THE DIVERSITY OF CORPORATE GOVERNANCE MODELS. OVERVIEW AT THE COUNTRY LEVEL

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ABSTRACT: *This paper concentrates on the key features of corporate governance models; first, it highlights the correlation between corporate governance and the economic welfare; secondly it sets forth the characteristics of the models at the country level. The focus is placed on the correlations between the key elements that are intrinsic to the governance evolution in time.*

KEY-WORDS: *corporate governance; system; conflict of interest; one tier model.*

JEL CLASSIFICATION: *G30; G32.*

1. INTRODUCTION

Sustainable economic growth is highly supported by innovative technology as well as by social and institutional development. At the worldwide level, in the context of the natural resources rarity and informational technology development, economic performances of different countries are highly interdependent.

An actual key-concept is represented by corporate governance. *Stricto sensu*, corporate governance encompasses a system of elements based on which a company is managed and controlled. In a market based economy, where a key role is played by investment process, corporate governance is represented by the assembly of economic, legislative and institutional elements which protect investors' interests.

From a wider perspective, corporate governance represents an assembly of policies and control mechanisms that are applied in order to protect and to harmonize various interests, frequently contradictory, of different entities acting within a company.

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Beginning with ’80, a deep focus has been oriented towards corporate governance area. This aspect can be explained by Anglo-American codes of good corporate governance, like the Cadbury Code (1992) in UK and the Principles and Recommendations of the American Law Institute (1984) and the Treadway Commission (1987) in the USA. These determined other countries to consider the possibility to implement different version of these codes adapted to their national systems.

In parallel, international organisations such as OECD and the World Bank set forth own standards on corporate governance, including corresponding recommendations and principles.

Other entities deeply involved in the phenomenon such as corporate managers or financial managers were at the core of these actions.

Another key element that generated the development of the corporate governance standards was represented by the obligation for the companies that are listed on the stock exchanges to implement the corporate governance standards.

2. HETEROGENEITY OF CORPORATE GOVERNANCE MODELS

The diversity of the corporate governance codes reflects the peculiarities at the country level. Literature contains several discussions regarding the impact of the financial globalization on the corporate governance models, especially from the perspective of a potential alignment of corporate governance systems to identical standards. The hypothesis of an unique corporate governance model generated many controversial discussions on the model at the country level that would represent the reference pillar in accordance with which there will be elaborated the single model.

The polemic on a single corporate governance model triggered numerous pros and cons, being unlikely to reach a certain compromise.

The pros generally rally upon the idea that harmonized policies in terms of employment, production and marketing give incentive to a highly competitive environment.

The cons assume the impossibility to align different corporate governance because of intrinsic diverse features originating in different legal systems, financial markets or social environments.

Academic literature on this topic pointed out that in some countries managers proved to protect primarily investors’ interests (USA, UK) while in other countries the focus was oriented towards stakeholder’s interests (Japan).

Recently, theories regarding corporate governance rallied upon control mechanisms that are specific to the shareholders and managers relationships; the control becomes effective at the level of the tripartite relationship between institutional and private investor-creditor-manager as well. From a theoretical perspective, these relationships ground on divergent objectives. Classic theories acknowledge that shareholders aim at company value maximization while private investors look for profit maximization.

In opposition, institutional investors focus on the social dimension, deeply anchored in corporate social responsibility area.

Despite the so-called objectives divergence, explained by different interests incurred by various entities, analysts confirmed that a common goal support the relationships characteristic to corporate governance area: profit increase.

This common objective lies behind different corporate management strategies; although there are different manners by which these strategies are elaborated, the common goal determines an alignment of interest. In line with this idea, the agency costs tend to reduce this asymmetry, revealing the importance of the control mechanisms that in essence aim at ensuring all the parties involved in a business that rules are complied with and all the actions and measures that are taken subscribe to wealth accumulation.

There are several discussions on the management and corporate governance activities; some analysts consider them to interfere to a large extent, but the majority of the opinions assume the clear differences between them.

Management refers strictly to coordination, organisation and internal control activities, being deeply anchored in the internal environment of the company.

Corporate governance is rooted especially in external environment, referring to the control exerted by shareholders on the company managers.

The two types of control –internal and external- are exerted on different layers, triggering the involvement of third entities represented by the capital market or banking industry; the involvement of these entities is triggered by the necessity to make financing operations.

The first main challenge in terms of corporate governance analysis is represented exactly by the necessity to define corporate governance systems.

There are two approaches as for corporate system definition:

- *a narrow one*, referring strictly to the relationships between managers and board of directors and especially to the manner in which this relationship is structured. This type of definition is frequently encountered in the o corporate governance codes and the *OECD Principles of Corporate Governance*, issued in 2004.
- *a broader one*, grounding on the relationship between shareholders and mangers. This broader definition is related to a larger extent to the internal environment of the company, reflecting the involvement of the institutional investors and of the financial markets in the current life of the enterprise.

The difficulty to capture the characteristics of the corporate governance into a strict definition is determined by its complexity.

Out of the control mechanism dimension, corporate governance area can be associated with the process of wealth creation and distribution (Klein, 2002, pp.375-400).

There are various classifications of corporate governance systems, taking into account the country, company or social level peculiarities. Nevertheless, literature contains many variations on two basic models: on one hand the liberal model and on the other hand the social model.

The liberal model envisages the company to be the property of shareholders while the social model reflects the company under the form of a social community, with multiple entities incurring various interests. These different interests represent the rationale for agency theory that includes the perspective of various entities such as managers, employees and stakeholders.

An extension of the social model allows a classification of the corporate governance models at the country level. In Germany, France and Japan, the financial markets exert a deep impact on corporate governance models; analysts uncovered that important features characteristic to corporate governance models are derived out of the effect bearing the mark of the financial market (La Porta, et al., 1999, pp.471-517).

The financial globalization represents a challenge for the multinational companies from the perspective of the corporate governance model that have to be implemented in the organizational structure at the worldwide level. This process implies the necessity to select a benchmark corporate governance model in reference with which there will be elaborated the global model.

3. CLASSIFICATION OF CORPORATE GOVERNANCE MODELS

Corporate governance structure relies on the following key actors: shareholders, managers, employees, suppliers and creditors that interact in a different manner within three various corporate governance systems: traditional model, co-determination model and stakeholder model.

Traditional model (*North-American model*) bases on two legal relationships and three levels: one is established between shareholders and board by the virtue of an agency contract while the other one is established between board and managers. In the latter, managers dispose of a form of authority that derives from the board authority. This model is assimilated with shareholders' revenues maximization model; the overall firm risk is concentrated on the capital provider who ultimately asks for residual revenues.

Shareholders select company's Board of Directors; possessing a share is equivalent with a vote right and the Board of Directors selects the management which is assumed to make the proper decisions in order to maximize the shares' value. In this case, shares value is based on the present value of future dividends which derive out of the net profit.

In the **co-determination** model (West European countries model) there are three legal relationships and four hierarchization levels; one is established between shareholders, managers and employees' representatives, another level is established between managers and employees' representatives and the last one becomes effective through the relationships between managers and shareholders.

In comparison with the traditional one, this model introduces a system of participative management, grounding on the assumption that business risk is lower for shareholders in comparison with employees because of the impossibility to diversify investment portfolio from the perspective of the last ones.

As for the relationship between shareholders and board members, it is very important to mention that there is a superior council that interposes between; this council is composed out of shareholders' and employers' representatives.

The role of the superior council is identical with the role of the shareholders from the perspective of certain aspects since it exerts the control function, analyzes the startegical objectives of the company and formulates recommendations to the board members.

In the **stakeholder model** there are two legal reports and four levels: one between shareholders and employees representatives, clients, banks, suppliers, state or public administration and a report between managers and employees' representatives and the other entities: clients, banks, suppliers, state or public administration.

It is forbidden to interpose another entity between shareholders and managers.

The rationale of this model consists of the necessity that the activity of a company should not be affected by the relationships that are created between entities that incur different risks and interests.

In comparison with the co-determination model, this model extends the system of participative management, although it doers not reflect in a sufficient manner the wrights and the obligations of every person in the balance that has to be kept from the perspective of the decision making process. The decision making process has as main objective to increase the revenues of the company and to enforce its financial position, rendering difficult the management control by shareholders since the principle of ,,one share – equals one vote" does not perform.

3.1. The single-tier model of corporate governance in the UK

In UK, corporate governance relies upon the one-tier model that implies a deep control exerted by the board of directors on the global activity of the company; the current management responsibilities are delegated to some of the executive directors. An interesting aspect consists of the fat that executive directors are partly involved in the board.

The UK model envisages the shareholders to be the unique owners of the company. In 1985 there has been adopted the Companies Act as a reform measure that asked for considering the employees interests as well, not only the shareholders'. Nevertheless, the act did not manage to trigger any enforceability of a potential involvement of the employees to participate in the management structure of the company or in the oversight of the board activity.

Literature reflecting the evolution of the corporate governance theories revealed that even during this period of time the role of the managers was represented by the administration of the company in the best interests of the stakeholders.

Another interesting element consists of the fact that UK is the first UE country that initiated important measures regarding the elaboration of precise corporate governance standards. Consequently, in 1992 the Cadbury Committee elaborated the Cadbury Code of Corporate Governance under the protection of the London Stock Exchange and the Order of Financial Auditors.

The Cadbury Code represents an important step in the evolution of corporate governance systems; its main peculiarity derives from the obligation imposed to the companies that are listed on the London Stock Exchange to obey to the rule of comply-or-explain principle.

Another step in the evolution of the corporate governance system is the report published by Greenbury Committee, together with a code attached including principles on the disclosure relative to director remuneration; shortly, this aspect became compulsory for the companies listed on the Stock Exchange.

Even if the specialists made efforts in order to elaborate different standards governing the issues of corporate governance, there was a problematic aspect regarding the high degree of complexity and even bureaucracy relative to these standards.

That is why in January 1998, the Hampel Committee Report made a research on the implementation of the Cadbury guidelines and revealed some deficiencies caused evenly by their bureaucracy. This is the reason that lies behind a modified version of a Combined Code dating from 1998; this version represents in fact a synthesis of the former codes that diminishes the bureaucracy degree.

Another reference point in the evolution of corporate governance model is the Turnbull Report focused on the internal control mechanism.

In January 2003 the Higgs Report highlighted the role and effectiveness of non-executive directors in the context of the financial scandals occurring that time in USA.

An important point consists of the persistency of this Combined Code until present; nevertheless, there were slight changes made in 2006 and 2008.

UK preoccupation for the development of appropriate corporate governance standards continued until the present period; this deep interest is supported by numerous associations in this area such as Association of British Insurers, National Association of Pension Funds and the Institute of Chartered Accountants in England and Wales (ICAEW). These legal entities elaborated their own policies in the field of corporate governance, many of them containing more strict requirements than those that are promoted in the Combined Code.

Literature unveiled that the UK corporate governance code, together with other European countries codes, concentrated on the necessity to obey managers to disciplinary actions so that they should not be capable of tailoring the company strategy to their own interest.

A lot of studies revealed that managers do not have to be the object of such measures as long as their activity envisaged competitive products and services. Analysts disclosed that this aspect can be figured out as a compromise solution that could solve out a potential conflict between the interests incurred by different entities. If the managers are preoccupied by competitive products and services, then the economic growth and implicitly the profit accumulation were ensured. This superior level of the quality created the opportunity of a competitive advantage in relation with the other companies in the market.

In fact, the essential objective of corporate governance code consists of the process of value creation. Principles underlying corporate governance code aim at creating all the premises in order to give incentive to value creation. Academic studies disclosed that this process is highly dependent on a key management competency consisting of the managers' capacity to create an adequate work environment, characterized by a strong team spirit, in compliance with sound governance principles (Lins, 2007, pp.3-51).

Previous researches pointed out that the working climate is highly supportive to the value creation process; an important element of this working climate is exactly the capacity of managers to avoid the conflicts at the internal and external level.

Internally, conflicts may intervene between managers and employees while external conflicts are likely to appear between managers, board representatives and shareholders.

Enron scandal and Madoff fraud revealed that managers' delinquent actions are at the root of the company collapse. From this perspective, corporate governance system contributes to sustainable corporate growth.

3.2. The interpretation of the market model for corporate governance in the U.S.

The US corporate governance model assumes that company managers make efforts in order to increase the profit. The strategies they conceive in order to obtain benefits consist either of involvement in risky actions, commensurate with the company risk profile. A key element of the US corporate governance model consists of the limited responsibilities held by lower-level managers.

Jensen (1986) elaborated on the free cash-flow theory, suggesting that managers are reluctant to dividend distribution to shareholders, preferring rather to implement less profitable investment projects; this attitude can be explained by their willingness to exert control on the company financial resources.

The agency theory gave incentive to further reflections on corporate governance, leading to the idea of managers' motivations by the intermediary of capital they posses.

Literature revealed that if managers hold a certain percentage of the enterprise capital, they are more motivated to implement business strategies in compliance with company sustainable growth perspectives (Dahya, et al., 2002, pp.461–483).

Analysts showed that business strategies look usually for company value maximization; what is really important for company sound governance system consists precisely of the manner in which this objective pursued. Only sound practices that are in line with a sustainable long term growth ensure an adequate corporate governance system (Drobetz, et al., 2004, pp.267-293).

The US corporate governance model highlights that shareholders confer to the managers the power to make decisions; this is made in respect of the agency costs.
Researches at the level of US companies (Hermalin, 2004, pp.2351–2384) unveiled two key features of US corporate governance system:

- ✓ a high degree of dispersion among shareholders;
- ✓ moreover, a high percentage of company shareholders holds a low level of company capital.

These two key components reveal the unwillingness of company shareholders to bear the agency costs implied by the management oversight. Smith & Warner (1979) identified four sources of conflict between shareholders and creditors: the policy of dividend distribution, the risk of debt dilution, asset substitution and underinvestment.

Another important entity enclosed in the US corporate governance model is represented by the ***company' creditors***.

Financial resources impact company overall business, especially from the perspective of financial costs involved by external financing.

Credit granting is highly dependent on the company financial standing that is precisely subject to the financial analysis performed by the bank officers.

Literature unveiled that financial analysis, made prior to credit granting, may not reflect the main problematic aspects implied by the company activity (Franks & Mayer, 2001, pp.943-77). It is possible that credit may be extended to a company which do not fulfil the bank requirements in terms of solvency. This is likely to occur because of unreliable financial data reflected in the financial documents.

This aspect can lead to moral hazard phenomenon since creditors may be exposed to additional risks that are not captured by financial documents. Moreover, academic studies uncovered that there are frequent cases when, in a first stage, a company meets the solvency conditions imposed by the bank credit strategies, but it is possible for the company managers to behave subsequently in a manner that is non-compliant with sound corporate governance standards (Wymeersch, 2006, pp.1-14).

A fundamental aspect of US corporate governance model consists of its focus on shareholders' interests and on financial markets.

Literature revealed that a good part of the company financial revenues origin in investments in the capital market; this aspect was encouraged by the strong growth recorded on the financial market during the period of 2002-2007 (Pérez, 2009, pp.78-80). Moreover, financial markets offered the opportunity of retirement plans which were strongly promoted during the last periods.

The orientation of USA corporate governance model towards the financial markets can be explained also by the households' propensity to buy debt securities issued by corporations. From this perspective, this type of corporate governance model brings forth collateral entities such as pension funds, commercial and investment bankers, financial analysts and brokers of an essential importance for the structure of corporate governance model.

The sustained level of corporate growth recorded in USA gave incentive to other countries to implement a similar shareholder oriented corporate governance model. Experience showed that the implementation of such a model is not effective because of the financial market development degree. Only in the countries that posses a developed capital market this model can perform to the utmost effects.

The G8 countries made public their decisions to adopt effectively this market oriented corporate governance model. Precise strategies have been designed to this purpose and effective progresses have been remarked in this respect. Nevertheless, corporate governance models are still evolving, especially under the impact of recent financial turbulences.

4. CONCLUSIONS

Presented in detail modern theories on corporate governance in the light of control mechanisms that are specific to the shareholders and managers relationships; the control becomes effective at the level of the tripartite relationship between institutional and private investor-creditor-manager as well. From a theoretical perspective, these relationships ground on divergent objectives.

The approach highlighted classic theories according to which shareholders aim at company value maximization while private investors look for profit maximization. In opposition, institutional investors focus on the social dimension, deeply anchored in corporate social responsibility area.

Despite the so-called objectives divergence, explained by different interests incurred by various entities, research revealed that a common goal support the relationships characteristic to corporate governance area: profit increase.

This common objective lies behind different corporate management strategies; although there are different manners by which these strategies are elaborated, the common goal determines an alignment of interest. In line with this idea, the agency costs tend to reduce this asymmetry, revealing the importance of the control mechanisms that in essence aim at ensuring all the parties involved in a business that rules are complied with and all the actions and measures that are taken subscribe to wealth accumulation.

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