Governance in a time of oligarchs:
the global challenge of closely-held and family-dominated companies

Minority shareholders in Russian metals company Norilsk Nickel are unhappy spectators to a depressing sideshow. From at least 2010, the company has been a public battleground between two oligarchs: Oleg Deripaska, who leads Rusal, and Vladimir Potanin through his investment vehicle Interros. Both Rusal and Interros own 25% of Norilsk and the oligarchs have been battling to leverage these shareholdings into control of the business and to squeeze the other out.

While each oligarch has representative directors on the board (including Deripaska himself, but not including Potanin), it seems clear that Potanin is in pole position. Interros won the key disputed resolutions at the 2010 AGM – and the Russian courts have rejected Rusal's writ against that result. Other courts around the world have also declined to alter the status quo. Now there are attempts to buy out at least a portion of the Rusal stake, though the Rusal board has so far declined to accept any offers.

In the meantime, minority shareholders in this public company – those who have stayed invested – can only look on with embarrassment. Their scope for influence on the outcome of this dispute is as limited as their scope for influence over whichever oligarch succeeds in consolidating his dominance of the business.

It has been a spectacular story, but it is only a particularly colourful example of a wider tendency: public companies which are dominated by a single individual who also controls a significant block of shares. This piece calls such individuals 'oligarchs' even though many of them would not in normal language be referred to as such; nonetheless this is an easy shorthand for those usually thought of as oligarchs as well as entrepreneurs or leaders of family-dominated businesses. Governance in a time of oligarchs brings huge challenges for the modern investor, and few have thus far considered what they might need to change in their approach to investment as a result of what is a growing trend. This paper aims to offer investors some tools to begin addressing this key issue of our times, and proposes potential actions which long-term shareholders might look to take.

The Nature of the Beast

Companies managed by their founders are attractive investments for the most part. Generally, they are that rare thing, a genuinely entrepreneurial public company, and institutional investors find the mix which they tend to offer of tight management and growth opportunities an inviting investment. There are a number of leading investors, particularly emerging market investors, who have an explicit or implicit approach of deliberately investing alongside such founder-managers, supporting them and taking the benefit of their business acumen and leadership.

Some but not all oligarch companies are such businesses run by their founders. But often instead, they are pre-existing businesses which have been taken forwards under the wing of an individual who had enough force of personality and sometimes enough political or other influence to take control and to take the company forwards in dramatic fashion, restyling the company in their own image and to a scale which suited the oligarch's perception of his or her own worth. Often they therefore do have some of the positive characteristics of founder-managed businesses: the entrepreneurialism and the hunger. Sometimes however, oligarch businesses are run more as personal fiefs in which maintaining control is more important than almost anything else. This view that a company is a personal fief can also create other risks, not least the risk that value will be appropriated into the pockets of one or more individuals rather than created to the benefit of all shareholders.

This risk of misappropriation of value from shareholders is something to which all companies dominated by an individual or family are prey – or at least it is a long-running fear for their minority investors. On rare occasions such individuals struggle to separate the company from their own personal wealth, or sometimes they just see such opportunities as a perk of their role or an entitlement because of their own – as they perceive it at least – clear worth to the business. It is for this reason that investors seek independent board oversight and clear regulations which protect their interests and so free them to invest with confidence.

And that need for independent board oversight is particularly acute for oligarch-dominated businesses because otherwise they can fall prey to the judgements of a single individual. It is hard enough in ordinary businesses for the CEO to hear voices of disagreement, and it is only the most self-aware CEOs who are able to create the atmosphere where they hear bad news or dissent from proposed courses of action. That challenge is very much greater for companies led by oligarchs, and rare will be the oligarch to foster such a culture of openness. This means that companies often perform spectacularly well as the controlling mind of the corporation drives it forward to exploit its opportunities; but it also means that that performance can fall apart just as rapidly as the company over-reaches itself with a large deal or otherwise, or its entrepreneurial and aggressive culture becomes damaging rather than a driving force.

