SUSTAINABLE ENTREPRENEURSHIP PROJECT

Governance: A Global Survey of Theory and Research

SUSTAINABLE ENTREPRENEURSHIP PROJECT
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About the Project

The Sustainable Entrepreneurship Project (www.seproject.org) engages in and promotes research, education and training activities relating to entrepreneurial ventures launched with the aspiration to create sustainable enterprises that achieve significant growth in scale and value creation through the development of innovative products or services which form the basis for a successful international business. In furtherance of its mission the Project is involved in the preparation and distribution of Libraries of Resources for Sustainable Entrepreneurs covering Entrepreneurship, Leadership, Management, Organizational Design, Organizational Culture, Strategic Planning, Governance, Corpoorate Social Responsibility, Compliance and Risk Management, Finance, Human Resources, Product Development and Commercialization, Technology Management, Globalization, and Managing Growth and Change.

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Governance:
A Library of Resources for Sustainable Entrepreneurs
Contents

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§1:1 Introduction

In its *Principles of Corporate Governance* the Organisation of Economic Co-operation and Development described "corporate governance" as involving a set of relationships between a company's management, its board, its shareholders and other stakeholders that provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. The importance of corporate governance for companies and countries all around the world has been succinctly summarized as follows in a United Nations publication: "In a more globalized, interconnected and competitive world, the way that environmental, social and corporate governance issues are managed is part of companies' overall management quality needed to compete successfully. Companies that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action or accessing new markets while at the same time contributing to the sustainable development of the societies in which they operate. Moreover these issues can have a strong impact on reputation and brands, an increasingly important part of company value."[1]

Historically, corporate governance, to the extent it has been formally regulated at all, has been the concern of national policymakers and legislators and the level of their concern and activity has accelerated in recent years as the number of public companies has increased and well-publicized incidents of corruption by high-ranking officials of those companies has triggered concerns about protecting shareholders. The result has been a plethora of laws, regulations, reports and guides of best practices in the US and in Europe, particularly in the United Kingdom, focusing on increasing the rigor and effectiveness of internal controls, expanding disclosure requirements, regulating remuneration of executive officers and directors, and imposing broader oversight requirements on independent directors and audit committees of the board.

The response to these national laws and regulations, such as the Sarbanes-Oxley Act of 2002 in the US, has been decidedly mixed, with companies complaining about the added costs and commentators questioning the effectiveness of the initiatives. In addition, many have questioned the appropriateness of a complex and diverging patchwork of national corporate governance standards for an increasingly globalizing economy in which companies often operate in multiple jurisdictions and have argued that global corporate governance standards would be a more practical and efficient solution. This line of reasoning has led to the adoption and promotion of models for global governance standards such as the Organisation for Economic Co-Operation and Development's Principles of Corporate Governance. However, there is a good deal of skepticism as to whether a global standard of corporate governance is a realistic objective in a world in which cultural values, legal structures, political and financial institutions, perceptions of shareholder participation and attitudes toward leadership behavior and style are so widely divergent. Moreover, researchers such as Bebchuk and Hamdani have criticized proposed global corporate governance standards and metrics for assessing the governance

[1] For further discussion of governance, see "Governance: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

of public companies in different countries that are based on conditions in countries such as the US and the UK, noting that while most public companies in those countries do not have a controlling shareholder the situation is quite different in most other countries where a dominating single shareholder is the norm.[2] They argue, in effect, that prescriptions for governance standards that fail to take into account local ownership structures will be unworkable.

Toonsi observed that a variety of descriptive labels have been assigned to corporate governance systems that appear to be favored by firms in different parts of the world, including "dispersed ownership market-based" systems preferred in the Anglo-American countries; concentrated ownership-based systems seen in parts of Europe and Asia; rules- and relationship-based systems; and, finally, market- and bank-based systems. Toonsi emphasized that one of the primary distinctions among these various systems is a "market" (or "outsider") versus "insider" orientation. Nisa and Warsi made a similar distinction in suggesting that there was evidence of three models of corporate governance in the developed and newly industrialized countries: the "outsider" model and two "insider" models, one found in Europe and the other found in East Asia.[3]

Nestor and Thompson listed the distinguishing features of the outsider model as including dispersed equity ownership with large institutional holdings (i.e., institutional investors primarily interested in portfolio diversification and maximizing return on investment); the recognized primacy of shareholder interests in the company law; a strong emphasis on the protection of minority investors in securities law and regulation; relatively strong requirements for disclosure of information to be used for making decisions regarding whether to increase or decrease the level of investment as opposed to participating in long-term strategy decisions; and a limited role for banks (e.g., short-term financing through "arms' length" relationships).[4] Other characteristics often mentioned with respect to market-based outsider systems include a preference for equity financing, active markets for corporate control and flexible labor markets.

In contrast, the insider systems commonly found in Europe, the Middle East and Asia feature concentrated ownership that is closely associated with managerial control; closer relationships with banks, which means higher debt-to-equity ratios and a higher dependence on bank credit as a source of financing; formal participation by various stakeholders—banks, employees and other business partners—on the board of directors; a dense network of supportive relationships with related businesses; and infrequent use of

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[2] L. Bebchuk and A. Hamdani, "The Elusive Quest for Global Governance Standards", University of Pennsylvania Law Review, 157 (2009), 1263-1317. They argued that "governance metrics that purport to apply to companies regardless of ownership structure are bound to miss the market with respect to one or both types of firms" and challenged the adequacy of well-known and influential assessment metrics such as the Corporate Governance Quotient, the Anti-Director Rights Index and the Anti-Self-Dealing Index.

[3] S. Nisa and K. Warsi, "The Divergent Corporate Governance Standards and the Need for Universally Acceptable Governance Practices", Asian Social Science, 4(9) (2008), 128-136, 130.

[4] S. Nestor and J. Thompson, "Corporate Governance Patterns in OECD Economies: Is Convergence Underway?" in S. Nestor and T. Yasui (Eds.), Corporate Governance in Asia: A Comparative Perspective (Paris: Organisation for Economic Co-operation and Development, 2000), 19-43, 23.

takeovers to cease control.[5] Nisa and Warsi referred to these systems as "control-based" and listed the following characteristics as contrasting to the market-based system described above: lower levels of investor protection; smaller and less liquid share markets; more ownership concentration, less institutionalization of equity holdings and larger shareholdings by founding families, corporate investors (cross holdings) and governments; greater attention to employee representation on the board and higher levels of government intervention.[6]

Nestor and Thompson observed that the distinguishing feature of the insider model is, of course, the concentration of ownership and control among small, identifiable and cohesive groups of "insiders" who have long-term stable relationships with the firm and are able to communicate with each other easily both in connection with firm matters and in other non-firm relationships (i.e., banking or supply relationships).[7] Members of these insider groups include family interests, allied industrial concerns, banks and holding companies and they are generally able to operate and communicate in a regulatory environment that Nestor and Thompson described as being "more tolerant of groups of insiders who act together to control management while excluding minority investors".[8] Nestor and Thompson confirmed what has already been mentioned: "[i]nsider systems have usually been bank-centered".[9] Insider systems rely more heavily on debt financing, as opposed to financing raised by selling equity securities in capital markets, and this means that those outside shareholders that do exist generally have fewer protections than shareholders in outsider systems, particularly a much lower level of required disclosures of information.[10] Other characteristics often mentioned with respect to control-based insider systems include a preference for long-term debt financing, weak markets for corporate control and rigid labor markets.

While Nestor and Thompson followed convention by recognizing two main categories of corporate governance systems, they also mentioned a so-called "family/state model" as a sub-category of the insider system.[11] This model featured strong alliances between a small number of "founding" families of entrepreneurs who had assumed important roles

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[5] F. Toonsi, "Cultures of Control: International Corporate Governance", QFinance, http://www.qfinance.com/corporate-governance-viewpoints/cultures-of-control-international-corporate-governance?full

[6] S. Nisa and K. Warsi, "The Divergent Corporate Governance Standards and the Need for Universally Acceptable Governance Practices", Asian Social Science, 4(9) (2008), 128-136, 129.

[7] S. Nestor and J. Thompson, "Corporate Governance Patterns in OECD Economies: Is Convergence Underway?" in S. Nestor and T. Yasui (Eds.), Corporate Governance in Asia: A Comparative Perspective (Paris: Organisation for Economic Co-operation and Development, 2000), 19-43, 27.

[8] Id.

[9] Id. at 28.

[10] While a large percentage of capital is provided through debt instruments, insiders do acquire controlling equity interests in their firms and maintain that control in relation to minority shareholders through a variety of means sanctioned by the local legal systems: corporate structures, shareholder agreements, special rights to designate representatives to the managing board and discriminatory voting rights and procedures.

[11] S. Nestor and J. Thompson, "Corporate Governance Patterns in OECD Economies: Is Convergence Underway?" in S. Nestor and T. Yasui (Eds.), Corporate Governance in Asia: A Comparative Perspective (Paris: Organisation for Economic Co-operation and Development, 2000), 19-43, 30-31.

in many areas of the economy (e.g., control, with their allies, over an extensive network of listed and non-listed companies) and a state that had assumed a "pervasive role" in the economy including control over large parts of heavy industry and the financial system. In countries where this model appears, such as Korea, the public capital market tends to be underdeveloped and outside financing, when needed, generally is provided by banks that are not nearly as independent as in those countries where the more traditional insider model is used. In fact, control of banks and the banking system in these countries is considered to be crucial to those in power: family companies and the state. The state also engages in other activities that are at odds with free and open competitive markets including the imposition of barriers to foreign direct investment, providing subsidies to favored firms and orchestrating soft landings for businesses that are failing. While the family/state model appears, on its face, to have a number of disadvantages and inequities, Nestor and Thompson noted that it has been beneficial in the earlier stages of economic development for many countries to the extent that it facilitates stability and long-term commitment and reinvestment of earnings to achieve continuing growth; however, the model becomes strained when it is necessary to transition to global financial and product markets and is also inherently risky in that the families do not enjoy the same level of limited liability as in other countries due to weaknesses in company laws and the excessive reliance on guarantees from the families as conditions to obtaining bank financing for their firms.[12]

Predictably, there is a good deal of debate regarding the factors that influence the choice and operation of corporate governance systems in a particular country. Toonsi, for example, mentioned factors such as the legal and regulatory framework and related institutions, particularly the extent to which a country's laws protect investor and property rights and the extent to which those laws are enforced, and political decisions regarding the power and influence of various potential stakeholders such as financial institutions and/or labor organizations.[13] For example, Toonsi argues that differences in the national political climate can explain why financial institutions do not play a large direct role in the corporate governance of US firms while they are significant players in the governance systems that have traditionally driven activities in Germany and Japan. Also not to be ignored is the potential influence of societal culture on the structure and emphasis of corporate governance systems, particularly those cultural characteristics that are based on elements of trust.

Numerous other researchers have advanced their own ideas regarding the factors that determine the preferred corporate governance in a particular country, often in the context of participating in the debate described below regarding the possibility of convergence upon a single universal governance framework. Among the factors most often mentioned are the legal system, political intervention, cultural differences and economic factors (i.e.,

[12] Id. at 31.
[13] F. Toonsi, "Cultures of Control: International Corporate Governance", QFinance, http://www.qfinance.com/corporate-governance-viewpoints/cultures-of-control-international-corporate-governance?full

variations in market size, firm size, uncertainty and industry structure).[14] Nisa and Warsi pointed to a correlation between the type of national legal system (i.e., common law versus civil law) and the methods used for addressing the apparent misalignment of interests between managers and shareholders in a system where ownership is separated from management: ". . . in common law countries this problem is resolved via the monitoring by the market for corporate control and regulation forcing managers to follow the interests of the shareholders . . . [but] civil law countries mainly rely on large shareholder, creditor or employee monitoring".[15]

Nestor and Thompson summarized some of the differences between common and civil law countries and the impact those differences might have on variations between the corporate governance systems typically associated with those countries.[16] For example, they explained that firms in common law countries are often able to free themselves from legal norms through contract while in civil law countries with their rigid statutory systems offer less flexibility to their firms. They also argued that one can observe differences in how the "corporate concept" influences the relationship between managers and shareholders in common and civil law countries. In Anglo-American countries, there is a fiduciary relationship between managers and shareholders; however, in countries with a civil law tradition Nestor and Thompson claimed that "the company has an independent will, i.e. in theory, what is good for the corporation might not be good for its shareholders".[17]

It has generally been acknowledged that there is no single model of corporate governance that will be viable and effective in all countries around the world. However, while approaches taken in various countries may differ, there are certain basic standards or principles that can and should be applied regardless of specific legal, political and economic circumstances and these have been broadly identified by the Business Sector Advisory Group on Corporate Governance to the OECD as fairness, transparency, accountability and responsibility. Standard & Poor ("S&P") used these principles as a guide in developing its methodology for analyzing corporate governance practices in countries and companies and generating a corporate governance score ("CGS") that "reflects Standard and Poor's assessment of a company's corporate governance practices and policies and the extent to which these serve the interests of the company's financial stakeholders, with an emphasis on shareholders' interests".[18] S&P explained that it considered corporate governance to include "the interactions between a company's

[14] S. Nisa and K. Warsi, "The Divergent Corporate Governance Standards and the Need for Universally Acceptable Governance Practices", Asian Social Science, 4(9) (2008), 128-136, 129.
[15] Id. at 129 and 136 (citing R. La Porta, F. Lopez-de-Silanes, A. Shleifer and R. Vishny, " Legal Determinants of External Finance", Journal of Finance, American Finance Association, 52(3) (1997), 1131-1150).
[16] S. Nestor and J. Thompson, "Corporate Governance Patterns in OECD Economies: Is Convergence Underway?" in S. Nestor and T. Yasui (Eds.), Corporate Governance in Asia: A Comparative Perspective (Paris: Organisation for Economic Co-operation and Development, 2000), 19-43, 40.
[17] Id.
[18] Standard & Poor's Corporate Governance Scores: Criteria, Methodology and Definitions (July 2002), 5.

management, its board of directors, shareholders and other financial stakeholders".[19] S&P assigned a CGS on a ten-point scale ("10" being the highest and "1" the lowest) and also generated scores on four components that, taken together, contributed to the overall CGS: ownership structure and influence; financial stakeholder rights and relations; financial transparency and information disclosure; and board structure and process.[20]

S&P noted that it did not produce CGS for individual countries and that the primary focus was on internal governance structure and processes at specific companies; however, S&P conceded that an overall assessment of the risks associated with governance practices of an individual company was not possible without some consideration of the legal, regulatory and market environment of the country in which the company was operating and S&P expected that as between "two companies with the same CGS, but domiciled in countries with contrasting legal, regulatory and market standards . . . [i]n the event of deterioration in governance standards at a particular company, investors and stakeholders are likely to receive better protection in a country with stronger and better-enforced laws and regulations".[21] S&P indicated that prior to assigning a CGS to companies in a particular country it would undertake an informal review and analysis of the corporate governance laws, regulations, and practices that are prevalent in the country and explained that the goal of this review and analysis was to "clarify what stakeholder rights exist as defined by legislation and regulatory practice . . . [and evaluate] . . . the relevance of these rights in practice".[22] According to S&P the four main areas of focus of its country-level analysis included legal infrastructure, regulation, information infrastructure and market infrastructure.[23]

Apart from understanding the applicable system of corporate governance in any given country, consideration must also be given to the specific roles, powers and responsibilities of the key actors in the governance structure. The answers come from laws and regulations, including statutes and case law, pertaining to corporate governance and from informal practices that have developed over time. In particular, it is important to understand the rights and duties of the directors of a corporation and the legal and business principles relating to the responsibilities of directors; the powers and rights of directors; the legal duties and obligations of directors; board processes, structure and operations; board committees; and potential liabilities of directors. In addition, attention needs to be paid to the roles and responsibilities of the members of the company's executive team, especially the leader of that team—the chief executive officer. Finally,

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[19] Id. S&P explained that "financial stakeholders" included both shareholders of a company and the company's creditors and that this approach was based on "the premise that the quality of a company's governance process can affect its ability both to honor contractual financial obligations to creditors and to maximize the value of a company's equity and distributions for its shareholders".

[20] Id. (includes discussion of methodology used to collect information and develop and assign components of the CGS). For further discussion of the process used by S&P to assign a CGS to individual companies, see "Governance: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

[21] Standard & Poor's Corporate Governance Scores: Criteria, Methodology and Definitions (July 2002), 6.

[22] Id.

[23] For full discussion of each of these four main areas see Standard & Poor's Corporate Governance Scores: Criteria, Methodology and Definitions 12-16 (July 2002).

the rights of the ultimate owners of the corporation—the stockholders—as well as other stakeholders (e.g., trade unions and regulators) need to be understood, particularly the ways in which those rights impact the day-to-day actions of executives and directors.

While the concerns of the directors are quite broad, and much has been written about their role as protectors of the interests of stockholders against self-dealing by the managers of the corporation, special attention needs to be paid to the steps taken to ensure that the corporation complies with the plethora of laws and regulations that apply to all companies in today's business world, regardless of their size, business model and scope of activities. In the US, for example, the universe of laws and regulations applicable to companies includes common law legal relationships with employees, creditors, and landlords; various licensing requirements imposed by federal, state, and local governments; intellectual property rights; employment laws; federal and state tax laws and regulations, including the reporting obligations imposed under such laws; domestic and foreign laws regulating technology transfers and the form and content of many common commercial relationships; federal and state statutes relating to antitrust and unfair competition; governance rules and regulations; federal and state laws relating to privacy and data security; federal and state securities laws; and federal and state statutes relating to consumer protection and other matters.

The penalties for failing to comply with laws and regulations can be significant and often can ruin a company and the careers of the persons involved in the misconduct. For example, criminal sanctions may include fines, probation, and remedial action, including restitution, community service, and notice to victims. Civil penalties can also be substantial and may include treble damages and the additional costs of litigation. Added to all of this is the damage to the company's reputation and employee morale, and additional scrutiny from government investigators. Finally, companies that have been found to have violated laws in government investigations may be exposed to stockholder lawsuits, loss of business partners and, at least in the case of US companies, debarment from government contracting. The consequences for non-compliance are so dire that courts, at least in the US, have recognized establishment and maintenance of effective compliance programs as being part of the directors' fiduciary duties to the corporation and its stockholders. As a result, good corporate governance now includes adoption and aggressive implementation of compliance programs in a wide range of areas.[24] Compliance programs are important even for companies that honestly believe they are acting in a lawful fashion, since these programs are probably the best way to establish formal policies and procedures that can guide the actions of employees and institutionalize regular assessment of actual practices. Moreover, the existence of a formal compliance program that is actually followed can be an important factor in reducing the liability of the company in the event that a problem arises in spite of the controls that have been put in place.

