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Disclosure of Beneficial Ownership after the Panama Papers

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Abstract

Publication of the so-called “Panama Papers”¹ focused public interest on how certain politicians, celebrities, and other elites may have used elaborate corporate structures and offshore tax havens to conceal their beneficial ownership of companies and obscure their personal assets. Rather than taking the Panama Papers as an indication of the need for more and stricter disclosure and reporting rules, this paper advocates an alternative approach. We need to start by acknowledging that many companies are currently experiencing “disclosure and reporting fatigue,” in which the constant demand for “more” and “better” transparency and reporting is having the unintended effect of promoting indifference or evasiveness. The practice of disclosure and reporting is widely perceived as an obligation to be fulfilled and not as an opportunity to add value to a firm.

This is confirmed by the findings of an empirical study conducted by the authors of this paper that examines how disclosure rules operate in practice across various jurisdictions. The key takeaway of the study is that—even in jurisdictions that have a robust disclosure regime—the majority of firms engage in “grudging” or “boilerplate” compliance, in which ownership and control structures are not adequately revealed in an accessible way and, perhaps more importantly, the impact of these ownership and control structures on the governance of a company is obscured.

In this paper the authors advocate an approach based on the current communication strategy of a minority of firms in their sample—firms that engage in what the authors characterize as “open communication.” These firms present information on control structures—and their effect on governance—in a direct, accessible, and highly personalized manner. Such firms seem to recognize the commercial and other strategic benefits to be gained from open communication. The paper explores the implications of such an approach for both business and regulators.

About the Authors

Mark Fenwick (Professor at Kyushu University in Japan) and **Erik P.M. Vermeulen** (Professor of Business and Financial Law at Tilburg University and Head of Governance at Philips Lighting in the Netherlands) are currently researching trends in how high growth companies organize themselves and communicate with the market in order to build and maintain relevancy. The goal for such firms is to identify and adopt governance structures that maximize opportunities for delivering innovative and meaningful products and services for consumers. This means putting in place a mission-driven culture that can attract the best talent and the right kind of investors.

1 Offshore tax havens can be, and frequently are, used for legitimate purposes. Also, the “Panama Papers” mention intermediate entities in very many jurisdictions other than Panama.

Foreword

Nearly 15 years ago, the Enron scandal revealed that extensive use of subsidiaries in tax-haven countries enabled the firm to avoid paying \$2 billion in federal taxes. The Enron case triggered widespread debate about the real reasons multinational corporations establish subsidiaries in tax havens. On the one hand, do they use tax havens primarily to shield the firms from high tax regimes by shifting revenues to the subsidiaries? Do they use it for other legitimate purposes? Or on the other hand, do managers and controlling owners use tax havens for their own personal interests, such as illicit related-party transactions?

The tax-saving motive has featured prominently in economic thinking to justify the use of tax-haven subsidiaries. Earlier studies found that large, international corporations with significant intra-firm trade and high R&D intensity account for a substantial portion of firms that use tax havens to earn higher returns. But despite those substantial tax-shielding benefits, recent work indicates that tax havens play a key role in enabling private parties to extract firm resources for their own personal benefit. However, the widespread implementation of TIEAs (tax information and exchange agreements)—bilateral agreements between countries and tax havens to exchange information—seems to make it more difficult and costly for individuals and firms to pursue illicit activities at the expense of shareholders.

Yet questions persist about how much offshore wealth is attributable to tax evasion by firms and wealthy individuals. In April 2009, the G20 countries announced “an end to bank secrecy,” and more recently they endorsed a new global tax transparency standard. The disclosure of beneficial-ownership information has also been high on the political agenda. For example, G8 leaders have pursued reforms that seek to address the problem of corporate opacity. Notably, the United Kingdom is the first mover in this area, requiring companies there to publish the names of their owners on company registers. While there have been major complaints about sharing information on beneficial ownership, the justification for it is fairly straightforward. Beneficial-ownership rules allow shareholders to monitor related-party transactions and manage other conflicts of interests. Besides mitigating agency costs and improving market efficiency, ownership disclosure is an effective tool for issuers in identifying and communicating effectively with their investors.

In April 2016, the public as well as media commentators were taken by surprise by the leak of over 11.5 million confidential documents from Mossack Fonseca, a Panamanian law firm. The so-called “Panama Papers” scandal serves as an example of how the rich and powerful in some cases may have used complex legal structures to conceal their beneficial ownership in offshore subsidiaries. The Panama Papers scandal has provided an opportunity for policymakers to call for stricter rules to promote the disclosure of ultimate beneficial ownership.

Mark Fenwick and Erik Vermeulen offer a comprehensive analysis of the strategies for concealing beneficial ownership as well as of the conventional arguments in favor of disclosure and reporting requirements. It turns out that there are multiple legal strategies to circumvent any regime that requires beneficial-ownership disclosure. Moreover, it seems likely that firms with complicated ownerships structures will not disclose. To the extent that open and substantive

beneficial-ownership disclosure is not feasible, requiring more and stricter information is unlikely to facilitate more meaningful disclosure among the vast majority of companies. Accordingly, it is not surprising, as Fenwick and Vermeulen show empirically, that the majority of firms analyzed in various jurisdictions engage in “grudging” compliance, making sure the regulator does not have a comprehensive picture of the complicated ownership structures. Talk of imposing stricter rules has the effect of undermining the current information-disclosure regime, and given the distortion and unreliability of existing information disclosure, it may no longer be desirable to pursue this mode of ownership regulation.

Alternatively, Fenwick and Vermeulen point to a cultural shift in attitudes toward disclosure, in which a few firms are choosing to disclose information on control structures in an accessible and highly personalized manner. Once the authors have made the case for this “open communication,” they turn to a number of implications it has for the economics of the firm. First, open communication provides a simple mechanism to coordinate different relationships among the firms’ stakeholders. Second, open communication has the potential to encourage firms to engage in more effective and personal disclosure with the market. Third, it is likely that clear principles will evolve regarding how firms communicate with regulators. Thus the open-communication approach to beneficial disclosure may hold out an exemplar for dealing with many company misuse issues.

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1. *The Lesson of the Panama Papers*

The April 2016 leak of over 11.5 million confidential documents from a Panamanian law firm, Mossack Fonseca, placed the issue of beneficial ownership at the center of global media attention.² The Panama Papers exposed how the rich, powerful, and famous in some cases may have used elaborate corporate ownership and control structures to ring-fence³ their personal assets. The choice of offshore companies in lightly regulated tax havens was made on the — ultimately mistaken — belief that such activities would remain beyond the reach of regulatory and public scrutiny.

Not surprisingly, the public response to the disclosure of this information has been anger, and — at least for some of those implicated — the consequences were swift and dramatic. Within days, the prime minister of Iceland was forced to resign over a failure to disclose his interest in his family's offshore account. There was no suggestion that he had violated any Icelandic law, but a lack of transparency and a perceived conflict of interest were enough to irreparably damage him. Elsewhere, a number of other political leaders faced similar unwelcome questions about their own personal and family finances. Against a background of deep cuts in public services, the revelation that political elites and their families were avoiding the consequences of “austerity” met with widespread indignation.

More generally, release of the Panama Papers has contributed to the mood of public skepticism that currently surrounds the financial-services industry and corporate capitalism. Out of the 2008 financial crisis a new political discourse emerged as issues that were previously confined to the margins of economic debate — derivative contracts, credit default swaps, collateralized debt obligations — entered the mainstream political and media debate. Public confidence in the integrity of the corporate world is at an all-time low as scandals involving household brands have become an almost routine feature of everyday life. Previously respected companies such as Enron, Olympus, or Volkswagen

Within days, the prime minister of Iceland was forced to resign over a failure to disclose his interest in his family's offshore account.

² A beneficial owner is the ultimate natural person or state that benefits from the ownership of a company, even though formal legal ownership is in the name of another person (the “nominee” or “registered owner”). A more detailed discussion can be found in Section I.C, below.

³ Ring-fencing is when a portion of a company's assets or profits are financially separated without necessarily being operated as a separate entity. A ring fence is to protect the assets from inclusion in an investor's calculable net worth or to lower tax consequences.

The standard response of policymakers looking to appease the public in the wake of such scandals has been the introduction of more regulation.

We suggest that a demand for more and stricter mandatory disclosure rules is not necessarily the right lesson.

have become synonymous with arrogance, greed, and at times a breathtaking disregard for the law. Even global celebrities such as Leonard Di Caprio, George Clooney, and Angelina Jolie have joined the chorus of critics, using the platform afforded by fame to berate corporations for the harm (social, financial, and environmental) that they are now perceived to be causing.

The standard response of policymakers looking to appease the public in the wake of such scandals has been the introduction of more regulation. Earlier incidents involving large publicly listed firms, for instance, resulted in ever-stricter rules in the areas of corporate governance, tax, finance, and sustainability. In a U.S. context, “Sarbanes-Oxley” and “Dodd-Frank” function as shorthand for these new legal rules, but a similar trend can be found in most countries (McCahery and Vermeulen 2005). The inevitable result has been the emergence of a fragmented regulatory landscape that requires large modern corporations to make a much more significant investment in compliance and the management of legal risk (Fenwick 2015).

Much of the commentary in the immediate aftermath of the release of the Panama Papers was characterized by similar calls for stricter and more stringent rules that attempt to force more information into the public domain. Unsurprisingly, the regulatory strategies particularly focus on the disclosure of “ultimate beneficial ownership” as a prerequisite in preventing tax evasion, tax avoidance, money laundering, and corruption (for example, see *Economist* 2016). The leak has been interpreted as an opportunity for regulators, including the regulators of tax havens, to work together to develop a coordinated global solution that ensures greater transparency in the ownership of firms (Piketty 2014).

However, we suggest that a demand for more and stricter mandatory disclosure rules is not necessarily the right lesson—and perhaps even the wrong lesson—to be taken from this kind of scandal. In a globally connected society in which open communication represents the “new normal,” concealing information becomes increasingly difficult. In part, this is the result of digitalization, modern communication technologies, and social media, which make the instant reproduction and rapid global dissemination of information easier than ever before. And it is not feasible to expect to keep negative information secret, at least in the medium to long term.

In addition to this technological change, an important cultural shift has taken place in attitudes toward information disclosure. All stakeholders within and outside firms—investors, executives, managers, employees, professional service providers, business partners, consumers, and the general public—now expect and demand more open and honest communication practices. We need to understand that the recent proliferation of corporate scandals, as well as the Panama Papers, signals a new social order in which the nondisclosure of negative information is no longer tolerated (recall the prime minister of Iceland). Thus a lack of transparency in communication strategies has become a source of enormous risk for companies—as well as for individuals who have a reputation to lose.

Moreover, strategies of more open communication have become a source of tremendous opportunity for companies that can leverage such openness to their advantage. This cultural shift in the meaning of information management and communication strategy is the real lesson to be taken from the Panama Papers, and unpacking the implications of this technological and social transformation is the key challenge in formulating any regulatory response to scandals of this kind.

This paper expands on this idea by first introducing conventional debates on why beneficial ownership matters (Section II), with a focus on beneficial ownership in listed companies. We then introduce some of the strategies often used to conceal beneficial ownership (Section III)—it appears that, even in jurisdictions that have a robust disclosure regime, anyone wishing to conceal his or her beneficial ownership of a company has ample legal means to do so. We confirmed this assumption via an empirical study that examined how some of the largest and most successful companies currently comply with disclosure and reporting requirements for beneficial ownership (Section IV).

A key finding of the study is that the vast majority of companies currently engage in what we term “grudging” or “boilerplate” disclosure, in which formal requirements are met but the ultimate owner is often difficult or, in many cases, impossible to identify with any degree of certainty. This is true not only for companies that are controlled by multinationals and institutional investors but also for government-controlled and family/founder-controlled companies. Such firms signal to the market the greater risk that attaches to an investment. In the medium to long term, such companies seem likely to struggle;

A lack of transparency in communication strategies has become a source of enormous risk for companies.

A small number of companies with concentrated ownership structures go far beyond what the current disclosure rules oblige them to reveal.

at least, there are doubts about their capacity to attract the sustained rounds of new investment necessary to fund growth and long-term success (Vermeulen 2016).

