

Justifications for Minority-Co-Owned Groups and Their Corporate Law Implications

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Abstract

Corporate groups with listed subsidiaries are common around the world, despite the risks they pose to minority shareholders. Shaping a firm as a web of formally independent, minority-co-owned legal entities facilitates controllers' diversion of corporate wealth (tunnelling) via intragroup transactions and other non-transactional techniques. This paper problematizes the conventional view of groups as tunnelling-facilitating infrastructures by arguing that organizing as a group with listed subsidiaries (a minority co-owned group) may create value for all shareholders. Organizing as a minority co-owned group may increase transparency, improve performance thanks to the possibility of using stock options for subsidiaries' managers, allow for the circumvention of inefficient restrictions to dual class shares, facilitate cross-border acquisitions and be a second-best solution in the presence of path dependence issues preventing firms from moving from concentrated to dispersed ownership. If these are the economic rationales for having minority co-owned groups, how should they be regulated? An increasingly popular policy in continental Europe are special corporate law rules centred on a relaxation of directors' fiduciary duties within minority co-owned groups, with a view to facilitating intra-group transactions. These, in turn, would blur the separation between the minority co-owned listed entity and other members of the corporate group as an independently managed firm. However, because the rationales for minority co-owned groups presuppose the opposite, namely a clear and transparent separation between the minority co-owned listed entity and the group, our conclusion is that stringent self-dealing rules (or at least to no less stringent rules than those established for other conflicted transactions) are required for minority co-owned groups to create value for all shareholders rather than merely facilitating tunnelling.

Keywords: Corporate Governance, Corporate Groups, Corporate Law, Pyramidal Groups, Related Party Transactions

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Corporate groups with listed subsidiaries are common around the world, despite the risks they pose to minority shareholders. Shaping a firm as a web of formally independent, minority-co-owned legal entities facilitates controllers' diversion of corporate wealth (tunnelling) via intragroup transactions and other non-transactional techniques. This paper problematizes the conventional view of groups as tunnelling-facilitating infrastructures by arguing that organizing as a group with listed subsidiaries (a minority co-owned group) may create value for all shareholders. Organizing as a minority co-owned group may increase transparency, improve performance thanks to the possibility of using stock options for subsidiaries' managers, allow for the circumvention of inefficient restrictions to dual class shares, facilitate cross-border acquisitions and be a second-best solution in the presence of path dependence issues preventing firms from moving from concentrated to dispersed ownership. If these are the economic rationales for having minority co-owned groups, how should they be regulated? An increasingly popular policy in continental Europe are special corporate law rules centred on a relaxation of directors' fiduciary duties within minority co-owned groups, with a view to facilitating intra-group transactions. These, in turn, would blur the separation between the minority co-owned listed entity and other members of the corporate group as an independently managed firm. However, because the rationales for minority co-owned groups presuppose the opposite, namely a clear and transparent separation between the minority co-owned listed entity and the group, our conclusion is that stringent self-dealing rules (or at least to no less stringent rules than those established for other conflicted transactions) are required for minority co-owned groups to create value for all shareholders rather than merely facilitating tunnelling.

INTRODUCTION

Corporate groups are an important reality of the modern corporate landscape. Virtually every large firm is organized as a group,¹ i.e., as a network of formally independent

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¹ See, e.g., Luis Alfonso Dau, Randall Morck & Bernard Yeung, *Business Groups and the Study of International Business: A Coasean Synthesis and Extension*, 52 J. INT'L BUS. STUD. 161, 161 (2021) ("Business groups . . . are not only prevalent across much of the globe but, in many countries and regions, are the primary form of business organization."); Klaus J. Hopt, *Groups of Companies: A Comparative Study of the Economics, Law, and Regulation of Corporate Groups*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 603 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2017) ("Groups of companies rather than single independent companies are the modern reality of the corporation."). For

companies, each having formal legal personality² (and thus its own assets and liabilities, creditors and shareholders), under the common control of a “parent” company.³

A significant number of corporate groups around the world are minority co-owned groups (MCOGs),⁴ namely groups with one or more listed subsidiaries. Some of them are long-lived, others are newly formed. A prominent example of the former is South Korea’s Samsung Group, existing since before WWII⁵ and comprising today numerous listed subsidiaries operating across several different businesses.⁶ A very recent example of MCOG is the Volkswagen group after Porsche was listed on the German stock exchange as a subsidiary of Volkswagen, itself a listed company in turn controlled by a holding company.⁷ Multiple layers of listed companies, also known as pyramids (of which figure 1 provides an extreme Italian example from the 2000s), are not the only form of MCOGs.

a comprehensive study of business groups in western countries, also containing empirical data, see BUSINESS GROUPS IN THE WEST: ORIGINS, EVOLUTION, AND RESILIENCE (Asli M. Colpan & Takashi Hikino eds., 2018).

² The legal personhood is the legal “device” that allows to treat the company as a separate legal entity (as a fictional person), capable as such of owning assets and assuming liabilities.

³ The most common technique to attain control over a company is via direct and indirect equity stakes in it. Throughout this analysis we refer to groups formed via this technique.

⁴ See, e.g., Luis Dau, Randall Morck & Bernard Yeung, *Corporate Governance, Business Group Governance and Economic Development Traps* (NBER Working Paper No. 28069, 2020), <https://www.nber.org/papers/w28069> (last visited April 22, 2021), at 3 (observing that “[i]n many economies, most large listed companies came to belong to one of a handful of business groups.”). This is rather the exception than the norm in the U.S., where subsidiaries are most often wholly owned. See, e.g., Richard Squire, *Strategic Liability in the Corporate Group*, 78 UN. CHI. L. REV. 605, 611 (2011). For two examples of U.S. minority-co-owned groups, one involving Coca-Cola, see Vladimir Atanasov, Bernard Black & Conrad S. Ciccotello, *Law and Tunneling*, 37 J. CORP. L. 1, 29-33 (2011).

⁵ <https://en.wikipedia.org/wiki/Samsung>.

⁶ Among them, Samsung Electronics, Samsung Heavy Industries, Samsung Engineering, Samsung Life Insurance, Cheil Worldwide.

⁷ See, e.g., Alexandra White & Peter Campbell, *Investors Rush to Snap up Shares ahead of Porsche IPO*, FIN. TIMES (Sept. 26, 2022), <https://www.ft.com/content/7e59d4a6-0c01-49b8-9cad-62da3b50fb14>.

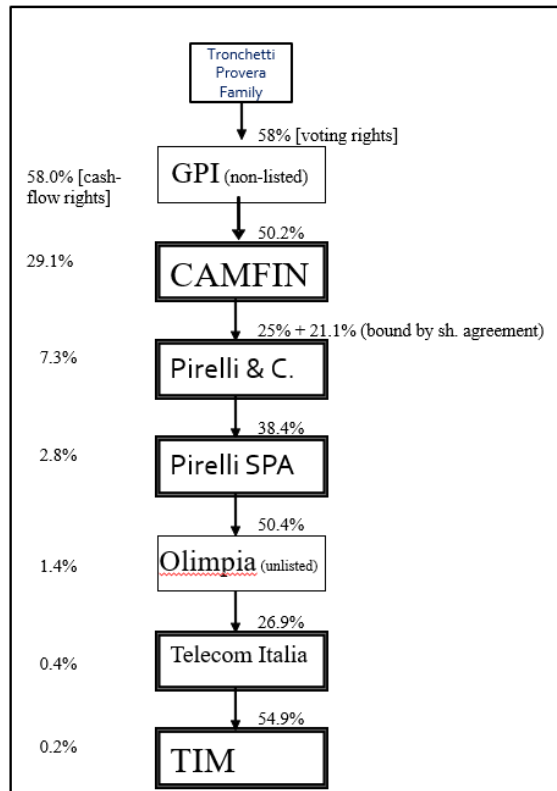


Figure 1: the Pirelli/Telecom Italia group in 2001⁸

A simpler structure is one where a holding company directly controls both a listed company and some wholly owned subsidiaries, as in figure 2.

⁸ Based on ownership disclosure filings available in the Consob website (at https://www.consob.it/c/portal/layout?p_1_id=959857&p_v_1_s_g_id=0).

