12-1-2002

International Corporate Governance Practices and Their Implications on Investors

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Corporate governance has become a bonafide subset of company’s law that is concerned with who directs the company and for whose benefit. Its application varies in countries found in the main legal jurisdictions of common and civil law. This thesis identifies these differences by highlighting national corporate governance systems existing in Germany, Japan, United Kingdom and United States. Together, these countries represent systems adopted by several countries located on all continents. Increased cross border investment in this era of globalization has been significantly affected by these governance systems. The thesis shows the reasons why investors, multinational corporations and nations have put corporate governance on their agenda’s. The thesis also discusses the theory of convergence, which predicts that competition will eventually cause the various national governance systems to converge into a single model. Finally, the attempt to create this single model by the Organization of Economic Cooperation and Development is explored.

INTERNATIONAL CORPORATE GOVERNANCE PRACTICES AND THEIR
IMPLICATIONS ON INVESTORS.

by

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LL.B., The University of Zambia, Zambia, 1992

A Thesis Submitted to the Graduate Faculty of The University of Georgia in Partial
Fulfillment of the Requirements for the Degree

MASTER OF LAWS

ATHENS, GEORGIA

2002
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This thesis is dedicated to my wonderful parents. My father George Hamala Hamanyanga and my mother Edith Kaliba Minya as a token of my appreciation for their unconditional love and support.
ACKNOWLEDGEMENTS

I would like to thank my major professor, Professor Fredrick Huszagh, University of Georgia, School of Law, for his guidance during the course of this thesis. I particularly thank him for the many illuminating discussions we had and for the articles and references he brought to my attention. I also thank Professor Gabriel Wilner who was both my second reader and the Associate Dean for the LL.M program. He not only set a wonderful tone for the program, but also shared helpful insights on how to approach the research and writing of a thesis. My gratitude goes to Joellen Childers from computer services who, in anticipation of this work, gave me useful advice on how to maximize my computer skills. Lastly, I thank Lorie Segars, the LL.M program administrative assistant who went out of her way on numerous occasions to make me feel comfortable and enjoy the year I spent at the University of Georgia.
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CHAPTER 1
INTRODUCTION

The corporation, probably more than any other influence, is the organizational form that conditions the nature and quality of people’s lives, whether or not they work for one\textsuperscript{1}. People have predominantly turned to corporations to achieve economic success as well as for many other purposes \textsuperscript{2}. Similarly at a national level, in most economies, corporate enterprises play a critical role in shaping economic outcomes through the decisions they make about investments, employment, and trade and income distribution\textsuperscript{3}.

Indeed it has been boldly suggested that today corporations are effectively more powerful than governments\textsuperscript{4}. Whether they are or not is arguable, but this suggestion led the writer’s mind to deduce that perhaps ‘corporate governance’ is a term not very different from ‘good governance’ which is commonly used to describe the positive attributes of democratic nations. In both scenarios, there are institutions to be governed, persons vying for elected office and the exercise of universal suffrage. The difference lies in semantics. When discussing corporate governance, instead of a country to be

\begin{itemize}
  \item \textsuperscript{1} Courtney C. Brown, Putting The Corporate Board To Work 3 (1976).
  \item \textsuperscript{2} Id.
  \item \textsuperscript{3} Mary O’Sullivan, Corporate Governance and Globalization, 570 annals am. acad. poll. & soc. sci. 153, 154 (2000).
\end{itemize}
governed, there is a corporation at stake. Where one would normally have politicians vying for office, we have directors and the electorate is comprised of hundreds or perhaps thousands of shareholders. In short, corporate governance becomes to a corporation what good governance is to a nation.

The origin of the word ‘governance’ comes from the Latin word ‘gubernare’ which means to rule or steer. A defined governance structure is necessary whether the body in question is a nation, state, town, professional society or business corporation. Corporate governance, in particular, is concerned with the processes by which corporate entities are governed. That is the exercise of power over the direction of the enterprise, the supervision and control of executive actions, the concern for the effect of the entity on the other parties, the acceptance of a duty to be accountable and the regulation of the corporation within the jurisdiction in which it operates.

In their 1932 publication of ‘The Modern Corporation and Private Property’, Berle and Means developed a model of publicly held corporations that set the terms of the modern debate of corporate governance. In this influential book, the authors asserted that while the law treated shareholders as the owners of a company, investors in

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6 Id. at 8.
public corporations usually did not act in the manner one would expect of an owner. The reason being that stock was owned by many dispersed shareholders none of who owned enough shares to impact on the management. Instead shareholders allowed management to deal with matters of importance and run the company, resulting in the separation of ownership and control\(^9\). In short the book showed how professional managers were not accountable to the owners. This scholarship pointed to the narrow view of corporate governance, which was how to ensure that managers followed the interest of shareholders. However a broader definition of corporate governance in which the interests of the corporations many stakeholders, beyond just the shareholders, are taken into account is gaining ground\(^10\).

In the legal realm corporate governance has now developed as a separate and definable area of corporation law, which applies to many different types of companies and industries\(^11\). Although it started to develop in places like the US in the 1970’s\(^12\), by the early 1990’s it was still considered fairly new in most parts of the world\(^13\) but by the late 1990’s it was a major and contentious issue in both advanced and developing economies\(^14\). It was soon appearing on international agendas\(^15\). Currently, the subject has

\(^9\) Cheffins, *supra* note 8.


\(^12\) Details of the development of corporate governance in the United States are given in Chapter 3. infra. P. 18.

\(^13\) Kevin Keasey et al, Corporate Governance: Economic and Financial Analysis 2 (Kevin Keasey et al, eds., 1997).


become increasingly important not only from a legal standpoint, but as a multi
disciplinary subject of economics, business ethics and politics\(^\text{16}\).

The boundaries of corporate governance have long been a standing topic of debate
as have issues concerning its importance and application. A lot of legal jurisdictions have
developed their own standards. One possible explanation has been due to divergent
economic, political and historic backgrounds\(^\text{17}\). As trade barriers fall, markets expand and
technology advances it has become easier for investors to invest in corporations in
foreign countries\(^\text{18}\). This has resulted in the flexibility of local governance practices that
are changing to accommodate global trends\(^\text{19}\).

Currently there are number of contemporary issues going on in this field. One
debate is which system of corporate governance is better and how can they be improved
with codes of best conduct\(^\text{20}\). Another issue is the growing pressure on national corporate
governance systems to merge especially in light of integrated financial markets\(^\text{21}\). A
theory of convergence predicts that national governance systems will eventually merge
into one model\(^\text{22}\). Ahead of this theory is an attempt to ‘globalize’ corporate governance
through ‘universal’ principles adopted by the Organization for Economic Cooperation
and Development\(^\text{23}\).

\(^{16}\) Vives, supra note 10.
\(^{17}\) Licht, supra note 15, at 148.
\(^{18}\) Cheffins, supra note 8, at 5.
\(^{19}\) Id.
\(^{20}\) Vives, supra note 10, at 1.
\(^{21}\) O’Sullivan, supra note 3, at 154.
\(^{22}\) Ronald Gilson, Globalizing Corporate Governance: Convergence of Form or Function, 49
\(^{23}\) International Corporate Governance Network (visited April 24.2002)
www.icgn.org/documents/globalcorpgov.htm
This thesis draws from the debate of all these current issues. Its main aim is twofold. Firstly it studies the national corporate governance systems that have been adopted by different countries and distinguishes the elements of each system. The two dominant governance models are the market-oriented model found in Anglo-Saxon countries and the bank/labor model found in continental Europe and Japan. This thesis shall examine the characteristics of these models in selected countries. A study will also be done of what is possibly the first attempt to ‘globalize’ corporate governance through principles formulated by the Organization of Economic Cooperation and Development (OECD). The second aim is to study the implications of these national corporate governance systems and the global system on investors, multinational corporations and other countries. This is particularly important in this era of technological and telecommunication revolution when it has become easier for investors to invest in corporations located in different countries and continents. In a nutshell this is the theoretical framework of this thesis.

The second chapter will explore the various definitions of corporate governance and will attempt to condense, into a single chapter features and issues that have shaped ideas on governance as a legal discipline.

The third chapter focuses on corporate governance practices in the common law and civil law jurisdictions and elaborates their salient differences. A further analysis of these distinctions is undertaken in a study of the national governance systems of

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Germany, Japan, United States\textsuperscript{25} and the United Kingdom\textsuperscript{26}. These countries have been selected because collectively they represent some of the distinct features found in both legal jurisdictions. The impact of these different national systems on the investor and multinational corporations will be discussed. In a similar fashion, the fourth chapter discusses globalization vis-à-vis the corporate governance principles of the Organization for Economic Cooperation and Development and the theory of convergence. Scholarly arguments in favor of and against globalization and its implications will be considered. A brief conclusion ends the discussion in Chapter five.

The overall result of this thesis shall be an understanding of the international corporate governance systems that currently exist, theories that have been formed and how the systems affect investors and nations in this era of globalization.

\textsuperscript{25} Michael Bradley et al., \textit{The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at Crossroads}, 62-sum law & contemp. probs.9, 51(1999). Where is noted that together, the United States, Germany and Japan comprise three of the world’s largest industrial economies in the world and at the end of 1994, 350 of the worlds 500 largest non-financial companies were found in one of these three countries. Also their governance systems have spread to other countries. In Europe countries like Austria, Belgium, and Hungary and to a lesser extent France, Switzerland, much of northern Europe and newly liberalized countries of Eastern Europe have evolved their system on Germanic lines. The influence of the Japanese governance system is evident in Asia where it has been the largest direct foreign investor in the last decade. Variants of the Anglo-American system found in the United States are found in the United Kingdom, Canada, Australia and Europe.

\textsuperscript{26} Douglas M. Branson, \textit{The Very Uncertain Prospect of Global Convergence in Corporate Governance}, 34 cornell int’l J.321, 336 (2001). Where it is states that British company law and institutions have influenced the Pacific Rim, Australia, New Zealand, Hong Kong, Singapore, Malaysia, Sri Lanka and India. In Africa, Egypt, Ghana, Kenya, Malawi, Namibia, Tanzania, Zambia and Zimbabwe.
CHAPTER 2

PRINCIPLE FEATURES OF CORPORATE GOVERNANCE

A. What is Corporate Governance?

The absence of any real consensus of what corporate governance is means there is no single definition of the term. One author in the early nineties described corporate governance as a topic recently conceived, as yet ill defined and consequently blurred at the edges. However this opinion does not stand in the present age given the plethora of academic writing and research in this area. Over the years the subject has been written on extensively from the standpoint of academics, legal practitioners, economists and the like.

