

# The NBER Digest

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## Management Ownership and Corporate Performance

Many large American corporations are not run by the people who own them. How does such separation of ownership from control affect the firm's performance? A new NBER study by **Randall Mørck**, **Andrei Shleifer**, and **Robert Vishny** finds that corporate performance is highest among firms whose directors own between 5 and 20 percent of the stock. When directors own more or less than this share of the equity, performance falls off.

Mørck, Shleifer, and Vishny use two measures of performance: the profit rate and the ratio of the firm's market value to the replacement cost of its physical assets. They find that ownership patterns have similar effects on both of these measures.

There may be a very logical explanation for this finding. When managers hold little equity in their firms and the ownership of the stock is widely dispersed, they may slack off or pursue goals other than maximizing profits. As their stake in the company rises, managers have greater incentives for improving performance. On the other hand, managers who own a large portion of their companies may not worry about being fired and therefore may not work as hard as managers whose jobs are less secure.

In **Management Ownership and Corporate Performance** (NBER Working Paper No. 2055), Mørck, Shleifer, and Vishny also report that for firms incorporated before 1950, having a member of the found-

ing family as chairman or president significantly lowers corporate performance. Among new firms, however, such managers tend to raise performance. This suggests that the founders of a firm may play an important leadership role, but that their descendants would raise profits if they hired outsiders to run the company.

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To analyze these issues, the authors studied performance and ownership patterns among *Fortune* 500 firms for 1980. In 28 percent of these firms, directors owned less than 1 percent of the firm's equity; in 20 percent of the firms, directors owned more than 20 percent of the equity. The median level of ownership by directors was 3.4 percent, while average ownership was 10.6 percent. Most chairmen and presidents owned only a negligible portion of total equity, but in 12 percent of the firms their stake exceeded 20 percent.

## How Important Is Welfare Dependence?

For some time, there has been a concern among policymakers and other interested observers that our welfare system encourages dependency. For example, some people believe that once a woman receives AFDC (Aid to Families with Dependent Children), she is not likely to leave the welfare rolls. But a new study for NBER (*Working Paper No. 2026*) by **Rebecca Blank** finds that the length of time a woman has been receiving AFDC does not affect whether she will continue to receive it next week or next month.

Even though some women rely on welfare as a long-term source of income, their long spells on welfare are neither created nor lengthened by the receipt of AFDC itself. Blank observes that a woman is as likely, or more likely, to get off the rolls after six to eight months on AFDC as she was when she first started receiving it. After about eight months on the program, the probability of leaving AFDC starts to decrease, but after 18-24 months that probability levels off and remains virtually constant.

Blank observes that "household characteristics are very important in determining how quickly a woman will leave welfare. White women who are older when their welfare spell starts, who have higher education, . . . higher alternative sources of income, fewer children, and fewer young children move off welfare faster" than other AFDC recipients do. The black women in Blank's sample have longer spells on AFDC than the white women do, but that appears to be because they are less likely to get off welfare by marrying than the white women are. They are just as likely to leave the program because of an increase in earnings or other income.

Blank also finds that the average length of a spell on AFDC is about 18 months. Around 40 percent of AFDC spells begin after there has been a change in the woman's marital or household status, but only 8 percent begin with the birth of a child. The rest begin with a change in household income.

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Blank concludes that there may be two distinct groups of AFDC recipients: one with a low probability of leaving the program, whose rate of exit changes

little over time, and a second group that is affected by time spent on AFDC. Indeed, more than half of the women in her sample have a very low monthly probability of leaving AFDC, but this is unaffected by time on the program.

Blank's results may differ from those of previous studies because she uses monthly data while others have used annual data. To compile the annual figures, an interviewer would ask a woman whether she received welfare at any time in a given year. If a household received AFDC in January of one year and not again until December of the following year, it could be counted as a continuous spell on welfare of two years' duration. Naturally, this would overestimate the length of welfare spells.

Blank uses monthly data from 1970-6 on female heads of households in Seattle and Denver. Of the 1121 women in the sample, 714 received AFDC at some time. There were 508 welfare spells that started between 1970 and 1976; 323 of these spells were completed over the 72 months.