By contrast, a small number of companies with concentrated ownership structures go far beyond what the current disclosure rules oblige them to reveal. Such companies present additional information; but more than that, they present this additional information in a more accessible and sometimes engaging and highly personalized way. We suggest that this approach, which we characterize as “open communication,” is an effective means of generating investor confidence and affords such companies the best opportunity of attracting new—and long-term—investment and, perhaps more importantly, new and productive relationships with other stakeholders that can add value to a business (Verhezen 2015).

Therefore, it would seem that, over time, the market itself might resolve the problem, because companies that communicate openly about corporate information, including ownership structures, seem better placed to flourish. But the problem is whether the market mechanism alone does enough *ex ante* to protect investors from investing in—and other stakeholders from engaging with—errant companies, or whether it ensures the most efficient allocation of capital. Some regulation is required (McCahery and Vermeulen 2014b).

Advocates of transparency and information-disclosure regimes suggest that more rules and regulations that compel and enforce transparency and mandatory disclosure unavoidably represent the most reliable means of ensuring the effective operation of the market mechanism. If potential investors have more information, then they can make better decisions, which in turn enhances the efficiency of the market.

Although some disclosure rules are clearly necessary, we claim that a regulatory approach that focuses exclusively on more transparency, disclosure, and reporting rules will not succeed and merely produces “reporting fatigue” and the kind of *grudging* compliance that currently seems to be the norm. The act of disclosure and reporting is framed and perceived as an obligation to be fulfilled and not an opportunity to add value. Therefore, efforts to compel more transparency via more rules may not have the intended, or hoped for, effects. Rather than promoting greater transparency, adding more layers of

transparency rules seems likely to induce even more evasiveness and formalistic compliance.

If the right kind of information is not forthcoming, then the market mechanism cannot function effectively. And if the wrong kind of information is being disclosed or if the information is presented—as it often is—in an impenetrable technical or legalistic style that renders disclosure meaningless, it may actually make the situation worse, as it has the potential to obscure the reality or create a misplaced sense of confidence in a particular firm or firms.

Instead, we argue that regulators need to focus on “nudging”—encouraging, persuading, and empowering—companies to recognize and embrace the commercial and other strategic benefits of more open communication (Section V). This would involve reframing the debate (from mandatory disclosure to open communication) and focusing on *nudging* firms to acknowledge the business case for open communication.

Crucially, the small minority of firms in our sample that are currently engaged in some form of open communication already seem to understand the multiple benefits of a more open and personalized approach to transparency. But for many firms—and particularly firms in emerging markets—some nudging may be required. We suggest that open communication about ownership and control structures not only will bring multiple benefits for individual firms but also will highlight the “gap” in approach between the different types of companies and alert stakeholders to the possible risks associated with engaging with companies that do not embrace such openness (Section VI). Doing so can enhance the efficiency of the market mechanism, further reinforcing the pressure on more recalcitrant firms to engage in meaningful communication.

The paper concludes by asking how regulators might achieve this “nudging” effect (Section VII). We suggest an approach in which regulators work together in partnership with companies, investors, and business practitioners to identify best practices and practical strategies for other firms seeking to take advantage of the multiple benefits of open communication.

If the right kind of information is not forthcoming, then the market mechanism cannot function effectively.

We argue that regulators need to focus on “nudging”.

2. *Why Disclosure of Beneficial Ownership Matters*

Conventional thinking suggests that public trust in corporations and markets largely depends on the existence of an accurate disclosure regime that provides transparency in the beneficial ownership and control structures of companies. Beneficial-ownership information is necessary to detect and prevent tax evasion, corruption, money laundering, terrorist financing, and other illicit behavior involving one or more companies. This is again confirmed after the Panama Papers leak. More importantly, the Panama Papers discussion shows that the general public increasingly finds the misuse of corporate structures unacceptable.

Moreover, investor confidence in financial markets is dependent on the accurate disclosure of the ownership and control structures as well as the ultimate beneficial owner (who could be an individual, group of individuals, or the state) of publicly listed companies. This is especially important in corporate governance systems characterized by concentrated ownership, such as Asia or parts of Europe (Bratton and McCahery 2001). In such systems, large investors with significant voting and cash-flow rights may facilitate long-term growth and firm performance (Mayer 2013). However, there is a risk that controlling beneficial owners, with large voting blocks, may also have an incentive to divert corporate assets and exploit opportunities for personal gain at the expense of minority investors and to the detriment of the company. Protecting such minority investors and ensuring the most efficient allocation of capital is seen as an important issue in the regulation of capital markets (Pacces 2013).

In addressing this issue, most jurisdictions have passed legislation mandating shareholders to disclose and report the accumulation of a substantial ownership of shares (Vermeulen 2013). The rationale behind disclosure requirements seems clear: by alerting minority investors or potential investors to material changes in control and ownership structures, we allow them to make a more informed assessment about the company's prospects. However, devising an effective legal framework that facilitates the disclosure of the *ultimate* beneficial owner has not proven easy. Even with a system of disclosure rules and regulations, the *true* ownership of a company can remain opaque or, in many cases, impossible to establish.

Investor confidence in financial markets is dependent on the accurate disclosure of the ownership and control structures.

The “separation of ownership and control” provides an opportunity for those in management to exploit their informational advantage.

The rest of this section provides more context for the issues and argument presented here. It describes the agency problems that have been identified in different types of securities markets, focusing in particular on markets associated with investor-controlled companies (Subsection A); describes the underlying rationale for the conventional measures (rules requiring disclosure of control structures) to address this problem (Subsection B); summarizes some of the main features of the current legal framework for ensuring disclosure (Subsection C); and explains which institution or person is responsible for the disclosure of the beneficial ownership positions (Subsection D).

A. The (Agency) Risks of Inside and Outside Ownership

In markets characterized by small and widely dispersed shareholdings—liquid trading markets—the corporate governance discussion has centered on creating mechanisms intended to curtail agency problems, notably those that arise between self-interested management and passive investors (Stout 2012). These problems are usually explained by the “vertical agency relationship,” in which the managers are the agents and the shareholders are the principals. This type of agency problem stems from shareholders being disengaged from the task of monitoring and, if necessary, disciplining management. The “separation of ownership and control” provides an opportunity for those in management to exploit their informational advantage regarding a company’s strategies, policies, and prospects without the risk of being detected (Jensen and Meckling 1976).

In the concentrated ownership—or “blockholder” systems—found in different forms in Europe, Asia, and other capitalist economies, the scale of the “vertical agency problem” is mitigated, because some investors tend to hold a disproportionately larger stake in listed companies and have both the incentive and the capacity to monitor and discipline management. In blockholder systems, we can distinguish two types of listed firms.

First, there are listed companies, such as those “controlled” by institutional investors, in which the substantial voting rights and cash-flow rights are identical and based on the proportion of total shares held. These investors, generally referred to as “outside blockholders,” make listed companies susceptible to a three-way conflict between controlling shareholders, managers, and minority shareholders. Since outside blockholders usually

mitigate the problems related to managerial opportunism, it is not surprising that policymakers and regulators focus on possible conflicts that may occur in the “horizontal agency relationship” between outside blockholders (and the managers, who have an incentive to respond to their demands) and passive minority investors (Bebchuk and Jackson 2011).

Note that in the current financial world, which is typically characterized by high-frequency trading and rapid and continuous changes in share ownership, institutional investors are inclined to focus on short-term returns. The short-term stance of the outside blockholders’ investment strategy exposes the minority shareholders to opportunistic behavior. Outside blockholders have increasingly used derivative instruments and short-selling techniques to make profits, which merely compounds the “horizontal agency problem” between outside blockholders and minority investors (Strine 2013).

Second, there are listed companies, such as the many family-owned—and sometimes even state-owned—companies, with “inside blockholders” who actually hold management positions or serve on the board of directors of the companies in which they invest. “Vertical agency problems” are irrelevant in this context, but “horizontal agency problems” are a major concern in listed companies with sizable inside blockholders (Holderness 2003).

In this context, the controlling shareholders may use several strategies to extract resources and assets from firms they control, thereby significantly increasing horizontal agency costs. Obvious risks include 1) dilutive share issues, 2) insider trading, 3) withholding important information from prospective investors, 4) allocation of corporate opportunities and business activities, and 5) related-party transactions. The aim of this section is twofold: first, to critically review the existing regulatory framework for mitigating these risks in the context of listed companies; and second, in light of various inadequacies with this framework, to propose an alternative framework that offers more satisfactory results.

B. The Rationale for Disclosure and Reporting Requirements

There is a wide range of legal mechanisms designed to prevent corporate actions that may lead to opportunistic behavior by blockholders. For instance, preemption rights in company-law statutes give all shareholders in a company the right to be

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Countries have implemented an array of legal and regulatory instruments aimed at information disclosure.

offered proportionally any newly issued shares before the shares are offered to either nonshareholders or one or more of the existing shareholders. Because the offer of new shares to existing shareholders usually must be made on a pro rata basis, this legal provision prevents blockholders from expropriating the interests of minority investors by initiating dilutive share issues.

A second example of legal provisions that regulate potentially self-dealing transactions can be found in the listing rules of several Asian countries. The listing rules of the Hong Kong SAR and Singapore stock exchanges, for instance, insist that material related-party transactions be put to a vote by the minority shareholders of listed companies, providing them with information and control over expropriation attempts.

Nevertheless, no matter how effective these mechanisms are, they do not provide a sufficient remedy for the challenge raised by blockholders. Indeed, minority investors must have the means of monitoring and observing blockholders' behavior to detect possible opportunism and expropriation at an early stage. Therefore, an accurate disclosure and reporting regime that provides transparency in the ownership and control structures of publicly listed companies is generally considered an essential element of an effective corporate governance infrastructure (Easterbrook and Fischer 1991). If an investor or potential investor has more information regarding the ownership structure, particularly relating to the ultimate beneficial ownership, then that investor can make better decisions, which in turn enhances the efficiency of capital flows within the market (Jurdant 2013). Information disclosure thus increases market efficiency. Below, we will question this justification, but for the moment let us examine the type of legal framework that this way of thinking has produced.

C. The Current Legal Framework

In dealing with beneficial ownership and control issues, countries have implemented an array of legal and regulatory instruments aimed at information disclosure. In most jurisdictions, these instruments are included in their securities laws and regulations (including listing rules). This subsection briefly summarizes some of the main features of the current legal framework for ensuring disclosure. We should note, however, that even though there is a significant degree of convergence, certain jurisdictions offer lax and flexible company laws that make it relatively simple

to conceal beneficial-ownership positions. We discuss these strategies in Subsection D.

At the core of most disclosure laws is a definition of the beneficial owner. In general, a beneficial owner can be defined as the legal or natural person entitled to the benefits accruing from the beneficial ownership of securities and/or having power to exercise controlling influence over the voting rights attached to the shares. Different jurisdictions fill out this bare-bones concept in different ways. At one end of the spectrum, we find jurisdictions where the definition of beneficial ownership is restricted to certain benefits, most obviously the pecuniary benefits attached to the shares. A more detailed definition can be found at the other end of the spectrum, where a beneficial owner is defined as the ultimate owner of the deposited securities and is entitled to all rights, benefits, powers, and privileges and subject to all liabilities, duties, and obligations attached to, or arising from, the deposited securities.

Generally speaking, there are three groups of natural persons/legal entities for which the disclosure of beneficial ownership information is required. In the first group are directors and chief executives/senior officers, who are required to make disclosure of their interests in the company, regardless of their actual shareholding percentage. The second group includes substantial shareholders, which are classified by a minimum shareholding percentage (usually fixed at 3 percent, 5 percent, or 10 percent) and are required to report their beneficial ownership.

Most jurisdictions distinguish between *de jure* and *de facto* beneficial ownership. The third group consists of *de facto* owners. Because it is the rule rather than the exception to look at *de facto* beneficial ownership in addition to *de jure* beneficial ownership, a pertinent issue is the content of such *de facto* ownership. In very general language, applying such a concept will result in shares held under the name of third parties also being counted as under the control of the beneficial owner.

The first and most straightforward category of ownership is when the shareholders are natural persons. Applying the concept of *de facto* beneficial ownership results in the securities held by a person's spouse and/or minor children being counted as securities held by that person. To be sure, this is a common practice adopted in most jurisdictions around the world.