Academicians like Monks and Minow have defined corporate governance as the relationship among various participants in determining the direction and performance of corporations. The primary participants being: the shareholders, the management (led by

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27 Kevin Keasey et al., The Corporate Governance Problem - Competing Diagnosis and Solutions, in Corporate Governance: Economic and Financial Issues 2 (Kevin Keasey et al., eds., 1997).
30 Gregory V. Varallo and Daniel A. Dreisbach, Fundamentals of Corporate Governance; A Guide for Directors and Corporate Counsel, 52 bus. law. 729 (1997), where Monk is described as the one of the founding gurus of corporate governance.
the chief executive officer), and the board of directors. Other participants include the employees, customers, suppliers, creditors and the community.\textsuperscript{31}

An internationally accepted definition used by the Organization for Economic Development Cooperation reads:

“Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.”\textsuperscript{32}

One common theme coming through is that corporate governance is ‘a matrix of legal responsibilities’ among the different participants.\textsuperscript{33} This is because the right, obligations and impact of the relationships amongst them play a role in determining the corporate direction, strategy and performance.\textsuperscript{34} Corporate governance also calls for the study into the intricacies of the relationships of the various parties of the corporation and the relationship it shares with persons that own it, manage it and other stakeholders.\textsuperscript{35}

When we look back at the Berle and Means theory of the modern public corporation, they demonstrated that the direction of the business corporation was no longer in the hands of those who owned stock in them, the shareholders, but was in the hands of those hired to operate the company, the managers and directors.\textsuperscript{36} This was

\textsuperscript{33} Maw, \textit{supra} note 28, at 3.
\textsuperscript{34} Monks, \textit{supra} note 31, at 1.
\textsuperscript{35} Id.
\textsuperscript{36} Richard Ellis, foreword in BROWN, \textit{supra} note 1, at xix.
considered to be the inevitable feature of the public corporation at the time. It was not until recently that the possibility of uniting ownership and control existed\textsuperscript{37}.

The advent of institutional investors changed the corporate scenario as shareholding became more concentrated and the Berle and Means theory model of public held corporations was no longer valid\textsuperscript{38}. The impact of the institutional investors will be further discussed in the next chapter. Suffice to say, for the moment, that where individual shareholders previously had no clout, this new breed of investors has the power and influence to demand accountability from the corporations. Today's institutional investors have the largest concentration of investment dollars and the sharpest growing rates\textsuperscript{39}. Unsatisfied shareholders no longer divest themselves of their interests in companies but demand reform on a myriad of issues ranging from environmental issues to social reform and even changes in corporate practice\textsuperscript{40}.

B. Corporate Constituents.

The law speaks of a corporation as a ‘legal person’ created separate from its owners and having statutory rights and responsibilities\textsuperscript{41}. There are four main characteristics that are essential to a corporate form. These are; limited liability, legal personality, transferable investor rights and centralized management\textsuperscript{42}. The concept of the corporation in countries whose governance structures this paper will review; Germany, Japan, United Kingdom

\textsuperscript{37} Bainbridge, \textit{supra} note 8 at 671, 672 (1995).
\textsuperscript{38} \textit{Id}.
\textsuperscript{40} James C. Worthy and Robert Neuschel, Emerging Issues in Corporate Governance 1 (1984).
\textsuperscript{41} Tricker, \textit{supra} note 5, at 10.
and United States, is basically the same. However the precise details and governance mechanisms differ\textsuperscript{43}.

The most significant players in the corporate world are the shareholders, the board of directors and the executive managers. Although for countries like Japan and Germany it shall later be shown that banks and other investors that own indirect controlling interests in the corporations occupy prominent positions in the governance systems\textsuperscript{44}.

The notion of accountability in governance shows that it is a two way street. Just as the corporation is responsible towards its shareholders and other stakeholders, governance practices determine how these shareholders and stakeholders monitor and control the corporation\textsuperscript{45}.

**Shareholders.**

Shareholders are people who own a certificate representing entitlement to a proportional share of the corporation\textsuperscript{46}. The fact that the shareholders are the owners of a corporation goes to the root of corporate governance\textsuperscript{47}. This ownership confers certain rights and obligations that are determined by law. Some of the more important rights the shareholders have are; to vote, transfer their shares, to sue the directors or managers for breach of duty, the right to certain information from the company and when the company

\textsuperscript{42} Monks, *supra* note 3, at 11.
\textsuperscript{43} Franklin Allen and Douglas Gale, Corporate Governance and Competition, in Theoretical and Empirical Perspectives 23 (Xavier Vives eds., 2000).
\textsuperscript{44} Vives, *supra* note 10, at 3.
\textsuperscript{45} Timothy L. Fort and Cindy A. Schipani, *Corporate Governance in a Global Environment; The Search for the Best of Both Worlds*, 33 vand j. transnat’l l. 829, 833 (2000).
\textsuperscript{46} Monks, *supra* note 31, at 100.
\textsuperscript{47} Maw, *supra* note 28, at 1.
is liquidated, to residual rights once the creditors are paid\(^{48}\). Shareholders influence the corporation management by exercising their voting rights at the general meeting to elect the board of directors\(^{49}\). They may also use the proxy process to introduce shareholder proposals\(^{50}\). In the United States they also have additional power to commence derivative suits against the corporation to correct wrongs done to the corporation\(^{51}\). Individual shareholders may have little impact because of their minority shares, but the advent of institutional shareholders, at least in the common law jurisdictions, has seen a greater influence exerted on managers\(^{52}\). However in many countries in the civil jurisdiction the shareholders have less influence. For instance in Japan they virtually have none except to supply capital\(^{53}\).

**The Board of Directors.**

The Board of directors is a crucial part of the corporate structure\(^ {54}\). It is the link between those involved in the day-to-day running of the corporation, the managers, and those who own it, the shareholders\(^ {55}\). The board is concerned with a broader view and long term strategic planning\(^ {56}\). It determines the corporate strategy, monitors the implementation

\(^{48}\) Id.

\(^{49}\) Maw, \textit{supra} note 28, at 7.


\(^{52}\) Vives, \textit{supra} note 10, at 7.

\(^{53}\) Monks, \textit{supra} note 31, at 268.

\(^{54}\) Id at 178.

\(^{55}\) Id

\(^{56}\) Brown, \textit{supra} note 1, at 6.
processes and supervises management\textsuperscript{57}. It adds the element of checks and balances to the corporate structure. The board members have a fiduciary duty to all their shareholders and are accountable to them and to the corporation\textsuperscript{58}. There is no standard global practice that maps out how the board ought to be composed or the methodology of how to achieve its role\textsuperscript{59}. Each board determines its own procedures. However what remains constant is that it lies at the center of all governance models.

Governance is concerned about the need for directors to stand for elections regularly, to disclose their remuneration, the presence of non-executive directors and the establishment of independent committees of the board. However in certain situations like bankruptcy, the structure of corporate control is altered and does not rest with the board of directors. In these instances corporate control may rest with a Trustee, Receiver or by whatever name they may be called in different jurisdictions.

**Executive Management.**

The managers are the technocrats involved in the day to day running of the business. Their traditional focus is on planning, organizing, motivating, controlling and coordinating\textsuperscript{60}. They are concerned with internal relationships and procedures. Corporate governance is not concerned with this level of running the corporation per se, but with giving it an overall direction that normally starts at the level of Executive Director. It is a

\textsuperscript{57}Mary E. Kissane, Global flies: Applications and Implementations of US Style Corporate Governance Abroad, 17 n.y. l. sch. j. int’l & comp.L.621, 625 (1997).
\textsuperscript{58}Monks, supra note 4, at 182-184.
\textsuperscript{59}Kissane, supra note 57.
\textsuperscript{60}Tricker, supra note 5, at 6.
function that is quite distinct from management. Governance is largely concerned with the relationship of the corporation to the institutions and environment within which it functions\(^6^1\). It involves setting the corporate direction and is involved in executive action, supervision and accountability\(^6^2\).

**Corporate Stakeholders.**

These stakeholders include the employees, banks, auditors, regulators, creditors, customers, suppliers and the community. Corporate stakeholders are generally free to bargain their contracts and agreements with the company that, to a large degree, defines the relationship of the stakeholders to the corporation.

For instance in the civil law jurisdiction of Germany and Japan, banks plays a huge role in the corporate structure\(^6^3\). Overall governance must take into account the existence of duties and responsibilities that a corporation has, under general law, to all these bodies. It makes managers internalize the welfare of these stakeholders in the firm\(^6^4\).

**C. Enforcement Mechanisms.**

Corporate governance is enforced through a framework of laws, regulatory institutions and reporting requirements that condition the way the corporate sector is managed\(^6^5\). The laws that govern the relationship of the corporate constituents to the corporation are

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\(^6^1\) Worthy, *supra* note 40, at 4.

\(^6^2\) Tricker, *supra* note 5, at 10.

\(^6^3\) Vives, *supra* note 10, at 3.

\(^6^4\) *Id* at 1.

\(^6^5\) Halpern, *supra* note 50, at 6.
defined by legislation and by the laws of the market place\textsuperscript{66}. Regarding the former, this enforcement and regulation comes in the form of case law, legislation and corporate practice\textsuperscript{67}. Simultaneously an enforcement role is played by corporate regulators such as the Stock Exchange and the Securities and Exchange Commission whose monitoring is an important element in the area of disclosure\textsuperscript{68}. Corporate governance is also enforced through checks and balances to maintain legitimacy and credibility in the system\textsuperscript{69}. This is done mostly through independent non-executive directors and auditors.

Markets play an important role in the enforcement process. An efficient market monitors managerial activities through the presence of information on the corporations. But this only happens if the corporation operates in an efficient market\textsuperscript{70}.

D. Does Corporate Governance Matter?

Efficiency and Corporate Governance.

There has been skepticism about the benefits of corporate governance especially in the light of so many other issues like competitors, financing and marketing which seem to

\textsuperscript{66} Monks, \textit{supra} note 31, at 21.
\textsuperscript{67} Maw, \textit{supra} note 28, at 4; Vives, \textit{supra} note 10, at 3. Where the article states that the quality of legal protection provided by corporate governance is measured by (1) the exercise of the shareholders right to elect the board and vote on matter like mergers (2) the enforcement of the boards fiduciary duties (3) enforcement by creditors exercising their right to repossess assets or collateral thereby altering the management structure through a reorganization and (4) the quality of legal empowerment and the standards of accounting.
\textsuperscript{68} \textit{Id} at 6.
\textsuperscript{69} Monks, \textit{supra} note 31, at 23.
\textsuperscript{70} Halpern, \textit{supra} note 50, at 6.
have the investors’ priority\textsuperscript{71}. One of the issues that corporate governance is concerned about is finding that delicate balance between the need to hold companies accountable without making the requirements too burdensome that the economic efficiency of the corporation is impaired\textsuperscript{72}.

