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Cambridge University Press
978-1-108-96402-9 — Corporate Governance
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1 Introduction

Corporate governance is of critical importance in a global economy where corporations are the leading players. Corporations have assumed the role of the compelling force in the transformation of the world economy, 'the engine, worldwide, for private sector participation in the global market – to raise capital, create jobs, earn profits, and divide the value added among those contributing to its success' (OECD 1998: 13). The ownership and control of corporations, the purposes they pursue, and the ways they are controlled will determine the prospects for economic and social stability (Clarke, O'Brien, & Kelley 2019).

1.1 Defining Corporate Governance

The recognition of the profound impact of corporations on the economies and societies of all countries of the world has focused attention on the growing importance of corporate governance (Clarke 2017). The most generic definition of this concern is that '[c]orporate governance is the system by which companies are directed and controlled' (Cadbury Report 2002: 15). Among the competing definitions of corporate governance, Margaret Blair's estimation encompasses 'the whole set of legal, cultural, and institutional arrangements that determine what publicly traded corporations can do, who controls them, how that control is exercised, and how the risks and returns from the activities they undertake are allocated' (Blair 1995: 3). In a similar vein Davis (2005: 143), in *New Directions for Corporate Governance*, suggests corporate governance refers to 'the structures, processes, and institutions within and around organizations that allocate power and resource control among participants'.

However, selective interpretations of the definition and purpose of corporate governance abound, and at one extreme this is reduced to: 'Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment' (Shleifer & Vishny 1997: 737). The OECD proposed a broader and more responsible definition and purpose of corporate governance when it first published the original *OECD Principles of Corporate Governance*:

> A good corporate governance regime helps to assure that corporations use their capital efficiently. Good corporate governance helps, too, to ensure that corporations take into account the interests of a wide range of constituencies, as well as of the communities in which they operate, and that their boards are accountable to the company and to the shareholders. This, in turn, helps to assure that corporations operate for the benefit of society as a whole. It helps to maintain the confidence of investors – both foreign and domestic – and to attract more 'patient' long term capital. (OECD 1999: 7)

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More expansively still, Cadbury (2000) in work for the World Bank idealistically recognized the role of corporate governance in contributing to the stability and equity of society and the economy: 'Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability and stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations, and society'.

Therefore, the definition and meaning of corporate governance varies considerably according to the values, institutions, culture, and objectives pursued: 'Corporate governance may be defined broadly as the study of power and influence over decision-making within the corporation . . . . Existing definitions of corporate governance are closely tied to different paradigms or ways of conceptualizing the organization or firm' (Aguilera and Jackson 2010: 5).

1.2 Diversity in Corporate Governance Systems

The expansive dimensions of corporate governance were narrowly translated in recent decades with the increasing ascendancy of financial markets and intellectual domination of agency theory into an almost obsessive concern for the problems of accountability and control involved in the dispersal of ownership of large listed corporations, and a rigid focus on the mechanisms that orientate managers towards delivering shareholder value (Dore 2000; Davis 2005; Clarke 2016b).

This Anglo-American hegemonic view of the purpose of the corporation and the direction of governance institutions has proved central to the progress of globalization, and the advance of international capital markets. The rather different cultural orientations of enterprise towards the economy and society in Europe, Asia, and other parts of the world have progressively been weakened (Clarke & Bostock 1994; Aguilera & Jackson 2003 and 2010; Clarke 2013 and 2017; Clarke & Chanlat 2009; Aglietta & Rebérioux 2005; Amable 2003). Both European and Asian perceptions of the role and significance of governance have changed in recent decades towards the Anglo-American view, in some respects simply in terms of formally adopting governance codes, in other ways more substantially such as in becoming more dependent upon Western capital markets. However, business leaders, governments, and regulators in Europe and Asia, while acknowledging the increasing salience of shareholder value, continue to recognize the substance of stakeholder values.