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To attain more voting/control rights in excess of the cash-flow rights, a shareholder may use a set of control-enhancing mechanisms.

The second category is when another company holds the shares of a listed company. The de facto approach would certainly require that disclosure be made beyond the level of the signatory of the “institutional” shareholder, but the key issue here is how far the disclosure could reach. Is a beneficial owner recognized at the first, second, or the ultimate layer of beneficial ownership of shares in listed companies? Although most jurisdictions do mandate that disclosure be made to the level of ultimate beneficial owner(s), their answers to this question still vary a great deal regarding the technical particularities about how to reach the ultimate beneficial owners. One example is the threshold of shareholding that would constitute “control” in a company, which could vary from 20 percent to 33 percent among the responding jurisdictions in a recent OECD study on beneficial ownership in Asia (OECD 2016).

De facto beneficial ownership also covers the situations where two or more people jointly hold shares. Most jurisdictions also impose a disclosure obligation on beneficial owners “acting in concert.” A special kind of shareholder is a trust. Consistent with the above, if a jurisdiction requires disclosure of beneficial ownership up to the ultimate level, this requirement usually already covers the obligation of disclosing trust arrangements.

To attain more voting/control rights in excess of the cash-flow rights, a shareholder may use a set of control-enhancing mechanisms. Typically, such mechanisms (discussed in more detail below) include pyramid structures, cross-shareholdings, dual-class shares and nonvoting shares, derivative products of shares (depository receipts), and shareholder coalitions and agreements. Certainly, while using mechanisms to enhance control in general is not uncommon, one jurisdiction can differ from another in the extent of regulatory acceptance of these mechanisms, resulting in one or more of them being illegal or at least somehow conditioned in certain countries.

D. Who Must Disclose?

In general, disclosure of beneficial ownership is mandated first from the (potential) beneficial owners themselves. These typically include directors and chief executives (to whom no minimum shareholding applies) and substantial shareholders, defined as holding at least 3 percent, 5 percent, or 10 percent of the company’s (voting) securities. These individuals or other entities (including their authorized nominees) are obligated to

report relevant information about their beneficial ownership in the company, which in turn should record such information in its register of shareholders, prospectus, and/or periodic reports (if and where applicable). Thus both beneficial owners and the listed company have the obligation to disclose, in an accurate and timely manner, information about beneficial ownership in the company to the national securities regulator and/or the stock exchange where the company is listed. Finally, listed companies must include information about their major shareholders (and usually also the beneficial owners) in their annual reports.

Consistent with the de facto approach, however, third parties other than the beneficial owners and the listed companies may also be subject to certain obligations, with the aim of enhancing beneficial-ownership disclosure. One important group of “other third parties” consists of firms involved in the service and consulting industry. These firms often have obligations to identify the ultimate beneficial owners of the client companies under “customer due diligence” rules and regulations based on Financial Action Task Force (FATF) standards (FATF 2012).

Reporting requirements also include the ownership of bearer shares, which are still considered legal in certain jurisdictions. Bearer shares normally are not registered in a shareholders’ register, making it almost impossible to determine the identity of the shareholders. To be sure, registration with the company is often necessary, at least if holders of bearer shares intend to vote or want to receive dividends. Without effective disclosure and reporting requirements, however, bearer shares might enable shareholders to secretly acquire potential control over a listed company, thereby facilitating market manipulation and abuse.

Bearer shares normally are not registered in a shareholders’ register.

3. *Multiple Strategies for Concealing Beneficial Ownership*

Even with a robust disclosure regime in place, however, a number of lawful mechanisms make it possible to conceal the true identity of the ultimate beneficial owner of a company's shares. This section briefly examines various strategies of those seeking to conceal beneficial ownership (Subsection A) and suggests that the ready availability of such concealment strategies undermines the effectiveness of any approach that aims to compel disclosure (Subsection B).

A. Concealment Strategies

The aim of this subsection is not to provide a comprehensive discussion of concealment strategies but rather to indicate the range of options available to anyone determined to conceal his or her ultimate beneficial ownership of a company. We offer the following brief descriptions of some of the more popular options.

1. Nominee shareholders. In practice, a nominee shareholder is typically a company created for the purpose of holding shares and other securities on behalf of investors. Nominee shareholders hold the shares on trust for one or more beneficial owners, and often only they are identified on the register of shareholders. Usually, foreign investors have to open single-client nominee accounts, because their global account provider is not permitted to participate directly in a local central securities depository. The concern for regulators is clear: the appointment of nominee shareholders would, in effect, provide beneficial owners the opportunity to shield their true identity from investors and other stakeholders, making it more difficult to detect expropriation by controlling beneficial owners.

2. Omnibus accounts. An omnibus account is a securities account that involves many investors. Although the account is opened in the name of the account provider, it can be viewed as an umbrella covering a large number of individual accounts. Omnibus accounts seriously reduce transaction costs that are due to clearing and settlement fees and procedures. There are often legitimate reasons to use omnibus accounts, particularly in less developed markets. However, because the breakdown behind the omnibus accounts is often hidden for the listed companies and

A number of lawful mechanisms make it possible to conceal the true identity of the ultimate beneficial owner of a company's shares.

In most countries, ownership pyramids or cascades are the most widely used mechanism to accumulate control power with a relatively limited investment.

their investors, they could also serve as an instrument to conceal the identity of beneficial owners.

3. Derivatives. Recently, investors have used cash-settled equity derivatives and related techniques to obtain effective control of the underlying shares without the need for disclosure under the transparency and disclosure regimes. Consider the following transaction: An investor (also called holder of the long position) purchases and acquires from a derivatives dealer or bank (the holder of the short position) a long cash-settled swap covering the underlying shares in a listed company. Under the agreement between the holder of the long position and the holder of the short position, the investor benefits from price increases in the underlying shares and incurs losses if the price decreases. The derivatives dealer usually assumes a neutral risk position by physically acquiring the underlying shares at the strike price of the derivative. The swap arrangement thus results in a decoupling of the voting rights from the beneficial ownership of the shares. The decoupling leads to “hidden ownership” and could also result in “empty voting” issues, where a shareholder only retains the voting rights of the shares (Hu and Black 2006).

4. Pyramid structures. There are complex control and ownership arrangements designed to give investors voting/control rights in excess of their cash-flow rights. These arrangements are commonly used by inside blockholders, who usually have voting control even if they ostensibly have no majority stake in the company. Voting rights, for instance, can be separated from cash-flow rights by setting up pyramid or cross-shareholding structures, issuing multiple voting-rights shares, and participating in shareholder coalitions. In most countries, ownership pyramids or cascades are the most widely used mechanism to accumulate control power with a relatively limited investment. They enable a shareholder to maintain control through multiple layers of ownership and, at the same time, share the investment with other (minority) shareholders at each intermediate ownership tier. Pyramid structures reduce the liquidity constraints of large shareholders while allowing those shareholders to retain substantial voting power.

5. Multiple voting-rights shares. Such shares provide shareholders with control in excess of their share ownership. The separation of beneficial ownership from control rights (or voting rights) results in significant private benefits beyond the usual financial return on the shares. The negative effect of

concentrated ownership is reflected in the size of the control premium—the difference between the market value of shares and how much someone is willing to pay for those shares if they confer (or maintain) control over a company.

The existence of a control premium enables “controlling” shareholders to make gains at the expense of minority shareholders. The size of the control premium depends on a number of factors, including the competition in the market for corporate control, the size of the block sold, the distribution of shares in the target firm, the inequality of voting power, the nationality of the buyer, and the financial condition of the firm involved. The existence of large private benefits of control suggests that blockholders may be able to obtain a large share of the rents. For instance, the holder of multiple voting-rights shares is usually allowed a seat on the board of directors and will thus receive nonpublic information on the company’s cost structure and performance. Multiple voting rights or dual-class shares are prone to severe agency problems (McCahery and Vermeulen 2014c).

6. Chains of corporate vehicles. Controlling beneficial owners can use chains of corporate vehicles to conceal their true identity and set up complex ownership structures and arrangements in listed companies. Companies may have legitimate or clear economic motives to use chains of corporate vehicles. However, the use of a chain of local and offshore corporate vehicles or international holding structures is sometimes an indication that controlling beneficial owners are engaging in abusive and opportunistic behavior, particularly when offshore company laws do not require ownership disclosure.

While misuse of corporate entities is often difficult to discover, it is possible to limit the potential for misuse of corporate vehicles by having companies maintain and share information on beneficial ownership and control in the corporate vehicle. This requirement may come through a number of legal and regulatory measures, including 1) requiring upfront beneficial ownership disclosure to the public authorities and official intermediaries, 2) mandating private corporate service providers to maintain beneficial ownership information, and 3) primary reliance on an investigative system.

The crucial takeaway from this brief review of selected concealment strategies is that devising an effective legal

The existence of a control premium enables “controlling” shareholders to make gains at the expense of minority shareholders.

framework that facilitates the disclosure of the “ultimate” beneficial owner is not easy. Yet the central question is whether the introduction of more stringent disclosure and reporting rules will in fact improve the ownership and control information available to regulators, investors, and other stakeholders.

B. Stricter Disclosure Rules?

The availability of multiple strategies for concealing beneficial ownership creates a perception that the regulatory framework—and particularly the transparency regime—is failing to adequately address the issue of agency risks. As the leaking of the Panama Papers also shows, the perception of regulatory failure has led to calls for more and stricter disclosure requirements.

For instance, the G20 considers the transparency of beneficial ownership of legal persons and arrangements, as well as the implementation of the FATF standards on this issue, a matter of high priority. In November 2014, the G20 Summit in Brisbane adopted new “High-Level Principles on Beneficial Ownership and Transparency.” The principles, which build on existing international instruments and standards, encourage countries 1) to have a definition of “beneficial owner” that captures the natural person(s) who ultimately owns or controls the legal person or legal arrangement, 2) to ensure that beneficial-ownership and control information is adequate, accurate, current, and accessible, and 3) to have a legal framework that enables national authorities (including law enforcement and prosecutorial authorities, supervisory authorities, tax authorities, and financial-intelligence units) to participate in information exchange on beneficial ownership both domestically and internationally. The importance of beneficial ownership and control disclosure was again emphasized in the G20/OECD Principles of Corporate Governance.

In what follows, we suggest that it might be time to acknowledge the limitations of the existing disclosure-oriented approach to this issue and contemplate an alternative to ever-stricter reporting requirements. After all, as the discussion above brought out, if people are determined to conceal, or at least obscure, their beneficial ownership of a company, then they are going to be able to find the techniques to do so. There are enough lawful strategies available to make this possible without having to resort to misrepresentation. From this perspective, simply ratcheting up the disclosure requirements to force the information into

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the public domain seems unlikely to be effective and merely encourages new and more imaginative means of circumvention.

The reality that multiple strategies for circumvention are so readily available undermines the prospects of any regulatory regime predicated on compelled information disclosure. If the right kind of information is not forthcoming, then investors are going to make suboptimal investment choices and the market is not going to function at full efficiency. In particular, companies with the most problematic control structures will not be revealed. If the wrong kind of information is being disclosed, market efficiencies may actually be worse, as false information has the potential to create a misplaced sense of confidence in a particular firm. And companies with the better control structures will not enjoy the benefits.

Of even greater significance is the impact that more and stricter disclosure requirements might have on the vast majority of firms that do not wish to conceal their ownership structures and—at least initially—seek to be open and sincere in their disclosure efforts. What is the likely effect of more rules on this type of firm? Will more and stricter disclosure rules contribute to a positive change of their behavior? Or might such rules have other, unintended and unexpected, effects?

Our starting point in seeking to answer these questions was the suspicion that more rules may actually create confusion among such firms and contribute to “reporting fatigue,” with firms growing increasingly tired, indifferent, or evasive when confronted by the demand for more transparency. Our hypothesis, therefore, was that an unintended and counterproductive effect of more transparency rules may be disclosure that is actually less meaningful—across the vast majority of companies, not just those where beneficial owners seek to obscure their ownership interests.

There are good reasons for this kind of skepticism. Although some of the existing regulations certainly have proven to be more effective than others (for example, rules regarding the disclosure of related-party transactions), this is not always the case. Law reforms—and particularly the ones hastily enacted in the shadow of high-profile corporate scandals—have spawned many cumbersome and costly rules that are unproductive (unable to change corporate behavior and prevent more failures) and occasionally destructive.

