Controlling Shareholders in the Twenty-First Century: Complicating Corporate Governance Beyond Agency Costs

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I am grateful to Jill Fisch, George Georgiev, Ronald Gilson, Curtis Milhaupt, Sergio Mittlaender, Bruno Salama, and participants in the Wharton conference in honor of Ronald Gilson for their comments and suggestions. All errors are my own.

Abstract

By the end of the twentieth century, the then-dominant literature on "law and finance" assumed that concentrated ownership was a product of deficient legal systems that did not sufficiently protect outside investors. At the same time, commentators posited that the competitive pressures of economic globalization would push countries around the world to adopt an efficient regime of strong investor protection, which was thought to facilitate ownership dispersion. Nevertheless, at the dawn of the 2020s, ownership concentration not only persists, but appears to be on the rise among the world's largest companies. This symposium essay in honor of Ronald Gilson explores what went wrong with the original predictions from two decades ago and the resulting lessons for corporate governance analysis. It shows that the focus on agency costs that dominated the earlier literature overlooked the fact that corporate governance structures are both (i) influenced by factors beyond tradeoffs in agency costs (such as non-pecuniary private benefits of control and nationalism), and (ii) affect social welfare in ways other than through their effects on investor protection. The essay then reflects on the emerging challenges to what I call the "modularity approach" to corporate law scholarship, and contemporary law-and-economic analysis more generally, which stipulates that each area of law should serve one key efficiency objective.

Keywords: controlling shareholders, corporate governance, nationalism, modularity

JEL Classifications: K10, K22, L21, L50, O16

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I. Introduction

Comparative corporate governance is one of the fields that has greatly benefited from Ronald Gilson's pathbreaking scholarship.[1] In *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, published by the Harvard Law Review in 2006, Gilson presented a new framework that better explained the incidence of controlling shareholders around the globe and its implications.[2] "When the world seems more complicated than what our theory can explain," Gilson noted, "we probably do not yet understand the world."[3]

This essay aims to recast and highlight Gilson's contributions in view of subsequent developments in corporate governance and the world order at large. Only thirteen years have passed since the publication of *Controlling Shareholders and Corporate Governance*. However, it is striking how much the corporate landscape has changed since then, to the point that the Article at times has a distinctive twentieth-century feel to it. When it was written, the debate about the merits of concentrated ownership and dual-class shares mostly concerned non-U.S. firms in Europe and developing countries.[4] There is also no discussion of state ownership and control, a topic that would find renewed interest given the rise of China and other emerging markets. The alternative mode of

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[1] Additional contributions include *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 YALE L.J. 871 (1993); *Globalization of Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329 (2001); *The Poison Pill in Japan: The Missing Infrastructure*, 2004 COLUM. BUS. L. REV. 21; *Choice as a Governance Mechanism: The Case of Japanese Corporate Governance*, 53 AM. J. COMP. L. 343 (2005) (with Curtis J. Milhaupt); Ronald J. Gilson, *Controlling Family Shareholders in Developing Countries: Anchoring Relational Exchange*, 60 STAN. L. REV. 633 (2007); *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the United States and the European Union*, 63 STAN. L. REV. 475 (2011) (with Henry Hansmann and Mariana Pargendler).

[2] Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1650 (2006).

[3] *Id.* at 1650.

[4] In fact, Gilson went to great lengths to emphasize the existence of controlling shareholders in the U.S. context. *Id.* at 1660 and 1666.

ownership concentration in the hands of institutional investors—which would receive Gilson's attention a few years later[5]—is also entirely out of the picture.

Controlling Shareholders and Corporate Governance begins by drawing attention to the shift in corporate governance scholarship from the debate on hostile takeovers of the Anglo-Saxon world to the merits of controlling shareholder systems that dominate most jurisdictions around the globe. Although this is framed as a premise rather than as a primary contribution of the Article, Gilson was a pioneer in articulating and promoting such a shift. This important shift would only gain force in subsequent years, as controlling shareholders started to become more salient.

The Article aimed to "highlight the value of distinguishing between efficient and inefficient controlling shareholder systems, and between pecuniary and nonpecuniary private benefits of control."[6] In doing so, it advanced three main claims, each of which would prove to be highly prescient in anticipating the current state of corporate governance and its future direction:

> Claim #1. Controlling shareholders also appear in "good law" jurisdictions that offer adequate protections to outside investors, resulting in efficient controlling shareholder systems.
>
> > *Since the mid-*2000s*, there has been a renaissance of controlled dual-class firms in "good law" jurisdictions (especially in the United States), which are now among the largest companies in the world.*[7]
>
> Claim #2. Nonpecuniary private benefits of control (NPBC), such as psychic benefits and socio-political prestige associated with control, help explain the relative prevalence of controlling shareholders in different jurisdictions and industries.
>
> > *NPBC plays an important role in the rise of controlling shareholders in the booming technology industry.*[8]
>
> Claim #3. Controlling shareholders may have detrimental macroeconomic consequences to national welfare even when minority investors are sufficiently protected.
>
> > *Since the global financial crisis, scholars and policymakers have increasingly recognized that corporate governance can have broader macroeconomic effects beyond problems of investor protection.*[9]

Nevertheless, despite such outstanding foresight, some of the predictions of *Controlling Shareholders and Corporate Governance* have not materialized, such as the suggestion that dispersed ownership may have an edge "in high technology industries

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[5] Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 883 (2013).
[6] *Id.* at 1642.
[7] *See* Part II.A *infra*.
[8] *See* Part II.B *infra*.
[9] *See* Part II.C *infra*.

characterized by intense market competition and rapid technological change."[10] Today, with the benefit of hindsight, the opposite is believed to be true,[11] given the rise of controlling shareholders and dual-class structures in the technology sector.[12] More generally, Gilson was not exactly bullish about the long-term prospects of controlling shareholder systems, which he viewed as less adaptable to change. This raises the question: if the analysis was so prescient, what went wrong with some discrete predictions?

I will suggest that some of the forecasts faltered because, ironically, they did not give enough weight to the Article's own theoretical framework. The relevant ingredients were there but were used in too small amounts. For instance, the new political and cultural clout of technology firms was not fully apparent in 2005, when Google had just gone public with a then unusual dual-class structure[13] and "thefacebook" had recently been founded at Harvard college. Consequently, the Article did not sufficiently consider the emerging role of NPBC in the technology industry.

In other respects, the world economy simply followed an unforeseen direction. As most scholars at the time, Gilson expected globalization to increase product market competition, which, he thought, would put pressure on controlling shareholder systems, for two reasons. First, product market competition substitutes for monitoring, thereby lessening the role of controlling shareholders in mitigating managerial agency costs.[14] Second, product market competition would require more efficient firm management and access to external capital markets, thereby undermining inefficient controlling shareholder systems.[15] And yet, surprisingly, the promise of increased competition due to globalization can no longer be taken for granted, with several authors pointing to a decrease in product market competition in the last decades.[16]

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[10] *Id.* at 1658.

[11] *See, e.g.*, Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 789 (2017).

[12] *Controlling Shareholders* dedicates only one sentence to the use of dual-class shares in the then recent IPO of Google, and generally argues that dispersed ownership is better suited to high-tech firms. Gilson, *supra* note 2, at 1658 and 1660. In fact, Google's Registration Statement specifically noted that dual-class shares were then rarely used in the technology industry. Jill Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, BOSTON U. L. REV. __ (forthcoming 2019). While dual-class shares used to be less common among Silicon Valley companies than S&P100 firms, the opposite pattern has come to prevail in recent years. *See* Fenwick & West LLP, *Corporate Governance Practices and Trends: A Comparison of Large Public Companies and Silicon Valley Companies* (2018) ("Historically, dual-class voting stock structures have been significantly more common among S&P 100 companies than among the technology and life sciences companies in the SV 150, though the frequency in the SV 150 has surpassed the S&P 100 in recent years"); CFA INSTITUTE, DUAL-CLASS SHARES: THE GOOD, THE BAD, AND THE UGLY: A REVIEW OF THE DEBATE SURROUNDING DUAL-CLASS SHARES AND THEIR EMERGENCE IN ASIA PACIFIC 4 (2018) (same).

[13] In fact, Google's Registration Statement specifically noted that dual-class shares were then rarely used in the technology industry. Fisch et al., *supra* note 12.

[14] Gilson, *supra* note 2, at 1641 ("focused monitoring by a controlling shareholder may have no comparative advantage over market-based monitoring when competition in the product market is sufficiently intense") (citing Mark J. Roe, *Rents and Their Corporate Consequences*, 53 STAN. L. REV. 1463 (2001); Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. FIN. 537 (2004)).