[24] For further discussion of compliance programs in the US, including compliance audits, risk assessments, records retention and contract management programs and internal investigations, see "Compliance and Risk Management: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

§1:2 Corporate governance systems around the world

The elements of a framework for identifying and contrasting national differences in corporate governance systems have been hotly debated over a significant period of time and have attracted the interest of a number of researchers all around the world[25] and the consensus is that "corporate governance systems vary across nations" when comparisons are made using a variety of dimensions including ownership and board structure, managerial incentives, the role of banks and large financial institutions, the size and development of stock markets, company law, securities regulation and government involvement.[26] Corporate governance researchers have identified several different types of national systems, or models, of corporate governance that can be used for comparisons, to explain why various internal and external governance mechanisms are used and to predict the success and impact of proposed changes to governance rules and practices. While "convergence" is a widely debated topic among corporate governance experts it seems clear that while the corporate model has become a universal framework the business form and system of corporate governance used in particular instances will depend on a variety of social and economic factors such as "national regional and cultural differences; ownership structure and dispersion; the industry and market environment of the corporation; firm size and structure; lifecycle variations, including origin and development, technology and periodic crises and new directions; [and] CEO tenure, attributes and background".[27]

The most common means for comparison is to focus on the "outsider" model associated with the Anglo-American countries and the "insider" model typically associated with Europe and Japan. Clarke provided the following summary: "In the rich diversity of corporate governance forms internationally, there is a clear divergence between outsider systems found in Anglo-American countries with dispersed equity markets, separation of ownership and control and disclosure-based regulation; and the insider systems which predominates in Europe, Asia Pacific and other regions of the world, with concentrated ownership, bank finance and the representation of majority interests on the board of

[25] See, e.g., E. Gedajlovic and D. Shapiro, "Management and ownership effects: Evidence from five countries", Strategic Management Journal, 19 (1998), 533–553; M. O'Sullivan, Contests for corporate control. Corporate governance and economic performance in the United States and Germany (New York: Oxford University Press, 2000); J. Parkinson and G. Kelly, "The conceptual foundations of the firm" in J. Parkinson, A. Gamble and G. Kelly (Eds.), The political economy of the company (Oxford: Hart Publishing, 2001), 113–140; T. Pedersen and S. Thomsen, "European patterns of corporate ownership: A twelve-country study", Journal of International Business Studies, 28 (1997), 759–778; S. Prowse, "Corporate governance in an international perspective: A survey of corporate control mechanisms among large firms in the U.S., U.K. and Germany", Financial Markets, Institutions, and Instruments, 4 (1995), 1–61; A. Shleifer and R. Vishny, "A survey of corporate governance", Journal of Finance, 52 (1997), 737–783; and S. Thomsen and T. Pedersen, "Ownership structure and economic performance in the largest European companies", Strategic Management Journal, 21 (2000): 689–705.

[26] S. Nisa and K. Warsi, "The Divergent Corporate Governance Standards and the Need for Universally Acceptable Governance Practices", Asian Social Science, 4(9) (2008), 128-136, 129.

[27] T. Clarke, International Corporate Governance: A Comparative Approach (2007), 9 (citing M. Huse, Accountability and Creating Accountability: A Framework for Exploring Behavioral Perspectives of Corporate Governance, 16(s1) British Journal of Management S65, S68 (2005)).

directors."[28] These models are often used as the launching point for the argument that all large public corporations will ultimately opt for the separation of ownership and control associated with the Anglo-American approach (i.e., the "outsider" system); however, the available evidence indicates that traditions in other countries are difficult to overcome and that the more likely outcome will be the survival of institutional diversity in developed countries and emergence of corporate governance models in developing countries that are based on unique local historical and cultural factors.[29] Another criticism of this approach was offered by Aguilera and Jackson, who argued that "this classification only partially fits Japan and other East Asian countries, the variations within Continental Europe, Eastern Europe and multinational firms.[30]

Banks, following the practice of many others, referred to the main governance models as "market", "relationship" and "hybrid" and explained: ". . . some countries have very diffuse shareholdings and rely heavily on market forces to instill governance and control discipline. Others feature concentrated shareholdings and focus primarily on long-term relationships and monitoring to enforce governance. In fact, these models have developed over a relatively long period of time (several decades at a minimum) often in response to the specific characteristics of the national or regional marketplace. Different power and control groupings and structures thus emerge to cope with particular characteristics or inadequacies of the system (such as lack of a capital market, lack of a strong regulator, lack of a strong legal framework and lack of long-term relationships)."[31]

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[28] T. Clarke, International Corporate Governance: A Comparative Approach (2007), 9. For a table of the properties of insider and outsider systems of corporate governance, see Id. at 10.

[29] For further discussion, see J. Coffee, "The Rise of Dispersed Ownership: The Role of the Law in the Separation of Ownership and Control", Yale Law Journal, 111(1) (2001).

[30] R. Aguilera and G. Jackson, "The Cross-National Diversity of Corporate Governance: Dimensions and Determinants", Academy of Management Review, 28(3) (2003), 447-465, 447 (citing, with respect to Japan and other East Asian countries, R. Dore, Stock market capitalism: Welfare capitalism. Japan and Germany versus Anglo-Saxons (New York: Oxford University Press, 2000); M. Gerlach, Alliance capitalism: The social organization of Japanese business (Berkeley, CA: University of California Press, 1992); H. Khan, Corporate governance of family businesses in Asia (Tokyo: East Asian Development Bank Institute, 2001); H. Knudsen, Employee participation in Europe (London: Sage, 1995); M. Orru´, N. Biggart and G. Hamilton, The economic organization of East Asian capitalism (Thousand Oaks, CA: Sage, 1997); R. Whitley (Ed.), European business systems: Firms and markets in their national contexts (London: Sage, 1992); with respect to Continental Europe, F. Barca and M. Becht, The control of corporate Europe (New York: Oxford University Press, 2001); M. Rhodes and B. van Apeldoorn, "Capital unbound? The transformation of European corporate governance", Journal of European Public Policy, 5 (1998), 406–427; J. Weimer and J. Pape, "A taxonomy of systems of corporate governance", Corporate Governance, 7 (1999), 152-166; R. Whittington and M. Mayer, The European corporation: Strategy, structure, and social science (New York: Oxford University Press, 2000); with respect to Eastern Europe, R. Martin, Transforming management in Central and Eastern Europe (Oxford: Oxford University Press, 1999); and M. Wright, I. Filatotchev and T. Buck, "Corporate governance in Central and Eastern Europe" in K. Thompson and M. Wright (Eds.), Corporate governance: Economic, management and financial issues (Oxford: Oxford University Press, 1997), 212-232; and with respect to multinational firms, M. Fukao, Financial integration, corporate governance and the performance of multinational companies (Washington, DC: Brookings Institution Press, 1995)).

[31] E. Banks, Corporate Governance: Financial Responsibility, Controls and Ethics (2004), 25-26. Banks noted that descriptions of the various models should only be taken as attempts to illustrate general characteristics of each model and that it should be expected that exceptions can and do exist in any specific situation. Id. at 25. Evolution of each of the governance models is a widely debated subject with some

The "market" model is essentially the "outsider" system described above and typically associated with developed Anglo-American countries such as the US, UK, Australia and Canada and, according to Banks and others, features "very diffuse shareholdings, liquid capital markets, dynamic capital reallocation, advanced legal and regulatory frameworks, and an active market for corporate control".[32] The shareholders are the primary stakeholders in this model and boards tend to be composed primarily of outsiders and rely on committees and internal controls to oversee the activities of company managers. For their part company management, although subject to board monitoring, exercise considerable autonomous power and, in the words of Banks, "tend to operate in a decentralized, entrepreneurial fashion . . . are often compensated handsomely . . . [and are] very focused on investments with measurable returns that seek to maximize enterprise value and the stock price, particularly over the short run".[33] In contrast to the relationship-based model discussed below, it is probably fair to state that companies operating under market model are more interested in transactions that produce tangible short-term results as opposed to investing time and effort in relationships for which results may not be known for a long period of time.[34]

The "relationship" model is similar to the "insider" system described above and is used in other major developed countries such as Japan, Germany, Italy, the Netherlands and France and stands in somewhat stark contrast to the market model and features "greater concentrated ownership stakes and cross-shareholdings, moderately liquid capital markets, less active capital reallocation and less corporate control activity".[35] Banks noted that while legal and regulatory frameworks and systems in these countries are generally quite strong and robust, there is a tendency among participants to supplant (or at least supplement) formal rules and procedures with informal negotiations in the context of the long-term business relationships that arise among the primary stakeholders in these countries: banks, large company or family shareholders (as opposed to widely dispersed investment-focused shareholders in the market-based countries) and employees. Board membership in these countries typically ranges from primarily insiders, as is typically found in Japan, to mixed, as is generally the case in Germany, and is based on appointments made by the primary stakeholders mentioned above. Board committees are rare; however, internal controls do exist albeit not as strong as those found in the market-based countries. Banks argues that management style in these countries is centralized

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arguing for convergence on one universal model, generally thought to be close to the market model due to the influence of investors in countries using that model, and others predicting that multiple models can and should exist. Id. at 29-30.

[32] The description of the market model in this paragraph is adapted from E. Banks, Corporate Governance: Financial Responsibility, Controls and Ethics (2004), 26.

[33] Id.

[34] See also the general discussion of Anglo-American Corporate Governance in T. Clarke, International Corporate Governance: A Comparative Approach (2007), 129. Clarke described the central characteristics of what he called the "market-based outsider model" as "diffuse equity ownership with institutions having very large shareholdings; shareholder interests are considered the primary focus of company law; there is an emphasis on effective minority shareholder protection in securities law and regulation; [and] there is a stringent requirement for continuous disclosure to inform the market". Id.

[35] The description of the relationship model in this paragraph is adapted from E. Banks, Corporate Governance: Financial Responsibility, Controls and Ethics (2004), 26-27.

and rigid and that managers receive less compensation than their counterparts in the market-based countries and are very intensive to short-term movement of stock prices and focus on measurable returns on internal investment and longer-term goals such as building and maintaining market share, technical leadership and perpetuation of the firm.[36] Firms following the relationship model tend to focus more on cooperative relationships over a long-term horizon rather than on achieving short-term transaction-based results, which often appears to be the primary goal among firms following the market model.[37]

The "hybrid" model includes, according to Banks, "significant elements of the relationship model, but also includes dimensions of the market model and certain unique characteristics of its own" and "appears to be linked closely with some emerging nations (e.g., Indonesia, Thailand, Malaysia, Korea and Mexico)".[38] At the macro level one finds that countries operating under the hybrid model have relatively illiquid capital markets with little or no market for corporate control and rudimentary legal and regulatory frameworks. Micro level characteristics of the hybrid model include large family ownership stakes, related conglomeration of companies, significant ownership ties between companies and banks and strong cooperative relationships between companies and governmental bodies. Controlling shareholders are generally the primary stakeholders of companies operating under the hybrid model and such companies typically have board membership dominated by insiders and little in the way of internal controls. Banks observed that "[i]n the absence of well-established regulations and/or legal foundations, business dealings are often based on trust and relationships".[39]

Toonsi observed that a variety of descriptive labels have been assigned to corporate governance systems that appear to be favored by firms in different parts of the world, including "dispersed ownership market-based" systems preferred in the Anglo-American

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[36] Banks pointed out that making generalizations with respect to the members of the relationship model group can be misleading and noted: "For instance, Japan still features fairly diffuse shareholdings compared with Germany, Japanese boards are almost exclusively insider and most lack board committees, German boards have labor representatives and so forth. While companies in both [Japan and Germany] are interested in perpetuating the existence of their firms, German companies favor technical leadership and Japanese companies market share." See E. Banks, Corporate Governance: Financial Responsibility, Controls and Ethics (2004), 27.

[37] While many scholars and commentators have found characteristics of the relationship model in European countries and in developed Asian countries such as Japan, it is common to distinguish between corporate governance regimes in Europe and the Asia-Pacific region. See, for example, the general discussion of European Corporate Governance and Asia-Pacific Corporate Governance in T. Clarke, International Corporate Governance: A Comparative Approach (2007), 170 (Europe) and 200 (Asia-Pacific).

[38] E. Banks, Corporate Governance: Financial Responsibility, Controls and Ethics (2004), 27. The description of the hybrid model in this paragraph is adapted from E. Banks, Corporate Governance: Financial Responsibility, Controls and Ethics (2004), 27.

[39] Id. The description of the hybrid model in this paragraph is adapted from E. Banks, Corporate Governance: Financial Responsibility, Controls and Ethics (2004), 27. See also the general discussion of Asia-Pacific Corporate Governance in T. Clarke, International Corporate Governance: A Comparative Approach (2007), 200 (noting, among other things, that "[m]ost countries of the region have corporate governance systems that are essentially based around close relationships, usually involving family control, and ongoing close relationship with creditors, suppliers, and major customers . . . [and] . . . regulators and state officials").

countries; concentrated ownership-based systems seen in parts of Europe and Asia; rules- and relationship-based systems; and, finally, market- and bank-based systems. Toonsi emphasized that one of the primary distinctions among these various systems is a "market" (or "outsider") versus "insider" orientation. Nisa and Warsi made a similar distinction in suggesting that there was evidence of three models of corporate governance in the developed and newly industrialized countries: the "outsider" model and two "insider" models, one found in Europe and the other found in East Asia.[40]

Simply put, in market-based outsider systems, of which the US and UK are primary examples, ". . . ownership is dispersed and completely separated from control, companies benefit from sophisticated capital markets and thus incur lower debt-to-equity ratios, stakeholders are rarely formally represented and do not participate in company management . . . [a] hostile takeover is the severest sanction for management misconduct . . . [and] . . . outside investors . . . are less interested in the strategic long-term goals of the company than in the short-term returns available in the market".[41] Nisa and Warsi provided their own similar list of the characteristics of "market-based systems": large and liquid stock markets, dispersed ownership, relatively high levels of minority investor protection, predominant role of institutional investors and other portfolio investors in share ownership, high product-market competition, one-tier boards and performance-sensitive executive compensation arrangements.[42]

Nestor and Thompson listed the distinguishing features of the outsider model as including dispersed equity ownership with large institutional holdings (i.e., institutional investors primarily interested in portfolio diversification and maximizing return on investment); the recognized primacy of shareholder interests in the company law; a strong emphasis on the protection of minority investors in securities law and regulation; relatively strong requirements for disclosure of information to be used for making decisions regarding whether to increase or decrease the level of investment as opposed to participating in long-term strategy decisions; and a limited role for banks (e.g., short-term financing through "arms' length" relationships).[43] Other characteristics often mentioned with respect to market-based outsider systems include a preference for equity financing, active markets for corporate control and flexible labor markets.

In contrast, the insider systems commonly found in Europe, the Middle East and Asia feature concentrated ownership that is closely associated with managerial control; closer relationships with banks, which means higher debt-to-equity ratios and a higher dependence on bank credit as a source of financing; formal participation by various

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[40] S. Nisa and K. Warsi, "The Divergent Corporate Governance Standards and the Need for Universally Acceptable Governance Practices", Asian Social Science, 4(9) (2008), 128-136, 130.

[41] F. Toonsi, "Cultures of Control: International Corporate Governance", QFinance, http://www.qfinance.com/corporate-governance-viewpoints/cultures-of-control-international-corporate-governance?full

[42] S. Nisa and K. Warsi, "The Divergent Corporate Governance Standards and the Need for Universally Acceptable Governance Practices", Asian Social Science, 4(9) (2008), 128-136, 129.

[43] S. Nestor and J. Thompson, "Corporate Governance Patterns in OECD Economies: Is Convergence Underway?" in S. Nestor and T. Yasui (Eds.), Corporate Governance in Asia: A Comparative Perspective (Paris: Organisation for Economic Co-operation and Development, 2000), 19-43, 23.

stakeholders—banks, employees and other business partners—on the board of directors; a dense network of supportive relationships with related businesses; and infrequent use of takeovers to cease control.[44] Nisa and Warsi referred to these systems as "control-based" and listed the following characteristics as contrasting to the market-based system described above: lower levels of investor protection; smaller and less liquid share markets; more ownership concentration, less institutionalization of equity holdings and larger shareholdings by founding families, corporate investors (cross holdings) and governments; greater attention to employee representation on the board and higher levels of government intervention.[45]

Nestor and Thompson observed that the distinguishing feature of the insider model is, of course, the concentration of ownership and control among small, identifiable and cohesive groups of "insiders" who have long-term stable relationships with the firm and are able to communicate with each other easily both in connection with firm matters and in other non-firm relationships (i.e., banking or supply relationships).[46] Members of these insider groups include family interests, allied industrial concerns, banks and holding companies and they are generally able to operate and communicate in a regulatory environment that Nestor and Thompson described as being "more tolerant of groups of insiders who act together to control management while excluding minority investors".[47] Nestor and Thompson confirmed what has already been mentioned: "[i]nsider systems have usually been bank-centered".[48] Insider systems rely more heavily on debt financing, as opposed to financing raised by selling equity securities in capital markets, and this means that those outside shareholders that do exist generally have fewer protections than shareholders in outsider systems, particularly a much lower level of required disclosures of information.[49] Other characteristics often mentioned with respect to control-based insider systems include a preference for long-term debt financing, weak markets for corporate control and rigid labor markets.

While Nestor and Thompson followed convention by recognizing two main categories of corporate governance systems, they also mentioned a so-called "family/state model" as a

[44] F. Toonsi, "Cultures of Control: International Corporate Governance", QFinance, http://www.qfinance.com/corporate-governance-viewpoints/cultures-of-control-international-corporate-governance?full

[45] S. Nisa and K. Warsi, "The Divergent Corporate Governance Standards and the Need for Universally Acceptable Governance Practices", Asian Social Science, 4(9) (2008), 128-136, 129.

[46] S. Nestor and J. Thompson, "Corporate Governance Patterns in OECD Economies: Is Convergence Underway?" in S. Nestor and T. Yasui (Eds.), Corporate Governance in Asia: A Comparative Perspective (Paris: Organisation for Economic Co-operation and Development, 2000), 19-43, 27.

[47] Id.

[48] Id. at 28.

[49] While a large percentage of capital is provided through debt instruments, insiders do acquire controlling equity interests in their firms and maintain that control in relation to minority shareholders through a variety of means sanctioned by the local legal systems: corporate structures, shareholder agreements, special rights to designate representatives to the managing board and discriminatory voting rights and procedures.

sub-category of the insider system.[50] This model featured strong alliances between a small number of "founding" families of entrepreneurs who had assumed important roles in many areas of the economy (e.g., control, with their allies, over an extensive network of listed and non-listed companies) and a state that had assumed a "pervasive role" in the economy including control over large parts of heavy industry and the financial system. In countries where this model appears, such as Korea, the public capital market tends to be underdeveloped and outside financing, when needed, generally is provided by banks that are not nearly as independent as in those countries where the more traditional insider model is used. In fact, control of banks and the banking system in these countries is considered to be crucial to those in power: family companies and the state. The state also engages in other activities that are at odds with free and open competitive markets including the imposition of barriers to foreign direct investment, providing subsidies to favored firms and orchestrating soft landings for businesses that are failing. While the family/state model appears, on its face, to have a number of disadvantages and inequities, Nestor and Thompson noted that it has been beneficial in the earlier stages of economic development for many countries to the extent that it facilitates stability and long-term commitment and reinvestment of earnings to achieve continuing growth; however, the model becomes strained when it is necessary to transition to global financial and product markets and is also inherently risky in that the families do not enjoy the same level of limited liability as in other countries due to weaknesses in company laws and the excessive reliance on guarantees from the families as conditions to obtaining bank financing for their firms.[51]

Toonsi proposed a useful, and simple, framework for describing and comparing the prevailing form of corporate governance system used in different parts of the word and referred to these as Anglo-American, Germanic, Latin and Japanese systems. The Anglo-American model is, of course, the market-based outsider system. The Germanic and Latin systems are two versions of the European insider system and the Japanese system is an example of the way that the insider system manifests itself in East Asia. In fact, Toonsi's Japanese system is presented below as the "East Asian model". The features, or dimensions, in this framework included orientation, market- or network-oriented; the "prevailing concept of the firm", instrumental versus institutional; the board system, one- or two-tiered; the main stakeholders in a position to exert influence on managerial decision making (e.g., shareholders, financial institutions, the State, employee representatives, familial ownership groups and/or suppliers/customers); the importance and influence of bond and stock markets; the existence of a "market for corporate control", ownership concentration; the use of performance-based compensation systems and the time horizon of economic relationships (i.e., short- versus long-term).

§1:3 --Anglo-American model

[50] S. Nestor and J. Thompson, "Corporate Governance Patterns in OECD Economies: Is Convergence Underway?" in S. Nestor and T. Yasui (Eds.), Corporate Governance in Asia: A Comparative Perspective (Paris: Organisation for Economic Co-operation and Development, 2000), 19-43, 30-31.
[51] Id. at 31.

