The Corporate Governance of Business in the Netherlands during the 20th century; structural change and performance

Introduction

The way in which businesses in the Netherlands are being managed – their 'corporate governance' – is the result of a set of rules that developed in the past and that are embedded in the culture and society of the country. Traditions in this field go back to the East Indies Company (V.O.C.) of 1602, the first company based on tradable shares (Frentrop 2002). The most salient features of corporate governance were that it was managed by a team of directors, who took decisions in board meetings, that it had a two tiered system of management and supervision, and that its management was based on the acknowledgement that other stakeholders (such as the state) had an important interest in the company as well. Some of these rules have been adapted to circumstances in the past four centuries, but their essence has remained unchanged. The observation by Van Vree (2000), that the Netherlands is the only country that has been governed by meetings (*vergaderingen*) for the past 400 years, also applies to a large extent to its (big) companies.

The rules of corporate governance are a crucial part of the 'business system' of a country, a concept introduced by Whitley to analyse the persistent differences in the way in which business is organized and relates to the wider society and culture, the result of the national development paths pursued by different countries and by the institutions that have been generated out of the interaction of social groups (Whitley 1992, 1998). The most striking rules in the case of the Netherlands are: collegial management by teams who operate on the basis of consensus and who take the most important decisions in meetings (following centuries old traditions which are sometimes referred to as the 'poldermodel' (Van Zanden 2002; Van Vree 2000), the relatively strong position of managers vis-à-vis other stakeholders, supported by the development of a number of protective devices (takeover defenses or *beschermingsconstructies*), the recognition of the role and importance of other stakeholders (in particular labour – via workers'councils – and the state), and the relatively important role played by family firms in economic development and of families in the management of 'their' companies (again facilitated by *beschermingsconstructies*). An important change occurred during the 1960s and 1970s, when the importance of banks grew, which moved the Dutch business system more into the direction of the German (Continental model). The increased weight and presence of directors of banks in the supervisory boards of companies also stimulated the formation of a tightly knit network of managers who (as *commissarissen*) together managed Dutch business. Such a network is said to reduce information asymmetries and enhance information flows, but has also been criticized for the concentration of power in the hands of a few insiders (and has also been called the 'old boys network') (Helmers *et al.* 1975)

In the final quarter of the 20th century a trend towards the Anglo-Saxon business system (or 'model') can be discerned, resulting in the strengthening of the role of the chairman of the board of directors (the Chief Executive Officer or CEO in American firms), a growing influence of shareholders on decision making and supervision, a weakening of the role of other stakeholders (in particular labour), and, perhaps, a declining role of banks in supervision of the big companies (Heemskerk *et al.* 2002 for a first analysis of these trends between 1976 and 1996). These changes have been accompanied by a lively debate on the corporate governance of Dutch business, which was also stimulated by attempts to harmonize these rules by the EU. This has resulted in a set of new guidelines for corporate governance – the '*Nederlandse corporate governance code*' or *code Tabaksblat* issued in 2003 – which already has a big impact on the management of Dutch companies. It also appears that the new rules, in combination with other developments, such as the decline of the number of banks operating in the Netherlands due to the mergers of c. 1990, have led to the weakening or perhaps even the disintegration of the network of directors and supervisory directors (*commissarissen)* who previously dominated Dutch business. This has also been linked to weakening of the 'national' character of Dutch business as a result of the process of globalization.

As this brief sketch shows, the Dutch system of corporate governance has certain specific features embedded in its culture and society (such as the omnipresent *vergadercultuur*), but is also relatively open to international influences. An important idea behind the changes in the past 30 years – such as those proposed by the commission Tabaksblat – is that the Anglo American 'market oriented' business system, in which the power of shareholders and the role played by the stock exchange in financing industrial expansion is relatively large, is more efficient than the network-based systems found in Continental Europe (see for a discussion of these differences Hall and Soskice 2001). The debate on this is still going on. One of the limitations of most contributions to it, is that they focus on the very recent period (during which indeed the Anglo-Saxon economies have been more dynamic than the Continental ones) and often concentrate on relatively short-term indicators of financial performance, whereas the viability of a business system is a long-term affair. For example, La Porta *et al.* (2002) relate governance structures in 27 countries to the stock market valuation of firms at a specific point in time. A notable exception is De Jong (1991), who considers ten year growth rates and non-financial performance measures like employment.