[15] Gilson, *supra* note 2, at 1677-78.

[16] *See, e.g.*, Federico J. Díez et al., *Global Declining* Competition, IMF Working Paper (2019) (documenting rising mark-ups in global markets between 2000-2015, particularly in advanced economies and large mark-up firms); Federico J. Díez et al., Global *Market Power and its Macroeconomic*

At times, the forecasts suffered due to the prevailing uncomplicated, but also unsatisfactory, understanding of corporate governance developments exclusively in terms of agency costs. This is, again, a problem that did not escape Gilson's notice in *Controlling Shareholders and Corporate Governance*. Beyond highlighting the importance of NPBC, the Article was a precursor in calling for the understanding of the macroeconomic consequences of governance arrangements for "the country as a whole."[17] There is, in fact, an interesting tension in the Article, which is highly revealing of the future development of corporate governance. On the one hand, Gilson follows the mainstream approach in equating efficiency in corporate governance with the reduction of agency costs (as in Claim #1). On the other hand, he foresees that the welfare consequences of corporate governance arrangements can be far broader (as in Claim #3).

Following in Gilson's steps, I will argue that existing corporate governance scholarship needs further "complication." First, there are different types of controlling shareholders within a single jurisdiction (such as state and family shareholders), and the same types of controlling shareholders may operate differently in different countries depending on the underlying institutional environment.[18] Second, and more fundamentally, the agency cost lenses that dominate the literature do not sufficiently capture real-world developments and the actual stakes of corporate governance choices around the world.

I will illustrate this argument by focusing on nationalism, which is a powerful, but often neglected, force in the evolution of corporate law and governance.[19] While the literature has focused on the interaction between corporate governance and competition among firms, it has mostly ignored the role of corporate governance in the competition among nations. Yet nationalism has significantly shaped recent developments in ownership structures and control rights based on the premise that domestic control has important welfare effects for a given jurisdiction and may confer on it economic and geopolitical advantages. Conversely, various corporate law initiatives (most conspicuously at the E.U. level) have been premised on the countervailing economic and geopolitical benefits of economic integration. Beyond the conflict between nationalism and economic openness, this further development to consider the external effects of ownership structures and corporate governance arrangements is essential to make sense of other emerging challenges of the twenty-first century, such as competition and stability. While Gilson has pointed to the need for a broader form of macro analysis, much work remains to be done.

This remainder of this essay is structured as follows. Part II examines the central claims of *Controlling Shareholders and Corporate Governance* in view of recent

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Implications, IMF Working Paper (2018) (finding an increase in market power in advanced economies since the 1980s, which accelerated since the mid-2000s); Jan De Loecker, Jan Eeckhout & Gabriel Unger, *The Rise of Market Power and the Macroeconomic Implications*, NBER Working Paper No. 23687 (2017), https://www.nber.org/papers/w23687 (finding a sharp increase in market power in the U.S. economy since the 1980s); Germán Gutiérrez & Thomas Philippon, *Declining Competition and Investment in the U.S.*, NBER Working Paper No. 23583 (2017), https://www.nber.org/papers/w23583, Larry Summers, *Corporate profits are near record highs. Here's why that's a problem*, WASHINGTON POST, Mar. 30, 2016.

[17] *Id.* at 1668.

[18] *See* notes 86-92 *infra* and accompanying text.

[19] The analysis here builds on Mariana Pargendler, *The Grip of Nationalism on Corporate Law*, ECGI Law Working Paper No. 437/2019, https://ssrn.com/abstract=3144451.

developments. Part III builds on Gilson's lessons to call for yet another form of complication of corporate governance analysis—one concerning the very reach and purpose of the field. Part IV concludes.

II. Recent Developments on *Controlling Shareholders and Corporate Governance*

This section will outline the main themes of *Controlling Shareholders and Corporate Governance* and examine them in light of the current governance landscape. As we will see, its analysis remains highly illuminating, including in ways that are not fully appreciated by the contemporary literature. Moreover, even when some specific predictions did not come to pass, Gilson's theoretical framework still goes a long way in helping us understand why.

A. Controlling Shareholders and the Quality of Law

A key contribution of *Controlling Shareholders and Corporate Governance* was to question the then-prevailing negative view of controlling shareholder systems in corporate governance scholarship. Since the late 1990s, the influential literature on "law and finance" had found a correlation (which it claimed was causal) between high levels of legal investor protection and ownership dispersion.[20] As summarized by Gilson, the resulting conception was that widely-held firms dominated "good law" environments, while controlling shareholders were the province of "bad law" jurisdictions.[21]

Gilson showed that this view was inaccurate. While "bad law" indeed hindered ownership dispersion, "good law" permitted a diversity of ownership structures. Both Mexico and Sweden had a significant incidence of controlling shareholders. However, Sweden was a "good law" jurisdiction allowing for the extraction of low levels of pecuniary private benefits of control. Sweden therefore had more in common with the United States, another "good law" jurisdiction, than with Mexico, a "bad law" jurisdiction that permitted the expropriation of minority shareholders. Incidentally, Gilson showed, the United States also had a fair number of controlled firms.[22] In "good law" environments, concentrated and dispersed ownership were not discrete realities but rather part of a continuum of possible ownership distributions in response to tradeoffs in agency costs and the relative importance of NPBC in a given country or industry. The growth of dual-class firms in the United States in the intervening years, as described below, appears to support this analysis.

Elaborating on his previous work with Jeffrey Gordon,[23] Gilson emphasized the controlling shareholder tradeoff, which came to be widely accepted: controlling shareholders monitor managers and thereby reduce the managerial agency problem, but at the cost of extracting private benefits of control. Since his writing, various accounts of

[20] *See* Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, *Law and Finance*, 106 J. POL. ECON. 1113 (1998).
[21] The distinction between "good law" and "bad law" is a functional one depending on a system's ability to protect outside investors and thereby curb the extraction of nonpecuniary private benefits of control. Gilson, *supra* note 2, at 1654.
[22] Gilson, *supra* note 2, at 1660 and 1666.
[23] Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785 (2002).

the benefits of concentrated ownership or entrenched control structures have emerged.[24] Yet, *Controlling Shareholders and Corporate Governance* underscored the bright side of concentrated ownership at a time in which it was most salient outside of the United States. In doing so, it clearly departed from the type of "Yankee Panglossianism" that often characterizes many corporate law and comparative endeavors,[25] which regards existing U.S. practice as invariably efficient (and universally so).

While Gilson went to great lengths to emphasize the existence of controlling shareholders in the U.S. context at the time, their presence has since become highly conspicuous. Since the Article's publication, there has been a noticeable rise of controlling shareholders and dual-class structures in the United States, especially in the booming tech sector.[26] The use of dual-class structures in new U.S. listings rose from 1% in 2005 to nearly 20% in 2017.[27] Perhaps most importantly, dual-class firms in the technology sector are now among the largest firms in the United States and the world.

While the largest companies of yesterday mostly had dispersed ownership structures, they now frequently boast controlling shareholders. In fact, these are often controlling-*minority* shareholders through the use of dual-class structures, which amplify agency costs.[28] As portrayed in Figure 1 below, the list of the world's largest firms by market capitalization in 2005 included only one tech company (Microsoft) and one controlled company under a single-class structure (Walmart). By 2019, seven of the world's largest firms were in the tech sector (Apple, Amazon, Alphabet, Microsoft, Facebook, Alibaba, and Tencent Holdings) and four were controlled companies with dual-class shares (Alphabet, Facebook, Alibaba, and Berkshire Hathaway). Moreover, Amazon is a borderline case, with founder Jeff Bezos holding a sizable equity stake and outsize influence in the company.[29]

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[24] *See*, *e.g.*, Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560 (2016); Goshen & Squire, *supra* note 11.

[25] For the articulation of the general Panglossian argument in corporate law, *see* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005) ("According to this argument, we live in the best of all possible worlds because the market ensures that the best arrangements are always adopted").