The corporate governance model typically associated with the Anglo-American countries (i.e., the US, UK, Canada, Australia and New Zealand) is often referred to as "market-based" since it features an active external market for corporate control and is designed to support a fluid capital market that allows participants to quickly and efficiently access the cash needed to pursue market opportunities as soon as they are identified.[52] Proponents of this model usually point to the way in which it has facilitated progress by companies in the US and UK in the development and expansion of innovative products and "new economy" industries such as electronics, software, media, and financial services. However, there has obviously been a down side to this approach given the damage that has occurred for companies and investors due to the inherent volatility of the model and the short-term orientation of executives operating in these markets due to the widespread reliance on performance (short-term)-based compensation arrangements.[53]

According to Toonsi, the Anglo-American model is based on the fundamental principal that the firm is "instrumental" and to be used as a means for collecting and deploying resources in a way that facilitates the creation of value for the owners (shareholders in the corporate context). As such, it follows that the owners (shareholders) are the main stakeholders with respect to exerting influence on managerial decision making; however, ownership concentration is low among the Anglo-American countries. In the fact, it can rightly be said that the main feature of the Anglo-American model is the separate of control of the enterprise from an ownership group that has traditionally consisted of a large number of widely dispersed individual shareholders and, more recently, institutional investors (i.e., mutual funds, pension funds and insurance companies). The Anglo-American model relies on a one-tier board system with one level of directors and no distinctions between executives ("inside" directors) and non-executives ("outside" or "independent" directors), although recent changes in the legal and regulatory framework for corporate governance in the Anglo-American countries, particularly in the US, have led to more formalized and distinguishable duties and responsibilities for non-executive members of the boards of public companies. Stock and bond markets are extremely important in the Anglo-American countries and great emphasis is placed on their efficiency and performance.

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[52] The Anglo-American model has been given a number of different names including the outsider, common law, market-oriented, shareholder-centered, or liberal model. R. Aguilera and G. Jackson, "The Cross-National Diversity of Corporate Governance: Dimensions and Determinants", Academy of Management Review, 28(3) (2003), 447-465, 447. While associating the outsider model with the Anglo-American countries is appropriate, Nestor and Thompson reminded that in some of the smaller English-speaking countries (i.e., Australia, Canada and New Zealand) there is a discernibly higher percentage of ownership concentration than in the US and the UK, particularly family-owned firms; however, they concede that the corporate governance systems in those countries clearly have characteristics similar to those in the US and the UK: strong recognition of shareholder rights, institutional ownership of wealth, the tradition of strong legal regulation of securities markets and heavy insistence on transparency in accounting. See S. Nestor and J. Thompson, "Corporate Governance Patterns in OECD Economies: Is Convergence Underway?" in S. Nestor and T. Yasui (Eds.), Corporate Governance in Asia: A Comparative Perspective (Paris: Organisation for Economic Co-operation and Development, 2000), 19-43, 30.

[53] Portions of the description in this section is adapted from F. Toonsi, "Cultures of Control: International Corporate Governance", QFinance, http://www.qfinance.com/corporate-governance-viewpoints/cultures-of-control-international-corporate-governance?full

Shareholders in the Anglo-American model are heavily dependent on the actions of professional managers who have been vested with control over corporations and their assets, a situation that has led to referring to corporate governance in the Anglo-American countries as the "principal-agent" model. Clearly such a model has the potential for efficiency in light of the increasing size of firms required to attain competitive economies of scale; however, there is always the fundamental issue of how shareholders can ensure that their "agents" are acting in ways that further the interests of the shareholders and other stakeholders as opposed to simply taking advantage of their insider status and creating benefits for themselves. Not surprisingly, the Anglo-American countries have focused a good deal of attention on developing legal and regulatory frameworks that can provide protections for the shareholders.

The US and the UK share the same underlying legal system, generally referred to as the "common law", and thus the fundamental structure for governance of corporations in those two countries is quite similar.[54] Day-to-day management of the corporation is the responsibility of the members of an executive team who are charged under corporate law with fiduciary duties to act in the best interests of the shareholders who are the ultimate owners of the corporation. Shareholders are not expected to be involved in the day-to-day management of the business of the corporation; however, they exercise their control through the election of the members of the board of directors who are supposed to set the policies for the corporation and select and oversee the executive team. Boards of corporations with publicly traded securities, so-called "public companies", generally have 10 to 15 members and a majority of "outside", or "independent" directors who are not executives, officers or employees of the corporation, a structural decision designed to reduce the potential for self-dealing at the board level. For a long time, however, the outside directors were typically nominated by the chief executive officer ("CEO") and there were often serious doubts about whether outside directors could, or would, stand up to the CEO. Shareholders in the US and the UK traditionally had little input into corporate affairs other than the election of directors; however, the trend now seems to be toward giving shareholders more input into controversial issues such as executive compensation. Disclosure requirements have also been escalating in an effort to provide shareholders with an expanded view of the relationships between directors and executive officers on the one hand and the corporation on the other.

§1:4 --Germanic European model

The system of corporate governance used in the Germanic countries—Germany, the Netherlands, Switzerland, Sweden and Austria—has been characterized as relatively oligarchic and focused on long-term industrial strategies supported by stable capital investment, robust governance procedures and enduring network relationships among key

[54] The discussion in this section is based on F. Allen and D. Gale, Comparative Financial Systems: A Survey, http://www.econ.nyu.edu/user/galed/papers/paper01-04-01.pdf, 25-26. The article also appears as F. Allen and D. Gale, "Comparative Financial Systems: A Survey" in A. Boot, S. Bhattacharya and A. Thakor (Eds.), Credit, Intermediation and the Macroeconomy (Oxford: Oxford University Press, 2004), 699-770.

stakeholders such as shareholders, families and banks.[55] This type of system has facilitated success of German firms in industries that require long-term investment and creating and maintenance of high skill levels (e.g., luxury automobiles, precision instruments, chemicals and engineering). However, the model has been less successful in circumstances where flexibility is needed since the difficulties associated with modifying deep, long-standing relationships among different stakeholders slow the process of adjusting to changes in labor and product markets and creating or entering new businesses and industries.[56] The prevailing concept of the firm in the Germanic countries is "institutional", which means that firms are seen as autonomous economic units created and supported by strong and complex coalitions of diverse stakeholders including shareholders, managers, employees, credit providers (i.e., banks), suppliers and customers. Within this group of stakeholders the industrial banks are generally the major players and their role in providing capital tends to reduce the importance of stock and bond markets and thus the influence of outside investors. In fact, ownership concentration is moderate to high in the Germanic countries, another factor that makes it difficult for outside investor to meaningfully impact decision making, and there is no market for corporate control. Economic relationships evolve over a long-term planning horizon and the use of performance-based compensation is far less pronounced than in the Anglo-American countries.

Germany's corporate governance structure, which is based on a system referred to as "co-determination", is quite different from the structures observed in the US, the UK and Japan.[57] Germany law provides that companies with more than a specified number of employees must have two boards: a "supervisory" board and a "management" board. The supervisory board is the controlling body, much like the board of directors in the US, and designated percentages of the membership of that board are elected by the shareholders and employees, respectively. Shareholder representatives on the supervisory board are elected at the shareholders' general meeting and employee representatives are drawn both from the company's own workforce and from the trade unions involved in representing the interests of the company's employees. While the members of the supervisory board are elected by different constituencies, all of them are required and expected to represent the interests of the company as a whole and rules relating to voting by the supervisory board allocate tie-breaking authority to one of the directors elected by the shareholders. Supervisory boards in Germany are typically a little larger than the boards in the US and the UK but small than boards in Japan. The management board is

[55] The model typically associated with the Germanic countries has been described in a variety of ways including the insider, civil law, blockholder, bank-oriented, stakeholder-centered, coordinated or "Rhineland" model. R. Aguilera and G. Jackson, "The Cross-National Diversity of Corporate Governance: Dimensions and Determinants", Academy of Management Review, 28(3) (2003), 447-465, 447.

[56] Portions of the description in this section is adapted from F. Toonsi, "Cultures of Control: International Corporate Governance", QFinance, http://www.qfinance.com/corporate-governance-viewpoints/cultures-of-control-international-corporate-governance?full

[57] The discussion in this section is based on F. Allen and D. Gale, Comparative Financial Systems: A Survey, http://www.econ.nyu.edu/user/galed/papers/paper01-04-01.pdf, 26-27. The article also appears as F. Allen and D. Gale, "Comparative Financial Systems: A Survey" in A. Boot, S. Bhattacharya and A. Thakor (Eds.), Credit, Intermediation and the Macroeconomy (Oxford: Oxford University Press, 2004), 699-770.

appointed by the supervisory board and no person can be a member of both boards. As the name implies, the management board "manages" the day-to-day operations of the company under the supervision of the supervisory board. Management boards are smaller than boards in the US and the UK. Allen and Gale observed: "It is often argued that the dual board system better represents outside shareholders and ensures management must take account of their views. In addition, employees' views are also represented and their bias is presumably to ensure the long run viability of the firm."[58]

At least during the 1970s to 1990s, an interesting overlay to the German corporate governance system was the tremendous influence of German banks as large shareholders of German corporations. Germany, like Japan, has traditionally had a bank-based financial system in which banks and other financial institutions are the primary suppliers of capital to businesses and do so by collecting funds from individuals, placing them into accounts and then making those funds available to firms through loans. Aguilera and Jackson reiterated some of the well-known descriptions of bank-based systems including close relationships between banks and firms, small and underdeveloped capital markets that reinforce higher firm dependence on debt, close capital monitoring and contingent control of borrowers by banks and, finally, long-term commitment by capital providers to firms as a result of the terms upon which the capital is made available to those firms.[59]

Data from a 1978 study conducted by the German Monopoly Commission indicated that, taking into account proxies that banks obtained for shares that their customers held "on deposit" with the banks, banks at that time controlled the votes of nearly 40% of the equity of Germany's top 100 corporations and were represented on two-thirds of the supervisory boards of those corporations.[60] This so-called "hausbank" system thus included significant long-term involvement of German banks in the corporate governance of the firms to which they provided capital and provided the foundation for close ties between those banks and German industry. The high concentration of ownership of German banks in German corporations has been thought to be an effective tool in monitoring the activities of the managers of those firms to ensure they were acting to maximize shareholder value and, in fact, there is evidence that German firms with a higher proportion of equity controlled by banks have better performance.[61] In addition, strong ties with their banks have allowed some German companies to avoid liquidity constraints that might undermine their strategic plans.[62]

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[58] F. Allen and D. Gale, Comparative Financial Systems: A Survey, http://www.econ.nyu.edu/user/galed/papers/paper01-04-01.pdf, 27.

[59] R. Aguilera and G. Jackson, "The Cross-National Diversity of Corporate Governance: Dimensions and Determinants", Academy of Management Review, 28(3) (2003), 447, 453.

[60] F. Allen and D. Gale, Comparative Financial Systems: A Survey, http://www.econ.nyu.edu/user/galed/papers/paper01-04-01.pdf, 35.

[61] Id. (citing J. Cable, "Capital Market Information and Industrial Performance", Economic Journal, 95 (1985), 118-132; and G. Gorton and F. Schmid, "Universal Banking and the Performance of German Firms", Journal of Financial Economics, 58 (2000), 29-80).

[62] F. Allen and D. Gale, Comparative Financial Systems: A Survey, http://www.econ.nyu.edu/user/galed/papers/paper01-04-01.pdf, 35 (citing J. Elston, Firm Ownership Structure and Investment: Theory and Evidence from German Panel Data, Unpublished Manuscript, 1993).

Firm governance in Germany, at least among the larger companies, has long been dominated by reliance on "interfirm networks" that typically include both "capital ties" such as ownership and credit linkages and board representation, and non-financial links such as supplier relationships. Interfirm networks in Germany, which have long been encouraged by German competition laws, reinforce the commitment of capital to enterprises by making exit more costly and tend to reduce external influences and increase the importance of the strategic interests of business partners which are pursued through corporate governance mechanisms such as interlocking board directorates which tend to increase the propensity of partners to cooperate.[63]

The primary sources of law, regulation and practice relating to corporate governance for publicly listed companies in Switzerland are the Company Law; the Federal Stock Exchange and Securities Trading Act, which regulates exchanges, securities trading, market abuse and its sanctions, disclosure of shareholdings and public takeover offers relating to public companies; the Listing Rules of the Swiss stock exchanges, primarily the SIX Swiss Exchange AG ("SIX"), which include specific reporting and disclosure requirements designed to improve corporate transparency and governance; and the Swiss Code of Best Practice for Corporate Governance ("SCBP"), which was issued by an influential association of Swiss businesses and sets corporate governance standards in the form of non-binding recommendations in a wide range of areas including the definition of corporate governance, general shareholders' meetings, shareholders' rights to information and inspection, the composition of the board of directors and of board committees, the role of auditors and compensation for boards of directors and executive boards of public companies.[64]

While company law in Switzerland generally provides for a one-tier model, as a practical matter the responsibility for day-to-day management of Swiss companies is typically delegated from the board to senior management, thus creating a two-tier board structure. Board members are expected to represent and act in the best interests of the company, taking into account the long-term interests of the shareholders and the interests of other stakeholders such as creditors and employees of the company. Board members are also under an obligation to act in good faith and with due care to safeguard the interests of the company. By law, there are certain duties and responsibilities that the board cannot delegate or transfer. For example, regardless of any delegation of responsibilities to company executives or board committees, the entire board remains responsible for the ultimate management of the company and deciding upon corporate strategy and how the resources of the company should be allocated. Other responsibilities that cannot be delegated or transferred by the board include:

- Defining the fundamental organizational structure of the company;

[63] R. Aguilera and G. Jackson, "The Cross-National Diversity of Corporate Governance: Dimensions and Determinants", Academy of Management Review, 28(3) (2003), 447, 454.

[64] Portions of the overview in this section of Swiss corporate governance laws, regulations and guidelines applicable to listed companies is adapted from L. Olgiati, Switzerland, in Corporate Governance: Board Structures and Directors' Duties in 35 Jurisdictions Worldwide (2013), 216. Another useful summary of Swiss corporate governance is P. Kunz, Swiss Corporate Governance – An Overview (2009).

- Establishing accounting and financial control systems, including an internal control system, and providing for financial planning as necessary for the management of the company and its businesses;
- Performing a risk assessment, the results of which should be described in the company's annual business report to its shareholders;
- Appointing and removing the management as well as granting of signing authority to the individuals authorized to act on behalf of the company;
- Ultimately monitoring the individuals entrusted with management responsibilities, in view of compliance with applicable law and regulations and the governance documents of the company;
- Preparing annual business reports to the shareholders and conducting general shareholders' meetings; and
- Notifying the bankruptcy court when the company's liabilities exceed its available assets.

Interestingly, Swiss company law does not require that Swiss companies have a minimum number of non-executive or independent directors; however, the SCBP recommends that a majority of the board should consist of non-executive members (i.e., persons who are not engaged in carrying out a line management function within the company) as a means for encouraging exchange of ideas and critical views between the board and executive management, and also provides for board positions of "lead director" and "independent director" to prevent and/or resolve potential conflicts of interest.[65] SIX, through its comprehensive "Directive on Information Relating to Corporate Governance", has imposed extensive disclosure requirements relating to the boards of SIX-listed companies including information on individual board members; the organization of the board and its committees, including the tasks and areas of responsibility of board members and their working methods; the split of responsibilities between board and executive management; information and control instruments with regard to senior management; and compensation of board members.

While Swiss company law does not include any mandatory requirements or restrictions relating to board committees, the SBCP recommends that listed companies establish audit, compensation and nomination committees and that all of the members of the audit committee and a majority of the members of the compensation committee should be non-executive, preferably independent, members. The controversial "Minder Initiative", which entered into force on January 1, 2014, implements a number of sweeping changes including requirements that the members of the compensation committee must be elected annually by the shareholders' meeting and that the shareholders be given a binding vote at each such meeting on the aggregate compensation of the board of directors and the senior management (i.e., "say-on-pay"). Prior to the implementation of the Minder initiative, many Swiss listed companies, following non-binding SBCP recommendations, submitted "compensation reports" to their shareholders' meetings and sometimes found, to the surprise of the directors and senior managers, that shareholders, led by increasingly

[65] For further discussion of the role of independent non-executive directors in Swiss corporate governance, see B. Speck and J. Tanega, "UK and Swiss Corporate Governance: Comparing the Role of Independent Non-Executive Directors", I.C.C.L.R. (2005), 468.

activist institutional investors, would reject those reports when given the opportunity through consultative votes.

§1:5 --Latin European model

The system of corporate governance typically seen among the "Latin countries", such as France, Italy, Spain and Belgium in Europe and Brazil and Argentina in South America, is notable for its high level of network orientation and the protective concentration of ownership among key stakeholders such as families, industrial groups and the state. The relationship among these stakeholders are strong and enduring, which leads to stability and a preference for long-term investment horizons that is well suited to specialization in industries that the state has selected for sponsorship in support. For example, aerospace, nuclear and high-tech trains are all examples of "prestige industries" that have been championed by the state in France and both France and Italy have achieved worldwide success and notoriety for their international luxury goods companies. Critics of the Latin model argue, however, that capital markets in those countries are weak and narrow since minority shareholders have little or no voice in the face of the tight relationships among the above-mentioned key stakeholders and there are few rules that force those in control to feel any accountability to outside shareholders.[66]

As is the case in the Germanic countries and in the model associated with Japan described below, the prevailing concept of the firm in the Latin countries is "institutional"; however, the composition of the main stakeholder group is a bit different and includes financial holdings, the state and families. Ownership concentration is high, stock and bond markets are relatively unimportant and there is a dearth of protections for minority investors and no market for corporate control. In general, there is a moderate relationship between compensation and performance and planning horizons tend to be long-term. The corporate governance structure typically used in France incorporates elements both the US/UK ("Anglo-American") system and the German system through the ability of companies to choose between two types of governance structures.[67] The most common types is similar to the Anglo-American system and calls for a single-tiered board structure that sets policies for the company and elects a president who is like the CEO in the US and the UK but with more power. Directors in this structure are mostly outsiders drawn from shareholders, representatives of financial institutions who have business relationships with the company and, to a larger extent than in other countries, representatives of the government. The second type of governance structure is two-tiered, as is the case in Germany; however, employees in France to not have the right to represented on the supervisory board. It should be noted, however, that a unique feature

[66] Portions of the description in this section is adapted from F. Toonsi, "Cultures of Control: International Corporate Governance", QFinance, http://www.qfinance.com/corporate-governance-viewpoints/cultures-of-control-international-corporate-governance?full

[67] The discussion in this section is based on F. Allen and D. Gale, Comparative Financial Systems: A Survey, http://www.econ.nyu.edu/user/galed/papers/paper01-04-01.pdf, 27-28. The article also appears as F. Allen and D. Gale, "Comparative Financial Systems: A Survey" in A. Boot, S. Bhattacharya and A. Thakor (Eds.), Credit, Intermediation and the Macroeconomy (Oxford: Oxford University Press, 2004), 699-770.

of the French governance system is that regardless of whether a single- or two-tiered structure is selected workers' representatives do have the right to attend board meetings as observers for all companies have more than a specified minimum number of employees. When the two-tiered structure is used, the senior, or "surveillance", board appoints a small "directorate" of persons who will be responsible for management and that group taps one of its members to serve as president of the directorate.

Cunningham explained that the governance and finance system traditionally used in France was the "bank/labor model", which featured substantial investment intermediation and concentration of ownership and debt holdings that tended to reduce pressure for the development of actively functioning, deep and liquid capital markets.[68] Banks were the primary capital providers to French firms and when they acted as both shareholder and debt holder the tension that normally occurs between those two classes of stakeholders disappeared and there was little need to develop any systems of checks-and-balances or strengthen disclosure systems. Cunningham also pointed out that labor was centrally involved in French corporate governance and that the deep tradition of worker protection in France had, until recently, provided workers with job security and compensation arrangements that were consider fair and reasonable in relation to senior executives. According to Cunningham, all of this could be described as a "stakeholder model of corporate governance" in which the fiduciary duties of managers ran to all of the participants in the corporation including not only shareholders, but also to the debt holders and workers.

