Institution: *London Business School*.

Unit of Assessment: *C19 — Business and Management Studies*.

Title of case study:

Corporate Governance.

1. Summary of the impact

Julian Franks has studied corporate governance with reference to international experiences. He has revealed that free-rider problems in the dispersed ownership model (large corporations with many small shareholders) generate dysfunctional outcomes; concentrated ownership models (such as family businesses) fare better. Activist investors have a role to play, and corporate governance practices should reflect this. Via the Corporate Governance Centre at LBS he has conveyed these key evidence-based messages to business leaders and regulators in the United Kingdom and elsewhere. In summary: *this research has enabled corporate leaders to make better governance decisions and has alerted regulators to the governance risks which require most scrutiny*.

2. Underpinning research

This research has been led by Julian Franks; he has been a Professor at LBS throughout. The research programme stretches back over two decades; for example, Mayer and Franks published early work on corporate ownership and control in *Economic Policy* in 1990. The references listed here are examples from 2001–12 of more recent contributions to this programme. Julian's co-authors Stefano Rossi, Paolo Volin, and Hannes Wagner were based at LBS during this research.

The Franks programme has asked these questions: (i) How does and did corporate ownership and control vary internationally and dynamically? (ii) How do governance patterns interact with the regulatory environment? (iii) What lessons can be fed back to corporate leaders and regulators?

In answer to (i), the Anglo-American "outsider" system has dispersed ownership across large equity markets, and active takeover markets for corporate control; continental "insider" systems have fewer quoted companies, focused ownership, and less frequent takeover events. Franks-Mayer (2001) provides an in-depth study of German corporations, and Franks-Mayer-Wagner (2006) traces the history of German corporate ownership and control. Whereas family ownership declined over the 20th century, other companies and banks emerged as the main equity-holders, with banks holding shares primarily as custodians. Franks-Mayer-Rossi (2005, 2009) trace the experience in the United Kingdom. Family ownership was rapidly diluted in the twentieth century. Families retained control by occupying a disproportionate number of board seats, but hostile takeovers and institutional shareholders made this increasingly difficult. The result was a regulated market in corporate control that looked very different from its European counterparts.

Answering (ii), an international comparison is provided by Franks-Mayer-Volpin-Wagner (2012). In "outsider" countries with strong investor protection, family firms evolve into widely held companies.

With the weaker investor projection of "insider" countries, family control persists. In "outsider" countries family control is concentrated in industries that have low investment opportunities and low merger and acquisition activity. In "insider" countries family control is unrelated to external financing needs, suggesting that financial institutions adapt to serve those needs.

Turning to (iii), in an "outsider" country a mechanism for control is the threat of takeover. However, Franks-Mayer (1996, Journal of Financial Economics) suggests that takeover threats are ineffective. In contrast, evidence for the effects of shareholder activism is reported in Becht-Franks-Mayer-Rossi (2010): this is a unique analysis of private engagements by a large activist shareholder, the Hermes UK Focus Fund (HUKFF). In contrast with previous studies, HUKFF substantially outperforms benchmarks as a result of shareholder activism predominantly through private interventions that would be unobservable in studies purely relying on public information.

In summary, the listed outputs are samples from a wider programme which has empirically documented the patterns of ownership and control. Those patterns show that the regulatory environment and corporate ownership structures move together. Other aspects of the research reveal the governance mechanisms via which corporate performance can be influenced.

3. References to the research

"Ownership and Control of German Corporations," Julian Franks and Colin Mayer, *Review of Financial Studies* 14(4), 2001, pp. 943–977. `dx.doi.org/10.1093/rfs/14.4.943`

"The Origins of the German Corporation—Finance, Ownership and Control," Julian Franks, Colin Mayer, and Hannes F. Wagner, *Review of Finance* 10(4), 2006, pp. 537–585. `dx.doi.org/10.1007/s10679-006-9009-4`

"Spending Less Time with the Family: The Decline of Family Ownership in the United Kingdom," Julian Franks, Colin Mayer, and Stephano Rossi, in *A History of Corporate Governance around the World: Family Business Groups to Professional Managers*, National Bureau of Economic Research and the University of Chicago Press, November 2005, pp. 581–611. `ISBN: 0-226-53680-7`

"Ownership: Evolution and Regulation," Julian Franks, Colin Mayer, and Stephano Rossi, *Review of Financial Studies* 22(10), 2009, pp. 4009–4056. `dx.doi.org/10.1093/rfs/hhn108`

"The Life Cycle of Family Ownership: International Evidence," Julian Franks, Colin Mayer, Paolo Volpin, and Hannes F. Wagner, *Review of Financial Studies* 25(6), 2012, pp. 1675–1712. `dx.doi.org/10.1093/rfs/hhr135`

"Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK Focus Fund," Marco Becht, Julian Franks, Colin Mayer, and Stephano Rossi, *Review of Financial Studies* 23(3), 2010, pp. 3093–3129. `dx.doi.org/10.1093/rfs/hhn054.ra`

Evidence of quality. The *Review of Financial Studies* (RFS) is a "top three" finance journal, rated as "4$\star$" by the Association of Business Schools (ABS). The *Review of Finance* is a distinguished finance outlet with a "3⋆" rating by ABS. Item (e) is from a prestigious *National Bureau of Economic Research* conference. All outputs are highly cited, attracting 1500+ "google scholar" citations.

