PART I

General report

1

Comparative corporate governance: the state of the art and international regulation

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Abstract

Corporate governance, i.e. the system by which companies are directed and controlled, has become a key topic for legislators, practitioners, and academics in all modern industrial states. The recent financial crisis has highlighted the problems. Yet one goes astray if one does not understand

how the unique combination of economic, legal, and social determinants of corporate governance functions in each country. This functional comparative analysis based on reports from thirty-three countries and with references to economic literature deals with the concepts, instruments (including soft law), and sources of corporate governance, and analyzes the regulation and practice of the various actors in corporate governance: mainly the board and the shareholders, but also labor, gatekeepers (in particular the auditors), the supervisors, and the courts. In the end, a great deal of convergence emerges, though many path-dependent differences remain.

I Introduction

Corporate governance is a greatly discussed topic, particularly in the aftermath of the recent financial crisis. In less than one year, it has led to three Green Papers by the European Commission;[1] and in individual

A much shorter version of this chapter has served as the general report on "Corporate Governance" for the Eighteenth International Congress on Comparative Law in Washington on July 29, 2010. See K. Hopt, "Corporate Governance," in K. Brown and D. Snyder (eds.), *General Reports of the XVIIIth Congress of the International Academy of Comparative Law/ Rapports Généraux du XVIIIème Congrès de l'Adadémie Internationale de Droit Comparé* (Dordrecht/Heidelberg/London/New York: Springer, 2012), pp. 295–320. A longer version was published in *The American Journal of Comparative Law* 59 (2011), 1–73 and is the basis for the present version which is updated and includes considerably more references for an international audience. A German version is available in ZHR 175 (2011), 444–526. An alphabetical list of the original country reports is reprinted as section V of this chapter. The country reports are cited with the number of the report, an abbreviation of the country, and the page number as in the original version; for country reports that are included in the present book, an additional page reference is added in brackets, e.g. 31UK 1 [p. 913].

[1] *On corporate governance of banks*, European Commission, Green Paper, Corporate Governance in Financial Institutions and Remunerations Policies, COM(2010) 284 fin. (final) (June 2, 2010) and accompanying documents SEC(2010) 669, see text to fn. 37 below. *On auditors*, European Commission Green Paper, Audit Policy: Lessons from the Crisis, COM (2010) 561 fin. (October 13, 2010), see also as to the reform proposals of the European Commission of October 2010 text to fn. 398 below. *On corporate governance of companies*, European Commission, Green Paper, The EU Corporate Governance Framework, COM (2011) 164/3 (April 5, 2011), see section II B 3 below and text to fn. 66 ("comply-or-explain"); section III A 1 b below and text to fn. 127 (diversity and gender quota); section III A 3 b (iv) below and text to fn. 211 (evaluation); section III A 3 d below and text to fn. 228 (risk management); section III A 4 c below and text to fn. 259 (remuneration); section III B 2 a below and text to fn. 295 (minority protection); section III B 2 b below and text to fn. 319 ("absent owners," short time perspective, institutional investors); section III B 2 b below and text to fn. 333 (proxy advisors); section III C 2 below and text to fn. 370

European countries and elsewhere in the world, it has attracted increased attention from legislators, courts, corporate governance commissions, members of academia, and the general public alike.[2] Corporate governance as a concept and as a problem area was first discussed in the US; later, the European debate started in the UK. From there the issue of corporate governance began its pervasive course through all the modern industrial states, including Australia, China, and Japan. Contributions and research projects on the topic abound all over the world.[3] Since 1995 the European Corporate Governance Network in Brussels, now known as the European Corporate Governance Institute ("ECGI") and based in Brussels,[4] has been carrying out its interdisciplinary work, gathering under its banner academics and practitioners, lawyers and economists, researchers and regulators. Their common aim is to better understand

(employee shareholding). There have been hundreds of responses to the Green Papers, e.g., European Company Law Experts, "Response," *Rivista delle Società* 56 (2011), 1222; G. Bachmann, "Der 'Europäische Corporate Governance-Rahmen,'" WM (2011), 1301.

2 *Cf.*, e.g., arising from a conference in Berne, S. Emmenegger (ed.), *Corporate Governance* (Basel: Helbing Lichtenhahn, 2011); symposion of the *Zeitschrift für Unternehmens- und Gesellschaftsrecht* (Königstein, January 2012); the Deutsche Juristentag (German Lawyers Association) treated the topic at its biannual congress in Munich in September 2012 (written report: M. Habersack, lectures: P. Hemeling, P. Leyens, D. Weber-Rey).