Cunningham went on to note, however, that the French model of corporate governance has been undergoing substantial changes over the last two decades due to the influence of EC directives, privatization and globalization. For example, various EC directives have abolished, or substantially restricted, historical controls on foreign investment, thereby forcing France and other European countries to consider adopting regulations familiar to US investors to induce them to provide capital to European companies, and have also harmonized accounting rules and expanded financial disclosure requirements. Privatization in France has not only reduced the role of the state in directing the economy, but has also led to the introduction of technical governance reforms following the US model such as the creation of audit and compensation committees at the board level and greater transparency as a result of improvements in both the quantity and quality for financial and business information.

Goyer has also written about the transformation of corporate governance in France, noting at the outset that concepts such as "corporate governance" and "shareholder value" had initially been badly received in France as "generally been associated with lay-offs and short-term thinking that privileges the next quarter's financial results over the long-term health and social responsibility of the corporation".[69] Although contempt for US-style corporate governance, and inbound investment from foreign mutual and pension funds, could be found among all of the major stakeholders of the French economy—

[68] L. Cunningham, Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance (1999).
[69] M. Goyer, The Transformation of Corporate Governance in France (2003).

managers, state officials, trade unionists, and the general public, Gover argued that there had nonetheless been extensive changes to France's model of corporate governance that were most evident in three areas: a transition in the ownership structure of companies from concentrated cross-shareholdings in the hands of friendly fellow domestic companies to high levels of foreign ownership; an abandonment of corporate diversification strategies in favor of concentrating on a limited set of core competencies, a development that had led to dismantling of conglomerate structures that had previously provided employees of French companies with employment protection by serving as internal labor markets and as conduits for keeping poorly performing units afloat using subsidies from faster growing units within the same conglomerate; and adoption of managerial performance incentives, including an explosion of stock option packages for senior executives. In contrast to Cunningham, Gover argued that accounting standards among French companies had lagged behind other European countries with respect to increased transparency and that minority shareholders in France still had to work harder than their counterparts in other countries to overcome ownership ceilings and the unequal voting rights.

Gover suggested that the transformation of French corporate governance described above raised issues of both process and sustainability. On the process side, Gover noted that the decisions to adopt shareholder value institutions and practices, dismantle conglomerate structures and adopt performance-based incentives had often been made by the CEOs and other senior executives of large French companies without extensive consultation with other firms, the state or internal stakeholder groups. For example, Gover pointed out that conglomerate structures were often cast aside with providing employment guarantees or other concession to employees. As a result, many French workers found themselves living in a world with substantially reduced job security and pursuing career paths that were depended more and more on the financial and business performance of their employers as opposed to a social contract. Gover also questioned the introduction of stock options, noting that many companies had limited their use to CEOs and top management and that these performance-based incentives had been deployed without greater financial transparency that would discourage those at the top of the hierarchy with options from engaging in transactions calculated to increase the short-term value of the company's stock, and thus the value of their options. In other words, Gover feared that the members of the management teams of French companies would act in their own interests rather than continuing to follow the traditional process of serving the interests of all stakeholders and mapping and pursuing sustainable long-term competitive strategies.

One of the most interesting reforms made by the French to promote innovation was the creation of a new, more flexible, type of company that facilitated that the use of a corporate governance framework that was better suited to financing risky high technology start-ups.[70] The previously existing models of corporate governance in France discussed above restricted the ability of shareholders to exert control over the managers of the enterprise and it was believed that this structure would not be conducive to attracting venture capital investment, since those investors are generally unwilling to

[70] J. Vela, Radical Innovation in the Transatlantic Economy: Is a Silicon Valley Possible in Europe? (2009), 34-35.

put their capital at risk unless they can have a hand in making decisions regarding the strategic path of the company. In 1999, however, legislation was enacted that authorized formation of a new form of corporation that, although it could not issue shares publicly, offered several advantages to entrepreneurs looking to raise venture capital and attract skilled technical specialists to work on risky, innovative projects. For example, these corporations could establish their own rules for management and shareholders; issue different classes of stock with different voting rights, thereby providing investors with the opportunities to direct management of the firm; issue stock options; and operate without work councils, thereby streamlining the decision making processes and providing more flexibility to management.

§1:6 --East Asian model

The emergence of Japan as a global, and often dominating, economic power during the 1980s and early 1990s led to extensive attention on its strongly network-oriented model of corporate governance that featured the company as the institutional center of strong, deep and long-term relationships among all of the key stakeholders including banks and other financial institutions, investors, employees, suppliers, customers and, in many instances, the state. While this model is typically associated with Japan it has also appeared in similar form in China, India and the Middle East. For the Japanese, it allowed them to make the long-term investment commitments necessary for their firms to achieve success in electronics and low-cost automobiles, continuously dominating American and European competitors in their own markets. However, the long-running economic problems of Japan that began during the mid-1990s have led many to criticize elements of its traditional corporate governance model, particularly the lack of accountability and transparency (i.e., use of secretive governance procedures) and the apparent freedom to engage in what amounts to reckless financial speculation.[71] The prevailing concept of the firm in Japan and in the other countries and regions mentioned above is institutional and firms are created and operated under the oversight of a dynamic and diverse network of stakeholders with strong and enduring relationships. Ownership concentration is actually low to moderate; however, stock and bond markets have been relatively underdeveloped due to a legal and regulatory bias against financing of enterprises through non-bank sources.

The formal corporate governance structure in Japan is similar to that found in the US due to the lingering influence of the US occupation of Japan following World War II, which included an intense effort to impose US legal systems and related institutions on the Japanese.[72] However, at least on paper, there are some significant differences: Japanese shareholders appear to have more rights with respect to the nomination and election of

[71] Portions of the description in this section is adapted from F. Toonsi, "Cultures of Control: International Corporate Governance", QFinance, http://www.qfinance.com/corporate-governance-viewpoints/cultures-of-control-international-corporate-governance?full

[72] The discussion in this section is based on F. Allen and D. Gale, Comparative Financial Systems: A Survey, http://www.econ.nyu.edu/user/galed/papers/paper01-04-01.pdf, 26. The article also appears as F. Allen and D. Gale, "Comparative Financial Systems: A Survey" in A. Boot, S. Bhattacharya and A. Thakor (Eds.), Credit, Intermediation and the Macroeconomy (Oxford: Oxford University Press, 2004), 699-770.

directors and also have the right to vote on and approve management compensation at general shareholders' meetings. In reality though, Japanese shareholders have little in the way of real influence for several reasons. First, the board of directors of a Japanese public company is typically much larger than in the US and the UK, which makes it difficult for the board to concentrate and focus its efforts. Second, there are usually only a handful of outside directors on the board and they have little influence in relation to the rest of the board which is composed of directors controlled by the CEO and selected from among senior members of the management team, others from inside the company who owe their careers to the CEO and the auditors of the company. The bottom line is that absent severe financial distress Japanese public companies are firmly under the control of the CEO and other insiders. Management compensation is rarely linked to performance, the time horizon of economic relationships is long-term and planning has often been driven by the choices of the state regarding which industries, markets and technologies might be most appropriate for overall economic development of the nation.

Japanese companies have also differed significantly from their counterparts in the US and the UK with respect to the composition of their shareholder groups.[73] In the US, for example, banks were, for a long time, prevented from holding equity stakes in companies except in unusual circumstances and laws and regulations governing other financial institutions such as insurance companies have generally restricted equity holdings of those entities in non-financial institutions to relatively small amounts in order to promote diversification. As a result, only a small amount of the equity of non-financial corporations is held by financial institutions in the US while in Japan, as well as in France and Germany, the average holdings were significantly higher.[74] In turn, the percentage of equity ownership of non-financial corporations in the hands of individuals and mutual and pension funds were much higher in the US than in the other countries. As for ownership of shares of non-financial corporation by other non-financial corporations, the percentage in the US has always been much lower than in Japan, Germany and France, a situation that can be attributed to significant differences in antitrust and competition laws across all of the countries.

Nisa and Warsi, who preferred to talk about a broader East Asian model rather than simply focusing on Japan, observed that "[t]he typical East Asian form of corporate governance model embodies a purer version of the insider model where 'the founding family' generally holds a majority of the controlling shares, directly or through other holding companies, most of which in turn may be controlled by the founding families".[75] As such, the East Asian version of the insider model differs from the form used in Europe in the way that the relationship among the controlling stakeholders is forged: "family ties", generally unwritten, are the key in East Asia while Europe relies on complex

[73] Id. at 699.

[74] While their equity holdings in non-financial corporations are higher than in the US, banks and other financial institutions in Japan are subject to regulatory restrictions on holding shares and patterns of ownership including regulations on the proportions of the equity of firms that banks can hold. See F. Allen and D. Gale, Comparative Financial Systems: A Survey, http://www.econ.nyu.edu/user/galed/papers/paper01-04-01.pdf, 29.

[75] S. Nisa and K. Warsi, "The Divergent Corporate Governance Standards and the Need for Universally Acceptable Governance Practices", Asian Social Science, 4(9) (2008), 128-136, 129.

shareholder and other commercial agreements. Regardless of how the insider relationships are created and maintained, there is a higher tolerance in both Europe and East Asia for activities that may not be fully in the interests of common shareholders. For example, assuming that Firm A and Firm B are controlled by the same group of shareholders, Firm A may provide products and other resources to Firm B on extremely favorable terms in order to assist Firm B even though the transaction is not in the best economic interests of Firm A. If the minority shareholders of Firm A do not have an interest in Firm B they are particularly disadvantaged; however, such inequities are common and expected among organizations using the insider model.

§1:7 Corporate governance in developing countries

There has been a substantial amount of debate regarding the factors that influence the choice and operation of corporate governance systems in a particular country. Among the factors that are often mentioned, which are applicable to both developing and developing countries, are the legal and regulatory framework (i.e., common law versus civil law) and related institutions, particularly the extent to which a country's laws protect investor and property rights and the extent to which those laws are enforced; political decisions regarding the power and influence of various potential stakeholders such as financial institutions and/or labor organizations; the societal culture, particularly those cultural characteristics that are based on elements of trust; economic factors (i.e., variations in market size, firm size, uncertainty and industry structure); and the role of the state as owner, manager and/or regulator of key business enterprises.[76] Developing countries face a larger context when dealing with corporate governance in that they must not only consider the issues of corporate collapse and creative accounting that have been the driving force behind corporate governance reforms in developed countries, but they must also consider the effects on economic development and globalization and must also balance a locally acceptable and relevant corporate governance strategy with the need to meet internal expectations.[77]

The situation, prospects and challenges in each of the developing countries discussed below are obviously unique; however, the Center for International Private Enterprise has suggested that the following general challenges confronting developing, emerging and

[76] See F. Toonsi, "Cultures of Control: International Corporate Governance", QFinance, http://www.qfinance.com/corporate-governance-viewpoints/cultures-of-control-international-corporate-governance?full; S. Nisa and K. Warsi, "The Divergent Corporate Governance Standards and the Need for Universally Acceptable Governance Practices", Asian Social Science, 4(9) (2008), 128-136, 129; and S. Nestor and J. Thompson, "Corporate Governance Patterns in OECD Economies: Is Convergence Underway?" in S. Nestor and T. Yasui (Eds.), Corporate Governance in Asia: A Comparative Perspective (Paris: Organisation for Economic Co-operation and Development, 2000), 19-43, 40..

[77] D. Reed, Corporate Governance Reforms in Developing Countries, 37 Journal of Business Ethics 223-247 (2002). Although the reports and information are somewhat dated an excellent starting point for understanding corporate governance in developing countries is the governance assessments completed as part of the joint World Bank-IMF Financial Sector Assessment Program (FSAP) and Reports on the Observance of Standards and Codes (ROSC). These assessments are available through The World Bank website at http://www.worldbank.org/ifa/rosc_cg.html

transitional economies with respect to creating effective corporate governance systems in their countries include[78]:

- "Establishing a rule-based (as opposed to a relationship-based) system of governance;
- Combating vested interests;
- Dismantling pyramid ownership structures that allow insiders to control and, at times, siphon off assets from publicly owned firms based on very little direct equity ownership and thus few consequences;
- Severing links such as cross shareholdings between banks and corporations;
- Establishing property rights systems that clearly and easily identify true owners even if the state is the owner;
- De-politicizing decision-making and establishing firewalls between the government and management in corporatized companies where the state is a dominant or majority shareholder;
- Protecting and enforcing minority shareholders' rights;
- Preventing asset stripping after mass privatization;
- Finding active owners and skilled managers amid diffuse ownership structures;
- Promoting good governance within family-owned and concentrated ownership structures; and
- Cultivating technical and professional know-how."

§1:8 --Brazil

During the 1950s and 1960s, most of the firms in the private sector in Brazil were controlled by familial groups that owned all or a clear majority of the shares, thus making it difficult for their boards of directors to operate efficiently or independently. While reforms occurred in the 1970s—notably the promulgation of a new corporate law and the establishment of a Brazilian Securities and Exchange Commission—de Castro et al. observed that "corporate governance had made little headway in Brazil" by the mid-1990s.[79] Further efforts to improve corporate governance in Brazil were spearheaded by the National Institute of Board of Directors, later called the Brazilian Institute of Corporate Governance—the Instituto Brasileiro de Governanca Corporativa ("IBGC"), which was established in 1995 and went on to issue a Code of Best Practices in Corporate Governance in 1999. In 2001, the Brazilian stock exchanges adopted listing requirements that included commitments relating to corporate governance. Accounting rules relating to Brazilian companies were bolstered in 2007 through the adoption of standards based on the International Financial Reporting Standards. Finally, by the end of 2009 listed companies in Brazil were required to adhere to ongoing reporting and disclosure obligations relating to a number of areas, including financial information, risk factors, management analyses and corporate governance.[80]

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[78] Center for International Private Enterprise, Instituting Corporate Governance in Developing, Emerging and Transitional Economies: A Handbook 24-25 (2002).
[79] N. de Castro, I. Soares, R. Rosental and A. Sellare, Impacts of Corporate Governance on Companies in Brazil's Electricity Sector (Rio de Janeiro: Grupo de Estudos do Setor Eletrico UFRJ, December 2010).
[80] Id.

The IBGC summarized recent developments in the corporate governance landscape in Brazil as follows[81]:

> "In Brazil, professional and independent board members have appeared in response to the movement in favor of good corporate governance practices and companies' need to modernize their top management to become more attractive in the marketplace. This fact was accelerated by globalization, privatization and economy deregulation, which resulted in a much more competitive corporate environment. As a result, oligopolies (i.e., companies exclusively controlled and managed by families with a high capital concentration, passive minority shareholders and unrepresentative boards) have been replaced in Brazil by more active institutional investors, diffuse stock control, stronger focus on economic efficiency and management transparency. In addition, privatization has led to the first shared-control experiences in Brazil through shareholders' agreements. In such companies, controlling investors began to share the company's command and establish rules through agreements. At the same time, institutional investors – insurance companies, pension funds and mutual funds, among others – are taking an active position and begun to attend general meetings, exercise their stocks' voting rights and take a closer look at their investees. These changes in the companies' ownership and governance structure also occurred at the financial market. Foreign investment on the capital market increased, which led companies to adapt to international governance requirements and standards. In short, corporate governance practices became a priority for, and a source of pressure from, investors."

The IGBC also noted that corporate governance practices had been receiving increasing attention from associations and the government in Brazil starting with the preparation and publication of the first code of corporate governance by the IBGC in 1999 which focused on the role and conduct of the board of directors. In subsequent versions, the basic principles of good governance applicable to Brazilian companies have been further detailed and extended. In addition, Brazilian stock exchanges have adopted special listing levels for companies with high corporate governance standards (e.g., higher stock liquidity, better disclosure practices, additional shareholders' rights, stronger board of directors, limits on issuance of non-voting shares and reduced risk-taking). The Brazilian corporations law has been continuously reformed and the country's Securities and Exchange Commission has provided guidance on the relationships among top managers, board members, controlling shareholders, minority shareholders and independent auditors. However, while there has been significant activity the IBGC has concluded that "[u]nfortunately, despite these trends and changes, Brazil is still known for its high

[81] Instituto Brasileiro de Governanca Corporativa, Governance in Brazil, http://www.ibgc.org.br/Secao.aspx?CodSecao=101.

concentration of stock control, low board effectiveness and highly overlapping ownership and management".[82]

§1:9 --China

It has been observed that the long series of programmatic reforms that have been implemented in China since the last 1970s have recently become more focused on market reforms that would open the Chinese financial sector to greater foreign competition and modernize Chinese stock markets.[83] A key part of this process has been the transition away from reliance on state-owned enterprises (SOEs) that were tightly controlled by the government as both owner and regulator toward publicly held companies (PHCs) with outside non-governmental investors and the success of this evolution depends to a great extent on the scope and effective of corporate governance reform initiatives in China.

Child and Warner have noted several different influences on ownership and governance of business enterprises in China that follow both from the political history of the country and the impact of business systems imposed by foreigners. Obviously Chinese Communism, as well as the influence of the Soviet system, have been important factors and have generally led to the use of the "top-down" model for managing workers that prevailed for decades. The use of personnel procedures was a contribution made by Chinese capitalist and foreign-owned businesses that flourished before they were "nationalized" by the Communist regime in the 1950s and organizational practices were also influenced by the public and private enterprises formed and operated by the Japanese in Manchuria beginning in the early 1900s.[84] Child and Warner commented that "contemporary Chinese management" really began to unfold after the announcement of economic reforms in 1978 and the influences of history can still be seen around country such that it is difficult to identify a single ownership and governance model given that differences can be found among industries, regions and type of firm.

From the beginning of Communist rule in China through the end of the 1970s, SOEs dominated economic activities in the industrial sector, regularly producing about 75% of the China's annual industrial output value. Child and Warner argue that the SOEs may have had their roots in Japanese precedents in occupied Manchuria and were also influenced by the practices of the Communists in the Soviet Union. Regardless of their origins, SOE employees, working in mostly urban areas, were generally promised and received "jobs for life" and "cradle to grave" welfare.[85] SOE managers operated under

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[82] Id. For further discussion of risk and governance in Brazil, see E. Chehab, A Guiding Light for Investors in Brazil, in S. Borodina and O. Shvyrkov, Investing in BRIC Countries: Evaluating Risk and Governance in Brazil, Russia, India and China 3 (2010).

[83] L. Li, T. Naughton and M. Hovey, "A Review of Governance in China", in F. Lopez-Iturriaga (Ed.), Codes of Good Governance Around the World (2009), 415.

[84] J. Child and M. Warner, "Culture and Management in China", in M. Warner (Ed), Culture and Management in Asia (London: Routledge Curzon, 2003); M. Warner, The Management of Human Resources in Chinese Industry (London: Macmillan, 1995).

[85] J. Child and M. Warner, "Culture and Management in China", in M. Warner (Ed), Culture and Management in Asia (London: Routledge Curzon, 2003) (citing and quoting X. Lu and E. Perry (Eds),

strict guidelines set out in bureaucratically mandated plans that included quotas for both inputs and outputs, and their main role was to meet the production goals established by their owners—the government—rather than generate financial returns for the government as the sole investor in those enterprises. Li et al. described the situation as follows: "The governance structure of SOEs was an integral part of the general government framework. At that time, SOEs were characterized by low productivity and efficiency, high input and low output."[86] During the same period, enterprises engaged in agricultural activities were typically organized and operated as worker collectives that managed collectively-owned rural properties.

Following the announcement of economic reforms by Deng Xiaoping in 1978, SOEs remained an important part of the economic landscape in Chine; however, alternative forms of ownership of business enterprises expanded to include the possibility of private and joint venture enterprises in a limited number of sectors, many of which were financed and supported by foreign investors—when activities were focused on export markets the foreign capital generally came from multinational corporations either through direct investment or joint ventures with local partners and when the activities were focused on internal or domestic markets much of the capital came from other Chinese investors in the so-called "Greater China" network that included, among other places, Hong Kong, Taiwan and other parts of Southeast Asia.[87] This trend was facilitated by extensive changes and improvements to China's legal system relating to business enterprises—previously, unless specifically mandated, ownership rights lack consistent legal protection.[88] Gradually, large portions of economic activity shifted away from SOEs and Child and Warner reported that by 2002 the share of Chinese industrial output controlled by SOEs had dropped to just below 25%.[89]

Several factors and actions are worth noting with respect to the reduced role of SOEs in the Chinese economy over the last several decades.[90] First, the central government made a clear policy decision to restructure ownership of, or fully divest, many of the SOEs in order to expose them to market forces and increase private participation in the economy. Those SOEs that did remain were engaged in either key industries considered to be of major strategic importance or in activities best undertaken in ways that facilitate

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Danwei: The Changing Chinese Workplace in Historical and Comparative Perspective (Armonk, NY: M.E. Sharpe, 1997)).

