Ownerless Banks

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Good evening. Thank you, Fernando, for your kind words, and thank you for giving me the opportunity to be here tonight in front of such a distinguished audience. It is an honour to be part of this conference, jointly organised by the Basel Committee on Banking Supervision (BCBS), the Group of Banking Supervisors from Central and Eastern Europe (BSCEE) and the Financial Stability Institute (FSI).

As a representative of a European bank, which has successfully navigated ten difficult years of financial crisis, I cannot overstate the importance of financial stability and the need to implement regulatory reforms that dampen financial cycles. For that reason, I would like to recognise the role of the Bank for International Settlements, the Basel Committee and, in particular, of institutions such as the FSI in contributing to the effective implementation of global regulatory standards around the world. Such work benefits us all. I do encourage Fernando to continue with the FSI's excellent work.

I am also delighted to be in Vienna, a city where one can breathe European history and enjoy the finest opera and classical music.

Tonight, I would like to share with you a few thoughts on the importance of the ownership structure of companies, in general, and of banks, in particular.

I must admit that the title of this address, “Ownerless Banks”, is somewhat provocative. It refers to a particular structure of bank ownership: one in which the shares of a bank are widely dispersed among a large number of shareholders. In some sense, therefore, nobody feels as if they are the owner of the bank.

This structure is in contrast with one in which ownership is more concentrated, for example, with one large shareholder holding a significant percentage of the shares. Such a shareholder may feel like the owner of the bank in the sense that they can exert a significant influence in shaping the bank's mission, its culture and its strategy. They need not necessarily hold a controlling stake. A substantial stake will suffice.

I am not 100% sure what response I would get if I asked you what type of ownership structure would be preferable from a social welfare point of view. Some of you would probably say a dispersed structure, some would say a concentrated and some would certainly say (as economists usually do) "it depends".

My goal over the next few minutes will be to try to dispel the prejudice that some hold against concentrated ownership structures, in particular, against reference shareholders. I will feel that I have accomplished that goal if, by the end of the talk, I have sown a seed of doubt in you regarding the superiority of ownerless banks to banks with a reference shareholder. Even if that leaves many of you thinking that the right answer is still "it depends" - thinking that I can convince a group with a good number of economists in it to rule out such an answer would be foolish on my part-. Setting reasonable goals is a good principle to follow, even more so for bankers.

I will argue that both models -dispersed ownership and concentrated ownership structures- have advantages and disadvantages. I am afraid, however, that the advantages of having a reference shareholder may have been overshadowed by some unfortunate experiences that ought to be the exception rather than a rule.

Before I start delving deeper into this issue, a disclaimer is in order. Let me tell you where I am coming from. CaixaBank was founded in 1904, 115 years ago, as a savings bank. It is now a listed commercial retail bank, the largest by market penetration in Spain and with a significant footprint in Portugal through BPI. The largest shareholder is "la Caixa" Banking Foundation, who owns an almost 40% stake in the bank but no longer controls the Board. The Banking Foundation –which is one of the largest private foundations in the world- also holds stakes in other banks (like Inbursa in Mexico or the Bank of East Asia in China and Hong Kong) and European blue chip companies, like Suez, Telefonica and Naturgy. With income from this investment portfolio, the Foundation is currently dedicating a budget of more than 500 million euros a year to a broad range of social welfare programs –of which financing top medical research or fighting against child poverty are just a couple of examples. Therefore, as you can see, I have a vested interest here.

Let me now get to the core of the issue –that is, what are the advantages of having a reference shareholder compared to a widely dispersed ownership structure? I will focus on three dimensions: agency problems, short-termism and the stakeholder model for a company (in contrast to the shareholder value maximization model).

1. Dealing with the agency problems

Firstly, having a reference shareholder may reduce the agency problems that arise between shareholders and managers. It is well known that, with a dispersed ownership structure, the incentives for any individual shareholder to monitor management are very weak. Their capacity to hold management accountable is also limited. In this situation, managers may take advantage of information asymmetries and use their discretion to maximize firm size, pay themselves excessive salaries or entrench and protect themselves from indirect means of corporate control.

On the contrary, investors with large ownership stakes have strong incentives to maximize their firms' value and are able to collect information and oversee managers. Large shareholders also have strong incentives to put pressure on managers or even to oust them. In an important paper on this issue, Shleifer and Vishny (1997)[1] point out that "*Large shareholders thus address the agency problem in that they have both a general interest in profit maximization, and enough control over the assets of the firm to have their interest respected*."