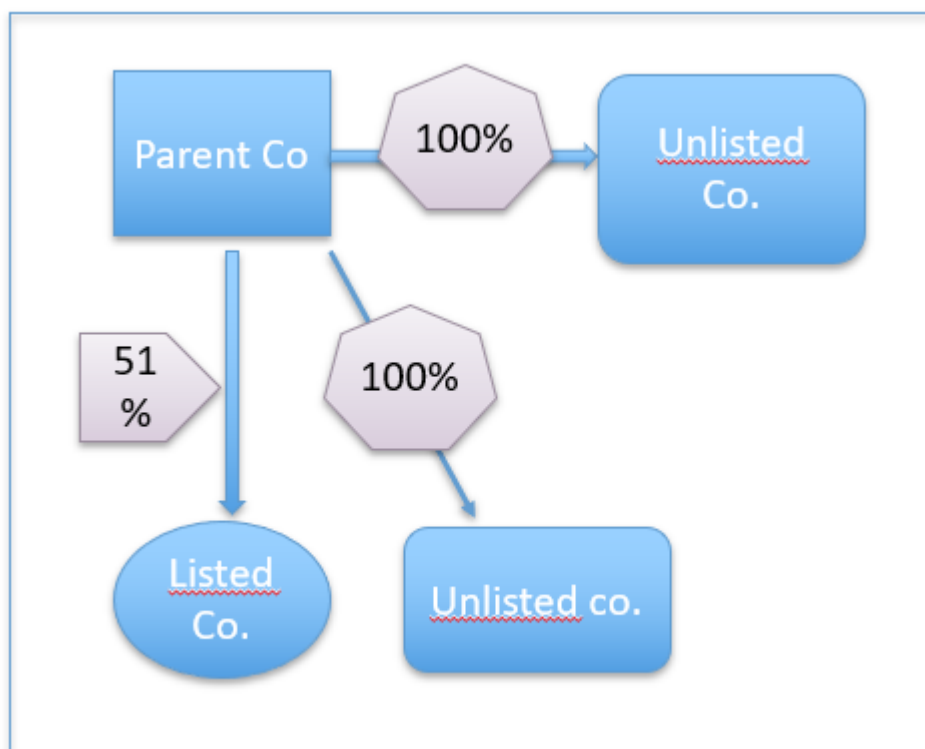


Figure 2: stylized non-pyramidal MCOG

A prominent real-world example combining the two stylized forms of MCOGs (pyramidal and non-pyramidal) is French media conglomerate Vivendi, a listed company controlled by the Bolloré family, which controls (or has a considerable block of shares in) a number of listed companies, such as leading French defense firm Lagardère and Universal Music Group,⁹ and also owns a 100% stake in many non-listed ones (figure 3).

⁹ Vivendi's 10 percent stake combines with the 18 percent owned by the Bolloré's family through other vehicles, making it Universal's largest shareholder. See Music Business Worldwide, Who Owns Universal Music Group Today?, May 22, 2023 (<https://www.musicbusinessworldwide.com/who-owns-universal-music-group-today/>).

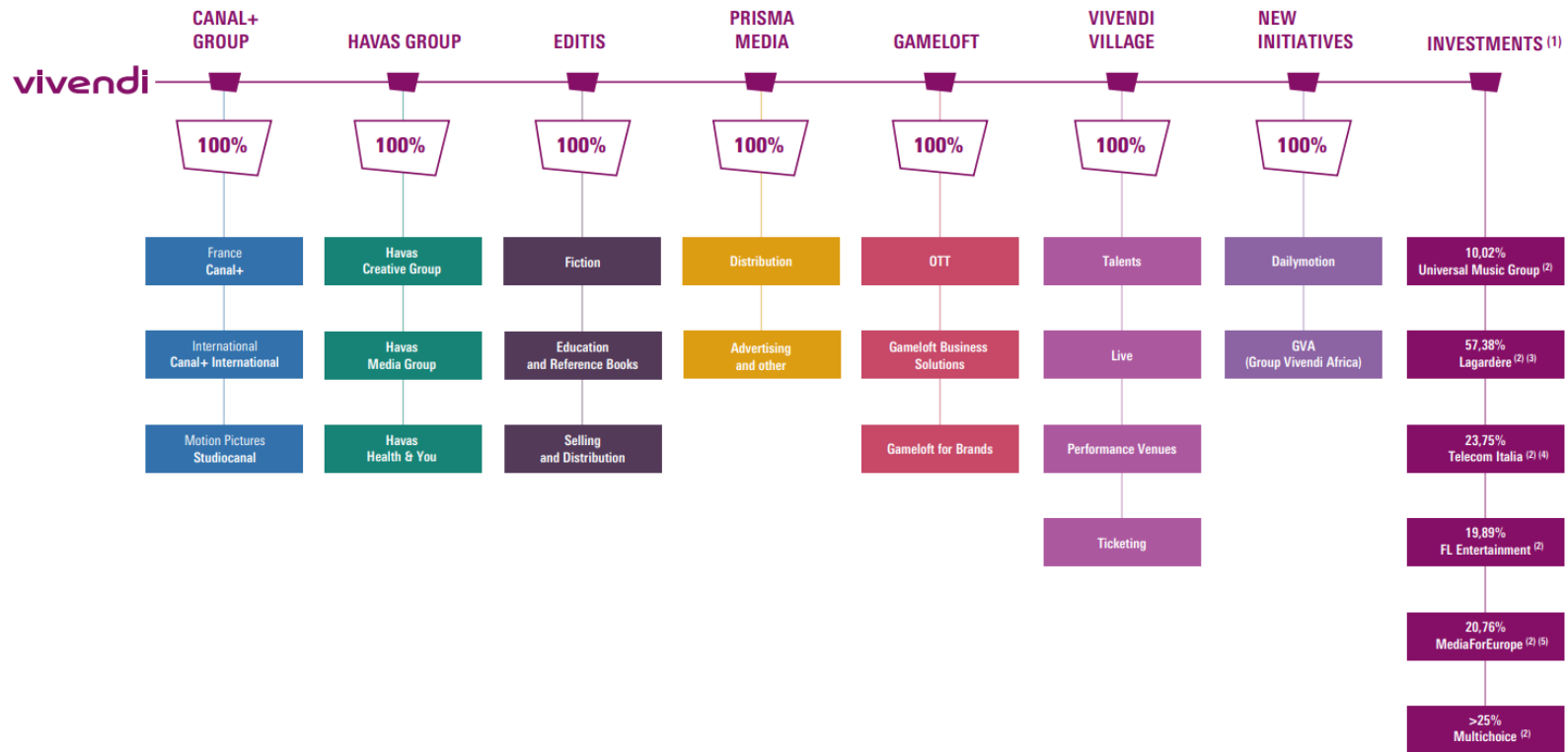


Figure 3: Vivendi group simplified organizational chart as of Sept. 30, 2022¹⁰

¹⁰ <https://www.vivendi.com/wp-content/uploads/2022/11/Vivendi-Simplified-organization-chart-as-of-September-30-2022-accessibility-version.pdf>

MCOGs are well-known to entail significant risks for minority shareholders. Relative to other corporate structures (the multidivisional single-entity firm and wholly owned groups, where minority shareholders are present, if at all, only at the parent company level),¹¹ MCOGs facilitate controllers' tunneling,¹² which in turn increases agency costs.¹³

By structuring their firms as MCOGs, controllers can engage in frequent intra-group transactions (IGTs)—the chief tunneling technique in groups—and obfuscate their negative effects on minority shareholders more easily, because conflicted transactions like IGTs tend to become routine business transactions.¹⁴ This is especially the case for groups where minority-participated subsidiaries operate in related businesses and (perhaps even more so) for vertically integrated groups, namely groups where minority-participated subsidiaries operate along the production chain of the same product or class of products. There, IGTs, far from being episodic, are by their very nature part of the firm's day-to-day operations. So much so, that, for example, in France IGTs are regularly treated by companies as exempt from the rules on related party transactions following their qualification as entered into at normal conditions in the ordinary course of business.¹⁵

¹¹ Wholly owned groups may raise creditor protection issues, as they may facilitate creditor expropriation, including via IGTs. However, creditor expropriation is a less serious problem than shareholder expropriation (at least in the context of groups). Creditors have fixed claims over the company's assets, a feature that makes them less prone to expropriation relative to minority shareholders (who instead have residual claims over the company's assets). Controllers' misbehavior does not harm creditors so long as it does not affect the subsidiary's solvency (and bankruptcy law and other creditor protection (including self-protection) tools are in place to protect creditors' claims reasonably effectively). To the contrary, any measure of controlling shareholder value diversion harms minority shareholders by reducing the value of minority shares.