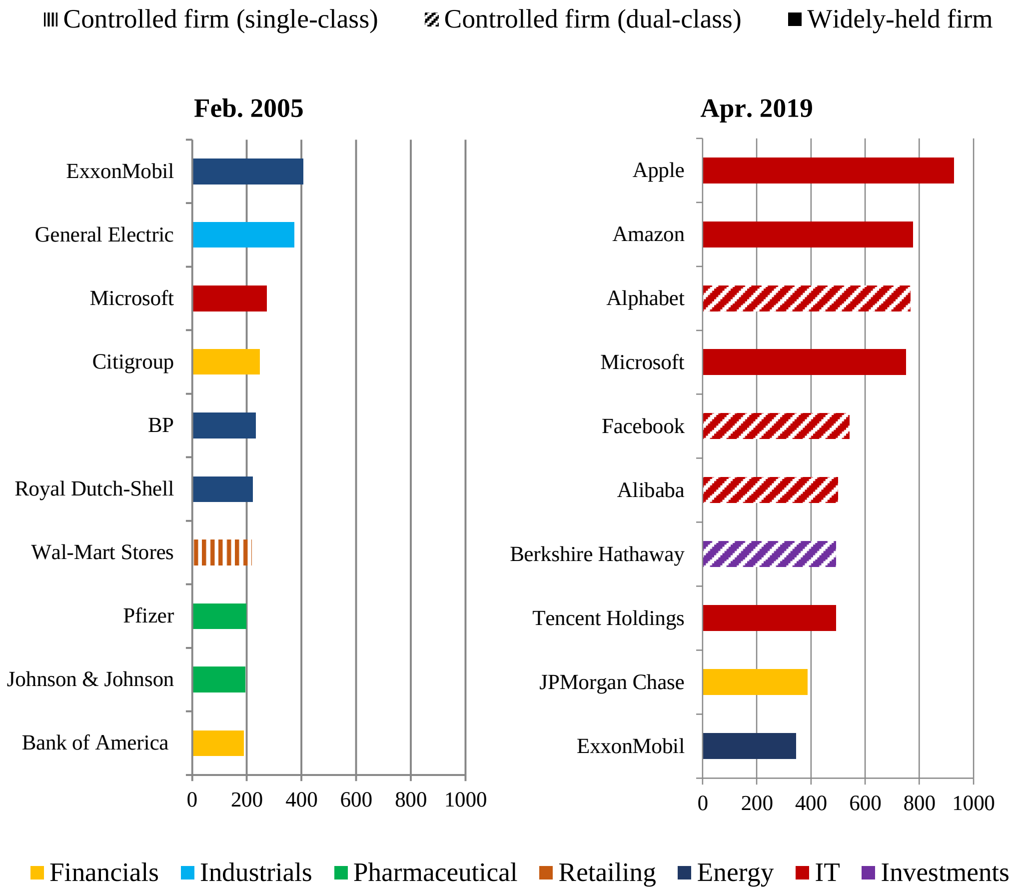
[26] *Controlling Shareholders* dedicates only one sentence to the use of dual-class shares in the then recent IPO of Google, and generally argues that dispersed ownership is better suited to high-tech firms. Gilson, *supra* note 2, at 1658 and 1660. While dual-class shares used to be less common among Silicon Valley companies than S&P100 firms, the opposite pattern has come to prevail in recent years. *See* Fenwick & West LLP, *Corporate Governance Practices and Trends: A Comparison of Large Public Companies and Silicon Valley Companies* (2018) ("Historically, dual-class voting stock structures have been significantly more common among S&P 100 companies than among the technology and life sciences companies in the SV 150, though the frequency in the SV 150 has surpassed the S&P 100 in recent years"); CFA INSTITUTE, DUAL-CLASS SHARES: THE GOOD, THE BAD, AND THE UGLY: A REVIEW OF THE DEBATE SURROUNDING DUAL-CLASS SHARES AND THEIR EMERGENCE IN ASIA PACIFIC 4 (2018) (same).

[27] Bernstein Litowitz Berger & Grossmann LLP, *When One Share Does Not Mean One Vote: The Fight Against Dual-Class Capital Structures*, LEXOLOGY, May 22, 2018. While the U.S. had 46 IPOs of dual-class firms between 2006 and 2010, the figure grew to 104 in the subsequent five years from 2011 to 2015. CFA INSTITUTE, *supra* note 26, at 1.

[28] Lucian A. Bebchuk, Reinier H. Kraakman & George G. Triantis, *Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights*, *in* CONCENTRATED CORPORATE OWNERSHIP (Randall Morck ed., 2000).

[29] Until recently, Jeff Bezos held more than 16% of Amazon's shares. After his divorce, his stake fell to 12%, though he retains the votes for his ex-wife's shares. Jeffrey Dastin & Arjun Panchadar, *Jeff Bezos Keeps Amazon Voting Power in Divorce Settlement*, REUTERS, Apr. 4, 2019.

Figure 1: World's Largest Companies by Market Capitalization and Industry[30]



This means that concentrated ownership structures are increasingly prominent in comparative corporate governance.[31] The debate about the merits of dual-class structures, which was then mostly limited to the European Union and emerging markets, is now at the front stage in the United States.[32] Moreover, the intervening decade has also witnessed the rise of China and, to a lesser extent, other developing countries, where concentrated ownership prevails and state-controlled companies abound.[33] During the height of the financial and oil crisis of 2008, four of the world's top largest companies were state-

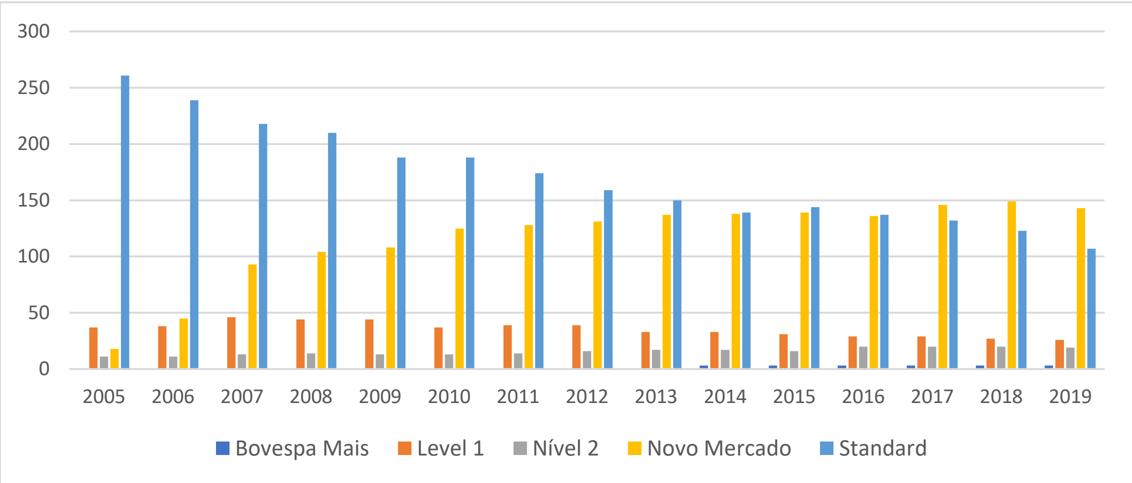
[30] Author's elaboration based on Forbes 2000 ranking.
[31] Gur Aminadav & Eias Papaioannou, *Corporate Control round the World* (Working Paper, 2019), https://ssrn.com/abstract=3404596 (finding that the proportion of controlled firms around the world has remained remarkably stable since 2004, though their share of market capitalization has increased slightly).
[32] *See, e.g.*, A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585 (2017); Fisch & Davidoff Solomon, *supra* note 12; The CLS Blue Sky Blog, *Symposium on Dual-Class Firms* (Jan. 2, 2019), http://clsbluesky.law.columbia.edu/2019/01/02/symposium-on-dual-class-stock/.
[33] Mats Isaksson & Serdar Çelik, *Who Cares? Corporate Governance in Today's Equity Markets*, OECD Corporate Governance Papers No. 8, 2013, at 7 (documenting "a dramatic shift in listings from developed to emerging markets over the last decade, which means that concentrated ownership at company level has become the dominant form of ownership in listed companies worldwide").

owned enterprises in emerging markets.[34] Since then, China continues to strive for economic dominance by relying on a model largely based on state ownership and control.

But if as Gilson argued (and others have come to agree) that the use of dual-class shares in "good law" jurisdictions may be benign for investors, what to make of their use in "bad law" jurisdictions? A central concern is that, by decoupling voting control from cash-flow rights, dual-class structures can magnify agency costs in an environment that is not able to control them.[35] By 2000, Brazil was a world leader in the use of dual-class shares and in abuses of minority shareholders, leaving it with stagnated capital markets.[36]

To increase investor protection while avoiding political resistance by incumbents to legislative changes, the São Paulo Stock Exchange launched the Novo Mercado, a voluntary premium corporate governance listing segment that offered stronger governance standards. Gilson, Hansmann and I termed this phenomenon "regulatory dualism," as this new parallel regime would coexist with the old regime.[37] A key contribution of the Novo Mercado was to break with Brazilian then-prevailing practice by prohibiting dual-class share structures that disenfranchised outside investors. Other intermediary premium governance listing segments (Level 1 and Level 2) imposed certain investor protections while permitting dual-class structures.[38]

Figure 2: Number of Listed Companies by Segment in Brazil[39]



After a slow start, the Novo Mercado came to be highly successful, serving as the listing venue of choice during Brazil's IPO boom in 2006 and 2007. In 2008, its stock market capitalization equaled its GDP for the first time, a major sign of capital market

[34] These were PetroChina, Gazprom, China Mobile, and Industrial and Commercial Bank of China. Anne-Britt Dullforce, *FT Global 500 2008*, FT MAGAZINE, June 27, 2008.
[35] Bebchuk, Kraakman & Triantis, *supra* note 8.
[36] Gilson, Hansmann & Pargendler, *supra* note 1, at 485 and 490.
[37] *Id.* at 478.
[38] Bovespa Mais is a premium governance segment targeted at smaller firms that also bans dual-class shares.
[39] Source: FGV Center for the Study of Markets and Investments (Ary Oswaldo Mattos Filho & Renato Villela, 2019), based on data from B3.

development.[40] As depicted in Figure 2, today a significant and growing fraction of Brazil's public firms are single-class companies listed on the Novo Mercado.

