26846

PUBLIC POLICY FOR THE

Privatesector

Note No. 195 September 1999

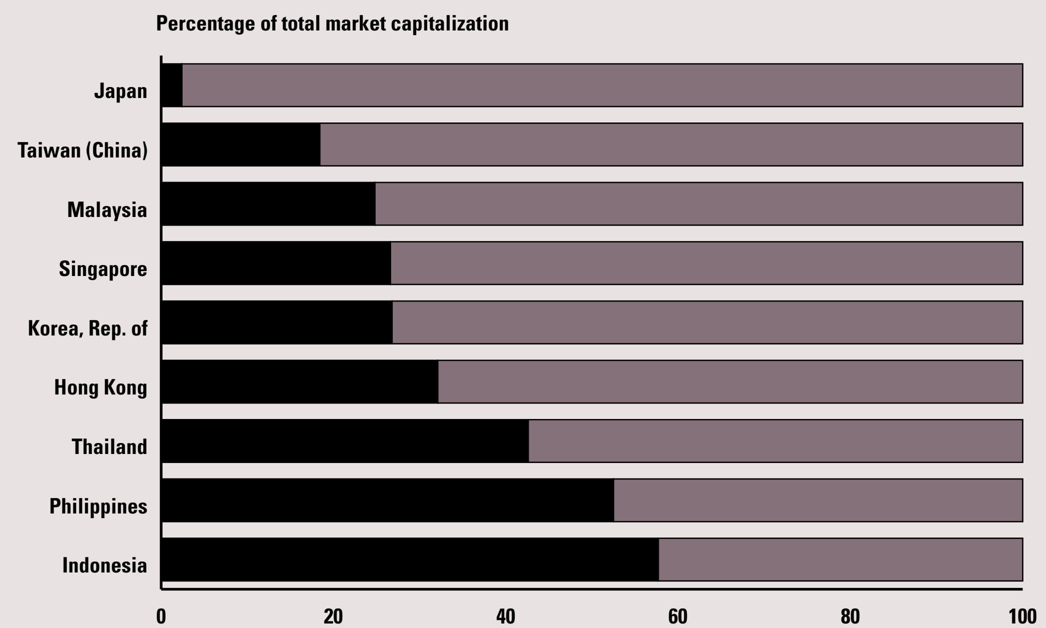
Who Controls East Asian Corporations—and the Implications for Legal Reform

Stijn Claessens, Simeon Djankov, and Larry H. P. Lang

This Note reports an analysis of ultimate control in nearly 3,000 publicly traded companies in December 1996—before the financial crisis—in nine East Asian economies: Hong Kong, Indonesia, Japan, the Republic of Korea, Malaysia, the Philippines, Singapore, Taiwan (China), and Thailand. The analysis shows that the ten largest families in Indonesia, the Philippines, and Thailand control half the corporate sector (in terms of market capitalization), while the ten largest in Hong Kong and Korea control about a third (figure 1). More extreme, in Indonesia and the Philippines ultimate control of about 17 percent of market capitalization can be traced to a single family.

While the analysis shows that ownership concentration in these countries is in keeping with levels in other developing and some industrial countries, its findings shed light on the viability and vulnerability of corporate governance structures in East Asia. The concentration of corporate wealth and the tight links between corporations and government may have impeded legal and regulatory development, directly or indirectly. To create incentives for better governance, East Asian governments may have to promote more competition, even by breaking up conglomerates, and curtail related-party lending by restricting ownership of banks.

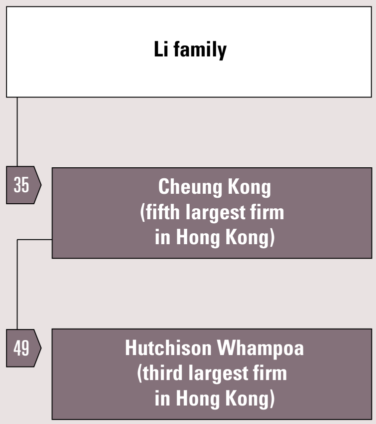
FIGURE 1 MARKET CAPITALIZATION CONTROLLED BY TOP TEN FAMILIES, 1996



Source: Claessens, Djankov, and Lang 1999.

The World Bank Group ▪ Finance, Private Sector, and Infrastructure Network

FIGURE 2 A PYRAMID OWNERSHIP STRUCTURE



Note: Numbers refer to percentage ownership shares.
Source: La Porta, Lopez-de-Silanes, and Shleifer 1999.