3 A list of selected literature on corporate governance in general and in various countries can be found in K. Hopt, H. Kanda, M. Roe, E. Wymeersch, and S. Prigge (eds.), *Comparative Corporate Governance* (Oxford: Clarendon, 1998), pp. 1201–1210; K. Hopt, E. Wymeersch, H. Kanda, and H. Baum (eds.), *Corporate Governance in Context – Corporations, States, and Markets in Europe, Japan, and the US* (Oxford University Press, 2005), pp. 731–742; P. Hommelhoff, K. Hopt, and A. von Werder (eds.), *Handbuch Corporate Governance*, 2nd edn. (Stuttgart/Cologne: Schäffer-Poeschel/Schmidt, 2009), pp. 931–952 (organized into ten topics by Patrick C. Leyens); M. Becht, P. Bolton, and A. Röell, "Ch. 12, Corporate Law and Governance," in A. Mitchell Polinsky and S. Shavell (eds.), *Handbook of Law and Economics*, vol. II (Amsterdam/Oxford: Elsevier North-Holland, 2007), p. 833; C. Bühler, *Regulierung im Bereich der Corporate Governance* (Zürich/St. Gallen: Dike, 2009); C. Mallin (ed.), *Handbook on International Corporate Governance, Country Analyses*, 2nd edn. (Cheltenham/Northampton: Elgar, 2011). *Cf.* also the collection Thomas Clarke (ed.), *Corporate Governance, Critical Perspectives on Business and Management*, 5 vols. (New York: Routledge, 2005) and R. Adams, B. Hermalin, and M. Weisbach, "The Role of Boards of Directors in Corporate Governance: A Conceptual Framework and Survey," *Journal of Economic Literature* 48(1) (2010), 58–107; on the state of the research see also L. Bebchuk and M. Weisbach, "The State of Corporate Governance Research," *Review of Financial Studies* 23(3) (2010), 939–961 and R. Aguilera and G. Jackson, "Comparative and International Corporate Governance," *The Academy of Management Annals* 4(1) (2010), 485–556.

4 ECGI, see www.ecgi.org/ with comprehensive information and two working paper series "Law Series" and "Financial Series"; SSRN CGN (Corporate Governance Network), see www.ssrn.com/cgn/index.html; International Corporate Governance Network, see www.icgn.org.

corporate governance and to improve it. In the meantime, corporate governance institutes and research groups have been formed in many countries and universities, including Harvard, Oxford, Cambridge, Hamburg, and Berlin. The topic is of particular concern in practice, especially for the shareholders, stock exchanges, listed corporations, banks and financial institutions, industrial associations, regulators and parliaments of many countries. During the last two decades in many of these countries, corporate and capital market law reforms have taken place or are underway with the express or implicit aim of improving corporate governance or particular elements of it.

In a nutshell, the problem of corporate governance is contained in a paragraph from Adam Smith's *An Inquiry into the Nature and Causes of the Wealth of Nations* of 1784:

> The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own … Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.[5]

This problem, known today as the principal–agent conflict between shareholders and managers, has been a challenge for corporate law and legislators since the beginning of the modern corporation in the early nineteenth century. Efforts to minimize this conflict have met with limited success, as the constant law reforms – sometimes exhaustive new codifications, sometimes piecemeal acts – amply illustrate.[6] The history of corporate governance[7] is also a history of crises and

[5] A. Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 3rd edn. (London: Strahan/Cadell, 1784), Book 5, chapter 1.3.1.2.

[6] Examples of codifications are the Australian Corporation Act 2001, the UK Companies Act 2006, and the plans of the "*grosse Aktienrechtsreform*" (major stock corporation law reform) in Switzerland, 27CH 2 [p. 871]. Germany stands as an example for piecemeal reforms with sixty-eight reforms of the Stock Corporation Act 1965. For France, see 10RF 1 [p. 447]; for Australia, 2Austr 5 *et seq.* [p. 109]. *Cf.* J. Hill, "Corporate Scandals Across the Globe: Regulating the Role of the Director," in G. Ferrarini, K. Hopt, J. Winter, and E. Wymeersch (eds.), *Reforming Company and Takeover Law in Europe* (Oxford University Press, 2004), p. 225; J. Hill, "Regulatory Responses to Global Corporate Scandals," *Wisconsin International Law Journal* 23 (2005), 367; L. Enriques and P. Volpin, "Corporate Governance Reforms in Continental Europe," *Journal of Economic Perspectives* 21 (2007), 117. But see also L. Bebchuk and A. Hamdani, "The Elusive Quest for Global Governance Standards," *University of Pennsylvania Law Review* 1263 (2009), 157.