The proposed project aims at contributing to this important societal debate from an economic-historical perspective, on the basis of a study of the long-term performance of the Dutch business system during the 20th century. Starting from the theoretical framework sketched here briefly (in brief: new institutional economics and financial economics), we aim to systematically analyse these developments in corporate governance using a unique set of data of Dutch companies (whose shares were traded at the Amsterdam stock exchange), and link them to the performance of the companies studied in order to answer the questions about the efficiency and long-term effects of the different rules. The approach is interdisciplinary: we combine the theories and methodologies of economists working with similar datasets for the recent period, with the long-term perspective of the historian, who is able to collect comparable data for the 20th century as a whole, and interpret their meaning on the basis of an intimate knowledge of the business and economic history of the period (building on the detailed work in business history of many of the companies studies carried out by business historians). Also, the new dataset that will be constructed, will be very valuable for future research and an important innovative part of the project itself. It will be possible to address many other relevant questions concerning the long-term development of Dutch business in the 20th century using these data.

This study forms part of the BINT-project (Bedrijfsleven in Nederland in de Twintigste eeuw; Dutch Business in the 20th century), an inter-university programme led by prof. Jan Luiten van Zanden, prof. Keetie Sluyterman and dr. Joost Dankers of Utrecht University, with participants from Erasmus University of Rotterdam, University of Eindhoven and the Netherlands Economic History Archive (NEHA). The BINT Project has the performance and changing characteristics of the Dutch business system during the twentieth century as its main focus. The goal is to make an in-depth analysis of the most important elements of the Dutch business system and their adaptation over time to the major economic, social and technological developments of the 20th century. The analysis will be internationally comparative because only in this way the typical Dutch characteristics can be highlighted. The analysis will be informed by relevant social theories, particularly, though not exclusively, drawn from institutional economics. Seven sub-projects (and volumes in the projected series) are being planned, a.o. dealing with innovation, entrepreneurship and internationalisation (see http://www.bintproject.nl/home.html). The development of the programme had been stimulated by an Advisory Board, consisting of a number of (former) captains of industry (including Mr. C. van Lede and Mr. M. Tabaksblat, chairman of the commission who wrote the new code), representatives from trade unions and the (former) chairman of the Social Economic Council, Mr. H. Wijffels (see http://www.bintproject.nl/organisatie.html#rva for full details).

To carry out the project on corporate governance a team has been formed of economic/business historians from Utrecht University and of economists from Erasmus University and Columbia University working in this field. Both groups have their international networks that will help to put the research into an international comparative perspective. Business historians from different European countries are working on similar projects. Important examples are 'Performance of European business in the 20th century', a project managed by prof. Youssef Cassis of Geneva/LSE (see www.lse.ac.uk/collections/BHU/performanceEB.htm for a description of the project), 'Evolution of Italian Enterprises in the 20th century' by Gianetti and Vasta 2006 (see www.essetiweb.it/imitadb/en/), and the project on stock market and performance carried out at the University of Antwerp (see S. van Nieuwerburgh, F. Buelens and L. Cuyvers 2006). De Jong and Röell are active members of the European Corporate Governance Institute (www.ecgi.org) and participated in the NBER project "The Evolution of Corporate Ownership and Family Firms" (www.nber.org/bookstoc/morc05-1.html) (see Morck 2005 for the first results of this network).

Overview of projects

The programme consists of four projects. The first three projects investigate corporate governance characteristics: (i) protective devices or takeover defenses; (ii) executives, supervisors and their networks; and (iii) dividend policy and financing. The fourth project is a synthesis in two respects, as it both describes the relations between governance characteristics in the previous projects and relates governance to performance. Performance will be broadly defined as financial results, employment and continuity. Below, the proposed dataset and the four projects are described in detail.

