guarantee that the agent will not take action which would damage the principal or to ensure that the principal will be compensated if the agent takes such actions. These actions include the retention of a larger than desired equity stake by the agent, or the adoption of a riskier than desired compensation plan. The residual loss is the reduction in the principal's welfare due to some divergence between the agent's decisions and those decisions which would maximise the principal's welfare.

Besides the effort (i.e., shirking) and perquisite problems described by Jensen and Meckling (1976), several possible factors or actions, such as different investment horizons and risk preferences between managers and shareholders, misallocation of company funds and overinvestment, may lead to a reduction in firm value (Byrd et al., 1998). Specifically, managers tend to have shorter investment horizons than owners and are typically more risk averse because much of their wealth is tied to the ongoing viability of the firm. Managers also have greater incentives to misallocate corporate funds or to consume excessive perks because they do not bear the full costs of such actions. They also have the incentives and the opportunities to undertake negative net present value projects. Some, however, argue that the most important agency problem is when managers can expropriate shareholders by entrenching themselves and staying on the job even when they are no longer competent to run the firm (Shleifer and Vishny, 1989). Evidence on the conflicts of interest between managers and shareholders is well documented. These findings particularly relate to conflicts of interest over issues of compensation (e.g., Jensen and Murphy, 1990), takeovers (e.g., Agrawal and Knoeber, 1998) and diversification (Denis et al., 1997).31

31 See Shleifer and Vishny (1997, pp. 742-744) for a comprehensive review of the agency problems between managers and shareholders.
Agency Problems and Ownership Concentration

The relationship between agency problems and ownership structure can be explained by Jensen and Meckling’s (1976) theory. Jensen and Meckling theorise that ownership structure may be chosen to minimise the sum of agency costs and diversification costs. Agency problems will be lower when the interests of agents (i.e., managers and principals) are more aligned through higher managerial share ownership. In particular, when managers own 100 percent of the residual claims on a firm, they will make decisions that maximise their utility. If they own only a fraction of the firm’s shares, they will bear only a proportion of the costs of any private benefits they take out in maximising their own utility, while other shareholders must bear the rest. Accordingly, Jensen and Meckling imply that an owner’s direct involvement in the management of the firm would reduce the cost of mitigating information asymmetries and the accompanying moral hazard. This notion is based on two assumptions. First, owner management is an efficient substitute for the costly control mechanisms that non-owner managed firms use to control the agency costs of managerial discretion. Second, the separation of ownership and control is the source of agency costs (Alchian and Woodward, 1988).

The possibility that outside shareholders serve to monitor and limit management’s self-serving behaviours, hence reducing agency costs, is also suggested by Jensen and Meckling (1976). The effectiveness of these actions, however, depends upon the power and incentive of outside shareholders. In corporations with a dispersed ownership structure, shareholder control over managers is weak due to poor shareholder monitoring caused by the free-rider problem. Diffuse shareholders are not keen on monitoring because they bear all the monitoring costs but only share a small proportion of the benefits (Grossman and Hart, 1980; Hart, 1995). Even if outside shareholders can obtain sufficient information, the spread of ownership makes it difficult for them to take serious collective action. Outside shareholders would only engage in managerial monitoring efforts if they perceive that the monitoring benefits are higher than the costs (Shleifer and Vishny, 1986). The primary agency problem in this type of firm is conflict between shareholders and managers.

The presence of large shareholders with greater controlling interest may solve the free-rider problem encountered by dispersed shareholders. Since large shareholders hold a significant percentage of firm equity, they have an incentive to collect information and monitor management (Shleifer and Vishny, 1986) as well as have enough voting power to force management to act in the interest of shareholders (La Porta et al., 1999). When larger shareholders are families, they are almost always directly involved in the firm’s management (e.g., Holderness and Sheehan, 1988). Therefore, the classic owner-manager conflict described by Berle and Means (1932) or Jensen and Meckling (1976) should be lower in closely-held firms than in widely-held firms.

