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Modernising corporate objective debate towards a hybrid model

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Abstract

In the light of the increasing significance and vivid dynamism of corporate governance practices, a vast amount of literature has been dedicated to the development of modes of corporate governance. This subject deals with the rights and responsibilities of boards of directors, their shareholders and stakeholders, and the balancing of their individual interests with the economic goals of the organisation as well as the interests of society as a whole. A fundamental topic lies at the heart of corporate governance regimes: whose interests should corporations be serving? This article rethinks the shareholder and stakeholder theory debate, treating it as a contemporary topic worth reconsidering in the context of the current climate of corporate scandals and financial crisis. Learning from experience, the article offers some guidance on how to establish an efficient corporate governance model by adopting hybrid model principles for higher investor confidence, better corporation shape, more active involvement from shareholders and stakeholders and more considerations of the views and interests of stakeholder groups. Thus, this paper provides some thoughts on corporate objectives in the convergent corporate governance model in order to formulate a hybrid model mechanism and provide some guidance for directors in the carrying out of their function.

Key words: Shareholder value, stakeholders, corporate objective, corporate governance, hybrid model

1 Introduction

Corporate governance is concerned with the processes by which organisations are directed, controlled and held accountable. During the last decade, corporate governance has been a contested issue. In spite of decades of economic globalisation and intense financial globalisation, corporate governance patterns still continue to differ markedly across countries.[1] Ever since it was demonstrated that fundamental differences do exist in corporate governance models across countries, there has been a debate about which model works more efficiently globally. The central question is whether a particular national corporate governance model has a competitive advantage over all other models in terms of its practicability and, if so, should the other models begin to emulate it.

1 M F Guillen, "Corporate governance and globalization: is there convergence across countries" in T Clarke (ed.), *Theories of Corporate Governance: The philosophical foundations of corporate governance* (London: Routledge 2004), p. 223.

Academic views on corporate objectives can be divided into two schools:[2] the shareholder primacy norm[3] and the stakeholder theory.[4] Each model has a characteristic set of structural elements, ownership patterns and strengths and weakness.[5] The shareholder primacy norm is usually characterised in terms of financing through equity, dispersed ownership, active markets for corporate control, and flexible labour markets.[6] In this model, companies rely more on stock and bond markets for external financing. The model prevails in common law countries with an effective legal enforcement of shareholder rights. Corporate law provides relatively extensive protections for shareholders and courts are also relatively active in enforcing those protections.[7] In contrast, the stakeholder model is normally described in terms of long-term debt finance, ownership by large blockholders, weak markets for corporate control, and rigid labour markets.[8] The blockholder-based system relies on codified law and emphasises rules protecting stakeholders. Companies rely more on banks for external financing. Large companies generally have one bank – for example, the main bank in Japan,[9] and a universal bank in Germany[10] – which owns a certain amount of shares in the company.

Changes in ownership structure, financial regulation and corporate governance legislation towards another system are respectively therefore a strong sign of convergence.[11] It is argued by many American scholars in the fields of law, finance, economics, politics and sociology that cross-national patterns of corporate governance are converging or will converge towards the Anglo-American, capital market-driven model which implies a convergence of the whole system.[12] It is also argued that the market-dominated Anglo-American model is the most efficient corporate governance model in the sense that it represents production efficiency, increased investment opportunities and reduced

2 There are also academics who divide the corporate governance system into four models, namely the outsider system, the Rhineland or insider system, the Latin system and the Japanese system; see L Van Den Berghe, *Corporate Governance in a Globalising World: Convergence or divergence? A European perspective* (Boston: Kluwer Academic Publishers 2002), p. 1. Meanwhile, other academics think that apart from the shareholder-oriented model, there are manager-oriented, labour-oriented and state-oriented models of corporate law; see H Hansmann and R Kraakman, "The end of history for corporate law" (2001) 89 *Georgetown Law Journal* 439, p. 441.

3 Namely, the Anglo-American outsider "market-orientated" model.

4 Namely, the European and Japanese insider "network-orientated" model.

5 C A Williams and J M Conley, "An emerging third way? The erosion of the Anglo-American shareholder value construct" (2005) 38 *Cornell International Law Journal* 493.

6 R V Aguilera and G Jackson, "Corporate governance: dimensions and determinants" (2003) 28 *Academy of Management Review* 447, p. 447.

7 B H McDonnell, "Convergence in corporate governance – possible, but not desirable" (2002) 47 *Villanova Law Review* 341, p. 344.

8 Aguilera and Jackson, "Corporate governance", n. 6 above, p. 477.

9 In Japan, the main bank has a long-term relationship with a Japanese corporation. It provides loans, holds equity in the corporation and, as the most important secured creditor of the company, the bank always has priority rights in monitoring the company and joining in major decision-making of the company board.

10 In Germany, the universal bank provides a wide range of financial services including deposits, securities services, and dealing in real estate.

11 U C Braendle and J Noll, "On the convergence of national corporate governance system" (2006) 15 *Journal of Interdisciplinary Economics* 57, p. 59.

12 For example, see J C Coffee, "The future as history: the prospects for global convergence in corporate governance and its implications" (1999) *Northwestern University Law Review* 642; Hansmann and Kraakman, "The end of history", n. 2 above; J N Gordon, "Pathways to corporate governance? Two steps on the road to shareholders" (1999) 5 *Columbia Journal of European Law* 219, p. 219.

transaction costs.[13] The market-oriented model focuses on the process of harmonisation and convergence from a market perspective. Adherents to this model propose that the market is the only relevant factor in driving the corporate governance system to its most optimal format.[14]

However, with the Enron scandal, the failure of the NASDAQ and the financial crisis beginning in 2007, the advantages of the shareholder primacy model are less self-evident. Enron, a name now synonymous with corporate scandal, was previously ranked in the US Fortune Top 10 companies based on its turnover. It ended its glory days in one of the most shocking cases of insolvency in US history, and was instrumental in the collapse of Andersen, one of the big five global accounting firms.[15] The US government implemented a series of reforms in the aftermath of the scandal with revisions of the New York Stock Exchange's listing requirements for more responsible corporations and directors. Since then, companies are required to have an audit committee wholly comprised of independent directors and to publish a code of ethics for senior financial officers.[16] These scandals provided a dramatic object lesson in the perils of a management obsession with share price. Public opinion regarding the advantages of different corporate governance models appears to have shifted towards the opposite end. In the past few years, there have been an increasing number of voices arguing that the Anglo-American corporate governance system is converging towards the continental European system.[17] A number of changes in Anglo-American corporate governance practice, including an increase in societal practice by corporations and institutional investors, growing shareholding concentration and stakeholder-related information disclosure, have been taken as evidence of convergence towards the stakeholder model.

However, although some academics accept the notion of corporate governance convergence, they do not agree that such a global model will be an exact copy of the outsider model. As the result of convergence based on the most successful elements of different corporate governance models, a more reasonable, "hybrid corporate governance

13 One of the arguments for the superiority of the Anglo-American regime is as follows: dispersed shareholdings mean that shareholders' wealth depends on more diversified portfolios of investments (held directly or through institutions such as pension funds and mutual funds) than is the case for shareholders in a closed regime with concentrated ownership. Since the risk of a diversified portfolio is lower than that of a concentrated one, shareholders require a lower return in relation to the risk; this in turn lowers the cost of obtaining capital for corporations, and makes capital for risky ventures more available. The argument holds particularly in the circumstances of global capital market integration. See R G Rajan and L Zingales, *The Great Reversals: The politics of financial development in the 20th century*, Working Paper W8178 (Cambridge: National Bureau of Economic Research 2001); V Errunza and E Losq, "International asset pricing under mild segmentation: theory and test" (1985) 40 *Journal of Finance* 105.

14 Hansmann and Kraakman, "The end of history", n. 2 above.

15 It changes the big five to the big four largest international accountancy and professional services firms comprising PricewaterhouseCoopers (PwC), Deloitte Touche Tohmatsu (Deloitte), Ernst & Young (EY) and KPMG.

16 For example, the Sarbanes–Oxley Act 2002 in the US; see also the earlier UK report *The Financial Aspects of Corporate Governance* (the Cadbury Report) (London: Committee on the Financial Aspects of Corporate Governance 1992).

17 See S Thomsen, "The convergence of corporate governance systems to European and Anglo-American standards" (2003) 4 *European Business Organization Law Review* 31; S Deakin and S J Konzelmann, "After Enron: an age of enlightenment?" (2003) 10 *Organization* 583; Williams and Conley, "An emerging third way?", n. 5 above; S. Deakin, "The coming transformation of shareholder value", (2005) 13 *Corporate Governance: An International Review* 11; C Strangberg, "The convergence of corporate governance and corporate social responsibility: thought – leaders study" (Strangberg Consulting 2005), available at www.corostrandberg.com.

model"[18] will be introduced.[19] The direction of corporate governance convergence, no matter whether it is toward a shareholder-oriented model or a hybrid model, is always determined by four factors. These are: board systems; the priorities placed on shareholder value or a combination of shareholder and stakeholder value; the relationship between control and ownership as well as the financial structure of the company; and the role of capital markets.

In this article, a justification for the convergence of corporate governance systems will be discussed, followed by the arguments for a hybrid model. In particular, the interests of stakeholders will be examined in different possible hybrid models.

2 Arguments for proceeding with convergence

The global nature of financial markets links companies and investors around the world. After recent corporate scandals (which have happened since the mid-1990s), it should come as no surprise to anyone that principles of good and effective corporate governance are converging while variations in national company law and practice remain.[20] Legislatively, the Organisation for Economic Co-operation and Development (OECD) developed principles[21] as a guide for governments worldwide to assist them in their efforts to improve their legal, institutional and regulatory frameworks for corporate governance. The internationalisation and globalisation of capital, capital markets, and trade are resulting in the convergence, confluence and homogenisation of internationalised corporate governance structures.[22] The convergence of corporate governance and pressures from the trend towards convergence will enable companies to reconfigure their governance structures and make them more efficient in order to promote the success of the company. International and cross-border companies in general compete globally and are free to alter their governance conventions because of the dynamic characteristics of corporate governance models.[23]

In practice, common features of corporate governance systems may be acquired through regulatory regime adjustments or, alternatively, obtained through firms' adaptations in the light of the successful governance practices of other companies with a competitive advantage. The first type of change is defined by Gilson as "formal convergence", which generally involves a political process of changing regulatory rules and complementary institutions;[24] the latter is considered a process of "functional convergence", in which existing governance institutions are elastic enough to respond to the demands of changed circumstances without transforming the formal characteristics of the governance system they reside in.[25]

18 See R La Porta, A Shleifer, and R W Vishny, "Legal determinants of external finance' (1997) 52 *Journal of Finance* 1131.

19 Van Den Berghe, *Corporate Governance*, n. 2 above, p. 13.

20 S Maier, "How global is good corporate governance?", Research Briefing of Ethical Investment Research Services (2005): www.eiris.org/files/research%20publications/howglobalisgoodcorpgov05.pdf, p. 5.

21 For example, OECD, *OECD Principle of Corporate Governance 2004* (Paris: OECD 2004).

22 M Fukao, *Financial Integration, Corporate Governance, and the Performance of Multinational Companies* (Washington DC: Brookings Institution 1995).

23 M J Rubach and T C Sebora, "Comparative corporate governance: competitive implications of an emerging convergence" (1998) 32 *Journal of World Business* 167, p. 180.

24 R J Gilson, "Globalizing corporate governance: convergence of form or function" (2001) 49 *American Journal of Comparative Law* 329, p. 336.

25 Ibid. p. 336.

Comparatively, functional convergence takes a more flexible form and can occur at different levels: at the level of the firm, or at national or supranational levels. Formal convergence mostly takes place in the form of regulatory change at or above the national level. In business practice, we often witness the occurrence of functional convergence in a variety of forms without the adjustment of local laws.

