

Editorial**Towards a Holistic Model of Corporate Governance**

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Abstract

Attention to corporate governance is largely motivated by public interest in the economic health of corporations and society in general. However, though the topic 'Corporate Governance' has gained worldwide prominence due to the recent spate of spectacular collapses, it is as yet ill-defined, and consequently blurred at the edges. The concept of corporate governance has got various dimensions as it potentially covers a large number of distinct economic, legal and social phenomena. This editorial therefore considers if researchers should look at corporate governance issues holistically, instead of the current 'silo' based approaches that seem to dominate the literature, and presents a 'contextual' corporate governance model that considers various control mechanisms that can be applied depending on the shareholder concentration levels as a framework for future research in the area.

Keywords

**Corporate Governance Framework
Contextual Governance Model
Shareholder Concentration
Governance Control Mechanisms**

Introduction

Corporate governance as a serious and urgent research issue has become established over the last ten years since about 1995, and especially after the public spectacle of failures of once-esteemed public firms during the first four years of the new century. As evidenced by the increasing number of codes of best practice developed by leading international bodies, stock exchanges, securities commissions, corporate governance reform has now become a key global issue (Subramaniam and Ratnatunga, 2003). Not only do factors such as the increasing globalisation of financial markets, the growth in multinational corporations and regional economic developments motivate the need for good corporate governance, protecting stakeholders has also become a priority in the face of recent spate of large corporate collapses in Western economies such as the cases of HIH Insurance in Australia, Parmalat in Europe, Enron and WorldCom in the United States. Whilst these clearly signal the urgency for significant improvements in corporate accountability and reporting, the issue of corporate governance is even more important in transitional economies (see Roland, G., 2000). Attention to corporate governance is largely motivated by public interest in the economic health of corporations and society in general. However, the concept of corporate governance has got various dimensions as it potentially covers a large number of distinct economic, legal and social phenomena. This editorial therefore considers if researchers should look at corporate governance issues holistically, instead of the current 'silo' based approaches that seem to dominate the literature.

**Corporate Governance
Conceptual Frameworks*****Evolution of Corporate Governance
Systems***

The evolution of corporate governance systems over centuries has been reactive in the sense that it has evolved in response to corporate failures or systemic crises. One of

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the earliest failures of governance was the South Sea Bubble of the 1700s, which revolutionised business laws and practices in England. Likewise, the securities law in the U.S. was commissioned due to the stock market crash of 1929. Further, crises such as the secondary banking crisis of 1970s in the United Kingdom and the U.S. savings and loans debacle of the 1980s are examples of the reactive nature of corporate governance. Finally, the history of corporate governance has also been punctuated by series of well-known company failures i.e., collapse of the Bank of Credit and Commerce International and Barings Bank, Enron, WorldCom, HIH, OneTel, Parmalat (and the list goes on). Each of these crises or corporate failures, which were consequences of incompetence, fraud and abuse as much as from lack of oversight rules, was met by new elements of an improved system of corporate governance.

Although corporate governance issues have been seen historically to be the province of lawyers and finance professionals, economists have begun to make important contributions in this area. Lawyers writing in this area tend to focus on the fiduciary duties of the directors and the need to have independent directors, who will represent the interests of minority shareholders (see for instance, Srivastava and Mock, 2000, who focuses on this aspect) without linking it to the role of the capital markets, whereas economists see good corporate governance as a means of improving the efficiency of the capital markets, so that sustainable economic growth can occur in this era of increasingly global capital markets (*The Economist*, 7th April 2001, pp. 1-18).

Discipline (Silo) Based Approaches to Corporate Governance

As a result of the area of corporate governance covering a large number of distinct phenomena, different people have come up with different definitions that reflect their special interest in the field (see www.encycogov.com). Thus whilst there is general agreement that corporate governance plays a very significant role in an individual company beyond the interests

of shareholders, how to implement good governance procedures remains elusive, and is very much influenced by the disciplinary (silo) viewpoint of the implementer.