In another well-known paper, Stijn Claessens of the BIS and his co-authors[2] find (using a sample of East Asian corporations) that firm value increases with the share of cash-flow rights in the hands of the largest shareholder, a result that is consistent with previous studies on the positive incentive effects associated with increased cash-flow rights in the hands of one or a few shareholders.

These authors, however, also point out that excessive control rights may have a negative effect on firm value through the entrenchment effect.

[1] See Shleifer, A. and R. Vishny (1997). "A Survey of Corporate Governance". Journal of Finance, 52(2).

[2] See Claessens, Stijn et al. (2002). "Disentangling the Incentive and Entrenchment Effects of Large Shareholdings." The Journal of Finance 57.6, 2741:2771.

Shleifer and Vishny argued that "*as ownership gets beyond a certain point, large owners gain nearly full control of the company and are wealthy enough to prefer to use firms to generate private benefits of control that are not shared by minority shareholders*." Indeed, Claessens et al find that, for the largest shareholders, the difference between control rights and cash-flow rights is associated with a value discount (a result that may be driven by the use of pyramid schemes, cross-holdings among firms or dual-class shares). They find, however, that the wedge between control and ownership is associated with value discounts for family-controlled firms and somewhat for state-controlled corporations, but not significantly for other types of owners. Obviously, corporate governance rules need to address these issues.

The challenge is to have a system that retains the benefits of monitoring provided by concentrated ownership while encouraging the flow of external funds to corporations from small shareholders.

2. The benefits of long-term investment versus short-termism

The second dimension that I wanted to comment on relates to the benefits of long-term investment versus short-termism, a trend that appears to be on the rise. In recent years, several initiatives have emerged designed to promote aspects such as long-term investment mandates and an end to quarterly guidance to the markets. In the United States, the movement against corporate short-termism has been led by well-known leaders such as Jamie Dimon and Warren Buffett[3]. Top CEOs acknowledge that financial markets have become too focused on the short term and that, under this pressure, companies frequently hold back on technology spending, hiring and research and development to meet quarterly earnings forecasts that may be affected by factors outside the company's control (such as stock-market volatility).

Problems deriving from an excessive focus on the short term have a larger impact in banking. As we all know, this is an industry that engages in maturity transformation and the full consequences of management actions

[3] See Dimon, J. and W. E. Buffet (2018, 6 June). "Short-termism is Harming the Economy", The Wall Street Journal. Retrieved from www.wsj.com .

are only revealed over time. Therefore, a short-term management bias is particularly harmful.

A reference shareholder may contribute to reduce short-termism. In particular, a stable one who is committed to stay as a shareholder for the long-term.

The consulting company McKinsey has systematically measured short and long-termism at a company level and they find that companies on the long-term end of the spectrum dramatically outperform those classified as short term[4]. Long-term oriented firms deliver higher revenue growth, less volatility, higher earnings and higher total returns to shareholders. They find, for instance, that during the crisis years, these companies continued to invest while others cut spending.

A few years ago, McKinsey, together with the Aspen Institute, concluded that the best strategy for firms to overcome excessive short-termism and support long-term value creation was to attract and retain intrinsic investors: sophisticated long-term institutional investors with long holding periods and concentrated portfolios[5]. These are investors that do not require a lot of detailed guidance on quarterly numbers. They need clarity, consistency and transparency from managers in communicating strategic priorities and their long-term goals.

3. Shareholder versus stakeholder value

Finally, the third dimension that I want to consider relates to the distinction between the shareholder model and the stakeholder model of the corporation. I will argue that a reference shareholder may facilitate the adoption of a stakeholder model –a model that I will defend. In contrast, a dispersed ownership bank will be under strong pressure to adopt a shareholder maximization model.

As you know well, according to the shareholder model, the primary responsibility of a firm is to maximise the wealth of its shareholders. The

[4] See Barton, D. et al (2017) "Measuring the Economic Impact of Short-termism". Discussion paper. McKinsey Global Institute, February.

[5] See Koller, t. et al (August 4, 2017) "The case against Corporate Short termism", Milken Institute Review. Retrieved from https://www.mckinsey.com.

criteria by which performance is judged in this model is simply the market value of the firm – that is, shareholder value. In its purest form, this model neglects the important role of other players such as employees, suppliers, customers and society as a whole[6].

