Corporate Governance and Financial Performance: A Study of German and UK Initial Public Offerings; Marc Goergen; Edward Elgar, Cheltenham, 1998, 183 pages ($80)

Since the early work of Jensen and Meckling, agency conflicts and their effects on the firm have been widely researched in finance. The present literature has examined the relationship between corporate governance and financial performance for both existing stock companies and the plethora of recent IPO firms. In Corporate Governance and Financial Performance: A Study of German and UK Initial Public Offerings, Goergen studies the combined effects of international governance structures, initial public offerings, and financial-performance measures. To determine whether governance affects performance, he contrasts the governance structure of the UK, characterized by a large diverse shareholder base and outside institutional investors, to that observed in Germany, marked by concentrated corporate ownership and a large influential, banking industry. By focusing on IPOs, Goergen tracks the progress of the firm from concentrated ownership to more diverse holdings and tests for subsequent changes in performance.

The book consists of eight chapters. Chapter one provides a brief overview while chapter two outlines the governance literature and contains a survey of relevant empirical studies. Chapter three details the major differences between the German and British financial systems, including an examination of the possible effects of listing rules and inheritances taxes on ownership. Chapter four analyzes the evolution of ownership and control in German IPOs while chapter five repeats the analysis for IPOs in the UK. Chapters six and seven compare the differences in ownership and performance levels, respectively, between the two countries’ IPOs. Chapter eight summarizes the book.

One of the strengths of the book lies in its descriptions of the UK and German financial systems and instruments. For example, the kinds of securities markets and the types of individual securities along with their assigned voting statuses (such as the Vorzugsaktien, German non-voting preference stock) are discussed. In addition, managerial components, such as the German two-tiered
board structure,\(^1\) are described. Anyone desiring a brief, concise description of the German governance system will find this material useful.

Drawing on the differences between the two governance models, Goergen tests whether the alternative ownership structures affect the performance of the firms operating in the two countries. He begins by examining the evolution of ownership in a German IPO offering from pre-issuance to six years afterwards. Consistent with the tenet of concentrated ownership in the German system, Goergen finds that in two-thirds of his sample the pre-IPO shareholders maintain control for the entire six-year period. Furthermore, the majority of control changes are conducted through private negotiations involving a new controlling shareholder. These results differ from those found in the US and UK where management normally undergoes an IPO in order to decrease its holdings and its level of control. Goergen also finds that German banks obtain seats on the supervisory board of the IPO firm prior to the public offering and that the percentage of these directorships held by the banks decreases with time.

Matching the British and German IPOs by size and industry,\(^2\) Goergen finds that issuing German firms tend to be three to four times older and twice the size of the companies undergoing IPOs in the UK. For both countries, the greatest frequency of IPOs occurred in the electronics and computer industry. Contrary to that found for the German IPOs, the original British shareholders normally lose majority control after two years. However, contrary to previous beliefs concerning the diverse UK shareholder base, Goergen finds that for 37% of his UK sample the original shareholders still maintain control after six years; thus, not all UK firms experience dispersed control.

To determine whether concentrated or diverse ownership appears to result in superior performance, Goergen analyzes the financial performance of the post-IPO firms. He uses three performance measures: cash flow divided by the book value of debt and equity, cash flow divided by the market value of debt and equity, and annual cumulative abnormal returns using a market model. Neither ownership structure appears superior under any of the performance measures. Goergen also analyzes the relation between ownership and performance through event-study and regression analyses, including tests of performance changes following major changes in control. He concludes that the financial performance of IPO firms appears independent of ownership structure.

Although Goergen’s empirical analysis has some blemishes, he is not alone as such difficulties plague all attempts to measure long-run performance. For

\(^1\) Goergen devotes much of his attention to the German governance structure, probably due to his presumption that readers are more familiar with the UK system than with the German framework. This book evolved from doctoral work of the author completed while at Oxford University.

\(^2\) Six times as many UK IPOs, than German issuances, were floated during this period.
example, his measurement of financial performance via free cash flow may lend itself well as a multi-stakeholder performance measure but does not work well under the Anglo-American system where shareholder-wealth maximization is the ultimate goal. Likewise, recent empirical research on long-run results raises serious questions about the use of annual cumulative abnormal returns based upon a market model. These concerns, however, are prevalent in all long-run research and are certainly not limited to this study.

Contrary to its title, the major contributions of Goergen’s book are its comparison of the evolutionary changes of ownership in German and UK initial public offerings and the descriptions of the characteristics of the firms undergoing these issuances. The book provides an empirical confirmation of the widely-held beliefs concerning the different stakeholder views prevalent in the two countries. By showing that German shareholdings begin as concentrated and largely remain so for the period of his study, Goergen confirms the conventional wisdom that German shareholdings are indeed more concentrated than those seen in the US and UK. Nevertheless, due to problems with the measurement of long-run financial performance, this book still leaves the question as to the relation between ownership and performance largely unanswered. On balance, I recommend this book based more on its merits as a comparison between the two governance structures than on its performance results.

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