

International Corporate Governance 2015 Exam
Saturday, February 27, 2016
Exam time: 4 hours

Maximum score is 70 points. Minimum required to pass the exam is 35 points. Avoid answers beyond two pages. Please write as clearly as possible.

1. The laws of most countries try to prohibit tunneling (minority shareholder expropriation). In all major legal systems, courts generally use two broad principles in dealing with tunneling: duty of care (refers to the responsibility of directors / controlling shareholders that are directors) and duty of loyalty (or fiduciary duty; addresses situations with conflict of interest). Discuss how the application of these two general principles tend to differ between civil law countries and common law countries and what implications such differences may have. [Johnson et al., 2000, "Tunneling"]

(20p)

2. Managers tend to deliver high performance when they think as owners. However, transforming managers of public companies into owners can be difficult without going private. Stewart (1990) suggests that public corporations can be revitalized through leveraged equity purchase plans (LEPP) and internal LBOs. Discuss how these plans work and what they can achieve.

(25p)

3. Mr. James is the owner of a company constructing office buildings. His cost for building a new office is EUR 300 000. Buyer Co. is a potential buyer of a new office building with a willingness to pay EUR 400 000 if Mr. James will not be cheating (e.g., producing below standard quality). Suppose Buyer Co. does not buy the building because its managers decide that there is no way to prevent being cheated on the quality.

- (a) What are the total agency costs in this case? How much do the residual loss and the monitoring/bonding costs amount to? (12.5p)

Next, assume that Buyer Co. hires an engineer for a cost of EUR 20 000 to monitor the building process. Buyer expects that the engineer will reduce James' likelihood of cheating on the contract. However, there is still some chance that James will cheat, so Buyer values the office at EUR 390 000 (instead of 400 000). Due to the EUR 20 000 expenditure, Buyer's maximum price is EUR 370 000. Suppose Buyer is offering a price of EUR 350 000 for the office construction.

- (b) What are the gains from trade and how are they divided between Buyer and James? How much do the total agency costs amount to? Split these costs into residual loss and out-of-pocket monitoring and bonding costs. (12.5p)

[Source: Lecture slides.]

(25p)

Good luck!

1. The law in most countries is a product of history (industry structure, economic conditions, etc.) and is not necessarily based on a set of principles. It is often a result of a long process of trial and error, and is often a result of a long process of negotiation between different groups of interest. It is often a result of a long process of negotiation between different groups of interest. It is often a result of a long process of negotiation between different groups of interest.

2. It is important to understand the legal environment when they think as owners. However, the legal environment of public companies and owners can be difficult without going through the legal system. The legal system is a complex one, and it is important to understand the legal environment when they think as owners. However, the legal environment of public companies and owners can be difficult without going through the legal system. The legal system is a complex one, and it is important to understand the legal environment when they think as owners.

3. The focus is the concept of a company consisting of a building. The cost of building a new office is EUR 100 million. The cost of a building is EUR 100 million. The cost of a building is EUR 100 million. The cost of a building is EUR 100 million. The cost of a building is EUR 100 million. The cost of a building is EUR 100 million. The cost of a building is EUR 100 million.

(a) What is the total agency cost in this case? (12.5p)

Next, assume the House Co. hires an engineer for a cost of EUR 20,000 to monitor the building process. The engineer will reduce the cost of the building process by EUR 20,000. The cost of the building process is EUR 100 million. The cost of the building process is EUR 100 million. The cost of the building process is EUR 100 million. The cost of the building process is EUR 100 million. The cost of the building process is EUR 100 million.

(b) What are the gains from trade and how are they divided between House and the engineer? (12.5p)