¹² See Hopt, *supra* note 1, at 608 (highlighting how the risk of controlling shareholder opportunism may be higher in groups than in stand-alone companies with a controlling shareholder). For empirical evidence of high tunnelling in Korean and Indian groups see Jae-Seung Baek, Jun-Koo Kang & Inmoo Lee, *Business Groups and Tunneling: Evidence from Private Securities Offerings by Korean Chaebols*, 66 J. FIN. 2415 (2006); Marianne Bertrand, Paras Metha & Sendhil Mullainathan, *Ferretting Out Tunneling: An Application to Indian Business Groups*, 117 QUART. J. ECON. 121 (2002).

¹³ See, e.g., Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430 (2008), at 431.

¹⁴ See, e.g., Luca Enriques, *Related Party Transactions*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE, *supra* note 1, 506, at 508. See also Sang Yop Kang, *Rethinking Self-Dealing and the Fairness Standard: A Law and Economics Framework for Internal Transactions in Corporate Groups*, 11 VA. L. & BUS. REV. 95, 105 (2016) (for evidence that intra-group exchange amounts to a significant fraction of overall exchange in Korea's top five groups).

¹⁵ For one example involving Vivendi, see AUTORITÉ DES MARCHÉS FINANCIERS, RAPPORT 2019 SUR LE GOUVERNEMENT D'ENTREPRISE ET LA RÉMUNÉRATION DES DIRIGEANTS DES SOCIÉTÉS COTÉES 42 (2019), <https://www.amf-france.org/sites/institutionnel/files/2020-02/rapport-2019-sur-le->

In addition, IGTs are often bilateral-monopoly transactions—a feature that makes it hard to assess whether they are an instrument for tunneling, since there is no readily-available market benchmark against which to measure their fairness.¹⁶

Importantly, tunneling entails social costs. First of all, widespread tunneling is likely to generate adverse selection in equity capital markets. The cost of capital will be unduly high for entrepreneurs who tap those markets but have no intention (for whatever reasons) to steal from outside investors. At the margin, some firms may have to forgo positive net present value projects and/or a listing on the stock exchange.¹⁷ Second, the ability to extract private benefits of control via tunnelling will lead controlling shareholders to structure and manage the group with a view to maximizing the value of the controlling block rather than firm (or share) value. For instance, they may retain a MCOG structure even when a wholly owned group structure would be more cost-effective (net of transition costs).¹⁸ Or they may retain control of an affiliated business not because of synergies but rather for the private benefits extraction opportunities its control creates. More generally, the ability to extract large private benefits of control may lead to investing,¹⁹ financing²⁰ and operational decisions, such as on whether to retain a controlled entity as a supplier rather than switching to a non-affiliate one or on how to allocate a certain asset (including a corporate opportunity) across subsidiaries, based on the rents they allow controllers to extract rather than on

[gouvernement-dentreprise-et-la-remuneration-des-dirigeants-des-societes-cotees.pdf](#) (criticizing Vivendi for qualifying all transactions between itself and wholly owned subsidiary Havas, whose CEO was the son of Vivendi’s founder and then CEO, Vincent Bolloré, as routine ones). On the exemption from RPT rules for routine transactions *see* Geneviève Helleringer, *Related Party Transactions in France. A Critical Assessment*, in *THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS* 400, 406-07 (Luca Enriques & Tobias Tröger eds., 2019).

¹⁶ *See, e.g.*, Alessio M. Paces, *Procedural and Substantive Review of Related Party Transactions: The Case for Non-Controlling Shareholder-Dependent Directors*, in *THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS*, *supra* note 15, 181, 196-199 (stressing the limitations of market-based criteria—such as the arm’s length standard—in assessing the fairness of transactions with idiosyncratic features).

¹⁷ *See, e.g.*, Alessio M. Paces, *Controlling the Corporate Controller’s Misbehaviour*, 11 *J. CORP. L. STUD.* 177, 192 (2011).

¹⁸ *See infra* Section II.E for a discussion of how transition costs may affect the efficiency of the choice to retain the MCOG structure.

¹⁹ *See, e.g.*, Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 *GEO. L.J.* 439 (2001), at 460 (pointing out that the ability to extract large private benefits of control may lead controllers to “select investment projects that maximize their own private returns over returns to the firm”).

²⁰ *Id.* (arguing that where large private benefit extraction is allowed, controllers will likely opt for retaining and reinvesting profits rather than distributing them, the reason being “that formal corporate distributions must be shared with minority shareholders, while earnings reinvested in the firm remain available for subsequent conversion into private benefit”).

the impact of those decisions on the bottom line.²¹ Finally, because tunnelling is (usually) illegal also where it is ineffectively policed, it must be hidden or disguised,²² which generates costs (both direct and indirect) that, from society's standpoint, are a pure deadweight loss.²³

Despite the social costs of tunneling and the fact that MCOGs facilitate it, across continental Europe various national legislatures, some courts and a large number of legal scholars have taken a much more positive view of groups, including MCOGs, respectively devising or advocating a special, laxer regime for IGTs. As a matter of fact, some national corporate laws in continental Europe relax directors' fiduciary duties by allowing subsidiaries' directors (under certain conditions) to prioritize the "interest of the group" over that of the subsidiary²⁴ (that is, to adopt decisions that harm the subsidiary but benefit the whole group) and by exempting IGTs from the procedural requirements applying to related-party transactions.²⁵

Explicitly or, more often, implicitly, this regime and the scholarly support therefor are premised on the view that organizing firms as groups, including MCOGs, creates value for society overall.²⁶ In a companion paper we describe the special regimes in place in some European jurisdictions and those advocated by academics and policymakers.²⁷ We also offer an efficiency-based critique of this special regime.²⁸ In

²¹ See, e.g., Alexander Dyck & Luigi Zingales, *Private benefits of Control: An International Comparison*, 59 J. FIN. 537, 540-41 (2004) (discussing the taking of corporate opportunities as an example of private benefits of control).

²² To put it differently, controllers must still refrain from outright theft or looting also where minority shareholder protection is scant.

²³ In an important sense, the very choice in favor of the MCOG structure is itself a technique to hide and disguise illegal expropriation of minority shareholders. Indeed, as we pointed out above in the text, that choice often allows controllers to conceal value-diverting actions more easily (and effectively). See also Kang, *supra* note 14, at 126-7 (showing how groups and intragroup exchange help controllers minimize the risk of incurring the criminal sanctions associated with more primitive forms of wealth diversion, such as outright theft and embezzlement).

²⁴ See *infra* text accompanying notes 69-70.

²⁵ See *supra* text accompanying note 15.

²⁶ Supporters of the special regime for groups frequently acknowledge that MCOGs create special problems of minority shareholder protection. See, e.g., Pierre-Henri Conac, *Director's Duties in Groups of Companies – Legalizing the Interest of the Group at the European Level*, 10 EUR. COM. & FIN. L. REV. 194, 221 (2013) (observing that "[i]n the case of non-wholly-owned subsidiaries, the most important issue becomes the protection of minority shareholders"). However, this rarely leads them to question the efficiency of the MCOG form relative to the wholly owned group. They tend rather to take it as a given that the large modern firm is (efficiently) organized as a group with little, or mostly no attention to the efficiency implications of the choice between the two group structures. See, e.g., Christoph Teichmann, *Towards a European framework for cross-border group management*, 13 EUR. COMP. L. 150, 150 (2013) (for the (generic) proposition that groups are "the most appropriate way" to organize multinational businesses).