The insistent focus of corporate governance on boards, CEOs, and shareholders – oriented single-mindedly towards financial markets and shareholder

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primacy – has not served the discipline well. This approach not only narrows the dimensions of corporate governance to a restricted set of interests, but as a result it has a very limited view of the dilemmas involved in corporate governance (Deakin 2005; Clarke 2013 and 2014a). 'Bibliometric analysis of more than 1,000 publications shows that corporate governance research is characterized by both the use of agency theory as the dominant theoretical lens, and empirical samples from one country, typically the US and to a less extent the UK' (Kumar & Zattoni 2015a: 1; Durisin & Puzone 2009). In fact, there are continuing and competing corporate governance systems in the market-based Anglo-American system; the European relationship-based system; and the relationship-based system of the Asia Pacific, together with new approaches to governance in emerging economies. This ongoing diversity of corporate governance systems is based on historical cultural and institutional differences that involve different approaches to the values and objectives of business activity (Aguilera & Jackson 2003 and 2010; Aglietta & Rebérioux 2005; Clarke 2017).

Ignoring the possibility of different responsibilities and purposes for the corporation, the Business Roundtable of the United States, which represents the majority of the major US corporations, maintained a single-minded commitment to shareholder primacy from the issue of its *Principles of Corporate Governance* in 1997. In a sudden apparent abandonment of the doctrine of shareholder primacy at the Business Roundtable August 2019 meeting in Washington DC, 181 CEOs signed a new *Statement on the Purpose of a Corporation* (2019) committing to lead their companies for the benefit of all stakeholders – customers, employees, suppliers, communities, and shareholders. The substance of these wider commitments, beyond their symbolic value, will be revealed over time.

2 The Significance of Corporate Governance

2.1 The Origins of the Corporation

The first corporations were founded by religious and educational organizations, traders, and merchant venturers licenced by the state. The Dutch East India Company and the English East India Company were prominent examples of the great ambition and huge risk associated with early corporate enterprise (Frentrop 2019; Stern 2019). The 1844 Joint-Stock Companies Act in England facilitated the process of incorporation, and joint-stock companies quickly proliferated. Beginning in Europe and North America, but spreading eventually to almost all jurisdictions, some legal version of the corporation developed. The process of incorporation involves the abstract concept of clothing the entity with the 'veil' of juridical personality.

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The conception of the corporation proved the inspiration for the modern business enterprise: the specific legal form of people and resources chartered by the state for the purpose of engaging in business activity. Unique characteristics distinguish the corporation from the other main legal forms – the sole proprietorship and the partnership. The vital elements of the corporation are:

- Limited Liability
  The losses an investor may bear are limited to the capital invested in the enterprise and do not extend to personal assets.
- Transferability of Shares
  Shareholder rights may be transferred without constituting legal reorganization of the enterprise.
- Juridical Personality
  The corporation itself becomes a fictive person, a legal entity which may sue or be sued, make contracts, and hold property.
- Indefinite Duration
  The life of the corporation may extend beyond the participation of its original founders (and may continue indefinitely).

2.2 The Increasing Scale and Impact of Corporations

As the scale and activity of corporations has increased immeasurably, the governance of these entities has assumed considerable importance. The corporation remains one of the most significant if contested innovations in human history (Coase 1937; Schumpeter 1942; Polyani 1941; Clarke, O'Brien, & O'Kelley 2019). 'It is not exaggeration to suggest that, with the possible exception of political democracy, the corporation has contributed more to human welfare than any other Western institution' (Stout 2019: 224). While the continuing influence of the state may have been neglected in global commentary in recent decades, the scale and influence of global corporations undoubtedly continues to grow and be recognized, even as their composition, structure, and operations are transformed. The largest international corporations have much greater economic clout than most countries in the world: if companies' revenues and selected emerging markets GDPs are compared, the leading one hundred corporations are much richer than most countries. The economies of most developing countries are diminutive compared to the revenues and assets of the largest international corporations. If we compare government total revenues with corporate turnover, of the world's largest 100 economies 31 are countries and 69 are corporations (World Bank 2016). And, of course, there are a lot more corporations: there are perhaps 200 viable countries in the world, versus several thousand large international corporations.

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Though the number of listed corporations in the United States peaked in the 1990s and then began a precipitous decline with the bursting of the internet bubble and the concentration of the banks, the market capitalization of US listed corporations continued to grow exponentially, with the global domination of the US platform technology corporations (Apple, Amazon, Microsoft, Google, Facebook) (Clarke & Boersma 2019; Clarke 2019b). In the rest of the world there was a sustained increase in the number of listed corporations, with the total of global listed corporations increasing from 15,000 in 1975 to around 45,000 in 2015 (Figure 1).

Business corporations have an enduring impact upon societies and economies. '[H]ow corporations are *governed* – their ownership and control, the objectives they pursue, the rights they respect, the responsibilities they recognize, and how they distribute the value they create – has become a matter of the greatest significance, not simply for their directors and shareholders, but for the wider communities they serve' (Clarke & dela Rama 2006: xix). These concerns originated with industrial capitalism and have become accentuated with the extensive internationalization of corporate activity in recent decades, the global deregulation of financial markets, and a growing awareness of the damaging economic and social consequences when corporate governance failures occur.

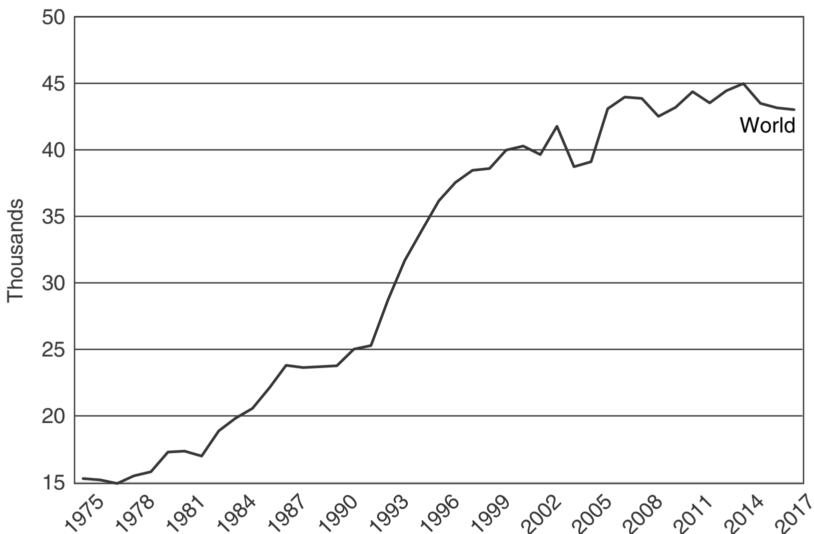

Figure 1 Increase in the number of global listed domestic companies 1975–2016

Source: World Bank (2018) https://data.worldbank.org/indicator/CM.MKT.LDOM.NO

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Among governments throughout the world, sound corporate governance is universally recognized as essential to market integrity and efficiency, providing a vital underpinning for financial stability and economic growth. The leading international agencies including the G20, OECD, IMF, and World Bank have seized upon corporate governance as a means of managing the risk of recurring corporate failure, but also as a route to improving economic performance, facilitating access to capital, reducing market volatility, and enhancing the investment climate. This was formally acknowledged when the OECD *Principles of Corporate Governance* became the G20/OECD *Principles* in 2015, with the diffusion of corporate governance codes around the world (Cuomo et al. 2016).

2.3 The Theoretical Understanding of Corporate Governance

The subject of corporate governance has long held a fascination for economists, lawyers, and management theorists from the moral economy of Adam Smith (1759; 1776) to the present day. The frequent dilemmas involved in business formation and operation were highlighted by historians, who have noted the association of pioneering business activity in the first years of mercantilism and industrialism in the seventeenth and eighteenth centuries with fraud and corruption (Frentrop 2003 and 2019; Stern 2019). Early in the twentieth century, Berle and Means (1933) in response to the devastation of the Wall Street crash and Great Depression critically analyzed the strengths and weaknesses of the emerging modern corporation.

According to Berle and Means, professional managers were in a position to determine the direction of the enterprise, and shareholders had 'surrendered a set of definite rights for a set of indefinite expectations' (Berle & Means 1933: 244). After the New Deal reconstruction of the US economy and the end of the Second World War, many US corporations in the 1950s and 1960s grew massively in scale and market domination, achieving pre-eminent positions in world markets. A new managerial and corporate mode of coordination of enterprise based on organization and planning had arrived as analyzed by Coase (1937) and later by Chandler (1977), transcending the market. This was an era celebrated in Galbraith's *New Industrial State* (1967) in which corporate growth and brand prestige apparently had displaced profit maximization as the ultimate goals of technocratic managers, as planning and administration in close cooperation with government had displaced market relations as the primary corporate dynamic (Henwood 1998: 259). In this technocratic milieu a shareholder was 'passive and functionless, remarkable only in his capacity to share without effort or even without appreciable risk, the gains from growth by

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which the technostructure measures its success' (Galbraith 1967: 356). However, the Galbraithian idyll began to disintegrate with the severe recession of 1973–5, the incapacity of US corporations to compete effectively with Japanese and European products in key consumer market sectors on quality and price, and the push towards conglomerate formation by Wall Street, which was interested in managing multiple businesses by a new discipline of strict financial performance. Technocratic managerialism, focused on products and consumers, was forcefully displaced by financial engineering focused on market indices and financial returns.