Ultimate control

Control is defined as 20 percent of voting rights (as in the methodology developed in La Porta, Lopez-de-Silanes, and Shleifer 1999). Corporations are divided into two categories: those widely held and those with ultimate owners. A widely held corporation is one in which no owners have significant control rights. Ultimate owners are of four categories: families (including individuals with large stakes), the state, widely held corporations, and widely held financial institutions such as banks and insurance companies.

The results of the analysis show family control in more than half the corporations in East Asia (table 1). But significant cross-country differences exist. In Japan corporations are generally widely held, while in Indonesia and Thailand they are mostly family controlled. And state control is significant in Indonesia, Korea, Malaysia, Singapore, and Thailand.

The analysis shows that in many East Asian economies control is enhanced through pyramid structures and cross-holdings, and voting rights consequently exceed formal cash flow rights (table 2). Pyramid schemes generally involve using control of a publicly held firm to gain control of others (as in figure 2). Management is rarely separated from ownership control, and in two-thirds of firms that are not widely held, the managers are related to the controlling shareholder.

Patterns of controlling ownership stakes differ across countries, with ownership concentration generally diminishing with the level of economic and institutional development. This negative association suggests that companies gravitate toward less concentrated control as their countries become wealthier.

Some of the differences in ownership patterns arise from differences in company and securities laws across countries. Various rules determine the ownership stake needed to exercise effective control, such as the minimum percentage of shareholdings required to block major decisions or to call an extraordinary shareholders meeting. In Korea restrictions on the voting rights of institutional investors in listed companies and high minimum percentages required to file class action suits (30 percent of the vote) imply that relatively small ownership stakes can result in effective control.

A possible factor in the degree to which corporations are widely held is the evolution of capital markets. In Thailand a formal stock market was established only in 1975—and in Indonesia, in 1977—while the stock market in Japan has existed since 1878, and the Stock Exchange of Hong Kong since 1891. Furthermore, in Japan following World War II, the Occupational Forces pursued a deliberate policy of dispersing ownership (Aoki 1990).

Family control

Perhaps a more meaningful focus of analysis, particularly if the concerns are market entry, access to financing, and government policy, is the pattern of control by family groups. To

TABLE 1 CONTROL OF PUBLICLY TRADED COMPANIES IN EAST ASIA, 1996
Percent, except where otherwise specified

			Corporations with ultimate owner			
Economy	Number of corporations in sample	Widely held corporations	Family	State	Widely held financial institution	Widely held corporation
Hong Kong	330	7.0	71.5	4.8	5.9	10.8
Indonesia	178	6.6	67.3	15.2	2.5	8.4
Japan	1,240	85.5	4.1	7.3	1.5	1.6
Korea, Rep. of	345	51.1	24.6	19.9	0.2	4.3
Malaysia	238	16.2	42.6	34.8	1.1	5.3
Philippines	120	28.5	46.4	3.2	8.4	13.7
Singapore	221	7.6	44.8	40.1	2.7	4.8
Taiwan (China)	141	28.0	45.5	3.3	5.4	17.8
Thailand	167	8.2	51.9	24.1	6.3	9.5

Note: Weighted by market capitalization.
Source: Claessens, Djankov, and Lang 1999.

TABLE 2 MEANS OF ENHANCING CONTROL IN EAST ASIAN CORPORATIONS, 1996
Percentage of sample

Economy	Cap = 20%V	Pyramids with ultimate owners	Cross-holdings	Controlling owner alone	Management
Hong Kong	18.84	25.1	9.3	69.1	53.4
Indonesia	19.17	66.9	1.3	53.4	84.6
Japan	19.89	36.4	11.6	87.2	37.2
Korea, Rep. of	19.64	42.6	9.4	76.7	80.7
Malaysia	18.11	39.3	14.9	40.4	85.0
Philippines	18.71	40.2	7.1	35.8	42.3
Singapore	19.91	55.0	15.7	37.6	69.9
Taiwan (China)	19.61	49.0	8.6	43.3	79.8
Thailand	19.22	12.7	0.8	40.1	67.5
All	19.46	38.7	10.1	67.8	57.1

Note: Cap = 20%V refers to the average percentage of book value of common equity required to control 20 percent of the vote. *Controlling owner alone* means that there is no second owner holding at least 10 percent. *Management* means that the chief executive officer, board chairman, or vice chairman is a member of the controlling family.
Source: Claessens, Djankov, and Lang 1999.

TABLE 3 HOW CONCENTRATED IS FAMILY CONTROL?