Agency Problems and Ownership Composition

The incentives to correct managerial failure depend not only on the concentration of ownership or control, but also on its nature, as specific classes of shareholders may value control differently (Jensen and Meckling, 1976). Furthermore, each type of large shareholder may have different agency relations and costs, and consequently have a different impact on the firm’s strategic decision making (Gugler, 2001). The identity of large block shareholders, therefore,
could prove important for understanding the concentration of corporate ownership (Holderness and Sheehan, 1988). Large shareholders can generally be classified into individuals or families, institutional investors, government and widely-held firms.

Some have argued that family blockholders have unique characteristics that cannot be easily replicated by other types of blockholders (Anderson and Reeb, 2003a). For example, families are highly undiversified and have a long term commitment to one particular firm, and are therefore usually involved directly in the management of the firm. This, in turn, acts as a counter to owner-manager agency problems. Other types of blockholders, such as government, corporations and institutional investors, are likely to have lower incentives to monitor managers.

Gugler (2003) argues that government-controlled firms can be viewed as manager controlled. In these firms, a double principal-agent problem exists. The ultimate owners of the firm (i.e., citizens) do not control the firm directly, but through their elected representatives. Due to large numbers, citizens may shirk their role of monitoring politicians, and thus politicians themselves may not actively monitor the companies owned by the state. This leads to even greater principal-agent problems between managers and citizens than for private firms. A similar argument can be applied to institutional blockholders. Gorton and Kahl (1999) argue that institutional investors are basically “synthetic large investors” created by small investors to mimic the advantages of family control. Since institutional investors are run by managers, they may also encounter a double principal agent problem or “agents watching agents problems.” Tufano (1996) shows that institutional investors often have significant shareholdings in different companies and thus are more likely to have an incentive structure similar to atomistic shareholders rather than a monitoring role.

THE RENT PROTECTION MODEL

Concept of Rent Protection

The choice between dispersed and concentrated ownership of corporate shares and votes can also be explained by the rent protection theory (Bebchuk, 1999a, 1999b). The foundation for this theory (referred to as a property rights approach to the theory of the firm) was provided by Grossman and Hart (1986) and Hart and Moore (1990). The authors view ownership of a firm as giving the owner residual control rights over the use of the firm’s assets; that is, the right to use assets in whatever way the owner chooses unless otherwise prohibited in a contract. In a property rights paradigm, therefore, ownership is synonymous with control. From this perspective, large shareholders often have effective control of the firm and can use this control to extract private benefits at the expense of minority shareholders.

Bebchuk (1999a; 1999b) argues that the size of the private benefits of control influences the choice of ownership structure. In particular, when private benefits of control are large, and when control is thus valuable enough, leaving control up for the taking would attract attempts to seize control by rivals seeking to capture these private benefits. In such circumstances, to prevent control being seized, founders of publicly held companies will tend to maintain a lock on control. Bebchuk also argues that corporate structures that have, and do not have, a controlling shareholder are different in critical ways. In widely held companies, control is “contestable” in that a rival can seek to seize control from the incumbent against their will. In contrast,
when a company has a controlling shareholder, control is rather “locked” (i.e., control cannot be obtained against the incumbent’s will but only through negotiations with the incumbent).

What then are the private benefits of control? Adam Smith (1776, Book II, Ch. 24) made the distinction that a landlord’s “real wealth is in proportion, not to his gross, but to his rent,” the difference mainly from his “private enjoyments and amusements.” Two centuries later, Jensen and Meckling (1976) describe private benefits as follows:

“Benefits he [the owner/shareholder] derives from pecuniary return but also the utility generated by various non-pecuniary aspects of his entrepreneurial activities such as the physical appointments of the office, the kind and amount of charitable contributions, personal relations ("friendship," "respect," and so on) with employees, a larger than optimal computer to play with, or purchase of production inputs from friends.”
(p. 312)

More succinctly, Bebchuk and Kahan (1990, p.1090) define private benefits as “any value captured by those controlling the company after the control contest and not shared among shareholders at large.” In a similar vein, Coffee (2001, p.9) describes private benefits as “all of the ways in which those in control of a corporation can siphon off benefits to themselves that are not shared with the other shareholders.” A further explanation by Johnson, La Porta et al. (2000) is that private benefits stem from “tunnelling” of minority shareholders with self-dealing transactions (e.g., asset sales and transfer pricing, excessive executive salary, loan guarantees), or without asset transfer (e.g., insider trading, minority discrimination transactions, creeping acquisition).

