COMPARATIVE INTERNATIONAL PERSPECTIVES ON MARKET-ORIENTED MODELS OF CORPORATE GOVERNANCE

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The study of corporate governance requires not only the knowledge of economic, financial, managerial and sociological mechanisms and norms, but it must also incorporate an ethical dimension, while remaining aware of the demands of various stakeholders. The interest towards good governance practice is very present in the company laws of many countries. National differences may lead to specific attributes derived from the meaning that is given to the role of competition and market dispersion of capital. Based on a research consisting of a critical and comparative perspective, the present contribution is dominated by qualitative and mixed methods. In conclusion, it can be said that a market-oriented corporate governance model, though not part of the European Union's convergence process, may very well respond to the increasing importance of investors' rights and to the gradual evolution of corporate responsibilities, beyond the national context, with the aim of ensuring market liberalization.

Keywords: corporate governance, comparative approach, international evidence, United Kingdom, European Union convergence, financial markets, agency theory

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1. Introduction

Corporate governance is a subject that is notoriously difficult to define in one sentence. Some view corporate governance in the narrow sense, dealing with the structure and functioning of the boards of directors, and their relationship to management. This narrow definition is the one often found in corporate governance codes and the *OECD Principles of Corporate Governance*, issued in 2004. A broader definition includes a company's relationships with shareholders, especially in organisations with concentrated ownership. Finally, academic studies dealing with governance broaden the definition to all internal relationships within a business, including the issues raised by the conduct of shareholders, especially institutional investors, the functioning of the general meeting and the company's relationship with the financial markets (Wymeersch, 2006).

No matter how complex the concept of corporate governance is, it can be eventually reduced to a simple formula by which to optimize its primary objective, the creation and distribution of wealth. Company law and the authorities regulating the financial markets are trying to formulate this optimization equation, thereby helping to design the rules by which to achieve a balance between various interests of corporate stakeholders. The different legal systems of the European Union are engaged in a convergence process: in each Member State, companies are properly functioning due to the harmonization of capital, personnel structures, sales and production opportunities. Conceptual differences relate to several aspects: the shareholders' involvement is connected to the postulate that managers are primarily appreciated for pursuing the investors' interests rather than those of other stakeholders, i.e. the degree of protection for employees and

creditors.
The local characteristics of economic entities are strongly rooted in national culture, which induces crucial features that are resistant to change. Whereas some EU Member States grant a certain privilege to the property rights of investors, a majority of countries in continental Europe are placing a particular emphasis on factors of a social nature. The issues outlined above are deemed to motivate a comparative approach to corporate governance systems. Such comparative analysis leads to the identification of two major models: one derived from a liberal approach, under which the company is considered the property of shareholders, and a second model, articulated on the financial and economic peculiarities of the Rhinelander area. The latter acknowledges the fact that the enterprise is a social community dominated by solidarity expressed by all its members, (i.e. the actors of the agency theory: the principal – the shareholders – and the agents: the managers, employees and, generally, all other stakeholders).
Supplementing the example of the social model and analyzing the cases of Germany, France and Japan, we find that large commercial banks, insurance companies and the governmental institutions play a dominant role in this system of governance, beyond the fact that these three major instances of economic power are backed up by the presence of financial markets. The gradual evolution of business beyond its national context is a commitment to provide market liberalization. The framework of globalization imposes the existence of an international benchmark for multinational companies. Many entities are striving to reach an optimal size, allowing them to achieve economies of scale which are necessary for better performance and increased foreign market presence. Therefore, the European economic environment is getting more and more accustomed to takeover bids which grant the transfer of economic control from smaller entities to larger conglomerates.

2. The analysis of market-oriented corporate governance

In order to analyze the events that have taken place since the second quarter of 2000, and taking into account their influence on corporate governance systems, it is possible to see further steps in the improvement of these systems, namely the institutional components and the way the agents concerned are involved. The two steps must be combined, since reducing institutional integration is a fundamental component of the profile and actions of the corporate agents. However, both the behavioral and institutional failures could be examined for each of the drivers of corporate governance system. In this respect, one could examine not only the corporate components involved but also the supporting elements, whose purpose is important in corporate governance. Some of these components bear the attribute of adjusting devices (Pérez, 2009).
If an entity's manager is also its creator and sometimes its major shareholder, the mechanisms of governance are either quasi-inexistent, either strictly peripheral. The opposite situation, when the investors' engagement leads to the formation of large companies managing a considerable fortune, is placed in the area of considerable success. In other words, to the extent that individual success can be easily explained, large enterprises have as sole concern not to be a barrier for independent development that would lead to the flourishing of new successful investment. This continuous monitoring of independent action in the context of financial markets clarifies the purpose of the securities commissions, i.e. the prevention of misleading interpretations, as it has been observed, for example, in the Microsoft case. However, the results are diametrically opposite when there is a separation between the managers and the legal rights expressed by business owners.
Two fundamental elements, both well established as American values, can be highlighted in this context. Firstly, the culture of entrepreneurship enables the managers to achieve their investments goals when confronted with new challenges related to shareholders' requests. Secondly, the primacy of property rights leads to the setup of several governance mechanisms designed to ensure that the owners are not harmed and that the entity's activities are conducted to their advantage. These two developments are more or less compatible, but they definitely lie within the

larger picture of political, ideological and cultural values of the American economic environment. They justify the implementation of specific corporate governance systems in the United States, considering the multiple facets of different historical periods under consideration.