		Percentage of total market capitalization controlled	
Economy	Average number of firms per family	Top family	Top ten families
Hong Kong	2.36	6.5	32.1
Indonesia	4.09	16.6	57.7
Japan	1.04	0.5	2.4
Korea, Rep. of	2.07	11.4	26.8
Malaysia	1.97	7.4	24.8
Philippines	2.68	17.1	52.5
Singapore	1.26	6.4	26.6
Taiwan (China)	1.17	4.0	18.4
Thailand	1.68	9.4	46.2

Note: Data refer to 1996.
Source: Claessens, Djankov, and Lang 1999.

capture this, the analysis looked first at the average number of firms in the sample controlled by a single family. That number is largest in Indonesia—more than four—and smallest in Japan—about one (table 3).

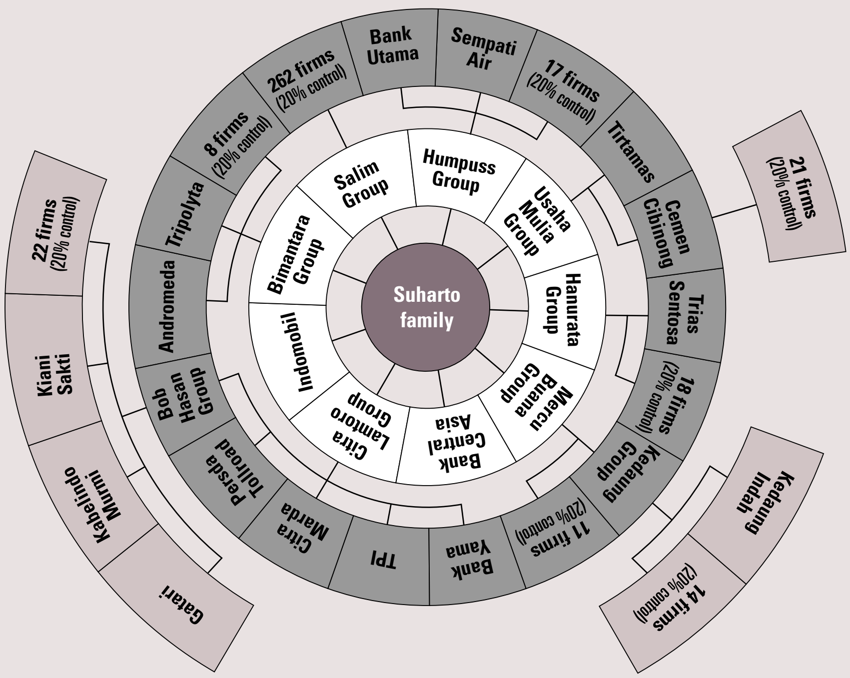
These numbers already suggest that in most East Asian economies ultimate control of the corporate sector rests with a small number of families. Further evidence is the number of firms and the market value of assets controlled by the largest family group in each country. The largest family group in a country does not necessarily coincide with the largest business group. In Japan the largest *keiretsu*—the Mitsubishi Group—controls more than 400 affiliated firms, but does not have a single controlling family. In Indonesia the largest conglomerate is the Salim Group, which is controlled mainly by Soedono Salim but also in part by the Suharto family. The Suharto family has many other holdings—members collectively control assets worth US$24 billion in the sample firms—and is considered the largest stockholder in Indonesia (figure 3). The largest family holder in terms of assets across all nine economies is the Chung Ju-Yung family—which owns Hyundai and its related companies—with holdings worth US$48 billion.

Another measure of wealth concentration is the share of market capitalization held by the top family or by the top ten. In Indonesia 16.6 percent of market capitalization can be traced to the ultimate control of the Salims—and in the Philippines, 17.1 percent to the Ayalas (figure 4). The top ten families in Indonesia and the Philippines control more than half the corporate sector (57.7 percent and 52.5 percent). Control is also concentrated in Thailand (46.2 percent) and Hong Kong (32.1 percent). In Korea, Malaysia, and Singapore the top ten families control a quarter of the corporate sector. In Japan family control is insignificant—the top ten own only 2.4 percent of market capitalization.

