

# **EUROPEAN CORPORATIONS AMERICAN STYLE?**

## **GOVERNANCE, CULTURE, AND CONVERGENCE**

by

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### **I. Introduction**

For both Europeans and Americans, the behavior of their corporations as key institutions in the generation and allocation society's resources is a subject of vital concern. Both Europe and the United States have therefore evolved their own complex systems to regulate corporate behavior. Those regulatory systems in both law and practice have been shaped not only by national policies but also by the cultures of the countries concerned. As globalization proceeds and interaction between Europe and the United States intensifies, one may ask whether their differing systems for regulating corporations, based as they are a strong cultural preferences, present opportunities for convergence, cooperation, or conflict. This paper will attempt to examine that question from the point of view of the American system and ask whether Europe will eventually have its corporations American style.

For the last twenty-five years, American public concern with corporate behavior has periodically expressed itself as two distinct themes: "corporate social responsibility" and "corporate governance." The theme of corporate social responsibility has focused on the impact

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of corporate activity on society, primarily on corporations' obligations to various *external* groups and constituencies. By contrast, corporate governance has looked primarily at the *internal* organization, rules, and relationships of the corporation itself. The emphasis in American public debate on one theme or the other has tended to ebb and flow with time and events. Thus, American investments in South Africa during the apartheid era were criticized as violations of corporate social responsibility. On the other hand, the recent financial collapse of Enron, one of the country's largest firms, is seen as a failure of corporate governance.

Europe, except for the United Kingdom, does not seem to have separated the issues of corporate governance from corporate responsibility as sharply in public discussion as has the United States. Moreover, it seems to have devoted relatively more attention to the social role played by corporations in the community and less attention to the specific question of "corporate governance," as that term has traditionally been understood in the United States and England. For that reason, it is important at the outset to seek a definition of corporate governance.

## **II. Defining Corporate Governance**

Students of corporate governance give the term a wide variety of definitions. Economists and social scientists have tended to define it broadly as "the institutions that influence how business corporations allocate resources and returns"<sup>2</sup> and "the organizations and rules that affect expectations about the exercise of control of resources in firms."<sup>3</sup> One noted economist has rather cryptically written that governance is "an institutional framework in which the integrity of the

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<sup>2</sup>. Mary O'Sullivan, "Corporate Governance and Globalization," 570 *ANNALS, AAPSS* 153, 154 (July 2000).

<sup>3</sup>. World Bank, *Building Institutions For Markets: World Bank Development Report 2002* p. 68.

transaction is decided."<sup>4</sup> These broad definitions encompass not only the internal structure of the corporation but also its external environment, including capital and labor markets, bankruptcy systems, and government competition policies.

U.S. corporate managers, investors, and lawyers, on the other hand, tend to employ a more narrow definition. For them, corporate governance is the system of rules and institutions that determine the control and direction of the corporation and that define relations among the corporation's primary participants -- shareholders, the board of directors, and company management.<sup>5</sup> This narrower definition focuses almost exclusively on the internal structure and operation of the corporation's decision-making processes. It has been this definition that has been central to public policy discussions about corporate governance in the United States.

Corporate governance as a public policy issue in the United States finds its origins in *The Modern Corporation and Private Property*, the classic work by Adolf Berle, Jr., a law professor, and Gardiner Means, an economist, first published in the 1932<sup>6</sup>. Berle and Means examined the growing concentration of economic power in the modern corporation and noted the rise of professional managers having operational control of large corporations but little or no ownership of the enterprise. They also pointed to the increasing dispersion of corporate shares among a growing number of persons, who, because they were widely dispersed and had relatively small

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<sup>4</sup>. Oliver E. Williamson, *The Mechanisms of Governance* 11 (New York: Oxford University Press, 1996).

<sup>5</sup> See Robert A. G. Monks and Nell Minow, *Corporate Governance* 1 (1995), defining corporate governance as the "relationship among various participants in determining the direction and performance of corporations. The primary participants are (1) shareowners, (2) management (led by the chief executive officer) and (3) the board of directors. See also California Public Employees' Retirement System, *Corporate Governance Core Principles & Guidelines* April 13, 1998, available at [www.calpers.org](http://www.calpers.org), which explicitly adopts this definition.

<sup>6</sup>. Adolf Berle, Jr. and Gardner C. Means, *The Modern Corporation and Private Property* (New York: Macmillan, 1932).

interests, were not able to exercise control over the corporation they owned. This divorce of ownership from control in the modern American corporation posed a challenge to the interests of shareholders. Berle and Means viewed corporate governance (a term that appears nowhere in their book) as a classical agency problem: how could corporate managers, as agents of the shareholders, be induced to manage corporate assets in the best interests of their principals?