[7] P. Frentrop, *A History of Corporate Governance 1602–2002* (Brussels/Paris/Amsterdam/Milan/Frankfurt/Luxembourg: Deminor, 2002/2003); R. Morck, *A History of Corporate*

scandals in nearly every country, as seen in cases like *Enron*, *World-Com*, and *Parmalat*.[8] The international financial crisis that began in 2008 has added additional problem cases, governance and systemic failures, and reform experiments, though one has to keep in mind that the extent to which corporate governance failures have contributed to the coming about of the financial crisis[9] is much debated. This is particularly true with regard to the purported excesses of remuneration and alleged board members' qualification defects,[10] though recent contributions cast doubts on their influence on the financial crisis.[11]

Governance Around the World (University of Chicago Press, 2005); R. Wright, W. Barber, M. Crafton, and A. Jain (eds.), *History of Corporate Governance: The Importance of Stakeholder Activism*, 6 vols. (London: Pickering & Chatto, 2004).

8 J. Coffee, *Gatekeepers: The Role of the Professions in Corporate Governance* (Oxford University Press, 2006); J. Armour and J. McCahery (eds.), *After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US* (Oxford/Portland, OR: Hart, 2006); C. Carrara, "The Parmalat Case," *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 70 (2006), 538; J. McCahery and E. Vermeulen, "Corporate Governance Crises and Related Party Transactions: A Post-Parmalat Agenda," in K. Hopt, E. Wymeersch, H. Kanda, and H. Baum (eds.), *Corporate Governance in Context – Corporations, States, and Markets in Europe, Japan, and the US* (Oxford University Press, 2005), p. 215. *Cf.* C. Reinhart and K. Rogoff, *This Time is Different, Eight Centuries of Financial Folly* (Princeton University Press, 2009).

9 J. de Larosière, *The High-Level Group on Financial Supervision in the EU* ("Larosière Report") (Brussels: February 25, 2009), pp. 33 *et seq.* n. 110 *et seq.*; D. Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities, Final Recommendations* ("Walker Review") (London: November 26, 2009); Financial Services Authority ("FSA"), *Effective Corporate Governance (Significant Influence Controlled Functions and the Walker Review)* (London: January 2010); Basel Committee on Banking Supervision, *The Basel Committee's Response to the Financial Crisis: Report to the G20* (October 4, 2010); H.-W. Sinn, *Casino Capitalism: How the Financial Crisis Came About and What Needs to be Done Now* (Oxford University Press, 2010); M. Hellwig, W. Höfling, and D. Zimmer, "Finanzmarktregulierung – Welche Regelungen empfehlen sich für den deutschen und europäischen Finanzsektor?" in *Gutachten E-G zum 68. Deutschen Juristentag, Berlin 2010*, vol. I (Munich: Beck, 2010); E. Avgouleas, "The Global Financial Crisis, Behavioural Finance and Financial Regulation: In Search of a New Orthodoxy," *Journal of Corporate Law Studies* 9 (2009), 23–59; M. Becht, "The Governance of Financial Institutions in Crisis," in *Festschrift für Hopt*, vol. I (Berlin/New York: de Gruyter, 2010), p. 1615.

10 See sections III A 4 c and III A 1 b (iii) below as well as I. MacNeil, "The Trajectory of Regulatory Reform in the UK in the Wake of the Financial Crisis," EBOR 11 (2010), 483, 518 *et seq.*

11 A. Beltratti and R. Stulz, "Why Did Some Banks Perform Better during the Credit Crisis? A Cross-Country Study of the Impact of Governance and Regulation," available at ssrn.com/abstract_id=1433502; K. Hopt, "Better Governance of Financial Institutions," available at ssrn.com/abstract_id=2212198; *cf.* also MacNeil, "The Trajectory of Regulatory Reform in the UK," 519 *et seq.* But the remuneration problem is generally overestimated, while the role of director qualification is widely underestimated. The systemic and structural problems are more important.