All companies dominated by a single individual also face the key challenge of succession planning. Just as Oliver Cromwell, that scourge of Britain's hereditary monarchy, later fell into the trap of thinking the only individual capable of taking over his close-to-monarchical powers was his son, many founders and oligarchs fall into the trap of mixing personal and family feelings into the business decision-making on their successor. And too many of their boards fall into the trap of allowing these individuals to choose their own successor, enabling family feelings to take precedence over the needs of the business. So again, investors need strong boards capable of effectively challenging the thinking of the oligarch and willing to seek the best rather than just the easiest candidates for key roles.

A Global Challenge

It is not just in emerging markets that investors are facing these new oligarch-controlled businesses. A number of them are listed on developed market stock exchanges. There was consternation in the UK

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recently when much of the independent element of the board of Kazakh miner ENRC was ousted at a stroke, without any warning to the market that such an event might occur. This cannot be called a coup as the ousting was delivered by the votes of the major shareholders, who simply retained control through the process. Nevertheless, it proved a major shock to the other shareholders which led to a 26% derating of ENRC shares on governance grounds (according to Credit Suisse estimates) as a direct consequence of their loss of confidence in the effective independence of the board from the controlling shareholders – concerns given more spice because of perceptions that board relations had broken down over a deal which many minority shareholders struggled to see as in their interests. Ironically, this ousting was facilitated by a move to annual elections for all directors under the new UK Corporate Governance Code, a move which had been backed by most investors as an improvement in governance.

Similarly, North American investors were shocked to find the values of various Chinese companies listed on their markets plummet as confidence in their financial reporting evaporated. The most prominent of these was Sino-Forest, whose asset base and entire business model was called into doubt by a hedge fund and sometime analyst shop called Muddy Waters. Having been brought to market through what are tautologically called reverse mergers, these companies had not been subject to the usual vetting required of a company undergoing an IPO, and it seems clear that in at least some cases weaker companies were allowed onto the market than such vetting would usually allow. Some have made an analogy to the similar way in which Vallar and Vallares, two shell vehicles listed in London, provided routes to the UK market with relatively lower regulatory hurdles for the companies that they acquired (Bumi and Genel Energy respectively), while allowing the creators of the shell vehicles to enrich themselves significantly on the basis of these transactions alone. At one of these companies, Bumi, the mix of cultures has become a clash as the major shareholders, Indonesia's Bakrie family, began to fail to see eye to eye with much of their board, leading to significant recent board changes.

A recent academic article on Chinese companies found that in effect investors regard the entire market as an oligarchic state. The Value of Relationship-based and Market-based Contracting: Evidence from Corporate Scandals in China[1] found that investors in the market react much more strongly to scandals with implications for a company's relationship with the Communist Party hierarchy than those which simply have implications for the trustworthiness of company management. So-called relationship-based scandals – which involve such issues as bribing state officials or the theft of state assets – see share prices cut by a third; those defined by the authors as market-based scandals, which include accounting irregularities or theft of company assets, saw prices drop by less than 10% on average. Within China itself, merely lying to the market has limited impact; damaging key relationships is vastly more significant; the market believes that control and influence are the crucial determinants of success in this oligarchic state. These numbers represent the experience in Shenzhen and Shanghai; Sino-Forest's shares fell by a more dramatic 90%, so it is clear that these concerns play out differently in the rest of the world.

And oligarchs and oligarch-led companies are not simply an emerging market phenomenon, wherever the companies might choose to list: the dual-listed share structures of companies such as Google and News Corporation, and the even more extreme version of insider control posed by Facebook, in effect entrench an oligarchic control of those businesses even where their founders sell a majority of the economic interest in the company.

The founders of Google explicitly designed their capital structure to minimise the influence of public market shareholders on the company. They suggested that such investors could not be trusted to take a long term perspective and 'not be evil' in the firm's simplistic morality, and they therefore made sure that outside investors were largely silenced in the future running of the company. Investors have largely accepted this and are in effect just silent partners alongside the oligarchs who have cemented permanent control of the company despite selling the bulk of it. Facebook's plan goes a stage still further, with the proposed consolidation of voting power reinforced by shareholder agreements ensuring that no one but Mark Zuckerberg in effect has any power to influence shareholder decisions, any more than management decisions.