This means that, in contrast to the United States, dual-class shares have receded in Brazil, as proportional voting has been increasingly embraced as a form of investor protection (or substitute for a lack of other forms of investor protection). Most new firms have gone public on the Novo Mercado, and several firms have migrated to the Novo Mercado by converting their non-voting preferred shares into voting common shares. Yet, despite the relative retreat of dual-class structures and the occasional appearance of a widely-held firm, controlling shareholders remain the norm in Brazil.[41]

However, the domination of single-class firms in Brazil does not appear to be inevitable. Some of the largest recent IPOs of Brazilian firms did not take place in Brazil, but rather on the New York Stock Exchange or Nasdaq with a Cayman Islands vehicle and a dual-class structure. The IPO of Brazilian fintech PagSeguro on the New York Stock Exchange, which was one of the largest offerings of 2018, well illustrates this trend. The Cayman Island holding company grants its controlling shareholder UOL 10 votes per share, a mechanism outlawed by Brazilian law (not to mention Novo Mercado regulations).[42] The extent to which this type of cross-listing in the United States effectively protects outside investors, or instead facilitates their expropriation, is an open question.

Even if product market competition did not develop as expected, regulatory competition certainly did some work. Worldwide competition for listings has led to the easing of constraints on controlling shareholders, rather than the avoidance of controlled ownership structures. After Chinese internet giant Alibaba obtained a NYSE listing under its now permissive system, the Hong Kong and Singapore stock exchanges eliminated their ban on dual-class shares subject to certain safeguards.[43] Following scandals involving controlled firms from emerging markets, the London Stock Exchange innovated in imposing new premium listing requirements on companies with controlling shareholders.[44] However, when faced with the prospect of attracting the IPO of state-owned giant Aramco, the London Stock Exchange proposed the creation of a new "premium" listing for SOEs that would drastically reduce the constraints on related-party transactions with the state as a controlling shareholder.[45]

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[40] Fabricio Vieira, Valor das empresas na Bolsa alcança o PIB, Folha de S. Paulo, June 16, 2008. Amidst Brazil's economic crisis, the stock market capitalization as of July 2019 stands around 60% of GDP.

[41] *See* Érica Gorga, *Corporate control and governance after a decade from 'Novo Mercado': changes in ownership structures and shareholder power in Brazil*, *in* HANDBOOK ON SHAREHOLDER POWER (Jennifer G. Hill & Randall S. Thomas eds., 2015) (describing greater ownership dispersion in Brazil's Novo Mercado, which is partly counterbalanced by control-sharing arrangements based on shareholder agreements).

[42] Brazilian law regulates dual-class structures by prohibiting multi-voting stock and capping the issuance of non-voting preferred shares at 50% of a company's capital.

[43] CFA INSTITUTE, *supra* note 26.

[44] Steve Johnson, *Shareholders beware when the majority stakes are high*, F.T., Mar. 2, 2014; Danny Tricot & Claire V. Consoli, *New Listing Rules for Premium-Listed UK Companies: The Fine Line Between Upholding Majority Rule and Protecting Minority Rights*, SKADDEN'S 2015 INSIGHTS: CAPITAL MARKETS (2015).

[45] *See* Caroline Binham, Dan McCrum & Hannah Murphy, *London Reforms Set to Open Door for Listing of Saudi Aramco*, FIN. TIMES, July 13, 2017.

Not only stock exchanges, but also countries have strived to make their laws friendlier to controlling shareholders after losing firms to foreign jurisdictions. In 2014, Italy abolished its longstanding prohibition on multi-voting stock to permit the issuance of treble-voting shares in close corporations and the adoption of a loyalty share regime granting double voting rights to shareholders after two years in public companies.[46] The reform followed the migration of legendary Italian firm Fiat Chrysler to the Netherlands, which already permitted the loyalty share regime.[47]

Controlling Shareholders and Corporate Governance specifically relied on the case of Fiat as an example of "the operation of the capital market to dissipate a controlling position."[48] Following a 2002 restructuring, the Agnelli family made additional equity investments to regain its 30% stake after a prior performance-related dilution, a development that Gilson praised as increasing a controlling shareholder's equity and thereby curbing the extraction of private benefits of control.[49] As of 2018, through its reliance on loyalty shares, the Agnelli family's holding company holds 28.98% of the equity of Fiat Chrysler but exercises 42.11% of its voting rights through the loyalty voting mechanism.[50]

Moreover, the rise of disparate voting rights in certain jurisdictions was not only a result of regulatory competition and private ordering, but rather a product of nationalistic government policy. France's openly protectionist *loi Florange* of 2014 reversed the existing default rule to impose the automatic grant of double voting rights to shares held for at least two years, unless a two-third majority affirmatively opted out.[51] The statute followed a closure of an industrial plant in the city of Florange after the acquisition of French steel champion Arcelor by Indian group Mittal. The primary intent and effect of the change in the voting rule was to strengthen the influence of the French state as a dominant shareholder, thereby evidencing the role of nationalist considerations in corporate law and ownership structures (a topic to which I will return below).[52]

B. The Importance of Nonpecuniary Private Benefits of Control (NPBC)

Controlling Shareholders and Corporate Governance not only underscored the healthy diversity of ownership structures in both the United States and Sweden, but also sought to explain why controlling shareholders were more prevalent in Sweden even though both jurisdictions offered "good law." Gilson's answer was noteworthy in not involving an agency cost (or principal cost) tradeoff. Instead, Gilson claimed, the answer lay in the levels of nonpecuniary private benefits of control (NPBC), which are the psychic, political or social benefits that accrue exclusively to controlling shareholders

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[46] Marco Ventoruzzo, *The Disappearing Taboo of Multiple Voting Shares: Regulatory Responses to the Migration of Chrysler-Fiat*, ECGI Law Working Paper N° 288/2015, http://ssrn.com/abstract_id=2574236.
[47] *Id.* at 3.
[48] Gilson, *supra* note 2, at 1677-78.
[49] *Id.* at 1678.
[50] Annual Report on Form 20-F for Fiat Chrysler Automobiles N.V. for the year ended Dec. 31, 2018, at 97.
[51] Pargendler, *supra* note 19, at 10.
[52] Marco Becht, Yuliya Kamisarenka & Anete Pajuste, *Loyalty Shares - A Coasian Bargain? Evidence from the Loi Florange Experiment* (Working Paper, 2017), https://ssrn.com/abstract=2996732 (finding that firms previously adopting the proportional voting default reversed to the prior regime, with the exception of companies in which the French state was a shareholder).

(therefore private) without any financial tunneling of corporate resources (therefore nonpecuniary).

Gilson argued that local context and industry affect the enjoyment of NPBC. Because Sweden is a small jurisdiction, controlling shareholders of large firms enjoy comparatively greater NPBC in the form of social and political power compared to their counterparts in the United States. The focus on NPBC also helped explain why concentrated ownership in the United States circa 2006 occurred disproportionately in media, communications, publishing, and printing industries, which put its controllers "at the center of major public and cultural issues, with the potential to influence the outcome."[53]

Gilson's analysis was prophetic in offering tools to explain the explosion of controlling shareholders and dual-class shares in the technology sector. Scholars have generally interpreted this trend from an agency cost (or principal cost) perspective, which posits that entrenched control structures serve to protect the unique vision of founders from misguided pressures of short-termist investors.[54] The role of NPBC, however, also turns out to be highly revealing.

The large tech-companies employing dual-class shares, such as Facebook and Alphabet (Google), can influence global culture and politics in ways that are coming to dwarf the role of traditional media.[55] While the United States is a large country, many tech firms inhabit the small world of Silicon Valley, a context where founder and controlling shareholder status entails significant social clout. Moreover, technology itself is also making the world smaller. And as global culture is shifting towards a workaholic elite,[56] the work and influence guaranteed by controlling shareholder status carry with it greater nonpecuniary appeal than in the past.