Some modern scholars would come to dispute the Berle and Means model of the modern corporation. Finding that dispersed share ownership is largely an American and British phenomenon, they have argued that because large publicly traded corporations in other countries are to a significant extent run by control groups or families with substantial equity interests the basic problem of corporate governance is to protect minority shareholders from expropriation by those groups.<sup>7</sup> Nonetheless within the United States, the corporate governance problem identified by Berle and Means seventy years ago has not diminished since the publication of their seminal work. Indeed, as the ownership of corporate shares by American households, both directly and through financial institutions, has increased and spread dramatically throughout American society, the principal concern of investors, practitioners and scholars of corporate governance in the United States has been how to protect the legitimate rights and interests of shareholders when faced with managers who control the corporation. The recent collapse of Enron has re-ignited public concern with the question of corporate governance in the sense of how to devise systems, rules and institutions that will induce corporate executives to manage corporate assets in the interests of the shareholders, not their own interests. The spectacle of certain Enron top managers emerging from the debacle with substantial financial gains while

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<sup>7</sup> Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, "Corporate Ownership Around the World," 54 *Journal of Finance* 471-517 (1999).

investors and employee shareholders sustained large losses has only served to highlight the problems posed by the divorce of ownership from control in the large corporation and to focus renewed attention on the need to reform corporate governance.<sup>8</sup>

Although the fundamental agency problem has not changed, what has changed since the time of Berle and Means has been the rise of institutional investors, propelled to a significant extent by the nature of the U.S. pension system and the aging of the American population. The dispersion of share ownership, which served to render shareholders powerless, has been countered by the growing concentration of corporate shares<sup>9</sup> in the hands of mutual funds, pension funds, and other institutional investors who have shown increasing willingness to advocate actively for shareholder interests and good governance within the corporations whose shares they manage. Institutional investors in the U. S. and the U. K. continue to view the corporate governance problem essentially as one of assuring that the corporation is managed in the best interests of its shareowners.<sup>10</sup> Indeed, since fund managers are compensated by how well they maximize shareholder value in relation to a stated “benchmark,” they have powerful incentives to do so.

Many Europeans consider the traditional American definition of corporate governance to

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<sup>8</sup> Enron employees have been injured in two respects: through loss of their jobs and through loss of their retirement savings invested in Enron stock. Public concern seems to have focused primarily on the latter i.e. the injury to Enron employees as shareholders.

<sup>9</sup> It is estimated that out of the total market value of all publicly traded shares of \$30 trillion in the United States at the end of 1999, \$20 trillion was under some form of professional management. See website of the Social Responsibility Investment Forum at [www.socialinvest.org](http://www.socialinvest.org).

<sup>10</sup> Many institutional investors prefer the term “shareowner,” to “shareholder.” The California Public Employees Retirement System (CalPERS), the largest public pension fund in the United States with assets of \$143 billion and an active advocate of good corporate governance, has stated that “shareowner” is preferable because it “reflects our view that equity ownership carries with it active responsibilities and is not merely passive ‘holding’ shares.” California Public Employees’ Retirement System, *Corporate Governance Core Principles & Guidelines* April 13, 1998, available at [www.calpers.org](http://www.calpers.org)

be too narrow. For many persons on the European continent, particularly in France and Germany where share ownership is much less dispersed among the public than it is in the United States<sup>11</sup>, the central preoccupation of corporate governance should not be the rights of shareholders in relation to managers, but rather the rights of the community in relation to the corporation itself.<sup>12</sup> For Americans, corporate governance is about shareholders controlling managers for purposes of shareholder profit (managerial responsibility); for many Europeans it is about society controlling corporations for purposes of social welfare (corporate social responsibility). Thus unlike Americans who have tended to separate issues of corporate governance from corporate social responsibility, Europeans have joined the two themes in discussions about how corporations should be managed and regulated. The difference in definition and perspective on the nature and purpose of corporate governance makes it essential that in any trans-Atlantic dialogue on "corporate governance" the two sides recognize that they may really be talking about two different things.

The corporate governance system in the United States, is drawn largely from three sources: 1) state law, 2) federal law and regulations and 3) private mechanisms established or agreed to by corporations themselves.<sup>13</sup>

State law in each of the fifty states governs the creation, basic structure, and operation of corporation. That law not only consists of corporation codes and legislation, but also judicial

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<sup>11</sup> Rafael La Porta *et. al.*, *supra* note 7. See also, John C. Coffee, "The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications," 93 *Northwestern University Law Review* 641, 644-45 (1999).

<sup>12</sup> Margaret M. Blair and Mark J. Roe (eds.), *Employees and Corporate Governance* 164 (Washington, D. C.: Brookings Institution, 1999).

<sup>13</sup> One authority on corporate governance has pointed out that the law governing corporate governance in the United States "is relatively unique in the great number of sources by which it is shaped." Melvin Aron Eisenberg, "An Overview of the Principles of Corporate Governance," 48 *The Business Lawyer* 1271,1273 (1993).

decisions by state courts. Important legal doctrines governing corporate behavior, such as "the business judgment rule" and the duties of care and of loyalty of corporate officers and directors are products of judicial decisions. State corporation laws have a high degree of similarity<sup>14</sup>, but they are not identical. Indeed, the corporate laws of certain states may favor one interest group over another. Throughout the twentieth century, individual American states, seeking to maximize revenues from corporate franchise taxes, engaged in a competition to become the state of incorporation for U. S. companies. A winner in this competition, the small state of Delaware is the legal home to about 60% the Fortune 500 companies,<sup>15</sup> America's largest publicly traded corporations, because managers have considered Delaware law to be favorable to their interests. As a result, the Delaware courts have been the sites of important corporate litigation over the years, and their decisions have been influential in shaping various doctrines of corporate governance.<sup>16</sup> Europe has not experienced a similar competition for corporations among countries, and European law has tended to inhibit the kind of corporate mobility experienced in the United States<sup>17</sup>

Although the United States has no federal corporation law, federal securities laws, principally the 1933 Securities Act, the 1934 Securities Exchange Act, and the voluminous regulations issued the by the Securities and Exchange Commission are a central element of corporate governance for firms that raise capital from the public or whose shares are publicly traded. While still subject to individual state laws on many aspects of internal governance,

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<sup>14</sup> Coffee, *supra* note 10, at 652.