[86] L. Li, T. Naughton and M. Hovey, "A Review of Governance in China", in F. Lopez-Iturriaga (Ed.), Codes of Good Governance Around the World (2009), 415, 418.

[87] M. Beeson, Regionalism and Globalization in East Asia (Houndmills: Palgrave Macmillan, 2007). While a good deal of the capital for domestic activities came from Great China, foreign multinationals have acted aggressively to establish themselves in what promises to be huge consumer market and Guthrie has reported notable presences by firms such as Coca-Cola, DuPont, General Motors, Kodak and Motorola. D. Guthrie, China and Globalization (New York: Routledge, 2006).

[88] R. Grainger and S. Chatterjee, "Chinese and Indian Systems: Divergent in the midst of Global Trends", in University of Sydney (Eds), Asia-Pacific Economic and Business History Conference (Sydney, Australia: University of Sydney, 2007), 1-45.

[89] J. Child and M. Warner, "Culture and Management in China", in M. Warner (Ed), Culture and Management in Asia (London: Routledge Curzon, 2003).

[90] The discussion in this paragraph is adapted from J. Child and M. Warner, "Culture and Management in China", in M. Warner (Ed), Culture and Management in Asia (London: Routledge Curzon, 2003).

"economies of scale". Second, a number of SOEs were "encouraged" to merge with one another in order to form larger business groups. The stated goal was to achieve scale economies; however, many observed that the real purpose was to facilitate integration of weaker firms into stronger ones so as to avoid the financial and social costs associated with shutting down those enterprises that would not otherwise be able to survive.[91] Finally, a large number of the former SOEs were converted to new forms of business entities including joint stock companies and limited liability companies that featured private ownership and, in many cases, employee ownership participation through the use of "employee shareholding cooperatives".[92]

The restructuring of SOEs in China has often been celebrated as a harbinger of the emergence of entrepreneurial activity in China and the willingness of the State to forgo control over increasingly larger portions of the economy in favor of private sector firms operating in freer markets. However, some have taken a more cynical view of the goals and objectives of the Chinese government. For example, Kroeber and Yao argue that the State's privatization policies have been carried to achieve the primary goal of *zhuada fangxiao* ("keep the big, lose the small") and that this has led to closure or divestiture of numerous unprofitable business lines—accompanied by displacement of millions of workers—so that the remaining portfolio of the state was dominated by large and profitable SOEs that dominate all of the significant industrial sectors in China apart from consumer electronics and certain light industries.[93] Mani has also commented that official data in China regarding forms of ownership is often hard to understand and misleading and enterprises that are characterized as shareholding companies, limited liability companies and collectives, rather than "state enterprises", may nonetheless still be under government control and not private sector initiatives.[94] Another blemish on the entire process has been alleged problems of corruption in connection with the privatization of certain of the old SOEs, with Beeson noting that new entrepreneurs seeking to take managerial control of these enterprises have had to depend on the favors over government officials during the transition period and that government officials have sometimes unscrupulously leveraged their connections with overseas Chinese business interests to obtain the capital necessary to purchase the assets formally owned and controlled by the SOEs.[95]

As time went by after the economic reforms began, shares of certain of the SOEs became publicly tradable on the country's emerging stock markets; however, these newly listed

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[91] L. Keister, Chinese Business Groups: The Structure and Impact of Interfirm Relations During Economic Development (Hong Kong: Oxford University Press, 2000).

[92] For further discussion and more detailed empirical data on the restructuring of SOEs during the late 1990s, see Y. Lin and T. Zhu, "Ownership Restructuring in Chinese State Industry: An Analysis of Evidence on Initial Organizational Changes", The China Quarterly, 166 (June 2001), 305-341.

[93] A. Kroeber and R. Yao, "Large and in Charge", Financial Times, July 14, 2008 (as references and discussed in S. Mani, The Growth of Knowledge-intensive Entrepreneurship in India, 1991-2007 (Maastricht, The Netherlands: United Nations University-MERIT Working Paper Series No. 2009-051, 2009), 6).

[94] S. Mani, The Growth of Knowledge-intensive Entrepreneurship in India, 1991-2007 (Maastricht, The Netherlands: United Nations University-MERIT Working Paper Series No. 2009-051, 2009), 6.

[95] M. Beeson, Regionalism and Globalization in East Asia (Houndmills: Palgrave Macmillan, 2007).

corporations typically remained under the control of the State and financial institutions and tradable shares amount only to a small fraction of the total number of outstanding shares.[96] In effect, Chinese corporate governance was following the path of other Asian countries: limited protection of minority rights and highly concentrated ownership that prevented any meaningful separation of management and ownership of the type seen in the US and other countries relying on an "outsider" model of corporate governance.[97]

The movement toward changes in the Chinese approach to corporate governance was triggered by the pressure to open and modernize Chinese capital markets. Li et al. reported that the corporate governance program followed several steps beginning in the late 1970s with the introduction of a series of laws pertaining to companies and securities that were designed to establish the foundation for full and partial privatization of SOEs and formation and operation of new PHCs that had never been SOEs.[98] One particularly notable feature of these laws was the statutory recognition of three corporate governing bodies: the shareholders, who were required to meet at least once a year and vote on the company's development strategies and investment plans; the board of directors, whose role was interestingly described by Fama and Jensen as "minimize[ing] the costs that arise from the separate of ownership and decision control of the modern corporation"[99]; and the board of supervisors, a unique body that was asked to oversee and supervise directors and senior managers of the company to ensure that they were fulfilling their duties and responsibilities.

Regardless of how one views the policies and processes regarding the SOEs, it is apparent that Chinese private firms, including reconstituted SOEs and completely new businesses, grew rapidly as economic reforms began to take hold and estimates were that they accounted for over 20% of industrial output in the country by 2002. These firms were either "fully private" or had a significant proportion of private ownership; however, in a relatively small number of cases the Government still retained a majority stake. The private sector in China also includes firms with foreign investment, including wholly-owned subsidiaries established by foreign direct investors after such transactions were first permitted in 1986, and these enterprises grew quickly to the point where they

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[96] According to Clarke, several governance issues arise when the government persists in maintaining full or controlling ownership in key enterprises including the goal of achieving productive efficiency as opposed to wealth maximization, the influence of politics and corruption on management of the enterprises, the often conflicting roles and goals of multiple government agencies involved in management of the enterprises and the difficulties in measuring the financial performance of SOEs. See D. Clarke, "Corporate Governance in China: An Review", China Economic Review, 14(4) (2003), 494 (cited and described in L. Li, T. Naughton and M. Hovey, "A Review of Governance in China", in F. Lopez-Iturriaga (Ed.), Codes of Good Governance Around the World 415, 429-430 (2009)).

[97] L. Li, T. Naughton and M. Hovey, "A Review of Governance in China", in F. Lopez-Iturriaga (Ed.), Codes of Good Governance Around the World (2009), 415, 417-418. For a comprehensive review of corporate governance in Asia as of the early 2000s, see S. Claessens and J. Fan, "Corporate Governance in Asia: A Survey", International Review of Finance, 3(2) (2002), 71.

[98] L. Li, T. Naughton and M. Hovey, "A Review of Governance in China", in F. Lopez-Iturriaga (Ed.), Codes of Good Governance Around the World 415, 418 (2009).

[99] Id. at 418 (2009) (citing E. Fama and M. Jensen, "Separation of Ownership and Control", Journal of Law and Economics, 26 (1983), 301).

accounted for over 15% of industrial output in China by 2002.[100] For a long time private firms in China suffered under what the International Finance Corporation characterized as a "harsh institutional environment"[101], but the situation improved significantly in 2000 when such firms were granted full legal rights. Private firms involved in growing areas such as software and Internet development were able to tap into the fledgling venture capital market in Shenzhen to fund their activities and may ultimately attract the interest of foreign companies looking for either local joint venture partners or acquisition candidates.[102]

While the number of SOEs has declined dramatically over the last few decades they remain key players in strategically important sectors of the economy designated by official policy. Given their strategic role and the typical desire to use SOEs to seek and achieve "economies of scale", it is not surprising to find that they are generally much larger enterprises than most of the privately-held firms and the combination of size and governmental influence usually leads to a bureaucratic structures and behaviors. Other relevant characteristics of the traditional structure of SOEs include large power distances in management-employee relationships; little or no delegation of authority; and complex and detailed organizational structures with heavy reliance on specialized departments and vertical linkages between hierarchies, a practice that often causes poor horizontal communication and collaboration. Another notable feature of the typical organizational structure of the SOEs is the vertical nature of worker identities and loyalties that follows from traditional Chinese respect for the "leader" and the tendency toward group orientation that causes workers to identify strongly with their immediate work group, which in essence becomes the workplace equivalent of China's more important social unit: the family.[103] This situation further complicates horizontal linkages within the organizational structure and, as Child and Warner explain, "[t]he combination of a strong group orientation with a penchant towards egalitarianism generates reluctance among many Chinese to accept responsibility and systems that reward performance on an individual basis".[104]

With the exception of those firms that have grown to the size where they are reliant on capital from outside investors, including foreigners, Chinese private firms have typically relied on a highly centralized model for organization and operations. Authority is vested in a single owner, or small group of owners, and is exercised by the ownership group and a small group of associates in the "inner circle" (i.e., spouses and relatives) through tight

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[100] J. Child and M. Warner, "Culture and Management in China", in M. Warner (Ed), Culture and Management in Asia (London: Routledge Curzon, 2003). Child and Warner also reported that by 1997 the number of newly launched companies wholly owned by foreign investors exceeded equity joint ventures with Chinese partners for the first time.

[101] International Finance Corporation, China's Emerging Private Enterprises (Washington, DC: International Finance Corporation, 2000).

[102] See, e.g., J. Becker, "Fortune at China's Fingertips", South China Morning Post Saturday Review, 28 (August 1999), 1.

[103] J. Child, Management in China During the Age of Reform (Cambridge: Cambridge University Press, 1994).

[104] J. Child and M. Warner, "Culture and Management in China", in M. Warner (Ed), Culture and Management in Asia (London: Routledge Curzon, 2003).

controls on decision making and information. This form of business ownership has been referred to as "indigenous or Chinese family business ownership".[105] However, while the organizational structure of the private Chinese firms is certainly hierarchical, it does not come with the same rigid bureaucracy still found among the SOEs due, in part, to the much smaller size of most of the private firms. Internal relationships within the private firms are based on trust, respect, intense loyalty to the "boss" and the desire to preserve "harmony" within the firm and formalities, such as written rules and procedures, are disfavored. Child and Warner cited an interesting observation by Chen regarding owner-subordinate relationships and the use of performance assessment and reward systems in Chinese private firms: "the owners of private Chinese firms tend to attach greater significance to the loyalty of their subordinates even than to their performance. They develop special ties with those upon whom they can rely and give special *ad hoc* rewards to them rather than adopting a standardized reward system."[106]

As a general matter, workers in private firms are not allowed to participate in decisions even as to matters relating to benefits. Child and Warner have observed two classes, or groups, of employees within the typical urban private firm. The first class includes local employees as well as university graduates recruited from outside of the community and members of this group usually occupy better positions in the organizational hierarchy, receive higher wages and benefits and remain with the firm for longer periods. Employees in this group are considered to be "long-term primary members of the corporate collectivity" and generally have a higher level of identification with the corporate culture of the firm. In contrast, the second class of workers includes migrants from rural areas who occupy what Child and Warner described as "a much more marginal position" with respect to the firm.[107]

All of this has been an interesting development with respect to the prospect for adoption of Western style governance processes by Chinese firms in the private sector since the family-owned businesses that are so prevalent are largely "closed" systems where the primary focus is on accumulation of wealth for the exclusive use of the family and decisions are made, and strategies set, "in-house" by the major owner acting as the CEO with the respectful and deferential support of his or her extended family.[108] As Grainger

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[105] R. Grainger and S. Chatterjee, "Chinese and Indian Systems: Divergent in the midst of Global Trends", in University of Sydney (Eds), Asia-Pacific Economic and Business History Conference (Sydney, Australia: University of Sydney, 2007).

[106] J. Child and M. Warner, "Culture and Management in China", in M. Warner (Ed), Culture and Management in Asia (London: Routledge Curzon, 2003) (citing M. Chen, Asian Management Systems (London: Routledge, 1995).

[107] J. Child and M. Warner, "Culture and Management in China", in M. Warner (Ed), Culture and Management in Asia (London: Routledge Curzon, 2003).

[108] G. Redding, "The Capitalist Business System of China and its Rationale", Asia Pacific Journal of Management, 19 (2002), 221-249. Child and Warner have also reported that Chinese firms that are wholly owned by private interests have tended to be smaller and control was vested in a single proprietor or a small group of associates, often including spouses and relatives, who not only owned the largest percentage of ownership interests but also oversaw day-to-day operations using tight controls and made most decisions personally and informally. See J. Child and M. Warner, "Culture and Management in China", in M. Warner (Ed), Culture and Management in Asia (London: Routledge Curzon, 2003). See also International Finance Corporation, China's Emerging Private Enterprises (Washington, DC: International Finance

and Chatterjee observe, "[o]utsiders are very rarely taken into the inner sanctums of such companies, and anything which made such a change mandatory, or even facilitated such a change, would be strongly contested".[109] This explains why Chinese private sector enterprises generally askew raising capital from outside investors that might lead to introduction of highly accountable boards of directors with independent members, management meetings and formal legal responsibilities to shareholders outside of the immediate family members of the controlling group. In fact, this aversion is sometimes so strong that large and successful Chinese family-owned businesses often pass on opportunities to have the shares of their enterprises publicly listed even when such a move would dramatically increase the value of their ownership holdings.

While most of the attention has focused on the new role of SOEs and the emergence of the private firms in the manufacturing sector, it should not be forgotten that collective enterprises, both urban and rural, grew to the point where they accounted for 40% of industrial output in China by 2002. These enterprises, including many "Township and Village Enterprises" owned and operated by local governments (i.e., villages and municipalities), have been criticized for being "low-tech, wasteful, and poorly managed"[110]; however, they appear destined to remain an important part of the Chinese economy given the contraction of SOEs and the growing trend of delegation of authority from the central government to local governments around the country. Child and Warner noted that the corporate cultures of the collectives "vary greatly between conservative unsophisticated cultures to some modern entrepreneurial ones".[111]

In the early 2000s government authorities issued a Code of Corporate Governance for Listed Companies in China (2001) and a Provisional Code of Corporate Governance for Security Companies (2004).[112] While the words and processes included in these Codes were predictably similar to those adopted in major economies elsewhere around the world, not surprising in light of the external political pressures on the Chinese government to adopt reforms as a condition to entry into the "big leagues" of global finance, several commentators have identified and documented a variety of key problems in the Chinese corporate governance system, which were summarized nicely by Li et al. as follows[113]:

Corporation, 2000) (usual forms of ownership for smaller private firms were sole proprietorship (40%) and partnership (30%)).

[109] R. Grainger and S. Chatterjee, "Chinese and Indian Systems: Divergent in the midst of Global Trends", in University of Sydney (Eds), Asia-Pacific Economic and Business History Conference (Sydney, Australia: University of Sydney, 2007).

[110] "Out of Puff: A Survey of China", The Economist, June 15, 2002, 1-16 (starting after page 62).

[111] J. Child and M. Warner, "Culture and Management in China", in M. Warner (Ed), Culture and Management in Asia (London: Routledge Curzon, 2003).

[112] L. Li, T. Naughton and M. Hovey, "A Review of Governance in China", in F. Lopez-Iturriaga (Ed.), Codes of Good Governance Around the World (2009) 415, 418.

[113] Id. at, 429-432. In their discussion of issues in the current governance model in China Li et al. included references to a number of additional scholarly studies that can and should be consulted for additional information including M. Hovey, L. Li and T. Naughton, "The Relationship Between Valuation and Ownership of Listed Firms in China", Corporate Governance: An International Review, 11(2) (2003), 112; D. Clarke, "Corporate Governance in China: An Review", China Economic Review, 14(4) (2003), 494; T. Lin, "Corporate Governance in China: Recent Developments, Key Problems and Solutions", Journal of

- Highly concentrated ownership as evidenced by the dearth of companies with a widely dispersed ownership structure and no one individual who owns a controlling block of shares. This situation has led to significant reduced market liquidity and market efficiency and abuse of discretion by large investors who act for their own interests at the expense of individual investors.
- Insider trading, self-dealing, collusion and market manipulation attributed to the absence of effective monitoring of companies by regulatory authorities and members of the boards of directors and supervisors of those companies even though the government has announced formal policies against these activities.
- Dysfunction of the boards of directors and supervisors of Chinese companies including not only the ineffective monitoring referred to above but also lack of independence, professional training and real power to control directors and senior managers. A specific issue is the ability of large shareholders to control appointment of directors and the corresponding impediment to meaningful representation of minority shareholders.
- Poor and ineffective regulation and enforcement of laws including the following major weaknesses with respect to the Chinese external governance structure: "lack of information transparency and professional managers; weak legal enforcement; the absence of or weak monitoring by banks, professional organizations and the media; and the insignificant roles played by individual shareholders and small institutional shareholders".[114] As a result, the "Chinese stock market is characterized by . . . high government intervention; low transparency and weak investor protection".[115]

After discussing the problems with Chinese corporate governance Li et al. continued with a summary of some of the recommendation that have been offered for improving the situation including making non-tradable shares owned by the state and legal persons tradable; clearly defining and strengthening the functions of boards of directors and supervisors and making their membership more independent; improving the functioning of investor protection laws and enforcement of those laws and related regulations; and providing better protections for the interests of individual investors and improving the enforcement of their rights.[116] Lei et al. concluded that: ". . . China has undergone

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Accounting and Corporate Governance, 1 (2004), 1; F. Allen, J. Qian and M. Qian, "Law, Finance and Economic Growth in China", Journal of Financial Economics, 77 (2005), 57; D. Clarke, "The Independent Director in Chinese Corporate Governance", Delaware Journal of Corporate Law, 31(1) (2006), 125; and M. Hovey and T. Naughton, "A Survey of Enterprise Reforms in China: The Way Forward", Economic Systems, 31(2) (2007), 138.

[114] L. Li, T. Naughton and M. Hovey, "A Review of Governance in China", in F. Lopez-Iturriaga (Ed.), Codes of Good Governance Around the World (2009) 415, 430-431 (citing T. Lin, "Corporate Governance in China: Recent Developments, Key Problems and Solutions", Journal of Accounting and Corporate Governance, 1 (2004), 1).

[115] L. Li, T. Naughton and M. Hovey, "A Review of Governance in China", in F. Lopez-Iturriaga (Ed.), Codes of Good Governance Around the World (2009) 415, 431.

[116] Id. As to the last point, better protections for individual (minority) shareholders suggestions have included enhancing shareholders' voting mechanisms; entitling shareholders to question the company's business operations; lowering the minimum required number of shares for the shareholders to raise proposals; and increasing the legal obligations on controlling shareholders. Id. (citing T. Lin, "Corporate

considerable corporate governance evolution but has yet to establish a unifying system that balances social-economic forces with the economy. China has a unique environment and the evolution of corporate management, supervision and governance is likely to continue to develop into a uniquely Chinese system."[117]

On June 28, 2008, the Chinese Ministry of Finance, China Securities Regulatory Commission, China Insurance Regulatory Commission, China Banking Regulatory Commission and the National Audit Office jointly issued a Standard on Internal Control of Listed Companies, Foreign Invested Companies and Small and Medium Enterprises. This was the first time that Chinese authorities issued a formal standard, particularly one that could effectively cover the majority of the listed companies in China. The Standard took effect from July 1, 2009 and was mandatory for all listed companies on a Chinese stock exchange. The Standard does not force non-listed companies to comply; however, they were encouraged to exercise good corporate governance through adopting sound internal controls in preparation for potential future compliance. Interestingly, the Chinese standard adopts COSO (The Committee of Sponsoring Organizations of the Treadway Commission), which is integrated guidance on internal controls first developed in the US, as the framework.

§1:10 --India

The Committee on Corporate Governance of the Securities and Exchange Board of India has defined corporate governance as the "acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal & corporate funds in the management of a company."[118] It has been suggested that the Indian approach to corporate governance is drawn from the Gandhian principle of trusteeship and the Directive Principles of the Indian Constitution, but this conceptualization of corporate objectives is also prevalent in Anglo-American and most other jurisdictions.

Large scale enterprises in India have traditionally been owned and controlled by a small group of families and these families exerted a substantial amount of control over the Indian economy for at least a century up until India achieved independence in 1947. For the first forty years after independence the government exercised a substantial amount of control in various sectors and this included nationalization of large core industries such as insurance and the banks; however, a number of large family conglomerates continued to

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Governance in China: Recent Developments, Key Problems and Solutions", Journal of Accounting and Corporate Governance, 1 (2004), 1).

[117] L. Li, T. Naughton and M. Hovey, "A Review of Governance in China", in F. Lopez-Iturriaga (Ed.), Codes of Good Governance Around the World (2009) 415, 432. For further discussion of risk and governance in China, see W. Wang, "Moving Toward Accountability in China", in S. Borodina and O. Shvyrkov, Investing in BRIC Countries: Evaluating Risk and Governance in Brazil, Russia, India and China (2010), 81; and G. Liu and P. Sun, "State-dominated Corporate Governance System in Transition: The Case of China", in C. Mallin (Ed.), Handbook on International Corporate Governance (2006), 109.

[118] SEBI Committee on Corporate Governance, Report of the SEBI Committee on Corporate Governance, February 2003, http://www.sebi.gov.in/commreport/corpgov.pdf. [Accessed September 14, 2012].

operate and expand and it is generally agreed that they currently dominate the Indian economy and exercise significant commercial power as well as exerting their influence into Indian political affairs.[119] Leading family-controlled business groups include the house of Tata and the Birla, Ambani and Modi families. Notice should be taken, however, of the emergence of new and powerful entrepreneurs—Murthy of Infosys and Premji of Wipro, for example—as India began its ascendency in the informational technology and knowledge sectors.[120] The government continues to exert substantial control in India due to its ownership and management of large state owned enterprises operating in a number of key infrastructure sectors including airlines, shipping, railways, postal services, major steel plants, machine tools, mineral exploration, power and oil and gas. In fact, most of workers in the infrastructure sectors are Government employees, including 200 million employees working for just one government-owned enterprise: Indian Railways.[121]

Even as family-owned businesses continue to play a significant role in the Indian economy the emergence of national and multinational companies in India has caused a migration toward a two-tier corporate hierarchy that is similar to those in most market-based economies. On the first tier is the board of governors and directors; the second tier is upper management hired by the board of governors. Elected by the shareholders, the role of the first tier board, as in developed economies, is to monitor managers of the corporation and act as an advocate for stockholders. In essence, the board of directors tries to make sure that shareholders' interests are well served. As in developed economies, board members can be divided into three categories:

- Chair: technically the leader of the corporation, the chair of the board is responsible for running the board smoothly and effectively. His or her duties typically include maintaining strong communication with the chief executive officer and high-level executives, formulating the company's business strategy, representing management and the board to the general public and shareholders, and maintaining corporate integrity. A chair is elected from the board of governors.
- Inside directors: these directors are responsible for approving high-level budgets prepared by upper management, implementing and monitoring business strategy, and approving core corporate initiatives and projects. Inside directors are either

[119] R. Grainger and S. Chatterjee, "Chinese and Indian Systems: Divergent in the midst of Global Trends", in University of Sydney (Eds), Asia-Pacific Economic and Business History Conference (Sydney, Australia: University of Sydney, 2007), 1-45. See also T. Kahanna and K. Palepu, The Evolution of Concentrated Ownership in India: Broad Patterns and a History of the Indian Software Industry (Working Paper 10613, National Bureau of Economic Research, Massachusetts, 2004) (". . . while the economy was governed by these significantly different regimes over time, family business groups continue to dominate the Indian corporate landscape").

[120] R. Grainger and S. Chatterjee, "Chinese and Indian Systems: Divergent in the midst of Global Trends", in University of Sydney (Eds), Asia-Pacific Economic and Business History Conference (Sydney, Australia: University of Sydney, 2007), 1-45.

[121] R. Grainger and S. Chatterjee, "Chinese and Indian Systems: Divergent in the midst of Global Trends", in University of Sydney (Eds), Asia-Pacific Economic and Business History Conference (Sydney, Australia: University of Sydney, 2007), 1-45 (citing T. Kahanna and K. Palepu, The Evolution of Concentrated Ownership in India: Broad Patterns and a History of the Indian Software Industry (Working Paper 10613, National Bureau of Economic Research, Massachusetts, 2004)).

shareholders or high-level managers from within the company. Inside directors help provide internal perspectives for other board members. These individuals are also referred to as executive directors if they are part of company's management team.

- Outside directors: while having the same responsibilities as inside directors in determining strategic direction and corporate policy, outside directors are different in that they are not directly part of the management team. The purpose of having outside directors is to provide unbiased and impartial perspectives on issues brought to the board.

As to the other tier of the company, the management team is directly responsible for the day-to-day operations (and profitability) of the company. Its key members are similar to those in market-based companies.

- Chief executive officer (CEO): as the top manager, the CEO is typically responsible for the entire operations of the corporation and reports directly to the chair and board of directors. It is the CEO's responsibility to implement board decisions and initiatives and to maintain the smooth operation of the firm with the assistance of senior management. Often, the CEO will also be designated as the company's president and one of the inside directors on the board (if not the chair).
- Chief operations officer (COO): responsible for the corporation's operations, the COO looks after issues related to marketing, sales, production and personnel. More hands-on than the CEO, the COO looks after day-to-day activities while providing feedback to the CEO. The COO is often a senior vice president.
- Chief finance officer (CFO): reporting directly to the CEO, the CFO is responsible for analyzing and reviewing financial data, reporting financial performance, preparing budgets and monitoring expenditures and costs. The CFO is required to present this information to the board of directors at regular intervals and provide this information to shareholders and regulatory bodies. Also, usually referred to as a senior vice president, the CFO routinely checks the corporation's financial health and integrity.

As with companies based in developed economies, both tiers attempt to maximize shareholder value. In theory, management looks after the day-to-day operations, and the board ensures that shareholders are adequately represented. But, the reality, as in developed markets, is that many boards are made up of management.

Chakrabarti et al. observed that much of India's extensive small- and medium-sized enterprise (SME) sector displayed relationship-based informal control and governance mechanisms, which had the effect of inhibiting financing and keeping the cost of capital at levels higher than necessary even though India ranks high with respect to the ease of getting credit and has a well-functioning banking sector with one of the lowest proportions of non-performing assets.[122] They also found that ownership among SMEs in India remained concentrated and that family business groups continued to be the dominant business model. With regard to governance practices among larger companies with publicly traded shares, Chakrabarti et al. noted that the securities regulation regime

[122] R. Chakrabarti, W. Megginson and P. Yadav, Corporate Governance in India, CFR Working Paper, No. 08-02, http://hdl.handle.net/10419/41393.

in India was "rigorous . . . to ensure fairness, transparency and good practice" and that "the corporate governance landscape in the country has been changing fast over the past decade, particularly with the enactment of Sarbanes-Oxley type measures and legal changes to improve the enforceability of creditor's rights".[123]

Mukherjee and Mallik described the corporate governance structures seen in India as being "somewhat in between" the market- and bank-based models discussed elsewhere in this chapter and elaborated as follows: "The corporate legal structure is Anglo-Saxon although share ownership is far more concentrated and financial institutions play a significant role in financing corporate activity as in bank-based models of Germany and Japan. On the other hand, unlike the bank-based models, in India, the DFIs have remained passive despite substantial holdings; this has result in the promoter acting as dominant shareholder . . ."[124] Mukherjee and Mallik commented that resolution of conflicts between management and owners is not necessarily the dominant issue of corporate governance in India and that the real problems lie with conflicts between dominant and minority shareholders and in figuring out the best way to improve unsophisticated equity markets and reduce what are universally recognized as high levels of corruption. As with other developing and emerging markets, enforcement of laws and regulations is a real issue in India and while the form of the Indian legal system, as measured by codification, has been praised India has often fared poorly in international measures of the rule of law and the degree to which laws protect the rights of investors in actual day-to-day practice.[125]

Mukherjee and Mallik undertook an extensive survey of corporate governance practices among three broad categories of Indian companies: public sector units (i.e., companies in which the government is the dominant shareholder and the public holds a minority stake); multinational companies (i.e., companies in which a foreign parent is the dominant, and usually majority, shareholder); and Indian "business groups" (i.e., companies in which "promoters" and their friends and relatives are the dominant shareholders with large minority stakes and the remaining equity is passively held by government-owned financial institutions and/or the general public).[126] Based on this survey they arrived at a number of conclusions and posited certain recommendations for reforms in the Indian corporate governance system. It is noteworthy that they concluded "all sectors of the corporate economy in India support an Anglo-American model of corporate governance".[127] However, in order for this ambition to become a meaningful reality more work needed to be done on strengthening board independence and ensuring that board members pay sufficient attention to "agency" issues and their conformance roles of overseeing management and making sure that management is responsive to the needs and concerns of shareholders. Mukherjee and Mallik pointed out that there appears to be conflict among those who believe that CEOs and managing directors are the most

[123] Id.
[124] D. Mukherjee and R. Mallik, Corporate Governance in India: Issues and Strategies, in F. Lopez-Iturriaga (Ed.), Codes of Good Governance Around the World (2009), 437.
[125] Id. at 440.
[126] Id. at, 442.
[127] Id. at, 476.

important actors in promoting responsible corporate governance and can be relied upon to do so without excessive external interference and others who "[prefer] to strengthen other disciplinary tools (e.g., financial markets, company law) in order to protect the interests of shareholders, stakeholders, and society as a whole".[128]

§1:11 --Indonesia

Banks presented a description of governance problems that gradually developed within Indonesian business and banking groups during the 1980s and early 1990s that ultimately contributed to a significant economic crisis in what had been one of the most vibrant economies in Asia.[129] Banks noted that Indonesia had been able to achieve annual growth in gross domestic product that consistently reached double digits and that the key players in this push for economic development were a large group of family-owned conglomerates that were able to tap into both internal and credit sources to fuel their investment activities.[130] All of the family conglomerates had a long history of preferring and relying upon debt financing from banks rather than raising capital by selling equity in the public markets that would dilute the interest of the controlling family and lead to greater scrutiny of the operations of the conglomerates and their individual companies. In addition, what Banks referred to as "official" conglomerates, while accounting for just 10% to 15% of the total number of conglomerates but over 60% of total conglomerate sales, has strong alliances and relationships with government officials and their families (including then-President Suharto) that gave them tremendous advantages in terms of access and connections that allowed them to rapidly develop and expand their businesses.

Banks noted that companies with controlling interests in banks and other financial institutions could draw on funds for virtually any purpose without having to meet and overcome meaningful due diligence and monitoring by the lenders. The "special relationships" between the official conglomerates and regulators led to suspension of meaningful regulatory oversight and failures in attempts to subject companies to meaningful financial accounting standards, disclosures and audit requirements. Heavy reliance on debt and operations using only the thinnest levels of equity made companies extremely vulnerable to any changes in their liabilities and this situation ultimately doomed the economy when the managed currencies of Indonesia and several other Asian

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[128] Id. at 477. For further discussion of risk and governance in India, see P. Manerkar, Corporate Governance is Growing Modestly in India, in S. Borodina and O. Shvyrkov, Investing in BRIC Countries: Evaluating Risk and Governance in Brazil, Russia, India and China 49 (2010); and S. Dahiya, Corporate Governance Developments in India, in C. Mallin (Ed.), Handbook on International Corporate Governance 232 (2006).

[129] The discussion of corporate governance in Indonesia provided by Banks in this section is adapted from E. Banks, Corporate Governance: Financial Responsibility, Controls and Ethics (2004), 250-255. See also the discussion above of the specific governance flaws in Indonesia identified by Banks.

[130] Banks reported that more than 200 private family-owned conglomerates were established during the 1980s and 1990s and that they collectively owned and operated over 10,000 individual businesses that accounted for approximately 13% of Indonesia's gross domestic product by 1997. Banks noted that the conglomerates could be classified as either "indigenous", meaning those that were owned and operated by Javanese, Batak, Padang and other native Indonesian ethnic groups, and "non-indigenous", meaning those that were owned and operated by Chinese and Indians. E. Banks, Corporate Governance: Financial Responsibility, Controls and Ethics (2004), 250-255, 251.

countries were "finally devalued under the strain of economic policies and financial forces" to create what became known as the Asian currency crisis of 1997.[131] Heavy losses and numerous business failures ensued and blame was placed on "fundamental governance problems . . . [including] corrupt practices, opaque disclosure, weak regulation, poor internal controls, lack of shareholder protections, and liberal 'house bank' borrowing".[132]

As was the case throughout the region, the 1997 economic crisis in Asia placed enormous pressure on the Indonesian government to move ahead with the process of corporate governance reform, particularly in those areas where there had been strong resistance before the crisis. In general, there was an attempt to shift the balance of power away from the politico-bureaucrats and the owners of the Indonesian conglomerates towards those who were in control of financial capital and their allies in Western governments as well as influential international financial institutions such as the World Bank, the International Monetary Fund ("IMF") and the Asian Development Bank. Responses included governance reform proposals, recapitalization and restructuring of the Indonesian banking sector and broader political and economic changes such as the ouster of Suharto and dismantling of his family business interests—which caused the politico-bureaucrats and conglomerate owners to lost their control over the governmental infrastructure—and the dissolution of several other large family-controlled conglomerates.[133] For example, Indonesia was forced to negotiate an economic rescue package with the IMF in late 1997 that called for the government to effectively surrender control over economic policy to that organization and the IMF used its structural power to force the government to adopt a list of reforms including changes in the corporate governance area as a condition to the delivery of financial assistance from the IMF. At the same time, many conglomerate owners were forced to surrender assets to the Indonesian Bank Reconstruction Agency because their banks could not repay liquidity credits borrowed from the central bank in the early stages of the crisis and most of the larger conglomerates were either demoted to a secondary board or delisted.[134]

Rosser provided a comprehensive summary of many of the main corporate governance reforms that were proposed and implemented in Indonesia in the late 1990s and early 2000s.[135] For example, the National Committee on Corporate Governance, a body that was established by the Coordinating Minister for Economy, Finance and Industry in 1999, prepared a Code for Good Corporate Governance by the National Committee on Corporate Governance that outlined a series of corporate governance principles and practices for Indonesia that were broadly in line with the outsider model of corporate governance and included equitable treatment of shareholders, appointment of independent directors and commissioners, timely and accurate disclosure, appointment of

[131] Id. at 250-253.
[132] Id. at 250-254.
[133] Id.
[134] World Bank, Indonesia: The Imperative for Reform 2.5 (2001); Jakarta Post, July 4, 2000 and July 29, 2000.
[135] The discussion in this paragraph and the following paragraph is adapted from A. Rosser, Coalitions, Convergence and Corporate Governance Reform in Indonesia in K. Jayasuriya, Asian Regional Governance: Crisis and Change 106, 118-122 (2004).

a corporate secretary, and establishment of an independent audit committee. However, Rosser noted that the primary weakness of the Code was that it had "no legal backing" and "was simply a point of reference for Indonesian businesses trying to improve their systems of corporate governance".[136] Rosser also described other changes in the regulatory framework for mergers and acquisitions, minority shareholder protection, financial reporting and bankruptcy.

The problem with the reforms that were introduced was that they were, in the words of Rosser, "not completely one-sided . . . did not eliminate the politico-bureaucrats and the owners of the major conglomerates as a political force" and did not prevent conglomerate owners from being "able to wield influence through bribery and intimidation . . . [and] . . . retain some power to frustrate some reform initiatives".[137] Rosser explained that the Indonesian government failed to take strong legal action against Indonesian auditing firms, a sharp contrast to the response in the US to accounting scandals at Enron and WorldCom, because "connections between Indonesian auditing firms and key parts of the Indonesian bureaucracy were strong enough to avoid prosecution".[138] Rosser summarized the situation by noting that while Indonesia's corporate governance reforms created a regulatory structure that looked a lot like the one commonly found in countries such as the US and the UK where an outsider model prevails, "there have been serious problems with implementation in areas such as auditing and the bankruptcy system . . . [and] . . . [i]n this sense, in so far as convergence has occurred, it has been convergence in form rather than in substance.[139] He also observed that "Indonesia's system of corporate governance has remained distinct from the outsider model of corporation governance . . . [and] . . . Indonesian conglomerates remain heavily dependent on banks for finance".[140]

§1:12 --Korea

The base structure of Korean organizations and its management culture are dominated by Confucian values although Western culture has begun to challenge the Confucian dominant status. The influences of Confucianism in Korean corporate culture can be seen from the existence of favoritism in organizations, paternalism leadership, the significance of loyalty and harmonious values, collectivism, family concepts (i.e., a family-like working environment and blood-based succession), hierarchical structure and gender roles.[141]

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[136] A. Rosser, Coalitions, Convergence and Corporate Governance Reform in Indonesia in K. Jayasuriya, Asian Regional Governance: Crisis and Change (2004), 106, 119.
[137] Id. at 120-121.
[138] Id. at 121.
[139] Id. at 120.
[140] Id.
[141] T. Kee, Influences of Confucianism on Korea Corporate Culture, 5 http://portalfsss.um.edu.my/portal/uploadFolder/pdf/Influences%20of%20Confucianism%20on%20Korean%20Corporate%20Culture.pdf. For further discussion, see the "Management: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

The influence of Confucianism in Korea has contributed to the high incidence of family control in Korean corporate management. High ranking positions are usually dominated by the owner's family members, especially the sons of the owner. In Confucianism, the eldest son is expected to inherit the family assets and succeed his father in taking over the responsibility for the family. Many Korean company owners have applied the same concept to their managerial succession, believing that ownership of a business must remain in the family. One study found that in early 1980s, 26% of all large company presidents were founders, 19% the sons of founders, 21% promoted from within and 35% recruited from outside.[142] Family ties with important persons or leaders in the company guaranteed a better career development in the company and this phenomenon has happened in many Korean companies. This trend continued well into the 2000s as studies continued to find that most Korean *chaebol* managements were still controlled by the founders' family members; although sometimes the control is not always direct.[143] This situation leads to the conclusion that while the performance-based system and Western management styles have been introduced in Korean companies, the concept of blood ties is still deep-rooted in the Korean mind and that the traditional Confucian thought about family and social relations is not easily eradicated from Korean culture, even in the globalization era of today. Unfortunately, the absolute power held by the core family members in the company sometimes creates management inefficiencies and scandals when those in charge misuse power for their own personal gain. In addition, corporate leaders have been reluctant to implement changes and have sometimes been involved in impeding the government's efforts in carrying out corporate reforms.

§1:13 --Mexico

Corporate governance has been a widely discussed issue in Mexico for several decades. In fact, Mexico became one of the first countries in Latin America to formally address corporate governance issues when the Mexican Enterprise Coordinating Council, which included both private sector and market authorities, issued a Code of Best Corporate Practices in June 1999 which, among other things, compelled all publicly traded firms in Mexico to include a list of their corporate governance practices at the end of their annual reports.[144] The Code, which was subsequently amended in 2010, was followed by a series of changes in Mexico's securities market laws—new requirements for information disclosure and greater protection of minority shareholders adopted in 2001—at the same time that global debates on corporate governance were heating up and the US was adopting sweeping changes in its Sarbanes-Oxley Act of 2002, which impacted Mexico due to the geographical proximity of the countries and the large volume of cross-border trade and investment. By 2006 Mexico had determined to implement an entirely new securities market law which went into effect at a time when the World Bank ranked Mexico 125th out of 145 countries with respect to protection of shareholders' rights.[145]

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[142] F. Fukuyama, Trust: The Social Virtues and the Creation of Prosperity (1995).

[143] K. Yon-se, Generation Shift Under Way, Korean Times (December 12, 2006).

[144] T. Okabe, Regulatory Framework of Corporate Governance in Mexico: Challenges of the New Securities Exchange Act of 2006 and Its Effects (2009); and A. Chong and F. López-de-Silanes, Corporate Governance and Firm Value in Mexico (July 2006), 6-7.

[145] T. Okabe, Regulatory Framework of Corporate Governance in Mexico: Challenges of the New Securities Exchange Act of 2006 and Its Effects (2009) (citing World Bank, Doing Business Survey 2006:

Okabe commented that the 2006 initiative was noteworthy because of the influence of the Anglo-Saxon legal system, particularly with respect to the grouping of the duties of directors, the introduction of modern board practices to Mexico and the incorporation of the business judgment rule, and the indication that Mexico was attempting to identify and implement international standards of corporate governance in a way that was suited to local conditions in that country.[146]

In describing the historical and culture foundations for corporate governance in Mexico in a paper prepared for the OECD in 2000, Ramos noted large Mexican firms, similar to the case in other Latin American countries, had traditionally been organized as business groups, or conglomerates, that were owned and controlled by families or closed groups of investors.[147] He pointed out that these business groups were actually vertically and horizontally linked networks and that members of each of the groups could presumably take advantage of economies of scale or scope and reduced transaction costs that allowed them to earn monopolistic profits and diversify risk by being able to engage in productions and related operations in different economic activities. Noteworthy from a corporate governance perspective was the popularity of cross-shareholding and the interlocking directorships and the relatively commonplace involvement of banks and other financial institutions as key elements of these business groups.

Ramos found that among large Mexican firms there was a high concentration of control rights due not only to large holdings of stock by family members but also the common practices of using pyramids and issuing "non-voting" shares.[148] Specifically, large shareholders of Mexican firms also held executive positions and the board of directors of those firms were typically staffed principally by designees of the large shareholder blocks (e.g., directors with family ties to the majority owner-chief executive and executive directors of the firm appointed by the majority owner-chief executive) rather than independent parties that might be able to protect the interest of smaller shareholders. Ramos also noted that "the legal system in Mexico lacks the proper protection for the small investor, either stock or debt holders". In addition, evidence was found of tight relationships between banks and business groups that served as conduits for channeling of external financing to the groups. Ramos observed that while this might be advantageous for the firms it may well be inefficient from an overall "macro" perspective when credit is allocated based on shareholding relationships as opposed to the productivity and related creditworthiness of the borrower.

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http://www.doingbusiness.org/ and noting that only three countries of Latin America were inferior to Mexico at that time: Honduras, Costa Rica and Venezuela).

[146] T. Okabe, Regulatory Framework of Corporate Governance in Mexico: Challenges of the New Securities Exchange Act of 2006 and Its Effects (2009).

[147] G. Castañeda Ramos, Corporate Governance in Mexico (2000), 1. Okabe also noted that Mexican companies have long followed a "traditional family structure" in which the corporate culture was closely linked to family ties and there was little effort to separate ownership and management control of the enterprise. See T. Okabe, Regulatory Framework of Corporate Governance in Mexico: Challenges of the New Securities Exchange Act of 2006 and Its Effects (2009).

[148] G. Castañeda Ramos, Corporate Governance in Mexico (2000).

Ramos argued that the essential features of the largest companies in Mexico at that time "[fit] with the stylized facts of the business groups found in many developing countries"[149] and described three main features as follows[150]: "Firstly, there is a high concentration of control rights, not only because family members own large holdings of stock in these firms, but also because it is a common practice to use pyramids and to issue "no-voting" shares. Secondly, there seems to remain a high degree of integration and diversification, despite the recent developments in the Mexican financial markets and the increased competition observed in product and input markets. Thirdly, banks and other financial institutions affiliated with groups are still important conduits for channeling external financing, as can be seen by analyzing the financial information of firms quoted on the stock exchange."

The World Bank issued its last assessment of corporate governance in Mexico in relation to global standards such as the OECD Principles in 2003 and commented that "[i]n recent years there have been a number of major reforms, including the drafting of an early code of best practice, the redrafting of key provisions of the securities market law (including requirements for mandatory audit committees and independent board members), new regulations of the market for corporate control, and regulations issued in 2003 that resulted in an "issuer manual" specifying disclosure guidelines for listed companies that largely meet OECD guidelines . . . [h]owever, experience around the world suggests that implementation and enforcement of the rules remain key challenges".[151] The World Bank report included a number of recommendations to improve the compliance of listed companies in Mexico with the OECD Principles and highlighted several key themes with respect to implementation of reforms including the creation of a director training institution to increase "director professionalism"; heightened and continuous focus on enforcement of new corporate governance rules, particularly monitoring disclosures and enforcement of the corporate governance provisions in Mexico's securities laws; expanding and disclosing the corporate governance duties and responsibilities of Mexico's pension funds, which have long been among the largest institutional investors in the country, with respect to their portfolio companies; and legislative reforms such as the creation of an accounting oversight board.[152]

In 2006 Chong and López-de-Silanes issued a comprehensive report prepared under the auspices of the Inter-American Development Bank that analyzed the evolution of Mexican capital markets over the two decades leading up to the report and their effect on the availability of external financing in Mexico and concluded, in relevant part, that the Mexican legal environment posed serious problems for access to capital and that a

[149] Id. at 1. Castañeda Ramos explained: ". . . [t]he [business group] is typical of countries where financial markets are poorly developed, and where public offerings constitute a small percentage of the total capital of the firm. Some economists argue that business groups are the result of poor legal systems, where rights of minority shareholders and small creditors are scarcely protected. The existence of large investors creates a vicious circle that hinders capital markets. This is so because rent expropriation capabilities of controlling shareholders reduce the interest of minority participation." Id.

[150] Id.

[151] The World Bank, Report on the Observance of Standards and Codes: Corporate Governance Country Assessment for Mexico (September 2003).

[152] Id. at 15.

substantial amount of attention needed to be paid to "institution building" including "development of financial institutions such as banks and stock exchanges, development of the legal infrastructure supporting business, and creation of regulatory mechanisms compatible with best world practice".[153] The writers focused specifically on various measures of shareholder rights including the ability of shareholders to oppose actions proposed by the board of directors and the rights of minority shareholders and concluded that the results "paint[ed] a very bleak picture of shareholder rights in Mexico".[154] Chong and López-de-Silanes also argued that Mexico had very weak legal institutions and accounting standards and that enforcement of existing laws and regulations was poor in relation to international standards.[155]

Chong and López-de-Silanes went on to suggest a series of reforms for deepening Mexico's financial markets.; however, they cautioned that implementation of reforms would like encounter political obstacles including opposition from the controlling shareholders of large corporations and labor interests who had been enjoying economic rents from the status quo of the corporate governance landscape.[156] Chong and López-de-Silanes noted that the then-recent passage of a new securities law in Mexico had substantially increased the level of disclosure for listed firms and strengthened the corporate governance requirements imposed on those firms and argued that these changes should be supported through reforms in the judicial system to make it easier for shareholders to assert right given to them by law. Another interesting suggestion was that the Mexican government could set an example for private firms by improving corporate governance practices with the large number of state-controlled enterprises that were still in operation in spite of the push for privatization. Chong and López-de-Silanes commented: "Most of the state-run firms in Mexico are large public utilities or in natural resources. External funding is just as important for them, if not more important, than for private firms, because of substantially reduced government expenditures. They need higher levels of investment to meet the demand from the growing private sector. Therefore, it becomes imperative for them to find mechanisms to fund their projects from capital markets. Reform of corporate charters and improved investor protection would also alleviate the government budget constraint."[157] Finally, Chong and López-de-Silanes advocated for the use of market-based mechanism to supplement legal reforms and suggested that markets should develop and enforce public measures of good governance practices that facilitate competition and push firms to improve their corporate governance as a means to gain access to capital at lower cost.[158]

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[153] A. Chong and F. López-de-Silanes, Corporate Governance and Firm Value in Mexico (July 2006), 4-5.
[154] Id. at 9.
[155] Id. at 11-12.
[156] Id. at 33-34.
[157] Id. at 33.
[158] Id. at 34. Of course, good governance is not all that is needed to improve financing opportunities and it has been noted that many smaller companies must go through extended periods of development, and self-financing, before they can reach the point where they have accumulated sufficient capital to seek listed company status. The problem, in other words, is a lack of financing prior to initial public offering. See T. Okabe, Regulatory Framework of Corporate Governance in Mexico: Challenges of the New Securities Exchange Act of 2006 and Its Effects (2009).

In 2012 Deloitte, which had launched a website dedicated to corporate governance issues in Mexico, offered the following summary of what it described as "the main legal and regulatory elements that characterize[d] corporate governance in Mexico based on its reading and assessment of Mexican laws relating to capital markets and the amended version of the Code of Best Corporate Practices[159]:

- The board of directors is the governing body responsible for overseeing and monitoring the strategic operations for a company business and carrying out a variety of key functions including establishing a strategic vision and ensuring the creation of shareholder value; monitoring the managers of the business; approving operational policies, compensation and the use of corporate assets; approving related party transactions; overseeing responsible disclosure of information and establishing internal control mechanisms; promoting formal succession plans and issuing a code of ethics.
- Companies should have audit committees of their boards of directors that are responsible for safeguarding the assets of the company by monitoring the activities of internal and external audit; reviewing fiscal, regulatory and legal compliance; monitoring related party transactions; monitoring risks and ensuring the credibility, transparency and quality of the financial information prepared and issued by the company.
- Company should have corporate practices committee of their boards of directors that are responsible for monitoring business strategy and business growth by reviewing the company's strategic plan and the activities of the managers of the business with respect to executing that plan; following up on social responsibility programs; ensuring the proper functioning of the ethics code; authorizing the company's budget; identifying and preventing conflicts of interest and reviewing related party transactions that occur during the course of operating the business and nominating, evaluating and compensating key officers and directors.
- The Code of Best Corporate Practices recommended that companies create a committee that would be responsible for risk management and promulgating and monitoring operational, prudential and self-regulatory standards relating to risk management that would be applicable to the company and its debtors and creditors. The Code also recommended that the risk management committee require regular reports on identified risks and develop criteria for disclosure of such risks.
- The board of directors, with specific support from the corporate practices committee discussed above, should be responsible for the appointment and compensation of the company's chief executive officer and other key members of the senior management team and should develop and implement policies for determining the reasonable

[159] Deloitte, Corporate Governance Profile, http://www.corpgov.deloitte.com/site/MexEng/governance-profile/. Another good resource on practices of boards of directors in Mexico, particularly in comparison to other Latin American countries, is OECD Global Corporate Governance Forum, Achieving Effective Boards: A Comparative Study of Corporate Governance Frameworks and Board Practices in Argentina, Brazil, Chile, Colombia, Mexico, Panama and Peru (June 2011).

remuneration of the CEO and other senior managers and for determining the scope of the board's functions and objectives and assessing its own performance.

§1:14 --Russia

In April 2002, using the OECD Principles of Corporate Governance as a guide, Russia adopted a Code of Corporate Conduct, also known as the Code of Corporate Governance ("CGC"), that contained provisions relating to shareholders' meetings, the board of directors and executive bodies, major corporate transactions, disclosure of information regarding the corporation, supervision of financial and business operations of the corporation, dividends and, finally, resolution of corporate conflicts. Naoumova and Judge observed that Russia's decision to adopt the CGC was largely a response to the perceived need to "integrate into the global economic environment" and that reliance of various governance codes from other countries as a source for the CGC was due to the fact that "Russia did not have enough experience or time for experimenting with an internally-developed [corporate governance code], so she largely copied western models".[160] The principles included in the CGC were, as is often the case, originally put forward as recommendations and thus optional; however, within a few years adherence to many parts of the CGC was made mandatory for publicly listed companies in Russia and stock exchanges were placed under an obligation to monitor issuers' compliance and comply with the CGC with respect to their own operations.[161]

Naoumova and Judge conducted interviews with representatives of large Russian companies active in a range of industries as well as with representatives from Russia's stock exchange and financial regulators, managers of medium- and small-sized companies and other interested stakeholders (e.g., educators and a representative from the Russian Chamber of Commerce) to assess the overall progress of Russian corporate governance initiatives.[162] Among the conclusions they reached from these interviews was that the CGC "played the role of catalyst in developing best practices in Russian corporate governance world, attracted attention of the legislators to the underdeveloped system of corporate law enforcements, increased the confidence of foreign and domestic investors in the sustainability of Russian economy [and] educated large groups of managers of open and closed joint stock companies"; however, they also noted that there was room for significant improvement "especially in the areas of better protection of minority owner rights and enhanced information disclosure".[163] In addition, they reported that interviewees had criticized Russian regulators and government officials for failing to encourage compliance with the CGC, monitor its effectiveness and enforce violations of officially adopted governance standards. Naoumova and Judge predicted that "relatively new and small entrepreneurial firms with global aspirations, and relatively

[160] I. Naoumova and W. Judge, The Evolution and Current State of the Corporate Governance Code in Russia, in F. Lopez-Iturriaga (Ed.), Codes of Good Governance Around the World (2009), 353, 354.
[161] Id. at 355-356. In 2004 responsibility for regulation of Russian financial markets, including oversight of the corporate governance practices of listed companies, was vested in a new federal agency known as the Federal Financial Markets Service. Id.
[162] I. Naoumova and W. Judge, The Evolution and Current State of the Corporate Governance Code in Russia, in F. Lopez-Iturriaga (Ed.), Codes of Good Governance Around the World (2009), 353, 356.
[163] Id. at 364.

old and large communally-focused firms with local ties are likely to be the pioneers of the future in terms of good corporate governance in Russia".[164]

§1:15 --South Africa

In general, business organizations in Africa today can be divided into three main types. The first organization, which remains the most dominant in almost all of the African countries, is the public enterprise that is majority controlled by the state. These organizations are typically established to perform specific functions and pursue policy goals and objectives that are generally thought not to be appropriate for internal governmental departments or agencies. The second group of organizations involves some degree of foreign investment, including wholly-owned subsidiaries established by foreign companies, joint venture companies and other multinational companies. One finds these types of organizations involved in a wide range of industry sectors, particularly manufacturing, and they tend to be quite large. Given the role of foreign investment in establishing and operating these organizations, it is not surprising that they are the focal point for integration of Western and other modern management principles with traditional African beliefs and customs and the transfer of knowledge and technology from external sources. The last organizational form is the private indigenous businesses that are owned and operated by local entrepreneurs. With limited exception, these firms are comparatively small and reliance on any formal management principles is very limited.

The history of South Africa includes several centuries of colonization by Dutch and English settlers, followed by more than four decades of apartheid, all of which were characterized by continual conflict between settlers of European descent and indigenous Africans. By 1994, when the first non-racial democratic elections were held, South African society was consequently split along racial and economic lines. Unsurprisingly, the corporate governance landscape in South Africa reflects the centuries of colonialism and apartheid. Corporate law and corporate practice have been adopted mainly from the UK, and, even after the end of apartheid, the minority white population has largely retained control over South African companies.

South Africa's corporate governance structures generally fit Reed's characteristics of the Anglo-American model.[165] A single-tiered board structure is standard, without any representation for stakeholders such as employees. South Africa has an active stock exchange; however, ownership of companies on the securities exchange is relatively

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[164] Id. at 365. For further discussion, see W. Judge and I. Naoumova, Corporate Governance in Russia: What Model Will It Follow", 12 Corporate Governance: An International Review 302 (2004); O. Shvyrkov, Corporate Governance is Advancing in Russia, in S. Borodina and O. Shvyrkov, Investing in BRIC Countries: Evaluating Risk and Governance in Brazil, Russia, India and China 23 (2010); and P. Bartha and J. Gillies, Corporate Governance in Russia: Is it Really Needed?, in C. Mallin (Ed.), Handbook on International Corporate Governance (2006), 71.

[165] D. Reed, Corporate Governance Reforms in Developing Countries, 37 Journal of Business Ethics 223 (2002). For an additional general overview of corporate governance in South Africa, see P. Armstrong, Corporate Governance in South Africa, in C. Mallin (Ed.), Handbook on International Corporate Governance (2006), 210.

concentrated and there is only limited merger and acquisition activity. Banks do not control South African companies and maintain arms-length relationships with clients. The government has long expressed a commitment to privatization of state assets and promoting competition; however, it has often intervened in the labor market to rectify racial imbalances in the workplace and increase ownership of South African companies by the black population.

The development of corporate governance in South Africa has been significantly influenced by three reports produced by a commission originally established under the leadership of retired judge Mervyn King in 1994 to establish a code on corporate governance in South Africa: the King Report on Corporate Governance (King I) issued in November 1994; the King Report on Corporate Governance for South Africa 2002 (King II) issued in March 2002 and the King Report for Governance in South Africa (King III) and accompanying King Code of Governance Principles issued in September 2009. The second report, which is the primary focus of the paragraphs below, was commissioned partly as a result of changes in corporate governance worldwide, after taking into account political and economic uncertainty in the country that was prevalent at the time that King I had been issued.[166]

King II began with a quote by Sir Adrian Cadbury, responsible for the Cadbury reports on corporate governance in the UK, which referred to the goal of "align[ing] as nearly as possible the interests of individuals, corporations and society". In line with corporate governance reports worldwide, King II referred to the "four primary pillars of fairness, accountability, responsibility and transparency."[167] A review of the topics covered by King II and corporate governance reports issued in the UK (the Combined Code, the Turnbull Guidance, the Smith Guidance and the Higgs report) revealed that similar issues and topics were addressed and covered including boards of directors, directors' remuneration, internal control and risk management, and accounting and audit. The only area of significant difference was the section on Integrated Sustainability Reporting in King II for which there was no counterpart in the UK reports.

Given the Anglo-American nature of the South African corporate environment, the ties that many businesses and business leaders have with other Anglophone countries and the fact that control over South African companies remains largely in the hands of white South Africans, one may initially expect the King reports to uphold a traditional shareholder model of corporate governance. King II, however, described its approach to corporate governance as inclusive. A review of the introduction to the report reveals that this is expressed through a number of related characteristics:

- All stakeholders should be considered: as noted in King II, "The inclusive approach recognises that stakeholders such as the community in which the company operates, its customers, its employees and its suppliers need to be considered when developing the strategy of a company."[168]

[166] Institute of Directors, King Report on Corporate Governance for South Africa – 2002 (2002).
[167] King II, Introduction, para. 23.
[168] King II, para. 5.3.

- Shareholders are to be considered as one of a number of stakeholders, albeit with their own particular interests: King II states, "The modern approach is for a board to identify the company's stakeholders, including its shareowners …",[169] and, "Because the shareowners have little or no protection, the quality of governance is of absolute importance to them."[170]
- Directors' responsibilities are to the company, not shareholders: according to King II, "the so-called shareowner dominant theory ... has been rejected by Courts in various jurisdictions ... Consequently, directors, in exercising their fiduciary duties, must act in the interest of the company as a separate person."[171]

In South Africa, the inclusive approach is really a form of stakeholder theory (a view supported by Rossouw).[172] The section on Integrated Sustainability Reporting provided a detailed example of how stakeholder concerns are addressed in the body of the report. It included recommendations for reporting on non-financial aspects of the business, including transformation progress (employment equity and black economic empowerment), human capital development policies, safety and health concerns (with particular reference to HIV/AIDS), as well as recommendations for the establishment of processes governing organizational ethics (through the use of ethics codes), environmental impact and social investment policies. All of these were clearly areas of significant concern to stakeholder groups such as employees, community groups and society at large.

The inclusive approach of King II was justified on several grounds:

- By appeal to improved economic efficiency for the company: "A company is likely to experience indirect economic benefits such as improved productivity and corporate reputation by taking [social responsibility] factors into consideration."[173]
- By appeal to current socio-economic conditions in South Africa: "... companies in South Africa must recognize that they co-exist in an environment where many of the country's citizens disturbingly remain on the fringes of society's economic benefits."[174]
- By appeal to traditional African values: the report mentions a number of values considered to be characteristic of the African worldview and culture, including co-existence, collectiveness and consensus.[175] The exclusion of stakeholders in decision-making would seem to run contrary to these principles. In a similar fashion the section on Integrated Sustainability Reporting supports its recommendations by appealing to African values,[176] the financial consequences of non-financial issues,[177]

[169] King II, para. 5.1.
[170] King II, para. 17.5.
[171] King II, para. 17.3.
[172] G.J. Rossouw, "Corporate Governance Reforms in Developing Countries", 37 Journal of Business Ethics (2002), 223.
[173] King II, Introduction, para. 18.7.
[174] King II, Introduction, para. 36.
[175] King II, Introduction, para. 38.
[176] King II, Chapter 1, para. 8.
[177] King II, Chapter 2, para. 7.

the principle of accountability to shareholders as paramount,[178] and the "moral obligation for directors to take care of the interests of investors and other stakeholders."[179]

King II was praised as being "world class" for its emphasis on social, environmental and ethical concerns,[180] particular its Integrated Sustainability Reporting section. However, as is typically the case in corporate governance reports, all such reporting was voluntary and South African companies have tended to lag when it comes to social and environmental reporting. KPMG's Integrated Sustainability Reporting in South Africa 2003 survey revealed that while more and more companies were providing some disclosure on sustainability-related issues, much of this disclosure was only superficial and general in nature.[181] It also noted that 20% of the companies surveyed from South Africa's JSE Securities Exchange produced a stand-alone non-financial report compared to 45% of the Global Fortune 250 companies.[182] The more recent KPMG International Survey of Corporate Responsibility Reporting 2005[183] painted a more promising picture, noting that since 2002 reporting in this area by South African companies had improved, and "South Africa is not lagging far behind the rest of the world."[184]

As noted above, the third King report (King III) was issued in September 2009 and was notable for its emphasis on integrating governance and sustainability into the strategy, operations and reporting of organizations and its push for continuing to raise the standards of board effectiveness in South Africa. In an interview with King himself the following were identified as being among the highlights of King III[185]:

- The philosophy of King III revolved around leadership, sustainability and corporate citizenship and corporate leaders are admonished to act responsibly in directing company strategies and operations with a view toward achieving sustainable economic, social and environmental performance.
- King III was not designed on a "comply-or-else" basis, nor on a "comply-or-explain" basis, but rather on an "apply-or-explain" basis" that was intended to provide boards with the freedom to apply the recommendation differently (or apply another practice) if they considered that to be in the best interest of the organization as long as they explained their reasons for departing from the recommendation.
- King III was drafted to provide principles of good corporate governance that could be applied and used by all types of entities including public, private and non-profit organizations.

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[178] King II, Chapter 2, para. 2.
[179] King II, Chapter 3, para. 15.
[180] G.J. Rossouw, "Corporate Governance Reforms in Developing Countries", 37 Journal of Business Ethics (2002), 223, 291; M. Barrier, Principles not Rules, 60(4) Internal Auditor 68 (2003).
[181] KPMG, Integrated Sustainability Reporting in South Africa 2003 2 (2003).
[182] KPMG, KPMG International Survey of Corporate Responsibility Reporting 2005 2 (2003).
[183] KPMG, KPMG International Survey of Corporate Responsibility Reporting 2005 2 (2003).
[184] KPMG, KPMG International Survey of Corporate Responsibility Reporting 2005 (Amsterdam: KPMG International, 2003), 2.
[185] International Federation of Accountants, Governance Is King: An Interview with Mervyn King, http://www.ifac.org/sites/default/files/downloads/1.3-king-governance-is-king-final.pdf

- King III followed a "stakeholder inclusive" model in which the board of directors was required to consider the legitimate interests and expectations of stakeholders on the basis that this is in the best interests of the company.
- King III recognized alternative dispute resolution (i.e., negotiation, mediation and expedited arbitration) as important management tools and dispute resolution mechanisms.
- King III adopted a risk-based internal audit approach to determine whether controls were effective in managing the risks which arise from the strategic direction of the company.
- King III introduced the concept of information technology governance into the scope of governance responsibilities for directors.
- King III recommended integration of economic, social and environmental reporting that would record how the company's business has impacted positively and negatively on the community, and how it intends to enhance those positive aspects and eradicate or ameliorate the negative aspects in the year ahead.

§1:16 --Turkey

One of the most important guidelines for corporate governance practices in Turkey has been the Corporate Governance Principles issued by the Capital Markets Board of Turkey ("CMB") with inputs from experts and representatives from the CMB, the Istanbul Securities Exchange and the Turkish Corporate Governance Forum as well as academicians, private sector representatives and various professional organizations and non-governmental organizations.[186] These Corporate Governance Principles ("Principles") mainly address publicly-held joint stock companies; however, it was hoped and expected that the Principles would also be implemented by other joint stock companies and institutions, active in both the private and public sectors. Unfortunately, as is typically the case with "best practices", implementation of the Principles was optional although annual reports must include an explanation concerning implementation status of the Principles, using a "comply or explain" approach; conflicts arising from inadequate implementation of the Principles; and an explanation on whether there is a plan for change in the company's governance practices in the future. The Principles were laid out in four main sections covering shareholders, disclosure and transparency, stakeholders and the board of directors and elements of each section were as follows[187]:

- "The first section discusses the Principles on shareholders' rights and their equal treatment. Issues such as shareholders' right to obtain and evaluate information, right to participate in general shareholders' meeting and right to vote, right to obtain dividend and minority rights are included in this section. Matters such as keeping shareholders records and free transfer and sales of shares are also covered.
- The second section discusses the Principles regarding disclosure and transparency issues. Within this scope, Principles for establishment of information policies in

[186] The Capital Markets Board of Turkey, Corporate Governance Principles (2005).
[187] Id. at 8.

companies with respect to shareholders and adherence of companies to these policies are discussed.

- The third section is concerned mainly with stakeholders. A stakeholder is defined as an individual, institution or an interest group that is concerned with the objectives and operations of a company in any way. Stakeholders of a company include the company's shareholders and its workers, creditors, customers, suppliers, unions various non-governmental organizations, the government and potential investors who may consider investing in the company. This section includes the Principles regulating the relationship between the company and its stakeholders.
- The fourth section includes Principles concerning functions, duties, obligations, operations and structure of the board of directors; their remuneration, as well as committees to be established supporting board operations and its executives."[188]

§1:17 --Vietnam

Prior to the adoption of economic reform measures in 1986, state-owned enterprises ("SOEs") and other collective cooperatives were the only forms of business entities permitted to operate legally in Vietnam. Private ownership was not allowed or condoned as it would be contrary to the overriding principles of socialism upon which the country's political and economic philosophies were based. Zhu et al. summarized the situation as follows: "SOEs operated mainly in industries considered critical to the national economy, and their activities followed a plan preset by the central government. The command economy in Vietnam also was associated with a distinctive system of labor regulation that encompassed particular forms of labor allocation, employment status, wage and nonwage benefits, and management-labor relations. Key characteristics included job allocation based on a quota system set up by the Labor Bureau, permanent employment status, a nationally standardized wage system and welfare benefits, and party and management control at the workplace and over trade unions."[189]

The economic reforms triggered a slow and steady transition from the failing socialist system to a market based economy that included a dramatic change in the ownership system for enterprises to a mix of public and private ownership including SOEs, multi-national companies (i.e., wholly-owned foreign-invested companies), joint ventures between foreign investors and local SOEs, and local privately-owned enterprises. Still another form of enterprise was added in 1992 as many of the former SOEs were

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[188] Interestingly, under the board section, the board of directors should be composed of two different types of members—executive and non-executive members. An executive member bears has administrative duty as a managing member. A non-executive member is defined as an individual not having any administrative duties within the company. The Capital Markets Board of Turkey, Corporate Governance Principles (2005), 8-9. For further discussion of corporate governance in Turkey, see M. Ararat and M. Ugur, Turkey: Corporate Governance at the Crossroads, in C. Mallin (Ed.), Handbook on International Corporate Governance (2006), 193.

[189] Y. Zhu, N. Collins, M. Webber and J. Benson, "New Forms of Ownership and Human Resource Practices in Vietnam", Human Resource Management, 47(1) (Spring 2008), 157-175, 160 (citing also Y. Zhu and S. Fahey, "The challenges and opportunities for the trade union movement in the transition era: Two socialist market economies—China and Vietnam", Asian Pacific Business Review, 6 (2000), 282-299).

"restructured" as part of a broad rationalization of the SOE sector through the sale of a portion of their shares to the public to create a new type of mixed ownership entity referred to as "equitized (partial privatization) companies".[190] The changes in the ownership system led to a transformation in the landscape of management styles and practices in Vietnam as the local private companies introduced what Thang and Quang referred to as a "'family-style' and 'patronage' approach to management" and foreign investors imported their own brands of "modern" managerial expertise into an environment that had previously relied almost exclusively on management philosophies based on socialist and traditional principles.[191]

The goal of the equitization process among the SOE sector was to improve the overall efficiency and effectiveness of those enterprises and the State sector in general; however, while a number of government-owned firms have been equitized the SOEs in Vietnam, as in China, remain an important part of the national economy.[192] In 2001, 15 years after the beginning of the economic reforms, SOEs contributed 39% of the GDP while employing just 4.5% of the national labor force. Most of the SOEs, as well as the joint venture companies, are large when assessed in terms of numbers of employees and generally fall within the "medium" or "large" categories.[193]

The adoption of the Enterprise Law in 1999 eased the regulatory burdens associated with launching new businesses and provided a catalyst to the formation of new firms in the private sector. Most of the local privately-owned enterprises would be categorized as "small", meaning that they employed less than 50 employees. By March 2009, the number of privately-owned small- and medium-sized enterprises ("SMEs") in Vietnam had grown to about 349,000 and the Vietnamese Government had set ambitious goals to bring the number of SMEs up to half a million by 2010. While the initial contribution of SMEs to the national economy was modest, reports indicate that by 2008 Vietnam's private SME sector was contributing approximately 40% of GDP, including a significant percentage of industrial output, and that firms in the sector were creating a majority of the new jobs in the economy.[194]

Zhu et al. studied Vietnamese businesses forms based on ownership patterns.[195] The study evaluated SOEs, privately-owned enterprises ("POEs"), joint ventures ("JVs") and multinational corporations ("MNCs"). They found that ownership is a predictor of which governance models they used:

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[190] L. Thang and T. Quang, "Human Resource Management Practices in a Transitional Economy: A Comparative Study of Enterprise Ownership Forms in Vietnam", Asia Pacific Business Review, 11(1) (March 2005), 25-47, 26.
[191] Id.
[192] Id. at 28.
[193] T. Quang and N. Vuong, "Management Styles and Organisational Effectiveness in Vietnam, Research and Practice in Human Resource Management", 10(2) (2002), 36-55.
[194] V. Hoang and T. Dung, "The Cultural Dimensions of the Vietnamese Private Entrepreneurship", The IUP Journal of Entrepreneurship and Development, VI (3 & 4) (2009), 54-78.
[195] Y. Zhu, N. Collins, M. Webber and J. Benson, "New Forms of Ownership and Human Resource Practices in Vietnam", Human Resource Management, 47(1) (Spring 2008), 157, 168.

- Traditional governance model: this model's elements are lifetime employment (only used by, and by all, SOEs); government wage scale for wage determination (used by all SOEs and some POEs); unions as government agents (used by all SOEs, some POEs and some JVs); and harmonious labor—management relations (used by all SOEs, most POEs, some JVs and some MNCs). Interestingly, other dimensions of the traditional model had disappeared: governmental planning of job allocation, externally controlled recruitment and staffing, and use of external institutions for training and development.
- Personnel governance model: this model's elements are team performance wage relations (used by all POEs, most JVs, some SOEs and some MNCs); internally controlled access to training (used by most POEs and a few of the other enterprises); unions for conflict resolution (used by some JVs and a few POEs); and institutionalized labor-management relations (used by some MNCs and a few JVs).
- Human resources governance model: this model's elements are fixed-term contracts (used by most POEs and most MNCs); individual performance wage relations (used by most SOEs, most JVs and most MNCs); internally planned training (used by most SOEs, most JVs and most MNCs); de-emphasis on unions (used by MNCs, some POEs and some JVs); and cooperative culture of labor-management relations (used by some JVs and some MNCs).

The results of the survey illustrated that no particular governance model has become the dominant form in Vietnam, although it did appear that there was slightly more orientation toward the personnel governance model and, to a lesser extent, the human resources governance model.[196] While it was true that those enterprise forms relying more heavily on foreign capital — MNCs and JVs — tended to adopt more of the practices associated with human resources governance, the data also showed that these types of enterprises (as well as newly-formed POEs) incorporated elements of the socialist traditional model into their governance practices, a finding that the researchers attributed to the influence that local practices, rules and norms have on even the strongest foreign partners.[197]

Some of the explanations for preferring the personnel governance model, and slowness to adopt elements of the human resources governance model, even as widespread reforms of the economic system continued were: slow progress in the transition from a centralized planning system to a market-based system, even though it has been over twenty years since the formal abandonment of central planning; poor and uneven enforcement of laws and regulations, which contributed to a continuously unstable and unpredictable business

[196] Id. at 170.

[197] Id. at 171. Elements of the socialist traditional model commonly adopted by JVs and MNCs include wage determination by management decision and labor-management relationships emphasizing harmony and low power distance. It was also common to find JVs and MNCs using several of the elements of the personnel management model such as unlimited and fixed-term employment contracts and internal centralization of job allocation and recruitment and staffing. Research in another emerging market with a socialist tradition — China — has found that MNCs and JVs had a positive impact on human resources practices including introduction of updated management systems and practices and influencing local enterprises to make changes from their traditional management practices with regard to human resources. See, e.g., D. Ding, K. Goodall and M. Warner, "The End of the 'Iron Rice-Bowl': Whither Chinese Human Resource Management?", International Journal of Human Resource Management, 11(2000), 217.

environment; remaining internal controls and centralization and lack of networks of external personal relationships; and fit between the personnel governance model and traditional Vietnamese national and organization cultural preferences for organizational hierarchy and collectivism.[198]

One of the most extensive recent efforts to assess and improve corporate governance among publicly listed companies in Vietnam has been a project supported and carried out by the International Finance Corporation, the Global Corporate Governance Forum and the State Securities Commission of Vietnam which included three "scorecard reviews of corporate governance practices in Vietnam" completed annually from 2010 to 2012.[199] In the 2012 review the sponsors commented: "Vietnamese legislators and regulators have been working on the reform of Vietnam's business environment for several years. Initiatives have included the review and amendment of related legislation and the development and issuance of mandatory and voluntary guidance on company governance. Within the past two years, the Ministry of Finance (MOF) issued a number of Circulars providing guidance on corporate governance and information disclosure. Conscious of the need to attract investors, these regulatory activities have been designed to build a better business environment to allow local and foreign investors to have confidence and trust in the market."[200]

The 2012 scoreboard review was based on information collection from an examination of 100 companies listed on the Hanoi Stock Exchange and the Ho Chi Minh Stock Exchange at January 1, 2011 which collected represented more than 80% of the total market capitalization in Vietnam. The scoreboard review focused on several different sub-categories including overall corporate governance performance, rights of shareholders, equitable treatment of shareholders, role of stakeholders, disclosure and transparency and responsibilities of the board. The results indicated negative trends in each of the sub-categories in comparison to 2010 and confirmed that Vietnam lagged significantly behind other Asian countries such as Hong Kong, the Philippines and Thailand. Several possible explanations for the setbacks were offered include an economic downturn and corresponding push to reduce expenses and it was suggested that perhaps annual reports and other disclosures had become less expansive "due to challenging conditions and/or to mask poor results".[201] Economic problems may also have explained the decreased attention to stakeholder interest since "[i]n difficult economic times companies seemed to not consider, not do as much previously or not report on activities regarding employees, the environment, the community and in relation

[198] Y. Zhu, N. Collins, M. Webber and J. Benson," New Forms of Ownership and Human Resource Practices in Vietnam", Human Resource Management, 47(1) (Spring 2008), 157, 171.

[199] International Finance Corporation and Global Corporate Governance Forum (in collaboration with The State Securities Commission of Vietnam), Vietnam Corporate Governance Scorecard 2012 (2012). See also International Finance Corporation, Corporate Governance Manual (2nd Ed) (2010), which was created as part of the Corporate Governance Program in Vietnam implemented by the IFC in partnership with Finland, Ireland, the Netherlands, New Zealand, and Switzerland and launched in September 2009 with the aim of assisting companies and banks in Vietnam to improve their corporate governance standards

[200] International Finance Corporation and Global Corporate Governance Forum (in collaboration with The State Securities Commission of Vietnam), Vietnam Corporate Governance Scorecard 2012 (2012), 11.

[201] Id. at 13.

to working conditions, health and safety."[202] As is the case in many developing countries, both around Asia and elsewhere, monitoring and enforcement of corporate governance regulations noticeably declined.

The sponsors of the report offered a long list of recommendation for improving corporate governance in Vietnam including the following[203]:

- Regulators should provide relevant guidance for companies on the implementation of corporate governance practices, especially best practice guidance on independent directors, the role of audit committees, board nomination practices, the role of a company secretary, internal audit and internal controls, related party transactions policies and what information may be considered as 'material' and should be released to shareholders and the investor public.
- Regulators should build the skills, capacity and resources to equip them to actively monitor, enforce and guide quality corporate governance in markets in a timely manner.
- The quality of financial and non-financial reporting from Vietnamese companies needs to improve and the early adoption of all current International Financial Reporting Standards
- (IFRSs and IASs) is recommended to assist the quality and comparable financial information in Vietnamese companies. In that same vein, regulators should require auditors' attestations of their independence and promote the role of auditors as independent reviewers of financial statements.
- Regulators should require intensive corporate governance training of all directors at the time of a company's listing and regular board evaluations should be required and reported on.
- As has been mentioned for other developing countries such as Mexico, the state, as a major shareholder in the Vietnamese securities market, needs to become a 'champion' of better corporate governance.
- Initiatives to build institutions necessary for good corporate governance in Vietnam should be taken including establishment of an institution to develop and support quality corporate governance in Vietnam, the development and provision of quality corporate governance training programs for directors and senior management and improvement of accounting and audit professional standards and practices in Vietnam.
- As for the companies themselves, they should focus on implementing best corporate governance practices in three important areas: the responsibilities of the board; disclosure and transparency; and the equitable treatment of shareholders and their inclusion in company affairs. Companies must also improve the quality of information they disclose to shareholders and the wider investor community.

[202] Id.

[203] The entire list of recommendations appears at International Finance Corporation and Global Corporate Governance Forum (in collaboration with The State Securities Commission of Vietnam), Vietnam Corporate Governance Scorecard 2012 (2012), 23-25.

- Each company should develop and apply a company Code of Ethics/Conduct and Corporate Governance Code, endorsed by all directors and made available on the company website.
- Companies should ensure that all activities of an audit committee in global best practices are undertaken and the establishment of an audit committee is recommended. Companies should also form corporate governance and nominating committees to ensure better corporate governance, quality board appointments, a transparent appointment process and ensure board of director succession planning.
- Boards should increase engagement in the oversight and reporting of company risks and particularly in ensuring the establishment of a framework, policies and processes for an appropriate control environment, including the establishment of an internal audit unit.
- Companies should be responsive to expectations of company approaches to environmental, social and governance and the reporting thereon and of corporate responsibility.