The *economic view* of corporate governance is that it has an impact on the vitality and integrity of the market system. According to Guillen (2000), corporate governance plays a key role in any economy by providing a framework for the division of labour and financial results in the firm. He reiterates the fact that a well-functioning corporate governance system can contribute to economic efficiency and perhaps even social equity whereas, on the other hand, a poorly conceived system can wreak havoc in the economy by misallocating resources or failing to check opportunistic behaviour by agents, which precipitates serious political risk for the ruling elites. Such observations have initiated discussions on corporate governance in a number of countries around the world, thus leading to the introduction of the globally recognised OECD principles of corporate governance.

Some important definitions in this approach are highlighted in the following quotes:

"Corporate governance is a field in economics that investigates how to secure/motivate efficient management of corporations by the use of incentive mechanisms, such as contracts, organisational designs and legislation. This is often limited to the question of improving financial performance, for example, how the corporate owners can secure/motivate that the corporate managers will deliver a competitive rate of return", (Mathiesen, 2002, p. 35).

"Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment", (Shleifer and Vishny 1997, p. 737).

At a microeconomic level, therefore, the economic view of corporate governance is that managers of the company are the custodians of the assets and their prime responsibility is to use those assets

efficiently in the pursuit of the firm's objectives. That is, economists believe that creating value for the shareholders is the essence of good corporate governance. In an ideal world of corporate governance, the managers would also enjoy the freedom to manage in meeting the shareholders expectations. There has been research which suggests that investors value corporate governance in both developed and emerging economies. However the amount of premium the investors want to pay for the role of the board and accounting standards vary in respect to developed and emerging countries (Fitzroy and Hulbert, 2005) (see also Appendix 1).

Despite the workings of the market mechanism and the premium investors are willing to pay for good corporate governance, recent high profile cases of governance failure (Enron and WorldCom) led to corporate misconduct whereby the public, employees and pensioners have lost billions in investment and savings at the expense of gains to insiders, much of it by fraud. These events have demonstrated that the current corporate governance mechanisms have not kept up with the free-market philosophies of the economists. Therefore, the development of robust governance tools and incentive structures in light of rapid changes in the markets and financial innovation are needed for limiting present inconsistencies and confusion assumes prime importance, despite the attractions of agents' incentive compensations

The **legal viewpoint** of corporate governance is that it refers to the procedures and rules, explicit and implicit, that provide the incentive framework for companies to attract financial and human capital, perform efficiently and avoid corruption. These rules have evolved over time, and are *still evolving* in response to corporate failures and systemic crisis (World Bank, 1999). Those subscribing to such an approach are of the view that corporate governance is a modern expression on an issue which companies have been facing for decades i.e., that of "accountability". Corporate governance is

seen as how those entrusted with day-to-day management of a company's affairs are held accountable to shareholders and other stakeholders by ensuring that the organisation has appropriate corporate structures to underpin such accountability.

Some important definitions in this approach are highlighted in the following quote:

"Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance", (OECD April 1999).¹

The **societal (social) viewpoint** of corporate governance is that it is about communications, i.e., how the company presents itself to the wider world - shareholders, potential investors, employees, regulations and other groups with a legitimate interest in its affairs (www.pwcglobal.com/uk/eng/ins-sol/survey-rep/surv). This view rests on the premise that, whilst corporate governance is principally concerned about the relationship between shareholders, management and the board in determining the direction and performance of the corporation (Monks and Minow, 2001, p.1), its scope should be even broader, encompassing other issues like the ethical standards, crisis management, reporting to stakeholders not only in strict compliance with legal issues in a country, but also in terms of social responsibility.

Some important definitions in this approach are highlighted in the following quotes:

¹ OECD's definition is consistent with one presented by Cadbury, 1992; page 15.

"Corporate governance - which can be defined narrowly as the relationship of a company to its shareholders or, more broadly, as its relationship to society" (The Financial Times, 1997)

"Corporate governance is about promoting corporate fairness, transparency and accountability" (Wolfensohn, 1999)

We shall explore these three viewpoints later in this editorial. It must be noted that some commentators take too narrow a view in defining corporate governance, and say corporate governance is the fancy term for the way in which directors and auditors handle their responsibilities towards shareholders. Others use the expression as if it were synonymous with shareholder democracy (Maw *et al.*, 1994, page 1).

Core Aspects of the Discipline Based Models

Despite the varied approaches of the discipline based models, most definitions of corporate governance refer to two things:

- *the mechanisms by which corporations are directed and controlled; and*
- *the mechanisms by which those who direct and control a corporation are supervised*²

This core view of corporate governance indicates that it relates to how the various constituencies that define the business enterprise serve, and are served by, the firm. Thus corporate governance is concerned with the relationship between shareholders and other stakeholders, the board of directors and management, as shown in Figure 1. Explicit as well as implicit relationships between the corporation and its employees, customers, creditors, suppliers, and host communities (and the dynamics of the relationships among these constituencies) fall within the

² Weil, G. and Manges L.L.P., Comparative Study of Corporate Governance Codes relevant to the European Union and its Member States. ©Australian Securities & Investments Commission, July 2002 Page 5.

boundary of an embracing definition of corporate governance. Some principles of corporate governance are of universal value, most importantly, transparency and disclosure principles. Thus corporate governance is about balancing two objectives. One is to promote business enterprise (economic), and at the same time assuring accountability of business to shareholders (legal) and to society (social) (www.gcgf.org/library/speeches/).³

Defining corporate governance therefore calls into question not only the definition of the corporate form, but also its purposes and its accountability to each of the relevant constituencies. Therefore, corporate governance is more than simply the relationship between the firm and its capital providers.

Globalisation and the Convergence of Corporate Governance Frameworks

Globalisation and the increasing volume of Foreign Direct Investment (FDI) flowing into most developing countries have led to a convergence of what used to be differing corporate governance frameworks based on legal, economic and social dimensions. FDI has become a very important international issue mainly due to the shareholders and other stakeholders now being global rather than local. Thus a shareholder of an US company residing in Finland may be very concerned with sharing the profits obtained by using child labour in China. FDI is one of the main issues facing those who deal with the international political economy and business studies (Sarkar and Sarkar, 2000). This and other factors that motivate the need for good corporate governance are pointed to by Subramaniam and Ratnatunga, 2003:

- Increase globalisation of financial markets
- Growth in multinational corporations
- Regional economic developments

Investors in most countries are accepting the reality that holding an international equity portfolio leads to higher returns and

³ Michel Magdi Iskander, Director, PSD, World Bank.

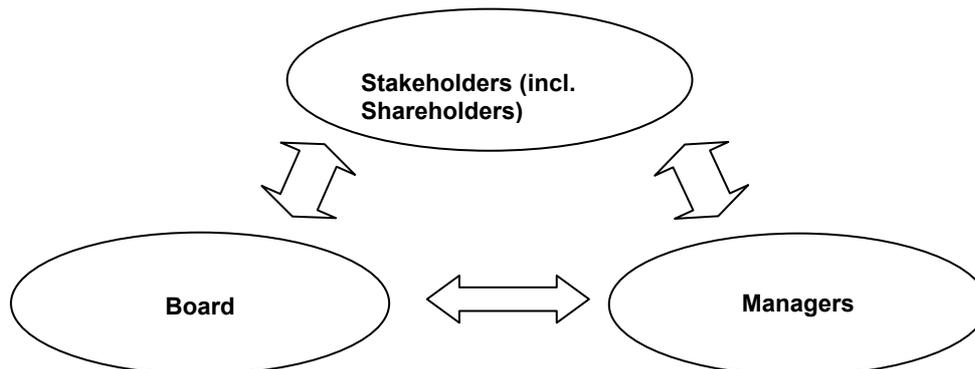
lower risk compared to a purely domestic portfolio.

Simultaneously, non-finance companies realise that broadening the investor base will lower their cost of capital and may also reduce volatility in stock prices. Further, the pattern of privatization, high equity issuance and loosening of traditional inter-company ties has led to some remarkable changes in the equity ownership of some countries. For example, in France, the combined share of foreign shareholders and financial institutions rose from 27% in 1993 to 55% in 1997. The institutional investors have forced companies to adapt their behaviour in order to be able to tap global capital markets leading to international convergence in corporate governance. Another change that is favouring corporate

governance norms is the globalisation of product markets, aptly stated in the following comment:

'If countries are to reap the full benefits of the global capital market, and if they are to attract long-term 'patient' capital, corporate governance arrangements must be credible and well understood across borders. Even if corporations do not rely heavily on foreign sources of capital, adherence to good corporate governance practices will help improve the confidence of domestic investors, may reduce the cost of capital and ultimately induce more stable sources of financing.' (OECD, 1999).

Figure 1: Core Corporate Governance Model⁴



A Contextual Approach to Corporate Governance

As we have discussed, corporate governance models differ widely due to differences in the disciplinary (silo) approaches. Another reason for differences is the business context within which these models develop. The basic contextual factor is shareholder concentration, which not only includes the percentage holdings of various stakeholder groups in terms of the ownership of the total number of shares that

are publicly traded, but also includes aspects of concentration in terms of the power of the CEO, shareholder identity, liquidity of the market and level of mutual shareholdings (see Appendix 2).

These contextual factors have resulted in the development of different models of corporate governance around the sphere. Among the developed countries, the main ones have been seen to be those of the English Speaking Countries, with discrete controls, and on the other hand German and Japanese models, which reflect a more

⁴ Source: Adapted from Fitzroy & Hulbert, 2005.

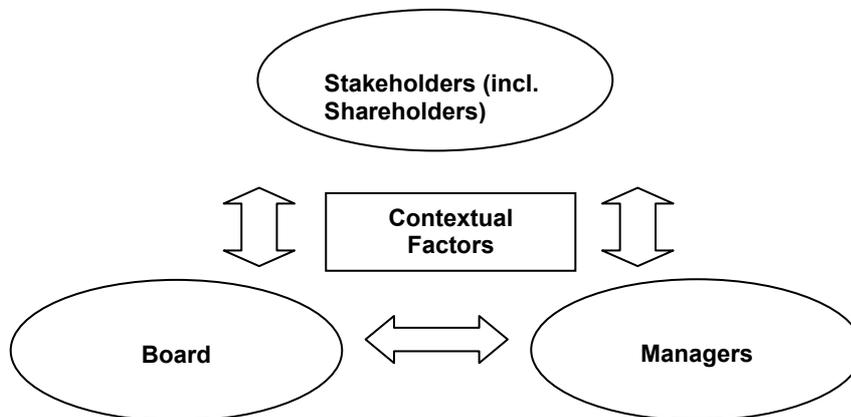
concentrated ownership structure. Developing countries like India have a corporate governance system which is a hybrid of the arms-length market-based systems of UK and USA and the insider-dominated-bank-based systems of Germany and France (Sarkar and Sarkar, 2000). Two corporate governance models are analysed below – The Anglo-Saxon and The Continental European models.

In the *Anglo-Saxon* or market-based system, markets play a decisive role. The government is at arm’s length relationship with corporations while creating a strong competitive environment in which firms operate. Firms are put under pressure in the product and factor markets, whilst managers are put under pressure in the managerial labour markets. The belief underlying this system of corporate governance is that competition and working of the market system will force companies and managers to act truly in the best interest of shareholders (Carati and Rad, 2000),. This model of corporate governance is more prominent in the U.S. and the U.K.

However, when it comes to performance measurement, the role and values of other stakeholders need to be understood. One of the tasks of the board is to determine the nature of other stakeholders and their importance compared to shareholders.

The second model considered is The *Continental European* model which is also known as the stakeholder model. The focus of the Continental model is on the need to satisfy societal expectations, in particular, the interest of employees and other stakeholders (suppliers, creditors, tax authorities and the community). This view dominates in continental Europe (particularly Germany, France and the Netherlands) and in certain countries in Asia (Gregory, 2000). (Please refer to Ooghe and Vuyst (2001) and Appendix 2 for the differences between the abovementioned corporate governance models).

Figure 2: Contextual Corporate Governance Models⁵



A Holistic Corporate Governance Framework

It can be seen, therefore, that each disciplinary approach has different focus

aspects in terms of control and governance procedures, and that those contextual factors such as stakeholder concentration plays a part in what control mechanism is chosen for good governance.

⁵ Source: Adapted from Fitzroy and Hulbert, 2004.

A holistic corporate governance framework therefore should combine these two approaches, and such a model is presented in figures This model in Figure 2 indicates that good governance depends on a number of contextual factors. These factors are elaborated in Figure 3. For example, when shareholder concentration is low (i.e. no one stakeholder group – including the CEO - controls the company) then good governance can be achieved legally via the proper preparation of financial statements and economically via capital market efficiency. If social issues are raised these would pertain mainly to environmental issues in that all group of stakeholders are ultimately affected by the quality of the societal/global environment. When there is more stakeholder concentration (medium level) then legally, accountability issues arise where corporate governance procedures are required to ensure that the

organisation has appropriate corporate structures in place so that those entrusted with day-to-day management of a company’s affairs are held accountable to shareholders and other stakeholders. Issues such as internal audits and minority interests arise in such situations. The economic incentives on the managers are incentive based, with good performance (high rates of return) appropriately rewarded by the stakeholders. Some social issues will emerge at this point whereas there will emerge consensus of opinion amongst some stakeholder groups on issues such as ethics, environment, child labour etc. (for example these have resulted in the establishment of ethical investment funds in Australia by Rothschild Australia, Westpac, Tower, AMP, HESTA, UniSuper and VicSuper).

Figure 3: The Contextual Factors of a Holistic Corporate Governance Model

STAKEHOLDER CONCENTRATION	High	<i>Fiduciary Duties of Directors</i>	<i>Shareholder Value</i>	<i>Triple-Bottom Line Accounting</i>
	Medium	<i>Accountability of Managers and Internal Audit</i>	<i>Economic Incentives to Managers</i>	<i>Social Audits of Managerial Actions</i>
	Low	<i>Financial Statement Controls</i>	<i>Capital Market Efficiency</i>	<i>Environmental Accounting</i>
		Legal	Economic	Social
FOCUS OF CONTROL MECHANISMS				

Where there is high stakeholder concentration, then less reliance can be placed legally on financial statements and other accountability and audit measures. The recent examples of spectacular corporate collapses have been due mostly to significant concentration of power with the CEO. Thus the failure of the firms can, at least in part, be attributed to corporate governance (designed to work well within less concentrated contexts) being unable to cope in high stakeholder concentration environments. That inappropriate corporate governance mechanisms could lead to corporate failure represents a waste of scarce resources within the economy. Also

we cannot overlook the inconvenience, or sheer misery, that high profile collapses cause at the level of the individual.

Sporadic and reactionary attention paid to corporate governance and the role and activities of the board of directors in controlling and monitoring of the management of the firm is insufficient. The examples of corporate collapses in the 1990s in the exuberant years of Thatcherite-American-type capitalism illustrates, investors and others are concerned at how well firms are being managed and whether they are being managed in a manner which delivers value to the society. Implications

from Enron have thus been noted - need for the board to be active, involved, knowledgeable, and be willing to take on management and also bear responsibility for performance of the firm (Fitzroy and Hulbert, 2004).

In Australia, the failures in 2001 of the insurance giant HIH, the third largest Telco, One-Tel, and of the second largest airline, Ansett, have led to concerns about the lack of due diligence during takeovers and the inadequacy of protection of workers and of customers. It has led to workers' entitlements being put at the top of the queue of creditors. It is also clear in the context of such collapses that, though the existence of a market for takeovers has been seen as improving corporate governance (World Bank, 1999), in practice HIH's takeover of FAI and Air New Zealand's takeover of Ansett, without adequate due diligence, contributed to poor corporate governance outcomes just a few years after the events. Similar stories could be told of Parmalat in 2004.

At first glance it therefore appears that when stakeholder concentration is high, more specific legal controls are required. The essential common points in the various codes or guides put out around the world deal with such specific controls may be noted:

- That corporate governance is a means of ensuring that the exercise of economic power by the corporate sector is grounded in accountability – whether that is accountability to shareholders or to the broader community;
- That boards have supervisory and managerial functions;
- That there should be separation between the supervisory and managerial roles.

Some of the practices suggested in the codes for that purpose include for example:

- Separation of the roles of the Chairman and CEO;
- The appointment of independent directors; and
- The use of board committees, particularly in the areas where the

interests of management and the interests of the company may come into conflict - e.g. audit, remuneration and nomination.

Most codes also call for comprehensive disclosure to shareholders on all aspects of corporate governance, in particular, on the issues of director and executive remuneration, independence of directors, and share ownership.

In terms of economic focus when stakeholder concentration is high, then maximising shareholder value must be the core focus as it is the shareholders that bring a company into existence and ultimately it is the shareholders that can wind down the company. Other stakeholder concentrations must be satisfied within the context of maximising long-term shareholder wealth. Good governance structure should ensure that the shareholders interest does not by itself preclude protections to other stakeholders.

Recent corporate failures had a significant impact on those directly involved such as employees (Ansett) and on society more generally in all cases. The failures of HIH, OneTel and Ansett are particular examples that have had a significant impact throughout the economy of the country (Australia). They had even more impact on shareholders. The question is therefore whether there is any correlation between performance (creation of value) and corporate governance in terms of the firm's ownership and board. The literature provides us with mixed results with no consistent findings for any formulation of a definitive theory of ownership and firm performance.

According to analysts at the U.S. investment bank, Morgan Stanley, share prices falls at just five companies – WorldCom, Tyco, Qwest, Enron and Computer Associates – have together inflicted a collective \$460 billion loss on stock market capitalisation (Holland, 2002).

Of the empirical studies, Morek *et al.*, (1988) stands out for the insights it

provides. While it offer some support for a relationship between insider ownership and firm value, the authors find that the magnitude of the block holding *is* a relevant variable. Their results indicate that firm value increases with insider ownership to 5 per cent, but declines within the band of 5 per cent to 25 per cent. Beyond 25 per cent, the results are inconclusive. Looked at from the international perspective, international investor confidence has already been severely dented. At the end of March 2002, foreign investors owned US\$1.75 trillion worth of U.S. equities, nearly 13 per cent of the outstanding capitalisation of stocks. Investors, afraid that the U.S. economic miracle of the previous five years may have been just a mirage of false accounting, began to bail out of these assets and shift their capital abroad (Holland, 2002). An international survey of research on corporate governance and firm performance by Gugler (2001) also found mixed results on the relationship between these two variables. The way researchers approach this issue and the way regulators approach reform of corporate governance varies between the Anglo-American model and elsewhere (see Appendix 2).

It must be noted at this point there are those who still regard the recent increase in attention to governance as a fad. As this group sees it, the stock of a well-governed company may be worth more simply because governance is such a hot topic these days. Believing in the value of corporate governance should no longer be a question of faith. Some investors will pay a significant premium for good governance as is noted in Appendix 1. Therefore, although governance is more important in some circumstances than in others, and more important to managers of some types of funds than others, it remains clear that good board governance can serve as a tool for attracting certain types of investors, as well as influencing what they will pay for stock.

According to a report in *Far Eastern Economic Review* citing Corporate Accountability (Holland, 2002), U.S. scandals make investors wary, rattle the global economy and shake up regional

currencies. Investors are worried by accounting scandals, corporate bankruptcies, telecom companies' woes and the possibility of a further decline in equity prices. As such, investors just about everywhere are cutting their losses and bailing out of equities. Although the immediate market fallout may have been contained, the wider implications of the Enron and WorldCom debacles will not be shrugged off so lightly. The exposure of fraud on such a massive scale threatens severe consequences for Corporate America, worldwide investor confidence and even the global economy. As mentioned in the same source, the fallout could be even worse, in that the Enron corporation debacle might forever change the way Corporate America deals with auditors, regulators and investors. There is some evidence of this.

Investors expect good corporate governance. There are three main reasons why investors will pay a premium for good governance. Some believe that a company with good governance will perform better over time, leading to a higher stock price. This group is primarily trying to capture upside, long-term potential. Others see good governance as a means of reducing risk, as they believe it decreases the likelihood of bad things happening to a company. Also, when bad things do happen, they expect well-governed companies to rebound more quickly. An earlier 1996 a survey by McKinsey reported that investors surveyed would place an average premium of 11% on stocks of well-governed companies. The reciprocal, of course, is that investors will punish individual companies, or broader markets, or even whole national capital markets, for serious governance deficiencies (recall the marked down values of Japan and ASEAN economies in the late 1990s). In the new century, these cautionary studies cannot be dismissed as academic over-cry. We are living through this reality in the most sophisticated and developed economies the world have ever seen (OECD, 1999). In Wall Street parlance, smart investors *discount* for fraud, meaning they now assume dishonesty in corporate auditing

and have *priced in it* when they calculate a stock's value. Others have fled the market entirely. (Holland, 2002).

The Jensen and Meckling's (1986) agency model of the firm has as a central theme the alignment of the interests of directors and owners through the acquisition of substantial holdings by directors. Corporate governance has been linked to the ambition to ensure, through adequate investment in the corporate sector, a long-term economic growth and, if possible, social welfare. From this perspective, it becomes evident that the importance of good corporate governance extends far beyond the interest of shareholders in any individual company. There is also a growing awareness that ownership, control and the monitoring of management of business organisations are significant variables which explain firm performance and the protection of stakeholders. This interest has been fuelled by debate in the popular media.

When stakeholder concentration is high, triple-bottom bottom line accounting is required in the social context, where companies are recognised as existing to create wealth or long-term value on an economically, socially and environmentally sustainable basis, i.e. 'sustainable value creation'. This issue will be dealt with in a future editorial.

Conclusion

Though the topic 'Corporate Governance' gained worldwide prominence, as yet it is ill-defined, and consequently blurred at the edges. It is evident undoubtedly that corporate governance is relevant as a subject, as an objective, or as a regime to be followed for the good of shareholders, employees, customers, bankers and indeed for the reputation and standing of a nation and its economy (Maw *et al.*, 1994).

Nevertheless, whatever corporate governance arrangement a public company chooses, they have to rest on a sound platform. They have to be well understood and accepted by those who provide the company with key resources, namely, capital. Anything less will not only hurt the

organisation itself; it will also hurt the entire capital market and eventually the economy's prospects for prosperity. It can be argued from the above discussion that every organisation operates under its own specific contextual factors though. Thus, in order to operate efficiently, firms need to adapt their governance system to these circumstances as it has become very challenging for organisations to create value and gain shareholders' confidence for broadening the investment base both in domestic and international markets in a turbulent world, *ex post* the collapses of big corporate bodies, Enron, WorldCom, OneTel, Ansett, HIH, Parmalat and so on. It is also evident that globalisation may have initiated the adoption of a few common corporate governance standards across regimes but there is little evidence to show that these standards have or will be implemented widely. As Harvey L. Pitt, the former chairman of the Securities and Exchange Commission (SEC) stated:

"It is a time for serious commitment to enhancing and embracing international accounting standards; for sensibly redressing conflicts of interest which have beset corporate managers, auditors, analysts and other intermediaries and professional service providers; for examining ways to motivate and empower shareholders – including institutions and fund managers – to accept greater responsibility for enforcing corporate accountability; and for examining methodologies by which Boards might better secure high governance standards." (ASIC, 2002)

Therefore the design and development of corporate governance systems should aim at protecting the vulnerable from exploitation by those who manage and control corporations while making it punitive for the professionals managing the accounts from falsifying the books. Though the evidence of a strong positive link between governance and firm performance is limited, there does seem to be a link between active boards and performance (Fitzroy and Hulbert, 2004). However, corporate governance - viewed not as

merely a legal ritual to manage directors' liabilities, but as a living economic dynamic, integrated into the business – can help build a solid foundation to create wealth and protect shareholder interests. Corporations should strive to achieve a culture of governance and resist the temptation to give formal, rather than substantive compliance to the principles of good governance (Lucy, 2002).

Professionals monitoring and certifying a firm to be a safe entity should engage the more recently developed models that use information to warn of impending failures just as much as the society's role in safeguarding the stakeholders' welfare must be enhanced by letting the larger society have a say in this issue beyond the corporations.

APPENDIX 1: Average Premium Investors Are Willing to Pay for Good Governance

Country	Premium %
Venezuela	28
Indonesia	27
Thailand	26
Malaysia	25
Italy	22
Japan	20
Germany	20
United States	18

Source: Coombes and Watson (2000) (Selected Countries only)

APPENDIX 2: Difference between Anglo American and European Models

Shareholder concentration

A first difference between the two models is that Anglo-American countries have a low concentration of shareholders, whereas in Continental Europe shareholder groups hold large percentages of the total number of shares that are publicly traded. Further, Anglo-American countries have a large number of listed companies, whereas in Continental European countries only a small proportion of the total numbers of firms are listed. For example, in the UK, which follows the Anglo-American model, institutional investors' share of stock market investment rose from 19% in 1963 to 59% thirty years later.⁶

⁶“Converging cultures: trends in European Corporate Governance”, 1997. www.pwcglobal.com/uk/eng/ins-sol/survey-rep/surv-converging.html

Shareholder identity

A second difference between the two corporate governance models is the identity of the shareholders. In the United States and the United Kingdom most of the shares are in the hands of the agents of financial institutions (more than 50%) rather than private persons (20-30%). This is in sharp contrast with the pattern in Germany, France, and Italy where private companies (20-40%), financial institutions themselves (10-30%), and private persons (15-35%) hold most of the shares. For example in Italy, the five largest shareholders in listed companies typically hold nearly 90% of the shares, compared to 21% in Britain.⁷

Liquidity of the market

A third difference between the Anglo-American and the Continental European business context is the number of listed companies as a percentage of the total number of companies in a country. In the United States and the United Kingdom, many companies are listed and their shares are publicly traded. This means that many companies have little personal contact with their shareholders. In Continental European countries, on the other hand, fewer companies are publicly traded. Because more companies are private, a strong (personal) relationship exists between the management of the company and its shareholders. In many cases, these two functions are not separated.

Mutual shareholdings

Due to the number of mutual shareholdings and the limited extent of information disclosure, the ownership structure in Continental European countries is not as transparent as in Anglo-American countries. Regulations such as anti-trust laws and the "arm's length rule" between parent and daughter companies have further limited the complexity of the ownership structure in Anglo-American countries as compared to Continental countries.

⁷ *op cit*

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