<sup>15</sup> E. Norman Veasey, "The Defining Tension in Corporate Governance in America," 52 *The Business Lawyer* 393, 401 (1997).

<sup>16</sup> Similarly, the state of Maryland is home to many mutual funds, largely because mutual fund promoters consider that Maryland law facilitates launching and managing of mutual funds.

<sup>17</sup> John C. Coffee, *supra* note 10 at p. 651.

publicly traded companies must at the same time respect the complex of Federal rules on a wide range of matters from informing shareholders about corporate activity to securing proxies from shareholders. The structure of federal law tends to give a high degree of uniformity to the systems of corporate governance of publicly traded corporations throughout the country. Federal legislation covering labor, anti-trust and taxation also have important consequence for American systems of corporate governance.

The rules and decisions of certain private bodies, such as stock exchanges and the Fair Accounting Standards Board, also influence corporate governance. Within the limits of state and federal law and the applicable rules of private regulatory bodies, American corporations have relatively wide discretion to shape their own internal mechanisms of corporate governance, including the terms of managers contracts, the composition of corporate boards, and the internal structure of the corporation, to mention just a few. In order to influence the exercise of this discretion, industry groups, such as the Business Round Table, and institutional investors, such as CalPERS, have prepared codes and statements of corporate governance that they have presented to or pressed upon the management of American corporations.

The traditional legal mobility of corporations from state to state and the broad discretion afforded corporate organizers tend to reflect a basic “enabling approach” (i.e., everything is permitted unless it is specifically prohibited) of American corporate law, as compared to the greater restrictions on mobility and discretion in Europe that reveal a more “mandatory” approach (i.e., everything is prohibited unless specifically permitted) that seems to characterize European corporate law and practice.

In view of its complexity and diversity, a discussion of the U. S. system of corporate

governance in a short paper faces a challenge in determining the precise elements to be covered. The author has therefore chosen to simplify the task by relying to a large extent on *Principles of Corporate Governance: Analysis and Recommendations* by the American Law Institute (ALI), an organization of lawyers, judges, and academics who for nearly a century has prepared authoritative restatements of key areas of American law. In 1994, after fifteen years of study, debate and some public criticism, the ALI issued *Principles of Corporate Governance*, a two-volume work of over 800 pages, in an effort to provide a comprehensive statement of corporate governance in the United States. Regularly cited by both federal and state courts in cases involving corporate governance, the restatement adopts a narrow definition of corporate governance and confined itself largely to the following topics: 1. the objective and conduct of the corporation; 2. corporate structure; 3. duties of directors and officers, and 4. remedies for violation of corporate governance principles.<sup>18</sup> This paper will adopt the ALI structure.

### **III. The Relationship of Corporate Governance to Culture**

Rules and institutions are shaped by the culture of the societies in which they function. Moreover, within individual corporations, corporate governance systems are constantly interacting with organizational culture, sometimes reinforcing one another and sometimes conflicting. For example, the prevailing corporate culture in the Enron Corporation seems to have conflicted with, and indeed overwhelmed, its formal governance system. As a result, any consideration of corporate governance must also take account of culture, both national and

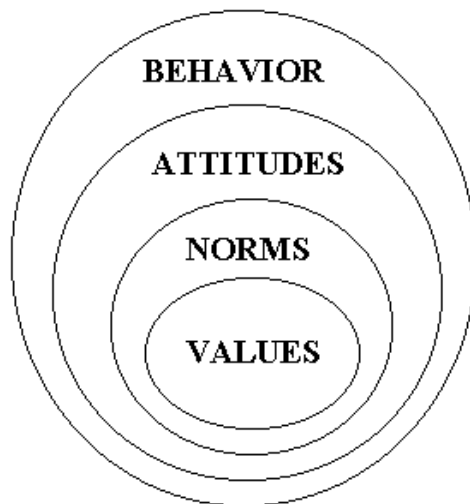
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<sup>18</sup>. The American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* (St Paul, Minn.: American Law Institute Publishers, 1994). The two-volume statement consists of seven parts: I. Definitions; II. The Objective and Conduct of the Corporation; III. Corporate Structure: Functions and Powers of Directors and Officers; Audit Committee in Large Publicly Held Corporations. III-A Recommendations of Corporate Practice Concerning the Board and the Principal Oversight Committees; IV. Duty of Care and Business Judgment Rule; V. Duty of Fair Dealing; VI. Role of Directors and Shareholders in Transactions in Control and Tender Offers; and VII. Remedies.

organizational.

Definitions of culture are as numerous as definitions of governance. For some scholars, culture is "the way in which a group of people solves problems and reconciles dilemmas,"<sup>19</sup> for others culture is "an integrated pattern of basic assumptions, values and artifacts that sets the stage for action, belief, and policy."<sup>20</sup> For purposes of this paper, culture is defined as the socially transmitted behavior patterns, attitudes, norms and values of a given community.<sup>21</sup> Depending on the nature of the inquiry, the community in question may be a nationality, an ethnicity, an organization, or a profession.

One may conceive of the four cultural elements mentioned above -- behavior, attitudes, norms and values -- as forming a series of concentric circles, like the layers of an onion, below.



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<sup>19</sup>. Fons Trompenaars and Charles Hampden-Turner, *Riding the Waves of Culture: Understanding Cultural Diversity in Global Business* 6 (New York: McGraw-Hill, 2nd ed., 1998).