Our hypothesis, therefore, was that an unintended and counterproductive effect of more transparency rules may be disclosure that is actually less meaningful.

In this context, we refer not only to the direct compliance costs but also to the adoption of a risk-averse “depersonalized corporate culture” based on box-ticking and an overemphasis on formalistic compliance. For a better sense of the emergence of this type of depersonalized corporate culture, consider the role of consultants and intermediaries, such as corporate lawyers, accountants, auditors, and other advisers. These intermediaries are generally considered to be conservative, risk averse, and reluctant to think creatively. They tend to recommend boilerplate standardized arrangements and compliance with one-size-fits-all best practices rather than offering their clients customized and optimal solutions.

To examine more closely this skeptical perception of the likely effects of more transparency rules, we conducted an empirical review of how disclosure rules currently operate in multiple jurisdictions, and we focused in particular on how firms respond to such rules. If we assume that previous behavior is the best predictor of likely future behavior, the results of such a study can provide important evidence for understanding the probable effect of even more transparency rules.

4. Mapping Disclosure and Transparency

Our first step in seeking to better understand the past—and likely future—impact of disclosure and reporting rules was to learn how some of the largest and most successful companies in various jurisdictions have actually complied with the existing transparency requirements. In this section, we describe the methodology adopted in this empirical study (Subsection A) and identify the various different approaches to complying with disclosure requirements, ranging from “no disclosure” to “open communication” (Subsection B). The key takeaway is that—even in those jurisdictions that have (or are known for) a robust disclosure regime—the majority of firms engage in “grudging” or “boilerplate” compliance in which control and ownership structures are not revealed in an accessible way and, perhaps more importantly, the impact of these structures on the governance of a company are obscured. The study results suggest that the majority of firms are failing to engage in meaningful disclosure and that the transparency rules are not having the intended or hoped for effects (Subsection C).

A. A Note on Methodology

How do disclosure rules work in practice? How do firms actually disclose information about beneficial ownership, and how easily can potential investors find information about the beneficial owner of a company? For potential investors unfamiliar with the local situation, how quickly, reliably, and accurately can such information be established, if at all? Finally, might broadly similar disclosure rules have different results in different jurisdictions?

To explore these issues, we conducted an empirical review of current practice, focusing in particular on disclosure in annual reports. Although information regarding beneficial and ultimate owners is available from a range of sources (such as corporate websites and other publicity materials), we assumed that a firm’s annual report can be legitimately taken as a proxy for the disclosure and reporting of ownership more generally.

We were particularly interested in answering the following questions: 1) Can the natural persons (or, for state-owned enterprises, the particular state) that ultimately owns and/or controls the company be found based solely on information contained in the annual report? 2) How is information regarding

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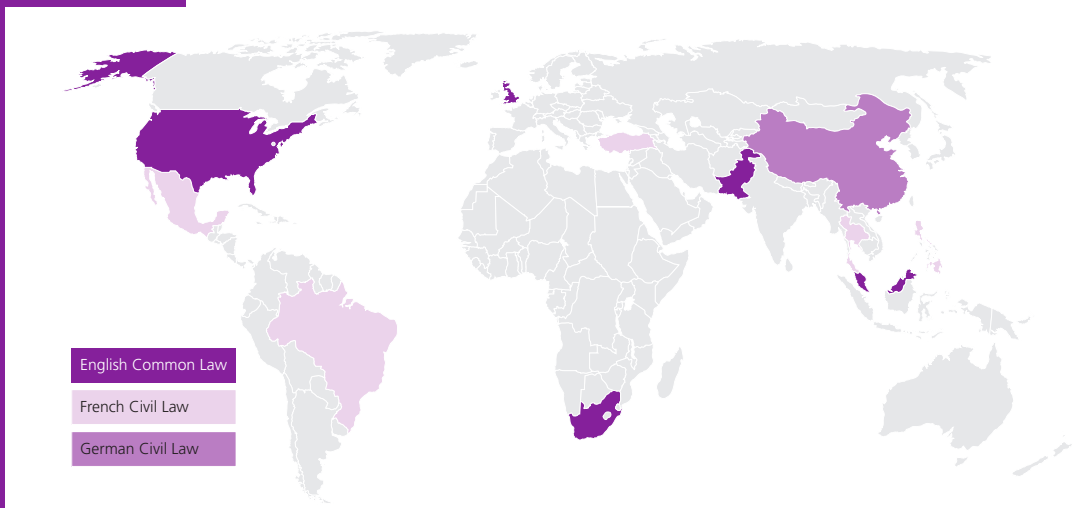
Many of these companies are household names and recipients of awards for best corporate governance.

substantial shareholders and beneficial owners actually presented in the annual report, and what patterns can we see in approaches to information disclosure? 3) To what extent is the impact of ownership on the actual governance of that company disclosed? 4) How does the presence of widely dispersed ownership affect the dynamics of information disclosure?

To answer these questions, four of us — two corporate governance experts and two people who had no affiliation with corporate law — examined the 2014 annual reports of 280 listed firms from 14 jurisdictions. With the exception of China, we focused on the English-language version of the reports. This section contains their consolidated view. The sample consisted of the top 20 firms, according to their market capitalization on May 29, 2015, in the stock market index of each of the 14 jurisdictions. Many of these companies are household names and recipients of awards for best corporate governance (something that we noticed is often prominently displayed in their annual reports).

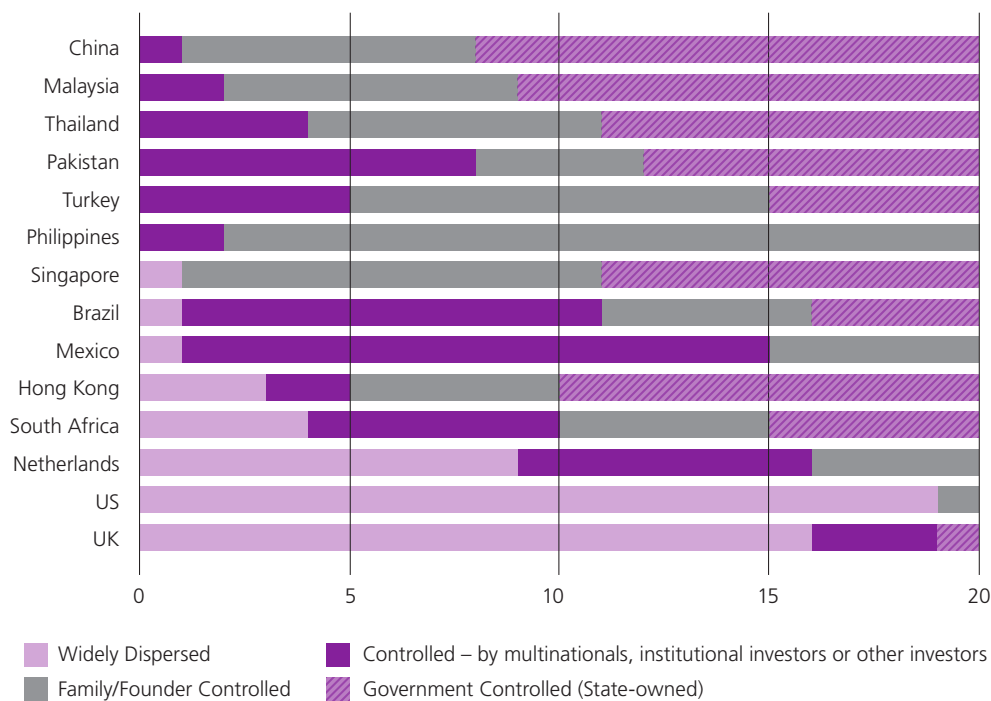
A number of considerations influenced the choice of jurisdictions. In particular, we wanted to select countries with diverse legal origins and diverse ownership structures. Broadly speaking, the 14 selected jurisdictions can be split into three legal traditions (see Figure 1), namely English common law (Hong Kong SAR, Malaysia, Pakistan, Singapore, South Africa, the United Kingdom, and the United States), French civil law (Brazil, Mexico, the Netherlands, the Philippines, Thailand, and Turkey), and German civil law (China).

Figure 1: The Jurisdictions



There are also significant differences in the prevailing ownership structures (see Figure 2). The Netherlands regime lies between the Anglo-America systems of diffuse or widely dispersed stockholders (as can be found in the United Kingdom and the United States) and the concentrated ownership characteristics of the other countries in the sample. Moreover, countries can also be characterized by the type of controlling shareholder (in China, for example, state-owned enterprises play a pivotal role, whereas the Philippines is clearly dominated by family-owned companies). We wanted to choose jurisdictions from different continents and to select the more developed securities markets within each region. In this way, we could ensure that the firms we examined are representative of the current reality regarding disclosure of beneficial ownership. An interesting observation is also that the Panama Papers had a disproportionate impact on most of the countries we investigated.

Figure 2: Ownership Structures



By selecting the top 20 firms of jurisdictions with more developed stock markets, we ensured that companies not in compliance with the rules were weeded out and excluded from the study.

Thus the focus of this survey is on the disclosure practices of companies that do comply with the rules, rather than with the issue of noncompliance.

To map how firms actually comply with disclosure rules, we conducted a preliminary study in which we examined the disclosure practices of a random sample of well-known companies that appear on the list of Financial Times Global 500 companies (which provides a snapshot of the world's largest companies according to their market capitalizations). This preliminary study of annual reports yielded seven variables, which we designed to measure the full range of disclosure options, from minimal to full, or optimal, disclosure (See Figure 3).

Figure 3: The Variables



In the preliminary study, we found that *a table of substantial shareholders* (Variable 1) and *disclosure of beneficial owners* (Variable 2) were present in all of the reports. This seemed to constitute the absolute minimum level of disclosure but need not

Thus the focus of this survey is on the disclosure practices of companies that do comply with the rules, rather than with the issue of noncompliance.

necessarily identify the ultimate beneficial owners, particularly the natural persons or state, that control the company.

Disclosure of the ultimate beneficial owner (Variable 3) was the next step along the disclosure trail. Such disclosure meets the G20 requirement of identifying the natural persons, or the particular state, that control the company. Information about the ultimate beneficial owners sometimes could be determined indirectly by going through the annual report. At times it was possible to guess who the ultimate beneficial owners were, particularly when they also held management positions or directorships. Here we mainly focused on explicit, direct, and detailed disclosure of ultimate beneficial owners, but we also took “indirect” disclosure into consideration. However, establishing this information was not always easy. Trawling through 200-plus pages of an annual report to identify the ultimate beneficial owner could be time-consuming, as the information was not always readily accessible and there was a risk that it was not 100 percent accurate.

To measure for speed, accessibility, and precision in the disclosure of ultimate beneficial ownership, we identified two additional variables, namely *speed: ownership information in table of contents* of the annual report (Variable 4) and *accessibility: figures and charts of ownership* (Variable 5). If these additional variables were present, the report was immediately more accessible. More importantly, it became possible to determine the identity of the ultimate beneficial owners with a greater degree of accuracy.

But more is needed if investors really want to understand the role of the ultimate beneficial owner. A sixth variable was *precision: technical description of ultimate owners and impact on corporate governance* (Variable 6). Firms that included this point move beyond the mere facts of ownership to what really matters, namely how ownership structures affect the actual governance structure of that company (preferred ownership).