²⁷ Luca Enriques & Sergio Gilotta, *The Case Against a Special Regime for Intragroup Transactions*, 24 EUR. BUS. ORG. L. REV. 471, 477-86 (2023).

²⁸ *Id.* at 486-502.

this essay, we complement our critical analysis of the more lenient regime by taking a closer look at the question how MCOGs may create value for shareholders as such rather than controllers. More specifically, we identify five ways in which the MCOG form may create value for all parties involved rather than acting as a mere tunnelling infrastructure. For the sake of argument, we assume that the benefits stemming from the MCOG form are higher than the costs of allowing for the existence of MCOGs. However, we also note that, for MCOGs-related benefits to materialize, minority co-owned entities must be managed independently from the rest of the group (the independence requirement). Because a European-style laxer regime for groups would be inconsistent with the independence requirement, we conclude that this regime is inconsistent with the reasons why MCOGs may be justified as a value-enhancing organizational structure. We thus provide a critique of the special rules on groups building on the very premises they are based on.

The paper proceeds as follows. First, we recall the major efficiency reasons for organizing a firm as a group, rather than as a single entity, and show that they do *not* also justify the choice of an MCOG structure (Part I). Next, we turn to the question whether there are rationales, other than controllers' intent to maximize private benefits of control, for structuring a firm as an MCOG (Part II). We find five non-mutually exclusive rationales: first, the MCOG structure may increase firm transparency, potentially decreasing the group's cost of capital. Second, it allows subsidiaries to compensate their managers with equity-based compensation linked to the performance of those subsidiaries rather than the group's, which may lead to reduced managerial agency costs and a lower cost of capital. Further, the MCOG structure may be used to circumvent inefficient restrictions on dual class shares or to facilitate acquisitions by foreign firms. Finally, the MCOG structure may find a justification in path dependency and the high costs of switching to more efficient organizational structures.

If, across the board, the benefits arising from MCOGs performing these functions are higher than the related agency costs, then MCOGs perform a positive function in the economy. In turn, this may cast a more positive light on European policymakers' favor for laxer corporate law constraints on self-dealing when it takes the form of IGTs. Indeed, by decreasing group management costs this regime would facilitate the management of MCOGs and therefore incentivize its use, supposedly to the advantage of society as a whole.

Yet, this would be the wrong implication to draw from our analysis. As argued in Part III, none of the value-enhancement justifications for MCOGs that we identify are aligned with the claim that corporate law's constraints against unfair self-dealing should be relaxed for firms organized as MCOGs. Quite the opposite, because each of those justifications presupposes the managerial independence of the minority co-owned entity from the rest of the group, they actually reinforce the proposition that rules on IGTs should be rigorous or, at the very least, not less rigorous than those established for other conflicted transactions.

I. JUSTIFICATIONS FOR THE EXISTENCE OF GROUPS

MCOGs are a powerful tool for tunnelling. Does that mean that controllers' opportunism is the sole rationale behind organizing a firm as an MCOG?

For sure, MCOGs exist because controllers choose to structure the firms they control as such. Rational controllers can be expected to choose the organizational structure that allows them to maximize the sum of (1) their equity stake as valued in the public market and (2) the private benefits of control.

Yet, the fact that MCOGs can only be observed when they allow controllers to maximize the value of their controlling stake does not necessarily imply that they are always an inferior form of business organization. If an MCOG structure entails benefits for shareholders as such that are greater than the increase in agency costs that the structure entails, then MCOGs create value not only for the controllers but also for society as a whole. The goal of section II is to identify such benefits. Before we do that, however, we have to make it clear that what matters for our purposes are potential benefits attached to the use of MCOGs rather than, more generically, group structures. In fact, there are a number of good reasons why organizing a firm as a group rather than as a single entity may create value. In this part, we briefly identify the main business rationales for structuring a firm as a group to make the point that none of them requires the presence of minority shareholders at the level of one or more subsidiaries and, hence, that the benefits attaching to such rationales are irrelevant to the question of what the optimal corporate law regime should be for MCOGs.

The vast economic and legal literature on corporate groups has provided several value-creation-based explanations for the existence of wholly owned groups. We do not aim here at providing a comprehensive account of these explanations—a task that would far exceed the more limited goals of this essay. Rather, we report here

only the most common and widely accepted ones and, without engaging with the question whether these explanations support the proposition that organizing as a group creates value,²⁹ we highlight that they fail to answer the separate question of whether groups where minority shareholders are present at the subsidiary rather than exclusively at the top company level also create value for all the relevant shareholders, let alone whether they are efficient.

First, groups are frequently regarded as capable of providing better risk management than single-entity firms, thanks to the opportunities offered in this respect by the subsidiaries' limited liability.³⁰ Limited liability allows investors to control risk exposure when the firm expands into new businesses and markets. It isolates the firm's existing assets from the risks associated with the new venture, allowing the firm (its investors) to diversify³¹ and exploit new business opportunities more cheaply.

Second, scholars frequently point out that groups allow for better firm management. The fact that each member of the group is a separate legal entity with its own governance bodies, assets and liabilities, "facilitates the delegation of activities and decision-making"³² and provides managers, employees and stakeholders of the subsidiary with improved incentives,³³ thus reducing the firm's overall agency costs of management. These benefits can be particularly valuable for firms displaying a high degree of internal complexity, such as those operating across multiple jurisdictions (multinational enterprises), unrelated businesses (diversified conglomerates), or different levels of the production chain (vertically integrated firms).

Third, a group structure may help the firm to get external finance at a lower cost, especially when the firm operates across a number of unrelated businesses: the firm is partitioned into two or more legally distinct subsidiaries under common control,

²⁹ See e.g., J. Ramachandran, K.S. Manikandan & Anirvan Pant, *Why Conglomerates Thrive (Outside the U.S.)*, 91 HARV. BUS. REV. 110 (2013) (offering a number of reasons why groups are more efficient than multi-divisional single firms).

³⁰ See Klaus J. Hopt & Katharina Pistor, *Company Groups in Transition Economies: A Case for Regulatory Intervention?*, 2 EUR BUS. L. REV. 1, 13 (2001); but see George G. Triantis, *Organizations as Internal Capital Markets: The Legal Boundaries of Firms, Collateral, and Trusts in Commercial and Charitable Enterprises*, 117 HARV. L. REV. 1102, 1131 (2004) (highlighting how single entities encompassing different business projects provide *creditors* with better protection, through the diversification of insolvency risk due to exogenous shocks).

³¹ See Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 510 (1976) (explaining groups as the result of shareholder attempts to "reduce risk through diversification").

³² Hopt & Pistor, *supra* note 30, at 13.

³³ See generally Andreas Engert, *The Corporate Group as an Organizational Form – Separating Control from Value Appropriation* (2016) (unpublished manuscript) (on file with the authors) (arguing that the group structure can be viewed as a tool to align the incentives of a subsidiary's stakeholders).

each running one of the firm's businesses, allowing creditors (especially trade creditors, like customers or suppliers, or industry-specialized lenders) to focus on the business they know best. This, in turn, reduces creditors' screening and monitoring costs, thus lowering the firm's cost of funding.³⁴

Other value-creation-based justifications for groups point to their "gap-filling" role in economies that lack well-developed market-supporting institutions.³⁵ More precisely, groups represent, from this perspective, an adaptive response to the absence of well-developed key input markets, such as financial³⁶ or labor markets.³⁷ Consider financial markets. Where, due to their absence or underdevelopment, external finance is unavailable or excessively costly, a group's internal capital market can make up for it and provide the necessary funds. Thus, courtesy of the cash flows produced by other group affiliates, new profitable entrepreneurial projects (e.g., entry into an unrelated but promising new business) that would otherwise be forgone may be financed.³⁸

³⁴ See, e.g., Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 399-401 (2000). Note, however, that, in order to fully exploit such advantages, subsidiary-level financial data must be available to creditors and the subsidiary must not offer guarantees to other group members. See Henry Hansmann & Richard Squire, *External and Internal Asset Partitioning: Corporations and their Subsidiaries*, in OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE, *supra* note 1, 251, at 260-1. In a similar vein, the group structure is also thought to facilitate the transfer of the firm's contractual rights or obligations. See generally Kenneth Ayotte & Henry Hansmann, *Legal Entities as Transferable Bundles of Contracts*, 111 MICH. L. REV. 715 (2013).