Dataset

All parts of the programme plan to use a common database with data on all non-financial companies that have been listed at the Amsterdam Stock Exchange in the period 1903 to 2003. The database will contain two types of annual information about these firms. First, corporate governance characteristics, which include protective or takeover defenses (*beschermingsconstructies*), all members of the managerial and supervisory boards, involvement of families, and share ownership. The second type is financial and other firm data, such as the profitability, stock returns, dividends, mergers, and the number of employees. The number of companies in the dataset will range between approximately 140 to 350 per year and we expect to have over 25.000 observations in the period of 101 years. In total around 50 variables are collected per company per year (a detailed description of the dataset is available on request). The main data source for our dataset is a yearly guide of exchange-listed companies, Van Oss' Effectenboek. This book provides over the period 1903 to 1977 extensive information per firm aimed at shareholders: the legal structure (including takeover defenses), financial structure (including types of shares issued), activities (including major mergers and acquisitions), board members, and a balance sheet and profit and loss statement. Additional sources include the Gids bij Officiële Prijscourant/Effectengids, Officiële Prijscourant (and predecessors) and the CBS dataset of listed companies (starts in 1974).

In 2003, De Jong and Röell (2005 and 2006) collected the above-mentioned data for three representative years in the 20th century: 1923, 1958 en 1993. The analysis shows that the data is of good quality and can be gathered consistently over time. In 2005 a second pilot project – partially financed by the Stichting Vereniging van de Effectenhandel and other external sources – was started to collect information in the period 1960-2000. This project focuses on the Van Oss Effectenboek in the period 1960-1977 (because for the post-1977 period most data are already available on-line). The pilot project has so far achieved its goals, which makes it possible to plan the finishing of the whole dataset.

A key goal of the programme is to finish the dataset. The data will be made available to other researchers after completion of the project (a.o. via the BINT-website).

Takeover defenses

Since Royal Dutch adopted the first takeover defense in the Netherlands in 1898, many firms have taken legal measures to prevent a hostile takeover by limiting the influence of the general meetings of shareholders (Voogd 1988). These protective devices differ from common measures in most other countries, where structural barriers have arisen (a.o. pyramids and cross-holdings in Italy and France) or legal measures only affect firms in case of a takeover threat (a.o. poison pills in the United States). The Dutch setting is unique, because the Dutch takeover defenses are not only extremely effective provisions against a takeover, but also shift power from shareholders to the company's board in 'peace times'. Previous attempts to explain the presence and consequences of takeover defenses show that takeover defenses have – mainly negative – effects on corporate performance, but find it difficult to explain the presence of defenses. Moreover, legal theories (La Porta *et al.* 1998) predict that countries with poor protection of shareholders (as common in the Continental or Rhineland model) will have less developed public capital markets than other (Anglo-Saxon) countries. Contrastingly, the well-developed Dutch stock market in conjunction with the takeover defenses has puzzled policy makers and researchers.

The long-term perspective of an analysis of the 20th century seems to be the most promising avenue for further research. A theoretical framework for the long-term analysis is provided by Bebchuk and Roe (1999), who distinguish structure-driven and rule-driven path dependencies. We plan to describe the presence of specific takeover defenses (a.o. certificates and priority shares) over time and the characteristics of firms that have specific defenses. Next, we investigate whether the dynamics of the population of firms influence the diffusion of defenses: Do newly listed companies have different defenses? Which defenses are adopted in case of a merger between two firms? Are firms with specific defenses more likely to de-list, due to takeovers or distress? In order to assess the effectiveness of the devices, we describe the use of defenses in takeover battles. In addition we provide a description of societal forces of influence on defenses: the development of Dutch company law (including stock exchange requirements); political discussions; legal discussions (opinions in legal journals (TVVS) and judgements in cases (*Ondernemingskamer*); opinions in newspapers; and private initiatives such as the commissions Peters and Tabaksblat).

This project will be carried out at Erasmus University. The project requires the dataset of Dutch listed companies, while other inputs are financed from other sources.

Executives, supervisors and their networks

The presence or absence of networks between companies and banks are an important aspect of corporate governance. In the Rhineland model close relations exist between banks and industrial companies; bankers are members of supervisory boards, have access to information flows within the company, which helps to solve information asymmetries on the capital market. Other characteristics are rather inactive and limited stock market and passive shareholders. In the Anglo-Saxon model these networks are much looser, and the stock market is much more important in supplying capital; here shareholders have an important voice. Differences between the models lead to dissimilar priorities of companies. We suppose that the Dutch business system has changed its position a number of times, which in itself is a rather unique phenomenon. The first movement towards the German model occurred during the 1910s, but the change was aborted by the financial crisis of the early 1920s (Jonker 1989). Only in the 1960s and 1970s did the importance of banks in financing industrial companies increase substantially, and did these networks probably become much denser as well. This leads to much debate about the concentration of power in Dutch business, in particular in the hands of the directors of the two banks, ABN and AMRO, which formed the two centres of the network (Helmers *et al.* 1975). Since the 1980s and particularly the 1990s, the ‘old-boys network’ is disintegrating, for example because of internationalization of their boards and the concentration movement in the banking sector (Heemskerk *et al.* 2002). The recommendations of the code Tabaksblat seem to be the logical result of this renewed trend towards the Anglo-Saxon model.

