

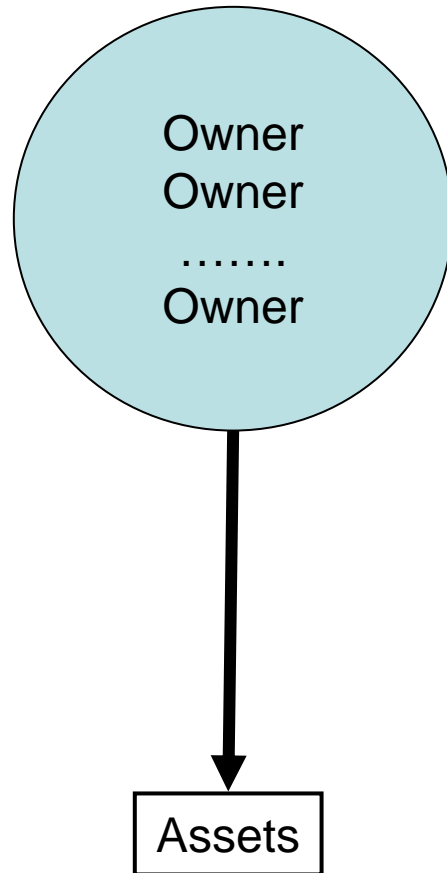
The Nature of the Business Corporation

Based on an article by
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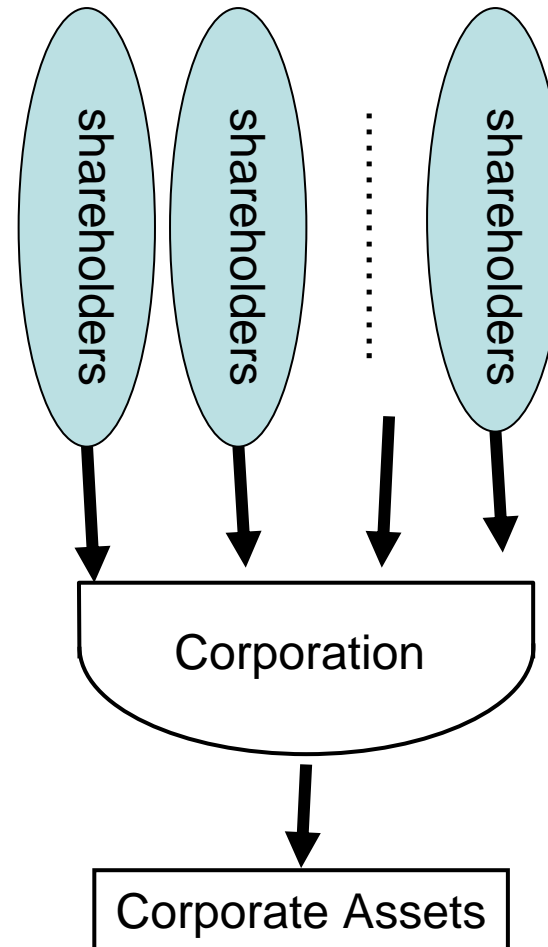
Who are the owners of the corporate assets?

- Corporate assets are legally owned by the corporation as a “legal person”.
- Then, who owns the corporation?
 - The shareholders do.
- A shareholder owns a fraction of the corporation as a *thing*. However, she/he does not directly own the corporate assets.

The Classical Firm



The Business Corporation



A classical firm is a nexus of contracts

- In a classical firm, each individual owner has an equal right and duty to the contracts. (Fig.3)
- Any contract must be endorsed by other owners if the owner who wrote it departs the firm. This creates enormous transaction costs if outside relations are widespread.

The corporation is not a nexus of contracts

- We can save the transaction costs greatly by creating a corporation that has the same legal capacity as the shareholders have.
- A corporation is created not only by the agreement of the shareholders, but by the *wish* and the *recognition* held by the outside parties.

The corporation as a person/thing duality

- As a person, as a subject of property rights, a corporation owns the corporate assets.
- As a thing, as an object of property rights, a corporation is owned by the shareholders.

Corporate Personality Controversy

- Corporate *Nominalism*: The corporation is merely a contractual association of shareholders.
- Corporate *Realism*: The corporation is a fully fledged organizational entity, whose legal personality is an external expression of its real personality in the society.
- We can eliminate either personality or thingness, starting from the duality nature of the corporation.

The fragmented corporate ownership

- Berle and Means (1932) argued that large corporations were effectively controlled by professional managers, due to the fragmented ownership of the corporate shares. This was viewed as a triumph of corporate realism.
- However, the threats of outside takeovers discipline managers who fail to promote shareholder interests. This is the return of corporate nominalism.

Eliminating Personality

- If a single individual or group owns more than 50% of the shares of a corporation, it will lose its personality, and become a mere object of property right.
- *TOB*: A corporate raider offers a higher price to buy the shares of the targeted corporation.
- *LBO*: A corporate raider can finance its TOB by borrowing money and pledging the very assets of the targeted corporation as collateral.

The Extreme Nominalism

- The legalization of holding corporation has opened the way to the pyramidal system of corporate ownership and control.
- A share only slightly greater than 50% suffices for a full control of a corporation.
- As more layers are added to the ownership hierarchy, capitalists at the top can multiply the controlling power by the number of the hierarchical layers.

Case Studies

- The pyramidal system has the following examples.
 - The prewar Japanese *zaibatsu*.
 - The present-day Italian family enterprises
 - Korean *chaebols*.
- *Livedoor*, an Internet portal site owner, has bought more than 50% of *Nippon Radio Broadcasting*, which owns more than 20% of *Fuji Television*, the leading TV network center of Japan.

Horiemon

- *Takafumi Horie* was a leading entrepreneur in the IT industry in early 2000s.
- He founded an internet service provider in late 90s, when he was an undergraduate in the University of Tokyo.
- His current company, *Livedoor*, extended its business along the IT bubble, and was listed in TSE in early 2000.
- He said, “Even love can be purchased by money”.



Nippon Broadcasting System (NR)

- Nippon Broadcasting System (Nippon Radio or NR in this lecture) owned 20% of the shares of the Fuji TV, which is a major TV broadcast center in Japan.
- Horiemon purchased slightly less than half shares of NR, and became the largest shareholder of the Fuji TV.
- He wanted to control Fuji TV.
- His investment was financed by borrowing from the Lehman Brothers.

Fuji TV

- Fuji TV issued the rights to purchase new shares of the company only to the shareholders who were friendly to the Fuji management.
- Horiemon sued the Fuji to the court, which sentenced that such an exclusive rationing of corporate shares was unfair.
- After the negotiation, Fuji TV purchased their stocks from Horiemon at a premium price, which was much higher than its market price, and gave a huge profit to Horiemon.

Nippon Radio and Fuji TV

- NR was founded in 1953 by the Shikanai family.
- NR founded the Fuji TV as a subsidiary company in 1957.
- Now the Fuji TV is much larger than Nippon Radio.
- The Fuji manager has reduced the influence of the Shikanai family by issuing new shares to other companies except for NR.
- However, NR was still the largest shareholder of the Fuji TV, when Horiemon bought their shares.

The aftermath

- In 2005, Horiemon ran for the general election to support the victory of Koizumi, while he failed in his seat.
- In 2006, Horiemon was arrested by the police and prosecuted for cheating the accounting report of the Livedoor.
- His decline was interpreted by young people as a symbol of an end to the success stories of young entrepreneurs in Japan.

Eliminating Thingness

- However, a corporation can be free from any control from real human beings, by owning its shares.
- Legally it is impossible because the repurchased shares lose their voting rights and are kept in the corporate treasury's safety box ("treasury stocks").

Cross-shareholding

- However, two corporations can hold a majority of each other's shares, and exclude any control of real human beings.
- Again this is impossible because there are legal limits on the cross-shareholding between corporations.
- Yet it is possible to circumvent this difficulty if many corporations form a group and hold each others' shares, like Japan's *Keiretsu*.

A Case Study

- Fuji TV was legally owned by Nippon Radio, which was owned by Shikanai family, the founder of the Fuji-Sankei Corporate Group, while Fuji TV was the leader in the group.
- The Fuji TV issued new shares, which were held by many corporations in and out of the group.
- This decision was initiated by the Fuji managers in order to reduce the control power of the Shikanai family.

The Indeterminacy Principle

- The *two-tier* ownership system of the corporation enables a wide variety of organizational forms of a corporate group.
 - Pyramidal system VS Horizontal network.
 - Concentrated ownership through the hierarchy VS Dispersed ownership with professional managers.
- The corporate law cannot pin down what types of corporate organizations to be chosen and realized.