And some have suggested that the ethical failings within News International – with news sourcing apparently based on criminal activity – arise at least in part because of its dominance and that of its parent company, News Corporation, by a family and those who support the ongoing dominance by that family. Certainly it seemed apparent as the crisis unfolded that those executives with close relationships with the oligarchic family were supported beyond the point of good business sense. Perhaps there was less independent challenge throughout the organisation than there might have been.

A Need for Change

This dominance of some companies by oligarchs means that our normal approach to corporate governance is under challenge in these cases. Built in most countries on the foundation established by the Cadbury Committee in 1992, the 'comply or explain' model (adapted in a limited way in other markets to 'apply or explain' – in much of Europe – or 'if not, why not' in Australia), the current approach to governance generally relies on a situation where minority shareholders can have a clear influence through dialogue with boards and so can effect change where that is seen to be necessary.

Yet these oligarch-led companies have in many cases – not usually as explicitly as Google but with the same deliberate determination – excluded minority shareholder powers. And by limiting the influence of minority shareholders they have put the foundations of the world's usual governance model, the comply or explain approach, under strain. It is hard for minority shareholders to influence the boards of companies which can feel more clearly their need to be responsive to the views of

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major oligarchic shareholders. This fact was brought home very directly to many investors by the events at ENRC; it is being built into Facebook from its listing, as because of its dual class share structure and voting agreements it declares itself a controlled company.

This is a return to the world of Berle & Means, in their seminal work The Modern Corporation and Private Property[2]. A recent article suggested we have entered the 'Twilight of the Berle and Means Corporation'[3], and while it is true that we can no longer imagine a US where the whole economy is in the hands of a few paternalistic corporations which span multiple industries and employ tens and even hundreds and thousands of people, that same approach is not far from the economic model seen in, for example, India and South Korea.

And we have returned to Berle & Means in another way. Looking back, one of the most striking elements of their analysis is not the separation of ownership and control, which has become now an unsurprising part of our understanding of the role of the shareholder and the need for shareholders to manage the principal/agent problems which arise from the split of ownership and management. The most striking element for a modern reader is that Berle & Means suggest that not only are ownership and control separate but that each are also entirely separate from the third pillar, management. In other words, in a Berle & Means world management as well as ownership is separated from control.

When we think of the mighty joint chair/CEOs of US corporations who still in a few cases appear to control all they survey, including their own boards, this idea that there is a separation of management and control seems a peculiar notion. But when we enter the world of oligarchs, it is an analysis of vital importance. In many situations the modern oligarchs do not directly manage the companies which their ownership gives them the power to control; in many cases indeed they do not even sit on the boards of these companies. Instead, they sit in a nebulous world where they exercise great influence on what happens but are not subject to public accountability. If they direct matters, they do it as shadow directors and not as board directors who are at least obliged to go through the process of putting themselves up for election by the shareholders.

This is a further way in which the traditional corporate governance model is facing challenge – in many cases those who are fundamentally in control of some companies are not accessible for minority shareholders and so are not accountable to them. Even where the oligarchs do sit on the board, and were only re-elected because of a dual share class structure which in effect rigs the votes in their favour – as at News Corp – the embarrassment factor has not thus far been enough to encourage the significant board changes which the bulk of shareholders (setting aside the dual class share structure) clearly believe is necessary.

There follows a set of a dozen prescriptions for this new world order: a set of expectations that are necessary to ensure that investment continues to make sense in a world of oligarchs, and ensure that such companies can continue to gain the investment that they deserve.

Investors in Norilsk Nickel have gained some recent comfort with the addition of genuinely independent directors, not least including governance doyen Lucian Bebchuk (a professor and director of the programme on corporate governance at Harvard), and look forward to these individuals properly carrying out their crucial role as independent overseers of these businesses and their bosses. Yet unless further protections are in place, investors continue to take the risks inherent in investing alongside oligarchs.

