Chapter 34
Governance and Corporate Control Around the World

Multiple Choice Questions

1. The United States has a market-based financial system because:
   (I) it has a large stock market
   (II) it has a large corporate bond market
   (III) it has financial institutions
   A) I only
   B) II only
   C) III only
   D) I and II only
   Answer: D   Type: Easy   Page: 931

2. Financial markets are more important for firms to raise funds for investment in the:
   (I) U.S.A
   (II) U.K.
   (III) Germany
   A) I only
   B) II only
   C) III only
   D) I and II only
   Answer: D   Type: Easy   Page: 931

3. Financial institutions are more important for firms to raise funds in (the):
   (I) U.S.A
   (II) Germany
   (III) Japan
   A) I only
   B) II only
   C) III only
   D) II and III only
   Answer: D   Type: Easy   Page: 931

4. Individual investors in the U.S.A. can play an important part in corporate governance because:
   (I) a large fraction of households' portfolio is held directly in equity securities
   (II) a large fraction of households' portfolio is held in pension funds
   (III) a large fraction of households' portfolio is held directly in bank deposits
   A) I only
   B) II only
   C) III only
   D) II and III only
   Answer: A   Type: Medium   Page: 933
5. The following are sources of financing for corporations:
   (I) Households
   (II) Financial institutions
   (III) Other corporations
   A) I only
   B) II only
   C) III only
   D) I, II, and III
   Answer: D   Type: Easy   Page: 934

6. In Japan inter-company financing is in the form of:
   A) Term loans
   B) Trade credit
   C) Leasing
   D) None of the above
   Answer: B   Type: Easy   Page: 934

7. The legal system in the U.S.A is based on:
   A) Common law tradition
   B) Civil law tradition
   C) Sharia tradition
   D) None of the above
   Answer: A   Type: Easy   Page: 936

8. The legal system in France is based on:
   A) Common law tradition
   B) Civil law tradition
   C) Sharia tradition
   D) None of the above
   Answer: B   Type: Medium   Page: 968

9. The following countries have legal system based on civil law tradition:
   (I) Germany
   (II) France
   (III) Scandinavia
   (IV) U.K
   A) I only
   B) II only
   C) I, II, and III only
   D) IV only
   Answer: C   Type: Medium   Page: 936
10. Large business combinations in Japan are carried out through reciprocal ownership of common stock. These are called:
   A) Keiretsu
   B) Chaebols
   C) Conglomerates
   D) Industrial houses
   Answer: A   Type: Easy   Page: 936

11. Large business combinations in Japan are normally carried out through reciprocal ownership of common stock. These networks, or keiretsu, involve a large number of diversified companies centered around a large bank, industrial firm, or trading firm. One of the main benefits of this structure is argued to be:
   A) The monopolistic control of economic segments
   B) The reduction of financial distress costs
   C) Large scale diversification that cannot be done by individual shareholders
   D) Greater efficiency in management because the management skills are homogeneous even for
   Answer: B   Type: Medium   Page: 937

12. In Japan, commercial banks can own a company's stock up to:
   A) 1% of the total shares
   B) 5% of the total shares
   C) 10% of the total shares
   D) Commercial banks cannot own stocks of companies
   Answer: B   Type: Difficult   Page: 937

13. The banking system in Germany is:
   A) Nationally chartered banking system
   B) Dual banking system
   C) Universal banking system
   D) State chartered system
   Answer: C   Type: Medium   Page: 940

14. Large firms in Germany have:
   (I) the board of directors
   (II) the supervisory board
   (III) the management board
   A) I only
   B) II only
   C) III only
   D) II and III only
   Answer: D   Type: Medium   Page: 941
15. A firm whose only assets are controlling blocks of shares are called:
   A) a conglomerate
   B) a holding company
   C) a pyramid
   D) Dual-class company
   Answer: B Type: Medium Page: 942

16. "Effective control" of a firm requires approximately:
   A) 100% ownership
   B) 51% ownership
   C) 50% ownership
   D) 20% ownership
   Answer: D Type: Medium Page: 942

17. Dual-class equity is banned in:
   (I) U.S.A.
   (II) China
   (III) Japan
   (IV) Spain
   (V) Singapore
   A) I only
   B) II only
   C) II, III, IV, and V
   D) IV and V only
   Answer: C Type: Medium Page: 943

18. A Korean conglomerate is called a:
   A) Keiretsu
   B) Chaebol
   C) Industrial house
   D) Conglomerate
   Answer: B Type: Easy Page: 944

19. Conglomerates can be effective in:
   A) the U.S.A.
   B) Great Britain
   C) developing economies
   D) none of the above
   Answer: C Type: Easy Page: 944
20. Tunneling resources between companies takes place by:
(I) lending money at a low interest rate
(II) buying the output at a high price
(III) selling assets at a low price
A) I only
B) II only
C) III only
D) I, II, and III
Answer: D   Type: Medium   Page: 945

**True/False Questions**

T  F  21. Firms raise funds from financial markets and from financial institutions
Answer: True   Type: Medium   Page: 931

T  F  22. Japan has bank based financial system.
Answer: True   Type: Medium   Page: 932

T  F  23. In the United States, individual investors can play an important role in corporate governance
because of well-developed democracy.
Answer: False   Type: Medium   Page: 933

T  F  24. Direct individual investment in the equity market is relatively small around the world.
Answer: True   Type: Medium   Page: 933

T  F  25. Households, financial institutions and other firms are the main sources of funds for firms.
Answer: True   Type: Medium   Page: 934

T  F  26. The legal system in the U.S.A. and U.K. is based on civil law tradition
Answer: False   Type: Difficult   Page: 936

T  F  27. The legal system in France, Germany and Scandinavia have evolved from common-law
tradition.
Answer: False   Type: Medium   Page: 936

T  F  28. In Japan, a keiretsu is a network of companies organized around a major bank.
Answer: True   Type: Medium   Page: 936
T  F  29. Japan has main bank system where banks and firms have long-standing relationships between them.
Answer: True   Type: Medium   Page: 936

T  F  30. Conglomerates in Korea are called chaebols.
Answer: True   Type: Easy   Page: 944

**Essay Questions**

31. What is corporate governance?
Type: Difficult   Page: 931
Answer:
The issue of corporate governance arises from the separation of ownership and control that exists in companies. Stockholders of firms may be thought of more as investors than owners for practical purposes as managers of large firm generally control the day-to-day decision-making. This makes most shareholders passive investors in a firm and thereby providing important opportunities for the managers of such firms to make decisions that may benefit themselves personally rather than the shareholders. In order to protect owner/investors, there is an established set of checks and balances, generally referred to as corporate governance.

32. Briefly explain the two important legal traditions in Europe and the U.S.A.
Type: Medium   Page: 936
Answer:
The legal systems in the U.S.A. and U.K. have developed from common-law tradition. The legal systems in France, Germany and Scandinavia have developed from civil law tradition.

33. Under what circumstances would a conglomerate be effective?
Type: Difficult   Page: 936
Answer:
Generally conglomerates perform well in less developed countries and also in countries where the legal system is based on civil-law systems.

34. Briefly explain the term "keiretsu."
Type: Medium   Page: 936
Answer:
This is an institutional arrangement that is unique to Japan. A keiretsu is a network of companies that is usually organized around a major bank. These companies have cross-holdings arrangements and enter into business relationships among themselves.
35. Briefly explain why a bank in Germany can own shares of a corporation while a bank in the U.S.A. cannot?
Answer: Germany has universal banking system and it allows for banks to invest in non-financial corporations. But, in the U.S.A. federal law prohibits equity investments by banks in non-financial corporations.

36. Briefly explain why large firms in Germany have two boards of directors?
Answer: Large firms in Germany have two boards of directors—the supervisory board and management board. This arrangement is geared towards reconciling the demands of industrialization with liberal concepts about individual rights.