## The Effects of Exchange Rate Intervention

On September 22, 1985, a group of finance ministers and leading central bankers from the United States, Germany, Japan, England, and France (the G-5 countries) met at the Plaza Hotel in New York to plan a coordinated intervention in exchange markets aimed at reducing the value of the dollar. The subsequent decline in the dollar relative to other G-5 currencies has been hailed in the popular press and in official circles as testimony to the effectiveness of coordinated intervention. But **New Evidence on the Effects of Exchange Rate Intervention** (*NBER Working Paper No. 2052*) by **Martin Feldstein** shows that the dollar fell no faster in the nine months after the G-5 meeting than it had in the preceding six months. Thus, the efficacy of coordinated intervention as an instrument of economic policy remains questionable.

The G-5 meeting was one response to the magnitude of the U.S. trade deficit and threats of protectionist legislation in Congress. In the days after the

meeting, the central banks of the major countries intervened heavily in foreign exchange markets. The dollar fell immediately, about 4 percent in the first trading day after the meeting. In the nine months that followed, the dollar slid an additional 25 percent against the yen, 18 percent against the mark, and 15 percent against a multilateral trade-weighted basket of currencies.

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However, Feldstein finds, except for a 4 percent drop in the dollar's value that occurred immediately after the meeting and has largely persisted, the overall trade-weighted value of the dollar declined at an average 2 percent per month before G-5 (March–September 1985) and after it (October 1985–June 1986). The multilateral trade-weighted index he uses is calculated by the Federal Reserve Board, but Feldstein gets similar results when he uses a bilateral weighted index produced by Morgan Guaranty Bank and the exchange rates for individual currencies.

Moreover, the data from Morgan Guaranty show that the dollar's rate of decline relative to the pound was substantially *less* after G-5 than before. Indeed, the yen is the only major currency against which the dollar declined more rapidly after G-5 than before it. Even so, Feldstein believes, the case for intervention is ambiguous since the Japanese government, unlike the other G-5 countries, made a major shift in monetary policy after the Plaza meeting to strengthen the yen. Moreover, the yen was the major currency most likely to appreciate as a result of the massive and unexpected decline in the price of oil in the first half of 1986.

## **Government Spending, Deficits, Interest Rates, and Prices**

For over 200 years, until the end of World War I, big increases in government spending in the United

Kingdom were almost always associated with wars. According to NBER Research Associate **Robert Barro**, these spending increases were largely financed by budget deficits rather than tax increases and generally led to an increase in interest rates.

In **Government Spending, Interest Rates, Prices, and Budget Deficits** (*NBER Working Paper No. 2005*), Barro reports that there were ten episodes of substantial budget deficits between 1701 and 1918, eight of which occurred during major wars. The ninth, in 1835–6, was associated with compensation payments to slave owners, and the tenth resulted from a legislative dispute in 1909–10 over what kinds of taxes to enact.

Barro finds that the government's military spending averaged 6.7 percent of GNP from 1701 to 1918 but rose to 16 percent of GNP during the Seven Years' War (1756–63), to almost 10 percent during the American Revolutionary War, and to almost half of GNP during World War I. The biggest increase in government *debt* occurred during the Napoleonic Wars (1797–1815), primarily because they lasted so long. Government debt rose from less than 90 percent of GNP in 1795 to almost 160 percent of GNP in 1816. During the peacetime years of the 19th century that followed, the ratio of debt-to-GNP declined steadily, falling to 30 percent by 1914. By 1918, however, the ratio rose once more, to 110 percent.

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Barro also reports that wartime spending tended to increase prices mainly when the Bank of England suspended the gold standard. When the gold standard was in effect, the government refrained from printing money to finance its expenditures. As a result, there was little growth in the money supply, and price rises were small. During 1797–1821 and 1914–8, however, the suspension of the gold standard allowed rapid increases in money and prices.

Barro concludes that “military spending during wars led to money creation (and sharp price increases) only if it led first to the suspension of the gold standard.”

Finally, Barro finds that a temporary increase of one percentage point in the share of GNP spent by the government raised long-term interest rates by six basis points before World War I. However, the

enormous increase in government spending during World War I had a much smaller effect on interest rates than previous increases in spending had, ac-

ording to Barro, because so much of the British economy was subject to direct controls over prices and output.

## NBER

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