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Abstract

This article provides insight into the evolving convergence of corporate governance systems and discusses these changes within the context of the political-institutional, economic, legal and social features. In doing so, asking where are they, and where might they be headed? Moreover, this article also examines the evidence that varying legal and social traditions and rule of law directly impact corporate governance styles and efficiency. It is our contention that during the 1990s various nations, in particular the EU nations, experienced strong pressures to develop more effective corporate governance systems, tending toward the Anglo-Saxon model as applied in the U.S. and the U.K.

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Introduction

Recently there has been an increasing limelight focused on the notion of corporate governance in general and global corporate governance in particular. Although over the last few years the media has sensationalized the debate surrounding corporate governance, there is a more serious deliberation of the underlying trend in the global convergence of corporate governance and its resulting impact taking place at the multilateral level i.e. Organization of Economic Cooperation and Development (OECD), World Trade Organization (WTO), etc..

This is not to say that the media's debate about corporate and the recent exposure of American CEO greed and deceit is not a serious fissure in the corporate governance arena and to the public faith in it. For example, the Securities and Exchange Commission (SEC) of the United States pursuing companies beyond the borders of the United States for securities law violations; Royal Dutch Shell agreeing to pay fines of \$150 million to the SEC and UK regulators for overstating its energy reserves; the Italian company Parmalat reached a monetary settlement with the SEC for defrauding investors in a debt offering; the SEC filed charges against the US subsidiary of the Dutch company Ahold for inflating profits in its annual reports; Vivendi Universal and its former chairman agreed to pay \$51 million in fines for misleading investors about Vivendi's financial condition; the SEC opened an investigation as to whether Nortel Networks committed accounting fraud; Morgan Stanley agreed to pay \$2.2 million in fines for being late in disclosing customer complaints and staff misconduct; Parmalat's Administrator in Bankruptcy sued Citigroup, saying that the bank had aided Parmalat's management to engage in fraud; and Yukos, the Russian oil company, currently being accused of tax fraud and tax evasion, to name just a few¹. That was one page on one day. Of course, we are also all familiar with Enron, WorldCom, Tyco, Adelphia, Global Crossing, Freddie Mac, Boeing, Health South and others and even more familiar with the recent troubles of personalities, such as, Kenneth Lay and Jeffery Skilling (Enron), Bernie Ebbers (WorldCom), Diana "DeDe" Brooks (Sotheby's), Michael D. Eisner (Disney) and even the seemingly untouchable Jack Welch (General Electric). This is not a uniquely American phenomena as can be seen in the U.K. with Anita Roddick (Body Shop) and Asil Nadir (Polly Peck), in France with Jean-Marie Messier (Vivendi Universal), and in Sweden with Percy Barnevik (ABB)². These matters are generally concerned with the effects of greed and deceit of corporate managers and the negligence of directors. The backlash in some countries, particularly the U.S., has been generally to demand more controls in the areas of accountability and transparency.

This article, will, however, focus on the more long-term critical issue of not only the growing global trend in the convergence of corporate governance but also on the more subtle influences of legal traditions and societal norms i.e. the notion of transparency, rule of law, shareholder protection, etc in the shaping of this growing trend towards global convergence.

Evolution of Modern Corporate Governance³ and Review of the Literature

Any organization, whether it be a club, a corporation, country, or even an international institution has a mechanism composed of rules, procedures and customs by means of which decisions are taken and the organization is run. Depending on the level of organization and the political, economic, legal, and social-cultural context in which it exists, there may be more or less

¹ The Wall Street Journal, Friday July 30, p.1.

² Some parts of this section are based on Rehman, Scheherazade S. "Governance?," Journal of International Law and Business, Fall 2004.

³ Some parts of this section are based on Rehman, Scheherazade S. "Can Financial Institutional Investors Safeguard American Stockholders Or Are New Rules of Law needed for U.S. Corporate Governance?," NYU Business Law Review, forthcoming Spring 2005.

reliance on rules and concomitantly more or less reliance on custom. Whatever its make up, that mechanism by which the organization is run is its system of governance.

In the early days of entrepreneurial activity – and even today – the owner was – and often still – is the individual who does the work, makes the decisions and runs things in general. This, in the business enterprise, is known as a sole proprietorship. As early as the European Middle Ages, people pooled resources in order to attain a common corporate goal. For example, the allocation and specialization of natural, labor and capital resources in the basic creation and functioning of a town, i.e. the construction of vital town institutions, such as, monasteries and their accompanying libraries. This type of pooling of resources benefited many as the presence of a monastery which, among others, taught the art of reading and maintained collections of knowledge and technology in the form of the written word. Taxes were collected, allowing for better constructed roadways which lead to enhanced commerce. The monks also helped advance technology and efficiency in farming and they themselves produced crops which increased the food supply and provided alms to the less able in the township. All of these activities mark early efforts at incorporation, the pooling of resources in order to achieve the greater good. Later, in 1600, 218 British merchants formed the East India Company in England. That event set two new precedents in corporate governance and in world business. It was the world's first multinational corporation, and because the merchants realized that their number made for an unwieldy management group, they appointed a smaller number of themselves to represent all shareholders, thus constructing the world's first board of directors (Cadbury, 2002).⁴

Since then governance systems for corporations have evolved into those found today in a variety of guises in a variety of countries. The corporate form of business entity has a variety of advantages over the sole proprietorship described above. A corporation is formed under the laws of the jurisdiction in which it is formed; it is therefore a statutory entity. For this reason it can have perpetual life, far beyond the life of the founding sole proprietor. Many entrepreneurs can pool their resources, become shareholders, and in doing so create more capital liquidity for the enterprise. This, in turn, allows the enterprise to be more flexible in not only weathering bad economic times but also in being able to take advantage of opportunities that may arise due to the changing business environment. The law also provides in almost all jurisdictions for a corporate veil of protection for the shareholders, so that creditors of or claimants against the corporation cannot pursue the corporation's shareholders. Only their investment is at risk and not their personal fortune or possessions. A further advantage lies in the spreading of economic risk among all shareholders instead of risk being borne by a sole owner. Even so, there is a disadvantage. As in the case of the British East India Company, it is unwieldy for shareholders to manage a corporation on a daily basis. In fact many are merely investors and know nothing of managing a business. Custom and now the law in many jurisdictions provide that the shareholders will appoint directors to be responsible for the conduct and management of the corporation, representing those shareholders. The directors in turn appoint, hire and fire managers. Enter corporate governance, the mechanism by which those shareholders – and other stakeholders – are represented in the conduct of the affairs of the enterprise by the board of directors and by the management of the corporation. Management is thus separated from ownership.