³⁵ See, e.g., Tarun Khanna & Krishna Palepu, *Is Group Affiliation Profitable in Emerging Markets? An Analysis of Diversified Indian Business Groups* 55 J. FIN. 867, 868 (2000) (for the observation that business groups in developing economies may "internally replicate the functions provided by stand-alone intermediary institutions in advanced economies", thus providing a solution to the external market failures caused by the absence (or underdevelopment) of such intermediaries).

³⁶ See, e.g., Triantis, *supra* note 30, at 1112-3 ("Internal capital markets play a greater role in capital reallocation when external capital markets are less developed."); Tarun Khanna & Yishay Yafeh, *Business Groups in Emerging Markets: Paragons or Parasites?*, 45 J. ECON. LITER. 331, 336 (2007) (observing that incomplete capital markets make "the use of internal capital markets relatively efficient . . .").

³⁷ Khanna & Yafeh, *supra* note 36, at 336.

³⁸ The gap-filling rationale has a number of variations. See Sang Yop Kang, *Generous Thieves: The Puzzle of Controlling Shareholder Arrangements in Bad-Law Jurisdictions*, 21 STAN. J.L. BUS. & FIN. 57, *passim* (2015) (discussing the role of "trustworthy" controlling shareholders (i.e., controlling shareholders who show self-restraint and predictability in the extraction of private benefits), whose existence may mitigate firms' difficulties in raising external finance); Eric Friedman, Simon Johnson & Todd Mitton, *Propping and tunneling*, 31 J. COMP. ECON. 732 (2003) (providing a theory of "propping," or intragroup support of ailing subsidiaries, in groups operating in weak legal environments, where financial markets are likely non-existent or underdeveloped); Khanna & Yafeh, *supra* note 36, at 335-6 (arguing that the group structure allows shareholders to lower risk via firm-level business diversification where risk reduction via portfolio-level diversification is unfeasible or too costly because of underdeveloped financial markets).

Finally, the choice in favor of a group structure might be driven (and in practice is often driven) by tax and/or regulatory arbitrage considerations.³⁹ The underlying goal is to minimize a firm's tax burden or to choose the most favorable legal regime for the firm's shareholders (e.g., by locating labor-intensive productions in countries with poor labor protection).

One common element of the various functions of group structures that we have briefly described is that none of them postulates the presence of minority shareholders in the group's subsidiaries. For instance, more effective risk management via the exploitation of a company's legal personality and limited liability may be achieved equally effectively in a group comprising only wholly owned subsidiaries or in one with minority co-owned ones. And common tax arbitrage techniques, such as the channeling of group profits where they are taxed less via IGTs (transfer pricing),⁴⁰ may take place with no minority shareholders at the subsidiary level. Indeed, what usually suffices to this end is that the transacting companies have separate legal personalities. With the obvious exception of pyramids as a tool to circumvent limits or bans on dual class shares,⁴¹ that is the case also for other regimes that a group structure enables the avoidance of.⁴²

To sum up, a number of good reasons justify the choice of the group structure over the single entity structure. However, none of them postulates the presence of minority shareholders at the subsidiary level and hence provides an efficiency rationale for the choice of the MCOG structure.

³⁹ See, e.g., Maribel Sáez Lacave & María Gutiérrez Urriaga, *Corporate Groups: Corporate Law, Private Contracting and Equal Ownership* 9 (ECGI Law Working Paper No. 581, 2021), <https://ssrn.com/abstract=3826510> (claiming that “[t]he first reason why groups are valuable is that they offer the possibility to engage in regulatory arbitrage” and that “[r]egulatory arbitrage can explain why many group structures are so complex and legally intractable”).

⁴⁰ See, e.g., Prem Sikka & Hugh Willmott, *The Dark Side of Transfer Pricing: Its Role in Tax Avoidance and Wealth Retentiveness*, 21 CRIT. PERSP. ON ACC'T 342 (2010) (documenting that transfer pricing is used for tax minimization purposes).

⁴¹ See *infra*, Section II.C. We note in passing that some jurisdictions limit the use of pyramids as a substitute for dual class shares (as is the case in Israel: see, e.g., Federico Cenzi Venezze, *The Costs of Control-enhancing Mechanisms: How Regulatory Dualism Can Create Value in the Privatisation of State-owned Firms in Europe*, 15 EUR. BUS. ORG. L. REV. 499 (2014)) or make them tax-inefficient by taxing intercompany dividends (as is the case in the US: see, e.g., Randall Morck & Bernard Yeung, *Dividend Taxation and Corporate Governance*, 19 J. ECON. PERSP. 163, 173-77 (2005) (for a detailed account of intercompany dividend taxation in the US and a discussion of its impact on the use of pyramids in that jurisdiction)).

⁴² One additional exception might be when the choice in favor of the MCOG structure reduces the likelihood that remedies against creditor expropriation, such as veil piercing doctrines, will be applied. In this case, opting for an MCOG structure is valuable for the parent company's shareholders. See Lacave & Gutiérrez Urriaga, *supra* note 39, at 9.

II. JUSTIFICATIONS FOR THE EXISTENCE OF MINORITY-CO-OWNED GROUPS

The previous section showed that the most commonly agreed-upon value-creation rationales for the existence of corporate groups are of no use to explain why MCOGs exist other than to facilitate tunnelling, because their benefits can be achieved also without the presence of minority shareholders at the level of a group's subsidiaries. This Part lays out the five ways in which MCOG structures themselves can create value for all shareholders. Two of them, MCOGs' ability to improve information about listed firms' operations and performance and their potential for reducing managerial agency costs, are inherent to the MCOG form. The remaining three arise from the interaction between MCOG characteristics and market and/or regulatory features that some jurisdictions may display and therefore are contingent on the presence of those features in the jurisdiction where the MCOG operates. These are: (1) using MCOGs to circumvent (presumptively) inefficient restrictions on dual class shares; (2) using them to assuage national governments' aversion (but not total closure) to foreign acquisitions; and (3) their working as a second-best organizational choice where high transition costs make it inefficient for all involved shareholders to have them converted into a different organizational form.

A. *Enhanced transparency.* One value-enhancing function that MCOGs can serve is to improve information production and disclosure about large firms' operations and performance. Such firms often display a high degree of internal complexity that makes them hard to understand for outside investors (if not for the controllers themselves).⁴³ This is especially the case of multinational enterprises, diversified conglomerates and vertically integrated firms.⁴⁴

The lower transparency of these firms largely depends on the fact that their disclosures tend to be less informative than those of more focused firms. Indeed, financial statements tend to aggregate information about the different business areas in which the firm operates and therefore may not always offer a sufficiently fine-grained

⁴³ See Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 791 (2003).

⁴⁴ Consider again the Samsung example and imagine that none of its subsidiaries were listed. Intuitively, the whole group would be much less transparent and understandable for outside investors than it actually is thanks to its having sixteen controlled entities with shares traded on the Korea Exchange (see Son Ji-hyoung, *Samsung's W130tr market cap evaporates in 10 months*, THE KOREA HERALD, Nov. 1, 2022, <https://www.koreaherald.com/view.php?ud=20221101000475>).

representation of performance.⁴⁵ Greater information asymmetry, in turn, may negatively affect the firm's cost of capital, as investors may require a discount to buy shares in a more opaque company.⁴⁶

Reducing the firm's size and scope by selling off one or more divisions or wholly owned subsidiaries is an obvious way to alleviate this information asymmetry.⁴⁷ In fact, the sale would enhance the selling company's focus. Increased focus, in turn, would make the firm's financial statements (and other disclosures) more informative. In addition, enhanced firm focus allows managers to specialize, improving performance.⁴⁸

However, for firms operating in related businesses (such as vertically integrated firms or firms producing related products or services), the sell-off option may in fact destroy value. For such firms, the fact that the divisions or subsidiaries are kept under common control usually yields significant advantages in terms of tighter coordination and reduced transaction costs.⁴⁹ These benefits may well outweigh the transparency and other benefits that the parent company may obtain from the sale.