An important type of private benefit of control, identified by Bebchuk, (1999b), is the opportunity to engage in self-dealing and in taking corporate opportunities. For example, controlling shareholders may obtain inside information about potential opportunities in other more or less related areas. It would then be easy for them to exploit these opportunities through their other companies with no advantage to the initial firm’s shareholders. The net present value of these opportunities represents a private benefit of control (Dyck and Zingales, 2004). Pound (1988) argues that large shareholders can also collude with the managers to extract private benefits at the cost of minority shareholders. Pound shows evidence that these parties vote together during a proxy contest. Other examples of private benefits of control are empire building, intercorporate loans at non-market rates, use of the firm’s money and prestige to lobby politicians to promote the controlling shareholders’ social and political agendas (Mayer, 2001), excessive risk taking, and transfer pricing to and from other beneficiary companies (Barclay and Holderness, 1989).

The control over dividend policy may also give the controlling shareholders private benefits of control. For example, they may choose a dividend payout policy which is optimal to their own specific tax situation but not to that of the majority of minority shareholders. In addition, if controlling shareholders have incentives to extract private benefits at the costs of minority shareholders, they might prefer a low dividend payout policy to preserve free cash flows (Silva et al., 2004).

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Table 1: A Typology of Private Benefits of Control

<table>
<thead>
<tr>
<th>Pecuniary</th>
<th>Non-pecuniary</th>
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<tbody>
<tr>
<td>High transferability</td>
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</tr>
<tr>
<td>I. &quot;Self-Dealing&quot;</td>
<td>III. &quot;Amenities&quot;</td>
</tr>
<tr>
<td>- Excessive salary</td>
<td>- Winning the world series</td>
</tr>
<tr>
<td>- Diversion of resources</td>
<td>- Influencing public opinion</td>
</tr>
<tr>
<td>- Asset transfers at arbitrary prices</td>
<td>- Owning a luxury brand</td>
</tr>
<tr>
<td>- Cheap loans and guarantees</td>
<td>- Physical appointments</td>
</tr>
<tr>
<td>Low transferability</td>
<td></td>
</tr>
<tr>
<td>II. &quot;Dilution&quot;</td>
<td>IV. &quot;Reputation&quot;</td>
</tr>
<tr>
<td>- Insider trading</td>
<td>- Social prestige</td>
</tr>
<tr>
<td>- Creeping acquisitions</td>
<td>- Family tradition</td>
</tr>
<tr>
<td>- Freeze-out and squeeze-out</td>
<td>- Promotion of relatives</td>
</tr>
<tr>
<td>- Issuance of shares at dilutive prices</td>
<td>- Personal relations</td>
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</tbody>
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*Source: Modified from Ehhardt and Nowak (2001, p.5)*.

Private benefits of control also might be non-pecuniary. These benefits usually exist when the controller founded the firm, when the firm has been controlled by families for a long time, or when control of the firm provides the controller with some prestige and glamour (e.g., the control of professional sports teams or newspapers) (Bebchuk, 1999b). To summarise, there are two dimensions on which private benefits of control can be differentiated: pecuniary or non-pecuniary and transferability. Table 1 presents four types of private benefits defined based on these two dimensions.

Private benefits, however, do not necessarily reduce the wealth of minority shareholders. For example, Holderness (2003) argues that neither non-pecuniary pride nor synergies in production that result if a corporation is the blockholder (a common situation) will reduce the wealth of minority shareholders. Indeed, both of these private benefits could produce benefits to minority shareholders; both types of private benefits of control could, in other words, result in shared benefits of control. In addition, Mayer (2001) argues that the efforts of promoting or protecting the family reputation do not necessarily involve investor expenditure. Denis and Denis (1994) also argue that the motivation to enhance the family reputation and to pass on firms to their heirs might limit managerial self-dealing, inspiring family blockholders to realise large private benefits of control without sacrificing the performance of a firm.