The media implications of stock evolutions in the last decade and the increasingly significant involvement of financial analysts have led to the expansion of managerial opportunism which, in some cases, was a major driver towards the entities' bankruptcy. Some cases of accounting and auditing fraud became heavily publicized, i.e. Enron and Worldcom. The long-term vision of the company implies a strategic direction of a rational nature, leading to an enhanced performance of the entity. Profitable choices will thus contribute to improving the competitive situation for a larger market share or group of companies, primarily aimed at reducing the risks of all activities of that group. Legal representation in the short-term derives from the fact that shareholders have fixed contractual links with the entity and, as such, they can easily give up the capital they have committed. In the event of resale, the costs shall include any losses of value (when the sale price is less than the purchase price) and transaction costs (costs incurred during the buying and selling of shares). Shareholders will aim at improving financial indicators (cash flow, earnings per share), and will not take into account other indicators which point to increasing the long-term performance of the entity (Finet, 2005).

3. International perspectives on corporate governance models

The manager has a significant role in the debate concerning corporate governance because she/he is a major player in the economic process that aims at creating and distributing value. Agency theory in a formal sense originated in the early 1970s in the United States, but the concepts behind it have a long and varied history. Among the influences are property-rights theories, organization economics, contract law, and political philosophy, including the works of Locke and Hobbes. Some noteworthy scholars involved in agency theory's formative period in the 1970s included Armen Alchian, Harold Demsetz, Michael Jensen or William Meckling.

Agency theory raises a fundamental problem in organizations: a corporation's managers may have personal goals that compete with the owner's goal of maximizing shareholder wealth. Since the shareholders authorize managers to administer the firm's assets, a potential conflict of interest exists between the two groups. Countries with more concentrated ownership structures often have majority shareholders who significantly influence the board. Consequently, an 'agency' conflict arises between controlling 'majority' shareholders who may extract private benefits at the expense of minority owners. In the UK and US there is an emphasis on creating wealth for shareholders. That said, while approaches may differ, there is global appreciation of the OECD's generic corporate governance principles of responsibility, accountability, transparency and fairness.

Studying the models of corporate governance in various countries allows the determination of differences between Anglo-Saxon countries, where financial markets have a strong position, and countries belonging to Continental Europe where financial structures are a mix of three elements: bank financing, market-oriented capital and governmental intervention.

Corporate governance practices in the **United States** are not regulated by any one particular statute but instead are affected by the governing instruments, the corporate law and the court decisions of each issuer's state of incorporation, and, in the case of many publicly-owned issuers, by the U.S. federal securities laws and requirements of the national securities markets. Matters governed by state law include the voting rights accorded to shareholders, the functions of the board, and the ability of board members and executives to enter into transactions with the company. U.S. federal securities laws also affect corporate governance practices, primarily in the areas of disclosure and financial reporting, proxy voting, and the submission of shareholder proposals for consideration at shareholders' meetings. In addition, the national securities markets impact corporate governance practices through their requirements applicable to issuers of securities traded on their markets. Subject to all of these different laws and regulations as

applicable, corporations may establish their own governance practices in their corporate charters and bylaws. Stakeholders in a U.S. company may participate as shareholders (e.g., through employee stock ownership plans) and through service as directors. In the United States, the rights of stakeholders are established by a variety of laws, such as labor law, contract law and insolvency law. If their rights as established by these laws are violated, stakeholders can obtain effective redress through the courts and, in some cases, administrative agencies.

British incorporated companies listed on the UK Stock Exchange are subject to the Combined Code on Corporate Governance. The most recent (2008) version of the Code combines the Cadbury and Greenbury reports on corporate governance, the Turnbull Report on Internal Control (revised and republished as the Turnbull Guidance in 2005), the Smith Guidance on Audit Committees and elements of the Higgs Report. The changes which have taken place in British corporate governance over the past decade, both in the composition of boards and in the behavior of institutional investors, have been incremental rather than radical, and fall well short of the systemic reform which some observers believe is necessary. The Cadbury Code is a global landmark achievement in terms of financial governance, by encouraging listed company with generally recognized "best practices" in accordance with the comply-or-explain principle (Feleagă et al., 2009). British corporate governance is often described as a system of control by outsiders, rather than the insider control system which – at least until recently - has prevailed in Germany. This reflects, among other things, the larger role which the stock market plays in Britain and a different ownership structure. Germany has fewer publicly quoted companies than Britain, and most of them have at least one large shareholder who is represented on the supervisory board and takes a close interest in management decisions.