Concentration, rule of law, and corruption

There are many direct and indirect channels through which business may influence government, and government may play a role in busi-

FIGURE 3 THE SUHARTO GROUP



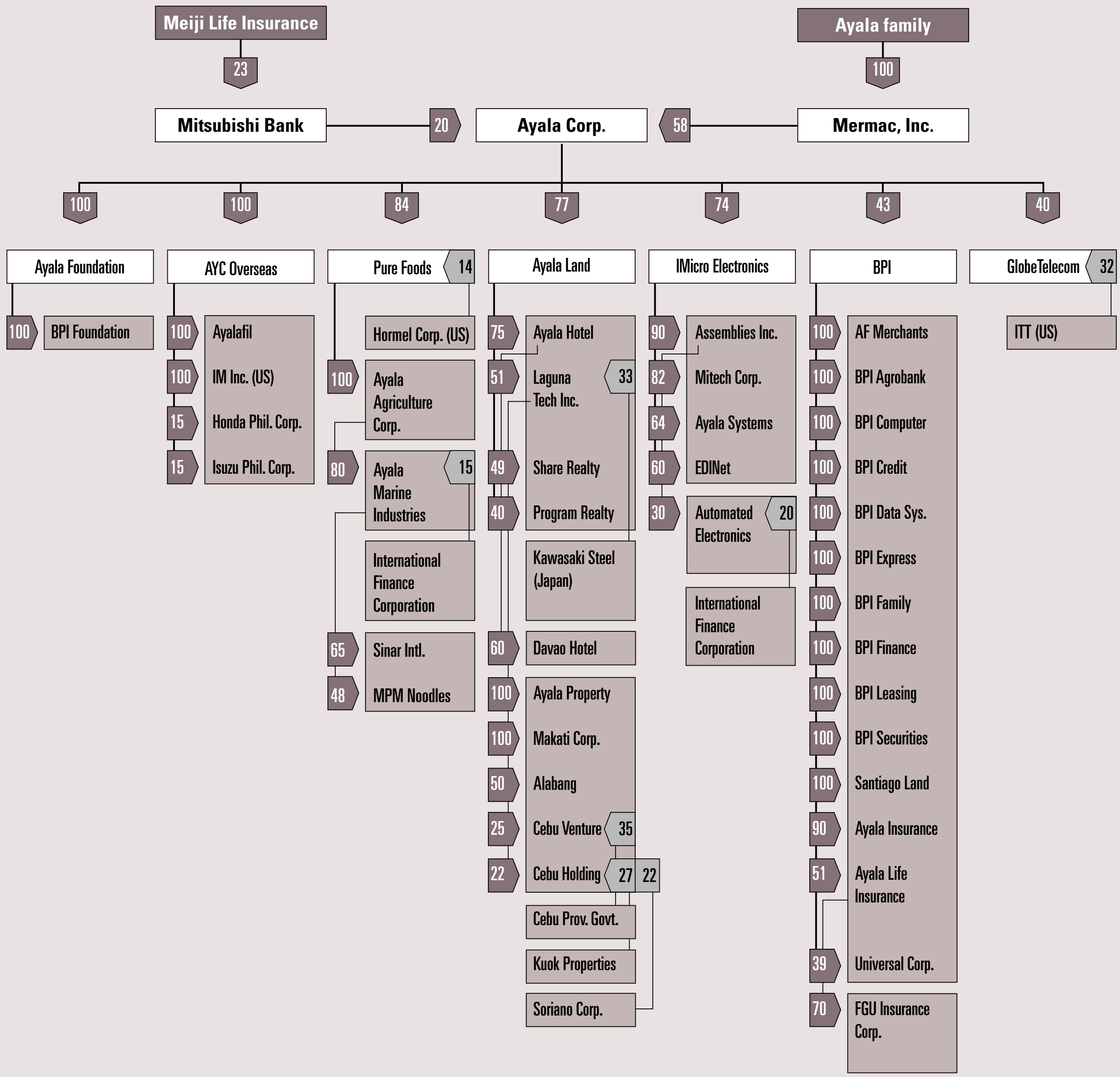
Source: W.I. Carr 1997.

ness. For example, senior government officials may give preferential treatment to family members. A case in point is the business empire of the Suharto family in Indonesia. Business groups led by Suharto's children, relatives, and business partners, many of whom also serve in the government, control 417 listed and unlisted companies. The most direct link, of course, is through the large state-controlled companies prevalent in Malaysia and Singapore.

Government and business may also be linked through indirect control of companies by ruling political parties. In Taiwan (China) the main political party, Kuomintang, has a controlling stake in 155 companies, some of them overseas. Kuomintang's corporate holdings range from scores of small textile and pharmaceutical businesses to highly protected financial oligopolies with exclusive rights over a wide array of investment transactions. Many companies operate in defense-related industries and are thus exempt from financial and ownership disclosure requirements, making it difficult to estimate the true size of the party's corporate portfolio (Baum 1994). The main political parties in Malaysia—Umno and the Malaysian Indian Congress—also have substantial business holdings.

