



# Law and Corporate Governance

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# Law and Corporate Governance

- > The History of CG
- > The Legal Origins -theory
- > Corporate Law and Corporate Governance
- > Legal Strategies for Corporate Governance



# History of Corporate Governance

elsinki

# History of Corporate Governance

- > Reputational governance
  - Banking: Rothschild's
  - CG: J.P. Morgan
- > Early institutionalization
  - Authorization of early corporations
  - Stock exchange rules
- > Managing conflicts of interest remained problematic
  - End-game situations
  - Insiders vs. Outsiders
  - Scandals

# History of Corporate Governance

- > The Separation of Ownership and Control
  - Jensen & Meckling
- > The Political Preconditions for Separation
  - The peace dividend
  - Experiences from transitional economies
- > The Role of Law in supporting dispersed ownership
  - Regulating private benefits of control
  - Regulating conflicts of interest
  - Requirements on legal systems?
- > Alternative elements (other than law)?

# Legal origins theory

- > The argument is made that in states with inadequate minority protection regulation, investors must seek to protect their investment by retaining the possibility to exercise direct control. Concentrated ownership can therefore be seen as a response to inadequate investor protection. Correspondingly, dispersed ownership would be found in states with a high level of investor protection.
- > But CO also found in states with low PBC / high levels of investor protection



# Corporate Law

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# Corporate Law and Corporate Governance

- > Corporate Law
  - Default model for organizing economic enterprise
  - Legal rules to some extent "arbitrary"
    - Control rights vs cash-flow rights
    - Majority rules
    - Capitalization
  
- > Factors that shape corporate law
  - Industrial structures
  - Patterns of corporate ownership
  - Political forces
  - International coordination / competition

# Finnish corporate law

- > Developed during the 20th century
- > Based on Nordic models
- > Traditionally "bank-friendly" / "owner-friendly"
  - Insolvency law
  - Creditor rights
  - Taxation of dividends
  - large shareholder power
  - GM and bd election process
  - A/B shares and taxation
- > "Recent" developments
  - Financial crisis (labour nothing to lose => increase of min. rights)
  - International investors => (Anglo-saxon "CG forms" introduced)
  - EU => (stronger impact on small countries)

# Key areas of corporate law for CG

- > Financial Structure and shareholder rights
  - Equity, debt, hybrids
- > Minority shareholder protection
  - Control rights vs. cash-flow rights
  - Related party transactions
- > Significant Corporate Changes
  - Articles
  - New shares
- > Change of Control
  - Takeovers
  - Mergers



# Legal Strategies

# Legal Strategies

	Regulatory Strategies		Governance Strategies		
	Agent Constraints	Affiliation terms	Appointment Rights	Decision Rights	Agent Incentives
Ex Ante	<u>Rules</u>	<u>Entry</u>	<u>Selection</u>	<u>Initiation</u>	<u>Trusteeship</u>
Ex Post	<u>Standards</u>	<u>Exit</u>	<u>Removal</u>	<u>Veto</u>	<u>Reward</u>

Kraakman et al.

# Legal Strategies

## > Regulatory

- Board duties (standard)
- Redemption rights (exit)
- Transparency of holdings / related party transactions
- Shifted burden of proof

## > Governance

- Voting rights
- Qualified majority
- Board election mechanisms



# Observations

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- > Corporate law
  - "Arbitrary default model" reflecting industrial and political developments
  - Efficient?
- > Corporate Governance
  - "Securing your investments" (Shleifer & Vishny) OR
  - "Negotiating input and output from enterprise" (Hart, Zingales, Ilmonen)
  - CG must be understood in the broader institutional context

Thank you for your interest

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