Based on the consideration of both global competitive pressures and national path dependence persistence, Gilson concluded that corporate governance convergence would be most likely to be achieved in function first rather than in form.[26] By engaging in functional convergence, firms have the opportunity to choose and adapt various components to fit into their own systems; formal convergence indicates the fact that the whole system, including its complementary elements, has to be changed to converge with the configuration of the new regime. Since the hybrid model that will be put forward in this article is principle-based, with the requirement that each jurisdiction should create enforceable supplementary measures in implementing those principles, the author favours the trend towards functional convergence largely due to path dependence theory.

2.1 Institutional investors and convergence

Proponents of the globalised corporate governance model have concluded from the rise of foreign direct and portfolio investment that there is a trend towards convergence in corporate governance. Institutional investors, such as banks, insurance companies, pension funds, mutual funds, hedge funds, exchange-traded funds and other financial institutions, occupy an increasing percentage in the shareholder structure within companies, especially in multinational companies. The increase of investment funds will push the harmonisation in corporate governance still further.[27]

Taking the US as an example, institutional shareholders have been increasingly playing a leading role in the last decade:

> Latest available year-end 2005 data show that US institutional investors have since rebounded robustly to control $24.1 trillion in assets, up from a low of $17.3 million in 2002; institutional investor ownership of US corporations also rebounded during the post-2002 market break period and, in 2005, institutional investors held a record 61.2 per cent of total US equities, up from 51.4 per cent in 2000.[28]

In Japan, too, where *keiretsu* holdings are significant, institutional shareholders have become increasingly active in their involvement in corporate governance.[29] The distribution of share ownership changed greatly between 1950 and 2003. In terms of institutional shareholders, the percentage of bank and trust company shareholders grew from 12.6 per cent to 17.4 per cent; pension funds grew from 0 per cent to 4.5 per cent; insurance companies grew from 0 per cent to 8.0 per cent. In contrast, the proportion of shares owned by individual shareholders dropped from 61.3 per cent to 20.5 per cent.

26 Gilson, "Globalizing corporate governance", n. 24 above.

27 M Bradley, C A Schipani, A K Sundaram and J P Walsh, "The purposes and accountability of the corporation in contemporary society: corporate governance at a crossroads" (1999) 62 *Law and Contemporary Problems* 9, p. 67.

28 C K Brancato and S Rabimov, *The 2007 Institutional Investment Report*, No 1400 (New York: The Conference Board 2007).

29 T Seki, "Legal reform and shareholder activism by shareholder investors in Japan" (2005) 13 *Corporate Governance* 377, p. 382.

This trend is also present in the UK, where the percentage of institutional shareholders grew from 29 per cent in 1960 to 60 per cent in 1994.[30] Institutional investors controlled about 80 per cent of the UK equity market as of 31 December 2003.[31] In contrast, individual investors owned 54 per cent of the shares in 1963 but the proportion of shares owned by this group fell steadily until by 1989 it had dropped to 21 per cent. By 2006, the percentage of shares in the hands of individual shareholders had dropped to 13 per cent, even though there are reasons why individual share ownership had been encouraged during that time, such as the large privatisation issue which occurred in the UK in the early 1990s and, in more recent years, the demutualisation of some of the large building societies.[32] Holding 94 per cent of the European market's share ownership up to 31 December 2005, institutional investors conspicuously dominate and drive that market.[33]

Institutional investors, working together with advocacy organisations,[34] monitor corporate governance activities and provide voting advice. They will also collectively abstain or vote against management at annual general meetings, sending strong messages to company boards. Based on evidence from the shareholding structure modification in the last 20 years in the UK and the US, it is apparent that institutional shareholders are becoming increasingly important in the operation of the entire corporate governance system. The obvious growth of institutional investment has begun to influence the views of corporate governance worldwide via the rapid internationalisation of the capital market.[35] Institutional investors in the US, Europe and elsewhere seek to invest increasing amounts of capital throughout the world, which create pressure that "disturbs pre-existing factual and legal patterns of owner–manager relations within private firms" in different countries.[36]

Institutional investors insist that companies respect international norms of governance, especially in terms of the duties owed by directors to manage and control the shareholders in order to respect the minority shareholders and prove transparency and procedures for exerting corporate control.[37] Therefore, companies are always required and obliged to adapt their behaviour accordingly.

Institutional investors, in contrast to individual shareholders, will compare investment opportunities globally before investing. The directors, the chief executive officer (CEO), and the reputation and future of the corporation will all be included as factors to be considered, and will be judged not only against domestic companies and companies in neighbouring countries, but also against the companies worldwide. Instead of facing millions of anonymous shareholders, the directors of companies are in fact facing several thousand identifiable money managers. The institutional shareholders' managers are "much

30 See P Davies, "Institutional investors as corporate monitors in the UK" in K J Hopt and E Wymeersch (eds), *Comparative Corporate Governance* (Berlin/New York: Walter de Gruyter 1997).

31 C Mallin, A Mullineux and C Wihlborg, "The financial sector and corporate governance: the UK case" (2005) 13 *Corporate Governance: An International Review* 532.

32 C A Mallin, *Corporate Governance* 3rd edn (Oxford: OUP 2010), p. 106.

33 European Social Investment Forum (Eurosif), *European SRI Study 2006* (Brussels: Eurosif 2006), p. 9.

34 Such as the Pensions Investment Research Consultants (PIPC) or Institutional Shareholder Services.

35 E W Orts, "The future of enterprise organization" (1996) *Michigan Law Review* 1947, p. 1964; for a more detailed account of the extent and cause of the internationalisation of capital markets in the last few decades see U Geiger, "The case for the harmonization of securities disclosure rules in the global market" (1997) *Columbia Business Law Review* 241, pp. 247–55.

36 R M Buxbaum, "Institutional owners and corporate manager: a comparative perspective" (1991) 57 *Brook Law Review* 1, p. 5.

37 S Nestor and J K Thompson, "Corporate governance patterns in OECD economies: is convergence under way": www.oecd.org/, p. 20.

more demanding and less patient than individual shareholders".[38] They "look for company competitiveness of corporations, and clamour for change when companies fall short".[39]

Cross-border institutional investors will set out corporate governance principles and put pressure on poorly performing companies to improve their corporate governance practices.[40] Companies all struggle to adopt and apply the best corporate governance principles with the intention of attracting and retaining institutional shareholders. The increasing proportion of institutional shareholders will lead to a focus on shareholder proposals that are generally applauded by commentators. The focus will also entail alteration to board structure to enhance its independence from management. The separation of management and control brought about by the increasing number of institutional shareholders in the stock markets in Japan and continental European countries will create pressure towards convergence to an outsider model of corporate governance. Besides, the increasing number of institutional investors will make the shareholder structure in jurisdictions with insider models more dispersed, rather than highly concentrated as was previously the case. This is further evidence that the insider corporate governance model is moving towards the outsider model.

On the other hand, in practice, many institutional shareholders are starting to monitor companies' performance, especially around issues concerning social and environmental factors that impact upon stakeholders.[41] Care and concern for stakeholders' interests are not just the result of philanthropic or ethical motives. The more motivating reason is based upon a perception that corporations which ignore stakeholders' concerns will always ultimately put the interests of shareholders at risk. Therefore, it is reasonable for the institutional shareholder in an outsider model to promote the stakeholders' interests and therefore the ethical responsibility of the company.

2.2 Integration and globalisation of economy and markets

The profound effect of economic integration – that is the openness and integration of national economies into the international economy through trade, foreign investment, capital flows, communication and modern technology – in facilitating the fast growth of common governance practice has been well recognised.[42] At the outset, the massive integration of financial markets, and in particular the dramatic increase in foreign exchange and portfolio capital flows, has advanced the expansion of international financial linkages and economic integration.[43]

The growing integration of financial markets is an important factor favouring convergence of corporate governance. An increasing number of investors agree that holding an international equity portfolio, rather than a purely domestic portfolio, will lead to a higher return and lower risk.[44] Therefore, it is a very common and modern phenomenon that many pension funds allocate a certain portion of their portfolios to international equities while a large number of specialised mutual funds have been developed

38 M Useem, "Corporate leadership in a globalizing equity market" (1998) 12 *Academy of Management Executive* 43, p. 45.

39 Ibid.

40 Davis, "Institutional investors", n. 30 above.

41 J Armour, S Deakin and S J Konzelmann, "Shareholder primacy and the trajectory of UK corporate governance" (2003) 41 *British Journal of Industrial Relations* 531, p. 545.

42 J Bhagwati, *In Defense of Globalisation* (New York: OUP 2004), p. 3.

43 T Clarke, *International Corporate Governance: A comparative approach* (Oxford: Routledge 2007), p. 3.

44 Nestor and Thompson, "Corporate governance", n. 37 above, p. 19.

to allow individuals to participate in foreign equity investment.[45] The phenomenon of international diversification is normal in countries with strong institutional shareholder communities. Therefore, similar diversification is expected to be generalised in other countries to succeed in developing institutional saving.[46]

Besides, foreign listings are also becoming an increasingly important strategic issue for companies and stock exchanges alike.[47] It is normally very beneficial for companies to access foreign capital markets via an equity listing as companies become global in their product market and investment strategies.[48] Global financial transactions have increased over recent years with more companies raising equity outside their home country.[49]

Moreover, the growing wish of both investors and issuers to operate in the international capital market requires a certain degree of acceptance of common values and standards.[50] Many companies, both domestic and multinational, have become involved in cross-border activities in the product and capital markets. Cross-border business activities highlight corporate diversity in financial reporting practice under different jurisdictions, each established according to its own political, legal, cultural and business environments. This may lead to a financial reporting system which lacks international comparability. However, it is argued that greater comparability in information will enable resources to be allocated more efficiently and will facilitate better investment decisions.[51]

As a result of rising international trade, the development of internationally comparable business practices and standards is becoming increasingly necessary.[52] The International Accounting Standards Committee (IASC) was formed in 1973 by professional accounting bodies from 10 countries and has worked to develop a core set of international accounting standards which could be employed in the presentation of financial statements worldwide. The IASC completed its task in 1999, and it is now up to the European Commission and its regulatory counterparts throughout the world to assess the acceptability of the International Accounting Standards (IAS).[53] The European Commission has regarded harmonisation as a key element in meeting the growing need for transparent corporate accounts and the need to compare financial statuses in order to streamline the process of convergence and the transparency of financial information from a global perspective. Therefore, the European Union decided to implement the international standards, already used by some EU businesses published by the International Accounting Standards Board (IASB). The application of the IAS in the EU is regulated by EU Regulation No 1606.02 with the objective of adopting and use of:

> IAS in the Community with a view to harmonising the financial information presented by the companies in order to ensure a high degree of transparency and

45 Nestor and Thompson, "Corporate governance", n. 37 above.

46 Ibid.

47 M Pagano, A A Roell and J Zechner, "The geography of equity listing: why do companies list abroad" (2002) 6 *The Journal of Finance* 2651, p. 2651.

48 Companies are able to collect funding abroad at a cheaper price, or they might find that capital is more easily available. Also by listing abroad, firms may improve the terms on which they can raise capital or on which their shareholders can sell existing securities.

49 P Walton and A Haller, *International Accounting* (London: International Thomson Business Press 1998).

50 Nestor and Thompson, "Corporate governance", n. 37 above, p. 20.

51 Braendle and Noll, "On the convergence", n. 11 above, pp. 67–8.

52 J Solomon, *Corporate Governance and Accountability* 3rd edn (Chichester: John Wiley & Sons Ltd 2010), p. 198.

53 C I Isaac (Commissioner Isaac C Hunt Jnr, US Securities and Exchange Commission), "International Accounting Standard: The Rules of the Game" (paper presented at the University of Texas School of Law 22nd Annual Conference on Securities Regulation and Business Law, 2000): www.sec.gov/news/speech/spch348.htm.

comparability of financial statements and hence an efficient functioning of the Community capital market and of the Internal Market.[54]

The right of EU member states to allow or require the adoption of the IAS by EU-listed companies was included in the regulation, with reference to annual financial statements, and unlisted companies, with reference to annual and consolidated financial statements. Furthermore, the subsequent EC Regulation No 1725/03 completed the EC Regulation No 1606/02 and adopted all accounting standards issued by the IASB (except for IAS 32 and IAS 39), which must be complied with when preparing annual and consolidated financial statements.