A research in the United States asked Chief Executive Officers and other top executives whether they were willing to pay more for the stock of a well-governed corporation. They were asked to compare two well performing companies and state whether they would pay more for the stock of one of these companies if it was well governed. The response was in the affirmative. As one Chief Executive Officer explained,

“Good corporate governance is somewhat akin to the headlights of a car. If these two companies are in a daytime race nothing goes wrong – then they are evenly matched. If the race goes past dusk, however, the company with good governance has the headlights to deal with the problem.”\textsuperscript{73}

According to this research\textsuperscript{74}, over one hundred investors, chief executive officers and senior executives said that good governance made a difference which investors were willing to pay for. The study identified three types of investors who cared about good governance. They could be separated into three groups; the investors with lower turnover ratios who held shares longer and believed that good governance would improve the companies performance in the long run, investors who pursued a ‘value strategy’ by

\textsuperscript{71} Robert Felton et al, \textit{Putting a Value on Board Governance}, 170 the mckinsey quarterly (1996)
\textsuperscript{72} Swanson, \textit{supra} note 39, at 417.
\textsuperscript{73} Felton, \textit{supra} note 71, at 36.
\textsuperscript{74} \textit{Id}.
investing in undervalued corporations with low price/earnings ratio in the hope that the company would grow. They believed a good board would help improve underperforming stock and capture hidden value. The third group were investors who managed money for high net worth individuals, endowments, foundations and public pensions.

The four main reasons these investors would pay a good premium for good governance were; a belief that a company would perform well over time and this would lead to higher returns, that it reduced the likelihood of bad things happening to the company and even if they did happen, a well governed company would rebound more easily. Finally some investors did so because the governance debate was a considered ‘a fad’.

While this study did not show that corporate governance was a top priority, because items like strategy, cash flow, and competitive position ranked higher, it nonetheless showed that governance occupied a position somewhere on the priority list. This led to the conclusion that believing in the value of corporate governance should no longer be a question of good faith.

That said, however, the existence of a clear link between corporate governance and corporate performance is not self-evident. It is a mere hypothesis. There have been some empirical studies done that have been undertaken to establish this connection. Some of these studies have established that regulatory and institutional structures influence the development of stock markets. Another has shown that the mandatory disclosure of

\[ \text{Ronald Gilson, } \textit{Corporate Governance and Economic Efficiency; When Do Institutions Matter?} \]
\[ \text{74 wash. u. l. q. 327, 328 (1996).} \]
\[ \text{William Bratton and Joseph A. McCahery, } \textit{Incomplete Contracts Theories of the Firm and} \]
reliable information is directly proportional to a firm’s ability to encourage investor participation in the stock market. While a third study done to test national systems against different indices like shareholder protection, ownership concentration and the financial system showed a positive co-relation between the level of legal investor protection on the one hand and the size of the market and prevalence of dispersed shareholders on the other hand.

The Role of Competition.

One argument raised about the relationship between corporate governance and efficiency is the role of competition. It has been argued that competition is a powerful force for ensuring good corporate governance. For instance, if managers of a firm are wasteful or consume large amounts of resources, the firm will be unable to compete favorably and will go bankrupt. That the role of competition in providing information and an environment for comparison acts as a catalyst for efficiency. It forces the board and management to be disciplined.

Comparative Corporations Governance, 2 theoretical inquiries 745, 751 (2001)

Id.

Id at 751.

Allen, supra note 43, at 56.

Id.

Id.

Id.
CHAPTER 3
NATIONAL CORPORATE GOVERNANCE SYSTEMS

A. Distinguishing Corporate Governance in Common law and Civil Law Jurisdictions.

The evolution of corporate governance has taken place world wide at different paces and systems differ even amongst the worlds advanced market economies. Systems have evolved differently mainly due to varied historical, political, social and economic backgrounds. But perhaps the most important influence could be attributed to the legal jurisdictions that have shaped the way corporations are governed in different countries. Legal jurisdictions are broadly divided into two groups; civil law and common law. The starting point of the governance debate in either jurisdiction is not the same. The civil law jurisdiction, also known as Romano Germanic, is predominantly found in continental Europe and other countries influenced by that part of Europe. It utilizes statutes and comprehensive codes as the primary means of organizing its legal principles. The common law tradition is found in the United States, Canada, United Kingdom and other countries whose modern development was heavily influenced by these nations. It is

83 Gilson, supra note 22, at 329.
84 Emmons, supra note 82, at 66.
85 Maw, supra note 28, at 119.
86 Emmons, supra note 82, at 67.
characterized by Judge made laws and the use of precedents.\(^{87}\) However it's important to note that even though common law countries share a common history in their legal system, to a large extent their internal judicial systems have subsequently had independent developments. These countries, albeit being part of the same legal system, have differences amongst themselves.\(^{88}\) However, comparative legal scholars generally agree that countries following common law share more critical features with each other than with members of other legal groups. In the civil law system, countries have developed more independently and diverged from each other more than countries under common law.\(^{89}\)

Corporate governance in the common law system is market oriented.\(^{90}\) It is also referred to as the *shareholder-market model* or the *stock market-centered capital model*.\(^{91}\) It is characterized by a liquid stock market and dispersed ownership of public corporations.\(^{92}\) Shareholders own the corporation’s equity and it fluctuates depending on how well the company is doing.\(^{93}\) The investing public are the direct risk takers.\(^{94}\) Banks act as a source of extra funds but generally play a limited role.\(^{95}\) The possibilities of

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\(^{87}\) Id.  
\(^{88}\) Id.  
\(^{89}\) Emons, *supra* note 82, at 69.  
\(^{90}\) Kissane, *supra* note 57, at 622.  
\(^{91}\) Gilson, *supra* note 22, at 329.  
\(^{92}\) Kissane, *supra* note 57, at 622.  
\(^{93}\) Cunningham, *supra* note 24, at 1136.  
\(^{95}\) Vives, *supra* note 10, at 2. Where it states that in the United States the Glass-Steagall Act, repealed in November 1999, kept banks out of corporate governance by not allowing them to own equity. In the United Kingdom, though the banks were not restricted, they did not get involved.
takeovers, proxy fights and boardroom coups are not foreign concepts to this model. In contrast, the civil system is referred to as the bank/labor model or the bank-centered capital model. It is characterized by concentrated family control of large businesses. Capital for both debt and equity financing is supplied by banks. These banks enter into long term and stable relationships with the corporations. They also own large amounts of stock in these companies. There is no active liquid capital market because of the presence of concentrated ownership and bank debt holdings. This means that the jurisdiction requires fewer regulatory mechanisms as compared with the market model that requires a complex system of checks and balances.

In the market model, shareholders are the owners of the corporation. But management rests in the hands of the directors. The relationship of the employees, suppliers, creditors and customers to the corporation is set by contracts. In the bank/labor model, the board and managers operate the firm in the interest of all the stakeholders and not just the shareholders.

These differences have been conceptualized in a theory that refers to the market model as contractualism and the bank-labor model as communitarian. Shareholders lie

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96 Bratton, supra note 76.
97 Cunningham, supra note 24, page 1139.
98 Gilson, supra note 22, at 329.
99 Id.
100 Cunningham, supra note 24, at 1139.
101 Vives, supra note 10, 2.
102 Visentini, supra note 94, at 837.
103 Cunningham, supra at 24, at 1139.
104 Visentini, supra at 94, at 836.
105 Cunningham, supra note 24, at 1136.
106 Id.
107 Fort, supra note 45, at 829. This article explains the characteristics of countries rooted in a
at the center of the contractualism model and the corporations primary concern is to them\textsuperscript{108}. The corporation is viewed as a myriad of contracts, which together with market forces act to regulate the relationship between the shareholders and the managers\textsuperscript{109}. In the communitarian school of thought, the corporation has a social responsibility to all stakeholders\textsuperscript{110}.

The existence of these diverse practices has ignited a debate over which system of corporate governance is better\textsuperscript{111}. Theory has emerged that the ‘competition’ between the shareholder market model and bank/labor model systems of governance will lead them to converge and form a single efficient system\textsuperscript{112}. Interestingly some scholars have argued that the convergence will result in a worldwide replication of the American system by larger corporations\textsuperscript{113}. That this convergence would either be functional convergence or formal\textsuperscript{114}. The idea of such convergence has been heavily criticized as presumptuous and impractical\textsuperscript{115}.

contratarian approach and those holding communitarian ideals. The differences mirror the characteristics of the market model and the bank/labor models of corporate governance respectively.

\textsuperscript{108} Monks, supra note 31, at 268.
\textsuperscript{109} Fort supra note 45, at 837.
\textsuperscript{110} Id at 835.
\textsuperscript{111} McDonnell, Convergence in Corporate Governance-Possible but not Desirable 47 vill. l. rev, 341.
\textsuperscript{112} Bratton, supra note 76, at 474, explains this theory as a “convergence project.” The article assumes that in the meantime both systems possess equal competitive fitness.
\textsuperscript{113} McDonnell, supra note 111, at 345, sums up the views of scholars in favor of the notion that eventually all governance systems will replicate the American system; Henry Hansmann & Reiner Kraakman, The End of History for Corporate Law, 89 geo. l. J. 439(2001) contains the most blunt statement that this convergence to the United States system will bring the evolution of corporate law to an end.
\textsuperscript{114} Branson supra note 26, at 323.
\textsuperscript{115} Detailed discussion of the views expressed by scholars against the idea of converging global practices is made in Chapter 4 infra page 45.
While subsequent discussion will show that countries are now increasingly changing practices to attract foreign investment, the fact is they have still retained features that make them distinct. The next section explores the salient features of corporate governance practices in selected countries, which collectively represent the civil and common law legal jurisdictions.

B. National Corporate Governance Systems.

The review of these systems will be limited to; the board of directors, shareholder participation, stakeholders and major factors that have influenced the systems. This analysis is based on past research conducted in this field.

Germany.

The distinct feature of Germanys company law is the two-tier board of directors system that is a legal requirement for all stock companies employing five hundred or more employees\textsuperscript{116}. This legal system has a unique management structure that comprises two boards of directors; the management board with executive responsibilities, *vorstand* and the supervisory board with control functions, *Aufsichtsrat*\textsuperscript{117}. The former board is responsible for the day-to-day operations of the business while the latter is concerned with the supervision\textsuperscript{118}. The two boards are so distinct in character and composition that

\textsuperscript{116} Monks, *supra* note 31, at 287.
\textsuperscript{117} Klaus Hopt, The German Two-Tier Board; A German View On Corporate Governance 3 (Klaus Hopt et al, eds. 1997).
\textsuperscript{118} Angel Quendo, Breaking *Through to the Other Side; Understanding Continental European Corporate Governance*, 22 u. pea.j. int’l econ.L.975 (2001).
members of one board cannot sit on the other. The supervisory board, management boards and shareholders are the three legal organs that meet at the annual general meeting. The other two features that stand out in Germany are the voting strengths of the banks and the power of the labor force.

The origin of the board system in Germany dates back to the beginning of German Corporation law and reform in the nineteenth century. The supervisory board, the Aufsichtsrat, was formed to substitute the state charter and previously existing continuous state controls were abolished. Its duty is to supervise management and attend to the long term strategic planning of the corporation. Its power over management extends to making appointments, dismissals and fixing remuneration for the management board. While it does not make management decisions, it approves certain actions contemplated. The supervisory board is composed of shareholders, the workforce and trade union representatives. They are appointed, respectively, by the shareholders, the workers of the corporation and the trade union. Their ratio on the boards is determined by general law that requires that in companies with a work force of

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119 Hopt, supra note 117, at 4.
120 Monks, supra note 31, at 288.
122 Id at 242.
123 Hopt, supra note 117, at 6.
124 Clarke et al, supra note 121, at 242.
125 Hopt, supra note 117, at 4.
126 Cunningham, supra note 24, at 1140.
127 Hopt, supra note 117, at 4-6.
less than 2000 employees, one third of the supervising board shall be elected by the employees. In larger corporations, the ratio of employees would be half\(^\text{128}\).

The management board represents the company in third party dealings and submits regular report to the supervisory board\(^\text{129}\). The members are appointed for five-year terms by the supervisory board and may be dismissed for compelling reasons\(^\text{130}\). Critics however fear that the close interaction of these boards may affect objective supervision\(^\text{131}\).

In a country known for its extensive banking network, banks play a prominent role in the governance of corporate entities. They are in a position to exercise this influence by virtue of their significant holding in the majority of German companies and through their representation on the supervisory boards of about two thirds of Germanys listed companies\(^\text{132}\). Even though the banks representation on company boards has greatly reduced, the influence of German banks is much wider in context than their mere presence on the supervisory board\(^\text{133}\). Their real influence comes from the combination of the supervisory board seats, stock participation, bank proxy votes and the banks credit and underwriting business\(^\text{134}\). In addition, although wealthy individuals and families as well as non-financial firms tend to be large stockholders, the individual investors will

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\(^{128}\) Monks, supra note 31, at 288.

\(^{129}\) Cunningham, supra note 24, at 1140.

\(^{130}\) Hopt, supra note 117, at 4.

\(^{131}\) Kissane, supra note 57, at 648.

\(^{132}\) Id.

\(^{133}\) Id.

\(^{134}\) Id.
normally give the banks proxy-voting authority to administer these shares on their behalf\textsuperscript{135}.

The employees’ presence on the supervisory board can be traced to the end of the First World War\textsuperscript{136}. This practice of worker participation on the board commonly referred to as \textit{co-determination} was further ingrained in 1976 when the current legal framework in Germany was established\textsuperscript{137}. Co-determination refers to the dual-board structure peculiar to Germany and is modeled on a theory that because labor and capital co-determine a corporation’s future, both should be represented on the supervisory board\textsuperscript{138}. The role played by the employees is a question of debate. But their presence has definitely been consolidated by the fact that two-thirds of the employees pension contributions are retained within the corporation and this represents a source of internal revenue to the corporations\textsuperscript{139}.

The result of the corporate structure means that the board represents a wide range of interests beyond just the shareholder\textsuperscript{140}. Less emphasis is placed on dividends, as compared to the United Kingdom and the United States. More emphasis is placed on the long-term viability of the company\textsuperscript{141}. Shareholders are concerned more with the

\begin{footnotesize}
\footnotesize{\textsuperscript{135} McDonnell, \textit{supra} note 111, at 343.}\\
\footnotesize{\textsuperscript{136} Clarke, \textit{supra} note 121, at 244.}\\
\footnotesize{\textsuperscript{137} \textit{Id} at 245.}\\
\footnotesize{\textsuperscript{138} Cunningham \textit{supra} note 24, at 1141.}\\
\footnotesize{\textsuperscript{139} Clarke, \textit{supra} note 121, at 245. Corporations retain two thirds of employees pension contributions and this represents an important source of internal financing for the companies. In 1994, employees pension contributions retained were worth 300 billion Deutsce marks. This could explain why the German capital market is illiquid.}\\
\footnotesize{\textsuperscript{140} Fort \textit{supra} note 45, at 852.}\\
\footnotesize{\textsuperscript{141} Clarke, \textit{supra} note 121, at 246.}
\end{footnotesize}
companies’ strategic plans than with dividends\(^{142}\). Perhaps owing to this reduced status, the shareholder meeting in Germany has been compared to communist party conventions where people are not encouraged to dissent\(^{143}\).

Japan.

The Japanese corporate governance system is best understood from a historical perspective following the Second World War. The shortage of capital pushed banks into prominence because they played the dual role of holding shares in corporations and simultaneously providing capital, which, amongst other things, allowed corporations to invest in shares of other companies\(^{144}\). Resulting from this history, banks play a key role in corporate governance.

Japanese company law is codified in the Japanese Commercial Law\(^{145}\). It has its origins form the late nineteenth century Germany and though it resembles the German system in some ways, it differs in many respects\(^{146}\). One thing it did not import was the German dual board system because following American occupation, after the Second World War, it imported many United States rules which included the American style board of directors\(^{147}\). The Japanese board is a management board that is comprised almost entirely of full time employees or former employees\(^{148}\). It is described as ‘homogenous’

\(^{142}\) Monks, *supra* note 31, at 289.
\(^{143}\) Kissane, *supra* note 57, at 651.
\(^{144}\) *Id* at 658.
\(^{145}\) Hideki Kanda, Trends in Japanese Corporate Governance, in Comparative Corporate Governance 186 (Klaus J. Hopt et al eds., 1997)
\(^{146}\) Monks, *supra note* 31, at 287.
\(^{147}\) LaChance, *supra* note 8, at 294.
because it is generally composed of; about twenty-five men, at least 50 years old and most of whom are former employees\textsuperscript{149}. Corporations must have at least three directors elected by shareholders to serve fixed terms not exceeding two years. The directors are bound by fiduciary duties to the shareholders that elected them\textsuperscript{150}. However shareholders rarely seek the enforcement of fiduciary duties\textsuperscript{151}. The presence of outside directors is a rare phenomenon\textsuperscript{152}.

Another significant feature is the large companies whose stock is held by ‘concentrated shareholders’\textsuperscript{153}. Stable shareholders that include other corporations, major creditors, major customers or suppliers hold the majority of these shares\textsuperscript{154}. This shareholding is done on reciprocal basis and has resulted in a dense network of mutual shareholding\textsuperscript{155}. This network, known as keiretsu, refers to a group of corporations in which the individual firms each own some stock of the other member firms\textsuperscript{156}. Apart from corporations, banks and insurers also own large stock in the keiretsu firms equal to about 5\% each thus creating a voting block of over 20\% of the keiretsu stock\textsuperscript{157}. A clear pattern emerges where the majority of shareholders in Japan are corporations that are

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\begin{itemize}
  \item \textsuperscript{149} Id at 187.
  \item \textsuperscript{150} LaChance, supra note 8, at 294.
  \item \textsuperscript{151} Id.
  \item \textsuperscript{152} Monks, supra note 31, at 272. Almost 80 percent of all Japanese corporations have no outside board members and another 15 per cent have no more than 2 outside board members.
  \item \textsuperscript{153} LaChance, supra note 8, at 292.
  \item \textsuperscript{154} Takeo Hoshi, Japanese Corporate Governance as a system, in Comparative Corporate Governance 860 (Klaus J. Hopt et al eds., 1997).
  \item \textsuperscript{155} Id at 892.
  \item \textsuperscript{156} LaChance, supra note 8, at 292.
  \item \textsuperscript{157} Id.
\end{itemize}
both shareholders and stakeholders in the corporation.\textsuperscript{158} The role played by individual shareholders is minimal\textsuperscript{159}.

The *keiretsu’s* monitor the firms that it has an interest in. They conduct much of this monitoring at monthly meetings of the *keiretsu* president’s council\textsuperscript{160}. This is essentially a ‘second board’ on which the presidents of the *keiretsu* member boards sit. Though the council does not vote, members of the companies’ boards will not act contrary to the council’s opinion. They will also consult the council when one of the *keiretsu* firms is about to make a major decision\textsuperscript{161}.

The banks are involved in monitoring and will usually choose one bank from amongst them to conduct this monitoring\textsuperscript{162}. They are generally forceful and will intervene when a company goes into financial problems by sending in their own set of directors. Together, the *keiretsu* and the banks exercise tremendous power over managers\textsuperscript{163}. The government also plays a major role in regulating businesses\textsuperscript{164}.

**United Kingdom.**

The formal system of corporate governance in the United Kingdom is a very traditional one\textsuperscript{165}. Very little of the corporate model has changed from that which was devised by

\begin{itemize}
\item \textsuperscript{158} Hoshi, *supra* note 154, at 860.
\item \textsuperscript{159} *Id.* Statistics show that individuals only own 20.4 percent of Japanese stock.
\item \textsuperscript{160} LaChance, *supra* note 8, at 292.
\item \textsuperscript{161} *Id.*
\item \textsuperscript{162} Hoshi, *supra* note 154, at 861.
\item \textsuperscript{163} LaChance, *supra* note 8, at 292.
\item \textsuperscript{164} Monks, *supra* note 31, at 271.
\item \textsuperscript{165} Paul L. Davis, *Institutional Investors as Corporate Monitors in the United Kingdom*, in *Comparative Corporate Governance* 47 (Klaus J. Hopt et al eds., 1997).
\end{itemize}
parliament in the middle of the nineteenth century\textsuperscript{166}. The control of the company is determined by its share structure\textsuperscript{167}. The opinions of the majority shareholders rule. With the decrease of individual equity ownership\textsuperscript{168} and an increase of institutional shareholding, this majority ownership is increasingly lying in the hands of institutional shareholders\textsuperscript{169}. Even though historically these institutional investors have traditionally influenced management behind closed doors, they are now more visible in their confrontations\textsuperscript{170}. The value of their equity holding has made them the most important single group holding securities\textsuperscript{171}. The main reason for their growth stems from the expansion of pension funds available for investment as a result of increased private retirement savings and a growth of insurance companies\textsuperscript{172}. However unlike in the United States where similar change precipitated corporate governance, in the United Kingdom institutional investors were not active but reactive in taking an active role in the development of corporate governance\textsuperscript{173}.

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\textsuperscript{166} Tricker, \emph{supra} note 5, at 90.
\textsuperscript{167} \emph{Id} at 13.
\textsuperscript{168} Helen Short and Kevin Keasey, Institutional Shareholders and Corporate Governance in the United Kingdom, in Corporate Governance: Economic and Financial Issues 19 (Kevin keasey et al eds., 1997). Individual equity ownership in the United Kingdom decreased from 54 percent in 1954 to less than 18 percent in 1993 and in direct proportion to this decrease was an increase in the dominance of institutional investors.
\textsuperscript{169} Cheffins, \emph{supra} note 8, at 12. Institutions like pension funds, insurance companies and mutual funds play an important role in ownership. Collectively they own 60 to 70 percent of the equity market.
\textsuperscript{170} Kissane, \emph{supra} note 57, at 637.
\textsuperscript{171} Maw, \emph{supra} note 31, at 84.
\textsuperscript{172} Short, \emph{supra} note 168, at 19.
\textsuperscript{173} \emph{Id} at 22.
\end{flushleft}
Shareholders are central to the corporation and they exercise corporate suffrage by voting for the board\textsuperscript{174}. There is no worker representation on the board and though this idea was floated in the 1970’s, it did not take effect\textsuperscript{175}. The board’s main duty is to overlook the affairs of the company and ensure management performs efficiently\textsuperscript{176}. It is typically composed of senior full time executives and non-executives or outside directors\textsuperscript{177}. All directors owe fiduciary duties to the shareholders and are collectively responsible for the decisions taken by the board\textsuperscript{178}.

The British governance system differs from continental European systems\textsuperscript{179}. It resembles the United States in many ways with some salient differences\textsuperscript{180}. Both countries have adopted a shareholder model\textsuperscript{181}. Very few large corporations are controlled by dominant owners and the majority of shareholders are dispersed\textsuperscript{182}. These management executives have typically run the corporation\textsuperscript{183}. But unlike the United States, Britain has a non-executive chairman on the majority of its boards and a majority of inside directors\textsuperscript{184}. The governance debate in this jurisdiction has mainly been on the

\textsuperscript{174} Davis, supra note 165, at 48.
\textsuperscript{175} \textit{Id}.
\textsuperscript{176} Maw, supra note 28, at 4.
\textsuperscript{177} Cheffins, supra note 8, at 8.
\textsuperscript{178} \textit{Id}.
\textsuperscript{179} Davis, supra note 165, at 48.
\textsuperscript{180} Monks, supra note 31, at 303.
\textsuperscript{181} Kissane, supra note 57, at 624.
\textsuperscript{182} Cheffins, supra note 8, at 12.
\textsuperscript{183} \textit{Id} at 15.
\textsuperscript{184} Monks, supra note 31, at 303. Only 42 percent of all directors are outsiders and 9 per cent of the largest UK companies have no outside directors at all.
role of non-executive directors and institutional shareholders in monitoring executive performance.\textsuperscript{185}

The corporate governance debate in the United Kingdom reached a climax in 1991 when the Financial Reporting Council, the London Stock Exchange and the accountancy profession set up the Cadbury Committee to examine the financial aspects of corporate governance. This became necessary following concerns of an apparent lack of confidence in financial reporting and in the effective supervision of management by company boards.\textsuperscript{186} The reasons for this negativity were well summed by the Cadbury committee chairman Sir Adrian Cadbury who said that;

"The harsh economic climate is partly responsible, since it has exposed company reports and accounts to unusually close scrutiny. It is, however, the continuing concern about standards of financial reporting and accountability, heightened by Bank of Credit and Commerce, Maxwell and the controversy over directors' pay, which has kept corporate governance in the public eye."	extsuperscript{187}

The Cadbury committee had the task of codifying the responsibilities of executive and non-executive directors, audit committees, auditors and linking the responsibilities of the board, shareholders and auditors.\textsuperscript{188} The work resulted in the Cadbury Code of Best Practice. It had a wide range of recommendations.\textsuperscript{189} Though many of its guidelines were

\textsuperscript{185}Cheffins, supra note 8, at 39.

\textsuperscript{186}John C. Shaw, The Cadbury Report, Two Years later, in Comparative Corporate Governance – Essays and Materials 21, 23 (Klaus J. Hopt & Eddy Wymeersch eds., 1997)

\textsuperscript{187}Maw, supra note 28, at 157. To read about the collapse of the Bank of Credit and Commerce see British Financial Times dated, Nov 9, 1991 at 1 and to read about the collapse of the Maxwell Empire, see British financial times dated Dec 6, 1991 at 2.

\textsuperscript{188}Monks, supra note 31, at 141.

\textsuperscript{189}Maw, supra note 28, at 140. Where it gives a summary of the committee’s terms of reference, the draft report, reaction to the draft report and the final report.
not applied in the United Kingdom, the report is credited with improving corporate standards in companies\textsuperscript{190}.

Subsequent to the Cadbury committee, two other committees were set up in 1995. The Greensburg committee and the Hampel committee. Both were named after their respective chairmen. The first committee was convened to explore the issue of directors’ remuneration\textsuperscript{191}. This committee recommended the composition of remuneration sub-committees composed of non-directors and it also called for increased shareholder participation and transparency\textsuperscript{192}. Many of its recommendations were incorporated in the stock exchange listing rules\textsuperscript{193}.

The Hampel Committee studied the recommendations of the two previous committees and explored how they could be achieved. Its focus was on three areas; disclosure of executive pay, the role the executive and non-executive directors and the participation of institutional investors\textsuperscript{194}. It concluded its work in 1998\textsuperscript{195}. Its final report culminated in the ‘Combined Code’ which was attached to the listing rules of the London Stock Exchange, also referred to as the ‘Yellow Book’. Listed companies are expected to observe these rules in this yellow book\textsuperscript{196}.

\textsuperscript{190} Kissane, \textit{supra} note 57, at 644.
\textsuperscript{191} \textit{Id}.
\textsuperscript{192} Cheffins, \textit{supra} note at 8, page 20.
\textsuperscript{193} \textit{Id},
\textsuperscript{194} Kissane, \textit{supra} note 57, at 643.
\textsuperscript{195} Cheffins, \textit{supra} note 8, at 24.
\textsuperscript{196} \textit{Id} at 18-25.
United States of America.

Focusing on the last three decades in the United States, the corporate governance debate and its development was catalyzed by certain key events. Firstly while for many years publicly traded corporations raised capital by selling shares to the public, managers still retained corporate control over the companies. This was largely because the shareholder base was composed of several unconnected individuals who did not have the ability to influence management. Individually, shareholders had little clout to influence any changes. Hence the ‘wall street rule’ was the route to take. Translated, it meant that if shareholders did not agree with the way management conducted the business, they were free to sell their shares and walk away.

An increase in the financial wealth of United States households was directly proportional to an increase of pensions and mutual funds because a number of families chose to invest in them. Furthermore the enactment of legislation in the United States permitting pension funds and trusts to invest in equities was an added attraction that saw the growth of institutional investors in the capital market. The increase of these institutional investors took place over the last three decades. This resulted in a

198 Maw, supra note 28, at 7.
199 Supra note 197, at b13.
200 James D. Cox, Securities Regulation 23 (3rd ed.2001) Where it is noted that the mutual fund has replaced savings account as the typical families major source of savings. In addition, retirement funds are maintained by pension plans. Even self-employed people have retirement funds, which are committed either to an Insurance company or a Mutual Fund.
201 O’Sullivan, supra note 3, at 153. The Employment Retirement Income Security Act (1974) was amended in 1978 to permit pension funds and Insurance companies to invest in equities and other risky securities. This was a departure from the limitation to investment in high grade corporate and government securities.
202 Cox, supra note 199, at 23. While in 1958 individual investors held ninety per cent of
significant change in the ownership of public corporations. Similar to the United Kingdom, institutional investors represented the largest number of individual investors. As a result they not only held significant blocks of shares, they had the power of attorney to act as though they were the equity holders. Because they managed large blocks of equity, it became impractical for unsatisfied institutional investors to divest themselves of their interests and exercise the ‘wall street rule’ as this would impact negatively on the value of their shares. Instead they chose to maintain their equity holding but begun pressing for changes and exploring for ways to exercise their influence in corporations failing to live up to their expectations. One way was by demanding their representation on the boards. By the 1970’s and 1980’s most corporations added outside directors to their boards so that most boards now consisted of at least a majority of outside directors.203

One of the institutional investors who rejected the ‘wall street rule’ and believed that the most responsible and successful investor approach was to present shareholder concerns directly to management and encourage it to make changes was the Teachers Insurance and Annuity Association (TIAA-CREF)204. In 1993, it released a detailed list of its corporate governance policies that it intended to pursue on all its portfolio companies.205 Its statement focused on a need for boards of directors to have a majority

American equities, by the 1990s it was institutions that controlled more than half of the equity.  
203 Supra note 197, at b13.  
204 Peter C. Clapman, Current initiatives of the Tiaf-cref corporate governance program. It is the largest private pension system in the world with approximately $225 billion under its management. Its role in governance dates back to the 1970s.  
205 Monk, supra note 31, at 143.
of outside directors, compensation and adequate disclosure\textsuperscript{206}. Other institutional investors like the California Public Employees Retirement System (CALPERS) joined in the ‘institutional activism’ and public companies were forced to hear their voices\textsuperscript{207}.

Other reasons that precipitated corporate governance was the 1980’s period that was characterized by takeovers, leveraged buyouts and junk bonds\textsuperscript{208}. Corporations responded to these threats by adopting charters and by-laws that included poison pills, classified boards \textit{et al}. This created tension amongst institutional investors who felt the boards and management tried to entrench themselves and frustrate the shareholders desire to get an immediate premium on their shares\textsuperscript{209}. The investors again recognized that their influence on the board would only be possible if they were represented.

By 1982 the Corporate Governance Project of the American Law Institute (ALI) had begun to work on its first, albeit controversial, draft of the principles on Corporate Governance. This was probably the first documented attempt to articulate this topic and give it boundaries and substance\textsuperscript{210}. The institute examined corporate governance widely and produced the principles in 1994. However, the importance of the project was overshadowed by controversy and difficulties resulting from the plethora of corporation law that existed\textsuperscript{211}. The principles addressed issues concerned with the objective and the

\begin{footnotes}
\item[206] Id.
\item[207] Kissane, \textit{supra} note 57, at 633. Calpers activism has included negotiation, the use of proxies or threatened and actual litigation.
\item[208] Daniel P. Hann, \textit{Emerging issues in US Corporate Governance; Are Recent Reforms Working?} 68,def. couns. j. 191 (2001).
\item[209] \textit{Supra} note 197, at 18.
\item[210] Melvin Aron Eisenberg, \textit{An Introduction to the American Law Institutes Corporate Governance Project} 52 geo. wash. l. rev 495,495-500 (1984). The chief reporter of the ALI Corporate Governance Project gives an overview of the project.
\item[211] Swanson, \textit{supra} note 39, at 431.
\end{footnotes}
conduct of business, corporate structure, management fiduciary obligations and remedies.
The results of this project were unsatisfactory to many and most agree that the principles will have little effect\textsuperscript{212}.

