

## FEDERAL-OWNED ENTERPRISES AND CORPORATE GOVERNANCE IN FEDERAL-OWNED ENTERPRISES IN UNITED STATES

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### **Abstract:**

The article is a working paper showing the progress of research on federal-owned enterprises in the United States economy. Differences in definition of federal-owned enterprises in US are pointed, those type of enterprise is represent by three kind of companies. Second part indicates the different methods of corporate governance in federal-owned companies in US. Enhance the leading form of corporate governance (that is board of directors) chosen by US government. Then there is pointed out changing evaluation of board of directors as way of corporate governance in federal-owned companies. Last part, based on previous information set out the likely trend in the corporate governance in federal-owned enterprises in the United States the next few years.

*Keywords: general management, business, Federal-owned enterprises, corporate governance, United States, board of directors*

## 1. DEFINITION OF STATE CONTROLLED ENTERPRISES IN DIFFERENT VIEWS

Bringing up the subject of State corporate governance in the economy it is necessary above all to determine what it is possible to call the enterprise controlled by the State, in order to correctly conduct deliberations. This will enable to determine which enterprises are supervised by the corporate governance.

Considering the issue from ownership shares point of view in a business it is possible to distinguish enterprises about total, majority and minority contribution of the State (we omit business entities which constitute in 100% a private property, because they aren't the subject of analysis). And how, in two first cases, the enterprise can be regarded as controlled by the State, as in the situation, in which the State is a minority owner of encountered certain difficulties in defining entities actually holding control over the enterprise. This is because the law enables to retain control over the enterprise e.g. so-called law of the golden share.<sup>1</sup> Another issue is fragmentation of shares. In a situation of considerable shareholders fragmentation with minority owner's State share, the State can effectively carry out control when a considerable part of shareholders isn't interested in active interfering in the company activity. An example of such a behavior is usually short-term stock investors, who buy stocks of enterprises with a view to their subsequent resale and obtain profits due to price differences. Those aspects of minority contribution cause that the concept of enterprises controlled by the State is blurred.<sup>2</sup>

Next issue is to determine of what it is possible to recognize as the State contribution. Unquestionably, the ownership of State Treasury can be recognized as the State-owned shares. However, there are entities recognized as the State, such as government agencies, self-government entities, etc., on which the State doesn't have a full impact. In view of need to define subject of analysis, it was decided to assume for this study purposes that as enterprises controlled by the State there will be included enterprises about majority or total State-owned share, without narrowing only to shares held by the central government.<sup>3</sup> In hereby study, it wasn't decided to bringing up the issue of enterprises about minority State shares in the owner's structure, because it blurs the definition of subject matter – this subject deserves a separate study.

Another issue is enterprise formed by the State and next handed to private investors, but over which the State carry out control by virtue of legal conditions This category is important, although isn't a direct part of State enterprises category. Due to its great importance, and a lot of common features in carrying out owner's control with enterprises, which the Federal Government is a shareholder; it was decided to refer to this specific group during research.

For this study purposes it was decided as the definitions of corporate governance (we will continue to use this notion as the substitute of owner's supervision)<sup>4</sup> to accept the definition of rules and laws aimed to protect the owners and so-called Soft law, recommendations concerning control over the enterprise.

## 2. ENTERPRISE CONTROLLED BY THE STATE IN UNITED STATES

The United States were formed as the federation of 13 states – rebellious British colonies – that is opposition to the State. The fact widely known is a leading role of private property and personal freedom of the United States derived from formation period of the State and reflected in this country constitution. Therefore, for this reason in the United States there is no tradition of the public property –

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<sup>1</sup> This law is currently restricted, at least within the European Union

<sup>2</sup> There are cases in which it isn't possible to determine whether shares held by the State enable to control the enterprise, because the situation in terms of remaining shares ownership can dynamically change by which the State could gain or lose control over the enterprise at not-changing number of shares

<sup>3</sup> This approach will enable to separate enterprises constituting property of the United States federal government from enterprises involved in local self-government, which often are subject to local legal regulations, due to specificity of the Anglo-Saxon law

<sup>4</sup> About detailed differences between the concept of corporate governance and corporate governance wrote among others M. Kucharski, C. Mesjasz

it is treated as an exceptional economy element.(Bałtowski, p 6.) Also among the largest American enterprises there is no State enterprise.<sup>5</sup>

## 2.1. Presentation of current status

An important question which it is necessary to bring up by analyzing principles of the corporate governance in the economy of United States, it's a role which the State enterprises has in this economy.