Carving out a division or subsidiary and listing it on a stock exchange—thereby transforming what was before a multidivisional single-entity firm or a wholly

⁴⁵ Financial accounting principles address this problem by requiring firms to provide disaggregated data about each single business in which they operate ("segment reporting"). However, segment reporting applies only to some information items, such as profits or assets and liabilities pertaining to the single business areas (*see, e.g.*, IFRS 8 (Operating Segments)), and therefore may not provide sufficient additional information.

⁴⁶ A higher information asymmetry should lead to an increase in the firm's cost of capital: *see, e.g.*, David Easley & Maureen O'Hara, *Information and the Cost of Capital*, 59 J. FIN. 1553 (2004); Christian Leuz & Robert E. Verrecchia, *The Economic Consequences of Increased Disclosure*, 38 J. ACCT. RES. 91 (2000).

⁴⁷ *See, e.g.*, Katherine Schipper & Abbie Smith, *A Comparison of Equity Carve-outs and Seasoned Equity Offerings*, 15 J. FIN. ECON. 153, at 154 & 174 (1985); Sudha Krishnaswami & Venkat Subramaniam, *Information asymmetry, valuation, and the corporate spin-off decision*, 53 J. FIN. ECON. 73 (1999) (for consistent empirical evidence). *See also* Ronald W. Masulis, Peter K. Pham & Jason Zein, *Family Business Group Expansion Through IPOs: The Role of Internal Capital Markets in Financing Growth While Preserving Control*, 66 MGMT SC. 5191, 5192 (2020) (for the general observation that improving transparency is a typical goal of divisional carve-outs in widely held companies).

⁴⁸ For consistent empirical evidence *see, e.g.*, Robert Comment & Gregg A. Jarrell, *Corporate Focus and Stock Returns*, 37 J. FIN. ECON. 67 (1995); Kose John & Eli Ofek, *Asset Sales and Increase in Focus*, 37 J. FIN. ECON. 105 (1995).

⁴⁹ This intuition goes back to Ronald Coase's seminal work on the nature of the firm (*see generally* R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937)) and has been subsequently developed and refined, among others, by Williamson (*see* OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (Free Press, 1975), OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* (Free Press, 1985)), Klein, Crawford and Alchian (*see* Benjamin Klein, Robert J. Crawford & Armen A. Alchian, *Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J. L. & ECON. 297 (1978)), and Grossman and Hart (*see* Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691 (1986)).

owned group into an MCOG—allows controllers to capture the benefits, in the form of a lower cost of capital, of enhanced transparency and lower information asymmetry⁵⁰ without forgoing the benefits of integration.

The carve-out and subsequent listing will improve transparency by increasing the sheer size of the information produced and disseminated by the group. In fact, the subsidiary's listing will provide investors with a significant amount of additional information regarding the subsidiary's business, as a consequence of securities regulation's numerous disclosure mandates.⁵¹

To be sure, if the goal is reducing information asymmetry and improving investor understanding of the firm's business, controllers always retain the option of *voluntarily* increasing the amount of information provided by the group. That is, they may disclose more disaggregated (division- or subsidiary-level) data than what accounting principles and/or securities regulation requires them to provide to the public. Increased voluntary disclosure would also appear to allow controllers to improve group transparency and it would have the advantage of avoiding the costs associated with a subsidiary's carve-out and subsequent listing.

However, the carve-out-and-listing option (i.e., the choice to resort to the MCOG structure) and the ensuing mandatory disclosure requirements offer firms at least two advantages that voluntary disclosures cannot confer. First, the subsidiary's listing allows controllers to credibly commit to enhanced transparency also for the future, thanks to the “lobster-trap” role played by securities regulation.⁵² Second, listing may be used to attract (or broaden) analyst coverage over the group's business, with the effect of a stronger reduction in information asymmetry.⁵³

⁵⁰ See *supra* note 46.

⁵¹ See, e.g., Schipper & Smith, *supra* note 47, at 174. Schipper and Smith identify an additional advantage of equity carveouts, namely that they alleviate the negative information effects of external equity financing described by Myers and Majluf (see Stewart C. Myers & Nicholas S. Majluf, *Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have*, 13 J. FIN. ECON. 187 (1984)), “reducing the probability that positive net present value projects of the subsidiary are foregone” (Schipper & Smith, *supra* note 47, at 169 and 175). Yet, this advantage does not require the subsidiary to retain its listing for long (*id.* at 179-80). More generally, there is ample evidence that equity carveouts are a temporary phenomenon (in the U.S.): they are often followed by a third-party acquisition or a reacquisition within a few years. See B. Espen Eckbo & Karin S. Thorburn, *Corporate Restructuring*, 7.3 FOUND. TRENDS FINANCE 159, 198 (2013).

⁵² On securities regulation as a commitment device see generally Edward B. Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 CARDOZO L. REV. 675 (2002). See also Schipper & Smith, *supra* note 47, at 174.

⁵³ See, e.g., Stuart C. Gilson, Paul M. Healy, Christopher F. Noe & Krishna G. Palepu, *Analyst Specialization and Conglomerate Stock Breakups*, 39 J. ACC'T RES. 565, 568-9, 575-6 (2001) (arguing that conglomerate stock breakups lead to an increase in the number of analysts following the firms resulting from the breakup and providing empirical evidence consistent with this hypothesis).

B. Improved management. MCOGs may improve corporate groups' management in at least three ways. First, MCOGs' enhanced transparency⁵⁴ may have indirect beneficial effects on capital allocation decisions within the group. Centralized (i.e., parent-level) capital allocation decisions may often be poorly informed due to information manipulation and other strategic behavior on the part of the potential beneficiaries of the funds (namely, the single subsidiaries' management teams competing for their allocation).⁵⁵ Having a listed subsidiary can reduce such biases, as market signals can be used to gauge the value of individual management teams' strategies and investment projects, thus allowing for a more efficient allocation of capital within the group. To put it differently, listing allows controllers to benefit from the market's evaluation and information-processing capabilities and thus to improve the quality of controllers' own capital-allocation decisions.

Second, differently from the wholly-owned group and the multidivisional single-entity firm, only an MCOG allows subsidiaries' managers to be rewarded with stock-based compensation schemes that are linked to the specific performance of their subsidiarised division's shares, as opposed to the shares of the one entity in the group (usually the parent company) that is listed.⁵⁶ To the extent that stock-based compensation tailored to the performance of the individual subsidiary works better than incentive schemes based on different metrics in aligning managers' incentives to shareholder interests, managerial agency costs at the subsidiary level will be reduced.⁵⁷ That, of course, is more likely to be the case where the effort of subsidiaries' managers is little correlated to the performance of the whole group and therefore this rationale is stronger for listed conglomerates than for integrated or multinational enterprises.

⁵⁴ See *supra* section II.A.

⁵⁵ See Paul Milgrom & John Roberts, *An Economic Approach to Influence Activities in Organizations*, 94 AM. J. SOC. S 154 (1988).

⁵⁶ See, e.g., Debra J. Aron, *Using the Capital Market as a Monitor: Corporate Spinoffs in an Agency Framework*, 22 RAND J. ECON. 505 (1991).

⁵⁷ See Gilson & Gordon, *supra* note 43, at 791. Multidivisional single-entity firms may resort to tracking stock, namely stock whose payoffs are linked to the performance of a specific division, as a substitute for stock options. However, the efficiency of tracking stock in reflecting managerial performance is limited, because the value of tracking stock is highly correlated with that of the firm's common stock. That is because, first, tracking stock's dissolution rights are usually not linked (or poorly linked) with the tracked assets (Edward M. Iacobucci & George G. Triantis, *Economic and Legal Boundaries of Firms*, 93 VA. L. REV. 515, 536 (2007)). Second, tracking stocks are usually not allowed to pay dividends if the company's general performance has been negative, that is, if the company's financial statement reports a loss, notwithstanding the division's positive performance (*Id.*, at 538-9). Because of these limitations, tracking stock is a poor substitute of subsidiary's stock options as an incentive compensation device.