**Private Benefits of Control and Ownership Structure**

The substantial differences in ownership structures across countries can be explained by Bebchuk’s (1999a, 1999b) model. It suggests that controlling shareholders should be more common in countries where the private benefits of control are large, and less common in countries where such benefits are small. This argument is consistent with the findings of La Porta et al. (1999), who identify a relationship between the presence of controlling shareholders and strength of legal investor protection. Controlling shareholder structures are more common when legal investor protection is weak. La Porta et al. (2000) also argue that the protection of minority shareholders by the legal system determines the value of private benefits of control, and in turn establishes corporate ownership structures in a country. In particular, in countries where private benefits of control are small due to strong legal protection of outside investors, the presence of controlling shareholders is uncommon.

The differences among companies within a country can also be explained by Bebchuk’s (1999b) model. This model suggests that a company is more likely to have a controlling structure when
the private benefits of control are large. These benefits are dependent not only on the country’s legislation but also on company-specific and industry-specific parameters. Therefore, within each country, controlling shareholders should be more common in industries in which the private benefits are relatively large. One factor that might make private benefits small is the presence of substantial regulation in the industry. Thus, regulated industries may have smaller private benefits because regulators monitor and reduce their extraction. This prediction is consistent with the evidence that concentration of ownership is lower in regulated industries such as financial services and utilities (Demsetz and Lehn, 1985).

A small number of studies, however, have estimated the private benefits of control for large shareholders. Among these studies, Barclay and Holderness (1989) indicate that on average, trades of large blocks of stock are typically priced at a premium of around 20 per cent to the post-trade market price and thus suggest that the net private benefits of large block ownership are positive. Research by Dyck and Zingales (2004) which estimated private benefits of control in 39 countries found that higher private benefits of control are associated with more concentrated ownership. The results, therefore, are consistent with Bebchuk’s (1999b) rent protection theory.

**Rent Extraction and Separating Control from Cash Flow Rights**

The literature suggests that combining ownership and control allows concentrated shareholders to exchange profits for private rents (e.g., Fama and Jensen, 1983; Shleifer and Vishny, 1997). Indeed, in countries in which controlling shareholders are prevalent, such controllers often maintain control while retaining substantially less than a majority of the cash flow rights (i.e., deviation from the one-share-one-vote principle). This can be done through the use of a controlling-minority structure such as pyramid structures, cross-holdings and dual-class stocks (Bebchuk et al., 1999; La Porta et al. 1999).

Pyramid structures are defined as owning a majority of the stock of one corporation which in turn holds a majority of the stock of another; a process that can be repeated a number of times (Claessens et al., 2000, p.93). For example, if a shareholder S owns 51 per cent of the voting share of firm A, which in turn owns 51 per cent of the voting share of firm B, there is an uninterrupted chain that gives shareholder S absolute majority control at each tier. The cash flow rights of shareholder S in firm B is only 26 per cent (i.e. 51 per cent x 51 per cent). If firm B owns 51 per cent of the voting share of firm C, shareholder S has a real equity stake of just 13 per cent in firm C (i.e. 51 per cent x 51 per cent x 51 per cent). It is clear that separation of cash flow rights and voting rights might let controlling shareholders control assets worth vastly more than its equity of the firm. This potentially creates severe moral hazard problems between controlling shareholders and minority shareholders.

In pyramid firms, there are three main potential agency problems between controlling and minority shareholder (Morck and Yeung, 2004). First, controlling shareholders can spend outside shareholder money on things they want, rather than on things that produce firm value (i.e., “other people’s money agency problem”). For example, if controlling shareholder S in the previous example orders firm C to spend one million dollars on an executive jet for shareholder S’s use, the value of firm C will presumably decrease by one million dollars. But this translates into a reduction of $130,000 in
the value of the firm A. Second, entrenchment of the agency problem in pyramid firms might be worse than in widely held firms. This is because mismanagement in widely held firms usually results in stock declines that in turn trigger pressures which lead to management’s ouster such as shareholder lawsuits, hostile takeovers, and challenges by institutional investors. The controlling shareholders in pyramid firms, however, cannot be ousted through such challenges if the pyramid is held together with controlling stakes greater than 50 per cent. Third, pyramid member firms are vulnerable to transfers of wealth among pyramid firms to the advantage of the controlling shareholders. For example, suppose an asset in Firm C increases by one million dollars. As already noted, only $130,000 of this gain ultimately accrues to the controlling shareholder S at the pyramid apex (i.e. Firm A). However, shareholder S controls the board of Firm C since s/he controls that of Firm B. If shareholder S orders Firm C to sell the asset to Firm A at its old price, the additional one million dollars will appear in Firm A instead. The wealth of controlling shareholder S therefore increases by $510,000 instead of only $130,000.