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Approaches to the Problem

The following is a series of proposed approaches or improvements which may help alleviate the negative implications of the nature of many current companies coming to the financial markets. It is a set of proposals for a world of governance in a time of oligarchs.

Index and passive

Since most of these issues arise because many investors in effect find themselves compelled to buy these oligarch-owned businesses, particularly those listing on developed markets, because they are included in indices which they track, the best place to start in addressing these problems is to consider those indices and passive investment approaches more generally. In many cases it seems clear that investment bankers are explicitly exploiting the index tracking activities of investors to compel them to buy companies with clear issues for minority investors; in some cases, they are simply arbitraging the difference in valuations between companies listed on domestic markets and those listed on the major developed markets, by placing a veneer of proper governance on top of otherwise unchanged organisations.

The following are some ways in which it may be possible to start addressing these issues:

1. Reinvent our understanding of passive investment.

We have become lazy in our language. Most of us now entirely equate passive investment with index tracking. While it is true that index tracking – essentially, buy and hold the whole market – is a form of passive investment, it is very far from the only way to be passive.

Index tracking is attractive because it achieves the index return at a cost lower than active investment. While some active investors may achieve a premium return above the market index return – alpha on top of the market beta – it is a great challenge to find active investors with this ability, and very often their charges eat up much of the excess return they generate, and on occasions the whole of that excess return and more.

Passive investment has a slightly different philosophy. It shares some of the intention of index tracking in seeking to minimise fee levels – by avoiding or minimising transactional costs, investors can remove significant frictional costs on their performance. But the aim need not simply be to replicate the market; instead, passive investment could take the form of thematic or strategic stances in investments and a straightforward buy and hold approach. By the same token, a passive investor which is not an index tracker could take decisions which exclude investment in companies with low free floats or which list in a country different from their incorporation or from their predominant or sole country of operation.

Thus rather than having their investments chosen for them, and their investment approach subjected to arbitrage by investment bankers bringing companies to the market in ways specifically designed to achieve inclusion in indices and so inclusion in investor portfolios, institutions could place their own passive criteria around their investment approach. Passive does not have to mean index tracking.

2. Change index membership criteria

An alternative portfolio approach to this issue would be to encourage the index providers themselves to impose enhanced criteria for index membership. Following the furore in relation to ENRC and the ensuing pressure from a number of investors including ourselves, FTSE recently changed its standards so as to require 25% free floats as a minimum level before a company would be included in its UK index. But this standard could and perhaps should be applied to other markets as well, and the step could be taken further so that certain minimum minority shareholder protections are required before companies are deemed suitable for inclusion. There are various minority protections which could be brought into play, such as perhaps: bars on dual classes of shares (or at least sunset clauses on them), clear standards for boards and their accountability to shareholders, protections from the influence of controllers who might otherwise become shadow directors, and guarantees on minority votes to authorise related party or other major transactions.

Perhaps the most powerful of these would be to bar any new company coming to the market with a dual class share structure. Reflecting the founder's dominance through ownership of a substantial portion of the shares is one thing, but entrenching that dominance going forwards by divorcing control from ownership through differential share rights is highly dangerous for portfolio investors.

But in a sense, this would be the index providers substituting for the regulators, which ought perhaps to be better placed to set standards for what is acceptable to bring to the public markets and to be available for investment by institutions and the retail market. And perhaps it would be preferable if the regulators carried out this role more effectively, rather than leaving it to the index providers and the market to substitute for their role as gatekeepers. The role of regulators in providing fuller protections for minority shareholders is considered below.

3. Shift from index-hugging behaviours

Even active investors which are not obliged to track indices are often seen to be closet trackers, investing in a way which largely replicates the index but with active positions at the margin. This index-hugging approach is common and commonly driven by the way in which asset owner mandates are written, predominantly in respect of strict limits on the fund manager's tracking error from the index performance, and the way that performance is assessed, which is typically by assessing deviations from the index as a benchmark. Smarter asset owners have begun to shift their active mandates so that constraints apply with less vigour and more intelligence, and while one of the toughest tasks in the financial industry remains how to assess fund manager performance, and particularly whether performance derives from skill or luck, asset owners are now beginning to be smarter about how they assess active fund management performance.

IPOs and related investor behaviour

Some investors are particularly cynical about the IPO process and the companies which are brought to market. Not least this is so given the number of newly listed companies which have struggled to regain the price at which they are listed. Some asset owners worry about the incentives which investment bankers have to maintain a flow of companies, whether good or bad, to the market, and their strong incentives to pump up the price of those issues to the greatest extent possible. Some of these incentives, and indeed some of the cynicism, could be reduced were asset owners proactively to adopt some of the measures discussed above, reducing the automatic nature of buying shares on listing and so the guaranteed demand for IPOs provided they are of sufficient scale. Some asset owners are also cynical about the role of fund managers in the IPO markets; suggesting that some may be keen for poor companies to come to the market at high prices because their share price declines provide an easy opportunity for outperformance.

There have also been scandals recently about companies coming to the markets in such a way that they avoid the IPO process altogether. As discussed above, Sino-Forest and several other Chinese companies reached North American markets in effect by the backdoor, through reverse mergers, rather than fulfilling the stringent requirements of an IPO.

The following are some suggested ways in which these concerns could be addressed by asset owners:

1. Decline to buy dual class shares

The academic evidence[4] suggests that dual class share structures, a common feature of the UK market in the first half of the 20th century, essentially fell out of favour because investment institutions refused to buy shares where their rights were so markedly lower than those of others. In many cases they refused to buy new share issues by such companies unless and until the dual share classes were removed. It's clear from recent events that this does not in itself solve the problem but it is at least a step in the right direction. While many oligarch-led companies are unlikely to need refinancing for some time, and it will be much harder to corral a consistent view from shareholders internationally than in was in London 50 and 100 years ago, investors need much more actively to consider whether they should be willing to purchase shares where their rights are curtailed in this way.

In particular, the dual class shares issued by newly listing companies in major markets seem a significant anomaly. Major investors in the US do themselves a disservice by being willing to buy into situations where shareholder rights are deliberately and explicitly limited. And other markets have similar issues; it was interesting to note that UK football club Manchester United was reportedly considering a listing in Singapore so as to enable it to have a dual class structure, leaving 88% of control in the hands of the Glazer family while enabling them to refinance the huge debt mountain they took on when they mounted a leveraged buyout of the club.

2. Insist on quality boards having been in place for some time

Too often companies come to IPO with a board which has been grafted on to the top of the company at the last minute before listing. The ability of such boards to add value to these companies will be limited and they can do little more than stand behind the due diligence carried out by the corporate advisers as part of the listing process. Some of these boards are highly effective and ensure that all shareholders' rights are protected from the moment of IPO onwards. However, others are not and certain early departures from boards have reduced investor confidence in boards which have been put into place at short notice.

It is a general truth that to be effective, boards cannot simply be afterthoughts; they need to be closely involved in the life of companies. This is still more true when the company is undergoing significant change such as an IPO. They therefore need to be in place for some time before the company comes to the public market. If this delays a listing, that is a small price to pay for a higher quality corporation whose approach provides investors with a good deal more confidence about its robustness.

3. Insist on marketing being carried out with finalised prospectus materials

Too often, even in markets where there are stringent requirements for prospectuses – or perhaps especially in them – the bulk of marketing is carried out by the investment banks without the prospectus having been completed or published. It is called pre-marketing, but all the parties to it understand that it is the marketing process, and non-participants at present tend to exclude themselves from acquiring the shares -ie it is very clearly not pre-marketing.