<sup>20</sup>. William C. Frederick, *Values, Nature and Culture in the American Corporation* 88 (New York: Oxford University Press: 1995).

<sup>21</sup>. Jeswald W. Salacuse, "Intercultural Negotiation in International Business," 8 *Group Decision and Negotiation* 217, 218-221 (1999).

The process of understanding a specific culture is similar to peeling an onion. The outer most layer of the onion is behavior, the words and actions of persons working within the corporation,-- for example the way meetings are conducted among managers or how members of one corporate division communicate with another division. A second layer consists of the attitudes of persons within the corporation toward specific events and phenomena, for example attitudes about cooperating with another division. Next are norms, the rules to be followed by members of the corporation in specific situations. The inner most layer -- the core that orients and shapes all the other layers -- consists of values, fundamental beliefs, for example whether an organization or community has a strong attachment to the value of individualism, a value preferences that can have profound impact on a wide range of systems from compensation to decision making. One of the essential characteristics of a value is the belief by an individual or group that a specific conduct is personally or socially preferable to an opposite conduct.<sup>22</sup>

Culture has two basic and crucial functions: 1) to permit a community or organization to survive and adapt to the external environment and 2) to integrate its internal processes and personnel to ensure its capacity to survive and adapt.<sup>23</sup> One of the important tasks of corporate leadership is to shape corporate culture – primarily its values -- in a way that will enable the corporation to achieve its perceived goals.

Whereas corporate governance is basically influenced by structures external to the

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<sup>22</sup> William C. Frederick, *Value, Nature and Culture in the American Corporation* (New York: Oxford University Press, 1995).

<sup>23</sup> . Edgar H. Schein, *Organizational Culture and Leadership* 50 (San Francisco: Jossey-Bass, 1985).

corporation, such as state and federal law, corporate culture is essentially shaped by internal phenomena, especially the values, beliefs and attitudes of its personnel. As a result, the potential for tension and conflict in a particular corporation between its system of governance and its prevailing culture may be great.

While U. S. law tends to give a degree of uniformity among systems of corporate governance in the United States, corporate culture, driven by the internal dynamics of individual corporations, tends to display much more diversity. For example, the culture of a family-run company differs significantly from that of a public corporation. And the culture of an established automobile manufacturing company is unlike that of software development firm that recently made an initial public offering of its shares. As a result, it is difficult to speak of a single American corporate culture. At the same time, as will be seen, corporate culture is influenced by national culture, and that factor may tend to give U. S. corporate culture a degree of homogeneity, at least when compared to the corporate culture of European firms.

#### **IV. The Objectives of the Corporation**

Any system of corporate governance must answer a fundamental question: what is the objective of the corporation? Seventy years ago, Berle and Means posed a similar question at the end of *The Modern Corporation and Private Property* when they asked: For whom should the corporation be run? They argued that there were only three possible answers: the shareholders, the managers, or the community. As between the interests of shareholders and managers, they believed that protection of shareholder interests was to be preferred. However, writing during the Great Depression, they suggested that there was a need to find ways to make the corporation more responsive to community needs. They argued that the community was in position to

demand that the modern corporation serve "... not alone the owners or the control but all of society."<sup>24</sup>

"It is conceivable, -- indeed it seems almost essential if the corporate system is to survive,-- that the "control" of the great corporations should develop into a purely neutral technocracy, balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity."<sup>25</sup>

Although Berle and Means are often cited in connection with issues of corporate governance, they were also clearly concerned about a second theme that would later emerge in policy debates about the U. S. corporation: corporate social responsibility.

Berle and Means' "third way," their idealistic vision of corporate governance and social responsibility, never became a reality. Years later, in the late 1970's in the wake of the Watergate scandal and the discovery that major corporations had engaged in secret political contributions at home and corrupt payments abroad, a movement developed seeking to find ways to promote "corporate social responsibility," to impose a duty on corporations to manage their affairs in the best interests of the community. It was also during this period that the term "corporate governance" came into prominent usage.<sup>26</sup> Numerous proposals were advanced at the federal level in pursuit of this goal, but except for the Foreign Corrupt Practices Act, which outlawed bribery abroad, none of them actually became law.

Despite periodic challenges to business in the face of political and social events since

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<sup>24</sup> . Adolf A. Berle, Jr. and Gardiner C. Means, *The Modern Corporation and Private Property* 356 (New York: MacMillan, 1931, 1948).

<sup>25</sup> Ibid.

<sup>26</sup> . E. Norman Veasey, "The Emergence of Corporate Governance as a New Legal Discipline," 48 *The Business Lawyer* 1276 (1993).

Berle and Means wrote seventy years ago, the formal system of corporate governance embodied in the laws of the United States has unwaveringly and clearly stated that the objective of the corporation is to maximize profits for shareholders. Thus the American Law Institute, after considering various formulations to accommodate social needs to corporate purposes, finally concluded in its *Principles of Corporate Governance*:

“...a corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain.”<sup>27</sup>

In other words, the purpose of the corporation is to make profits and the beneficiaries of those profits are the shareholders.