In contrast to pyramids, companies in cross-ownership structures are linked by horizontal cross-holdings of shares that reinforce and entrench the power of central controllers. The main difference between cross holding and pyramid structures is that the voting rights used to control a group remains distributed over the entire group rather than concentrated in the hands of a single company or shareholder (Bebchuk et al., 1999). Cross holdings are very popular in Asia, especially among Chinese family firms, because they make the locus of control over company groups less transparent (Weidenbaum, 1996).

Dual class firms are defined as “corporations with two classes of shares having different voting rights” (Coffee, 2001, p.10). Harris and Raviv (1988) indicate that dual stock structures reduce the probability of the incumbent being voted out. Extant literature show that dual stock structures are prevalent in family controlled firms. In particular, DeAngelo and DeAngelo (1985) report that U.S. firms with a higher family involvement tend to have dual stock structures. Taylor and Whittred (1998) show that Australian dual class IPO firms are smaller, less levered, and controlled by the founding family. Amokako-Adu and Smith (2001) report that Canadian firms with concentrated family ownership prefer dual stock structures.

Consistent with Morck and Yeung’s (2004) arguments of agency problems in pyramid firms, Claessens et al. (2002) show that in East Asian economies, the excess of large shareholders’ voting rights over cash flow rights has a negative impact on firm value. Lins (2003) reproduces this finding in a study of control pyramids in emerging countries and also finds that the effect is weaker in countries with better legal protection and in pyramid firms with larger outside shareholders. Furthermore, Lemmon and Lins (2003) show that firms low in control pyramids suffered disproportionately in the Asian financial crisis. In contrast, Faccio and Lang (2002) indicate that tunnelling is not common in Western European control pyramids, and suggest that this is due to better legal shareholder protection which constrains controlling shareholders more tightly in Europe than in Asia or emerging countries. The results are consistent with the argument that minority shareholder’s wealth expropriation depends on the level of shareholder legal protection (Burkart et al., 2003).

A model presented by Bebchuk (1999b) predicts that larger private benefits of control are more common with the use of voting-cash flow right separation. In particular, Bebchuk suggests that separation of cash flow rights and voting rights tends to be used in conjunction with controlling shareholder structures but not with non-controlling shareholder structures. Such schemes
enable controlling shareholders to maintain a lock on control without having to bear the cost of owning a large fraction of the cash flow rights. In contrast, in non-controlling shareholder structures, where the owner is giving up a lock on control, creating such separation will not produce value to the owner.

Empirical evidence supports this argument. For example, ownership of shares with a superior voting right is more likely to be concentrated when dual-class stocks are present (DeAngelo and DeAngelo, 1985; Nenova, 1999). Pyramidal structures are rare in countries with strong legal shareholder protection such as the U.S. and the U.K, in which private benefits of control are small. However, they are prevalent in many countries with weak investor protection, where share benefits of control are larger (La Porta et al., 1999). In addition, Claessens et al. (2000) found that in all nine East Asian countries in their sample, voting rights frequently exceed cash flow rights via pyramid structures and cross holdings. This phenomenon is most pronounced among family controlled firms and small firms. The disparity between ownership rights and control rights therefore is characteristic of countries that permit the exploitation of private benefits of control.

CONCLUSION

Concentrated ownership can be explained by the principal-agent model and the rent protection model. The former model assumes that concentration of shareholdings is the most direct way for outside shareholders to align their cash flow and control rights, especially when legal shareholder protection is weak. The latter model theorises that block ownership can be motivated by private benefits of control which arise from significant control. When their control rights are greater than cash flow rights (i.e., deviation from one-share-one-vote), large shareholders may expropriate the wealth of minority shareholders. This can be done via the use of a controlling-minority structure such as pyramid structures, cross-holdings and dual-class stocks. As such, large shareholders may mitigate or exacerbate agency problems.

References:


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