While this so-called pre-marketing speeds the listing process, it frankly makes a nonsense of the prospectus and the standards which are required in relation to it. Regulators should take control of this situation: the prospectus should not simply be a basis for litigation after the fact, which is all the current timeframes sometimes allow it to be. Rather, it must be what it was always intended to be: the basis of understanding of the company that is being brought to market, and the basis of all marketing discussions in relation to the sale of its shares. If this slows down the IPO process, that is no bad thing; the rush currently experienced is not conducive to appropriate pricing, nor to a clear understanding of the quality of companies brought to the market. It does not build the necessary trust between the company and its prospective shareholders, and so the prospectus process needs to change – investors could insist that they will not invest nor be marketed to without having had a full opportunity to study the final prospectus.

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4. Maintain downward pressure on IPO fees

Since the incentives for investment bankers leading IPOs are one of the key drivers for the unhelpful behaviours of companies being brought to the market at inflated prices and in a rush, sometimes before they are ready to become public companies, putting some downward pressure on banker fees might mitigate this behaviour. There have been repeated questions as to whether there is some anti-competitive activity in the market, and certainly it is unhelpful to the production of transparently independent research to see deals brought forward which in effect include almost every major investment bank in the consortium. One simple way to act against at least this apparently non-competitive behaviour would be for investors to insist on an additional discount on the issue price (above and beyond the usual discount expected because of uncertainties about the performance of a newly listing company) of a percentage point for each bank which is a member of the consortium bringing the company to market. If this approach had been applied to a number of issues over recent years, the share price fall seen in the company's first 6 months following listing would not have occurred.

One other way to address the issue of IPO fees would be for these fees to be paid in the shares of the company being listed, to be locked up for a significant period of time – perhaps one-third of the number of shares being released only on each of the first three anniversaries of the IPO. This should mean the investment bankers consider much more fully the long-term success and sustainability of the business. At the very least the current unhappy situation of their having pocketed cash from a deal which later proves a poor one for IPO investors would be avoided.

Flex governance standards and approaches for companies with major blockholders

Governance standards designed around comply or explain work extremely well for companies with responsive boards which are willing to listen to and intelligently consider shareholder views – though it is of course appropriate that they do not always respond to them. But it becomes harder to make comply or explain work where a board is wholly inaccessible or unresponsive – or where the control at the company is exercised not by the board but by parties who have influence from outside the boardroom, Berle & Means's controllers.

In these circumstances of oligarchic companies, it is worth considering how comply or explain and other governance standards can be tweaked in order to make them more effective. It's important to note that this paper is not intending to suggest that even in these situations comply or explain is the wrong basis for governance codes, it is just that the framework needs to be tweaked to make it more effective. Some of the assumptions built into certain governance codes break down in these extreme cases, and it is worth making reassessments of particular standards to see if they are appropriate in the case of oligarchic companies.

Some of the possible adjustments might be:

1. Abandon annual elections at companies with major blockholders

There is a basic assumption in many governance codes and investor approaches to governance that annual elections provide better accountability and so are a better form of governance. But this assumption breaks down in the case of oligarchic companies. Where a single shareholder holds more than 40% of the shares (or even 30% in countries where investor turnout is limited), annual elections in effect hand that shareholder the power to completely reshape the board at each AGM – and what's more, this is possible without the blockholder having to give any notice to other shareholders of its intention to do so. At least where board elections are staggered, the blockholder would need to make clear its intentions with a requisitioned meeting or AGM resolutions, or could only make the change over time.

The simple fact is that annual elections of the whole boards of companies where there is a major shareholder are – unless minorities have some other protection – a risk to good governance. So, unless there are other protections in place such as those discussed below, annual elections of the independent directors should be set aside for companies with blockholders and their boards should instead be classified, with only around a third of independent directors up for election in any one year, each of these directors being proposed for election at least every third year.

2. Establish an element of the board which can only be nominated and appointed by minority shareholders

Italy enjoys a system known as 'voto di lista' under which minority shareholders can propose a slate of usually three directors to form a significant element of the board which is clearly independent from the major shareholder(s). These individuals can only be elected by the minority shareholders, ensuring that minorities feel able to protect their interests in some small way.