Third, compensating managers based on the performance of their subsidiary may be valuable also to attract the best talent. That may be the case of a conglomerate which also operates in an industry where listed firms paying managers generous stock-based compensation packages are dominant and an entrepreneurial culture prevails among key employees.⁵⁸

C. MCOGs as an alternative to dual class shares where limits or bans thereon exist. MCOGs may be an adaptive response in the jurisdictions, such as many European ones, that have traditionally restricted the use of dual-class shares but not of pyramidal groups.⁵⁹ Both dual class shares and pyramids are techniques to deviate from the one-share-one-vote principle and therefore to achieve a wider separation of ownership and control.⁶⁰ The distortions and risks associated with (large) deviations from the one-share-one-vote principle are well-known.⁶¹ However, sometimes these deviations may also create value. This is the case, for instance, of newly listed, highly innovative firms for which a high and persistent information asymmetry exists between the founder-controller and outside investors. Letting controllers pursue their “idiosyncratic vision” of how the firm’s business must be run, free of market pressures, may be valuable also to outside investors, who may enjoy superior returns thanks to the founder’s comparatively deeper knowledge of the firm.⁶² Where dual-class shares are banned or restricted, a pyramidal MCOG enables knowledgeable controllers to insulate themselves from the influence of (less knowledgeable but potentially powerful) outside

⁵⁸ For evidence that carved-out subsidiaries tend to be high-growth firms see Eckbo & Thorburn, *supra* note 51, at 192.

⁵⁹ To name but a few, Italy, Germany and Spain have traditionally restricted companies’ freedom to deviate from the one-share-one-vote principle via dual class shares but, unlike Israel (see *supra* note 41), never went so far as to impose similar limits to pyramidal groups. See, e.g., Cenzi Venezze, *supra* note 41, at 510-12 (2014) (documenting how some European countries, including Italy and Spain, prohibit (or have prohibiting until recently) multiple voting shares but not pyramids).

⁶⁰ See, e.g., Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453, 1472-3 (2019).

⁶¹ See generally Lucian A. Bebchuk, Reinier Kraakman & George Triantis, *Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, in CONCENTRATED CORPORATE OWNERSHIP 295, 301-305 (Randall K. Morck ed., 2000), and, more recently, Bebchuk & Kastiel, *supra* note 60, *passim*.

⁶² See generally Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560 (2016).

investors while at the same time not forsaking external or internal growth opportunities requiring the issuance of new shares.

D. MCOGs as a solution to restrictions on cross-border acquisitions.

Governments often raise barriers—either formal or informal—to foreign corporations intending to acquire domestic firms (especially large ones, or those otherwise considered “strategic”).⁶³ However, they may sometimes be open to the idea of foreign takeovers (e.g., when the operation may help bail out troubled domestic firms), subject to an acquirer’s commitment to preserve the target as a separate domestic legal entity with local minority shareholders and/or a listing on the national stock exchange.⁶⁴ The local shareholdings and listing may in fact help politicians to retain influence upon such firms, whether via the sweeping powers of a securities regulator or thanks to local public pension funds holding large minority stakes. When national law or politics prevent foreign controllers from obtaining one-hundred-percent ownership of domestic firms, some valuable cross-border business combinations may be executed via an MCOG.

E. Path dependence. Finally, what may justify MCOGs could be the very simple fact that switching to a more efficient organizational structure may be too costly. If high enough, transition costs—namely the costs that must be borne to move from the MCOG to a more efficient structure—may outweigh the efficiency benefits brought about by

⁶³ As regards formal barriers, in the European Union, member states may impose restrictions on foreign direct investment within the (broad) boundaries set by Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, O.J. L 79I, March 21, 2019, 1. The U.S. tightened the Committee on Foreign Investment in the U.S. (“CFIUS”) regime expanding its scope and strengthening the Committee’s review powers in 2018, with the Foreign Investment Risk Review Modernization Act of 2018, Pub. L. No. 115-232 [2018]).

⁶⁴ See Sáez Lacave & Gutiérrez Urriaga, *supra* note 39, at 9 (reporting that “many developing countries impose ownership restrictions on the percentage of shares that a foreign firm may own in a local firm.”). In a recent example, the Italian Government authorized a Chinese firm’s holding of a large stake in Pirelli, so long as it abstained from exercising control over the company. See Giuseppe Fonte, *Italy rules Pirelli’s Chinese top investor Sinochem cannot choose CEO*, REUTERS, June 18, 2023, <https://www.reuters.com/business/autos-transportation/italy-rules-pirellis-chinese-top-investor-sinochem-cannot-choose-ceo-source-2023-06-17/>.

the transition to a new organizational form, justifying MCOGs as a second-best organizational structure.⁶⁵

These transition costs may take the form of onerous tax consequences for the required restructurings and the cost of financing or executing the acquisition of minority shares, which is likely to be treated as a related-party transaction and therefore may be procedurally onerous and legally risky. Unlikely as it is that these costs are large enough to tip the scale against a restructuring, we mention this additional rationale for the persistence of MCOGs for the sake of completeness. And we hasten to add that path dependence may more likely explain such persistence in a less benevolent way. It is in fact more likely that controlling shareholders' self-interest, rather than efficiency considerations, drives the choice of keeping the MCOG structure in place: controlling shareholders may refuse to proceed to a group restructuring whereby minority-co-owned subsidiaries are done away with if the rents they extract through the existing MCOG structure make their shareholdings (and their shareholdings only) more valuable than under a streamlined non-MCOG structure.⁶⁶ When that is the case, controlling shareholders may preserve the status quo even when the gains for the non-controlling shareholders from the group restructuring would be higher than the rents extracted by the controlling shareholders.⁶⁷

III. RELAXING CORPORATE LAW CONSTRAINTS AGAINST SELF-DEALING TO FACILITATE THE INTEGRATED MANAGEMENT OF MCOGS?

Explicitly or implicitly, the view that more lenient rules on self-dealing to ease the integrated management of MCOGs are justified rests on the idea that MCOGs serve a useful function in modern economies rather than being merely instrumental to facilitate tunnelling. In Section II, we followed this logic and gave substance to this claim by identifying five possible rationales, some inherent to MCOGs, others contingent on

⁶⁵ See Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 139-142 (1999) (identifying "sunk adaptive costs" and other factors that make the choice of keeping the existing corporate structures efficient). Still, path-dependent outcomes must display some "acceptable efficiency" (see Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641, 641 (1996)) in order to survive, i.e., they cannot be "too inefficient" (*id.*). Indeed, highly inefficient structures are worth changing also when transition costs are high. Even more intuitively, a MCOG may survive as a second-best form if the transaction costs of taking the subsidiary private are higher than the benefits of doing so. See Jens Dammann, *Corporate Ostracism: Freezing out Controlling Shareholders*, 33 J. CORP. L. 681, 698 (2008).

⁶⁶ Bebchuk & Roe, *supra* note 65, at 143-7.

⁶⁷ See *id.* at 130.

specific circumstances, for that organizational form. Having done that, we need not venture into a cost-benefit analysis to answer the question whether the positive effects of MCOGs for shareholders as a whole more than offset the drawbacks of MCOGs in terms of facilitating tunnelling and therefore contributing to adverse effects on corporate governance and capital markets at the macro level.

For the purposes of this paper, we can simply assume a positive answer to that question. In fact, what we are interested in is the further question whether, once it is assumed that the presence of MCOGs does create value for society, it follows that more lenient rules for groups of companies are justified. Anticipating our conclusion, our answer is negative: even if we accept the idea that MCOGs do serve a socially positive function, laxer rules on self-dealing to facilitate the integrated management of MCOGs would be unwarranted, because such rules would be inconsistent with the rationales for MCOGs that we have identified. In fact, these rationales presuppose, logically or politically, stringent rules to ensure the separate management of minority co-owned subsidiaries.

More precisely, the fallacious reasoning we want to debunk runs as follows:

1. for the reasons discussed in section II, MCOGs (can be presumed to) enhance value creation compared to single-entity firms and groups where minorities only own shares at the parent company level;
2. MCOGs integrate the various entities into an individual firm via their *de facto* unitary management as a single group-level firm;
3. the sheer number of intra-group interactions, mainly in the form of IGTs, needed for the various entities to act as an individual firm often make corporate law's ordinary protections against self-dealing impractical, if not incompatible with the group's efficient management altogether;
4. hence, special rules aimed at easing intragroup interactions should be devised for MCOGs.