At the same time, following American judicial decisions on the point, the ALI *Principles of Corporate Governance* also states that a corporation 1) *must* obey the law to the same extent as a natural person; 2) *may* take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of its business; and 3) *may*, but is not required to, devote a “reasonable amount of resources” to public welfare, humanitarian, educational and philanthropic purposes,”... even if corporate profit and shareholder gain are not thereby enhanced.”<sup>28</sup> *Principles of Corporate Governance* gives only general guidance for determining reasonableness of resources devoted to such purposes. It asserts that one important factor is the strength of the nexus between the use of corporate resources and the corporation’s business, stating: “In general the greater the amount of corporate resources that are expended, the stronger should be the nexus.”<sup>29</sup> Despite this concession to social action, *Principles of Corporate Governance* is far from the vision of Berle and Means. Maximization of shareholder value

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<sup>27</sup> ALI, *Principles of Corporate Governance* sec. 2.01(a).

<sup>28</sup> ALI, sec. 2.01 (b)

remains the basic objective of the American corporation.

To what extent does corporate culture in the United States reflect the value of shareholder profit maximization in the formal system of governance? Charles Hampden-Turner and Alfons Trompenaars, in a survey of 15,000 managers from around the world, asked executives to choose from the following as accurate statements of the proper goal of a corporation: 1. the only real goal of a corporation is making profit; or 2. a company, besides making profit, has the goal of attaining the well being of various stakeholders, such as employees, customers, etc. Out of the 12 nationalities surveyed, the largest percentage of managers selecting profit as "the only goal" were Americans (40%).<sup>30</sup> One may therefore conclude that among industrialized countries corporate culture in America is closest to the ideal of shareholder value maximization as a corporate goal. On the other hand, it should be noted, of course, that despite the large percentage in relation to other nationalities, 60% of American managers surveyed nonetheless considered that a corporation had other goals in addition to making a profit. Consequently, it would seem that the prevailing corporate culture in the United States may not completely accord with the system's stated goal of corporate governance.

In order to align the interests of managers to the goal of shareholder value maximization, U. S. corporations have increasingly compensated their executives in stock and stock options, now a widespread phenomenon throughout American corporate life, a phenomenon that is by no means confined to CEOs and top management. As a result, management contracts and compensation schemes have become important instruments of governance in the modern

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<sup>29</sup> ALI, *Principles of Corporate Governance*, vol. 1, p. 65.

<sup>30</sup> Charles Hampden-Turner and Alfons Trompenaars, *The Seven Cultures of Capitalism: Value Systems For Creating Wealth in the United States, Japan, Germany, France, Britain, Sweden and the Netherlands* 32 (Doubleday: New York, 1993).

American corporation. According to one study, the typical American corporation now allocates 1.4% of its equity each year to executives and other employees.<sup>31</sup> In 2000, the value of options granted by America's 325 largest corporations nearly equaled 20% of their pre-tax profits.<sup>32</sup> Equally important for managerial interests, stock has become the currency of corporate acquisitions and mergers. Thus a high stock price, presumably achieved to maximize shareholder value, also allows managers to substantially enlarge the corporate empires over which they preside and from which they derive substantial benefits.<sup>33</sup>

For many Europeans, the American emphasis on the maximization of shareholder value is misplaced as a corporate objective. Not unlike Berle and Means, they argue that the corporation should be managed for the benefit, not just of its shareholders, but of all its "stakeholders," a group that includes shareholders, employees, customers, suppliers, shareholders, and a wide variety of interest groups in the community. Germany, with its system of codetermination granting employees a formal role in governance, is often cited as the prime example of the "stakeholder model." Generally, a stakeholder model of corporate governance gives all stakeholders a "voice" in firm management and seeks to accommodate their diverse interests in deciding upon corporate action.<sup>34</sup> Another manifestation of the stakeholder model in European firms is the "relational board structure," which includes representatives of key constituencies, such as labor, lenders, and major customers or suppliers, whose positions on the board are a function of the corporation's special relationships with those constituencies and are unrelated to

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<sup>31</sup> Financial Times, August 12, 2000.

<sup>32</sup> New York Times, March 23, 2002.

<sup>33</sup> Mary O'Sullivan, "Corporate Governance and Globalization," 570 ANNALS, AAPSS 153, 168-169 (July 2000).

<sup>34</sup> Sigurt Vitols, "Varieties of Corporate Governance: Comparing Germany and the U.K." 337 in Peter A. Hall and David Soskice, eds. *Varieties of Capitalism: the Institutional Foundations of Comparative Advantage* (Oxford University Press, 1999).

any shares they may hold in the firm.<sup>35</sup>

The European lack of enthusiasm for the shareholder model, as opposed to the stakeholder model of corporate governance, is clearly reflected in Hampden-Turner and Trompenaars's survey data. Whereas 40% of American managers claimed to believe that the sole goal of the corporation was to make a profit, only 33% of the UK managers, 28% of Italian managers, 27% of Swedish managers, 26% of Dutch managers, 25% of Belgian managers, 24% of German managers and just 16% of French managers had the same preference.<sup>36</sup>

The difference between the American and European models of the corporation is a reflection of and to some extent is driven by two different cultural value preferences: individualism as opposed to communitarianism. According to Trompenaars and Hampden-Turner, "The individualist culture sees the individual as 'the end' and improvement to communal arrangements as the means to achieve it. The communitarian culture sees the group as its end and improvements to individual capacities as a means to that end."<sup>37</sup> By any measure, Americans place a high value on the individual and individualism, a characteristic that has been noted by observers of the American scene since the time of De Tocqueville. For example, of all managers and employees surveyed by Trompenaars and Hampden-Turner, Americans were by far the most individualistic.<sup>38</sup> The cultural value of individualism, which accords the individual a central role

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<sup>35</sup> Alexander Dyck, "Privatization and Corporate Governance: Principles, Evidence and Future Challenges," 16 *The World Bank Research Observer* 59. 60 (2000).