The **German** corporate governance system is different from that of the Anglo-Saxon countries insofar as it is based on the notion that it is possible, or indeed necessary, to integrate lenders and employees into the governance of large corporations. German corporate governance is shaped by a legal tradition that dates back to the 1920s and regards corporations as entities which act not only in the interests of their shareholders, but also have to serve a multitude of other interests. A narrow orientation toward shareholder value in the sense of an exclusive commitment of management to shareholders' interests is still not part of German business culture, nor is it in line with actual practice or with the law (Charkham, 1994). The German corporate governance system is generally regarded as the standard example of what Franks and Mayer (2001) have called an insider-controlled and stakeholder-oriented system. The past decade has seen a wave of developments in the German corporate governance system. Two of the factors which drive the evolution of financial systems in general, and specifically of national corporate governance systems, are European integration and globalization. It is often argued that these factors expose countries to the pressure of adopting a 'good' corporate governance system, and very often a good system is assumed to be one that comes as close as possible to the capital market-based Anglo-Saxon model of a financial system and the outsider-controlled model of a corporate governance system.

Following the publication of the two Vienot reports in July 1995 and July 1999, **France** now has a very extensive set of rules of corporate governance, promoting both efficiency and transparency. The aim of a corporate governance revolution in France was improving the workings of company bodies for management or the supervision of management, in particular the audit committee; the adequacy of accounting standards and practices; the quality of financial information and communication; the effectiveness of internal and external controls (by auditors and regulators); relations between companies and the various categories of shareholders; and the role and independence of various other market players, such as banks, financial analysts, ratings agencies. In the case of France, a broadening of corporate ownership has led to the opening of the Paris stock exchange to foreign investors and major. For some, it became necessary to reform the legal framework in order to impose greater transparency in the field of corporate governance. The internationalization of corporate ownership in French companies lead to the convergence of

reporting practices on matters such as proxy voting and shareholders' rights. In France, the debate on corporate governance sprung out of the financial market's opening to foreign and domestic investors. Broadening the ownership of the companies resulted in a request for greater transparency and the need to accommodate investors' expectations.
The working hypothesis is that the disclosure of accurate and timely information by the issuers of securities builds sustained investor confidence and constitutes an important tool for promoting sound corporate governance throughout the **European Community**. To that end, it is important that listed companies display appropriate transparency in dealings with investors, so as to enable them to express their views. The Council and the diverse Committees opted, in company law regulation, to provide for a framework for competitive business. This calls for flexible rules and forms of rulemaking, for light regulatory regimes where possible, scope for party autonomy and for less cumbersome and burdensome procedures. The system of harmonising company law through Directives - that have to be implemented by Member States - may have led to a certain 'petrifaction'. Simultaneously however, the "shelf life" of law tends to become more limited as society is changing more rapidly, and company law is no exception. Fixed rules in primary legislation may offer the benefits of certainty, democratic legitimacy and usually strong possibilities of enforcement. But this comes at the cost of little or no flexibility, and disability to keep pace with changing circumstances. EU Directives are in practice even more inflexible than primary legislation. That is the reason behind the diversity of legal instruments concerning corporate governance, when it comes to the binding power of each type of instrument.
In this respect, takeover bids are a threat to uncompetitive managers and an efficient mechanism to create shareholder value. However, in the **European Union**, Member States are reluctant to give a greater say to shareholders in the context of takeover bids. To prevent this from happening, the Takeovers Directive was adopted on 21 April 2004 and lays down, for the first time, minimum EU rules concerning the regulation of takeovers of companies whose shares are traded on a regulated market. The Takeovers Directive is one of the measures adopted under the EU Financial Services Action Plan. It aims to strengthen the Single Market in financial services by facilitating cross-border restructuring and enhancing minority shareholder protection.

4. Conclusions

The corporation has been the object of scientific research since the first decades of the 20th century. Professional management and dispersed ownership have driven the corporation into becoming the major form of business organization, mostly because it is believed that it favours a better allocation of resources. However, the classical theory that shareholder value maximization is the ultimate corporate goal has been challenged by the proponents of stakeholder theory, who argue that the satisfaction of corporate constituencies is of primary concern for managers and directors (Dragomir & Ungureanu 2009).
The institutionalization of mass shareholding through the involvement of investment funds has led to the development of a new perspective on corporate governance. The rise in the proportion of people's savings through acquisition of financial instruments has turned the attention of larger social groups to the principles of corporate governance and to the issues of shareholder value protection. On the other hand, a transnational and liquid capital market is an easy target for speculators and short-sighted investors. The last two decades of the 20th century have witnessed a series of bubbles and market contractions easily attributable to an 'irrational exuberance' (Greenspan, 1996).
In conclusion, corporate governance is intimately connected to the effect of strategic decisions on value creation (Pérez, 2009). Considering that managers are the authors of any corporate policy, the process of value maximization is almost entirely their responsibility. Within a market-oriented model, the role of corporate governance is to use various incentives and control mechanisms tailored to align managerial behaviour to the interests of shareholders. Shareholder primacy cannot be separated from the economic paradigm of the stock market; hence, the stock

market has a primordial role in the disciplining of managers and in reducing agency costs, thus creating value for the stakeholder society at large.

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