At this insecure juncture in the US economy, a group of Chicago-based economists left an indelible intellectual impression of the agency problems of corporate governance (Jensen & Meckling 1976; Fama 1980; Fama & Jensen 1983). This focused almost exclusively upon the problem of principals (owners of shareholdings) ensuring their interests were pursued by their agents (the managers of the companies in which they held shares). This starkly simple proposition exercised a fierce grip on the understanding and analysis of corporate and managerial behaviour for many decades to come, and in turn this promoted the shareholder primacy movement which insisted that the duty of corporations is to deliver shareholder value above all other considerations.

This stripped-down principal/agency theory view narrows the dimensions of corporate governance to a restricted set of privileged interests, and as a result it has a very limited conception of the dilemmas involved in corporate governance: 'Our perspective on corporate governance is a straightforward agency perspective, sometimes referred to as separation of ownership and control. We want to know how investors get the managers to give them back their money' (Shleifer & Vishny 1996).

In reality, multiple theoretical and methodological perspectives are required for an adequate understanding of the complexities of corporate governance (Zattoni & Van Ees 2012; Filatotchev & Wright 2017). Each of the theoretical perspectives including agency, transaction costs, stewardship, resource dependency, stakeholder, managerial hegemony, and class hegemony have a different view on enterprise and governance, different disciplinary foundations, different problem focus, and different assumptions on organization and relationships.

Theoretical approaches to corporate governance follow a continuum from the narrow focus of agency theory and transaction cost theory inspired by financial economics, through approaches including stewardship, resource dependency, stakeholder, and managerialist theories developed by organizational theorists, to more critical analysis originating in sociological and political critiques with an expansive view of the whole political economy. (Clarke 2004a). Each theoretical approach has its own logic and limitations, and though a number

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of the approaches represent opposing interpretations of the same problem, in some cases the theories serve to illuminate different dimensions of the governance problem.

After agency theory, the most established theoretical approach is transaction cost economics. Ronald Coase (1937) insisted (notwithstanding the assumption of neoclassical theory that the allocation of resources is coordinated through a series of exchange transactions on the market) that in the real world a considerable proportion of economic activity is organized in firms. Coase examines the economic explanation for the existence of firms, and why economic activities take place within firms rather than through markets. He explains the nature of firms in terms of the imperfections of markets, and in terms of the transaction costs of market exchange.

New institutional economics differs from agency theory in that the corporate governance problems of firms are perceived to proceed from a number of contractual hazards. This approach is concerned with discovering internal measures and mechanisms which reduce costs associated with contractual hazards to an efficient level: the external discipline of the market cannot be relied on to mitigate these problems, as it has only 'limited constitutional powers to conduct audits and has limited access to the firm's incentive and resource allocation machinery' (Williamson 1975: 143). Like neoclassical economics though, the locus of attention remains the shareholder-manager relationship, but in this case it is because shareholders are perceived to 'face a diffuse but significant risk of expropriation because the assets in question are numerous and ill-defined, and cannot be protected in a well-focused, transaction specific way' (Williamson 1985: 1210; Learmount 2002). As with agency theory, the narrowness of the focus limits the explanatory power of this analysis.

In contrast to agency theory, stewardship theory acknowledges a larger range of human motives of managers including orientations towards achievement, altruism, and the commitment to meaningful work (Hernandez 2008 and 2012). Stewardship theory maintains there is no inherent conflict of interest between managers and owners, and that optimal; governance structures allow coordination of the enterprise to be achieved most effectively. Managers should be authorized to act since, according to stewardship theory, they are not opportunistic agents but good stewards who will act in the best interests of owners. Stewardship theory recognizes a strong relationship between managers' pursuit of the objectives of the enterprise, the owners' satisfaction, and other participants in the enterprise reward. Davis, Schoorman, and Donaldson (1997) suggest that as managers maximize shareholders' wealth through raising the performance of the firm, they serve their own purposes. Managers balance competing shareholder and stakeholder objectives, making decisions in the

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best interests of all. However, there is an element of choice in corporate governance arrangements. Both managers and owners can choose to have either agency or steward relationships, contingent upon their assessment of the motivations of each other, and the situation of the enterprise. Stewardship theory rescues the integrity of management as a profession, something many managers would recognize and aspire towards.