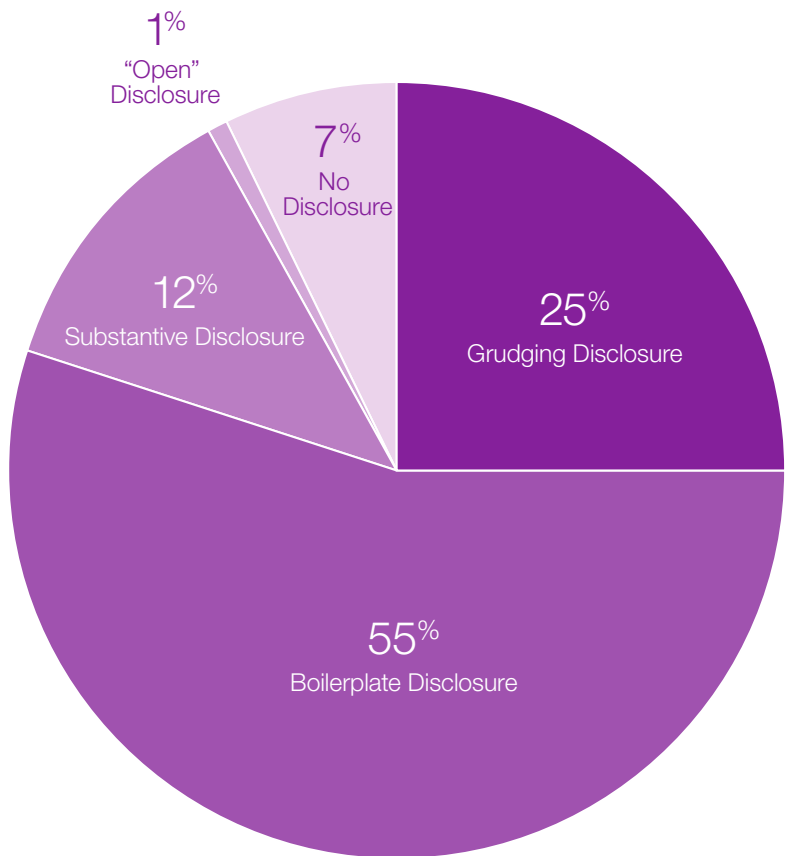
Finally, we wanted to adopt a variable that could function as an index of how some firms adopt or could adopt a radical approach (optimal disclosure) in which the facts of ownership and actual governance are explicitly connected and made transparent. For this, we chose *personalized communication* (Variable 7) in which the ultimate owner speaks directly and openly to shareholders and potential shareholders about the current state of the company.

But more is needed if investors really want to understand the role of the ultimate beneficial owner.

B. Five Different Approaches to Disclosure of Ownership

We then examined the 280 companies to see which of the seven variables were present in their annual reports. Based on the resulting dataset, we identified five different approaches to disclosure, and we developed a typology of five categories of information disclosure (see Figure 4).

Figure 4: Disclosure Approaches in 280 Annual Reports (Beneficial Ownership)



1. No disclosure (7 percent). None of the seven variables was present in the annual reports. In jurisdictions with a lack of clear rules and practices promoting the disclosure of beneficial ownership and control structures, the information in the annual reports typically does not identify the natural persons, states, multinationals, or institutional investors that ultimately own or control the company. That is not to say that these companies completely ignore the disclosure of ownership and control

structures. Their websites, for instance, usually contain an overview of the ownership structure. Unfortunately, however, the information in these overviews is not very detailed. It is noteworthy that Brazilian and Mexican companies that are deemed “foreign private issuers” under the Securities and Exchange Commission rules and regulations in the United States (because they have listed equity shares on U.S. exchanges and so have to file an annual report in the form of a 20-F) are more open. “Item 7” of their SEC Form 20-F annual reports requires them to list major shareholders and related-party transactions.

2. Grudging disclosure (25 percent). The first two variables (*table of substantial shareholders and disclosure of beneficial owners*, but not necessarily the ultimate owners) were present in the annual reports. This group comprises those companies that engage in what we would characterize as a grudging style of disclosure, in which the formal reporting requirements are met but the ultimate beneficial owner is often difficult, and in many cases impossible, to identify. Of particular interest is a certain amount of herd behavior: if you do not find the information in one company in a particular jurisdiction, then you are not likely to find it in other companies in the same jurisdiction. For instance, the disclosed information does not show the percentage ownership or fails to explain the relationship between the controlling shareholder, the ultimate beneficial owner, and the company—particularly when companies assume that certain information about shareholders and beneficial owners can be regarded as “local” or “public” knowledge.

3. Boilerplate disclosure (55 percent). In addition to Variables 1 and 2, Variable 3 (*disclosure of the ultimate beneficial owner*) was present in the annual reports. This group comprises the majority of companies that formalistically reveal the ultimate beneficial ownership structure. However, they often do so in a dry and literal manner that does not reveal much beyond the bare bones of ownership structures. Moreover, such firms often adopt a legalistic style of presentation—technical and footnote-heavy rather than reader-friendly—that often requires a certain degree of expertise or local knowledge to decode the information, and that provides little indication of how control affects the governance and direction of that firm.

In this group we also find companies with widely dispersed shareholders, when they listed in their annual reports the institutional investor or investors that beneficially hold a certain

If you do not find the information in one company in a particular jurisdiction, then you are not likely to find it in other companies in the same jurisdiction.

It isn't surprising that boilerplate disclosure has become the norm for widely dispersed companies in an increasingly regulated environment.

substantial percentage (more than 35 percent or 50 percent) of the outstanding shares of the company. It isn't surprising that boilerplate disclosure has become the norm for widely dispersed companies in an increasingly regulated environment.

Finally, it is often impossible for these companies to provide more information about the institutional investors that hold a significant number of their shares. Yet if institutional investors pursue a more active role in the operation of the company (or at least give this impression by owning, for instance, approximately 10 percent of the outstanding shares), these "activist investors" and the company could behave similarly to companies with a controlling shareholder and go beyond what is accepted as boilerplate disclosure and embrace a more substantive disclosure approach.

4. Substantive disclosure (12 percent). Variables 1, 2, and 3 were present as well as two of the three variables, 4, 5, and 6. This group comprises companies that include additional information beyond boilerplate disclosure. In particular, they present the information in a *speedy* (table of contents), *accessible* (figures and charts), and *precise* (technical description) style and reveal how ownership structures and governance of the company are interconnected. After all, identifying the ultimate beneficial owner does not reveal anything about how control structures affect the actual governance of the firm, and this is what potential investors are most concerned with.

An example of a clear statement about the relationship between the controlling owner, the company, and its stakeholders can be found in the annual report of Luxottica, the Italian eyewear company. The company is not in the sample but appeared in the 2014 *Financial Times* Global 500 list used in the preliminary study. The annual report makes it clear that, if there is a problem or disagreement regarding the direction of the business between other shareholders and controlling owner Leonardo Del Vecchio, he would exert his authority. Investors may not like this, but at least they are made aware of the reality of how the governance of the company is actually organized.

Interestingly, companies that are listed in China generally adopt a more substantive and accessible disclosure practice than their counterparts/peers in other jurisdictions. China Securities Regulatory Commission rules and regulations are undoubtedly the main drivers of the disclosure practice of Chinese listed

companies. The *Standards for the Contents and Formats of Information Disclosure by Companies Offering Securities to the Public No. 2—Contents and Formats of Annual Reports* (2014 Revision) contains detailed and stringent rules about the format for disclosing beneficial-ownership information (Article 40). As a result, most annual reports include information about the actual controlling owners and their relationship with the companies (suggesting that “law matters”). We should note, however, that in most cases these statements were standardized and meaningless, in that they failed to provide clear information. Moreover, most are available only in the Chinese language, so their efficacy for foreign investors is limited.

5. Open communication (1 percent). All seven variables were present in the annual reports. This final group comprises a very small number of companies that go far beyond what the disclosure rules oblige them to reveal. Not only do these companies present additional information, but they also present it in a detailed, easily accessible, and highly personalized way. That is to say that the controlling and ultimate owners (or their representatives, in family firms or state-owned enterprises) address their “fellow shareholders” in the annual reports (or separate shareholder letters) with a mix of business facts, ownership issues (such as succession and transition), innovations, and long-term expectations. They go beyond strict compliance with corporate governance rules and regulations and adopt a more integrated approach to their communication and presentation of information.

The companies in our sample (and in the *Financial Times* Global 500 list) that have embraced the “personalized and open communication” approach are usually characterized by visionary and often charismatic owners or founders who position themselves as managing partners or dominant leaders of their “corporate partnership.” They explain in detail how they are going to propel “their” company toward value creation in the short, medium, and long terms. As a real partner, they also admit operational mistakes and challenges. It is therefore no surprise that the family-controlled or founder-controlled companies in our sample are among the first movers that pursue the open-communication model.

A well-documented example of a company that has adopted this type of partnership attitude is Warren Buffet’s Berkshire Hathaway. His annual letters to shareholders are considered

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It is therefore not surprising that these letters from Warren Buffet and Jeff Bezos attract enormous attention on social media.

a “must read” for anyone with an interest in the corporate world (Cunningham 2014). The same goes for the letter to the shareholders that Jeff Bezos, the founder, chief executive officer, and substantial shareholder of Amazon, has written every year since the company’s initial public offering (IPO) in 1997. What is perhaps most interesting is that these letters not only provide investors and other stakeholders with last year’s financial information and future developments and growth prospects but also include business advice and insights. It is therefore not surprising that these letters from Warren Buffet and Jeff Bezos attract enormous attention on social media. They have created significant hype, which makes the communication even more personalized, open, and effective.

Consider also Google (or business conglomerate Alphabet). On April 8, 2013, the Google founders owned more than 80 percent of the outstanding Class B shares, giving them about 56 percent of the firm’s total voting power. Since their IPO in 2004, the founders have made very clear to investors and other stakeholders that the ownership structure is designed to give the founders long-term control over the company’s destiny (McCahery, Vermeulen, and Hisatake 2012).

Having reviewed the five models, we can now consider the prevalence of each approach in each jurisdiction and each type of company, according to ownership structure (see Figures 5 and 6).

Figure 5: Disclosure of Beneficial Ownership Practices (Countries)

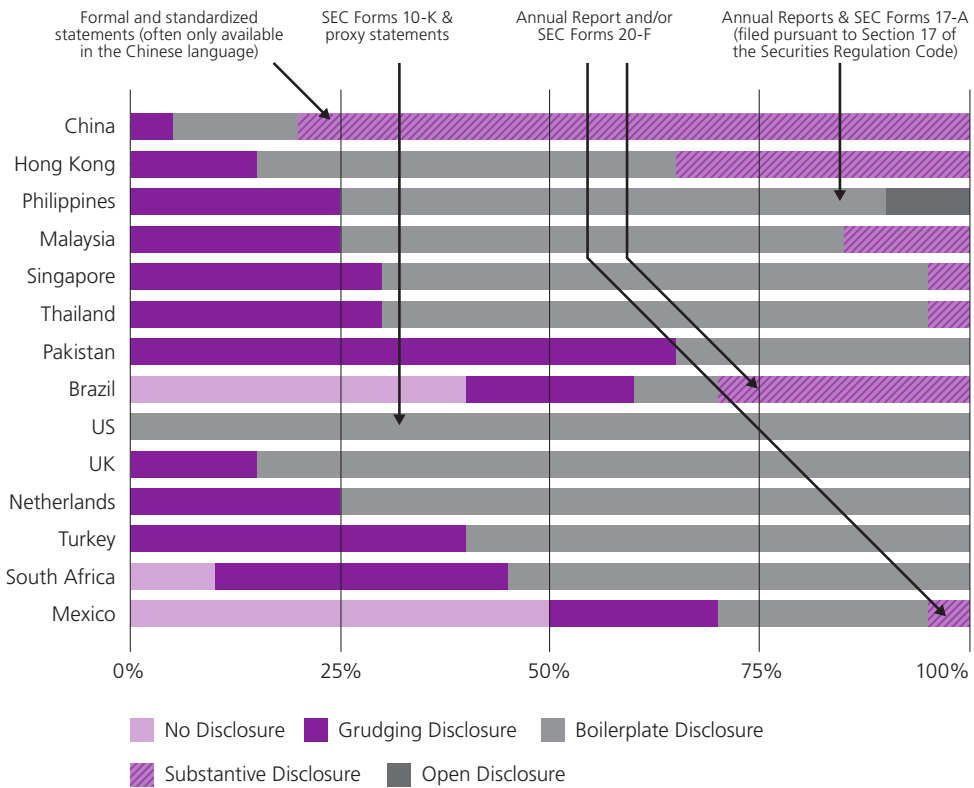
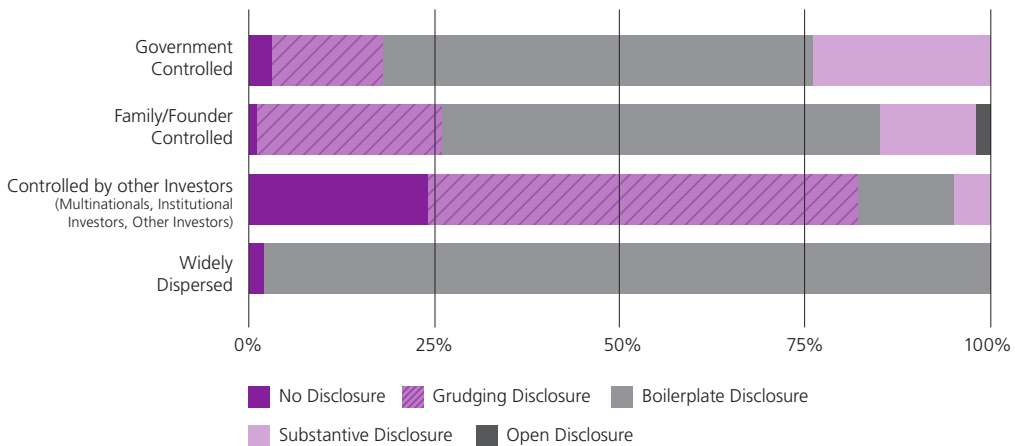


Figure 6: Disclosure of Beneficial Ownership Practices (Ownership Structures)



The prevalence of grudging and boilerplate disclosure among the supposedly best-run examples of the controlled companies exposes the false reality that currently surrounds the disclosure of beneficial ownership.