C. The Macroeconomic Implications of Controlling Shareholders

Controlling Shareholders and Corporate Governance concludes by reaching beyond firm-level agency costs to reflect on the possible macroeconomic consequences of concentrated ownership structures. Gilson raises the concern that the extraction of NPBC "may matter a great deal *to the country as a whole* even if minority shareholders accurately predict the controlling family's preferences and abilities."[57] He worries that the distortion of corporate action due to NPBC may operate as a drag on the economy even if it is correctly priced by outside investors.[58] He also argues that the possible negative macroeconomic effects of concentrated ownership tend to be compounded over time due to the likelihood of "declining skills in successive generations of family managers."[59]

In distinguishing between the short-term and long-term effects of concentrated ownership structures, the Article anticipates some of the key themes of the contemporary

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[53] *Id.* at 1666.
[54] *See supra* note 24 and accompanying text.
[55] The most prominent exception is Twitter, which did not go public with a dual-class structure.
[56] *See* DANIEL MARKOVITS, THE MERITOCRACY TRAP (2019).
[57] Gilson, *supra* note 2, at 1668 (emphasis added).
[58] *Id.*
[59] *Id.*

U.S. debate about sunset provisions in dual-class share structures.[60] However, it goes further by examining the issue from a perspective that goes beyond the goals of mitigating agency costs and protecting outside investors—an invaluable insight that anticipates the direction of corporate governance scholarship and the need for its further refinement, as explored in greater detail below.

Before proceeding, it is worth pausing to reflect on the contrast between the Article's initial definition of efficient controlling shareholder systems exclusively in terms of their ability to curb agency costs at the firm level, on the one hand, and its later recognition that controlling shareholder systems may be inefficient for the country as a whole, on the other. By incorporating these two modes of analysis, Gilson straddles between the internal efficiency (or "i-efficiency"[61]) approach that dominates traditional law-and-economics and corporate governance scholarship, according to which the purpose of corporate law is to reduce agency costs,[62] and the need for a general efficiency (or "g-efficiency") approach, which considers the broader economic consequences across different legal fields and objectives.

D. The Predictions: The Future of Controlling Shareholders

Despite underscoring (i) the presence of controlling shareholders in "good law" contexts and (ii) the role of NPBC in explaining concentrated ownership, Gilson was not completely enthusiastic about the prospects of the concentrated ownership model. First, he argued that controlling shareholder systems may hinder necessary adaptation to changing circumstances, which makes them ill-suited to the high-tech sector. Second, he conjectured that "efficient controlling shareholder systems will tend to deteriorate simply from the gravity of generations."[63] Third, he suggested that concentrated ownership may have negative macroeconomic consequences.

Yet, there currently appears to be no evidence of deterioration of concentrated ownership structures.[64] If the shareholder-oriented, widely-held firm appeared to be the end stage of corporate capitalism, this has not yet come to pass. It may well be that Gilson's was a long-term forecast, and time will prove it right. However, the very framework of *Controlling Shareholders and Corporate Governance* provides good reasons to doubt the ultimate demise of concentrated ownership.

One reason is that the analysis may have underestimated the magnitude and reach of his own NPBC framework in the emerging technology industry, as well as the importance of "idiosyncratic vision" by talented company founders.[65] Today, there is the perception that a controlled firm's ability to act in an agile manner can be a significant

[60] *See, e.g.*, Bebchuk & Kastiel, *supra* note 32; CFA INSTITUTE, *supra* note 26. *But see* Fisch & Davidoff Solomon, *supra* note 12.

[61] Zachary Liscow defines "i-efficiency" as efficiency analysis "internal to the rule" that does not consider social welfare maximization through redistribution. Zachary Liscow, *Reducing Inequality on the Cheap*, 123 YALE. L.J. 2478 (2014). I use "i-efficient" in an even narrower sense that I argue prevails in economic analysis, which examines the efficiency of legal rules in view of the single key economic objective attributed to any given area of law.

[62] *See* Part III *infra*.

[63] Gilson, *supra* note 2, at 1671.

[64] *See supra* note 31 and accompanying text.

[65] *See supra* note 24 and accompanying text.

competitive advantage. Facebook's sagacious acquisition of Instagram in 2012 followed a three-day negotiation period by controlling shareholder and CEO Mark Zuckerberg, with the board being "told, not consulted" at the last minute.[66]

While the gravity of generations may be a drag on controlling shareholder systems, there are countervailing dynamic effects favoring controlled firms. Companies whose founders derive great value from NPBC adopt dual-class shares and become hostile takeover proof. Companies whose founders do not value NPBC as much forego dual-class structures and therefore become easy takeover targets by the former firm type. For instance, Twitter, a now rare Silicon Valley tech prodigy that did not adopt a dual-class structure, is under constant takeover rumors.[67] Because widely-held companies can become targets of hostile acquisitions by controlled firms, but the reverse is not true, there can be a survival bias in favor of the latter.

Moreover, the macroeconomic consequences of controlling shareholders may be positive as well as negative. There is a strand of the literature suggesting that business groups led by controlling shareholders can help promote development in emerging markets.[68] Gilson himself has written about the special role of family controlling shareholders as enhancing the role of the corporation as a repository of reputation, a mechanism that is especially useful in developing countries given the deficiencies in formal contract enforcement.[69] Recently, scholars have argued that controlling shareholders may have a long-term orientation and greater ability to provide credible commitment more generally.[70]

Macro reasons are indeed important in explaining the durability of concentrated ownership. As I have argued elsewhere, nationalism has been a powerful force in the evolution of corporate law and governance.[71] The rise and persistence of concentrated ownership and dual-class shares in many jurisdictions is the product not only of agency cost and NPBC considerations, but also of nationalist objectives to ensure domestic control of major companies.[72] Historically, dual-class shares first emerged in France and

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[66] Shayndi Raice, Spencer Ante & Emily Glazer, *In Facebook Deal, Board Was All But Out of Picture*, WALL ST. J., Apr. 18, 20212.

[67] Jon Swartz, *Twitter Shares Soar, But Here Come Those Acquisition Rumors Again*, BARRON'S, Jan. 26, 2018.

[68] *See, e.g.*, Randall Morck, *The Riddle of the Great Pyramids*, *in* OXFORD HANDBOOK OF BUSINESS GROUPS (Asli M. Colpan et al. eds., 2010); Julian Franks & Colin Mayer, *Evolution of Ownership and Control Around the World: The Changing Face of Capitalism*, ECGI Finance Working Paper No. 503/2017, https://ssrn.com/abstract=2954589 (arguing that "there are countervailing benefits associated with controlling shareholders," as "in both China and Korea it is widely believed that their presence brought a stability and long-term focus to corporate activities which is missing from western economies and in particular from corporations in the UK and US with widely dispersed share ownership).

[69] Gilson, *Family Shareholders in Developing Countries, supra* note 1.

[70] *See, e.g.*, Albert H. Choi, *Concentrated Ownership and Long-Term Shareholder Value*, 8 HARV. BUS. L. REV. 53 (2018).

[71] Pargendler, *supra* note 19.

[72] Although the evidence is certainly mixed, there is strong political backing and some academic support to the idea that local control of large firms can be beneficial to the country or region in question, such as by promoting local employment, R&D activity and positive spillover effects. *See, e.g., Maria Carkovic & Ross Levine, Does Foreign Direct Investment Accelerate Economic Growth?, in* DOES FOREIGN DIRECT INVESTMENT PROMOTE DEVELOPMENT? 197 (Theodore H. Moran, Edward Montgomery Graham & Magnus Blomström eds., 2005) (finding that "the exogenous component of FDI does not exert a robust, positive influence on economic growth"); OECD, INTERNATIONAL INVESTMENT PERSPECTIVES 2007

Germany after World War I to preserve national control against foreign acquirers given the devaluation of local currency.[73]

Through a powerful political alliance uniting the interests of controlling elites and workers, and fueled by the popular appeal of nationalist sentiment, national politics often tends to favor domestic control.[74] And there are different reasons why domestic control, including in the form of entrenched local shareholders, may at times be beneficial to the country as a whole. First, NPBC may lead controlling shareholders to promote national welfare by taking actions that benefit communities, from preserving local headquarters to promoting good working conditions and charitable contributions. Second, by sharing the local culture, domestic controlling shareholders may be more effective in harnessing local norms to promote coordination in coordinated market economies. Third, controlling shareholders are likely to have a symbiotic relationship with the national political regime.[75]