Have the concentration of wealth and the important links between government and business helped shape the legal system in some East Asian economies? In the wake of the East Asian financial crisis, many analysts have argued that if a few

FIGURE 4 THE AYALA GROUP



Note: **The numbers refer to percentage ownership shares. BPI is the Bank of the Philippine Islands.**
Source: **Koike 1993.**

TABLE 4 DOES CONCENTRATED FAMILY CONTROL SHAPE LEGAL SYSTEMS?

Economy	Concentration of family control[a] (percent)	Judicial efficiency index[b]	Rule of law index	Corruption index
Hong Kong	34.4	10.00	8.22	8.52
Indonesia	61.7	2.50	3.98	2.15
Japan	2.8	10.00	8.98	8.52
Korea, Rep. of	38.4	6.00	5.35	5.30
Malaysia	28.3	9.00	6.78	7.38
Philippines	55.1	4.75	2.73	2.92
Singapore	29.9	10.00	8.57	8.22
Taiwan (China)	20.1	6.75	8.52	6.85
Thailand	53.5	3.25	6.25	5.18

Note: Data refer to 1996.

a. Share of total market capitalization controlled by the top fifteen families.

b. Assesses the efficiency and integrity of the legal environment as it affects business, particularly foreign firms.

Source: Claessens, Djankov, and Lang 1999.

families play a large role in the corporate sector and the government is heavily involved in and influenced by business, the legal system is less likely to evolve in a way that protects minority shareholders and promotes transparent, market-based activities. But little evidence has been collected to support this argument.

To test the argument, the analysis compared the concentration of corporate control by families with three indexes of judicial and legal development: efficiency of the judicial system, rule of law, and degree of corruption (La Porta and Lopez-de-Silanes 1998). The indexes run from 1 to 10, with 10 indicating the most efficient judicial system, strongest rule of law, and least corruption. The correlations between the market capitalization share of the fifteen largest families and low scores for the three indexes are very strong (table 4). This result suggests that the concentration of corporate control plays a major part in the evolution of the legal system—that there are relationships between the ownership structure of the corporate sector and the level of institutional development. Moreover, La Porta and others (1998) show a relationship between the ownership structures of individual corporations and judicial and legal development.

Conclusion

In most East Asian economies wealth is concentrated in the hands of a few families and links between government and business are extensive. These features may have directly or indirectly impeded legal and regulatory development. Thus relationships between patterns of ownership and the characteristics of legal systems are not necessary casual, as has been suggested for some countries. These findings imply that in some East Asian economies successful legal and regulatory reform may require changes in ownership structures and concentration of wealth. Findings also suggest that insider control may have contributed to the weak performance and risky investments of many East Asian corporations before the financial crisis.

References

Aoki, Masahiko. 1990. "Toward an Economic Model of the Japanese Firm." *Journal of Economic Literature* 28:1–27.

Baum, Julian. 1994. "The Money Machine: Taiwan's Kuomintang." *Far Eastern Economic Review,* August 11, pp. 62–66.

Claessens, Stijn, Simeon Djankov, and Larry H.P. Lang. 1999. "Who Controls East Asian Corporations?" Policy Research Working Paper 2054. World Bank, Financial Sector Practice Department, Washington, D.C.

Koike, Kenji. 1993. "The Ayala Group during the Aquino Period: Diversification along with a Changing Ownership and Management Structure." *Developing Economies* 31:442–63.

La Porta, Rafael, and Florencio Lopez-de-Silanes. 1998. "Capital Markets and Legal Institutions." Paper presented at the Fourth Annual Conference on Development in Latin America and the Caribbean, June 28–30.

La Porta, Rafael, Florencio Lopez-de-Silanes, and Andrei Shleifer. 1999. "Corporate Ownership around the World." *Journal of Finance* 54:471–518.

La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny. 1998. "Law and Finance." *Journal of Political Economy* 106:1113–55.

W.I. Carr, Banque Indosuez Group. 1997. *Indonesian Group Connections.* Jakarta.

Stijn Claessens (cclaessens@worldbank.org), Lead Economist, Financial Sector Strategy and Policy, Simeon Djankov (sdjankov@worldbank.org), Financial Economist, Financial Sector Strategy and Policy, and Larry H. P. Lang (llang@baf.msmail.cuhk.edu.hk), Professor, Chinese University of Hong Kong

To order additional copies please call 202 458 1111 or contact Suzanne Smith, editor, Room F11K-208, The World Bank, 1818 H Street, NW, Washington, D.C. 20433, or Internet address ssmith7@worldbank.org. The series is also available on-line (www.worldbank.org/html/fpd/notes/).

Printed on recycled paper.