<sup>36</sup> Hampden-Turner & Trompenaars *supra* note 30 at p. 32.

<sup>37</sup> Fons Trompenaars and Charles Hampden-Turner, *Riding the Waves of Culture: Understanding Diversity in Global Business* 59 (New York: McGraw-Hill, 2<sup>nd</sup> ed. 1998)

<sup>38</sup> Charles Hampden-Turner and Alfons Trompenaars, *The Seven Cultures of Capitalism: Value Systems For Creating Wealth in the United States, Japan, Germany, France, Britain, Sweden and the Netherlands* 48 (Doubleday: New York, 1993).

in the scheme of things, is manifest throughout the American system with its emphasis on individual rights and the availability of individual legal remedies to enforce those rights. American law and attitudes towards individual property rights and freedom of contract strongly manifest the American cultural preference for individualism. Transferred to the corporate arena, the law considers the individual shareholders as “owners” of the corporation. As such they are legally entitled to all its fruits. The United Kingdom, sharing a common language, history, and legal tradition with the United States, also favors the shareholder model of the corporation.

Countries on the European continent, on the other hand, tend to emphasize the role and importance of the community more than does the United States. Their special history has caused them to place greater store in communitarianism than individualism as a set of values. Europe’s emphasis on “social solidarity,” its skepticism about the merits of unfettered competition, and its formal inclusion of labor in corporate management all manifest the greater importance that European culture attaches to the community, particularly as opposed to American culture. American doctrines of “employment at will” and “freedom of contract,” both reflections of strong individualistic values, contrast with German concepts of “labor rights” and “good faith” in contracting,<sup>39</sup> which reveal strong communitarian values. This difference is also reflected in attitudes toward competition. For example, one survey found that whereas nearly 70% of American managers believed that increased competition as opposed to increased cooperation among business would lead to greater benefits for society, only 41% of German managers and 45% of French managers had the same view.<sup>40</sup>

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<sup>39</sup> See Steven Casper, “The Legal Framework for Corporate Governance: The Influence of Contract Law on Companies Strategies in Germany and the United States,” in Peter A. Hall and David Soskice (eds), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* 387,388 (1999).

<sup>40</sup> Hampden-Turner & Trompenaars, *supra* note 38 at p. 71.

The heightened importance of communitarian values in Europe would quite naturally lead to the belief that the corporation, as part of the community and having benefited from its position in the community, needs to take account of community interests, not just shareholder interests, in conducting its operations and distributing its benefits. The relative lack of dispersed share ownership among the European public may reinforce this view. On the other hand, there is evidence that the stakeholder model, and particularly co-determination, makes it harder to control management and that European managers manipulate the stakeholder model by playing off one set of shareholders against other stakeholders in order to advance managerial interests.<sup>41</sup> For example, one study of corporate governance and the role of banks suggests that affiliations between banks and their principal corporate borrowers in Germany and Japan often encourage excessive lending and deferred restructuring.<sup>42</sup>

The differing cultural views as to the objective of the corporation may account for some of the public protests against "globalization" that American corporations have encountered in Europe. Seeing the globalization movement led by American corporations whose declared governance system seeks to make profits for shareholders without regard to other stakeholders, various groups are protesting against corporations that refuse to accommodate other stakeholder interests. A further point a friction may arise as a result of American institutional investors using their holdings in European companies to press American notions of good corporate governance on European managers. In November 2001, for example, the California Public Employees Retirement System (CalPERS), America's largest public pension fund, allocated \$1.7 billion of

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<sup>41</sup> Katharina Pistor, "Codetermination: A Sociopolitical Model with Governance Externalities," in Margaret M. Blair and Mark J. Roe (eds.) *Employees and Corporate Governance* 190 ( Washington, D.C.: Brookings Institution, 1999).

<sup>42</sup> David Weinstein and Yishay Yafeh, "On the Costs of a Bank-Centered Financial System: Evidence from the Main Bank Relations in Japan," 53 *Journal of Finance* 635-672 (1998).

its investments specifically to pursue “active corporate governance strategies” in European and Japanese markets.<sup>43</sup> Good governance for institutional investors means the primacy of shareholder interests.

Many multinational corporations are sensitive to cultural differences between the American and European views on corporate goals. For example during the 1990's, the mantra of "building shareholder value" was a proclaimed objective of many American corporations and found prominence in both their internal and external communications in the United States. These same corporations were much more circumspect in Europe, fearing that explicit statements in favor of shareholder value maximization would antagonize European governments and labor unions that strongly believe that corporations should advance the interests of all its stakeholders. When asked about this difference in approach, one French CEO responded: “I drive differently in the U. S. than I do in France. I also manage differently.”