This is certainly the case in Sweden, where dual-class shares served to ensure national control of industry, which was critical for the country's strong system of social democracy.[76] As explained by Peter Högfeldt, "[t]he Social Democrats only get the necessary resources and indirect support for their social and economic policies from the private sector if the largest firms remain under Swedish control so that capital does not migrate."[77] Foreign investors have often identified the significant resilience of dual-class shares in the country as "an example of Swedish ultranationalism."[78]

However, *Controlling Shareholders and Corporate Governance* interprets the Swedish experience exclusively in terms of agency costs and NPBC, leaving the critical role of nationalism out of the picture.[79] Like most corporate law scholarship, the Article also appears to assume that the pro-takeover regime envisioned by the EU's Takeover Directive was primarily motivated by agency cost objectives, or the desire to "eliminate inefficient controlling shareholder systems."[80] Yet a central aim of the Directive was also to promote economic integration in the European Union by facilitating cross-border

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FREEDOM OF INVESTMENT at 85 ("Empirical work on the question of the effect of foreign takeovers on existing R&D capabilities provides no definitive answers"); Alice Amsden et al., *Do Foreign Companies Conduct R&D in Developing Countries? A New Approach to Analyzing the Level of R&D, with an Analysis of Singapore*, *Asian Development Bank Institute* (2001) (R&D activity in developing country rarely encompasses basic research or even applied research).

[73] Pargendler, *supra* note 19, at 9 & 11.

[74] *Id.* at 3.

[75] *Id.* at 40.

[76] *Id.* at 12 et seq.

[77] Peter Högfeldt, *The History and Politics of Corporate Ownership in Sweden*, *in* A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD 522 (Randall K. Morck ed., 2007).

[78] Joakim Reiter, *Changing the Microfoundations of Corporatism: The Impact of Financial Globalisation on Swedish Corporate Ownership*, 8 NEW POL. ECON. 103, 117 (2003).

[79] In a footnote, Gilson cites Högfeldt's work in supporting the importance of "local, nonefficiency" factors. Gilson, *supra* note 2, at 1663. Yet the grip of nationalism on corporate law is not a Swedish idiosyncrasy but rather a general phenomenon affecting most jurisdictions that has both efficiency and nonefficiency justifications. Pargendler, *supra* note 19.

[80] *Id.* at 1673.

M&A transactions. A key goal was to further a single capital market and thereby enhance European competitiveness in the world economy.[81]

The lasting grip of nationalism, rather than agency cost or NPBC considerations alone, was a crucial reason behind the Directive's ultimate failure to implement a pro-takeover regime.[82] Ironically, protectionist approaches to corporate law rose after the watered-down Takeover Directive, with most national legal reforms embracing more, rather than fewer, takeover defenses.[83] In South Korea, the nationalistic system of corporate ownership based on *chaebols* not only persists, but some forms of shareholder activism by foreign investors were even criminalized in recent years.[84] More recently, countries have gone to great lengths not only in imposing stronger administrative controls on foreign ownership (such as by the Committee on Foreign Investment in the United States (CFIUS) and its foreign counterparts), but also in relying on state ownership and control as a defense against foreign acquirers.[85] The experience with the EU Takeover Directive highlights the insufficiency of agency cost analysis to reveal the real stakes of corporate arrangements, a theme to which I now turn.

III. The Case for Further Complication: Taking a Broader View Beyond Agency Costs

Refining the analysis of controlling shareholder systems remains necessary for us to better understand their incidence and merits, and there are many ways to do it. One approach requires a more granular analysis of the different *types* of controlling shareholders, as well as of the complementary social, economic and legal characteristics of a given jurisdiction. Take, for instance, the peculiar characteristics and problems associated with government control of enterprise.

The state is a special type of controlling shareholder with unmatched influence over the corporate lawmaking process.[86] The state's motives for corporate ownership also differ significantly from those of private controlling shareholders. In particular, the state is distinct in its tendency to extract nonpecuniary but *political* private benefits of control through "policy channeling," which is the pursuit of public policy objectives through the firm.[87] Policy channeling often hurts shareholders even if benefits other stakeholders in a

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[81] Commission of the European Communities, Proposal for a Directive of the European Parliament and of the Council on Takeover Bids, COM(2002) 534 final (2002).

[82] The backdrop of the failure was a change of heart by Germany, given the trauma experienced by the then recent takeover of German champion Mannesmann by British telecom firm Vodafone. *See* Pargendler, *supra* note 19, at 12 and 21.

[83] European Commission (2007a), Report on the Implementation of the Directive on Takeover Bids, SEC (2007) 268 (Feb. 21, 2007) ("the number of Member States implementing the Directive in a seemingly protectionist way is unexpectedly large"); Paul Davies et al., *The Takeover Directive as a Protectionist Tool? in* COMPANY LAW AND ECONOMIC PROTECTIONISM, COMPANY LAW AND ECONOMIC PROTECTIONISM: NEW CHALLENGES TO EUROPEAN INTEGRATION 106 (Ulf Bernitz & Wolf-Georg Ringe eds., 2010).

[84] Kon Sik Kim, *Dynamics of Shareholder Power in Korea, in* RESEARCH HANDBOOK ON CORPORATE POWER (Jennifer Hill & Randall S. Morck eds., 2015).

[85] For numerous examples, *see supra* note 19. *See also* Michael Nienaber, *Germany to create fund to foil foreign takeovers after China moves*, REUTERS, Mar. 20, 2019.

[86] Mariana Pargendler, *State Ownership and Corporate Governance*, 80 Fordham L. Rev. 2917

[87] *See, e.g.*, Curtis J. Milhaupt & Mariana Pargendler, *Related Party Transactions in State-Owned Enterprises, in* THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS (Luca Enriques & Tobias Tröger eds., 2019).

given jurisdiction. Moreover, related-party transactions with the state can decrease social welfare not only when they harm the firm through "tunneling," as is usually the case in the private sector, but also when they *assist* the firm through "propping."[88] Although propping can benefit outside investors in SOEs, this form of subsidy can be detrimental to society by stifling competition and distorting the allocation of resources.[89]

Equally importantly, not all state-owned enterprises (SOEs) are alike. SOEs operate differently around the world depending on the varying state objectives as well as on the underlying public and corporate law institutions of any given jurisdiction.[90] The result is that state ownership functions very differently in Norway, Singapore, China, France, and Brazil, to use just a few conspicuous examples. This is the type of analysis that Gilson called for when he proclaimed the need to "think small."[91] Scholars (myself included) have since continued to develop this agenda.[92]

In this essay, however, I also want to address another form of emerging complexity. Gilson himself sowed the seeds for this agenda in arguing that ownership structures and corporate governance practices can have macro effects beyond their implications for investor protection. This refinement relates to the very focus of corporate governance analysis, which is moving beyond the agency costs/investor protection concerns that have dominated the academic literature, if not public discourse.

The prevailing view among economists and corporate law scholars (at least in the United States) has been that the exclusive goal of corporate law should be the mitigation of agency costs and the protection of shareholders. There are several reasons for this. First, shareholders do indeed need protection. While other contractual counterparties have fixed claims against the firm, shareholders only have a residual claim, which makes it more difficult for them to obtain adequate protection through contract alone. Moreover, shareholders' investment is "locked" in the firm, as they lack the ability to exit by forcing the liquidation of the company's assets. Second, the attempt to incorporate other interests in corporate law (such as by requiring directors to balance the interests of all stakeholders) is believed to be unworkable and inefficient, effectively permitting executives to pursue their own interest instead of social welfare at large. Third, and perhaps most important, there is the assumption that other constituencies and interests can obtain adequate protection by contract and other dedicated areas of law (such as labor laws, antitrust laws, consumer protection laws, environmental laws, financial regulation etc.).