An alternative route to a similar result would be to remove the extra voting rights attached to different share classes for the purposes of electing some or all of the board. While this might be difficult to retrofit to existing dual class shares – and essentially shareholders should be seeking the removal of all such situations over time – this might be a temporary compromise to make new issues more palatable, particularly if it were accompanied by a sunset clause which required the abandonment of the dual class structure after, say, 10 years.

This approach is not without risks: there is a danger of creating an almost inbuilt division within the board, of giving directors the impression that they are from factions and not subject to common directors' duties. There's a risk that oligarchs might feel that having the minority shareholders thus represented they could otherwise pack the board with yes-men and -women. But at least starting to talk about this sort of standard could increase expectations of the quality and independence of the boards of oligarchic companies.

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3. Establish a standard whereby major blockholders meet minority shareholders

Governance is inextricably linked with accountability. One of the problems in this new Berle & Means world of the separation of control from both management and the bulk of shareholders is that the controllers, although they have a dominant interest on the progress and prospects of the company, do not feel accountable to the wider shareholder base. We need to develop a mechanism for this to happen: it is vital that the shadow directors are brought out of the shadows. Having them meet with minority shareholders, perhaps in a group environment, might help build the sense of accountability which ought to come with their role at public companies.

Improve other regulatory protections

Alongside some of these other proposals, it ought to be possible for institutional investors to lobby for more effective protections from market regulators. Among the protections they might seek are:

1. Raise initial requirements for listing

Investors can engage with listing authorities to heighten regulatory standards such that only those companies with sufficient protections for minority shareholders and with appropriate governance standards are permitted to come to the market. Certain markets enjoy premium status among investors, which are prepared to pay more for companies listed there. In part this is due to the quality and depth of the market, and in part it is due to the protections which shareholders enjoy when investing in them. And in part the quality and depth of the market arises because of the security which investors enjoy when making investments in these markets with higher shareholder protections. Other markets could enjoy similar premiums if they were to begin raising the threshold standards they require of companies which can be listed on their markets. Key protections which should be built in might be around governance requirements, pre-emption rights and audit oversight.

One further specific enhancement that would be valuable for portfolio investors would be that listing requirements for directors should be applied to oligarchs – by which we mean significant owners of the business who are also dominant within its management – whether or not they are directors as such. In practice, such individuals will often be shadow directors, and the regulatory authorities should recognise this by applying whatever minimum standards are set for either suitability of directors or for disclosure about them to these shadow directors as well. If oligarchs can rebut the presumption that they are shadow directors, they could be exempted, but otherwise the standards would apply.

2. Require that only minority shareholders can vote on key transactions

It should go without saying that interested parties should not be able to vote on related party transactions, and that all such transactions where the board and/or major shareholder is conflicted go for minority shareholder approval – this ought to be a standard and expected requirement at all public companies. Sadly it is not universally true: many jurisdictions fail to provide what should be a basic standard of protection so that minority shareholders are not compelled to see the majority shareholder enrich itself at their expense. Where this is not the case this basic protection needs to be put in place.

But we should go further in order to ensure that oligarchic companies act fully and properly in the interests of all their shareholders: major transactions (involving say 25% of any of revenues, assets or profits) should be put up for vote solely by the minority shareholders. We can assume the controlling shareholder is supportive of such a deal. But it is important that such large deals genuinely carry the support of the bulk of the shareholder base as well, and this minority shareholder vote would require the board and perhaps the oligarchs to make wholly clear the value of the transaction for all shareholders. It would be a significant additional discipline on oligarch boards.

Notes:

1 Mingyi Hung, TJ Wong, Fang Zhang, T*he Value of Relationship-based and Market-based Contracting: Evidence from Corporate Scandals in China*

2 Adolf A Berle & Gardner C Means, *The Modern Corporation and Private Property*, 1932

3 Gerald F Davis, *The Twilight of the Berle and Means Corporation*, Seattle University Law Review, Vol 34:1121

4 Julian Franks, Colin Mayer, Stephano Rossi, *Spending Less Time with the Family: The Decline of Family Ownership in the UK*, ECGI Finance Working Paper No 35/2004

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