Although American systems of corporate governance permit but do not require corporate boards and management to take account of social welfare issues in their decisions, various internal and external factors, such as pressure from labor unions, environmental groups, and non-governmental organizations, have induced corporations in individual cases to integrate social considerations in their decisions; however, this tendency by no means implies the kind of dilution of shareholder rights entailed by the stakeholder model. Of particular note in this regard is the emergence of “socially responsible investing,” by which investors instruct institutional investors to take account of certain social criteria in making investment decisions. As of 2001, it

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<sup>43</sup> See “CalPERS Turns Up Corporate Governance Heat – Plan Calls For Efforts to Target Japanese and Continental Europe”, Press Release, November 15, 2001, *available at* [www.calpers.org/whatsnew/press/2001](http://www.calpers.org/whatsnew/press/2001).

is claimed that \$2 trillion in U. S. investments were subject to social responsibility criteria.<sup>44</sup> To some extent, this trend may represent a slight convergence of the differing American and European views on the purpose of the corporation. On the other hand, the growing influence of institutional shareholders and their increased assertiveness with European managers may also represent a force for convergence toward increased shareholder rights in Europe.<sup>45</sup>

## **VI. Corporate Structure**

### **A. The Board of Directors**

In the U. S. system, the key institution of corporate governance is the corporation's board of directors. Although many state corporation laws provide that "the management" of the corporation is entrusted to or is under the supervision of the board, in fact no board of director manages, as that term is commonly understood. The fundamental task of the board is oversight of the corporation's managers. In the words of one authority, the board's primary duty is "overseeing management's dedication to the polestar of profit maximization..."<sup>46</sup> Efforts in recent years to reform corporate governance have focused primarily on structural means to strengthen the board's oversight role. In general, the challenge has been to allow managers flexibility to conduct management operations in an efficient way but at the same time establish processes that ensure managerial accountability to shareholders for accomplishing the stated corporate objective of profit maximization.<sup>47</sup>

If the board is truly to hold corporate managers accountable to shareholder interests, the members of the board must genuinely represent shareholders, rather than management. Directors,

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<sup>44</sup> See the website of the Social Responsibility Investment Forum at [www.socialinvest.org](http://www.socialinvest.org).

<sup>45</sup> Mary O'Sullivan, "Corporate Governance and Globalization," 570 ANNALS, AAPS 153 (2000).

<sup>46</sup> Ira M. Millstein, "The Responsible Board," 52 The Business Lawyer 407,409 (1997).

<sup>47</sup> ALI, *Principles of Corporate Governance*, vol. 1, p. 77.

of course, are elected by shareholders, but that process has traditionally resembled an election in a one-party state: management chose a single slate of nominees, most of whom were managers or had close relations with them. In recent years, American corporate practice has stressed measures to give corporate boards greater independence from management in the hopes that the board would as a result represent shareholder interests more vigorously. Rather than enact legislation on these measures, the approach in the United States has been to develop codes of best practices and then through pressure by institutional investors and industry groups to induce corporations to adopt them.

One principle that has found wide spread adoption in practice, though not in law,<sup>48</sup> is that a majority of the board of publicly traded corporations should consist of persons who are not themselves managers of the corporation. In 2001, for example, the average board among Standard & Poor 500 companies had 82% of its directors as non/employees. In Germany by contrast, 50% of the members of an average board of a DAC 30 company were non-employees, while the percentage in France was 92%.<sup>49</sup>

Not being an employee of the corporation is no guarantee that a director will be truly independent of management. A variety of other factors, such a family connections, financial relationships, and links to controlling shareholders can limit the ability of directors to act independently -- to be, in the words of the United States Supreme Court, “independent watchdogs.”<sup>50</sup> Independence is a subjective matter. In order to provide some objectivity to the

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<sup>48</sup> State corporation laws do not set requirements for persons to serve on the board. The Investment Company Act, the law governing mutual funds, however, required that no more than 60% of the board be “interested persons”. An interested person has specified relationships with the managers of the fund. In 2002, the required percentage of “disinterested directors” was increased to a majority. Stock exchange rules also provide for a minimum number of non-executive outside directors for listed corporations.

<sup>49</sup> Davis Global Advisors, *Leading Corporate Governance Indicator 2001 p. 31 (2001)*.

<sup>50</sup> *Burks v. Lasker*, 441 U. S. 471, 484 (1979).

process, one organization has developed a set of criteria to weigh board member's independence from management. They include: 1. not having worked at the company for at least the last three years; 2. not having personal financial relationships with the company; 3. not having familial relationship with management; and 4. not having a connection to major or controlling shareholders. When these criteria are applied, the percentage of boards with independent directors falls dramatically in the United States to 69 %, in Germany to 50 % and in France to 25%.<sup>51</sup>

The more ready acceptance of an independent board in American corporations is perhaps a reflection of individualistic as opposed to communitarian values and their impact upon evolving corporate governance.

The collapse of the Enron Corporation, a majority of whose members were neither executives nor employees of the corporation, leads one to ask whether still other mechanisms are needed to assure director independence. The failure of Enron directors to act as "independent watchdogs" may have been influenced by the social, political and other connections that they had with Enron management.

Other structural devices that have been introduced to strengthen the board's oversight function include the establishment of specialized committees to conduct certain key functions. For example, the Securities and Exchange Commission now requires all publicly traded companies to have an audit committee. On the other hand, Enron had a specialized audit committee of independent directors but it nonetheless failed to detect and correct accounting irregularities Practice is also evolving in which most companies have separate nominating and

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<sup>51</sup> Davis Global Advisors, Leading Corporate Governance Indicators 2001 p. 35 (2001).

compensation committees. The basic thrust behind this movement is the belief that a specialized committee, known to the shareholders and particularly if composed of independent directors, is more able to perform these tasks effectively than if they are diffused to the board in general. One of the results of the introduction of these measures of corporate governance is that boards have become more activist in recent times than they were in years past. Thus, one can cite cases of board action to remove corporate CEO's whose performance was unsatisfactory and to turn aside management proposals judged to be inappropriate.