This form of modularity premised on functional specialization is not unique to

[88] *Id.* at 248.
[89] *Id.*
[90] Curtis J. Milhaupt & Mariana Pargendler, *Governance Challenges of Listed State-Owned Enterprises around the World: National Experiences and a Framework for Reform*, 50 CORNELL INT'L L.J. 473 (2017) (examining the peculiar features challenges when the state as the controlling shareholder, as well as the variety of objectives and institutional constraints observed in different countries).
[91] Gilson, *supra* note 2, at 1679.
[92] *See*, *e.g.*, Milhaupt & Pargendler, *supra* note 87; Milhaupt & Pargendler, *supra* note 90; Dan W. Puchniak & Umakanth Varotill, *Related-Party Transactions in Asia: Complexity Revealed*, *in* THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS (Luca Enriques & Tobias Tröger eds., 2019) (arguing that controlling shareholders are not homogeneous and that their identity matters for the regulation of related-party transactions).

corporate law but is rather a feature of contemporary law-and-economics analysis.[93] In this framework, each field has *one* key efficiency objective. The economic purpose of tort law is to reduce the cost of accidents; the purpose of antitrust law is to maximize consumer welfare; the purpose of bankruptcy rights is to maximize firm value for the benefit of creditors; the purpose of contract law is to reduce transaction costs; and the list goes on. Distributional objectives should be handled exclusively by the tax-and-transfer system.[94] While—remarkably—such modular specialization came to dominate policy discourse since the 1980s, it is increasingly coming under attack. There is, for instance, growing skepticism about the use of consumer welfare as the sole normative objective of antitrust law[95] and about the exclusive reliance on the tax-and-transfer system to achieve distributional objectives.[96]

The near-consensus about normative specialization and purity in corporate law is also slowly faltering. At least since the global financial crisis of 2008, corporate governance has been increasingly used to advance goals other than shareholder protection.[97] In fact, there has been a remarkable shift in corporate governance theory as applied to financial institutions. While prior to the crisis the mainstream position in the legal academy (at least in the United States) was that efficiency required all corporations to maximize shareholder value, there is now a near consensus that financial institutions are fundamentally different because of the systemic risk externalities they create and the inherent difficulties in regulating them. Consequently, single-minded shareholder value maximization is now deemed to be an inappropriate goal for the governance arrangements in financial institutions.[98] There are now multiple studies and legal initiatives suggesting that financial institutions require different, non-shareholder-centric corporate governance arrangements given the risks that their failure can pose to the general economy.[99]

Yet the context of financial institutions is by no means the only setting in which corporate governance reforms have come to embrace a broader—and external—set of interests. On the contrary, examples abound of recent corporate law initiatives that are *not* solely or primarily motivated by agency cost concerns: the emergence of gender

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[93] For a discussion of modularity as functional specialization in the cognitive sciences, *see* H. Clark Barrett & Robert Kurzban, *Modularity in Cognition: Framing the Debate*, 113 PSYCHOL. REV. 628 (2006)

[94] *See*, *e.g.*, Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667 (1994).

[95] *See*, *e.g.*, Suresh Naidu, Eric A. Posner & Glen Weyl, *Antitrust Remedies for Labor Market Power*, 132 HARV. L. REV. 456 (2018) (advocating for the use of antitrust law to combat labor market power and increase worker welfare); TIM WU, THE CURSE OF BIGNESS (2018) (arguing that antitrust law should be used to fight the political dangers ensuing from economic concentration).

[96] *See*, *e.g.*, *See* Lee Anne Fennell & Richard H. McAdams, *The Distributive Deficit in Law and Economics*, 100 MINN. L. REV. 1051 (2016); Zachary D. Liscow, *Reducing Inequality on the Cheap: When Legal Rule Design Should Incorporate Equity as Well as Efficiency*, 123 YALE L. J. 2134 (2014).

[97] *See* Mariana Pargendler, *The Corporate Governance Obsession*, 42 J. CORP. L. 359 (2016); Luca Enriques, Henry Hansmann, Reinier Kraakman & Mariana Pargendler, *The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies*, *in* THE ANATOMY OF CORPORATE LAW (John Armour, Luca Enriques et al., 2017).

[98] Even the most ardent supporters of shareholder value and power have embraced this shift. *See* Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L.J. 247, 247 (2010) (arguing that "banks' compensation structures have produced incentives for excessive risk-taking").

[99] *See*, *e.g.*, *id.*; John Armour & Jeffrey Gordon, *Systemic Harms and Shareholder Value*, 6 J. LEGAL ANALYSIS 35 (2014) (arguing for the imposition of stricter liability rules for directors and officers at financial firms); Jonathan Macey & Maureen O'Hara, *Bank Corporate Governance: A Proposal for the Post-Crisis World*, FRBNY Econ. POL'Y REV., Aug. 2016.

quotas for corporate boards in several jurisdictions; the Dodd-Frank Act's new disclosure requirements on the use of conflict minerals from the Democratic Republic of Congo and on the ratio between the pay of CEO and the median employees; the new consultation rights of employees in the takeover context in France; the new disclosure requirements regarding the impact of takeover offers on employment in the UK, as well as the new legal mechanisms permitting the bidder to commit to certain post-offer undertakings for the benefit of stakeholders (enacted by the UK's traditionally liberal Takeover Panel, of all places); and the rise of non-financial disclosure more generally.[100]

Recent reform proposals are also based on a broader set of objectives beyond investor protection, including national competitiveness. Elizabeth Warren's ambitious Accountable Capitalism Act, proposed in 2018, was premised on the view that current U.S. corporate law offers *excessive* protection to shareholders. The bill regards the negative implications of the shareholder value model as far-reaching: from the rise of income inequality to the decrease in American competitiveness vis-à-vis foreign acquirers.[101] In 2019, Senator Marco Rubio released a proposal to curb share buybacks through changes in tax laws in view of promoting investment and thereby countering the threat posed by the rise of China.[102] There is, of course, nothing new about the use of corporate governance to promote objectives other than shareholder protection. To give just one prominent example from the ownership structure context, Mark Roe has famously argued that dispersed ownership in the United States was a product of legal restrictions enacted for populist motives, rather than the natural result of market forces.[103]

The aim is not to defend or challenge any of these initiatives, many of which appear to be misguided. Instead, the goal is to focus on a particularly timely question. If corporate governance has macroeconomic implications beyond agency costs, as Gilson points out, what should be done about it?

The modularity embodied in traditional law-and-economics analysis, in the form of "one function per field," certainly has the advantage of reducing complexity. Administering complexity is, after all, a key purpose of modularity.[104] Yet, such simplification through modularity can also come at a cost. To use concepts embraced by Gilson and coauthors in another context, traditional corporate governance analysis faces a "modularity trap"[105] where excessive simplicity and rigidity in thinking detracts from our ability to better understand the world.

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[100] *See supra* note 97 and accompanying text.

[101] https://www.warren.senate.gov/imo/media/doc/Accountable%20Capitalism%20Act%20One-Pager.pdf ("Big American companies have chronically under-invested, opening the door to foreign competitors").

[102] U.S. Senate Committee on Small Business & Entrepreneurship, Made in China 2025 and the Future of American Industry: Project for Strong Labor Markets and National Development, Chairman Marco Rubio, Feb. 12, 2019, at 74, https://www.rubio.senate.gov/public/_cache/files/0acec42a-d4a8-43bd-8608-a3482371f494/262B39A37119D9DCFE023B907F54BF03.02.12.19-final-sbc-project-mic-2025-report.pdf

[103] MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1996).

[104] Henry Smith, *Property as the Law of Things*, 125 HARV. L. REV. 1691, 1701 (2002) ("Modularity is key to managing complexity. A system is complex when it has many interdependencies").

[105] Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 COLUM. L. REV. 431, 434 (2009) (examining the limits of modularity in contracting for innovation).

A key problem of modular thinking in law and economics is that different areas of law or legal rules are not fully separable or "nearly decomposable," in Herbert Simon's terminology.[106] Corporate governance arrangements often have consequences beyond agency costs and investor protection. Exporting the solution to these problems to other areas of law may be difficult or impossible. Indeed, mainstream economists and legal scholars are increasingly opening to the idea that firms may at times be able to address some social problems at lower cost than governments, and that corporate law may properly embrace broader objectives.[107] Markets are developing accordingly, as demonstrated by the notable rise in socially responsible investment (SRI) as well as of environmental, social and governance (ESG) factors in investment and management decisions.[108]

But what is exactly the alternative to modularity in law and economics? Evidently, the debate about the purpose of the corporation and corporate law—if shareholder value or social welfare more generally—has long been a fundamental theme in the field. The shareholder value consensus has always had its critics.[109] Yet, most such critiques paint with a broad brush, taking one of two forms. One approach is to embrace a broad stakeholder orientation, by enlarging the beneficiaries of directors' fiduciary duties or empowering other constituencies.[110] Another approach is to rely on certain corporate governance practices—such as director independence or shareholder empowerment—as all-purpose remedies to a variety of ills, ranging from corruption and systemic risk to underdevelopment and inequality.[111] Still, it is difficult to save a complex world with generic prescriptions, and efforts to do so can frequently be futile, if not wholly counterproductive.[112]

An emerging alternative is not the blind embrace of stakeholderism in corporate governance as a substitute for shareholder wealth maximization, but instead careful analysis of the potential externalities of corporate governance, as well as the best means to address them. It is difficult to discuss the merits of controlling shareholders and control-enhancing devices without accounting for their broader repercussions beyond agency

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[106] Herbert A. Simon, *The Architecture of Complexity*, 106 PROCEEDINGS OF THE AMERICAN PHILOSOPHICAL SOCIETY 467 (1962).