The prevalence of grudging and boilerplate disclosure among the supposedly best-run examples of the controlled companies exposes the false reality that currently surrounds the disclosure of beneficial ownership. For the vast majority of firms, we do not really know what is going on. This is true not only for companies that are controlled by multinationals and institutional investors but also for those controlled by government or families/founders. We have found a few exceptions in the Philippines, which is dominated by family-owned conglomerates. These conglomerates, specifically the Ayala Group and Aboitiz Group, understand the importance of personalized communication. They understand that their investors and other stakeholders not only are interested in the dry and formal financial statements but also look for more personalized expressions and authenticity.

Unfortunately, however, formal compliance has triumphed over substantive compliance. Most companies may believe that they are actively engaged in disclosure (and from a compliance point of view they are certainly meeting the legal requirements), but we can see from the data that in many cases this is mere legal and financial theatre. Nevertheless, we have also find some best-in-class examples in our dataset. In the remainder of this paper, we argue that the behavior of these examples will become more and more common practice in the future.

C. From “Mandatory Disclosure” to “Open Communication”

Corporate scandals and events such as the leaking of the Panama Papers have resulted in lots of initiatives advocating stricter transparency rules and regulations. However, based on how such rules are currently functioning, we suspect that further rules are unlikely to improve the situation by actually contributing to a positive change in firms. The above data seem to confirm this view and suggest that maybe we don't need more and stricter rules. The current effect of disclosure rules has been to promote among most firms a defensiveness that has resulted in formalistic compliance. The crucial takeaway from our study is that an increase in the number of rules only seems likely to promote even more defensiveness, depersonalization, and boilerplate compliance—and to feed reporting fatigue, in which key stakeholders within firms become indifferent, tired, or hostile in the face of additional rules.

Furthermore, adding such rules seems likely to make a confusing situation even worse. Every jurisdiction already has different rules, and navigating the resulting mosaic of transparency requirements imposes high transaction costs on any firm that conducts operations across multiple jurisdictions.

A further point concerns the question of why firms react to transparency rules in the way they do. Further research, of a more qualitative nature, would be needed to explain this phenomenon of reporting fatigue and firms' preference for more defensive forms of disclosure. But we can make several preliminary observations as to why the rules have the effect that they do. Certainly, ultimate beneficial owners often have a legitimate interest in concealing their identity—for example, if this information would disproportionately expose them and their families to violent crimes, such as kidnapping, extortion, and robbery. However, this argument often rings hollow when the beneficial owner's identity is clearly available on Wikipedia and other online sources.

Yet there is another reason for the defensive attitude of beneficial owners toward transparency rules. Our experience suggests that many companies “hide” because of a deep mistrust of government and the likely negative effect of more open disclosure, fearing that government will take any information that is revealed and use it against a firm, and that the effect will be further layers of rules that impose additional costs. Resistance to transparency does not necessarily mean that key decision makers within firms are acting dishonestly, but rather that they may be responding to concerns about the uncertain and potentially negative effects of more openness.

However, the above data suggest that some firms do go further and embrace genuinely open forms of disclosure. We believe that this is a significant development and—for reasons that we submit in Section V—represents a likely future trend. In what follows, we present a framework that can help foster an understanding of why more firms will—and should—embrace more open forms of disclosure, and why doing so makes commercial sense.

The final section of the paper explores the regulatory implications of this argument about the value of open communication. In particular, it allows us to develop a regulatory framework that

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moves away from a demand for more disclosure and reporting rules and toward an approach that places more emphasis on understanding the commercial advantages to be gained from more open forms of communication.

5. *Open Communication and the “New Firm”*

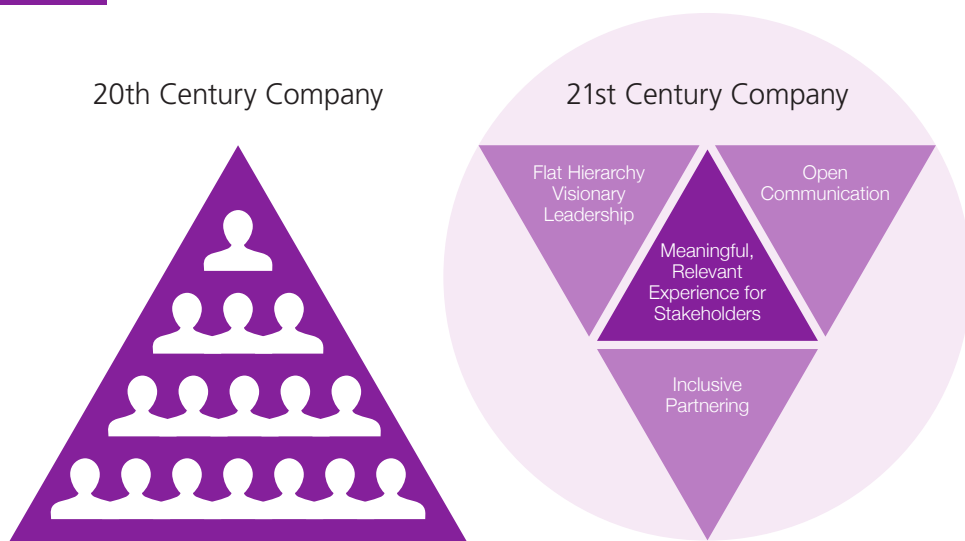
To survive and grow, corporations must operate with a new set of assumptions that help them remain relevant, competitive, and successful. With the rise of digital technologies, every corporation must now become agile and innovative and, more importantly, act as if it were a technology company (Vermeulen 2015). Ignoring the challenge of the networked age and the digital revolution is no longer an option and will merely accelerate a process of decline and failure. Based on our practical experience as well as research conducted elsewhere, we have identified a number of principles and practices recently adopted by the most successful and innovative firms (Fenwick and Vermeulen 2016a). We believe that these principles are relevant in the context of a discussion of beneficial ownership, in that substantive disclosure and open communication tend to be found in those firms that are already implementing these principles. Moreover, as other firms recognize that embracing these principles represents the best commercial strategy for adapting in an innovation-driven economy, we believe that they too will embrace more open forms of disclosure and communication. To that end, it is helpful to offer a brief review of the new-generation firm (Subsection A) and these governance principles and related practices (Subsection B).

A. What is a “New Firm”?

In our view, the distinctiveness of the most innovative firms today — what we term the new firm or 21st century firm — is that they implement practices and processes that better equip them to constantly reinvent themselves and adapt to rapid commercial, technological, and social change. In particular, the new firm deals with the need to remain relevant in hypercompetitive global markets by implementing what we characterize as governance principles: inclusive partnering, open communication, and flat-hierarchy/visionary leadership (see Figure 7).

We have identified a number of principles and practices recently adopted by the most successful and innovative firms.

Figure 7: The 21st Century Firm versus the 20th Century Firm



These governance principles give the new firm a number of tangible benefits that allow it to engage in a constant process of critical self-examination and agile reinvention, at least when compared with firms that persist with more traditional—static, hierarchical, bureaucratic, and overcrowded—20th century governance structures. In particular, these governance principles afford the new firm the best opportunity of delivering innovative products or services that provide a personally meaningful experience for consumers.

A number of features of this model are worth noting. First, the three governance principles (which we will discuss more fully below) combine to deliver a meaningful experience for stakeholders *inside the firm* (investors, members of the board of directors, executives, managers, and employees). Such stakeholders are increasingly entrepreneurial in the sense that they demand a meaningful experience and will move on if such an experience is not forthcoming. Much of the appeal of being involved, directly or indirectly, in a dynamic, innovative business is in large part about participating in a project to build something new and exciting that is *personally* meaningful and relevant. Smarter firms recognize and leverage this valuable resource to the benefit of all participants as well as the company itself. If a firm provides a meaningful experience, people will remain motivated and committed. In the absence of such fulfillment, the most talented stakeholders will opt for exit.

If a firm provides a meaningful experience, people will remain motivated and committed.

Second, in the context of a contemporary economy, a firm organized according to the three principles—inclusive partnering, open communication, and flat-hierarchy/visionary leadership—gives itself the best opportunity to deliver products or services that are meaningful for *consumers*. After all, the primary focus of any business, large or small, needs to be on delivering great products or services. Contemporary consumers expect products to deliver constant innovation in functionality, to have networked connectivity, and to facilitate personal self-expression (Fenwick and Vermeulen 2016b).

These two goals—delivering a meaningful experience for stakeholders involved with a firm and for consumers—are interconnected in that a firm that remains meaningful for stakeholders is better positioned to attract the capital and talent necessary to deliver innovative products that have meaning to consumers. At the very least, a firm that attracts the best talent and the most capital maximizes its chances of delivering innovative products.

B. The Three Principles

Now let's take a closer look at the main organizing principles mentioned above.

1. Inclusive partnering. The delivery of innovative products over the long term requires a greater degree of cooperation between multiple actors. Product development requires gathering disparate elements (of hardware and software) and integrating them into a coherent product with a value proposition that has relevancy for consumers. This task of gathering—identifying, coordinating, and then combining—diverse elements into a coherent package will require unprecedented levels of cooperation both within the firm (between different divisions) and outside the firm, with external participants such as start-ups and other strategic partners. It will be crucial for a firm to have the capacity to build and maintain inclusive relationships in which the partners work collaboratively. According to this approach, the existence of hierarchies or “silos” becomes enormously counterproductive, and firms that fail to embrace the possibilities of more inclusive partnering will struggle to innovate.

Inclusive partnering also helps maintain relevancy for both internal and external actors. People become more invested when they feel included. Moreover, stakeholders' capacities

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As the relationship between employees and firm becomes looser, a different form of coordination becomes necessary.

Open communication is about building an ongoing and constructive dialogue within the firm and with the market, which can then have a significant impact on the future performance of that company.

will be developed along with their sense of involvement and belonging. Thus a firm can ensure the sustained commitment of stakeholders to stay focused on the core task of innovating. Clearly, a personalized and open approach to communication is critical to inclusive partnering and engagement.

2. Open communication. With more fluid and inclusive relationships, we can no longer rely on traditional forms of coordination based on hierarchical and command-and-control models. Stakeholders in companies are not comfortable being told what to do, and they will opt to leave if the working environment fails to meet their needs. In the past, such fixed organizational forms provided a source of comfort, but now they are more likely to frustrate or irritate. As the relationship between employees and firm becomes looser, a different form of coordination becomes necessary. How then do we ensure a more personalized environment designed to facilitate *open innovation*? How do we build these more fluid and inclusive relationships?

Open communication between the various participants is particularly important in this context, because it provides a mechanism for coordinating the actions of different stakeholders. Its distinctive style of information dissemination and exchange redefines the character of the relationships between all actors in the firm. Adopting such a personalized approach involves acknowledging the potential benefits that accrue from a much freer flow of information, not only *within* an organization but also between the organization and those *outside* the organization.