The dataset of listed companies between 1903 and 2003 will make it relatively easy to document and analyse these trends because it will supply the information on the composition of the boards of listed companies. One of the fundamental issues in this kind of research is what exactly it means when a director of bank A is a supervisor at company B. Were they selected for their personal expertise, or *qualitate* *qua*, to protect the interests of the bank and lower transactions costs between bank and company? This question can be answered by studying changes in the network: What happened in cases of death and retirement of executives: were they automatically replaced by a colleague from the same bank, or by another financial specialist – or by a supervisor with no clear financial expertise? What happened when companies or banks merged – do we see continuity in the functional lines between companies and banks? (Keegstra 2003; Mintz and Schwartz 1981; Schijf 1993; Stokman, Van der Knoop and Wasseur 1988)

Another aspect of corporate governance that can be studied with the dataset is linked to the performance and accountability of managers. How long do managers have a seat on the managing and supervisory boards? Do executives take responsibility for bad company results followed by resignation? Do they (automatically) move up after retirement to the supervisory boards? (Bebchuk 2005; Bender 2004). Lastly, this sub-project deals with the development of the links between politics and business. We will link the information on the members of the boards of listed companies between 1903 and 2003 with data on the biographies of politicians (members of Parliament and ministers) collected by the Parlementair Documentatie Centrum (at Leiden University; see www.parlement.com). It can, for example, be tested if having an ex-politician on the board of a company increases (or decreases) its performance – or, vice versa, how many ex-managers (from listed companies) have entered politics and how successful they have been. (Dronkers and Schijf 2004, Duyvendak 2004; Mokken 1971) This will shed light on the embeddedness of Dutch business, and the links with different political parties.

We intend the project to be carried out by a postgraduate/post doc. The sub-project asks for an in-depth analyse of network and financial data, which requires complex research techniques. With ready knowledge of business history in the 20th century, the analyses can be related to existing literature and archival research.

Dividend policy: distribution of company profits

A firm's dividend policy determines the beneficiaries of the profits. All funds that are paid out as dividends benefit the shareholders, while retained earnings are internal financing for firm growth. This implies that dividend policy presents an outcome of the balance of power between shareholder and managers/employees. This project aims to explain aspects of dividend policy in Dutch firms. The first aspect is the variation of average dividend payouts over time. Van Zanden (1998) estimates that in 1911/13 80% of profits were paid out, while in 1980/84 this fraction is reduced to 38%. The second aspect is the dividend policy of individual firms.

In line with the reasoning that dividend relates to power, Van Zanden (1998) descibes that ‘managerialism’ has had an important influence on the development of dividend policy in the 20th century. At the beginning of the century a firm was perceived as a vehicle of its investors. As a result, most of the profits generated were distributed as dividends. Over the course of the century, firms became increasingly oriented towards growth and continuity, which has led to a steady decline in the pay out ratio; the increased importance of other stakeholders on decision making at the top, also tended to lower the pay out ratio. If this interpretation is correct, we must see a renewed increase in the pay out ratio since the 1980s, following the rising power of shareholders. Moreover, one expects a link with takeover defenses: the more management is protected against the influence of shareholders, the lower the share of profits paid out as dividends will be. In this explanation, the distribution of power within the company and societal perceptions of its goal are reflected in firm’s dividend policies. Recent development in financial economics provide a related theory, i.e. that dividend policy is related to catering towards investor demands (Baker and Wurgler 2004). This theory predicts that the time variation in dividends is driven by the demand from investors. In periods in which investors value dividend-paying stock relatively higher, more firms will initiate dividends, whereas higher values of non-paying stock induces firms to cut dividends. An empirical analysis of the time-variation of dividends in Dutch firms over the 20th century will be able to distinguish between the ‘managerialism’ and ‘catering’ explanations of changing dividends. This empirical analysis will first describe trends in dividend payout over the century, and the evolution of total earnings, firm growth and financing from other sources than dividends. In order to test the catering theory we plan to construct an index for the value differential between firms that do and do not pay dividends. The catering theory predicts that this index is a predictor of changes in the dividend policy of firms.