[107] In the economic literature, *see*, *e.g.*, Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, ECGI Finance Working Paper N° 521/2017, https://ssrn.com/abstract=3004794 ("even if the political process is efficient, it might be very difficult to write a regulation that specifies, say, that companies should treat their workers with dignity. It might be better to leave the implementation of this goal to shareholders (…). If political change is hard to achieve, action at the corporate level is a reasonable substitute"); Roland Bénabou & Jean Tirole, *Individual and Corporate Social Responsibility*, 77 ECONOMICA 1, 2(2010) ("The state… has a comparative disadvantage in policing minor nuisances such as a lack of respect for employees or conspicuous consumption by executives, or in directing resources to very local needs"). In the legal literature, *see*, *e.g.*, Daniel Hemel & Dorothy S. Lund, *Sexual Harassment and Corporate Law*, 118 COLUM. L. REV. 1583, 1670 (2018) (defying "[t]he notion that corporate law can pursue only one or a small set of objectives").

[108] Georg Kell, *The Remarkable Rise of ESG*, FORBES, July 11, 2018.

[109] I will not here rehearse this well-known debate in full. *See*, *e.g.*, the classic E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932) and the more recent LYNN STOUT, THE SHAREHOLDER VALUE MYTH (2012).

[110] For different uses of corporate law to protect external constituencies, *see* Luca Enriques, Henry Hansmann, Reinier Kraakman & Mariana Pargendler, *The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies*, *in* THE ANATOMY OF CORPORATE LAW (2017).

[111] Pargendler, *supra* note 97.

[112] *Id.*

costs. I would like to illustrate this point by showing how corporate governance arrangements are entangled with a defining economic and political issue of our time—nationalism and economic integration—which is clearly distinct from agency cost concerns.

From a traditional corporate governance perspective, the relevant variables about corporate control relate to their effects on agency and principal costs. There is no distinction between domestic and foreign control, even though the latter is far more likely to bring about public commotion and political resistance. There is little concern about externalities of control transfers, such as the effects on workers, nearby communities, and national economies, be it because they are assumed not to matter to social welfare or because these problems fall under the jurisdiction of other areas of law (such as labor law or tax-and-transfer mechanisms).

And yet takeovers, and especially cross-border takeovers, can impact social welfare in ways that transcend agency costs. It is often difficult, if not impossible, to reverse the broader effects of corporate laws through interventions in other fields. For instance, takeovers may harm consumers due to decreased competition. They may also benefit consumers due to scale economies and synergies. While antitrust laws can prevent mergers that harm consumers, they do little to promote consumer-friendly mergers that do *not* occur due to corporate law devices, such as dual-class shares. Similarly, whatever the merits of dual-class structures from an agency cost/principal cost perspective, they can get in the way of cross-border mergers and of the resulting benefits of economic integration. This reinforces the argument, advanced by Gilson, that even if private benefits of control are perfectly priced by shareholders, they can nonetheless lead to decisions that are detrimental to society more generally.

Conversely, one could argue that protecting domestic control over industry has countervailing economic and social benefits. Domestic controlling shareholders may have greater concern for the interests of local workers, communities, and governments. They may be more likely to retain national headquarters and R&D activity, and therefore benefit a given jurisdiction or locality with spillover effects. They are less likely to pose a covert threat to national security. Indeed, the economic literature on the economic consequences of foreign direct investment and foreign takeovers is decidedly mixed, so it not easy to brush off concerns about foreign acquisitions of local giants.[113]

The economic and geopolitical threat posed by the rise of China—whose economic system is conspicuously founded on controlling shareholders and especially on the state as a controlling shareholder—is now subverting traditional corporate governance analysis. Scholars and policymakers no longer consider the shareholder value model as the natural product of globalization and growing international competition, as previously assumed,[114] but instead increasingly regard it as a model whose survival requires protectionist legal action, or else it may lose to China's alternative model. In 2018, the U.S. government barred technology firm Broadcom from acquiring its rival Qualcomm due to a risk to national security—out of concern, among other things, that Broadcom

[113] Pargendler, *supra* note 19, at 37-42.
[114] Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2000-2001).

would implement a "private equity"-style direction following the acquisition and thereby reduce Qualcomm's (and therefore U.S.) technological competitiveness. Scholars have recently advocated the need to defuse the role of China as a "national strategic buyer" that pursues international acquisitions for purposes of industrial policy or national security, rather than shareholder wealth maximization.[115]

The growing recognition of the externalities of corporate governance practices and of its role in the competition among nations also gives rise to a different form of analysis. Although internationally-minded scholars have focused exclusively on "comparative corporate governance," an emerging field is that of "international corporate governance." While scholars had assumed that convergence would take place in a decentralized fashion as a result of competitive pressures among firms, international efforts at corporate governance regulation—from IMF, World Bank and OECD/G20 initiatives[116] to the emerging regulation of corporate governance in international treaties[117]—have increasingly played a role.

At any rate, it should be clear that the stakes of corporate control arrangements—including concentrated ownership and dual-class shares—can hardly be evaluated based on agency considerations alone. Because corporate control entails the exercise of residual control rights that have not been limited by contract or regulation, it is difficult, if not impossible, to reverse all negative social welfare implications of a certain form of corporate control through interventions in other areas of law. I have showed here how these factors interact with nationalism and economic openness, but this is but one external dimension. The rising concerns about the potential anticompetitive effects of common ownership have underscored the difficulties in disentangling the objectives of corporate governance and antitrust laws.[118] Indeed, today the most plausible alternative to controlling shareholder systems is no longer fully dispersed ownership but another form of ownership concentration in the hands of large institutional investors subject to common ownership.[119]

IV. Conclusion

In complicating the then-existing taxonomy, *Controlling Shareholders and Corporate Governance* proved to be prescient about the future direction of corporate governance. The merits of different ownership structures and dual-class shares is more

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[115] Jeffrey N. Gordon & Curtis J. Milhaupt, *China as a 'National Strategic Buyer': Towards a Multilateral Regime for Cross-Border M&A*, 2019 COLUM. BUS. L. REV. 192, 2017 (2019) (proposing a multilateral regime that relies on the use of "tools from the corporate governance toolbox in the service of international relations").

[116] Jeffrey N. Gordon, *Convergence and Persistence in Corporate Law and Governance*, *in* OXFORD HANDBOOK ON CORPORATE LAW AND GOVERNANCE (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018).

[117] Ram Sachs, *The International Law of Corporate Governance*, 33 Pace Int'l L. Rev. __ (forthcoming 2019).

[118] *See, e.g.*, Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267 (2016); Edward B. Rock & Daniel L. Rubinfeld, *Antitrust for Institutional Investors*, 82 ANTITRUST L.J. 221 (2018).

[119] *See* John C. Coates, *The Future of Corporate Governance I: The Problem of Twelve* (Working Paper, 2018), https://ssrn.com/abstract=3247337 (warning against "the likelihood that in the near future roughly twelve individuals will have practical power over the majority of U.S. public companies"). *See also* Lucian A. Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 BOSTON U. L. REV. (forthcoming 2019) (estimating that BlackRock, Vanguard and State Street Global advisors could cast as much as 40% of the votes in S&P 500 companies within two decades).

important than ever to the U.S. and global corporate governance debate. Nonpecuniary private benefits of control, such as the prestige of controller status or the influence over global politics and culture, go a long way in explaining the persistence of concentrated ownership and dual-class shares. Nevertheless, controlling shareholders may have broader macro consequences even if investors are sufficiency protected.

Following in Gilson's footsteps, this essay had drawn attention to this additional form of complication. The prevailing modular approach that views corporate governance arrangements exclusively in terms of their agency cost implications has clear limitations in describing real-world developments. While the agency cost lenses are often highly illuminating, they can at times become blinding. To borrow Gilson's words, the "parsimony" of the prevailing shareholder-centric analysis "camouflages a more complicated reality."[120] The assumption that agency costs are the only way by which corporate governance arrangements affect social welfare is, as Gilson said in another context, "simply so coarse as to be wrong."[121]

The repercussions of different forms of controlling shareholder systems span well beyond their effect on shareholder value. Efficient corporate governance practices from an agency cost perspective can nevertheless have detrimental consequences for national economic development or economic integration—and this is but one example. It may be hard to revert any negative effects of control arrangements through mechanisms situated in other areas of law. This new form of complication can be difficult as well as messy, but it is necessary for us to better understand and influence the world.

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[120] Gilson, *supra* note 2, at 1649.
[121] *Id.* at 1643.

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