But open communication is not just about sharing information (the one-way dissemination from one part of the company to another or from the company to external stakeholders, most notably investors). Open communication is about building an ongoing and constructive dialogue within the firm and with the market, which can then have a significant impact on the future performance of that company. It involves “Ego” disclosing all relevant information to “Alter,” with “Alter” being in a position to question “Ego” about “Ego’s” decisions. “Ego” must then be willing to respond to such questioning, and the cycle begins again.

Open communication is about respect (building trust and loyalty), but it is also about recognizing the material benefits that accrue from sharing (Bowles 2016). By embracing open communication, a firm can forge more inclusive and meaningful relationships among and between its stakeholders. Open

communication fosters a sense of belonging and expands the pool and diversity of actors who have significant involvement in key decision-making processes. Open communication is also linked to various aspects of participation in, and responsibility for, decision making within an organization. The most innovative companies have acknowledged that they stand to benefit from a more open attitude toward all insiders, which greatly expands the class of individuals responsible for guiding the direction of the company. In this way, open communication can create a powerful sense of participation and belonging that makes the corporate project more meaningful—from the perspective of the insiders as well as the firm.

Potentially, multiple additional benefits exist for a company that adopts this kind of open and engaged communication strategy. In particular, the firm will be better placed to make smarter decisions, enhance firm know-how, deal with problems more effectively, develop a more extensive and deeper network, retain more performance-related information necessary for planning, and offer a more collaborative and meaningful environment for all stakeholders. These are just a few of the tangible benefits a firm can enjoy if it embraces open communication and the more personal and inclusive relationships it can encourage.

3. Flat-hierarchy and visionary leadership. Tech moguls such as Larry Page, Sergey Brin, and Mark Zuckerberg run ostensibly public companies that in fact are essentially private fiefdoms. These charismatic leaders have so structured corporate control that there is no way for investors or board members to unseat them. It is not uncommon for charismatic leaders to implement dual-class share structures to ensure that regulatory requirements—for example, the short-term quarterly results and the demand for dividends and share buybacks—do not take over and kill the relevancy of the company (McCahery and Vermeulen 2014c). Of course, from the regulatory perspective, such a structure can make these firms appear to be governance renegades, something that might have a chilling effect on prospective investors.

But it would be a mistake to regard these firms as absolute monarchies, like the fiefdoms of history (Thiel 2014). Quite the contrary; these so-called renegade firms are often associated with a “best idea wins” corporate culture, which fosters open debate and collective decision making, and the seniority of the person making a proposal does not matter. Elon Musk has

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To succeed, however, a flat hierarchy depends on the active bottom-up participation of everyone inside the firm.

Multiple tangible benefits accrue from flatter and looser forms of organization.

described this sort of working environment as a *flat hierarchy* (Schectman 2010). The most effective charismatic and visionary business leaders recognize that the pace of innovation tends to be quickest in companies that embrace looser organizational forms, and they use personal control over “their” company to ensure that such a flat organization is allowed to flourish. Thus this type of best-idea-wins or flat-hierarchy culture comes from the top down and represents a considered choice on the part of a company’s leadership to break with more traditional and hierarchical corporate operating procedures.

To succeed, however, a flat hierarchy depends on the active bottom-up participation of everyone inside the firm. The basic principle is to push responsibility downward—to decentralize—to ensure that those people most familiar with an issue are empowered to make that decision. Without the cooperation and input of talented employees, this approach will not succeed.

An additional advantage of such an open working culture is that it provides those inside the company greater opportunities for personal expression and ensures that the company remains relevant to them. The most talented employees in search of a meaningful career experience are not willing to passively accept the view of out-of-touch managers and will be inclined to move somewhere else if the firm does not afford opportunities for personal growth. In this way, a flat hierarchy works to retain the relevancy of the firm for the best employees and other company insiders as well as for the consumers who benefit from the higher quality products or services that such a flat corporate culture produces (Hoffman, Casnocha, and Yeh 2014).

Again, multiple tangible benefits accrue from flatter and looser forms of organization. Flat hierarchies can encourage self-reliance, which liberates key players by minimizing the effects of external influence, such as the distortion of incentives arising as a consequence of the regulatory framework. Better decisions result from pushing autonomy down as far as possible within an organization—by radically decentralizing power—and empowering people who are closest to a problem and more likely to have a better understanding of how to address it. Another advantage of an open and inclusive working culture is that it provides greater opportunities for personal expression, as people who know the most about a problem are involved in the solution and then “own” the decisions they make. In this way, a flat

hierarchy helps keep the firm relevant for the employees and other stakeholders, and consumers benefit from better and more innovative products or services that such a flat corporate culture can deliver.

Adopting a flat-hierarchy governance structure can lead a company to develop a trust-oriented organizational culture rather than a control-oriented culture. In a contemporary context, trust is more likely to be effective than is control. It is based on empowerment and respect, qualities that foster dignity, a sense of inclusion, and loyalty—and can make people more willing to invest in the firm. By contrast, a control-oriented firm can undermine respect, dignity, and a sense of belonging. An expectation of control can be demotivating and destructive. Moreover, in a contemporary context, people are increasingly likely (and willing) to push back against control, further undermining the integrity and efficiency of an organization. In a 21st century environment, companies that communicate best will be better placed to establish a corporate culture built on trust and respect.

C. Embracing Open Communication

These three organizational principles help the new firm institute decision-making processes that are smarter, quicker, and more responsive to the challenge of doing business today. The products or services developed by the new-generation firm are evidence of these flat, open, and inclusive processes. This is not to claim that this approach is perfect or without difficulties, but rather that these processes offer the best opportunity to deliver consumer-relevant products or services in a highly uncertain and competitive business environment characterized by constant disruption. Moreover, these practices increase the likelihood that the new-generation firm will build more effective working relationships with other actors in the environment or ecosystem, as they provide the means and opportunity to engage more effectively with investors, employees, and other firms.

The takeaway is that open communication is increasingly vital to commercial success. It builds trust and facilitates the type of inclusive relationships that provide firms with the best opportunity to succeed in hypercompetitive global markets. Our contention is that the approach to *regulation* also needs to shift away from the current focus on rules that oblige ever more disclosure. Instead, regulation should focus on encouraging and

Adopting a flat-hierarchy governance structure can lead a company to develop a trust-oriented organizational culture rather than a control-oriented culture.

Regulation should focus on encouraging and empowering companies to better communicate with the market by adopting more imaginative and personalized disclosure and communication policies.

Openness will bring its own reward by highlighting the differences between firms.

empowering companies — particularly those currently adopting a grudging or boilerplate approach — to better communicate with the market by adopting more imaginative and personalized disclosure and communication policies. By adopting some form of substantive or, ideally, open communication, companies may distinguish themselves, making clear the “gap” in approach to stakeholders and alerting investors to the relative benefits and risks associated with investing in different types of companies, thus improving the efficiency of the market mechanism.

The regulatory challenge associated with this new approach is twofold: 1) to develop clear principles that can provide guidance to firms looking to communicate more openly with the market, and 2) to adopt regulatory strategies that convince companies of the value created by such open communication, particularly in communicating information on ultimate beneficial ownership and its relationship to company governance. To persuade companies of the benefits of adopting more open forms of communication, regulators need to base their argument on the business case for meaningful disclosure.

To recap: By adopting more open forms of communication, a firm will be in a better position to engage more effectively with the market. Openness will bring its own reward by highlighting the differences between firms. Firms that do not engage in open communication will find themselves marginalized, and the market mechanism will be allowed to take effect; openness will improve investors’ ability to distinguish between the different types of firms. Such an approach offers the best way of minimizing risk to investors and ensuring a better allocation of resources within capital markets. At the very least, we believe it offers a better approach than that of ever-stricter disclosure rules and the seemingly futile efforts to force information into the public domain.

6. *The Open Communication of Ownership and Control Structures*

Having outlined the rationale behind open disclosure, we focus in this section on identifying clear principles for the open communication of beneficial ownership and control structures. The next and final section will identify some possible strategies that regulators might adopt to persuade or “nudge” the business community to embrace more open forms of communication regarding beneficial ownership.

From the perspective of regulatory design, an empirical review of different disclosure strategies can provide useful insights. For instance, the activities of companies currently engaged in substantive and (especially) open disclosure can provide some hints for identifying best practice. Thus principles and practices for effective open communication can be based on and developed from actions that innovative companies are already taking.

Significantly, best practice involves the style and format of information disclosure as well as the actual content of the information disclosed. As a starting point for discussion, we suggest the following elements of an effective strategy for open communication.

1. Aim for transparency and relevancy. Most important is the need for detail and clarity of the information on ultimate ownership and its relationship with control and governance within the company. This might seem obvious, but even a brief perusal of the *grudging* and *boilerplate* disclosure approaches to compliance reveals that most firms do not even meet this minimal threshold.

Knowing exactly how much information to share is never going to be easy (partly due to competition considerations), but regulators need to encourage firms to be more aggressive in pursuing openness. Moreover, firms need to package the information in a form that is as accessible as possible. For instance, the use of engaging visuals in the presentation of information is absolutely vital, as is a clear style of writing. This ensures that information is available to all relevant stakeholders as well as potential stakeholders. Firms should not fear openness, but rather they should recognize the potential gains to be made through disclosure. The most significant gain is the increased

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possibility of establishing new and more inclusive partnerships that can prove crucial to the long-term prospects of a firm.

2. Personalize, humanize, and communicate a distinctive story. The shrinking of attention spans means that the style of disclosure matters enormously. It is important to think about the potential audience, such as current and prospective investors, and to try to speak to all the different constituencies in an engaging and personalized manner. The legalistic forms of writing that currently dominate need to be abandoned in favor of more direct and honest forms of expression. Moreover, information on control structures needs to be embedded in a clear and distinctive narrative about the past, present, and future direction of the firm and the governance of that company. A narrative creates a context that is vital for instilling confidence and encouraging a willingness to engage—as opposed to a more legalistic style that often communicates evasiveness and is unlikely to build or sustain trust.

3. Address the “hard” issues. Key challenges—such as those surrounding scale-up plans, succession issues, or compliance problems—need to be addressed directly and should not be obscured or hidden. For instance, if a scandal occurs, the firm should be completely open about how it deals with it. The 2015 revelation that Volkswagen deliberately installed “defeat devices” on its cars to evade emissions requirements is a good example of how a sophisticated firm can mishandle the fallout from a public disclosure of wrongdoing. Volkswagen should have been forthcoming much sooner about the extent to which top executives were involved in this scheme and—if they were not—how the culture within the company tolerated or encouraged such cheating.

In turn, the Porsche-Piëch families control a 100% stake in Porsche Automobile Holding SE. In January 2016, the media (based on inside information) mentioned that the families support Volkswagen’s chief executive officer in the handling of the crisis. However, compare this type of approach to the personalized and open communication strategies of Berkshire Hathaway, Amazon, and even Volkswagen’s competitor, Tesla (Fenwick, Hisatake, and Vermeulen 2016).

Of equal importance, *operational* mistakes or challenges also should be addressed fully. Openly confronting a sensitive issue can actually be a powerful way to generate trust among

A narrative creates a context that is vital for instilling confidence and encouraging a willingness to engage.

stakeholders, and this trust ensures that investors remain confident in the firm's prospects, in spite of any possible concerns that might otherwise deter them from making or maintaining an investment. Of course, disclosure of negative information runs the risk of communicating poor judgment and may cause damage to firm reputation, but the premium gained from dealing with difficulties openly can serve to mitigate such risks over the long term.

4. Demonstrate leadership. Central to any concept of leadership is the capacity to offer a vision—and the ability to motivate by inspiring members of an organization to embrace that vision. Information disclosure can provide an important opportunity for those in charge of a company to demonstrate leadership by articulating and disseminating their vision of the firm and its prospects.

Leadership is also important when things are not going well. Take the Volkswagen case again. In particular, the silence of the controlling shareholders, refusing to address the many problems within the company, merely compounded public anger. It shows the limits—particularly in a contemporary context—of a communication strategy that focuses on minimizing legal liability.

5. Generate buzz. If done properly, a firm's communication strategy can generate a whole ecosystem. Consider the build-up of excitement about the annual letters to shareholders by Warren Buffet of Berkshire Hathaway and Jeff Bezos of Amazon (Cunningham 2014). Information is a resource that can be exploited—via open communication—to the commercial advantage of a company. The hype that a company can build up in anticipation of the “event” of disclosure can be an effective means of feeding excitement and interest in the firm. It can make the company interesting and relevant for potential (and talented) employees as well as investors.