The first important feature of State enterprises in the United States is their small share that fluctuates in 2005-2012 from 0.6% up to 2.9%(Augustynowicz, Kwiatkowski, p. 5). Another distinguishing element is a division into enterprises that are the property of Federal Government – central administration (*Federal Government Corporations*) and enterprises owned by the State. Revealing here difficulty, due to customary character of the law in United States, is to indicate legislative differences which are peculiar for individual State. This is another argument for the rightness of chosen objective, i.e. analyses of enterprises owned by the Federal Government. State enterprises, included in the subject matter of research, can be divided into three categories (State Owned Enterprises, Examples of United States State-Owned Enterprises):

- 1) Government Sponsored Enterprises
- 2) Federal Government Chartered and Owned Corporations
- 3) Federal Government Acquired Corporations

First group Government Sponsored Enterprises are the State enterprises, which founder was the United States Congress. However, they don't constitute a property of American Government – their owners are private shareholders, although they were formed exactly from the central authority initiative. These enterprises are from the financial industry, the most known are (Kosar, 2007, p.3):

- Fannie Mae
- Freddie Mac
- Ginnie Mae

Enterprises were formed in order to improve the situation in selected industries. The first enterprise of this type was *Farm Credit System* (formed in 1916), which was aimed to reduce costs of credits for the agricultural industry (Hill, 2010, p.10-17). Considering the property criterion it is hard to regard *Government Sponsored Enterprises* as the State enterprises in a traditional understanding of this notion, since the supervision is carried out by private investors to obtain profit<sup>6</sup>.

Next *Federal Government Chartered and Owned Corporations* is a group of enterprises, which as its name indicates is owned by the Federal Government of United States. This caused that they are, in some respects, similar to the Polish State-owned enterprises. Examples of companies, which it is possible to include into this group, are:

- Federal Agricultural Mortgage Corporation
- Federal Deposit Insurance Corporation
- Panama Canal Commission

This group is very numerous to previous. Incomes are a source of revenue in that kind of enterprises from their activities, although they can in certain cases receive grants from the State budget (this is despite the attitude of American economy towards the free market.

Last of mentioned groups is *Federal Government Acquired Corporation*. These are enterprises formed by private shareholders, which next were taken over by the Federal Government. A group of these companies is relatively small, since the Government usually takes over private enterprises temporarily, in order to rescue them or fulfil other significant role. Examples of activities involving a takeover of private companies were taken by the American Government during the last crisis –nationalization rescue (total or partial) of private enterprises in 2008-2009 (Bałtowski, p.6). *Federal Government Acquired Corporations* usually constitute only a temporal property of the Federal Government.

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<sup>5</sup> List of 10 largest enterprises in the United States consists of private entities: Wal-Mart Stores, ExxonMobil, Chevron, Apple, Berkshire Hathaway, Phillips 66, General Motors, Ford Motor Company, General Electric, Valero Energy

<sup>6</sup> Desire to make a profit is the motive for private investors function

**Table 1:** Comparison of individual features in the categories of State enterprises in United States

	<b>Government Sponsored Enterprises</b>	<b>Federal Government Chartered and Owned Corporations</b>	<b>Federal Government Acquired Corporations</b>
<b>Founder</b>	State	State	Private investors
<b>Owner</b>	Private investors	State	State

Source: Own study

As noted above the division of enterprises in the American economy arose due to owning entity and an entity which is the founder. In the American economy there are all possible combinations of these two elements.

## 2.2. Analysis in terms of State enterprises contribution in the economy.

The economy of United States is a free market, and the property of State doesn't have a significant contribution in it. Table 2 presents a quantitative contribution of State enterprises in the number of given country companies.