Today, many large corporations around the world have their stock traded on national stock exchanges. Corporate governance can be viewed as the mechanism to minimize the loss of the foregone value of the separation of ownership from the management. Through the institution of the joint-stock company or publicly held corporation, investors are separated from management and while this separation provides benefits such as the specialization of management functions and diversification of risk across the investor- stakeholder base, there are some significant costs due to this separation. These costs are associated with the amount of foregone

⁴ Cadbury, Adrian. Corporate Governance and Chairmanship: A Personal View, Oxford University Press, New York, 2002, p. 2.

value due to the separation of ownership from management and minimized through effective corporate governance(OECD, 1998)⁵. As early as 1932 Berle and Gardiner argued that that the dispersion of ownership in American corporations was starting to provide for a separation of ownership and control, which would reduce value.⁶ Later Jensen and Meckling (1976)⁷ furthered these ideas in formulating what they termed “agency costs”, which amount to the reduction in value, which results from the separation of ownership and management. Investors and other stakeholders use the governance systems to influence managers to take action that allows such stakeholders to realize their particular goals through effective monitoring and incentive systems that may be economic or social or a combination thereof. It is in this sense that corporate governance systems reflect social values.

In a general sense, in the American view, the primary purpose of the corporation is to make money and increase shareholder value. However, for the majority of the rest of the world, corporate governance has a much broader stakeholder⁸ point of view. This view is reflected in the recent OECD report⁹ on corporate governance. In that report, the general objective of corporate governance is to align the interests of firms with those of society, to balance entrepreneurship with accountability and to enable companies to earn a rate of return on investment that generates additional capital. In the view of the OECD:

“...the world has witnessed a significant transformation in the role of the private sector in economic development and job creation. As more and more countries have adopted market-based approaches to economic policy, awareness of the importance of private corporations for the welfare of individuals has increased... Corporations create jobs, generate tax income, produce a wide variety of goods and services... and increasingly manage our savings and secure our retirement income. Amid growing reliance world wide on the private sector, the issue of corporate governance has similarly risen in prominence... A good corporate governance regime helps to assure that corporations use their capital efficiently. Good corporate governance helps, too, to insure that corporations take into account the interests of a wide range of constituencies, as well as of the communities within which they operate, and that their boards are accountable to the company and the shareholders. This in turn, helps to assure that corporations operate for the benefit of society as a whole. It helps maintain the confidence of investors – both foreign and domestic – and to attract more “patient”, long-tem capital¹⁰.”

In the narrow sense, corporate governance deals with the relationships among corporate management, the board of directors and the investors, or shareholders. But it can also concern itself with the relationship between the corporation and other stakeholders, in addition to investors. In a broader sense, corporate governance is formulated and disciplined by laws, regulations, stock market listing rules, commercial customs, and public opinion (Gregory,

⁵ For a detailed discussion see “Corporate Governance: Improving Competitiveness and Access to Capital Markets,” A Report to the OECD by the Business Sector Advisory Group on Corporate Governance, Paris: Organization for Economic Co-operation and Development, 1998.

⁶ A. Berle and B. Means, The Modern Corporation and Private Property, New York, MacMillan, 1932.

⁷ M. Jensen and W. Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,” Journal of Financial Economics, No. 3, 1976.

⁸ Stakeholder reflect the interests of all the major players associated with a firm i.e. shareholders, suppliers, employees, trade unions, etc..

⁹ “Corporate Governance: Improving Competitiveness and Access to Capital Markets.” A Report to the OECD by the Business Sector Advisory Group on Corporate Governance, Paris: Organization for Economic Co-operation and Development, 1998.

¹⁰ “Corporate Governance: Improving Competitiveness and Access to Capital Markets.” A Report to the OECD by the Business Sector Advisory Group on Corporate Governance, Paris: Organization for Economic Co-operation and Development, 1998. These principles were endorsed by M inisters at the OEVD Council meeting on May 26-27, 1999.

2003).¹¹ Differences exist from country to country as to how companies are governed, and the question “who do we govern the corporation for?” is answered differently.

The corporate governance systems used throughout the world are generally rooted in either the stock-market based Anglo-Saxon (outsider) or the more traditional bank-based (insider) European and Japanese governance systems (Halpern, 2000).¹² “In the stylized description of bank-based systems, companies raise most of their external finance from banks that have close, long-term relationships with their corporate customers. By contrast, the market-based systems... are characterized by arm’s-length relationships between corporations and investors, who are said to be concerned primarily about short-term returns” (Frankds and Mayer, 2005).¹³ At present, the Anglo-Saxon system is primarily used in the United States and, with modifications, in the United Kingdom and Ireland. The European system, with country-to-country variations, is practiced in the other EU nations while different versions of the Japanese system are used throughout the Pacific Basin Region (Schleifer, and Vishny, 1997).¹⁴ Again it should be mentioned that the concept of corporate governance in the United States, or even in the United Kingdom, that is, in the Anglo-Saxon type of system, is considerably narrower than that in many other countries, especially that of Europe.

The main features of the Anglo-Saxon system are dispersed ownership and detailed legal provisions. The rights and responsibilities of investors and other stakeholders are defined by formal rules and applied through contracts relying on competitive and transparent market transactions. As already alluded to, the primary responsibility of management is to maximize shareholder value. With management compensation tied to profits and stock options, managers are under constant pressure to realize this goal. Failure to do so is quickly reflected by declining share prices in the deep and liquid capital markets. Thus failure is generally visible, and either the shareholders, through voting at the annual meeting, or the Board of Directors, by chastising or replacing management, attempt to correct problems as they arise. The major strengths of the system are its flexibility, transparency and accountability, enabling corporate managers rapidly to respond to competitive challenges and shareholder demands. Its disadvantages are the limited influence of stakeholders other than shareholders and the income and wealth gap between managers and workers on the one hand and shareholders and the rest of society on the other hand. Labor unions in particular clamor about this.

The traditional European style corporate governance system has a desire for economic stability and social safety as reflected by the widespread acceptance of welfare states in continental Europe. European welfare states provide a broad and deep social safety net that includes, among other things, relatively secure employment, generous unemployment and other benefits, regulated working conditions and extensive public pension system benefits, all financed through high taxes. The system is characterized by inflexible economic structures comprised of regulated product-service, capital and labor markets, high taxes, generous public spending and managerial systems that are risk averse. Over time, this had brought about a corporate governance system that sustains and, in turn, is sustained by such economic features and managerial practices.

The Japanese corporate governance system is bank and stakeholder based with the "keiretsu," a unique form of industrial organization, playing a major role. A "keiretsu" is a

¹¹ Gregory, Holly J. “The Globalization of Corporate Governance”, Weil, Gotshal & Manges: New York 2003, Law Firm Publication, p.5.

¹² For more details see, Paul J.N. Halpern, " Systemic Perspectives on Corporate Governance Systems," in Steven S. Cohen and Gavin Boyd (editors) Corporate Governance and Globalization: Long Range Planning Issues (Northampton, MA.; Edward Elgar Publishing Inc., 2000) pp. 1-58.

¹³ Julian Frankds and Colin Mayer, “Corporate Ownership and Control in the U.K., Germany and France,” Donald Chew and Stuart Gillan, *Corporate Governance at the Crossroads*, Boston, McGraw-Hill Irwin, 2005 p. 360.

¹⁴ The dominant types of corporate government systems have been extensively discussed in the literature. See, for example, Schleifer, Andrei and Robert W. Vishny (1997) and Cohen and Boyd (2000) as cited previously. For a discussion of some of the changes in the Pacific Basin Region, see, "The End of Tycoons," *The Economist*, April 29, 2000, pp.67-69.

network of businesses made up of a core company and/or a main bank and associated firms that maintain concentrated cross-ownership arrangements.¹⁵ It represents a coalition of stakeholders without carefully delineated authority lines among, for example, suppliers, lenders, customers, shareholders holding a complex blend of senior, junior, short-term and long-term implicit and explicit claims against the firm. Its advantage is stability; however, this feature can turn into inflexibility, as seen in Japan since the early 1990s.

Corporate governance, in a very real sense, molds the development of a nation's financial market as it provides the framework for the accord between investors and firms, which provides the speed, amount and method to which investors will receive adequate returns on their investments. Moreover, corporate governance styles and efficiency in management decision-making determine to a large degree the extent to which firms have access to outside financing, that is, outside investors either willing to lend to firms or buy their securities. According to this line of research (La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 1997; Shleifer and Vishny, 1997; pp.737-783; Levine, and Zervos, 1998; Hart, 1995; Hellwig, 1991; Rajan, 1992; OECD, 1999b; Rajan and Zingales, 1995)¹⁶, a firm's ownership structure and its corresponding capital structure directly impact corporate performance. For example, if a firm does not generate enough confidence in outside investors, the firm's overall performance will suffer as it will have a difficult time growing or taking advantage of market opportunities due to its need to rely only on internal cash generation and accumulated financial resources. Moreover, corporate performance is further impacted by the availability of financing, i.e., a firm's performance can be negatively impacted if methods of available financing are limited due to lack of financial sector development or systemic rigidity. A firm's efficiency in terms of financial market access, costs, speed of transaction and available financial instruments has a direct impact on corporate performance.

In addition, according to the same type of literature, (Knack and Keefer 1995), (Levine 1996), (Levine and Zervos 1998), (Levy 1983), (Modigliani and Perotti. 1996), (Perotti and Von Thadden 2003), and (Rajan and Zingales 1996 and 1998), to name a few¹⁷, the overall economic performance of a country is also linked to these issues. It is clear that levels of economic development coupled with a nation's social and political heritage represent factors of crucial

¹⁵ In times of high economic growth and corporate profits (1970-1990) the system had worked well because it insured stability in all business relations. But in times of low growth and profits (1991-present,) requiring restructuring and other related corporate changes, the systems stability turns into rigidity. Consequently, the Japanese are currently reviewing the system as part of an overall examination of their economy. Changes, however, are slow in coming. Following the 1997-1998n financial crises, the same is true in the Republic of Korea and other Pacific Basin nations.

¹⁶ La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Vishny. "Legal Determinants Of External Finance," *Journal of Finance*, 52, 1997, pp.1131-1150; Shleifer, Andrei and Robert W. Vishny. "A Survey Of Corporate Governance," *Journal of Finance*, June 1997, pp.737-783; Levine, Ross and Sara Zervos. "Stock Markets, Banks And Economic Growth," *American Economic Review*, 88, (3), June 1998, pp.537-558; Hart, Oliver. Firms, Contracts, and Financial Structure, London: Oxford University Press, 1995; Hellwig, Martin. "Banking, financial intermediation and corporate finance," in Giovannini, Albert and Colin Mayer (eds), European Financial Integration, Cambridge: Cambridge University Press, 1991, pp.35-63; Rajan, Raghuram G. "Insiders and outsiders: the choice between informed and arm's-length debt," *Journal of Finance*, 47, (4), September 1992, pp.1367-1400; OECD. "International Banking and Financial Market Development," Paris: OECD, 1999b; and Rajan, Raghuram G., and Luigi Zingales. "What Do We Know About Capital Structure? Some Evidence From International Data." *Journal of Finance*, 50, December 1995, pp.1421-1460.

¹⁷ Knack, Stephen, and Philip Keefer, "Institutions And Economic Performance: Cross-Country Tests Using Alternative Institutional Measures." *Economics and Politics*, 7, November 1995, pp.207-227; Levine, Ross. "Financial Development And Economic Growth," *Journal of Economic Literature*, 1996, pp.; Levine, Ross, and Sara Zervos. "Stock Markets, Banks, and Economic Growth." *American Economic Review*, 88, June 1998, pp.537-558; Levy, Haim. "Economic Evaluation Of Voting Power Of Common Stock," *Journal of Finance*, 38, March 1983, pp.79-93; Modigliani, Franco, and Enrico Perotti. "Protection Of Minority Interest And Development Of Security Markets," Mimeo, MIT, 1996; Perotti, E.C. and E. von Thadden. "Will Capital Market Integration Force Convergence Of Corporate Governance?" *Journal of Financial and Quantitative Analysis*, 2003; Rajan, Raghuram, and Luigi Zingales. "Financial Dependence And Growth," NBER Working paper 5758, 1996; and Rajan, Raghuram G., and Luigi Zingales. "Financial Dependence And Growth." *American Economic Review*, 88, June 1998, pp.559-586.

importance in the evolution of a country's corporate governance system. Accordingly, even among the more advanced nations, there exist substantial differences in corporate governance.

For example, if one is to compare the U.S. Anglo-Saxon model versus Continental Europe's social market structure as measured by conventional macro-economic indicators such as growth, manufacturing productivity and unemployment, the European Union (EU) economies lagged behind the U.S. economy for almost all of the 1990s.¹⁸ America's economy, except for one year, maintained an average annual growth rate of more than 3% while the average annual EU growth rate was less than that, except for one year. Such performance is usually explained in terms of the traditional European desire for economic stability and social safety as reflected by the widespread acceptance of the welfare states following World War II.¹⁹ They are characterized by inflexible economic structures comprised of regulated product-service, capital and labor markets, high taxes, generous public spending and managerial systems that are risk averse. Over time, this had brought about a corporate governance system that sustains and, in turn, is sustained by such economic features and managerial practices.

Yet traditional European companies such as Siemens of Germany, Olivetti of Italy and Renault of France, to mention only a few, maintained a major presence throughout the world for many decades. They have and continue to offer high quality products effectively marketed, serviced and purchased by loyal customers. Eventually, these traditional companies were joined by other firms such as the cellular-phone manufacturers Nokia of Finland and Ericsson of Sweden that not only compete effectively but also took on the technological leadership of their industry. Moreover, jointly, they also obtained the largest global market-share in the industry (43% in 2000, with Nokia dominating) ahead of America's second-placed Motorola (14.8 %.)²⁰ Another example of a powerful emerging high-tech EU firm is the United Kingdom's Vodaphone that through mergers and acquisitions grew into the world's largest network operator by the beginning of the 21st century.

But such successful and globally competitive high-tech EU companies are still the exception rather than the rule. According to a report by the Economic Advisory Group of the EU Commission, of the 100 top companies in the broadly defined high-tech "New Economy" the EU nations are represented by only 6 firms, 3 of them Scandinavian.²¹ Instead of fully restructuring during the 1990s to meet the challenges of the rapidly changing global marketplace, most EU companies tinkered at the edges of efficiency, cutting a few jobs here and selling a division there. As a result, measured by annual revenues earned during the 1990s, of the world's 50 largest high-tech companies 36 were American and only 4 European.²² The strong performance of the American firms is usually ascribed to the flexible U.S. economy, liquid capital markets and the effective corporate governance system that is an integral part of it.²³

¹⁸ It has been a challenge to economists to explain the excellent performance of the U.S. economy during the 1990s. In time, explanations focused on the average annual productivity increase of 2.5% and the contributions of the information technology industry to the rest of the economy. "ITC Driving U.S. Productivity Gains." Press Release. U.S. Industrial Conference Board, October 29, 2001. The "Annual Economic Report of the President," released in January 2002 made the same point. It should be pointed out, however, that during the 1990s a number of individual EU economies have done well not only in terms of the levels of productivity and GDP per capita, but also in terms of productivity growth. But these relatively successful performers were small states such as Ireland, which led the group. The large nations, generating over 80% of EU GDP as, for example, Germany, the United Kingdom, France, Italy and Spain did not do well.

¹⁹ European welfare states provide a broad and deep social safety net that includes, among other things, relatively secure employment, generous unemployment and other benefits, regulated working conditions and extensive public pension system benefits, all financed through high taxes.

²⁰ Financial Times, Deutschland, October 2, 2001, p.4.

²¹ Financial Times, February 20, 2002, p.15.

²² The Economist, September 16, 2000, p. 77.

²³ Occasionally, the system breaks down, particularly the transparency, disclosure and monitoring aspects. Recent examples include Long-Term Capital Management in 1998 and the Enron Corporation in 2001- 2002.

Global Convergence of Corporate Governance

A variety of things are occurring in the world today, which have considerable impact on corporations in general and on their governance systems in particular. Globalization is hard upon us, and while globalization often leaves many behind and does not appear to spread its benefits equally to all, it is also true that the 20th Century was one of unprecedented economic growth. During that time global per capita GDP growth increased almost five times.²⁴ So the world is becoming collectively better off, at least in the aggregate. Trade is increasing overall, though not all countries share in the wealth to the same degree²⁵.

Goods traverse borders now at unprecedented levels and speeds. Money and labor are also increasing their mobility, especially money. It is the ability, or lack thereof, of the world's corporations to attract that money for their operating funds and capital investment, which can be seen to be one of the important factors impacted by the system of corporate governance within the corporation, and within the country that is home to the corporation.

International issues of corporate and national competitiveness and the increased mobility of capital in our globalizing economy make for a worldwide marketplace for goods and for equity investment funds. The way corporations are run, that is, the way they are governed at the top also has an impact on their profitability, and on their ability to attract capital. Corporate health and competitiveness have an impact on the competitiveness and economic health of a country.

The differences in corporate governance give rise to vast differences in the decision-making ability and decision-making speed of corporations around the world. Divergent corporate governance models also give rise to differences in the methods of and the ability to attract capital for corporate operations and expansion. Some believe that the U.S. and U.K. models (or "Anglo-Saxon Model") work best on both of these counts. If that is true, it has enormous implications for the prospect and desirability or lack thereof of convergence in corporate governance systems. Many of those who believe the foregoing assertion are attempting to change their systems to make them more similar to the Anglo-Saxon Model. If one believes that a shareholder with money will put his or her money, where it is not only protected, but where the recipient of that money has the view to increasing the wealth of the shareholder investor, then it is not difficult to understand why. In order for any sort of convergence to occur, structural, historical, political, legal, economic and social realities must be dealt with. Often those realities become barriers for convergence, but those barriers can cause national economies to lag and standards of living to either stagnate or regress. There never will be complete convergence. Corporations in different countries around the world have their own objectives to pursue and their own criteria with which to assess company performances. This will ever be so. Accordingly, corporate governance systems will always and must always reflect the varying social, economic, legal and political systems in different nations. Countries will need to seek particular solutions for themselves in order to address the commercial and social challenges extant in their own countries. Even so, corporate governance systems are becoming more similar; they are not diverging, they are converging.

Wide arrays of countries around the world are taking into account the abilities of their national companies to compete in the world market for goods and in the world market for capital. Since roughly the 1980's large institutional investors, consisting of pension funds, mutual funds, insurance companies and others, especially in the U.S. and the U.K. have become shareholders of an ever increasing number of corporations (Chew and Gillan, 2005).²⁶ With this trend in

²⁴ "Globalization: Threat or Opportunity?" Issue Briefs, International Monetary Fund (IMF), by IMF Staff, April 12, 2000, corrected January 2002, p. 3.

²⁵ Ibid.

²⁶ See "The growth of Institutional Stock Ownership: A promise Unfulfilled," Donald Chew and Stuart Gillan, *Corporate Governance at the Crossroads*, Boston, McGraw-Hill Irwin, 2005, p. 347.

globalization, those funds are now able to place their funds in a wider and wider array of companies across the globe. Capital seeks safety; people invest their money where they believe it is protected and many countries wish their corporations to impress owners of capital as safe places to invest. Those countries are seeking norms of corporate governance that provide this feeling and reality of safety. A recent survey of members of the Organization of Economic Cooperation and Development (OECD) has shown a trend toward an international convergence in corporate governance norms (Nestor and Thompson, 2001).²⁷ Studies show that corporate governance reform is moving Japan, Canada, and Germany closer to the “U.S. corporate governance paradigm” (Wade, 2002).²⁸ Moreover, places as far from the Western commercial mainstream as China and Russia are looking to Western models in order to reform or even construct their systems. This has developed in recent years due to a variety of factors: competition on a global scale in terms of manufacturing industries or international capital markets (Nestor and Thompson, 2001)²⁹; the increased need for attracting national and international capital; the corporate scandals such as Enron and WorldCom in the United States and similar scandals cropping up all over Western Europe. In a move to assist OECD and non-OECD governments in evaluating and improving the legal, institutional and regulatory framework for corporate governance in their countries, the OECD developed the “OECD Principles of Corporate Governance” in 1998 and continuously updates them (OECD, 2004).

An international agreement, however, on a single model of corporate governance rules is just as unlikely as it is unnecessary, even though, it is clear that the very influence of international capital markets and the globalization of competition will lead to a fair degree of convergence in governance practices. It seems that this convergence favors the Anglo Saxon model. This is especially true for those so-called global companies whose value-chains (R&D, sourcing of raw materials, labor and capital, manufacturing, marketing, etc) have not only been globalized but who must now also internationally benchmark at every step of that value chain. This holds particularly true for the sourcing of capital as securitization is seen as the most efficient form of external firm financing and the two largest stock markets (New York and London) follow Anglo Saxon corporate governance and related accounting practices. And since: “[a]s regulatory barriers between national economies fall and global competition for capital increases, investment capital will follow the path to those corporations that have adopted efficient governance standards, satisfactory investor protections and broad practices designed to provide independent, accountable oversight of managers³⁰”. The old European model is partially on the way out but no new predictable rules have yet emerged. The EU governments must take stock and avoid the temptation to look back nostalgically to the time when economic problems were magically solved by consensus. Such an era, if it ever existed, has long since ended.

Regional Changes in Corporate Governance: Examples in the U.S., Europe, Latin America and Asia

Companies around the world are in varying stages of making changes to their laws and corporate governance regimes in order to deal with some of the foregoing problems. Various European countries are at the fore in this movement, but it is occurring with increasing frequency

²⁷ Nestor, S. and J.K. Thompson, “Corporate Governance Patterns in OECD Economies: Is convergence under way? In OECD (Eds.), *Corporate Governance in Asia—A Comparative Perspective*. (pp.19-41). Paris France: OECD Publications 2001.

²⁸ Wade, C. L. (2002).Commentary: “Corporate governance in Japan, Germany, and Canada: What can the U.S. learn from other countries?” *Law & Policy*, 24(4) 2002, 442-448. From ProQuest Database.

²⁹ Nestor, S. and J.K. Thompson, “Corporate Governance Patterns in OECD Economies: Is convergence under way? In OECD (Eds.), *Corporate Governance in Asia—A Comparative Perspective*. (pp.19-41). Paris France: OECD Publications 2001.

³⁰ Report to the OECD by The Business Sector Advisory Group On Corporate Governance.

in Asia, Latin America and North America. We will turn to a few examples in order to appreciate the scope of changes occurring.

Germany is moving to further develop its capital markets³¹ and takeovers are now not unknown to Germans.³² In fact they are now growing in significance.³³ Studies show that since World War II, there have been four hostile takeovers in Germany, but significantly, three of them have occurred in the last four years.³⁴ Germany is concerned about the idea of transparency, so much a concern of the Sarbanes-Oxley act and the two major securities acts of the United States, and they have enacted legislation to provide for more transparency in company reporting.³⁵

Italy recently has reformed its laws to provide for a corporate governance system that approaches the Anglo-Saxon model in a variety of ways. Their reforms are deemed “crucial to promoting foreign and domestic confidence and, consequently, to reducing the cost of capital to Italian firms—in order to make the Italian system compliant with International standards.”³⁶ While the law does not require that there be a board of directors, many companies’ articles of incorporation require one, and where one exists, it is a unitary board. Most large Italian companies do have boards, consisting of both inside and outside directors.³⁷ There has been a major overhaul of the disclosure requirements, shareholder right to information, transparency and the way listed companies are now audited by outside auditors.³⁸

In the past, “companies due to lack of transparency are paying higher cost of capital and not obtaining enough foreign investments in” Latin America.³⁹ Companies view transparency as essential in order to increase the availability of and decrease the cost of capital. Countries in the region are taking action. In 1999, Mexico issued the Code of Best Corporate Practices.⁴⁰ The idea behind the code is transparency. From 2000 onward, Mexican listed companies are required to reveal to their shareholders the extent to which they comply with the Code. A series of accounting bulletins have also been issued in order to bring auditing practices more in line with international norms.⁴¹ Accounting standards similar to the International Accounting Standards⁴²

³¹ See Deutsches Aktieninstitut, DAI-Factbook 2000, Statistiken, Analysen und Graphiken zu Aktionären, Aktiengesellschaften und Börsen, Frankfurt 2000.

³² An example is the recent hostile takeover of Mannesmann by Vodafone.

³³ See Oechsler, Jürgen. “Die Übernahme börsennotierte Unternehmen” December 2001, and Andlinger Group took over 19.9% of the shares of MCE VOEST from VA Technologie AG (VA TECH) that is quoted on the Vienna stock exchange, and thus holds all shares of MCE VOEST, Presse Portal, December 18, 2002; Today’s extraordinary shareholders’ meeting of ABIT AG approved the merger of phinware AG with ABIT AG and a 2,972,536.00 euro increase in ABIT AG’s share capital increasing it from 5,415,548.00 euros to 8,388,084.00 euros in order to complete the merger. The general meeting of phinware AG shareholders had approved the merger on 11 December 2003, Presse Portal, December 12, 2003.

³⁴ Julian Frankds and Colin Mayer, “Corporate Ownership and Control in the U.K., Germany and France,” Donald Chew and Stuart Gillan, Corporate Governance at the Crossroads, Boston, McGraw-Hill Irwin, 2005 p. 371.

³⁵ Gesetz zur Kontrolle und Transparenz im Unternehmensbereich of April 27, 1998, Official Gazette 1998 I 786.

³⁶ Ulisi, Roberto. “Company Law Reform in Italy: An Overview of Current Initiatives” presented at meeting entitled Company Law Reform in OECD Countries, A Comparative Outlook of Current Trends, Stockholm Sweden, 7-8 December 2000, p. 3. Mr. Ulisi is the Director General, Head of the Banking and Financial System, and Legal Affairs Directorate, Department of Treasury, Ministry of the Treasury, Budget and Economic Planning.

³⁷ Ibid, p.5-6.

³⁸ Decree no. 58 of 24 February 1998, known as the Consolidated Law on Financial Intervention.

³⁹ Elorrieta, Ana María. “Disclosure and Transparency, Accounting and Auditing”, address to Third Meeting of Corporate Governance Roundtable, 8-10 April, 2002, Bolsa Mexicana De Valores, Mexico City. (OECD)

⁴⁰ Código de Mejores Prácticas Corporativas, Bolsa Mexicana de Valores June, 19, 1999.

⁴¹ Guillermo Zamarripa Escamilla, Vice Presidente, Supervisión de Instituciones, Comisión Nacional Bancaria y de Valores, Mexico, address to Third Meeting of Corporate Governance Roundtable, 8-10 April, 2002, Bolsa Mexicana De Valores, Mexico City.

⁴² International Accounting Standards are the standards promulgated by the International Accounting Standards Committee. They are international accounting standards that provide a common accounting language. They are gaining in importance as global investing and lending increased. The European Union and many countries and companies look to these standards developed by the International Accounting Standards Committee (IASC). See Paul Pacter, “International Accounting Standards” CPA Journal, July 1998.

were approved for implementation commencing July 2002. In Colombia a new law now requires the government to promote harmonization of Colombian accounting standards with International Accounting Standards. Although implementation is still partial in Panama and Costa Rica, International Accounting Standards were officially adopted in both countries in 2001. In El Salvador, full adoption of the standards is scheduled for 2004.⁴³

As mentioned earlier, it is fairly common in some countries and particularly in developing countries to have shares highly concentrated in the hands of very few investors. In Mexico, for example, there has been a high concentration of rights to control companies, not only because founding families own large concentrations of shares of stock in the companies, but also because of pyramid ownership structures and shares with no votes. This is, as has been stated, true where financial markets are not highly developed and where public offerings constitute a small percentage of the total capital of the company.⁴⁴ Even in publicly traded companies in Mexico, most of the shares are held by controlling shareholders, which of course, gives them a preponderant role in the management of the company.⁴⁵ The Mexican Code of Best Practices puts in place control mechanisms to protect minority shareholders and to ensure that they are given full disclosure.

Italy, where concentration of shares is also an ongoing reality, has recently overhauled laws affecting corporate governance. Three pieces of legislation have been enacted, one covering listed companies⁴⁶, one for non-listed companies that depend on the financial markets, which covers limited companies and pyramidal groups⁴⁷ and a new law on insolvency.⁴⁸ The phenomenon of concentrated shareholdings does not change overnight. Such practices are rooted in tradition, custom and history. Protection of the majority shareholder generally is not the issue; protection of those in the minority is. Liquidity, or the ability to sell shares, is now guaranteed in Italy, as is transparency in reporting practices and the ability of any shareholder to gain access to documents filed at a company's office.⁴⁹

The Russians have been concerned about providing for shareholder rights and the equitable treatment of shareholders, the role of stakeholders and transparency. In 1995, Russia adopted the law on Joint Stock Companies; in 1996 the Law on the Securities Market and in 1999 the Law on the Protection of Rights and Legal Interests of Investors on the Securities Market.⁵⁰ There still exists in Russia a substantial gap between the letter of the law and its enforcement, however, and the judicial system will be challenged in the years ahead to ensure that these laws are given credence in practice as well as theory. The Russian Federation has also promulgated a voluntary Corporate Governance Code.⁵¹ "These principles have been drafted according to the Principles of Corporate Governance of the Organization for Economic Cooperation and Development (OECD), international corporate conduct practice, as well as experience accumulated in Russia since the enactment of the Federal Law On Joint Stock Companies."⁵²

⁴³ Ellorieta, *op.cit.*

⁴⁴ See Ramos, Gonzalo Castañeda. Univesidad de Puebla, "Corporate Governance in Mexico", Address to The Latin American Corporate Governance Roundtable, 26-28 April, 2000, Sao Paolo Stock Exchange, Sao Paolo Brazil. (OECD)

⁴⁵ See Código De Mejores Prácticas Corporativas, p.1.

⁴⁶ Decree no. 58 of 24 February 1998, known as the Consolidated Law on Financial Intervention.

⁴⁷ Known as the "Mirone Bill", approved by the Italian government May 26, 2000.

⁴⁸ On July 8, 1999 the Decreto Legislativo no. 270 issued, completely changing bankruptcy and insolvency procedures. On October 27, 2000 the Italian Government approved a new insolvency bill. See Ulissi, *op.cit.*

⁴⁹ Ulissi, p.7.

⁵⁰ "White Paper on Corporate Governance In Russia", issued by the Russian Corporate Governance Roundtable, April 2002.

⁵¹ The final version of the Russian Code of Corporate Conduct was presented to the Russian and foreign business community, international organizations and federal authorities at The IV Coordination Council for Corporate Governance meeting on April 4, 2002.

⁵² Russian Code of Corporate Conduct, Chapter 1.

A variety of new laws have been introduced in China in the recent past. Legislation protecting foreign investment has been introduced because of China's concern over China's attempts to gain entry into the World Trade Organization (WTO), the passage of various Memorandums of Understanding between China and the United States and other countries, and efforts to maintain Most Favored Nation (MFN) status with the United States.⁵³

China set up its stock market in 1990, and a market for securities started at that time.⁵⁴ At that time, only 10 companies were listed on the exchange. At the end of 1999, 923 companies were listed, which had Chinese citizens as shareholders (category A shares), and 108 with foreigners listed as shareholders (category B shares). The total market capitalization of listed companies as of mid 2000 was RMB 2,647.1 billion, of which RMB 821.4 billion is traded on the open market. This amounts to approximately 31.82% of China's GDP. Most of the listed companies started out as state owned enterprises. Of those, until today, the percentage of state ownership is still relatively high. Those shares held by the state are not traded on the open market. There are a relatively high number of individual investors, but those investors typically own very few shares.⁵⁵

In the past twelve years over 300 new laws, regulations and rules have been promulgated in order to deal with the securities and futures market and corporate governance.⁵⁶ The issues dealt with have been particularly concerned with such issues such as transparency, accounting and audit standards and reporting and the like.⁵⁷ Even so, there is still a concern in China about minority shareholder protection and enforcement of the rule of law, inasmuch as the state still maintains a controlling position in many listed companies, and the concept of property rights is still an evolving issue in China.⁵⁸ Despite the challenges, we expect that China will continue to make headway in its changes to the regime of corporate governance and shareholder protection, as it continues to play a greater and greater role in the global economy.

Impact of Rule of Law, Shareholder Protection, and Social Traditions on Corporate Governance

Rule of Law & Shareholder Protection

The European Corporate Governance Institute has stated that:

“Our... research on corporate governance revealed that returns on investment were on average equal to company costs of capital in countries with Anglo-Saxon legal systems, but significantly lower than costs of capital in countries with civil law legal systems. A country's legal system can also be expected to influence the relationship between company investment outlays and cash flows. The better investment performance in countries with Anglo-Saxon legal systems is expected to come about, because these

⁵³China Law Web, <http://www.qis.net/chinalaw/prclaw>, August 12, 2004.

⁵⁴ Information Disclosure and Corporate Governance in China, China Securities Regulatory Commission (CSRC), May 2000, p.1. Much of the following textual data is from this report.

⁵⁵ Ibid.

⁵⁶ Ibid. p.2. See also Qian, Yingyi. “Reforming Corporate Governance and Finance in China”, in Masahiko Aoki and Hyung-Ki Kim, eds. Corporate Governance in Transition Economies: Insider Control and the Role of Banks, The World Bank, 1995, pp. 215-252.

⁵⁷ Information Disclosure and Corporate Governance in China, China Securities Regulatory Commission (CSRC), May 2000, p.3-12.

⁵⁸ See Lyn, Cyril. “Public Vices in Public Places: Challenges in Corporate Governance in China”, Article for Internal Workshop on Corporate Governance in Developing Countries and Emerging Economies held at OECD Development Center, Paris, April 3-4, 2000.

*systems offer shareholders better protection against managers' pursuing their goals. Anglo-Saxon legal systems should weaken the strength of the principal-agent problem*⁵⁹.”

It seems to be clear that where there is a strong legal system, which protects the rights of shareholders, there is fertile ground for diffuse equity investment, such as in the U.S. and U.K. In countries that have weak legal protection for shareholders, ownership concentration seems to be the preferred way of protecting shareholder rights.⁶⁰ The protection of shareholder rights in this fashion is common in many developing countries, and it is common in many Asian countries.⁶¹ Large block shareholders, often a single family, and often the family of the founder, manage the company. In this way, they look out for their own interests, and the management certainly represents the interests of the majority shareholder. A conflict arises when there are minority shareholders, whose interests may not be looked after with such care.

There are two main bundles or categories of rights of shareholders. The first has to do with ownership itself and includes the right to information on the performance of the company, the right to a equitable distribution of profits in the form of dividends, the right equitably and probably to participate in decision making, and the right to sell one's shares. The second bundle of rights is related to the separation of ownership and management. In this scenario, the company and its number of shareholders are too big to allow the shareholder rationally to participate in the day-to-day management decision-making, as in the case of the East India Company. Still, the shareholder wishes to assert his interests as to how the company (representing his investment) carries out its operations and makes decisions; at the very least, he wants those interests protected and not squandered or pilfered. In this bundle, the shareholder's rights are connected with the mechanism for shareholder participation in decision-making: shareholder meeting procedures; election of directors; approval of basic corporate actions. This bundle of rights concerns itself with disclosure and transparency; the lawfulness of corporate activities; and management entrenchment.

Investors everywhere often have differing interests and investment goals. Further differences crop up in the case where a single family or group has effective control of a company or where the government owns a substantial stake in the company. In this scenario, which is fairly common in developing nations, minority shareholders are not so much concerned about the basic strategic decisions taken by the company, rather they worry about company funds being diverted by those in control for their own benefit or, in the case of state control, they worry about whether such funds are sacrificed on the sacrificial block of politics or schemes of misguided social welfare. In other cases, especially in developing countries, we find that certain shareholders have voting rights greater than their proportion of shareholdings would seem to allow. Shareholders everywhere simply want to be treated equally and fairly. They want decision-making to be prudent.

The primary principle-agent conflict abounding in the Anglo-Saxon system of corporate governance is that between shareholders and the board of directors. On continental Europe [and in many developing countries] it is more often than not one between majority shareholders and minority shareholders. This is so because of the differences in the systems of stock ownership and corporate control found in the Anglo-Saxon system versus the system found in most countries of

⁵⁹ In an introduction to “Corporate Governance and the Determinates to Investment”, by Klaus Gugler, Dennis C. Mueller and B. Burcin Yurtoglu, Research of the Month, May 2004. Website of the European Corporate Governance Institute, www.ecgi.org. The “principle-agent problem” has to do with the fact that the managers, or agents, are to represent the interests of the shareholders. There is a secondary such problem, and that is the concept of, in some countries, the majority shareholders representation of or looking out for the fights of the minority shareholders.

⁶⁰ See Denis, Diane K. and John J. McConnell, “International Corporate Governance”, Finance Working Paper no. 05/2003, European Corporate Governance Institute, January 2003, p. 43.

⁶¹ See generally “White Paper on Corporate Governance in Asia”, OECD, 2003.

continental Europe [and such other countries]⁶². In these groupings, we find two types of corporate governance systems: the insider system and the outsider system. In the Anglo-Saxon system, as epitomized by the U.S. and U.K., neither individual shareholders nor institutions (or block shareholders) hold large portions of shares in any one company. In continental Europe, shares are generally highly concentrated in the hands of families or other companies (as in group holdings). In countries like Germany, banks are very large shareholders. Further, reciprocal shareholdings and cross shareholdings occur frequently in this type of system. In this type of company, the controlling shareholder or the parent company controls the board of directors. The laws in such countries increasingly deal with this phenomenon by providing, in greater or lesser degrees, protection for minority shareholders. Most countries do not have laws governing groups. Germany does.⁶³ There were attempts to enact such legislation at the European Union level, but they failed⁶⁴. Even so interest in such legislation continues and many Europeans feel that it is important to have rules for groups including disclosure, protection and withdrawal provisions⁶⁵.

Stakeholder interests have generally been given more protection than are shareholders in Germany and many other countries with systems like Germany.⁶⁶ The involvement of labor and other groups on boards of directors or management boards, in the view of many, are cause for slow decision making processes, sometimes causing companies to “miss the boat” in today’s fast-paced competitive environment. Portfolio investment is portable, quickly moveable. Stock holdings, particularly those exchanged on a national exchange can often be liquidated and moved out very quickly. Of course lawyers and business people alike often believe that the system used at home is the best one. But there is now considerable debate and worldwide interest in putting into place corporate governance systems, and legal protections that will attract and keep investment. There are considerable differences among countries insofar as investor protection is concerned, and research suggests that countries with weak investor protection usually have high concentrations of share ownership of companies and a low incidence of public equity markets⁶⁷.

Impact of Social Values on Global Corporate Governance

Many developing countries will not only have the challenge of implementing voluntary codes and legislative changes, which many are doing; the greater challenge for them will be that of enforcing the rule of law and convincing relevant populations of the prudence and necessity of the changes.

The various corporate governance systems around the world have different strengths and weaknesses and are subject to a variety of local cultural pressures and social norms. “One argument is that, as global market competition becomes more intense, the American market model emphasis on corporate performance will lead to market advantages, particularly in lowering their costs of capital over the long run. The increase in the power of the capital markets – in itself a key characteristic of globalization – should force the convergence to the model that

⁶² La Porta, R., F. Lopez de Salinas, and A. Shleifer, “Corporate Ownership Around the World”, *The Journal of Finance*, LIV, 199, 471, as quoted in “Modern Company Law Problems: A European Perspective”, Keynote Speech by Professor Klaus J. Hopt, at Conference entitled Company Law Reform in OECD Countries, A Comparative Outlook of Current Trends” Stockholm, Sweden, 7-8 December, 2000.

⁶³ The Stock Corporation Act of 1965.

⁶⁴ “Modern Company Law Problems: A European Perspective”, Keynote Speech by Professor Klaus J. Hopt, at Conference entitled Company Law Reform in OECD Countries, A Comparative Outlook of Current Trends” Stockholm, Sweden, 7-8 December, 2000

⁶⁵ “Forum Europaeum Konzernrecht”, Corporate Group Law for Europe, Stockholm 2000. See also European Business Organization Law Review (EBOR) I 2000, as quoted by Hopt, op. cit..

⁶⁶ See Klüber, F., “Shareholder Value: Eine Herausforderung für das Deutsche Recht?” in Festschrift für W. Zöllner, Cologne 1998, vol. I, p. 321.

⁶⁷ La Porta, R., F. Lopez de Silanes, A. Shleifer and R.W. Vishny, “Law and Finance” *Journal of Political Economy*, 106, 1998.

most successfully attracts international capital, something the American system appears better designed to do”⁶⁸ It has been argued that the Anglo-Saxon system also emphasizes innovation, fosters entrepreneurial activity, and tolerates failure, something the German and Japanese systems are often accused of discouraging⁶⁹.

“Conversely, German and Japanese governance systems have received praise for their sustainability and superior capacity for long-term planning, as well as their practiced ability to include stakeholder analysis within the decision-making framework through structured interaction between the CEO and other stakeholders. Moreover, the American demand for increased quarterly shareholder return and the practice of remunerating board members in stock may encourage financial legerdemain and corrupt oversight procedures, both of which featured prominently in the fall of Enron”⁷⁰.

United States companies are changing in ways that make their governance model more closely reflect that of the United Kingdom, in at least two ways: a growing number of large US corporations are separating the role of the chairman of the board and the chief executive officer; and there is an increase in the number of outside directors on corporate boards.

We cannot expect that American values of individualism will replace European or others’ attachment to community values any time soon. However, a middle ground or a *via media*, a point of convergence between the extreme of the pure shareholder model advanced by the Anglo-Saxon model and the extreme stakeholder model enjoyed by Europeans, which in turn are equally juxtaposed against those models abounding in the developing world, may reside in the notion of companies and national legislatures simply adopting those changes deemed necessary to make for shareholder protection, transparency and social responsibility, along the lines of the OECD Principles of Corporate Governance. There are many ways to approach these goals, but clearly those approaches will occur within the context of the country involved. To be sure, as can be seen from the foregoing, convergence is occurring apace, but national social structures and values are not changing.

Studies⁷¹ have been conducted that have explored the link between culture and corporate governance and has attempted to speculate on the possibilities for future convergence of corporate governance systems. Salacuse (2003)⁷² did this by reviewing statistical studies on dispersed shareholdings. The difference in the concentration of shareholder ownership between the U.S. and the U.K. on the one hand and the European continent on the other is striking. The study also conducted a sampling of companies traded on the NYSE (population of 1,309 corporations) and the NASDAQ (population of 2,831 corporations), found that the median size of block holding by an investor group was less than the minimum level requiring disclosure, that is, 5% under the U.S. Securities Laws. In the U.K., out of 1,926 listed companies, less than 3% of the companies had shareholders with majority control. In those European countries studied, including Austria, Belgium, Germany, Italy, Netherlands, France, Spain and Sweden, the occurrence of a single block holder, consisting of either an individual or a related group of investors, controlling a majority of the shares outstanding ranges from 20% up to 50% and above, depending on the country. It is clear that not only share ownership, but more importantly, voting power in publicly traded corporations is considerably more concentrated in Europe than it is in the United States and the U.K. Further, we find that a larger percentage of the population is

⁶⁸ Detomasi, D., “International Institutions and the Case for Corporate Governance: Toward a Distributive Governance Framework?” *Global Governance*, 8(4), 421-442, 2002. Retrieved from ProQuest Database.

⁶⁹ Ibid. and see generally Johnathon Charkham *Keeping Good Company: A Study of Corporate Governance in Five Countries*, Oxford University Press, New York, 1994.

⁷⁰ Detomasi, Op.cit., p. 431.

⁷¹ For example, Salacuse, J. W. “Corporate Governance, Culture and Convergence: Corporations American Style or With a European touch?” *European Review of Private Law*, 11 (5), 2003, 471-96. Retrieved from EBSCO Database.

⁷² Salacuse, J. W. “Corporate Governance, Culture and Convergence: Corporations American Style or With a European touch?” *European Review of Private Law*, 11 (5), 2003, 471-96. Retrieved from EBSCO Database.

shareholders in publicly traded corporations in the U.S. than in European countries. For example, whereas one half of all American adults directly or indirectly own stock in publicly traded corporations, only one in five Germans is a shareholder⁷³.

Concluding Remarks

In 1776, Adam Smith said:

“[B]eing managers of other people’s money than their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which partners in a private co-partner frequently watch over their own... Negligence and profusion therefore, must always prevail more or less in the management of affairs of a [joint stock] company⁷⁴.”

In other words, when ownership and management are not one and the same, there is a conflict of interest between the owners and the managers. Of course there is a chance for chicanery and theft, because, as Adam Smith pointed out, the agency problem must be dealt with. Corporate governance mechanisms can do that. Of course man, in his infinite wisdom can always overcome the advantages and positive trends provided by sound legal structures and good corporate governance systems by making stupid decisions and engaging in unethical behavior. But if we respect the rule of law and enforce it; if we respect sound governance systems and enforce them, then we go a long way toward avoiding both stupidity and breaches of ethics. There is no one right system of corporate governance, but there are right ways of doing things in a variety of cultural and commercial contexts.

⁷³ Ibid.

⁷⁴ Smith, Adam, An Inquiry into the Nature and the Cause of the Wealth of Nations, London: Ward Lock, 1838, p.586.

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