It is equally important to acknowledge that a certain amount of skepticism still surrounds this type of open, personalized approach. There is a lingering suspicion that a cynical and Machiavellian owner or chief executive officer has concocted a fictional story and is pushing it as a way to distract, obscure, or otherwise delude the audience. And of course it is important to retain a critical perspective when evaluating the communications of a particular chief executive officer. Nevertheless, we should

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Our study revealed a certain amount of herd behavior in attitudes toward disclosure.

not dismiss the possibility that such openness represents a sincere effort to communicate a substantial narrative, backed by quantitative data, that puts a firm's situation in a broader strategic context. Over time, this approach can be subjected to sustained scrutiny, allowing for an objective evaluation of the merits of any "buzz" that is generated.

6. Take advantage of alternative media. Our empirical study focused on annual reports, but there are many alternative ways to communicate. As we have seen, an increasing number of company owners/leaders now communicate with investors via an annual letter, and in many cases investors consider these letters a more important source of information than the annual report. Again, such letters work best when written in a highly personalized and honest style, as one (albeit controlling) shareholder communicating openly with other shareholders. Social media and other online media (such as blogs) are becoming more and more important, contributing to multiple new opportunities for more imaginative forms of information dissemination.

7. Monitor best practice and constantly review strategies. Our study revealed a certain amount of herd behavior in attitudes toward disclosure; if a number of companies in a particular jurisdiction or industry engaged in more minimal approaches toward disclosure, then other firms also tended to do so. Instead of falling into a negative cycle of disclosure, firms should monitor and review current best practice among new-generation firms and engage in a constant reevaluation of their own communication strategies, which can lead to improvement of their performance over time.

8. Build relationships and invite input. The ultimate aim, and benefit, of adopting open communication is the ongoing creation of new inclusive relationships, which can add enormous value to a firm and provide a valuable source of company-relevant information as well as a fresh perspective on growth strategies. To ensure that all stakeholders in the firm are invested in open communication, a firm needs to include disclosure of control structures in its more general communication strategy. This element of the new relationships can help company leaders make better decisions and avoid the type of tunnel vision or silo effects that plague corporate leaders who are not exposed to alternative voices and perspectives.

This kind of engagement also can offer more tangible commercial benefits, such as facilitating the identification of new business opportunities or providing a better sense of peers and competitors. Proactive engagement also helps corporate leaders identify “expertise gaps” on their boards of directors and executive teams. It is in this collaborative context that investors often have the most impact on their “portfolio companies” and consumers can influence corporate strategies. Such collaborative, trust-based relationships are the outgrowth of effective communication strategies, which make possible the type of inclusiveness that we have suggested is vital to the success of the new-type firm.

The above elements are merely indicative and need to be developed further, based on empirical research on current best practice. What is clear, however, is the overarching concept and direction of an open-communication strategy: Clear and accessible information on ultimate ownership and its relationship with governance needs to be located within a coherent and meaningful narrative of the firm’s current situation and future direction. Thus information can become an important resource that firms leverage to build more inclusive relationships with stakeholders.

Proactive engagement also helps corporate leaders identify “expertise gaps” on their boards of directors and executive teams.

7. *The Key Takeaway: “Nudging” Firms to Embrace Open Communication*

In the wake of the Panama Papers leak, what strategies might regulators adopt to convince companies of the potential value created by open communication, particularly in the context of communicating information on beneficial ownership and control structures? If our argument is sound, then constantly adding more layers of mandatory disclosure rules seems unlikely to work. Then is the correct response for regulators not to do anything? This type of argument can seem legitimate, particularly to someone who claims—as we do—that more and more firms will embrace open communication anyway as they realize the commercial and other benefits that accrue from openness.

Nevertheless, we think there still is a strong argument in favor of some regulatory intervention. Although the best-in-class companies—think Berkshire Hathaway or Amazon—have embraced and will continue to embrace the opportunities afforded by open communication, many other companies will either struggle to “get it” or simply lack the capacity to know what to do even if they are persuaded of the need for such an approach.

This task of recognizing and embracing the benefits of—and then successfully implementing—an open-communication strategy will be particularly challenging in the context of emerging markets. The lack of role models or experience, as well as uncertainty about the likelihood of accruing benefits, can result in pervasive skepticism. Nevertheless, we are convinced that the opportunities afforded by open communication also exist in emerging markets, and that good companies based in such markets may leapfrog the grudging-compliance stage and leverage open communication to scale their business.

Therefore, the regulatory challenge is to foster a greater awareness of the benefits of open communication and to provide firms with practical guidance in implementing such an approach. That means the regulators’ task is to “nudge” companies toward open communication rather than to impose thicker layers of regulation that merely perpetuate grudging disclosure—and reporting fatigue. In the type of model proposed here, the regulators’ primary goal is for companies to recognize the possibilities of adopting open communication, based on a business case for meaningful disclosure.

The regulatory challenge is to foster a greater awareness of the benefits of open communication and to provide firms with practical guidance in implementing such an approach.

Our empirical study suggests that law does matter, but perhaps not in the ways that policymakers hoped, expected, or anticipated.

The current regulatory approach appears to breed a formalistic style of compliance.

Our empirical study suggests that law does matter, but perhaps not in the ways that policymakers hoped, expected, or anticipated. As we see with the Chinese and U.S. experience in particular (see Figure 5 on page 31), the legal requirement to disclose information certainly does have an effect. But a rules-based approach that compels disclosure seems to have resulted in an unhealthy standardization of how the information is presented, which reveals little about how control actually affects corporate strategies and governance and which may actually obscure control issues. The current regulatory approach appears to breed a formalistic style of compliance that provides little in the way of genuine guidance for investors and other potential stakeholders.

An illustration of the pervasiveness of depersonalized modes of disclosure is the large number of firms that we might expect to engage in open communication, but instead are found among the grudging-disclosure group. Take LinkedIn, for example. In spite of being a social network company - the business model of which is predicated on promoting open communication - it can be found in the grudging-disclosure category. One factor may be the current regulatory system in the United States, which does not implement any measures aimed at promoting more open disclosure. This arguably explains the irony of a social network company that fails to provide clear, meaningful information about its ownership structure.

Another argument for a regulatory approach that encourages more open communication is that, as the new-firm model becomes more prevalent, more companies are going to embrace open communication anyway. Firms will need to adopt the organizational principles associated with the *new firm* to survive—to build and maintain relevance in increasingly competitive global markets. In particular, firms will need to embrace open communication to attract the *best* talent and the *best* investors and to build strong links with customers and other stakeholders. Thus the regulatory challenge becomes one of helping firms recognize that open disclosure matters.

Therefore, regulators need to make clear that adopting open-communication strategies will better position a firm to operate more effectively and engage more productively with the market—that more radical forms of open communication will bring multiple benefits, including the possibility of becoming a global player. Such strategies can improve a firm's ability to provide a meaningful experience to stakeholders, inside and outside the

firm, which is crucial in delivering products or services that will be commercially successful. Commercial and other benefits can be thought of as a byproduct of open communication. Conversely, firms that do not communicate openly with the market may well find themselves marginalized—and suffering accordingly.

How then might policymakers and regulators persuade firms to embrace open communication?

Perhaps the first point is that, as the governance principles of the new firm become more widely acknowledged, this change will happen anyway. The better firms will adjust their behavior. Moreover, for regulators and other policymakers, the lesson of our empirical study is that, although we need some disclosure and reporting rules, we should not fetishize such rules. In particular, we should not regard ever more layers of mandatory disclosure and reporting rules as part of the solution. Companies will choose to adopt open communication because they have to do so to prosper. Adopting an internal and external culture of open communication and radical transparency will bring its own rewards.

Insofar as regulators do have a role, it should be to support, encourage, and persuade firms to recognize the rewards that come from the open disclosure of beneficial ownership. A promising option might be regulation in which regulators address a particular issue via ongoing dialogue with those they are responsible for regulating—to develop strategies and practices that firms are then encouraged to adopt voluntarily. Such a regulatory approach, or “co-regulation,” can offer a more effective way to overcome difficulties of ensuring substantive compliance—at least when compared to command-and-control regulation—and has been used effectively to promote ethical conduct and fair trading in other regulatory contexts (Baldwin et al. 2010).

Co-regulation usually involves the state or an international organization persuading a group of firms in a particular industry or a professional group to help develop—in cooperation with the regulator—some normative standards based on current industry best practice. Its advantage is that the business community, in cooperation with the state and international organizations, is responsible for developing the applicable standards, monitoring compliance, and ensuring enforcement. Thus the standards developed are feasible and associated with

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Insofar as regulators do have a role, it should be to support, encourage, and persuade firms to recognize the rewards that come from the open disclosure of beneficial ownership.

Research suggest that industry-initiated schemes developed in partnership with public agencies are more likely to be effective when the interests of the industry and the community more generally coincide.

firms that have already enjoyed success and hence provide compelling evidence of the advantages of complying with such standards. Industry-based accreditation schemes might also provide some formal acknowledgment of compliance, which can have a signaling effect for other actors in the market.

Crucially, co-regulation frames the whole issue of compliance differently from current dominant practices. It emphasizes the potential benefits of conforming to the agreed on standards (and ideally going beyond them in individualized and imaginative ways) instead of perfunctorily meeting some minimal standard imposed by the state. This need to reframe the issue of compliance in a different context seems particularly pertinent to any discussion of beneficial ownership. Too often the issue of disclosure is framed as protecting investors from opportunistic managers (agency costs)—a perspective that seems unlikely to persuade managers of the value *for them* of genuine compliance, making it doubtful that firms would embrace open communication if so framed.

In the context of beneficial ownership, co-regulation would mean developing the strategies and practices of open communication introduced above in Section VI and identifying and publishing examples of current best practice (Baldwin et al. 2010). In such a case, an industry acting in its own interests will also be acting in the interests of the community as a whole.

A promising start in this context might be the upcoming IFC publication “Beyond the balance sheet: Strategic, governance, and sustainability reporting,”—which seeks to develop a *disclosure and reporting tool* that allows firms to monitor their progression on a matrix. A toolkit of this kind has the potential to rate highly in flexibility. Those responsible for developing the matrix would have an intimate knowledge of the most appropriate standards for the industry or profession as well as the objectives of the agreed standards. They are free to consider a range of options to ensure that the objective is met—and if there is an economic benefit for firms to participate, they will have an incentive to ensure that the objective is met as efficiently as possible.

In exploring this type of approach, it is important to accept that we are in the realm of imperfect alternatives and that there will always be recalcitrant members of any community.

Nevertheless, standards of good practice developed by an industry with a significant number of “rogue” members will directly benefit the members who sign on to the standards (by ensuring a greater market share and hence profitability). It will also benefit consumers (in this context, investors and other stakeholders), who will have more information available to help them differentiate between reliable industry members and those that are recalcitrant or worse.

Of course, giving too much autonomy to a business sector in determining its own regulatory standards may involve some risk. The regulatory framework might easily be “captured” by the industry or professional association and developed in a way that advances the interests of those doing the developing and not the interests of the wider community. Nevertheless, regulatory or other agencies can minimize such risks through effective monitoring.

Another potential risk is that such standards can become reified and transformed into just another code that merely adds to the fatigue associated with reporting and transparency. A toolkit—designed in close collaboration with business—needs to address how open communication adds value to a firm and helps firms build and maintain relevance in the market.

The key takeaway from this paper is that companies need to be proactive and imaginative in developing personalized open-communication strategies. The task of regulators is to “nudge” firms and provide some guidance by identifying strategies that have already proven successful. But in the end, the responsibility for effectively implementing an open-communication strategy rests squarely on key stakeholders within a firm, who must seize the initiative and develop clear strategies and practices that will assure that the firm can build and maintain relevancy in the marketplace. In this way, a firm can ensure that it offers a meaningful and personalized experience for all stakeholders and can therefore attract the investors and talent necessary to deliver the best products and services while providing the firm with the best opportunity to succeed.

The key takeaway from this paper is that companies need to be proactive and imaginative in developing personalized open-communication strategies.

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