On a microlevel the same is true for the relevance of corporate governance for firm performance.[12]

The inherent difficulty found in the principal–agent relationship between managers and shareholders is a general problem around the world.[13] This explains why board reform has come up as a major corporate governance issue in nearly every country. Yet, a closer look at the corporate laws of various countries and the scandals and crises therein reveals that two other relevant principal–agent conflicts can exist as well: first, depending on the different shareholder structures in various countries, between controlling shareholders and their fellow shareholders; and, in a broader sense, between the shareholders as a group and various non-shareholders such as bondholders, labor, other creditors, and even the state.[14] The focus of this book is on internal corporate governance, with emphasis on the three above-mentioned principal–agent conflicts and the major actors involved, i.e., boards, shareholders, labor, and auditors, with the supervisors and courts as enforcers.

All countries have experienced and are still experiencing crises and scandals of corporate governance. However, the problems are not necessarily identical, and adequate answers and reforms are even less uniform. While legislators and regulators often tend simply to imitate responses emerging in other countries in the vague hope that they will also benefit their own system, it is rather the characteristic features of the corporate governance system of each country that help to understand its unique crises and scandals. Reform proposals in particular go astray if one does

[12] *Cf.*, e.g., S. Bhagat and B. Bolton, "Corporate Governance and Firm Performance," *Journal of Corporate Finance* 14 (2008), 257. As to the problems of corporate governance indices, *cf.* K. Hopt, "American Corporate Governance Indices as Seen from a European Perspective," *University of Pennsylvania Law Review PENNumbra* 158 (2009), 27; J. Lieder, "Legal Origins und empirische Rechtsvergleichung – Zur Bedeutung des Rechts für die Entwicklung von Kapitalmärkten und Corporate-Governance-Strukturen," *Zeitschrift für Vergleichende Rechtswissenschaft* 109 (2010), 216.

[13] O. Williamson, "Corporate Governance," *Yale Law Journal* 93 (1984), 1197; J. Tirole, "Corporate Governance," *Econometrica* 69 (2001), 1.

[14] R. Kraakman, J. Armour, P. Davies, L. Enriques, H. Hansmann, G. Hertig, K. Hopt, H. Kanda, and E. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, 2nd edn. (Oxford University Press, 2009), pp. 35 *et seq. Cf.* also P. Leyens, "Corporate Governance: Grundsatzfragen und Forschungsperspektiven," *Juristen-Zeitung* (2007), 1061 and in C. Allmendinger, F. Dorn, T. Lang, S. Lumpp, and F. Steffek (eds.), *Corporate Governance nach der Finanz- und Wirtschaftskrise* (Tübingen: Mohr Siebeck, 2011), p. 3.

not understand how the unique combination of economic, legal, and social determinants of corporate governance functions in each country. *A functional comparative analysis* of existing methods will help to clarify the similarities and differences of corporate governance systems and therefore provide more useful general conclusions. Such an approach presupposes solid information on corporate governance features of not just a small handful of somewhat arbitrarily selected countries, but rather of a relatively large number of jurisdictions, and among them systems from different continents, legal families, cultures, and traditions. Such broad and wide-ranging information will aid our understanding of the different systems and their path-dependencies, assist us in developing best practices, and bring about meaningful reform on the basis of comparative experience.

II Corporate governance: concepts and general problems

A Concepts of corporate governance

1 Various concepts and definitions

The term "corporate governance" is relatively new; in most jurisdictions it is not a legal term, and its definition is ambiguous. For the purposes of this comparative study, the broad definition of the Cadbury Commission of 1992, written at the beginning of the modern corporate governance movement,[15] is best suited: corporate governance is "the system by which companies are directed and controlled."[16] Thus, *direction* and *control* are the two cornerstones of a corporate governance system.

More specifically, the use of either shareholder- or stakeholder-orientation characterizes the system. The classic approach is *shareholder-oriented* and prevails in the US, and also in economic theory. Many European countries, such as Germany and the UK, have a *stakeholder-oriented approach* instead; in the former, this concept is further strengthened by labor codetermination on the board. In its weaker form, corporate law mandates that the board act in the interest

[15] A. Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance* (London: December 1992) ("Cadbury Report"); Combined Code, see fn. 47 below. For the US *cf.* American Law Institute, *Principles of Corporate Governance* (1994).

[16] Cadbury Report, para. 2.5. *Cf.* A. Shleifer and R. Vishny, "A Survey of Corporate Governance," *Journal of Finance* 52 (1997), 737: corporate governance is the process that "deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment."