Harmonising Company Laws Within the European Union: Economic Implications for Firms with Dual Class Shares

Projektbeskrivelse

Background

An increasing takeover activity within the European Union extends the external pressure upon firms to allocate production resources efficiently and yields at least three wealth enlarging effects. First, it creates a better standard for corporate governance, since poor managers would be replaced more often. Second, it increases the focus on value maximisation, since firms that do not create maximum value would be targets for either friendly or hostile takeovers. Third, it creates a more efficient allocation of the production resources between European countries, due to an increasing number of cross-border takeovers.

This is basically the economic background for the EU initiative on the harmonisation of company laws. The latest proposal in this ongoing process proposed a number of changes to the existing company laws around Europe, some of which have stirred an intense debate among economists about the economic consequences of the proposed changes. The most controversial proposals are, first, the introduction of a Break-Through rule, which means that nay person who owns more than 75% of the cash flow in a corporation should also have absolute control and, second, the introduction of a proportionality principle, saying that the control any owner should achieve over a corporation must be proportional to the residual income right of the same owner.

To a large extent the organisation of firms in Denmark follows a Continental European pattern. Most publicly traded companies have concentrated ownership with relatively few large controlling owners. These are often funds or families. Further, there are relatively few publicly traded companies. These components are a common feature in Continental Europe. On the other hand there are also important differences between Denmark and Continental Europe, which can be important in relation to the harmonisation of the company laws in Europe. First, most important, dual class shares are a typical remedy to concentrate the ownership in Danish (and Scandinavian) firms. Second, pyramidal structures are used less frequently in Denmark, Finland and Sweden compared to the rest of Europe. Further, commercial funds are used frequently in Denmark. These funds often control the majority of the votes in the company.

The proposed harmonisation of the European company law is by many observers seen as a direct attack on dual class shares. Since this type of organization is so common in Denmark, it is likely that these changes may have significant impact on Danish firms and the Danish economy

Objectives

(1) To analyse the economic consequences of the proposed changes to the European company laws and to identify which firms within the European Union are likely to be affected by these changes. By changing the corporate governance system in Europe we expect that the harmonisation process will have significant economic impact on firm level and on country level within the Union.

(2) To analyse the need for the proposed changes. We want to investigate the economic costs and benefits of organising firms with dual class shares (A and B shares), which is the one organization form under particular attack from the proposed proportionality principle and Break Through rule

Description of work/methodology

First, we characterise the typical ownership structures within the European Union. To do this we need to collect data from the individual countries within the Union. Then we analyse the distribution of cash flow and control rights for European firms with dual class shares to understand why firms have chosen this method of organisation. We proceed to identify firms that will be affected by the proposed changes to the European company law.

Second, we analyse the ned for these changes by investigating if the affected ownership structures are less value creating than the proportional ownership structure supported by the Commission.