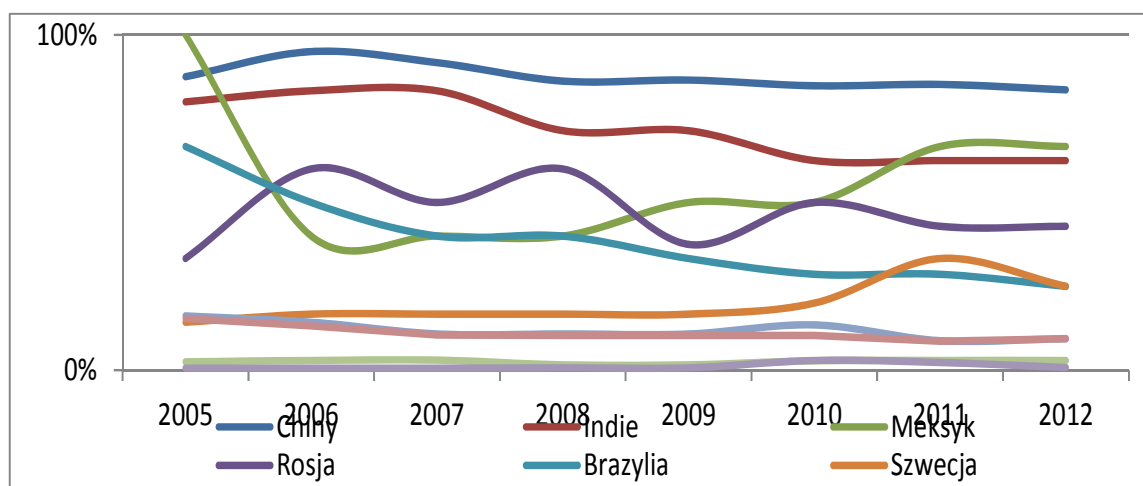
**Table 2:** Quantitative contribution of State enterprises in the company's number from a given country, in % of "Fortune 500" list

<b>Country</b>	2005	2006	2007	2008	2009	2010	2011	2012
China	87.5	95.0	91.7	86.2	86.5	84.8	85.2	83.6
India	80.0	83.3	83.3	71.4	71.4	62.5	62.5	62.5
Mexico	100.0	40.0	40.0	40.0	50.0	50.0	66.7	66.7
Russia	33.3	60.0	50.0	60.0	37.5	50.0	42.9	42.9
Brazil	66.7	50.0	40.0	40.0	33.3	28.6	28.6	25.0
Sweden	14.3	16.7	16.7	16.7	16.7	20.0	33.3	25.0
Germany	16.2	14.3	10.8	10.8	10.8	13.5	8.8	9.4
France	15.4	13.2	10.5	10.3	10.3	10.3	8.6	9.4
Japan	2.5	2.9	3.0	1.6	1.6	2.8	2.9	2.9
United States	0.6	0.6	0.6	0.7	0.7	2.9	2.3	0.8

Source: P. Augustynowicz, G. Kwiatkowski, Importance of State enterprises in the global economy – conditioning and directions of changes, 9th Congress of Polish Economists

As can be seen in the economy of United States the contribution of State enterprises was the lowest from all described States in every year – an only exception was 2010, when the Japanese economy managed to reach 0.1 p.p. of lower share. It was caused with rise in the quantity of State enterprises in the United States from 2008, an ultimate in this growth was in 2010 and in consecutive years the contribution of State enterprises underwent fall.

**Figure 1:** Quantitative contribution of State enterprises in the company's number from a given country, in %



Source: Own study based on: P. Augustynowicz, G. Kwiatkowski, Importance of State enterprises in the global economy – conditioning and directions of changes, 9th Congress of Polish Economists

This growth was caused with an increase in number of enterprises being subject to rescue nationalization as well as was an effect of the economic crisis.

### 2.3. Indication of branches with a significant contribution of State enterprises

The American economy in spite of its free market character has a diversified level of State enterprises contribution in individual industries. In conducted preliminary literature research the author didn't come across quantitative detailed data concerning contribution of State enterprises in individual industries and economic sectors of the United States.

However, there are a considerable number of companies from Government Sponsored Enterprises groups as well as Federal Government Chartered and Owned Corporations operating in the financial sector. Most recognizable GSE as Fannie May or Freddie Mac operates in the mortgage credits market. What's more, their contribution in this sector grows.