Apart from accounting standards, the Security and Exchange Commission has also been working with the International Organisation of Securities Commissions to develop international standards for non-financial statement disclosure. Furthermore, the high concentration of corporate auditing work with the few remaining international auditing firms also enhances the convergence of corporate governance practice: those firms have mature systems to apply international standards when evaluating expertise and performance in corporate practice, thus further prompting the unification of good corporate practice.[55]

Additionally, the number of cross-border mergers has dramatically increased during the last two decades.[56] Intensified competition in the globalisation process further contributes to the convergence of corporate governance practice by heightening anxiety about firm expansion. To survive in the competitive global market, it is important for firms to attain sufficient size and market influence by concentrating capital through mergers and acquisitions.[57] This inevitably results in the unification of governance standards and practices of those merged or acquired firms. Mergers and acquisitions via cross-border deals underwent an explosive growth during the 1990s, increasing by 500 per cent. Cross-border mergers provide an alternative mechanism for contractual convergence, which occurs when firms change their own corporate governance practices by adopting a better regime, possibly because of unchangeable legal systems due to lack of flexibility or immutable law.[58] The target always adopts the disclosure practices, accounting standards and corporate governance structure of the acquirers in a cross-border merger.[59] The target company will always modify its corporate governance model towards the acquired model when it is acquired by a foreign company.

For example, the French company Vivendi acquired the Canadian firm Seagram in 1999, and the merged firm adopted French accounting systems. Similarly, the French tobacco company Seita was acquired by the Spanish Tabacalera, in establishing a new corporation named Altadis in 1999. The new company prepares its consolidated financial statements in

54 Article 1, Regulation (EC) No 1606/2002 of the European Parliament and of the Council.

55 E Wymeersch, "Company law in turmoil and the way to 'global company practice'" (2003) *Journal of Corporate Law Studies* 283, p. 286. The current four largest accounting firms in the world are referred to as the big four, see n. 15 above.

56 D C Mueller, *The Corporation: Growth, diversification and mergers,* 2nd edn (London/New York: Routledge 2003).

57 C Lane, "Changes in corporate governance of German corporations: convergence to the Anglo-American model?" (2003) 7 *Competition and Change* 79, p. 87.

58 Contractual convergence is defined by Bris and Cabolis together with functional convergence (which occurs when institutions are flexible enough to respond to demands from market participants and no formal change in the rules is necessary) and formal convergence (which occurs when a change in the law forces the adoption of best practices). See A Bris and C Cabolis, "Corporate governance convergence by contract: evidence from cross-border mergers", Working Paper No 02-32 (New Haven: Yale ICF 2002); see also A Bris, N Brisley and C Cabolis, "Adopting better corporate governance: evidence from cross-border mergers" (2008) 14 *Journal of Corporate Finance* 224.

59 Bris and Cabolis, "Corporate governance convergence", n. 58 above, p. 3.

accordance with generally accepted accounting principles in Spain. Finally, Daimler Chrysler had to adopt the two-tier board structure required by German company law as the result of merger between a US and a German company. These examples demonstrate that mergers and acquisitions that happen globally will have an impact on the companies involved not only internally but also externally. This change could even be a complete transfer from one corporate governance model to another one.

In Europe, the creation of the single currency area within the EU (Euroland) seems to have boosted the development of a European corporate bond market. The rapid growth in the Euro-based corporate bond market will further reduce the role of bank loans as a source of corporate external finance which is a typical character of the insider corporate governance model in which banks are the dominant institutions providing both indirect and intermediate debt finance from the capital market. By eliminating exchange rate risk, European monetary union has eliminated a crucial obstacle to financial integration and opened up the possibility of a fully integrated continental financial market comparable to that of the United States.[60] Therefore, convergence can be expected to accelerate, at least from the perspective of Euroland.

2.3 Legal convergence

After discussing market convergence and standard convergence between corporate governance models, there is another crucial issue which needs to be explored in this context: the legal issue. The widely different systems and structures of corporate law and securities market regulations adopted in different countries have been regarded as a strong argument in support of divergence between national ownership and control environments. For example, there is an enormous equity market in the UK and the US, while Germany and France have much smaller markets. Hundreds of companies go public in the US each year while in Italy only a few dozen went public in a decade.

Academics make a distinction between two types of legal system, namely the common law and civil law systems. These two legal systems have different impacts on corporate governance.[61] Legal rules concerning protection of investors and the enforcement of these rules differs greatly and systematically across countries. Common law countries protect both shareholders and creditors the most, while French civil law offers the least protection; and German civil law falls somewhere in the middle. The main reason is because common law countries emphasise market discipline and private litigation while civil law countries put a stronger emphasis on state involvement. It is argued that private monitoring and contracting are more important than public enforcement of securities law, and it is concluded accordingly that these advantages of the common law tradition will be decisive for the superior quality of securities law and better protection for investors.[62]

However, the integration and globalisation of markets make the difference in legal systems of less importance in their interaction with corporate governance models. For example, convergence can occur at the level of securities regulation, even while convergence of corporate law has been largely frustrated.[63] Coffee thinks that this kind of "stealth" convergence is already on the doorstep.[64]

60 T Jappelli and M Pagano, "Financial market integration under EMU", Economic Paper 312 (Brussels: European Commission 2008), p. 2.

61 La Porta et al., "Legal determinants", n. 18 above.

62 R La Porta, F Lopez-de-Silanes, A Sheifer and R Vishny, "The quality of government" (1999) *Journal of Law, Economics and Organization* 222, p. 261.

63 Coffee, "The future as history", n. 12 above, p. 666.

64 Ibid.

It also seems to be the case that legislation concerning corporate governance has been converging over the last few years. In the case of continental European countries, one of the major recent objectives of German economic policymakers has been the promotion of a shareholding culture among German citizens.[65] It is emphasised that stock market channels should be developed for equity finance, in order to get rid of the hindrance resulting from the bank-centred finance model. In Germany, the corporate governance debate first found its way into legislation in 1996, with the introduction of the law on control and transparency in business which is known as KonTraG.[66] The Government Commission on Corporate Governance was appointed in September 2001 by the Federal Ministry of Justice, and its work was published in the draft code of December 2001; the final version was then adopted as the German Corporate Governance Code on 26 February 2002.[67] Creating transparency is the key function of the code in order to enhance companies' credibility, especially as far as consolidation is concerned. Similarly, the "Draghi" law drastically increased shareholders' rights in Italy in 1997.

At the other end of the spectrum, there is a trend towards independence of supervisory bodies in the outsider model, where the roles of non-executive directors are emphasised.[68] Furthermore, the US Securities and Exchange Commission is becoming more tolerant of "relationship investors" and is willing to grant "safe harbours" for consultations between them and company managements.[69] Additionally, directors' duties towards the interests of stakeholders through the enlightened shareholder value principle in the UK can also be regarded as a result of convergence.

2.4 The establishment of the European company as a sign of convergence

The status of European Company, the so-called Societas Europaea, was finally adopted by the Council of the EU on 8 October 2001.[70] This means that all companies in EU member states are allowed to incorporate as a Societas Europaea and they will be entitled to choose between a one-tier and a two-tier board model. The legislative foundation of the Societas Europaea can be found both in Regulation 2157/2001 of the European Council and in the Council Directive 2001/86, supplementing the status for a European company with regard to the involvement and participation of its employees.[71]

This legislation will create a brand new legal form of corporation, which will exist under the regulations both of European law and domestic law. The distinct differences between the social and cultural issues in each member state make it impossible to achieve the original objective of establishing an integrative legal form which is independent of national legislation. A general technique of renvoi was adopted, as the result of political compromise in order to match the new integrated legal form. The renvoi technique means that Societas Europaea will be directly regulated by relevant European regulations, while still referring

65 Gordon, "Pathways", n. 12 above, p. 220.

66 KonTraG means *Gesetz zur Kontrolle und Transparenz im Unternehmensbereich.*

67 G Cromme, "Corporate governance in German and the German corporate governance code" (2005) 13 *Corporate Governance: An International Review* 362, p. 364.

68 See M Sweeney-Baird, "The role of the non-executive in modern corporate governance" (2006) 27 *Company Lawyer* 67; T Long, V Dulewicz and K Gay, "The role of the non executive directors: findings of an empirical investigation into the differences between listed and unlisted UK boards" (2005) 13 *Corporate Governance: An International Review* 667.

69 Nestor and Thompson, "Corporate governance", n. 37 above, p. 22.

70 U Braendle and J Noll, "The Societas Europaea – a step towards convergence of corporate governance systems" (2007) 4 C*orporate Ownership and Control* 11, p. 14.

71 S Lombardo, "The 'Societas Europaea': a network economics approach", Working Paper in Law No 19/2004 (Brussels: European Corporate Governance Institute January 2004).

certain other aspects of the company to domestic legislation. Taking the UK as an example, the European Public Limited Liability Company Regulations 2004 were introduced by Parliament to clarify how to implement the rules for the Societas Europaea in the UK.[72] For the first time, companies registered in the UK were able choose between a one-tier board and a two-tier board. Moreover, for the first time, British plcs were confronted with employee representation at board level.[73] However, issues such as the method for choosing the employee representatives, seen as particularly important in the UK, are left to member states.

With the emergence and gradual adoption of the Societas Europaea, corporate governance models, at least within the scope of the EU, are becoming closer. The separation of the roles of CEO and chair of the board as well as the introduction of audit committees are signs of modification and movement from the one-tier to the two-tier board model. The legal status of the Societas Europaea illustrates the floating nature of the boundaries between signs and drivers of convergence in corporate governance. The distinctions between each system in the European Union are becoming less distinct, and the introduction of the Societas Europaea definitely enhances corporate governance convergence within EU member states.

3 Two optimal "standard school" models for convergence[74]

Comparative corporate governance is an area where the descriptive, the normative and the plain wishful thinking often coalesce.[75] The idea of using comparativism as a tool for of law reform via the process of legal transplantation has great allure in this field.[76] Comparative corporate scholarship will provide guidance on the following two issues: (1) whether the interests of stakeholders other than shareholders should be considered by directors in corporate governance models; and (2) how and why two particular ownership patterns for publicly traded corporations, either of widely dispersed shareholders or concentrated shareholding, developed in certain countries, and whether one pattern of ownership will eventually prevail.[77] The standard school believes that globalisation of the economy will lead to convergence of corporate governance towards one standard model. The detailed description of this standard model is not straightforward. However, the two main variants are the shareholder primacy model and a hybrid model based on the most successful elements of the two archetype models.

3.1 Corporate governance convergence and the shareholder primacy model

In the early 1990s, debate centred mainly around improving US economic performance by learning from governance mechanisms in other jurisdictions, such as Germany and Japan. However, by the mid- to late 1990s, with the US economy buoyant and the globalisation debate in full swing,[78] the flavour of comparative corporate governance changed

72 European Public Limited Liability Company Regulations 2004, SI 2004/2326.

73 Braendle and Noll, "The Societas Europaea", n. 70 above, p. 18.

74 Of course, classic stakeholder theory can also be regarded as a model of convergence. However, the arguments in this article on possible convergence models are limited to possible optimal convergent models from the "standard school" which is limited to two variants: the market-oriented model and the hybrid model.

75 O Kahn-Freund, "On uses and misuses of comparative law" (1974) 37 *Modern Law Review* 1.

76 See E Rock, "America's shifting fascination with comparative corporate governance" (1996) 74 *Washington University Law Quarterly* 367, p. 368, in which Professor Rock thinks the temptation of comparative studies is "to try to get something for nothing or at least a discount".

77 A R Pinto, "Globalization and the study of comparative corporate governance" (2005) 23 *Wisconsin International Law Journal* 477, p. 477.