Funding examples. The LBS research on corporate governance was supported by ESRC grant RES-060-23-0004 from 2006–10. The earlier (2001) Franks-Mayer work was supported by the EU Training and Mobility of Researchers Network, contract FRMX-CT960054.

4. Details of the impact

Context. The research was developed in the light of events such as the failures of Enron (in 2001) and WorldCom (in 2002) and later the financial crisis of 2007–08, which undermined the (once widely held) view that Anglo-American model—listed firms with shares widely held by institutional investors and monitored by a board of independent directors—is the best form of organisation.

Impact platform and channels. Julian Franks founded the Corporate Governance Centre (henceforth "the Centre") at LBS. It is a focal point for corporate governance research, and a platform to enable communication of the research output to both academic and practitioner audiences.

The main channel for the impact has been the direct interaction between Julian Franks and beneficiaries of the impact. In the context of extensive interaction, documented below, he has directly used the knowledge and expertise derived from his long-running research programme.

Beneficiaries. Franks and the Centre use LBS research to examine the effectiveness of capital market mechanisms for developing and sustaining trust between boards, corporate executives, investing institutions, regulators, and the public. The Centre is also a vehicle for discussing these issues with policy-makers and regulators. The stakeholders listed here are the key beneficiaries.

Policymaking. Franks has used his research directly in policymaking exercise: each contribution, consultation, or evidence provision was driven by the evidence-based research on corporate governance reported here. The following reports, reviews, and roundtables are policymaking impact events to which he contributed. This non-exhaustive list gives ten examples:

(i) Walker Report: a review of corporate governance in UK banks and other financial entities.

(ii) Breedon Committee: a taskforce that examined barriers to alternative debt markets.

(iii) Liikanen Group: the high-level expert group on reforming the structure of EU banking.

(iv) Kay Review: review of UK equity markets and long-term decision making, led by John Kay.

(v) Vickers Commission: a government into possible reforms to the UK banking sector.

(vi) Hogg Report: a review of the effectiveness of the Combined Code on Corporate Governance.

(vii) House of Lord Committee on Banking Standards: evidence on bank board governance.

(viii) UK Treasury: discussion of reform with respect to the state of corporate bankruptcy.

(ix) Bank of England: private roundtable on the governance of banks.

(x) Centre for the Study of Financial Innovation: roundtable on governance and listing rules.

Beyond this list, Franks has participated in European policy making: examples include a workshop on the European Commission Action Plan on Company Llaw and Corporate Governance in 2013, where he spoke on the future of governance regulation and chaired a panel discussion, and a seminar to the European Commission on shareholder activism in 2012. The latter seminar was directly related to the underpinning research of Becht-Franks-Mayer-Rossi (2010).

Impact events. Franks and the Centre have been involved in and hosted events which have been used to communicate the findings of the research to beneficiaries. Examples follow.

(i) In October 2008, the Centre provided a platform for leading figures from the City and regulatory communities. Stakeholders here included Hector Sants (CEO of the Financial Services Authority) and the leaders of UBS and JP Morgan investment banks.

(ii) In June 2009 Lord Myners, Financial Services Secretary to HM Treasury, asked the Centre to host a major Colloquium: "Boards and Investors: Mutual Obligations and Enhanced Responsibilities." This served as a major policy forum attended by senior managers, non-executive directors and senior investors, in the context of the Walker Report and the Hogg Code. Attendees included Lord Myners, Sir Martin Sorrell (CEO, WPP), Sir John Rose (CEO, Rolls Royce), Xavier Roulet (CEO, London Stock Exchange), Baroness Hogg (Chairman, 3i), David Pitt Watson (Hermes), David Jackson (BP) and Dr. Antonio Borges (Hedge Fund Standards Board).

(iii) A second event was convened by Lord Myners and the Centre in December 2009 to discuss and collect feedback on the Hogg and Walker reports. Over 50 attendees included Marcus Agius (Chairman, Barclays), Keith Skeoch (CEO, Standard Life), Sir David Walker, David Blitzer (Senior Managing Director, Blackstone), Gordon MCcullum (CEO, Virgin Group), Niall Fitzgerald (Thomson Reuters), Patricia Hewitt (BT Group), Richard Burrows (Chairman, BAT), David Tyler (Chairman, Sainsburys), and Roger Carr (Chairman, Cadbury).

5. Sources to corroborate the impact

Kay Review: Julian Franks is cited on page 89 of the final report.

(i) Liikanen Report: a member of the Liikanen Group.

(ii) Vickers Commission on Banking: the Chair.

(iii) Parliamentary Commission on Banking: a contact at the House of Commons.

(iv) Bank of England private roundtable: the Executive Director, Financial Stability.

(v) Breedon Committee: a contact at the Department for Business Innovation & Skills.

(vi) CSFI City Roundtable: the CSFI Director

The underpinning research of this study by Franks has been featured in the international press, including the Financial Times, the Economist, and the Wall Street Journal. FT examples include "The familial model finds favour once in the classroom," 1 April 2013; "Traditional investors adopt harder line," 6 May 2013. "The City drive to help small investors goes much too far," 27 June 2013.