There is a stream of theoretical approaches that widen the focus beyond internal monitoring, to explore the external challenges of corporate governance in terms of building relationships and securing resources. Resource dependence theory, institutional theory, and network theory all are interested in the external relations of corporations. Resource dependency theory highlights the interdependencies of organizations rather than viewing them simply in terms of management intentions. Hillman, Cannella, and Paetzold (2000), for example, examine how company directors may serve to connect the firm with external resources that help to overcome uncertainty, and provide access to relationships with suppliers, buyers, public policy makers, and other social groups. Resource dependency approaches add a vital external dimension to corporate governance relationships. Stakeholder theory defines organizations as multilateral agreements between the enterprise and its multiple stakeholders. The relationship between the company and its internal stakeholders (employees, managers, owners) is framed by formal and informal rules developed through the history of the relationship. This institutional setting constrains and creates the strategic possibilities for the company (Blair 1995; Clarke 1998). While management may receive finance from shareholders, they depend upon employees to fulfil the productive goals, to innovate, and to develop viable purposes and strategic intentions for the company. External stakeholders (customers, suppliers, competitors, special interest groups, and the community) are equally important, and also are constrained by formal and informal rules and interests that businesses must respect. Stakeholder theory has an intellectual appeal and practical application to the complexity of business enterprise, however it is argued from an agency perspective that multiple stakeholder responsibilities can leave management with too much freedom of maneuver, substituting their own interests for the shareholder interests (or even wider company interests).

From a more critical perspective, managerialist theory focuses on the distinctions between the myth and the reality of the relative powers of managers and boards. Mace (1971), for example, examines the 1960s ascendancy of US corporate executives, when powerful CEOs selected and controlled the boards of directors of the companies they ran. He outlines how CEOs in the US were able to determine board membership, decide what boards could and could not do, control the information and professional advice the board received, and

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determine the compensation of senior executives, including often themselves. When corporations fail, the question always arises, 'Where were the board of directors?' However, there is a wide gap between what directors are supposed to do, what people generally assume directors do, and what they are actually allowed to do in practice, or are inclined to do. Mace catalogues how dysfunctional boards, rather than being exceptional, became normal in the United States, as executives took control.

Finally, there are more radical theoretical critiques which suggest that corporations perpetuate the power of an elite, serving to exploit others in the interests of accumulating wealth and power for a few privileged shareholders and executives (Mills 1971). Though radical analysis faded after the 1960s, it has enjoyed a new lease of life in the widespread critique of the impact of globalization which corporations have spearheaded, with unemployment in developed countries and poor working conditions and pay in emerging economies where multinational corporation investment is concentrated. Most recently, there is a radical critique of the sustainability of corporations, that questions the impact of industry on climate change and the damaging impact on the ecology (Bansal and Hoffman 2011; Clarke 2016a and 2019; Helm 2015; IPCC 2014; Stern 2006).

In conclusion, the almost exclusive focus on agency theory in recent decades in the attempt to understand corporate governance has limited the field of inquiry, and the conception of shareholder value as the single defining corporate objective has fatally narrowed perceptions of corporate purpose and performance. The shareholder value regime is deeply flawed in terms of an understanding of directors' duties (Blair 2012), company law and practice (Deakin 2005), and executive incentives (Lazonick 2012), and conveys a lack of understanding of, or interest in, what actually takes place in companies in terms of the advance of innovation or the generation of wealth (Lazonick 2010 and 2017).

2.4 Accountability and Strategic Direction

Boards of directors acting solely as monitors for shareholders, as envisaged by agency theory, is a one-dimensional view of the role and responsibilities of directors (Blair & Stout 2001). The sad paradox of this exclusive focus on the monitoring of company directors to ensure they deliver shareholder value is that this excludes full consideration of the value-creating role of boards (Huse 2018). Boards of directors have a vital role to play working with the executives in leadership of the company and in value creation. This role is often neglected because of the emphasis of regulation upon the control and accountability functions of the board, and because of the almost exclusive focus of agency

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