78 Ibid. pp. 485–6.

significantly. It was no longer concerned with the idea of grafting foreign governance mechanisms into US law, but rather about the export of US-style corporate governance principles internationally.

3.1.1 The shareholder primacy norm on a convergence basis

The academic literature on international comparative governance research also has a tendency to combine the salient features of American and British capitalism into a single shareholder primacy model.[79] The model is characterised by "long term financing through equality and corporate bond markets".[80] The model is also characterised by a legal and regulatory approach, which is in favour of employing the public capital market and is designed to build confidence among non-controlling investors.[81]

The outsider model emphasises a number of features including: the primacy of shareholders as beneficiaries of fiduciary duties; the importance of equity financing; dispersed ownership as the predominant ownership structure, referring to the cash flow rights as well as the controlling rights of ownership;[82] active markets for corporate control as a mechanism of managerial accountability; and flexible labour markets and a one-tier board structure in which the executive and non-executive directors are integrated.[83] Convergence optimists have tended towards the market-oriented model, focusing on the evolutionary pressures of competitive international capital markets, and on the tendency of firms seeking to achieve a global scale of operation to opt into high-quality securities market regulatory regimes in order to promote transparency, accountability and shareholder fiduciary protection.[84] The pressure from market forces drives the existing system with the shareholder at the centre. Therefore, the outsider model will lead to higher wealth for all parties involved since capital markets have played a central role in the development of firms and countries.[85]

3.1.2 The interests of the stakeholders in the convergent shareholder primacy norm

It is believed by adherents to the shareholder primacy norm as the convergent standard model that law should sanction the axiom that corporations should be run in the interests of their shareholders exclusively. Instead of protecting stakeholders' interests through corporate law, the most efficient legal mechanisms to protect the interests of non-shareholder constituencies lie outside corporate law.

However, while some progressive scholars and reformers have attempted to protect stakeholders by changing corporate law, others have looked to other legal regimes to regulate corporate behaviour. Directors would be required by laws outside corporate law to consider the legal rights of various stakeholders. Corporate governance requirements are practices typically influenced by an array of legal domains, such as securities regulation, accounting and auditing standards, tax law, contract law, employment law, environment law, consumer protection law and insolvency law.[86] For example, in the US, from securities and

79 S Toms and M Wright, "Divergence and convergence within the Anglo-American corporate governance system: evidence from the US and UK, 1950–2000" (2005) 47 *Business History* 267, p. 267.

80 Van Den Berghe, *Corporate Governance*, n. 2 above, p. 9.

81 Nestor and Thompson, "Corporate governance", n. 37 above, p. 7.

82 Braendle and Noll, "On the convergence", n. 11 above, p. 58.

83 See ch. 10, "Varieties of corporate governance: comparing Germany and the UK", P A Hall and D Soskice, *Varieties of Capitalism: The institutional foundations of comparative advantage* (Oxford: OUP 2001).

84 Gordon, "Pathways", n. 12 above, p. 219.

85 Van Den Berghe, *Corporate Governance*, n. 2 above, p. 14.

86 OECD, *Principle*, n. 21 above, p. 2.

labour law reforms in the New Deal to the social welfare laws of the 1960s and 1970s, progressives have advocated a diverse and broad array of mandatory legal rules designed to limit corporate conduct which is perceived to be harmful to non-shareholder constituencies.[87] In fact, the influences of this legal protection for various stakeholders from sources outside corporate law are powerful forces in directing the decisions of directors. All these decisions are made under the mandatory legal rules embodied in employment law, workplace safety law, environmental law, consumer protection law, pension law, taxation law and bankruptcy law.[88] Those duties towards various stakeholders are fiduciary duties of company directors and are inseparable from corporate law and corporate governance. As a result, directors will, when they manage a corporation, find "their decision tree considerably trimmed and their discretion decidedly diminished by mandatory legal rules enacted in the name of protecting stakeholders".[89]

With regards to the convergent shareholder primacy model, the claims of victory for shareholders over stakeholders depend on an artificially narrow view of the law affecting corporate management.[90] The entity of corporate governance is not exclusively shaped by corporate law.[91] "Stakeholders exert their voice through legal mechanisms adopted largely outside of corporate law", and "stakeholder success outside of corporate law indicates the limited significance of any claimed victory of shareholders over stakeholders within corporate law".[92] The victory of the shareholder primacy model within the corporate law area does not equate to victory in the wider debate over corporate social responsibility (CSR), stakeholder protection and even the stakeholder theory itself. In the broader arena of business law in which battle extends to other areas, such as employment law and environmental law, the market-oriented model is a far from accurate description of the law of business or, more practically, of corporate practice. The norm will simply "exist in corporate law alongside the many other areas of the law of business that do interfere with the free market and restrain corporate management in the interests of corporate stakeholders".[93]

3.1.3 Objections to the "end of history" story

In 2001, Hansmann and Kraakman argued strongly for the belief that the shareholder primacy model will become the dominant normative consensus as a result of pressure from the capital market and listed companies. They boldly argued that not only is the shareholder-oriented model both desirable and inevitable, but also that, de facto, corporate governance systems in various jurisdictions have already largely converged to that kind of model. They famously and controversially pronounced that the triumph of the shareholder primacy model over its principal competitors is now assured,[94] a pronouncement that assumes that

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87 A Winkler, "Corporate law or the law of business? Stakeholders and corporate governance at the end of history" (2004) 67 *Law and Contemporary Problems* 109, pp. 110–11.

88 Term used in US law which is equal to the insolvency law employed in the UK or Australia.

89 Winkler, "Corporate law", n. 87 above, p. 111.

90 Ibid. p. 111.

91 For example, Robert Thompson and Hillary Sale have argued that "the most visible means of regulating corporate governance" is federal securities law rather than corporate law; see R B Thompson and H A Sale, "Securities fraud as corporate governance: reflections upon federalism" (2003) 56 *Vanderbilt Law Review* 859, p. 860; Steven Bank argues that one often overlooked influence on corporate governance is federal tax law; see S A Bank, "Tax, corporate governance, and norms" (2004) 61 *Washington and Lee Law Review* 1159; see also M E Kornhauser, "Corporate regulations and the origin of the corporate income tax" (1990) 66 *Indiana Law Journal* 53.

92 Winkler, "Corporate law", n. 87 above, p. 111.

93 Ibid. p. 112.

94 Hansmann and Kraakman, "The end of history", n. 2 above, p. 468.

convergence is virtually a fait accompli. They believed that an adoption of the model would lead to higher wealth for all parties involved, since capital markets have played a central role in the development of corporations and countries. They especially noted the similar characteristics of global large-scale corporations at the end of the nineteenth century, including: the full legal personality of the corporation; the limited liability of directors and shareholders; shared ownership; delegated management under a board structure; and transferability of shares.[95]

They tried to justify the supremacy of the model by force of logic, example and competition.[96] In their logical argument, they pointed out that the interests of equity investors in the firm (the firm's residual claimants) cannot be adequately protected by contract. Therefore, they must be given the right to control the firm.[97] However, even under the shareholder primacy model, shareholders do not have any direct rights in controlling the company. These rights are all in the hands of the board of directors rather than with the shareholders themselves. Therefore, this logical argument is not entirely correct.[98]

The second reason given by Hansmann and Kraakman is that, if the control rights granted to the firm's equity-holders are exclusive and strong, they will have powerful incentives to maximise the value of the firm. This is simply a repeat of the narrative argument in favour of the model, which cannot be used as grounds for argument in debating the topic itself. Besides, according to the model, the equity-holders do not own direct controlling rights in the corporation. Furthermore, employees' incentives to work efficiently for the company, customers' incentives in purchasing products from the company, suppliers' incentives to establish a sound supply-chain, and creditors' incentives to provide the company with reliable and sufficient funding are all critical in maximising the long-term value of the firm.

They also argued that other company stakeholders have already been given substantial protection by contract and regulation, and implementing the stakeholder model in the company will create more difficulties than it solves, even if contractual and regulatory devices offer only imperfect protection.[99] Hansmann and Kraakman did not enumerate any legislative facts or evidence in arguing the sufficiency of "substantial protection". If the protection is as substantial as they believed, why do they also make their initial assumption about imperfect protection? Furthermore, they did not explain in detail what they mean by the creation of "more difficulties". Does this mean that directors will have too many unexpected discretions in balancing the interests of the shareholders and stakeholders or anything else? The terms need to be redefined. Even if the directors do have too much discretion, this cannot be regarded as a justification for not considering the interests of stakeholders and not being socially responsible to the local communities, the environment or even to the government.[100]

95 Hansmann and Kraakman, "The end of history", n. 2 above, p. 468.

96 Ibid. p. 449.

97 Ibid.

98 This is why certain academics think that the model of corporate governance adopted in certain countries should more accurately be described as "director primacy" rather than "shareholder primacy". See L A Stout, "Bad and not-so-bad arguments for shareholder primacy" (2002) 75 *South California Law Review* 1189; L A Stout, "New thinking on 'shareholder primacy'", unpublished: www.law.ucla.edu/docs/bus.sloan-stout.pdf; S M Bainbridge, "Director primacy: the means and ends of corporate governance' (2003) 97 *Northwestern University Law Review* 547; S M Bainbridge, "The creeping federalization of corporate law" (2003) 26 *Regulation* 32; S M Bainbridge, "Director v shareholder primacy in the convergence debate" (2002) 16 *Transnational Law* 45.

99 See Hansmann and Kraakman, "The end of history", n. 2 above.

100 Ibid.

In addition, it is argued by proponents of the "end of history" argument that convergence towards the shareholder model largely depends on the theory that shareholders are owners of the company. However, it is clear that what shareholders actually own is merely some proportion of the company's shares. They consist of many thousands and millions of pension funds or insurance policies, managed by financial directors who are paid and trained to manage a portfolio of shares.[101] Some of the shareholders have barely seen any tangible part of what would usually be understood and regarded as the corporation. Legally defining the company as the property of these parties who are not even aware where their shares are held simply does not make any sense.[102]

Apart from the arguments mentioned above regarding the "end of history" theory, it is also argued that firms following the market-oriented model "have the upper hand"[103] in competitions and "can be expected to have important competitive advantages".[104] These advantages include: access to capital at a lower cost; a "stronger incentive" to reorganise in ways that are "managerially coherent"; and the ability to abandon "inefficient investment" more quickly.[105] It is obvious that this list of competitive advantages relates not to the economy as a whole but to the ability of the corporation to maximise shareholder advantages.[106] This makes the structure of the agreement tautological: the market-oriented model is superior because it is better at maximising shareholders' welfare. The argument by Hansmann and Kraakman only proves that shareholder-oriented companies will win if the measuring stick for the competition is shareholder advantage.[107] However, their argument does not prove that shareholder-oriented firms are better on any other basis. They cannot justify the claim that shareholder supremacy is always beneficial to corporations, since serving shareholder interests may not maximise the value of the firm, even in economic terms.[108]

Based on the justifications above, the arguments presented by Hansmann and Kraakman seem inaccurate and inadequate. Their bold argument for the end of the history of corporate law does not really terminate the debate on corporate objectives. The long battle between the conservative, private, shareholder-wealth-maximisation school and the progressive, public, stakeholder-protection and social-responsibility school is not over.[109] The objection to "the end of the history" was also admitted by Hansmann and Kraakman in the underlying thesis of *The Anatomy of Corporate Law*[110] where they argued that, in every jurisdiction, the central issue for corporate law is how to mediate three different kinds of "agency conflicts": those between managers and shareholders; those between majority and minority shareholders; and those between the firm and the corporation's other constituencies, including creditors and

101 J Williamson, "A trade union congress perspective on the company law review and corporate governance reform since 1997" (2003) 41(3) *British Journal of Industrial Relations* 511, p. 514.

102 Ibid. pp. 514–15.

103 Hansmann and Kraakman, "The end of history", n. 2 above, fn. 2.

104 Ibid.

105 Ibid. pp. 450–1.

106 K Greenfield, "September 11th and the end of history" (2002) 76 *Tulane Law Review* 1409, p. 1426.

107 Ibid.

108 K Greenfield, "The place of workers in corporate law" (1998) 39 *Boston College Law Review* 283.

109 Winkler, "Corporate law", n. 87 above; see also A Reberioux, "The End of History in Corporate Governance? A Critical Appraisal" (paper presented at Inaugural Workshop, Amsterdam Research Centre for Corporate Governance Regulation 2004): www.arccgor.nl/uploads/File/Reberioux%20Amsterdam%202.pdf; M Aglietta and A Reberioux, *Corporate Governance Adrift: A critique of shareholder value* (Cheltenham and Northampton: Edward Elgar 2005).

110 R R Kraakman, P Davies, H Hansmann, G Hertig, K J Hopt, H Kanda and E B Rock (eds), *The Anatomy of Corporate Law: A comparative and functional approach* (New York: OUP 2004).

employees.[111] They argued that the overall objective of corporate law is presumably to "serve the interests of society as a whole". More particularly:

> the appropriate goal of corporate law is to advance the aggregate welfare of a firm's shareholders, employees, suppliers, and customers without undue sacrifice – and, if possible, with benefit – to third parties such as local communities and beneficiaries of the natural environment.

3.2 Hybrid model

Sceptics of shareholder primacy convergence theory have focused on the embeddedness of governance systems in national political structures, which tends to protect both entrenched insider interests and non-shareholder constituencies against the incursions of Anglo-American governance agendas.[112] With increasing financial and legal globalisation, an improved model system is taking shape in the corporate governance debating arena. This hybrid model stream of the standard school suggests that the reason for the convergence is global competition between the corporate governance systems. Just as US states competed during most of the twentieth century for franchise tax revenues by offering the best terms for incorporation,[113] nations can now compete for firms and resources by creating the most efficient corporate governance environment.[114] It is believed that, instead of converging to a market-oriented model, the two main competing systems should borrow the best practice from one another. This borrowing will result in a "hybrid model" with the "right mix"[115] of market discipline, corporate regulation and power of corporate stakeholders.[116]

However, the hybrid model of corporate governance is based on the cross-reference hypothesis, which presupposes that corporate governance models are divisible.[117] This means that one model's components are able to be detached and adapted for use in another model without significant frictions or adverse effects.[118] A particular feature or innovation must be detachable from one model and adaptable to another.[119] The cross-reference hypothesis will only be robust if the systems in each country are de facto divisible. Indeed, the hybrid model is very likely to occur because of the globalisation of the product and capital markets.

3.2.1 Justifications for the hybrid model

The arguments in favour of the hybrid corporate governance system are based on theoretical, historical and logical analyses.

111 R R Kraakman and H Hansmann, "What is corporate law?", in Kraakman et al., *The Anatomy*, n. 110 above, p. 2.

112 Gordon, "Pathways", n. 12 above, p. 219; see also L A Bebchuk and M J Roe, "A theory of path dependence in corporate ownership and governance" (1999–2000) 52 *Stanford Law Review* 127.

113 See F H Easterbrook, and D R Fischel, "The incorporation debate and state anti-takeover statutes" in F H Easterbrook and D R Fischel (eds), *Economic Structure and Corporate Law* (London/Cambridge MA: Harvard UP 1991); R Romano, *The Genius of American Corporate Law* (Washington DC: AEI Press 1993).

114 T Khanna, J Kogan and K Palepu, "Globalization and similarities in corporate governance: a cross-country analysis" (2006) 88 *The Review of Economics and Statistics* 69, p. 72.

115 The term "right mix" will be further defined in this article when arguing the optimal hybrid model.

116 D Plihon, J Ponssard and P Zarlowski, "Towards a convergence of the shareholder and stakeholder model" (2005) 2 *Corporate Ownership and Control* 11, pp. 11–13.

117 W W Bratton and J A McCahery, "Comparative corporate governance and theory of firm: the case against global cross reference" (1999) *Columbia Journal of Transnational Law* 216, p. 242.

118 W C Kester, "Governance, contracting, and investment horizons: a look at Japan and Germany", in D H Chew (ed.), *Studies in International Corporate Finance and Governance Systems* (Oxford: OUP 1997), p. 227.

119 See S Berger and R P Dore (eds), *National Diversity and Global Capitalism*, Cornell Studies in Political Economy (Ithaca NY: Cornell UP 1996).

A Theoretical analysis

When corporate governance is increasingly driven by ethical norms and the need for accountability, and with CSR adapting to prevailing business practice, there will be a convergence between two separate sets of corporate governance mechanisms, one dealing with "hard-core" corporate decision-making and the other with "soft and people-friendly" business strategies. This will lead to a more hybridised, synthesised body of laws and norms to regulate corporate practices.[120] Research offers a theoretical background for how the two models have begun to converge towards a hybrid model, relying on directors' fiduciary duties,[121] stakeholder engagement[122] and economic analysis of management incentives to engage in CSR.[123]

The most convincing theoretical argument for the hybrid corporate governance model is global competition.[124] It is believed that the two archetype corporate governance models possess equal competitive fitness, so that they will merge into a single hybrid model.[125] Some features of certain national systems will be recognised as possessing problem-solving advantages and will therefore be widely adopted.[126] Global competition means a bigger market calling for larger capital-intensive but specialised producers, and necessitating cross-border collaboration among existing production organisations.[127] Like capital, innovative production technologies will rapidly diffuse to firms worldwide: the same should follow for corporate governance.[128] In a closely connected international market, it seems certain that the two major systems will attempt to assimilate their mutual advantages and the globalisation of the entire corporation model. Gradually, each corporate governance model will learn new things from the other system in order to perfect its own model.

The outsider model shifted its emphasis to a greater concentration on shareholding in order to be able to rely on more stable longer-term commitments from shareholders while the insider model relies more on the market to regulate its corporate governance model.[129] The potential failures of the market-oriented model could be prevented or at least ameliorated, by concentrated share ownership devices from the network-oriented system. By the same token, certain devices from the market-oriented model could be adopted by the network-oriented model in order to benefit from their advantages. The models' mutual improvement processes should lead ultimately to a hybrid corporate governance model.

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120 A Gill, "Corporate governance as social reasonability: a research agenda" (2008) 26 *Berkeley Journal of International Law* 452, p. 463.

121 See L Johnson and D Million, "Recalling why corporate officers are fiduciaries" (2005) 46 *William and Mary Law Review* 1597; M M Blair and L A Stout, "A team production theory of corporate law" (1999) 85 *Virginia Law Review* 247.

122 See L E Mitchell, "The board as a path toward corporate social responsibility" in D McBarnet, A Voiculescu and T Campbell (eds), *The New Corporate Accountability: Corporate social responsibility and the law*, (Cambridge: CUP 2007), p. 279.

123 See C Mackenzie, "Boards, incentives and corporate social responsibility: the case for a change of emphasis" (2007) *Corporate Governance: An International Review* 935; J S Johnston, "Signaling social responsibility: on the law and economics of market incentives for corporate environmental performance", Research Paper No 05-16 (Philadelphia: Institute for Law and Economics, University of Pennsylvania Law School 2005).

124 Van Den Berghe, *Corporate Governance*, n. 2 above, p. 15.

125 La Porta et al., "Legal determinants", n. 18 above.

126 Bratton and McCahery, "Comparative corporate governance and theory of firm", n. 117 above, p. 219.

127 R. Boyer, "The convergence hypothesis revisited: globalization but still the century of nations?" in S Berger and R Dore (eds), *National Diversity and Global Capitalism* (Ithaca: Cornell UP), p. 47.

128 C J Milhaupt, "Property rights in firms" (1998) 84 *Virginia Law Review* 1145, pp. 1186–7.

129 Van Den Berghe, *Corporate Governance*, n. 2 above, p. 16.

Notwithstanding the shift towards more ethical and accountable companies, large proportions of the public discourse and academic literature surrounding corporate governance focus on the goals of boards to increase profits for shareholders.[130] These discourses suggest that ultimately shareholders will be better off if directors are allowed to pursue long-term objectives. In the new economy, the increasing influence of information and communications technology and the emphasis on information and disclosure will prompt increased accountability and responsibility in the business world. As a result, the interests of various stakeholders will need to be considered by the directors in order to promote the accountability and responsibility of their corporations. Human capital and social capital will play a significant role in the new economy era for the purpose of promoting the competitiveness of the company and its shareholders.

B Historical evidence

The two models have always referred to each other. Adherents of the Anglo-American model think that continental European countries and Japan look to the corporate governance institutions of the United States and Britain to improve the quality of boardroom operations and enhance the depth and liquidity of their trading markets.[131] For example, Japan has removed both process restrictions that inhibited shareholder derivative actions, and legal restrictions on share issuance that prevented issuers from including stock options in management compensation arrangements.[132] The Italian government promulgated a package of securities and corporate governance law reform in 1998, in imitation of security regulations in the US.[133] Also, in Germany, various changes and modifications have transformed the German corporate governance model since the middle of the 1990s, bringing it closer to the Anglo-American model. Large and internationally oriented companies are affected, and the way strategic decisions are made in German firms has been changed in areas such as employment participation, shareholding structure, board structure and so on.[134]

On the other hand, in the 1980s, the shortcomings and disadvantages of the market-oriented model operating in the US and the UK were becoming clear. It was claimed that the shareholder primacy model unduly favoured the short-term "shareholder value" for instant maximisation of shareholder interests while deterring long-term investment in production processes.[135] Conversely, Japanese and German corporations had comparative advantages due to the fact that they invested more in searching for growth opportunities and the long-term interests of the company. Widespread hostile takeover activities in the UK and the US[136] in the 1980s and early 1990s were thought to be the result of the

130 See B Black, B Cheffins and M Klausner, "Outside director liability" (2006) *Stanford Law Review* 1055, p. 1089; R J Gilson, "Controlling shareholder and corporate governance: complicating the comparative taxonomy" (2006) 119 *Harvard Law Review* 1641.

131 K Lannoo, "A European perspective on corporate governance" (1999) 37 *Journal of Common Market Studies* 269.

132 Milhaupt, "Property rights in firms", n. 128 above, pp. 1188–9.

133 Coffee, "The future as history", n. 12 above, pp. 665–6.

134 See C Lane, "Changes in corporate governance of German corporations: convergence to Anglo-American model?" (2003) 7 *Competition and Change* 79.

135 W W Bratton and J A McCahery, "Comparative corporate governance and barriers to global cross reference" in J A McCahery, P Moerland, T Raaijmakers and L Renneboog (eds), *Corporate Governance Regimes: Convergence and diversity* (Oxford: OUP 2002), p. 31.

136 See P S Sudarsanam, "The role of defensive strategies and ownership structure of target firms: evidence from UK hostile takeover bids" (1995) *European Financial Management* 223; M S Weisbach, "Corporate governance and hostile takeover" (1993) 16 *Journal of Accounting and Economics* 199; A Shivdasani, "Board composition, ownership structure, and hostile takeover" (1993) 16 *Journal of Accounting and Economics* 167.

encouragement and legitimisation of short-termism[137] from the shareholder primacy model. In the early 1990s in the US, new legal controls constrained takeovers, simultaneously depriving the corporate governance system of a principal disciplinary device.[138] It was argued that the corporate governance model needed improvement and reform by learning from the stakeholder model, whose firms seemed to be beating American firms in the market and which had not evolved to rely on takeovers as an additional means of agency cost control and to re-establish a competitive position. The stakeholder model in bank monitoring, cross-holding and concentrated blockholding was regarded as a simultaneously corrective to conquer short-term investment objections as well as takeover decline.

If the debate on the shareholder and stakeholder approach is viewed historically, a cyclical pattern of dominance between the shareholder and stakeholder models has run in parallel with fashions in corporate governance over the years.[139] The corporate governance model that dominates at any time can only be understood as a set of responses to the separation of ownership and control at that time. It cannot be regarded as a permanent prescription for constantly changing markets and economic situations.

In the US, most of the corporations came in the form of quasi-public companies – for instance, charitable organisations, municipalities, public utilities and banks – in order to fulfil specific public policy goals in the early nineteenth century.[140] To a great degree, the directors of these corporations focused on the social welfare and interests of stakeholders of the company, since they were always created and supported by the state and were used as an instrument to discharge social responsibilities. However, in the late nineteenth century, motivated by the development of security and capital markets and the growing private business environment, earlier corporate concerns for stakeholders' benefits gave way to the pursuit of private wealth, specifically the wealth of shareholders. This trend was reflected in laws at that time, which also clearly indicated that corporations were supposed to be run for the benefit of the stockholders.[141]

Conversely, after the severe stock market crash and the Great Depression between 1929 and 1938, the shareholder theory lost its appeal for its supporters. It was criticised on the grounds that the overemphasis on shareholder profit maximisation had led to sightless production and uncontrolled markets, which further led to a severe economic depression in Western countries. As a consequence, stakeholder concerns started to gain ground again.[142] Many state-owned companies emerged and, until the 1970s, the focus of legislative tools swung away from capital investors to include the welfare of other corporate participants in

137 W Hutton, *The State We're In* (London: Jonathan Cape 1995).

138 Bratton and McCahery, "Comparative corporate governance and barriers to global cross reference", n. 135 above, p. 31.

139 Armour et al., "Shareholder primacy", n. 41 above, p. 535.

140 See J Hurst, *The Legitimacy of the Business Corporation in Law of the United States*, 1780–1970 (Charlottesville: University of Virginia Press 1970), pp. 58–66; see also A A Berle and G C Means, *The Modern Corporation and Private Property* (with a New Introduction by Murray L Weidenbaum and Mark Jensen) (London: Transaction Publisher 1991).

141 See *Report of the Committee Appointed Pursuant to House Resolution 429 and 504 to Investigate the Concentration of Control of Money and Credit,* House Report 1593, 62d Cong. 3d sess. (Washington DC: Government Printing Office 1913).

142 See A K Sundaram and A C Inkpen, "The corporate objective revisited" (2004) 15 *Organization Science* 350, p. 351; M E Dodd, "For whom are corporate managers trustees" (1932) 45 *Harvard Law Review* 1145–63.

corporations: "The three-decade burst of pro-shareholder sentiment during the early part of the twentieth century had been replaced by four decades of pro-stakeholder sentiment."[143]

After the 1970s, the corporate governance model swung back to the shareholder-centred view. This was mainly attributed to an upswing of the market for control and hostile takeovers during the last two decades of the twentieth century.[144] From the 1980s to the 1990s, when the American corporate governance system made reference to the continental European and Japanese system and corporations in stakeholder model jurisdictions were performing better, the stakeholder model was regarded as the model that should be internationally adopted.[145]

However, during the last decade and up to the present day, when the German, Japanese and other continental European countries often reference the shareholder primacy model, academics have begun once again to argue against the network-oriented model of corporate governance. It is argued that the one constituency whose claims remain completely wiped out in all the recent corporate failures is the shareholder.[146] Although almost all stakeholders' interests were undermined, most of them could get something back either by way of the bankruptcy process (e.g. suppliers and creditors) or by switching to other available services (e.g. customers).[147] The primacy of shareholder value has been re-emphasised to restore market confidence and to attract more investment to prompt business regrowth.

To make a bold guess, perhaps in the next 10 years, the network-oriented model will come back into fashion with the extensive analysis on the ongoing financial crisis since 1997 and the increasing importance of CSR. The dominant model of corporate governance at any given time is based on a wide variety of factors:[148] the dominance of one model could be simply "an accident of temporary good luck" .[149] Therefore, in the author's opinion, a formation of a hybrid corporate governance system will be the direction and trend in a convergence of corporate governance systems, since the two models will continuously and ceaselessly reference the advantages of the other in order ultimately to establish a best model. Although it is difficult to foresee exactly when this convergence will take place,

143 Sundaram and Inkpen, "The corporate objective revisited", n. 142 above, p. 351.

144 Ibid. p. 352; Hutton, *The State We're in*, n. 137 above.

145 See J C Coffee, "Unstable coalitions: corporate governance as a multi-player game" (1990) 78 *Georgetown Law Journal* 1495; J C Coffee, "Shareholder versus managers: the strain in the corporate web" 1986) 85 *Michigan Law Review* 1; K Lehn and A Poulsen, "Leveraged buyouts: wealth created or wealth redistributed?" in M Weidenbaum and K Chilton (eds.), *Public Policy toward Corporate Takeover* (New Brunswick, NJ: Transition Books 1988), p. 46; W S W Leung, "The inadequacy of shareholder primacy: a proposed corporate regime that recognizes non-shareholder interests" (1997) 30 *Columbia Journal of Law an Social Problems* 587; M E DeBow and D R Lee, "Shareholders, nonshareholders and corporate law: communitarians and resource allocation" (1993) 18 *Delaware Journal of Corporate Law* 393; M Jensen, "Eclipse of the public corporation" (1989) *Harvard Business Review* 61; M A O'Connor, "Restructuring the corporations' nexus of contracts: recognizing a fiduciary duty to protect displaced workers" (1991) 69 *North Carolina Law Review* 1189; A A Sommer, "Whom should the corporation serve?: The Berle-debate revisited sixty years later" (1991) *Delaware Journal of Corporate Law* 33; L Johnson, "New approaches to corporate law" (1993) 50 *Washington and Lee Law Journal* 1713.

146 Sundaram and Inkpen, "The corporate objective revisited", n. 142 above, p. 358.

147 Ibid.

148 A D Garrett, "Themes and variations: the convergence of corporate governance practices in major world markets" (2004) 32 *Denver Journal of International Law and Policy* 149; it is claimed that both internal and external factors influence companies to establish a good governance practice. Many different factors, such as philosophical approach, market forces, political forces, and the cooperation of various global entities, have played a role in the progress towards convergence; see also A Y Seita, "Globalization and the convergence of values" (1997) 30 *Cornell International Law Journal* 429.

149 B H McDonnell, "Convergence in corporate governance – possible, but not desirable" (2002) 47 *Villanova Law Review* 341, pp. 370–1.

arguments in favour of the hybrid corporate governance model seem very logical, convincing and possible.

C Factual evidence

It is easy and logical to assume that corporate governance models differ markedly between Anglo-American countries and continental European countries, given the intensity of debate about the two systems in this area. However, "recent events and market forces are leading toward increased harmonisation of corporate governance on each side of the Atlantic".[150] The interests of various stakeholders are widely considered by directors in the UK and the US.[151] The growth of large national corporations in the first decade of the twentieth century made it evident that the impact of directors' decisions drives corporate stakeholders, including consumers and the larger communities dependent upon industry.[152] Companies in the US and the UK are recruiting the services of CSR consultancies to produce CSR codes, write or verify CSR reports, train staff in CSR and market their CSR credentials.[153] In a worldwide business survey in December 2005, among 4238 executives surveyed, 84 per cent thought that high returns had to be balanced with contributions to the broader public good, while only 6 per cent of the executives agreed with Friedman's view that the sole purpose of business is to produce high returns for the shareholder.[154]

The political programmes of many governments throughout Europe focus on a third way. In the UK, under the terms of the Companies Act 2006, directors are required by law to consider the interests of stakeholders in order to promote the success of the company.[155] Apart from the UK, the active welfare state in Belgium,[156] the Polder model in the Netherlands and the Neue Mitte in Germany also suggest a hybrid model in corporate governance, relying on a number of common mechanisms such as independent boards of directors, information disclosure, accountability, and so on.[157]

Philanthropic responsibilities, at the top of the corporate responsibilities pyramid above economic, legal and ethical considerations,[158] are frequently taken into account in corporate strategies in the US and the UK, promoting good corporate citizenship by contributing resources to the public and improving quality of life, although there has been periodic discussion over whether corporations do, or should, have power by management decision or majority shareholder vote to make philanthropic gifts.[159] This is a part of voluntary

150 A Payne, "Corporate governance in the USA and Europe: they are closer than you might think" (2006) 6(1) *Corporate Governance: International Journal of Effective Board Performance* 69, p. 70.

151 Ibid.

152 Winkler, "Corporate law", n. 87 above, p. 115.

153 D McBarnet, "Corporate social responsibility beyond law, through law, for law: the new corporate accountability" in McBarnet et al., *The New Corporate Accountability*, n. 122 above, p. 11.

154 "McKinsey global survey of business executives: business and society" (2006) 2 *McKinsey Quarterly* 33.

155 Ibid.

156 D Whitfield, *Public Services or Corporate Welfare: Rethinking the nation state in the global economy* (London: Pluto Press 2001).

157 Van Den Berghe, *Corporate Governance*, n. 2 above, p. 17.

158 A B Carroll, "The pyramid of corporate social responsibility: toward the moral management of organizational stakeholders' (1991) 34 *Business Horizons* 39, pp. 40–1.

159 V V Brudney and A Ferrel, "Corporate charitable giving" (2002) *University of Chicago Law Review* 1, pp. 2–3. See also M A Eisenberg, "Corporate philanthropy symposium: corporate conduct that does not maximize shareholder gain: legal conduct, ethical conduct, the penumbra effect, reciprocity, the prisoner's dilemma, sheep's clothing, social conduct and disclosure" (1998) 28 *Stetson Law Review* 1; M M Blair, "A contractual defense of corporate philanthropy" (1998) 28 *Stetson Law Review* 27; D H Saiia, A B Carroll and A K Buchholtz, "Philanthropy as strategy: when corporate charity 'begins at home'" (2003) 42 *Business and Society* 169; J Mullen, "Performance-based corporate philanthropy: how 'giving smart' can further corporate

"corporate self-regulation"[160] that seeks to engender investor accountability and stakeholder engagement. The directors consider their stewardship interests and place a higher value on altruism in order to realise their collective responsibility.[161]

Academics argue that spending by corporations on charity is clever marketing or well-managed public relations. Apart from a close relationship with shareholder wealth maximisation in line with the long-term interests of the company, corporate charity will obviously help other corporate constituencies. Currently, in the US, taking Delaware corporate law as an example, the law imposes a ceiling established by a "reasonableness test".[162] The court in *Kahn* v *Sullivan*[163] held that contributions are reasonable if the amount of the donation agreed by the directors can be deducted under s. 170 of the Internal Revenue Code, which allows a contribution of up to 10 per cent of pre-tax profits.[164] However, if we logically consider the purpose of legally fixing a limit on charitable giving and placing limitations on the directors' discretion, the court still regards philanthropic ventures as a corporate strategy management policy with the purpose of benefiting stakeholders.

The converging hybrid model can also be justified from the perspective of cross-border investment and finance. Corporations are no longer solely subject to the priorities of performance criteria from their country of origin and registration.[165] Increasing numbers of corporations from the network-oriented system raise their capital in the securities markets in Britain and the US. Consequently, they have to conform to stricter accounting standards.[166] For example, Sony of Japan, Daimler Chrysler of Germany, and Schneider of France, together with a host of other internationalised corporations, have to perform in accordance with the expectations of Anglo-American institutional investors, the main suppliers of funds, if they want access to international capital.[167] Obviously, these firms will be required to apply the corporate governance standards of the outsider model.

Furthermore, it is argued that the separation between ownership and control has been reduced since the beginning of the 1980s, as a result of the ownership and profit incentives of officers and directors of US and UK corporations which were realised by means of stock ownership and an explosive growth in the use of stock opinion.[168] Therefore, the ownership structures in these countries have become more concentrated and the proportion

[n. 159 cont.] goals" (1997) (summer) *Public Relations Quarterly* 42; M Wulfson, "The ethics of corporate social responsibility and philanthropic ventures" (2001) 29 *Journal of Business Ethics* 135. For the case of the UK, see C J Cowton, "Corporate philanthropy in the United Kingdom" (1987) *Journal of Business Ethics* 553; S Brammer and A Millington, "The development of corporate charitable contributions in the UK: a stakeholder analysis" (2004) *Journal of Management Studies* 1411.

160 C Parker, *The Open Corporation: Effective self-regulation and democracy* (Cambridge: CUP 2002); N Gunningham and J Rees, "Industry self-regulation: an industrial perspective" (1997) 19 *Law and Policy* 363.

161 R V Aguilera, D Rupp, C Williams and J Ganapathi, "Putting the S back in CSR: a multi-level theory of social change in organizations" (2007) 32 *Academy of Management Review* 836.

162 See *Kahn* v *Sullivan* 594 A 2d 48 (Del 1991) in which the court holds the idea that federal tax law guides the determination of whether corporate charitable contributions are "reasonable".

163 *Kahn* v *Sullivan* 594 A 2d 48 (Del 1991).

164 S. 170(b)(2) Internal Revenue Code, 25 USC.

165 R H Carlsson, *Ownership and Value Creation: Strategic corporate governance in the new economy* (Chichester: John Wiley & Sons 2001), p. 95.

166 A Licht, "Regulatory arbitrage for real: international securities regulation in a world of interacting securities markets" (1998) 38 *Virginia Journal of International Law* 563, p. 566.

167 Carlsson, Ownership, n. 165 above, pp. 95–6.

168 Thomsen, "The Convergence of corporate governance systems", n. 17 above, p. 39; see also K J Murphy, "Executive compensation" in O Ashenfelter and D Card (eds), *Handbook of Labour Economics* vol. 3 (Amsterdam: North Holland 2000).

of insider ownership has increased substantially. This fact can be regarded as evidence supporting an increasing trend towards a long-term insider model in the UK and the US.[169]

From the theoretical, historical and factual evidence and arguments above, a hybrid corporate governance model would seem to be the right option for a convergent corporate governance system. However, a hybrid corporate governance model is not simply a chimera formed from half the insider model and half the outsider model. In the next section, the hybrid model will be divided into two possible alternatives.

3.2.2 Two types of hybrid corporate governance model

Hybrid models, based on an analysis of the process of transforming, can be divided into two categories: referencing combinative hybrid models; and developing combinative hybrid models. Although the adoption of each model will still be based on the traditions, culture and history of individual countries, the establishment and formation of the model will share the same process in each kind.

In the referencing hybrid model, governments will devise hybrid models that combine elements of both their own traditional models and a model at the opposite extreme. This kind of hybrid model will be adopted by countries that already have a solid corporate governance system which has been controlling and regulating corporations for a long time through corporate law legislation. The hybrid model is adopted in these countries mainly because of the pressures of Europeanization and globalisation, the increasingly important position of CSR in corporate strategy and the requirements of a new knowledge-based economy. In contrast, in the developing combinative model, governments are required to devise hybrid models that combine elements of both the shareholder primacy model and the stakeholder model, with the characteristics of their own country provided by path dependence justifications including traditions, history, culture, and stage of economic development. This kind of hybrid model should be adopted by countries that are still in a stage of establishing a sound model for their economic development. The existing corporate law and related legislation are always immature with underdeveloped capital and financial markets. In the author's opinion, hybrid models established in developing countries, such as the Chinese model, always belong to the developing hybrid model, while developed countries, in which a well-established legal system has already been dominant for some time, always establish hybrid models falling into the reference hybrid category.

4 Implication and enforcement of a hybrid model

After clarifying the relationship between a few key terms in an ideal hybrid corporate governance model, it is important to examine the implications and enforceability of this approach, especially in traditional shareholder-centred corporate governance, since the difficulties in practice of enforcing the duty of stakeholder consideration seriously challenge the practical effectiveness of any hybrid model. Six stages should be adopted by directors when executing their duties towards stakeholders, namely: "mapping stakeholder relationships, mapping stakeholder coalitions, assessing the nature of each stakeholder interest, assessing the nature of each stakeholder's power, constructing a matrix of stakeholder priorities and monitoring shifting coalitions".[170] Regarding the mapping of stakeholder relationships, directors are required to realise who the current and potential stakeholders are, and their relationships with the company. In addition, directors are

169 Thomsen, "The Convergence of corporate governance systems", n. 17 above, pp. 38–9.

170 See J E Post, W C Frederick, A T Lawrence and J Weber, *Business and Society: Corporate strategy, public policy, ethics* 8th edn (New York: McGrawHill 1996); see also W C Frederick, K Davis and J E Post, *Business and Society* 6th edn (New York: McGrawHill 1988).

required to understand external variables and their impact on both company and stakeholders. Next, when mapping stakeholder coalitions, the directors must analyse the stakeholders based on step one and categorise them into groups according to different criteria: primary or secondary stakeholders, external or internal stakeholders, and those with economic or political power. It is necessary to understand thoroughly the unique stakeholder group classifications in each company before it is possible to take their interests into consideration in strategic management policies.

Following on from steps one and two, directors should assess the nature of each stakeholder's interests and power (including voting power, political power and economic power) in order to understand the importance each stakeholder places on these interests before prioritising activities and focusing the available resources. After a mental map has been constructed concerning the level of each stakeholder's power and interests, directors are encouraged to build a matrix of stakeholders' priorities along the strategic dimensions of stakeholder theory. Distinctions should be made between highly strategic stakeholders, who are crucial and can affect the very survival or existence of the business organisation, and stakeholders whose interests have to be dealt with according to basic legal or institutional conditions through explicit or implicit contracts. Finally, based on full analysis of stakeholders' relationships, coalitions, nature and priorities, a matrix of corporate responsibility towards various stakeholders (including shareholders) should be constructed based on the corporate responsibility pyramid, from economic to voluntary (or philanthropic) responsibility. Figure 1 (p. 386) can be used as a guide for directors when enforcing their duties towards stakeholders in a hybrid corporate governance model.

5 Effectiveness of enforcement

Different countries have also evolved their own forms of enforcement measures on hybrid corporate governance models, if they tend to adopt such a model. There are numerous regulations and guidelines pertinent to stakeholders to ensure the enforcement of the hybrid model. In addition to the array of geographical jurisdictions from which such guidelines emanate, the scope of core legislations, regulations and guidelines ranges from human rights, sustainable deployment and employee practice to supply chain management.[171] Unlike the enforcement of shareholders' interests, broad legal supports are always necessary to best serve the stakeholders' interests, because the market can be subverted by purely strategic considerations.[172] Legal requirements will play an increasingly important role in enforcing voluntary corporate policies. New legal developments are directly or indirectly fostering voluntary stakeholder policies and market pressure to make what businesses have perceived as being voluntary, or beyond the law, in fact legally enforceable.[173] Legal doctrines and processes are employed by corporations as part of their strategy, and market forces are stimulated and facilitated by legal measures.[174]

Four levels at which "stakeholding principles are established in order to be effective" were defined by Stoney and Winstanley.[175] Adherents of stakeholder theory advocate the adoption of the principles at various levels of stakeholder intervention including: the

171 A L Friedman and S Miles, *Stakeholder: Theory and practice* (Oxford: OUP 2006), p. 243.

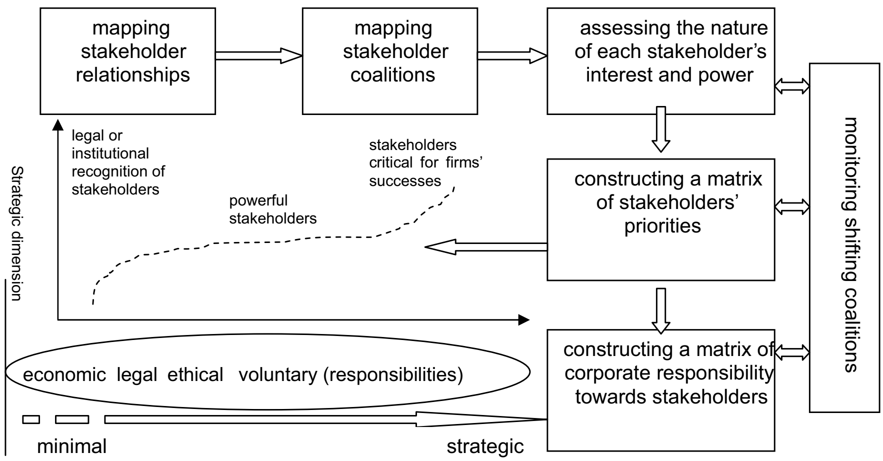
172 D M Nuti, "Democracy and economy: what role for stakeholder" (1997) 8 *Business Strategy Review* 14.

173 McBarnet, "Corporate social responsibility beyond law", n. 153 above, p. 31.

174 Ibid.

175 C Stoney and D Winstanley, "Stakeholding: confusion or utopia? Mapping the conceptual terrain" (2001) 38 *Journal of Management Studies* 603, p. 621.

Figure 1: Guidance for enforcing directors' duties towards stakeholders



Source: Based on the ideas presented in M Mclntosh, D Leipziger, K Jones and G Coleman, *Corporate Citizenship: Successful strategies for responsible companies* (London: Financial Time Management 2000); L S Munllia and M P Miles, "The corporate social responsibility continuum as a component of stakeholder theory" (2005) 110 *Business and Society Review* 371; A L Friedman and S Miles, *Stakeholders: Theory and practice* (Oxford: OUP 2006), p. 11.

establishment of individual right;[176] the development of a more inclusive framework of corporate governance;[177] and reformation of national public policy[178] and international institutional regulations.[179] These wide-ranging levels stand within the stakeholder debate as a discrete framework that allows us to focus on specific areas within the overall debate with the purpose of transforming stakeholder principles into practice.[180]

The dimension of stakeholder theory enforcement is "intended to capture the extent to which the stakeholder model is formally acknowledged and institutionalised within organisations and society".[181] "Coercion" lies at one extreme, enforcing stakeholders' rights through legal entrenchment, while "voluntarism" is at the opposite end of the spectrum, driven solely by an ethos or internal morality to do the right and just thing.[182] These two polar opposites can be regarded as enforcement measures, providing a theory and moral basis for directors' duties towards stakeholders in the hybrid model. In the hybrid model, the social and legal means of enforcement cannot be seen as exclusive alternatives for furthering corporate responsibility; instead they can be viewed as "complementary controls in a new style of corporate accountability that involves both legal and ethical standards".[183]

176 See R E Freeman, *Strategic Management: A stakeholder approach* (Boston and London: Pitman 1984); J W Weiss, *Business Ethics: A stakeholder and issue management approach* 3rd edn (Mason OH: Thomson South-Western 2003).

177 See K E Goodpaster, "Business ethics and stakeholder analysis" (1991) *Business Ethics Quarterly* 53; D Winstanley, J Woodall and E Heery, "Business ethics and human resource management: themes and issues" (1996) 25 *Personal Review* 5.

178 A Gamble and G Kelly, "Shareholder value and the stakeholder debate in the UK" (2001) 9 *Corporate Governance* 110.

179 Hutton, *The State We're In*, n. 137 above; C Stoney and N Aylott, "Tomorrow's company' (1994) 4 *Renewal* 56.

180 Stoney and Winstanley, "Stakeholding", n. 175 above, p. 621.

181 Friedman and Miles, *Stakeholder*, n. 171 above, p. 247.

182 Stoney and Winstanley, "Stakeholding", n. 175 above, pp. 619–21.

183 McBarnet, "Corporate social responsibility beyond law", n. 153 above, p. 55

From the most ethical and voluntary end, inclusiveness is a state of mind, spirit or ethos which, if cultivated, will encourage stakeholder philosophy and practice to emerge both in organisations and in wider society.[184] Other proponents of the voluntary approach support a range of options including exhortation and the establishment of an inclusive model of best practice.

It is argued by Donaldson and Preston that stakeholder theory can be differentiated into descriptive,[185] instrumental and normative approaches.[186] The instrumental (or strategic) approach is concerned with the impact stakeholders may have in terms of corporate effectiveness. This approach appeals to the company in terms of how it can achieve corporate goals by being responsible. The approach is placed lower down the enforcement ladder since it relies on exhortation and social leadership. The instrumental approach establishes a framework for examining the *ceteris paribus* connection, if any exists, between the practice of stakeholder management and the achievement of various corporate performance goals.[187] This approach rests at the level of business organisation governance, since directors are required to interconnect various stakeholders' interests in the formation of a strategic management policy. Finally, the normative approach is concerned with the requirement that corporations should take stakeholders' interests into account even in the absence of any obvious benefits. This approach focuses on what companies ought to do and it is placed at the level of "best practice" which transgresses basic social norms. As for the level of intervention, this approach focuses on individual stakeholder's rights rather than corporate objectives and is placed in the category of "individual rights".

The map (Figure 2) is designed to offer a platform for considering the effectiveness of enforcement in the stakeholder approach. There are positions in the diagram corresponding to both archetype models and to newly enforced hybrid models, such as enlightened shareholder value principle, depending on the arguments on the traditional shareholder primacy model, the classic stakeholder theory model and enlightened shareholder value principle in the UK.

6 Conclusion: an ideal hybrid corporate governance model and enforcement of the model

The ultimate hybrid model, a final convergence, will be based on adaptations within each model. As a result, the new model will combine the best practice of the two archetype models. However, the term "best practice"[188] is based on the criteria of the efficiency and promotion of success of the company. When considering the issue of the ideal hybrid model, it is necessary to avoid discounting the significance of any of the following four dimensions: social expectations; investor expectations; government expectation regarding statutes and regulations; and theoretical-cum-academic expectations, although these "in principle" expectations of the academic community carry the least weight.[189]

On the stakeholder model's side, it is important to increase and promote the effectiveness of markets (primarily capital and takeover markets) by increasing their

184 Stoney and Winstanley, "Stakeholding", n. 175 above, p. 622.

185 The related arguments on descriptive stakeholder approaches are clarified in the sections on "Justifications for the hybrid model" (3.2.1 above) and "An ideal hybrid corporate governance model" (6 below).

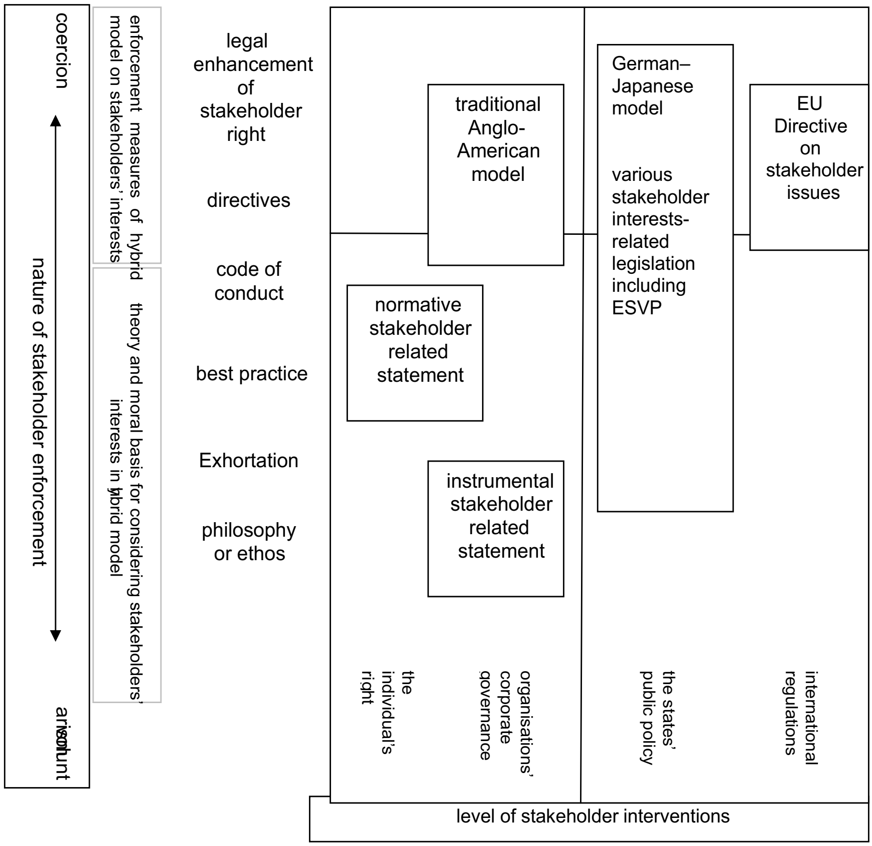
186 T Donaldson and L E Preston, "The stakeholder theory of the corporation: concept, evidence, and implications" (1995) 20 *Academy of Management Review* 65.

187 Friedman and Miles, *Stakeholder*, n. 171 above, p. 29.

188 Or the "right mix" which is also mentioned in this article.

189 C Parker, "Meta-regulation: legal accountability for corporate social responsibility" in McBarnet et al., *The New Corporate Accountability*, n. 122 above, pp. 215–16.

Figure 2: A platform for considering the effectiveness of enforcement in the stakeholder approach



Source: based on the ideas presented in C Stoney and D Winstanley, "Stakeholding: confusion or utopia? Mapping the conceptual terrain" (2001) 38 *Journal of Management Studies* 603, p. 619; A L Friedman and S Miles, *Stakeholder: Theory and Practice* (Oxford: OUP 2006), p. 243.

liquidity, with more listed companies and an increased volume of equity transaction. In the case of the shareholder primacy model, a move should be initiated towards more concentrated holding, to provide monitoring through institutional holding, or via specialised companies that make investments in order to monitor and, where necessary, engage in the management of companies in which they invest.[190] Moreover, in the German–Japanese governance context, it is important to emphasise shareholders' interests in order to attract more investments, especially from overseas institutional investors; from the Anglo-American side, stakeholders' interests should be redefined in corporate law in order to promote long-term interests for corporations.[191]

190 See P J N Halpern, "Systemic perspectives on corporate governance systems" in S S Cohen and G Boyd, *Corporate Governance and Globalization: Long range planning issues* (Cheltenham: Edward Elgar 2000), p. 37.

191 J Zhao, "New economy and stakeholder theory: promoting the competitiveness of companies in the 21st century", FEEM CRS Working Paper (2007): www.feem.it/Feem/Pub/Publications/CSRPapers/default.htm.

Although it is logical for various jurisdictions to share common rules and common policies on corporate governance, it is still hard to believe that complete convergence will ever occur,[192] because of the path dependence theory which argues that various factors determine the efficiency of corporate performance and arrangements must change in each jurisdiction because of their particular culture, politics and traditions.[193] In this case, a limited diversity in regulation can sometimes serve as a useful economic end in the sense of promoting innovation and competition without necessarily leading to a race to the bottom.[194] Although it is hard to find a single optimal solution, constructive adoptions and a convergence of two basic corporate governance models can "serve as a foundation for renewed growth and prosperity among the world's leading economic powers and as a model for emerging markets".[195] Convergence towards a hybrid model will stay within the constraints of principle rather than focus on detailed implemental measures which will largely depend on the unique situation of each state due to path dependence theory.

The term to define the best hybrid model is as important as its basic principles, which can be primarily adopted by each state to draw up a hybrid corporate governance model blueprint. The central tendency of hybrid models can be predicted based on the relative importance of the following requirements:

- It is necessary for the directors to realise the possibility of simultaneously meeting their duties to both shareholders and stakeholders.[196] Directors can seek to minimise costs to stakeholders while increasing shareholder wealth.[197]
- Regarding the purpose of entity maximisation and the fostering of entity wealth, directors should endeavour to increase the overall long-term market value of the company as a whole, taking into account the investments made by various people and groups.[198]
- Company directors should maximise shareholders' gains while minimising stakeholders' losses, and the entire process should be socially responsible because statutes enable directors to eliminate or mitigate losses to other constituencies for the purpose of assuring that a transaction in fact produces net gains in social wealth.[199]
- The ultimate purpose of establishing corporations is to promote the long-term success of the company. The purpose of corporate decisions should be consistent with fundamental corporate governance principles of fairness, accountability, transparency, and responsibility presented by the OECD.[200]

192 Halpern, "Systemic perspectives", n. 190 above, p. 37.

193 See Bebchuk and Roe, "A theory of path dependence", n. 112 above, p. 69; see also R H Schmidt and G Spindler, "Path dependence and complementarity in corporate governance" in J N Gordon and M J Roe (eds), *Convergence and Persistence in Corporate Governance* (Cambridge: CUP 2004), p. 114.

194 J A Grundfest, "Internationalization of the world's securities markets: economic causes and regulatory consequences" (1990) 4 *Journal of Financial Service Research* 349, pp. 371–3.

195 Payne, "Corporate governance in the USA and Europe", n. 150 above, p. 70.

196 W S W Leung, "The inadequacy of shareholder primacy: a proposed corporate regime that recognizes non-shareholder interests" (1997) 30 *Columbia Journal of Law and Social Problems* 587, p. 623.

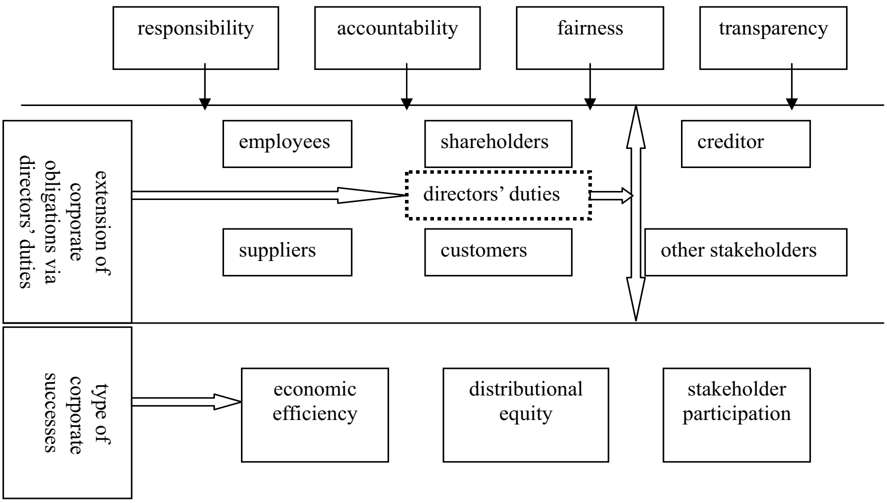
197 See Coffee, "Unstable Coalitions", n. 145 above, p. 1548; see also L E Mitchell, "A theoretical and practical framework for enforcing constituency statues" (1992) 70 *Texas Law Review* 579, p. 635.

198 A Keay, "Ascertaining the corporate objective: a maximisation and sustainability model" (2008) 71 *Modern Law Review* 663, p. 685.

199 This actually also derives objective standards for interpreting constituencies statues in realising a dual goal in the US; see M McDaniel, "Stockholders and stakeholders" (1991) 21 *Stetson Law Review* 121, pp. 161–2.

200 OECD, Principle, n. 21 above.

Figure 3: Directors' duties, corporate obligations and sound corporate governance virtues



Source: A West, "Corporate governance convergence and moral relativism" (2009) 17 *Corporate Governance: an International Review* 107.

- Stakeholders' legitimate positions, apart from protection provided by employment law, consumer protection law and environmental law, should be valid in corporate law to strengthen their position in corporations;
- Each country should create enforceable supplementary measures to implement these principles in order to protect the interests of stakeholders; at the corporate level, every company should set its own goals and corporate strategy through its board.
- The market for corporate control should encourage rather than penalise companies with long-term growth potential.

In an ideal hybrid corporate governance model, the relationship between directors' duties, corporate obligations, the four good corporate governance virtues, and different criteria for corporate success (referring particularly towards the goals of efficiency, equity and participation)[201] are further clarified in Figure 3.

201 B H McDonnell, "Convergence in corporate governance – possible, but not desirable" (2002) 47 *Villanova Law Review* 341, pp. 350–4.