**Table 3:** Contribution of individual entity groups in the mortgage credits and MBS market in United States

	1950	1960	1970	1980	1990	2000	2010
<b>Deposit institutions</b>							
Mortgage credits	60.00%	67.38%	70.89%	67.08%	40.89%	32.67%	28.10%
MBS	0.00%	0.00%	0.00%	4.28%	14.77%	11.82%	12.99%
Total deposit institutions	60.00%	67.38%	70.89%	71.37%	55.66%	44.49%	41.08%
<b>Market investors</b>							
Mortgage credits	37.78%	28.37%	22.26%	15.26%	12.12%	3.82%	4.54%
MBS	0.00%	0.00%	1.03%	6.90%	27.39%	28.30%	42.20%
Total market investors	37.78%	28.37%	23.29%	22.15%	39.51%	32.12%	46.73%
<b>State enterprises (only GSE category)</b>							
Mortgage credits	2.22%	4.26%	5.82%	6.48%	4.37%	8.48%	4.57%
MBS	0.00%	0.00%	0.00%	0.00%	0.46%	14.91%	7.61%
Total State enterprises (only GSE)	2.22%	4.26%	5.82%	6.48%	4.83%	23.39%	12.18%
Altogether entities	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: Own study based on: D. Jaffee, J.M. Quigley, The Future of the Government Sponsored Enterprises: The Role for Government in the U.S. Mortgage Market, Working Paper No. W11-005, Institute of Business and Economic Research, Berkeley, 2011 p. 60

Provided the market share isn't dominating, they constitute an important element of it, particularly in crises periods. Beyond the financial sector a significant contribution of State enterprises wasn't noted. However, it is necessary to take into account that the overall level of State enterprises contribution in the American economy is low compared with other States, even those with a long-standing free market tradition.

### 3. DETERMINANTS FACTORS FOR THE CORPORATE GOVERNANCE PRINCIPLE OF THE STATE IN UNITED STATES

Describing the owner's supervisions factors it is necessary to indicate differences between the corporate governance in such countries as Poland, and the corporate governance in the United States. There are four models of corporate governance (Herdan, 2007, p. 35): Anglo-American, German, Latin and Japanese.

**Table 4:** Classification of the corporate governance systems

Approach	Market	Based on relations in the environment		
	Anglo-American system	German system	Latin system	Japanese system
Countries	United States, Great Britain, Canada, Australia	Germany, Netherlands, Switzerland, Sweden, Austria, Denmark, Norway, Finland	France, Italy, Spain, Belgium	Japan
Corporation concept	Instrumental, directed to shareholders	Institutional	Institutional	Institutional
Authority form of the corporate governance	Single authority	Dual authority	Single or dual authority in France, single in remaining countries	Single authority
Influential shareholder	Shareholders	Banks, employees, oligarchical groups	Financial holding companies, government, families – generally: oligarchical groups	Banks, financial institutions, employees, oligarchical groups
Importance of the stock exchange	Large	Medium/Large	Medium	Large
Corporation control of the market activity	Large	Lack	Lack	Lack
Concentration of the ownership	Low	Medium/Large	High	Low/Medium
Dependence of the remuneration on results	High	Low	Medium	Low
Temporal range	Short	Long	Long	Long

Source: A. Herdan, Premises and conditions for corporate governance function, Notebooks of Higher Economic School in Bochnia, 2007, No. 6, p. 35.

The dominant model in United States is Anglo-American. Its main features were described in Table 4. In this model the shareholders have most important role. They take by its representative's action to conduct corporate governance over the activities of company. This representative maintain relations with the enterprise by seating in the boards of directors – Board of Directors is a set of high level corporation managers and employees as well as very often representatives from outside of the enterprise. The last usually sit in commission boards aimed to conduct internal audits in the enterprises (Herdan, 2007, p. 36).

Apart supervision over the enterprise by shareholders in the United States, there are also regulations dealing with this issue. Very important role in the process of establishing a legal frame of the corporate governance fulfill (Herdan, 2007, p. 36):

- Suggestions of the American Institute of Law
- Regulations of the New York Stock Exchange
- USD Securities and Exchange Commission

State enterprises in the United States, pose above mentioned with institutions, are also regulated by a set of specific provisions. A very important legal instrument in this matter is *Governmental Corporation Control Act* issued in 1945, which among others prohibited the Federal Government of formation new State-owned companies without the consent of United States Congress (Lund, 2009, p. 323-324).

There is no one form of corporate governance closely associated with corporate governance towards State enterprises in the United States (Kosar, 2011, p. 8-9). Number of possibilities, which before the State in corporate governance issue by establishing enterprise management are (Kosar, 2011, p. 8-9):

- a) appointment of full-time board of directors
- b) appointment of full-time director-general among board members operating on the part-time
- c) appointment the board of directors consisting of middle level clerks from various government agencies, who will work part-time in the company management
- d) appointment the board of directors consisting of private investors appointed to these positions
- e) appointment of a single person "the administrator", responsible before the Secretary of Department, to which the enterprise is reported, and before the President of United States

There is no clear answer to question 'which solution is best', each has its own good and bad points. However, it is worthwhile to notice that among State enterprises of the Federal Government nearly all have boards of directors. There are only two exceptions to this rule: Ginnie Mae and St. Lawrence Seaway Development Corporation (Kosar, 2011, p. 9).

In United States a board of directors is the most popular form of management and control over State enterprise. At the turn of 40s and 80s the boards of directors were assessed as an essential element of State enterprises and they best advantage (Kosar, 2011, p. 9). However, in the following years appeared less favorable opinions to this form of corporate governance over the enterprise. It was noted that in private enterprises the board of directors is aimed to ensure representing interests of many investors, whereas in State enterprises, which usually have one owner, there is no need to appoint the board of directors for this reason. At the beginning of 80s the critics of this form gained power. National Academy of Public Administration stated that the board of directors was an ineffective form, and a better solution in company management by the State would be appointment of the Administrator with a full ability to make decisions, as well as appointment of the Advisory Board. It would enable to gain the bigger control and directness in authority above enterprises by the State Administrations (Kosar, 2011, p. 9-10).

Board of directors constitutes a certain kind of buffer among the enterprise and politicians. The board being a solution adopted from the market of private enterprises allows State enterprises to retain some independence in relation to public authorities. Adoption of this model has some flaws. Efficiency of this problem solution regarding State control depends on a number of factors ((Kosar, 2011, p. 10):

- coherence of the legislation
- honesty and integrity of the board
- number and appropriate quality of board members

As can be seen the board of director's effectiveness as an element of corporate governance is dependent on both external and internal factors. After all, this is the most popular choice in the case of State enterprises. Board of directors as the management form borrowed from private enterprise seems to have no other significant alternatives in the current situation of United States. The factor that in a significant extent contributed to select this particular form was market of private enterprises.

#### **4. TENDENCIES IN THE PRINCIPLES DEVELOPMENT OF THE STATE CORPORATE GOVERNANCE IN UNITED STATES**

Conducted preliminary literature research doesn't include information concerning changes or plans of changes in the typical enterprises management form, which constitutes a property of the United States Federal Government. It results that in a nearest foreseeable future there shouldn't be any substantial

changes in so far chosen model of the corporate governance, and two listed enterprises representing the alternative model constitute an exception to this principle, rather than the beginning of new trend.<sup>7</sup>

In the issue of State-owned property in United States it is possible to conclude that its contribution level in the economy after crisis in 2008-2010 undergoes a decrease. This economy is characterized by a low contribution level of the State as an owner, and variations in this level resulted so far from the State intervention to stabilize the economic situation. Taking into consideration that this strategy brought positive effects, and the economy of United States more quickly than economies of European Union countries returned on the growth path in economy after last crisis, it is possible to assume that the strategy of State interventions will be carried on, and during another economic turbulence the contribution level of State enterprises in the American economy will grow, and then decrease. Probably there will be a cyclical fluctuation in the contribution level.

An issue of State enterprises and corporate governance in the economy of United States require further research. It is worthwhile to consider which factors, apart market tradition, decided that a typical administration form in State enterprise of Federal Government is the board of directors; it is also worthwhile to consider why Ginnie Mae and St. Lawrence Seaway Development Corporation didn't passed to this model.

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<sup>7</sup> They were formed relatively a long time ago, i.e. Ginnie Mae in 1968, St. Lawrence Seaway Development Corporation in 1954