Where the previous analyses describe trends in average dividends over the course of the 20th century, the second part of our research plan focuses on the motives of individual firms to pay dividends and the determinants of the fraction of earnings that is paid out to the shareholders. We test the empirical relevance of two dividend policy theories. The first model predicts that dividends are a governance mechanism.

Monitoring is generated by the need of firms to attract new financing from the public capital market or banks if the earnings after dividends are insufficient to finance new projects. A high dividend pay-out ratio will force managers/firms to undergo this disciplining of financial markets. The second theory predicts that dividends are related to earnings in the past year (Lintner 1956) or accumulated earnings (DeAngelo *et al.* 2006). This model is a.o. based on a firm's position in the life cycle, as growing firms will pay lower dividends to finance the growth while mature firms have more free cash available for dividends. The tests will show how firm characteristics influence dividend policies over time. Since the characteristics of Dutch companies have changed significantly over the 20th century, this presents a third explanation of the changing dividends over time. Our long run data set will enable us to track both firm-level and country-level determinants of dividend policy over time and thus enable us to distinguish between the competing hypotheses.

Synthesis: Corporate governance and performance

The synthesis will offer a chronological and thematic account of the development of the governance structure of Dutch business during the 20th century. It will incorporate the results of the other three projects dealing with different aspects of corporate governance, and analyse a number of case studies to show in more detail how the governance mechanisms operated in practice (or in some cases: failed to operate effectively), what the consequences were for performance of those companies and the role played by the different stakeholders. The themes outlined in the first part of this proposal will be dealt with in detail, including the societal discussion about corporate governance and its impact on the actual management structure of Dutch companies.

The leading themes of the synthesis will be to understand the specific features of the Dutch system of corporate governance as it has developed over the centuries, and is still developing as a result of its openness to outside influences. A related question is where to place the Dutch system of corporate governance in between the Anglo-Saxon and Rhineland models, with which it shared a number of features. Additional data will be collected on the size of the stock market and the importance of bank loans in financing industrial companies, in order to situate the Dutch system internationally within the spectrum between these two models.

The synthesis consists of three elements. First, an extensive description will be provided of the development of governance mechanisms in the Dutch setting. This description will summarize the results of the three previous projects (takeover defenses, boards and dividends), describe additional governance mechanisms (ownership structure, managerial compensation, etc.), and discuss the relations between governance mechanisms. Second, using statistical methods the relation between governance and firm performance will be established. Performance will be applied in a broad way, involving financial results, employment and continuity of the companies. Financial performance can be defined as the returns to shareholders, i.e. as stock returns and dividends. Alternatively, profitability is a measure of financial performance (Core *et al.* 1999). Additionally, measures based on financial data can be constructed, such as the growth in assets and labour productivity (Köke and Renneboog 2003). Non-financial performance measures include the employment, which is the (growth in) number of employees and the continuity. Continuity can be modelled as the survival of firms (Parker *et al.* 2002). These tests answer the important questions: Does governance increase performance? Are well-governed firms more likely to survive in the competitive arena? Does governance enhance societal wealth through increased employment or productivity?

The statistical analysis will be supplemented by case studies, which serve to illuminate findings and fill gaps in the analysis. The selection of case studies will a.o. be based on previous work by business historians and economists in this field, for example the recently finished study on Royal Dutch Shell 1907-2007 (Jonker, Sluyterman, Van Zanden and Howarth 2007), which offers a number of fascinating examples of the differences in corporate governance between the British and the Dutch part of the company. Case studies from the banking side of the corporate governance relationship can be derived from the detailed studies of ABN AMRO, Nationale-Nederlanden, AEGON and Rabobank and from Westerhuis who is working on her dissertation on the expansion of Dutch financial companies on the American market (2004, 2006, dissertation forthcoming). For the last period the study of Royal Ahold by De Jong *et al.* (2005) will be drawn on.

The synthesis will have a chronological set-up, similar to the other books in the BINT-series. A summary of the main findings will also be published as part of the English synthesis of the BINT-series.