One unique feature in the American legal system is federalism. Its significance on corporate governance is that persons wishing to incorporate a company have a choice of State corporation law\textsuperscript{213}. Irrespective of where that corporation selects to operate from, under the principle known as internal affairs, the laws that shape its corporate governance structure will be determined by the incorporating state with occasional exception\textsuperscript{214}. Traditionally states have the power to regulate the relationship between corporations, management and shareholders through legislation and judicial rulings\textsuperscript{215}. It has even been suggested that states are in a race to the bottom to attract companies to incorporate by lowering the standard of shareholder protection\textsuperscript{216}. Whatever the case, corporate governance cannot be understood only by reference to state law\textsuperscript{217}. Though the federal government has not created comprehensive federal corporation laws, technically it could\textsuperscript{218}. However, even in the absence of such federal laws, many federal statutes affect various aspects of corporate governance and these laws have to be taken into account\textsuperscript{219}.

\textsuperscript{212} Id
\textsuperscript{213} Donald E. Schwartz, \textit{Federalism & Corporate Governance}, 415 Ohio St. L. J. 545, 551 (1984).
\textsuperscript{214} Id at 151. An exception exists in Section 2115 of the California Corporation Code which employs a formula to determine the applicability of internal affairs rules of California, notwithstanding that the corporations were incorporated elsewhere.
\textsuperscript{217} Schwartz, at \textit{supra} note 213, at 557.
\textsuperscript{218} Scott, supra note 215, at 552
\textsuperscript{219} Schwartz, \textit{supra} note 213, at 558-561. While no single federal statute deals with the
While the intricacies of the substantive corporate governance systems differ from state to state, and corporation to corporation, corporate governance principles in the United States can be described in terms of generally favored practices\textsuperscript{220}. Shareholders occupy a prominent place as the residual owners of the company\textsuperscript{221}. They lie at the center of the governance system. Most public corporations have boards of directors that are composed of a majority outside directors. These directors are mostly drawn from ranks of current or retired chief executive officers of other corporations. It's also not uncommon to find university resident academicians and scientists appointed board members to corporations whose line of business they share at an academic level\textsuperscript{222}. The boards oversee the management of corporations. The directors and management owe the corporation and its shareholders fiduciary duties of care and loyalty. They are bound by these standards and there is a mechanism to enforce them\textsuperscript{223}. Under common law, courts have endorsed the business judgment doctrine, which creates an assumption that the board makes a decision that is reasonable, and safe\textsuperscript{224}. If the board breaches the business judgment rule, shareholders may commence derivative actions against the defaulting board on their own behalf and that of the corporations, Companies also have audit governance of corporations generally, numerous statutes affect the governance of corporations generally. Some examples are the National Bank Act (relating to election of directors and composition of the board), the Investment Company Act of 1940 (structural requirements relating to shareholders), The Public Utility Holding Company Act (capital structure, proxy solicitation, accounting practices and intra state company transactions), the Internal Revenue Code (employee stock ownership plans) and ERISA (impacts on governance of pension plans).

\textsuperscript{221} Schwartz, \textit{supra} note 213.
\textsuperscript{222} Hamilton, \textit{supra} note 220, at 361.
\textsuperscript{223} Swanson, \textit{supra} note 39, at 435
\textsuperscript{224} Charles R. T. O’Kelley and Robert Thompson, Corporations and Other Business Associations
committees, which liaise with the corporation’s external auditors. These committees are usually composed of outside directors\textsuperscript{225}.

The Securities and Exchange Commission is a key agency whose rule making authority affects a corporation’s governance\textsuperscript{226}. One significant way it has achieved this is by requiring corporations to set up special committees to the board. The most significant being the audit committee\textsuperscript{227}. The audit rules set out the qualifications for directors who serve on the committee and define how the outside committees will relate to the audit committee\textsuperscript{228}. The various Stock Exchange’ also adopt rules in their manuals that govern listing companies by requiring them to comply with their rules which affect governance. The most notable exchanges are the New York Stock Exchange and the American Stock Exchange.

C. International Investors in a Corporate Governance Maze.

Advances in telecommunications and the convenience of international travel coupled with expanding stock exchanges and pension funds have collectively increased globalization and demanded that those who control large companies have to be aware of governance systems beyond their own\textsuperscript{229}. There are a growing number of companies that seek to raise capital abroad and a corresponding large fraction of investors who are

\footnotesize{\textsuperscript{225} Swanson, supra note 39, at 437. \textsuperscript{226} 15 USCA (1934). \textsuperscript{227} Schwartz, supra note 213, at 573 \textsuperscript{228} Scott, supra note 215, at 557 \textsuperscript{229} Branson, supra note 26, at 323.}
investing funds outside their home countries\textsuperscript{230}. For instance, a French corporation may seek to issue securities in Great Britain that residents in the United States or Canada may purchase. Thereafter an initial purchaser may in turn resale the French issuer’s securities to other investors in other countries located on different continents\textsuperscript{231}.

These investors look to corporate governance standards to protect their funds\textsuperscript{232}. For these reasons international investors acting as issuer or purchaser, perhaps more than ever, need to understand the structure of different corporate governance regimes in various countries\textsuperscript{233}. As yet, there is no single corporate governance practice. When it comes to regulating cross border security transaction, countries apply their laws only to transactions that have connection with their territorial jurisdiction\textsuperscript{234}. But two schools of thought have been advanced on this matter. The first is that a corporation’s home country should regulate all transactions regardless of the location of the transaction, while the second school of thought calls for the harmonization of different securities regimes\textsuperscript{235}.

The desire to diversify their portfolios has caused institutional investors, particularly in America, to increasingly make significant investments abroad\textsuperscript{236}. Although on unfamiliar territories, these investors continue to use shareholder activism to minimize

\textsuperscript{231} Id.,
\textsuperscript{232} Id.
\textsuperscript{233} Cioffi, \textit{supra} note 29, at 529.
\textsuperscript{234} For example Regulation S of the Securities Act 1933 exempts issuers from the requirements of registration under section 5 if the securities are to be offered and sold abroad.
\textsuperscript{235} Choi, \textit{supra} note 230, at 163. The author refers to the harmonization of different securities regimes as ‘portable reciprocity’
\textsuperscript{236} Gilson, \textit{supra} note 22, at 346. For example, Calpers holds nearly $20billion in foreign equities representing almost 20 percent of its total investment in equity. On the Paris Stock Exchange 35 percent of outstanding shares of France’s forty largest companies are held by American and
their risk and costs of investing abroad. The presence of these foreign investors has had an impact on various national systems. For instance, United States institutional investors have urged European companies to make significant changes to their formal governance institutions to resemble United States style institutions. Countries like the United Kingdom, France, Germany and Japan have had to make changes. In Germany particularly, excessive influence by the banks has emerged as a key structural problem as the German capital markets compete for global investment. Federal legislation to reduce shareholding has been introduced by the ruling party. Japan is also moving toward a shareholder-market model.

Public corporations have also bent backwards in order to attract capital. Daimler-Benz was willing to change its accounting and disclosure practices in order to be eligible to list its securities on the New York Stock Exchange. Conversely the rejection of Rupert Murdoch’s proposed listing by the Australian stock exchange because he wanted to sell non-voting stock demonstrated how crucial governance considerations are. All these participants face scrutiny by investors, regulators, the media and the general public.

British institutional investors. The figure is 41 percent of Dutch companies. Kissane, supra note 57, at 623.
Gilson, supra note 22, at 346-347.
United States institutional investors like Calpers has announced a set of six general principles which companies they invest in are expected to abide by. These principals include director accountability and one share one vote capital structure. Kissane, supra note 57, at 651; Clarke, supra note 121, at 246.
Id at 652 and FN 180.
Cunningham, supra note 24, at 1150.
Monks, supra note 31, at xv.
Id.
as they develop and refine standards of corporate governance that will allow them compete for the attention of investors\textsuperscript{245}.

Securities Exchanges worldwide have responded to cross border investments with many exchanges forming partnerships with one another that cut across international boundaries. Frankfurt and London stock exchanges announced a plan to integrate their facilities and permit trading of each other’s listed securities on both exchanges\textsuperscript{246}. Other Exchanges in France, Italy and Spain also expressed their wish to enter into mergers\textsuperscript{247}.

In the global financial market, practices are being transformed to respond to the investor’s search for international capital. Hence while core national governance systems remain diverse, certain spheres, particularly in the area of accounting and disclosure have become more global and more responsive to the current era. Under a project commenced by the International Organization of Securities Commissions International (IOSCO) international investors can use international disclosure standards that facilitate cross border equity activities without compromising the amount or equality of information they receive\textsuperscript{248}. Similarly, International Accounting Standards Committee (IASC) gives foreign corporations the option to prepare financial statements for foreign listings by using IASC standards\textsuperscript{249}.

\textsuperscript{245} Kissane, \textit{supra} note 57, at 624.
\textsuperscript{249} \textit{Id} at 98.3
While the globalization of finance is growing stronger with respect to investment, barriers continue to exist with regard to banking services presumably because they are strategically tied to a nation's economy resulting in their protection from outside competition\textsuperscript{250}. The result of the standardized finance options allow investor's access to information that will enable them compare the benefits of investing in companies throughout the world\textsuperscript{251}. It also allows them to compare corporate performance at a global level.

D. Multinational Corporations and Governance.

A multinational corporation is an enterprise that engages in foreign direct investment and owns or controls value-adding activities in more than one country\textsuperscript{252}. This can be distinguished from international trading firms and domestic firms because it engages both in cross-border production and transactions\textsuperscript{253}. The growth of huge multinational corporations is touted as one of the most striking worldwide economic developments of the late 1990's and early 21st century\textsuperscript{254}. They are vehicles for the movement of capital, goods and services in the global economy\textsuperscript{255}. Predictions are that by 2010, the number of multinationals will be several times the number that existed a few years ago\textsuperscript{256}. The driving force behind this is a quest to be one of the largest corporations in a given field on

\textsuperscript{250} Visentini, supra note 94, at 836.
\textsuperscript{251} Id at 981.
\textsuperscript{252} Peter Hertner, Corporate Governance and multinational Enterprises in Historical Perspective, in Comparative Corporate Governance 41 (Klaus Hopt et al. eds., 1998)
\textsuperscript{253} Id at 42.
\textsuperscript{254} Branson, supra note 26, at 5.
a global scale. In 1999, the United Nations Conference on Trade and Development (UNCTAD) World Investment Report estimated that the total number of parent corporations worldwide was almost 60,000 with half a million foreign associates.