This kind of reasoning underlies the choice of some continental European jurisdictions to establish special, more lenient regimes for MCOGs (and groups more generally).⁶⁸ The details of these special regimes vary across jurisdictions but what they have in common is that they provide for a relaxation of directors' fiduciary duties. Their

⁶⁸ See, e.g., Pierre-Henri Conac, *supra* note 26, at 195.

key principle, as expressed in German and Italian corporate law statutes as well as by French courts, is that directors of a group subsidiary may adopt decisions that are functional to the “interest of the group,” even when they are disadvantageous for the subsidiary itself, provided that the harm so inflicted to the subsidiary receives proper compensation⁶⁹ or, in an even more enabling version of this rule, compensation may reasonably be expected to occur in the future.⁷⁰

In a companion paper we show that the benefits of this special regime are much more limited than their supporters believe, at least wherever, like in continental Europe, litigation over director fiduciary duties is rare.⁷¹ We also highlight that the risk of increased agency costs and adverse selection problems that these regimes entail is high.⁷² Here, the point we make is that none of the rationales for MCOGs that we have identified in Section II can be relied upon to support a special group law regime. Quite the opposite, they reinforce the idea that intra-group interactions should be treated no differently than other conflicted transactions.

Consider, first, the two benefits inherent to the MCOG form, namely enhanced transparency/reduced information asymmetry⁷³ and improved firm management.⁷⁴ For either of those benefits to play out the listed subsidiary must be granted a significant degree of independence from the rest of the group. Were that not the case and the listed subsidiary were to be managed just like any other division of the larger group (i.e., as a company engaging frequently in intragroup exchange and free from fair-price constraints), the gains in transparency and incentive alignment from the separate listing would be lost. In fact, the high number of IGTs, coupled with the uncertainty as to their fair pricing, would blur the separate picture that the subsidiary’s financial reports would be meant to provide, making it much harder to gauge the financial performance of the subsidiary and hence of its management team. This is precisely the effect of special group rules, as they allow controllers to deviate from fairness constraints in intragroup exchange by letting subsidiary directors execute IGTs at disadvantageous terms for

⁶⁹ For Germany *see* AktG, § 311; for France *see* the so called “Rozenblum doctrine” articulated by the Cour the Cassation (Cour de Cassation, Chambre criminelle, feb. 4 1985, no 84-91.581, in *Revue des Sociétés* 648 (1985)); for Italy *see* Art. 2497, para 1, Civil Code.

⁷⁰ The latter is the version adopted by the European Model Companies Act, a model law crafted by a group of European academics. *See* Paul Krüger Andersen et al., *European Model Companies Act (EMCA)* (2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2929348.

⁷¹ *See* Enriques & Gilotta, *supra* note 27, at 486-96.

⁷² *Id.* at 496-502.

⁷³ *See supra* section II.A.

⁷⁴ *See supra* section II.B.

their company. Thus, a regime of this kind would undercut MCOGs' specific functions of improving transparency and management and hence the related benefits for shareholders.⁷⁵ In other words, it would make it harder for MCOGs to perform their value-creation function.

Let us now turn to MCOGs' contingent benefits, starting from that of achieving the same result of dual class shares where the relevant jurisdiction prohibits or restricts such arrangements.

The main rationale for restrictions against dual class shares is the risk of mismanagement and abuse (including tunnelling) that they entail.⁷⁶ If MCOGs are a way to avoid such restrictions,⁷⁷ why should policymakers treat them more benevolently? The presence of multiple different entities linked by a chain of controlling equity stakes, in addition to increasing incentives for value diversion much in the same way as dual class shares do,⁷⁸ makes tunnelling easier than in the case of a single-entity firm (or wholly owned group).⁷⁹ If the aversion against dual class shares is motivated by concerns over tunnelling and mismanagement, the same concerns should lead policymakers not to enact lenient rules for MCOGs when they are used as functional substitutes of dual class shares.

Rather, if policymakers tolerate MCOGs as a way to let controllers avoid the strictures of one-share-one-vote policies, the straightforward solution would be to abandon such policies. And, to deal with the stock of pyramidal groups present when such policies are reviewed, rather than relaxing self-dealing rules across the board, it would be best to provide for rules easing the transition from a pyramidal group to one

⁷⁵ This intuition is in line with the finding by Apostolos Dasilas & Stergios Leventis, *The Performance of European Equity Carve-outs*, 34 J. FIN. STABILITY 121, 127 (2018), that the market reaction to equity carve-out announcements is more positive in European countries with a better record of minority shareholder protection.

⁷⁶ See, e.g., Bebchuk et al., *supra* note 61, at 301-305. See also, more recently, Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585 (2017) (arguing that the efficiency of dual-class shares decreases over time and thus that perpetual dual-class shares are an undesirable corporate arrangement).

⁷⁷ See *supra* section II.C.

⁷⁸ Similar to dual-class shares, pyramids increase the wedge between ownership and control, allowing controllers to control the firms at the bottom of the pyramid with an often negligible equity investment. See *supra* Figure 1 for an emblematic example.

⁷⁹ See *supra* text accompanying notes 12-16.

where the controller retains stable control over the single listed entity arising out of the restructuring.

Now consider the political justification for MCOGs as tools to enable foreign control of domestic firms in countries with mildly protectionist barriers to cross-border takeovers: its very logic is at odds with a regime that grants greater discretion—and thus greater power—to controllers as a matter of corporate law. By increasing controllers’ power over the company, such a regime would correspondingly decrease domestic policymakers’ direct or indirect influence over it. While lower political influence might be good for the subsidiary’s profitability, it would clearly be at odds with policymakers’ aversion to foreign control over domestic firms.

Finally, consider the path dependence rationale for MCOGs.⁸⁰ In line with this rationale, these groups would be worth more if they were organised as non-MCOGs, transition costs being the reason for their persistence. Here again, a regime favoring the transition to more efficient ownership structures, that is, reducing transition costs, would be the best solution. Relaxing rules on self-dealing to ease the integrated management of the MCOG would have the side effect of also facilitating the extraction of private benefits of control by the controlling shareholder, and therefore of raising transition costs, because the controlling shareholder will have to be compensated for the loss of a higher amount of private benefits than under a more stringent regime. And, incidentally, if the reason why MCOGs persist is in fact that controllers can extract high private benefits of control, then it stands to reason that policymakers should not adopt policies making the extraction of private benefits easier, as this would make controllers even more hostile toward the transition to more efficient structures.

To sum up, from the finding that there may be specific rationales that may make MCOGs efficient (assuming the benefits attached to those rationales are higher than the costs of allowing them) it does not follow that standard self-dealing restrictions must be relaxed or removed. Quite to the contrary, we have seen that those specific

⁸⁰ See *supra* section II.E.

rationales rather justify stringent rules on self-dealing that ensure (or at least are not detrimental to) the independent management of minority co-owned subsidiaries.

CONCLUSION

Minority co-owned groups are notoriously problematic: structuring an economically unitary firm as a constellation of minority-participated subsidiaries is a tremendously effective way for controllers to extract larger private benefits to the detriment of minority shareholders. Despite this, continental European policymakers and legal scholars have either already adopted or proposed special regimes that, by relaxing directors' fiduciary duties in the context of groups, make not only their integrated management but also tunnelling easier. Underlying these policies is the idea that there are benefits attached to this organizational form. This essay accepts this logic and explains the presence of MCOGs as being linked to value-enhancement features which may explain this organizational structure other than as an instrument to facilitate tunnelling.

After assuming, for the sake of argument, that MCOGs' benefits to the economy are higher than their costs, this essay has shown that none of the value-enhancement features it identifies justifies, whether logically or politically, the policy of relaxing directors' fiduciary duties to facilitate the integrated management of MCOGs. Quite the opposite, each of the value-enhancement features identified and discussed in this essay is consistent with the view that directors' duty to always act in the company's best interest (and, more generally, standard corporate law rules against unfair self-dealing) should fully apply to these groups' subsidiaries.

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