In contrast to this, the stakeholder model provides a broader approach, where a company should be managed serving the interest of a wider constituency of stakeholders. With this approach, profits are a way of achieving the ultimate goal of the firm, but are not the goal itself.

Relevant stakeholders include all those who need to contribute firm-specific assets for the success of the firm: employees, customers and suppliers. Financial investors (equity and bond holders) are not the only ones who invest in a firm: there are others who invest in intangible assets. But they do not do it only as a result of contracts or a price mechanism. They do it because they trust that their investments will be corresponded over time by other stakeholders. Thus, a stakeholder approach promotes the development of long-term relationships, trust and commitment amongst various stakeholders, through incentives for firm-specific investment and for cooperation. It leads to committed employees, customers and suppliers and this is crucial for the success of the firm in the long run.

The stakeholder approach also cares about the progress of society as a whole and, in particular, about the members of the communities in which the firm conducts its business. A firm that follows a stakeholder approach is, by construction, a socially responsible firm[7].

In my view, a stakeholder approach may be particularly beneficial in banking:

- Because it is a business based on long-term relationships, where customer trust is key.
- Because banks can generate systemic risks (important negative external effects arising from its own actions) and a stakeholder model better internalizes the external effects of a firm's actions.

[6] See Friedman, M. (1970, September). "The Social Responsibility of Business is to Increase its Profit", The New York Times Magazine, 13 September 1970.

[7] See, for instance, Maher, M. and T. Andersson (1999). "Corporate Governance: Effects on Firm Performance and Economic growth", OCDE.

- And because banks can also generate –through their activity- important positive external effects to the economy. For instance, through sustainable finance (by promoting financial inclusion or financing the necessary investments to fight the risks arising from climate change).

The role of foundations and concluding remarks

I have argued that a reference shareholder may contribute to alleviate the agency problems that arise from the separation of ownership and management; may induce a long-term view in the management of the firm; and may facilitate the adoption of a stakeholder model –if the reference shareholder supports such a model. This is particularly relevant in the banking business.

Obviously, a reference shareholder may also give rise to some problems. I already mentioned that a large shareholder may try to take advantage of smaller shareholders –and therefore it is important for corporate governance to protect, as it does, the rights of minority shareholders.

Also, the nature of the reference shareholder may also lead to insufficient monitoring of managers, problems of short-termism and objectives that have little to do with share values or a stakeholder approach. These problems clearly arise, for instance, when the reference shareholder is vulnerable to political interference – and that is why it is particularly important to avoid political meddling in the banking business.

Before I finish, let me briefly comment on the nature of a particular type of reference shareholder: foundations. Some of you may say that a bank in which a foundation is a reference shareholder is also an ownerless bank – in the sense that the foundation has no owners.

But there is an irony here. A foundation can have a strong personality and a strong governance. And that makes a difference. There is empirical evidence (looking at the experience of Denmark, for instance, where foundations are a common form of ownership) that foundation ownership is highly stable and promotes long-termism –top management changes less frequently and the level of long-term investments is higher[8]. Other studies find a strong and robust relationship between foundation governance and firm performance in the largest corporations in Denmark[9].

Indeed, a well-governed foundation (governed by an experienced and diverse Board of Directors not subject to political interference) with a strong character and a clear mission (which often implies the adoption of a stakeholder approach) may be an ideal candidate to be a reference shareholder of any company, and especially of a bank.

I am not sure if I have succeeded in casting any doubt around the prejudices you may have had against concentrated ownership structures. I have highlighted some of its benefits, particularly when referring to well-governed foundations as a shareholder reference of a bank. And the potential drawbacks are clear.

In any event, what I can certainly conclude is that a strong case can be made for maintaining a diversity of ownership structures. As is the case with a diversity of business models or a diversity of biological species. Structures will need to evolve, mutate and improve over time as we learn from experience.

Thank you for your attention.

[8] See Thomsen, S. et al (2018) "Industrial Foundations as Long term Owners". Finance Working Paper N`556, November. European Corporate Governance Institute.

[9] See Hansmann, H. and Thomsen, S. (2018) "The governance of Foundation–Owned Firms", Research Project on Industrial Foundations.