Several issues surround multinational corporations but the scope of this paper extends its interest only to the implications of international corporate governance practices on multinational corporations and vice versa. A multinational company’s choice of domicile involves choosing amongst different governance structures. The corporate governance challenge presented in well-developed governance systems is which domicile the corporation shall choose to operate in. That decision can affect its competitiveness in the open market and if it did, the corporation would choose to relocate elsewhere.

Conversely, multinational corporations may also take advantage of weak governance systems in developing nations. When they do, the corporate governance challenge existing in this scenario changes. In the absence of strong enforcement mechanisms, multinationals have been accused of violating labor, human rights and environmental rights. An increased interest by non-governmental organizations and the

256 Branson, supra note 167, at 352.
257 Id at 353. The desire to be the largest multinational is evidenced by the examples of multi billion mergers that have occurred. The oil industry saw the merger between Exxon and Mobil oil, British Petroleum and Amoco, in the automobile industry Chrysler and Daimler-Benz, as well as Ford and Volvo. Other mergers have taken place in telecommunications, banking and food and consumer product companies.
258 Ward, supra note 255.
259 Cunningham, supra note 24, at 1145.
260 Ward, supra 255, at 453.
261 Id at 454.
press in the activities of multinational corporations has served to highlight these factors. They have successfully acted as watchdogs of the system.

The negative activities publicized are inconsistent with the mandate of directors who are expected to act in the best interest of the shareholders and corporation as a whole. The result of such activities may reduce the corporation’s profitability through cost of litigation or fines imposed on the defaulting corporation. For economic and moral reasons, most institutional investors are committed to investing in socially responsible enterprises, as they believe that they maximize shareholders returns. The notion of ‘ethical investment’ exists worldwide. Investors want to be sure that the corporations they invest in are socially responsible. This responsibility is acknowledged by large multinationals. For instance in the United States, the Organization of Business for Social Responsibility was founded in 1992 to emphasize social responsibility. The organization boasts of a membership of fourteen hundred corporations including Coca-cola, Federal Express, Motorola and many other multinationals. Countries like Australia have passed laws that impose minimum standards of conduct by Australian companies of a defined size operating in foreign countries.

Multinational corporations need to use best practices principles when setting up shop in jurisdictions that have weak governance practices or enforcement measures. For

263 Cunningham, supra note 24, at 1156.
264 Id.
265 Diagnam, supra note 262, at 75.
reasons already discussed in this chapter, this is a subject that must occupy high priority on their agenda.
A. Impact of Globalization on the Corporate Governance Debate.

Global processes are changes whose effects are felt and experienced beyond the borders of a single locality. They may result from economic or political forces that create markets for goods and services beyond the control of any one nation\textsuperscript{266}. These ‘global forces’ encourage new forms of economic and legal integration across different countries and continents\textsuperscript{267}.

The globalization of corporate governance systems is part of the general globalization of markets that has world financial regulators concerned\textsuperscript{268}. The debate in this arena has been manifested at two different levels, one as a theory on convergence and the second as the effort by the Organization for Economic Cooperation and Development (OECD) to create global principles of corporate governance. The former is a theory premised on contemporary governance debate that the prospect of international convergence of corporate governance systems is imminent\textsuperscript{269}. Until recently, the governance debate had focused on the merits of different national systems and the extent


\textsuperscript{267} \textit{Id.}

\textsuperscript{268} Kissane, \textit{supra} note 5,7 at 622.

\textsuperscript{269} McDonnell, \textit{supra} note 111, at 341.
to which they positively promote corporations and the regional and national economies in which they exist\textsuperscript{270}. Now the focus has shifted to a view that these different corporate governance systems are achieving a high degree of uniformity and are likely to converge into a single standard model\textsuperscript{271}.

A study of the implications of international governance practices would not be complete without considering both these factors. This chapter highlights the OECD principles and considers the theory of convergence of corporate governance systems. These factors are considered in the light of their implications on investment.

\textbf{B. The Organization for Economic Cooperation and Development.}

The closest attempt, to date, at formulating global rules of corporate governance have been the basic principles of corporate governance formulated by the Organization for Economic Cooperation and Development in 1999\textsuperscript{272}. This was the first time that a full-scale international report was produced to provide guidance to both public and private policy makers on corporate governance\textsuperscript{273}.

The OECD is a predecessor to the Organization for European Economic Cooperation (OEEC) that was created with a membership of eighteen countries in April 1948 shortly after the World War Two. Its main offices were in Paris. The OEEC was established to oversee the Marshall plan aid to Europe and had the following aims; to promote cooperation and commerce in Europe’s reconstructed economies, to develop a

\textsuperscript{270} O’Sullivan, \textit{supra} note 3, at 154.
\textsuperscript{271} Haansman, \textit{supra} note 113, at 439.
Europeans customs union and a free trade area. The OEEC directed its energy towards developing Europe’s economy and helped lay the foundation for the European Economic Community (EEC). Once the EEC begun to function in 1977, the aims of the OEEC became redundant and the members decided to create a new organization in its place, the OECD. Its original membership of 21 countries has now expanded to 30 countries. The members include the founding Western Europe members, the United States, Canada and key NATO allies, Iceland and Turkey.

The OECD’s main duty is to provide management consulting to member governments. It researches and produces policies on a myriad of topics ranging from trade matters to environmental issues. It also has the power to make recommendations, which are non-binding agreements and to make decisions, which are legally binding on the members.

In 1998, the OECD Council meeting at ministerial level asked the OECD in conjunction with interested bodies to develop a set of corporate governance standards and guidelines. This was prompted in part, by concerns that weaknesses in the corporate governance system of some Asian countries led to the Asian crisis. In response to this, an Ad-hoc task force was established to develop the final set of principles. The negotiations took over a year and included the participation of key players.

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273 Dignam, supra note 262, at 73.
275 Id at 775.
276 Supra note 272.
277 Supra note 248, at 985.
278 Dignam, supra note 262, at 74.
279 Id at 990
principles were taunted as the chief response by Governments to the G-7 summit leader recognition of corporate governance as an important pillar of the 20th century global economy. On May 26-27, 1999, ministers representing 29 member countries voted the principles unanimously. In 2000, the OECD principles of corporate governance became one of the 12 core standards of global financial stability and are now used as a benchmark by international financial institutions.

The idea behind the principles is to assist governments in their effort to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries. Other powerful financial bodies like the International Monetary Fund and the World Bank have jumped on the bandwagon by placing governance on their agendas. They have adopted the OECD principles as a guiding standard and have included them as a pre requisite in their programs for aid to developing countries.

C. The OECD Principles of Corporate Governance.

The principles are divided into five parts. Each one dealing with aspects of corporate governance that the OECD has deemed to be necessary for good governance and has provided practical guidance. The standards provided are the minimum standards that countries have an obligation to meet. Additional rights may be provided in varied

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280 Supra note 23, at 4
282 Licht, supra note 15, at 152.
283 Id at 149.
284 Id
jurisdictions. The areas outlined are; the rights of shareholders, the equitable treatment of shareholders, the role of stakeholders, disclosure and the responsibilities of the board.

The Rights of Shareholders.
The OECD is concerned with the need to uphold the shareholders right to exercise corporate suffrage and their ability to do so from an informed position made possible by their access to accurate and timely information. Voting by proxy is encouraged and is given as equal importance as votes cast in person.

The shareholders ability to influence certain fundamental changes in the corporation like the election of the board, amendment of key documents and major changes to the corporations core business is protected. Other important shareholder rights include the rights to dividends, to divest themselves of their shares and the right to know of any corporate changes that will affect the corporate assets and the exercise of their voting power. The principles are also mindful of the rights by shareholders, within limit, to contribute to the agenda of the general meeting.

The Equitable Treatment of Shareholders.
Any divergence from the 'one share one vote' standard is frowned upon. Emphasis is placed on the need to give equal rights and treatment to shareholders holding shares in the same class. This ensures the protection of minority and foreign shareholders. They must be informed of the voting rights attached to the shares before purchase.
The voting system should not be made too difficult or expensive such as to deny any shareholder the right to vote. It is also expected that nominees should vote in a manner agreed upon with the beneficial owners of the shares. As part of the equitable treatment accorded to shareholders, the principles prohibit insider trading and self-dealing by the corporation.

**The Role of Stakeholders.**

The OECD takes into account the interest of stakeholders like investors, employees, creditors and suppliers. It recognizes that the success of any corporation is dependent on teamwork and the resources that different stakeholders bring to the company.

Though stakeholder rights are established and may be enforced by general law, the corporation has a responsibility to recognize the interests of these third parties and their role played in achieving the corporation’s aspirations. Stakeholders are entitled, in the event of a falling out, to transparent and clearly outlined channels of redress. They should also have access to information in order to fulfill their obligations. The governance framework encourages the enhancement of stakeholder participation. Particularly for employees through their representation on boards and stock ownership plans.

**Disclosure.**

A high value is placed on the presence of strong disclosure practices. Disclosure has long been recognized as a tool that coerces a corporation to act in the interest of its
shareholders. Therefore the existence of a positive culture of disclosure attracts investment and maintains confidence in the system. However this disclosure must provide accurate, adequate and timely material information whose quality should be of highest standards of accounting.

The OECD provides a non-exclusive list of items that must be disclosed. This includes the financial status of the company, its objectives, major share ownership, voting rights, information on members of the board and key executive, their remuneration and any foreseeable material risk factors or issues affecting the stakeholders that the investors should be privy to. Other information to be disclosed includes policies relating to business ethics, the environment and other matters of public policy. It’s important for stakeholders to relate the corporation to the society within which it operates.

The corporation should have annual audited accounts and statements prepared by external auditors using high standards of accounting practices. These reports should be accessible to the shareholders. The company should disclose this information using the Internet or other technological means required in that jurisdiction. Annual reports and audited accounts should be accessible. Board audit committees are encouraged as they limit the risk of conflicts of interest.

The Responsibilities of the Board.

The OECD recognizes that even though board structures may vary, their basic duties remain constant. A key responsibility is to monitor management’s activities and ensure good returns for the shareholders while simultaneously ensuring that the corporation is
conducting its activities within the general framework of the existing laws. The Boards functions also include strategic planning and maintaining the integrity of the corporation’s accounts and finances.

The existence of independent committees like the remuneration, audit and nomination committees composed of non-executive board members is strongly encouraged. This strengthens the boards transparency and effectiveness. The standard of care required of the Board is that they act on a fully informed basis, in good faith, with due diligence and care in the best interest of the company.

D. Implications of the Principles.

The OECD principles have on the one hand been welcomed as a remarkable convergence on corporate governance common ground among diverse interests, practices and cultures\textsuperscript{285}. They have gained influence as they have been embraced by leading financial institutions like the International Monetary Fund and the World Bank which are traditional lending institutions to private sector development in emerging and developing nations. The significance of this is two fold. Firstly, these principles have universal application because both members of the OECD and non-member nations that want to have access to investment opportunities and financing must observe the minimum standards provided \textsuperscript{286}. Secondly the principles are not only confined to publicly listed corporations, but extend to unlisted private companies and state owned enterprises in so

\textsuperscript{285} Supra note 23.

\textsuperscript{286} O’Sullivan, supra note 3, at 154.
far as either may wish to tap into the international capital market. This is true particularly in countries that do not have well-developed liquid capital market and generally look to local banks or International Finance Companies for capital. This fact was acknowledged at the first Pan-African consultative forum on corporate governance held in Africa in 2001\textsuperscript{287}.

Though the principles appear somewhat harmless, as they are non-binding and only for guidance purposes, the two significant factors mentioned show that they are less harmless and may begin the imposition of a foreign corporate culture on several Asian, African, South American and continental European States\textsuperscript{288}. These countries, who wish to attract foreign aid in the form of loans, grants or under schemes of project financing are required to impress donors with the OECD driven standard of corporate governance in order to be considered as candidates for financial assistance. It is possible that non-compliance by countries will lead to ostracism and the threat of retaliation measures that can harm the profitability of a countries enterprise\textsuperscript{289}.

\section*{E. Criticism of the Principles.}

The main argument against the OECD principle is that the ‘one size fits all’ concept of corporate governance means that issuers on different continents are being forced to comply with rules imposed by institutional investors in London or New York in order to

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{287} Philip Armstrong, All About Corporate Governance, Times of Zambia, August 8th, 2000, at 5.
\item \textsuperscript{288} Dignam, \textit{supra} note 262, at 76.
\item \textsuperscript{289} D.A. Guobadia, \textit{The Rules of Good Corporate Governance and The Methods of Efficient Implementation: A Nigerian Perspective.} comp.law. 119, 122 (2001)
\end{itemize}
\end{footnotesize}
tap into the international capital market. Because the principles have an Anglo-Saxon orientation, their impact on developed countries in the Anglo-Saxon jurisdiction will not be significant. The same cannot be said of less developed nations and those falling outside this jurisdiction. These principles ignore the need to understand corporate governance systems in particular reference to their differences. Particularly that a nation's cultural values affects the development of its laws in general and its governance system in particular. That is why the concept of a company and whose interest it serves varies. For instance while in the United States a corporation is primarily run in the interest of shareholders, in Germany and Japan it is considered irresponsible to run the company exclusively for the interest of shareholders. Other stakeholders and society in general have to be considered.

Suggestions have been made that the best way to formulate minimum standards of global corporate governance is not by imposing this singular view of corporate governance on the world. But rather to ‘regionalize’ it. This means formulating regional corporate governance principles for both equity based or bank based jurisdictions. Another option would be to determine zones of influence and formulate principles for each zone. This would result in the presence of multiple principles for the main legal

291 Dignam, supra note 262, at 74-75. The OECD principles of corporate governance overlap those of the United Kingdom as they both have an Anglo-Saxon orientation. The only point of divergence is the issue of stakeholders. The principles are liberal in advocating that their interests be taken into consideration which view is not adopted by the United Kingdom.
292 Licht, supra note 15, at 151.
293 Id 149.
294 Fredmond, supra note, 270.
295 Dignam, supra note 262, at 76
jurisdictions and perhaps another set formulated for regions falling outside these jurisdictions.296.

F. The Theory of Convergence.

The theory of convergence was postulated by comparative legal scholars who viewed national governance systems to be in competition. They predicted that this competition would cause the systems to converge into a single efficient system.297 This view has been consistently held save for a change in the desirable system that the convergence will replicate. For a while, the Japanese system seemed the favored one until the Japanese ‘bubble economy’ burst.298 Currently the American system is the favored one and it is the theory of some American scholars that other countries are in the process of converging to the American system.299 The debate also includes how this convergence will take place. Whether it will be formal, where legislative action alters the basic structure of existing corporate governance structures or functional, where the existing structures respond to demands of change without altering their formal characteristics. There is no consensus on which mode the convergence will adopt.300 But pressure will also come from the global

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296 Id.
297 Gilson, supra note 22, at 330.
298 LaChance, supra note 8, at 304. In the second half of 1997, the Asian economy experienced a severe economic crisis. Japan, in addition to Thailand, Korea, Indonesia, Malaysia and the Philippines suffered a devaluation of currency, plummeting stock market, unemployment and a banking crisis. Corporate governance in Japan was reassessed. The system that seemed so compelling at first now seemed to be part of the problem.
299 Haansman, supra note 113. Contains for the boldest statement of the view that all governance systems will converge to the United States system. For other articles in support of convergence to the United States system, see Gilson supra note 22; Cunningham supra note 24; Kissane supra note 57.
300 Gilson, supra note 22, at 337.
integration of financial markets. Advocates predict that this convergence will lead to more efficient allocation of capital and improve access to investment opportunities and financing.\(^{301}\)

G. Critics of the Convergence Theory of Corporate Governance Systems.

This theory of convergence has been met with dissenting opinions. Criticism has been leveled against scholars who are predicting the convergence of governance systems in general. One criticism is that it is a mistake to impose one corporate governance system on another.\(^ {302}\)

In postulating this criticism, one strong dissent suggests how culture can be factored into governance. It states that cross-cultural psychology can provide means of evaluating international cultural differences and assessing their effect on corporate governance systems. By using values, which refer to desirable goals and modes of conduct to promote these goals, cultural differences can be grouped into predefined concepts that transcend nations. With the aid of numerical values, statistics can be obtained on national corporate governance systems and this can answer the question of which national culture is fundamental.

The point being driven home is that the existence of divergent cultures causes fundamental concepts of governance to occupy different levels of importance and this makes the likelihood of convergence impractical. One example of how corporate culture differences can lead to a deadlock was the failure by the European Union (EU) to adopt

\(^ {301}\) O'Sullivan, supra note 3, at 154.
its draft fifth directive that attempted to harmonize corporate law and especially governance practices amongst European member countries. This failure was blamed on cultural differences. The attempted exercise led to bitter feuds amongst the members and an expert panel concluded that differences in national cultures made the harmonization impossible.

In further criticism of the scholarship of convergence, it has been asserted that no ideal structure for governance exists. Different forms will work well in different countries at different times. The bottom line is that each system finds its own way of holding those who direct the corporations accountable to other entities or persons. Whether it’s to the shareholders in the Anglo-American model of the United States or United Kingdom, or the supervisory board in Germany or by elevating governance to national culture in Japan.

In response to the global convergence advocacy scholarship suggesting that this convergence will replicate the American system, it has been criticized for not being supported by empirical data nor having a truly global analysis. The response is that even if the systems were to converge, they would not necessarily follow the best one. To their credit, the scholars advocating for convergence to the United States system admit that a single model is unlikely to emerge even though the trend continues in that

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302 Monks, supra at 31, at 271
303 Licht, supra note 15, at 151.
304 Id.
305 Monks, supra note 31, at 269.
306 Branson, supra note 26, at 231.
307 McDonnell, supra note 111, at 34.
direction\textsuperscript{308}. Convergence may very well occur in financial accounting and disclosure standards but it won't be easy in corporate governance\textsuperscript{309}.

\textsuperscript{308} Cunningham, \textit{supra} note 24, at 1146.
\textsuperscript{309} Branson, \textit{supra} note 26, at 362.
CHAPTER 5
CONCLUSION

This thesis introduced the general elements of corporate governance and the variety of national corporate governance systems that exist. Their differences can be accounted for at two levels. Firstly they are distinguishable by the attributes of the legal jurisdiction to which they belong to, be it common law or civil law. Secondly, even within similar legal jurisdictions countries differ at individual levels. Important national differences exist in law and practice. Scholars have further attributed these differences to legal, cultural, political and social factors. What is certain is that these differences have led to competition at corporate and national levels. The result of which has led countries to compete by incorporating best practices to their corporate governance system\textsuperscript{310}. After all, investors will be attracted by markets with the most open shareholder governance structure and will be repelled by low dividends, shareholder gagging or weak disclosure laws\textsuperscript{311}. Corporate governance does matter to individual investors, institutional investors, local or multinational corporations, nations and at a general international level.

This thesis has also shown that the implications are clear. For investors, it is imperative that they become familiar with different governance systems. Companies seeking to raise capital abroad and investors diversifying their portfolios with foreign

\textsuperscript{310} Cunningham, supra note 24, at 1146
investment must deal with corporate governance practices in multiple jurisdictions\textsuperscript{312}. The ideal solution, especially for institutional investors who have the economic power, is to conduct their own research. Individual investors can rely on the services of brokerage firms or several other firms managing investment portfolios. But as long as investors look beyond their borders for investment opportunities they will need to go forum shopping for host countries that have attractive laws. To a large extent, the laws they will be concerned with define the corporate governance systems. Corporate governance does matter.

For the multinational corporation, whether they are located in countries that have a strong or weak enforcement mechanism, the importation of best practices of governance practices should be the standard practice. The activities of multinational corporations are increasingly drawing attention and watchdogs in the form of pressure groups and the press are seeing to that. Only corporations with good corporate governance will have the social responsibility and ability to be concerned with a variety of issues like the environment, fair wages and child labor. These issues are not only of interest to the shareholders but are also important to the well being of the corporation.

At national level, corporate governance takes on even more importance. Developed nations face the challenge of constantly refining their practices in order to

\begin{footnotesize}
\begin{enumerate}
\item Monks, supra note 31, at 271
\item Choi, supra note 230, at 639
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have a competitive edge in a global environment where cross border transactions are the norm. Whether this competition will lead to convergence is a theory that is being floated. There is evidence of national governance systems making changes in order to attract more investors but the question of whether this will lead to convergence into any single model of corporate governance is currently unsupported by empirical data.

For developing and transitional economies, the notion of corporate governance goes hand in hand with good public governance and positive economic policies in order to be a vital element for private sector development. Good corporate governance is much harder to achieve in a climate of corruption, poor public and economic governance. The challenge is improve all three in order to attract investors.

The OECD principles of corporate governance have laid down minimum standards to be complied with by member and non-member states. However, they ignore the existence of different national systems of governance molded on nation’s varied backgrounds. Neither do they consider the fact that countries are at different stages of development. The notion of ‘regional corporate governance systems’ discussed in the fourth chapter seems ideal. This would make the principles seem less as an imposition and provide a better standard to be aspired by countries in regions that share a common heritage.

That said, so far the OECD principles remain the only effort towards an attempt to formulate a global corporate governance system. Though they have been criticized, they remain a good effort largely because they expound a system based on universal principles
of accountability, responsibility and transparency that should be the cornerstone of every corporate governance system no matter the legal, economic, political or social background.
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