### **B. The Executives of the Corporation**

If the selection of corporate directors resembles an election in a one-party state, the position the chief executive officer (CEO) in the modern American corporation is like that of a third-world autocrat. Indeed, like political systems dominated by the "cult of the leadership personality," it is not unfair to say that most American corporations manifest a cult of the CEO. It is almost an article of faith of American business that the CEO, and the CEO alone, is responsible for the rise or fall of the corporation's fortunes. Popular and managerial opinion in the United States considers that Lou Gerstner single handedly turned around IBM, that Jack Welch built GE into a modern force all by himself, and that Sandy Weill alone created Citigroup. CEOs not only manage. They write books. They appear regularly on television. They are the superstars of American corporate culture.

In recognition of this role, American CEOs are paid extravagantly. The average CEO of an American corporation received a record breaking \$20 in compensation in 2000. According to *Business Week*, the average American CEO made 42 times the average blue-collar worker's pay in 1980, 85 times in 1990, and 531 times in 2000. While it is true that almost two-thirds of a

CEO's pay takes the form of stock options, it is also true that the average American CEO earns almost twice as much as any other nationality.

Despite effective performance on the part of individual CEOs, one may attribute American's emphasis on the role and importance of the CEO, at least to some extent, to its cultural value of individualism. Americans believe that organizational achievement is disproportionately attributable to the actions of the individual leader, rather than to the efforts of the group. From the Lone Ranger to Huckleberry Finn, American culture is filled with tales of the individual triumphant. In countries with a more communitarian culture, such as Germany, corporate management tends to be more of a group effort than in the United States, a factor that influences CEO compensation in relation to that of other executives and employees. Moreover, European culture with its emphasis on community values and its large number of family companies seems to give the European CEO the status of a patriarch or father figure within the corporation.

In view of the overwhelmingly dominant position given the CEO in American corporations, it is curious that both the formal and informal instruments of corporate governance have little to say about the CEO or other senior executives. Corporate codes and laws hardly mention them. Informal statements of practice limit themselves to trying to create structures that will prevent or inhibit the CEO from dominating the board, whose basic function, after all, is to hold the CEO accountable. Thus for example, one emerging tenet of good corporate governance practice, advocated by certain groups is that the CEO should not also serve as company chairman. Indeed, many good governance advocates also favor a chairman who is an outsider, rather than a current or recent corporate executive. It is interesting to note that while the concept

of the separate chairman and CEO is prevalent in many countries, it is not common in the United States. For example, only 19% of S&P 500 companies had this type of arrangement, while 100% of Germany's Dax 30, 90% of UK's FTSE 100, and 100% of Netherland's top 11 did.<sup>52</sup> The American preference for combining both offices is no doubt strongly influenced by cultural values of individualism, as well as claims of efficiency.

Perhaps influenced by their own belief in the cult of the CEO and their own cultural preference for individualism, American advocates of corporate governance have not pressed as hard for this structural division as they have for other corporate government devices.

### **C. Shareholders**

The U. S. system of corporate governance also grants shareholders, as owners of the corporation, the right to make decisions directly about certain key matters affecting fundamental interests of the corporation. The extent of these shareholder rights can vary from state to state and indeed from company to company by virtue of differing corporate articles and by-laws. The importance of these rights is seen in proxy fights for corporate control and most recently in the battle between management and dissident shareholders over approval of the \$12 billion dollar merger between Hewlett Packard and Compaq, a battle that resembled a political campaign in the use of the media to influence shareholder votes. Corporate governance advocates are increasingly pressing corporations to grant shareholders the right to approve a variety of fundamental issues affecting the corporation and to have easy access to the proxy process. Once again the thrust is to involve shareholders in certain fundamental corporate decisions as a check on management action. These efforts represent a further attempt to affirm the role of shareholders as "owners," not merely stakeholders, of the corporation.

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<sup>52</sup> Davis Global Advisors, *Leading Corporate Governance Indicators 2001* p. 38 (2001).

In general, the Anglo-American system of corporate governance, when compared to systems on the European continent, has evolved strong legal protections for minority shareholders. Professor John Coffee has argued that dispersed share ownership in the U.S. and the U.K. is a product not of political restrictions on financial institutions but of effective legal protections that encourage investors to become minority shareholders.<sup>53</sup> If true, one can make a subsidiary argument that these legal protections for minority shareholders are themselves at least to a certain extent the product of a cultural preference by U.S. and U.K. courts and legislatures for the values of individualism.

The U. S. shareholder rights model may encounter difficulty in being transplanted to Western Europe, where a tradition of equity holding by corporations from the same country and with ties to the CEO may stifle attempts by shareholders to curtail managerial decisions that they perceive as threatening shareholder wealth maximization.

## **V. The Legal Duties of Directors and Officers**

Corporate law in the United States has traditionally imposed two basic duties on directors and officers: a duty of care and a duty of loyalty. Failure to meet either of these duties can result in legal liabilities enforceable in a court of law. As a general matter, the law does not impose liability simply because a business judgment taken by the board or management turns out to be wrong or to have caused the corporation to incur a cost. Directors and officers are not intended to be insurers of corporate actions. They are subject to a duty of care that gives both officers and directors wide latitude. To do otherwise would place American courts in the unenviable position of judging the wisdom, rather than the legality of corporate acts, something that they historically have been reluctant to do. The basic duty of care, as set out the *Principles of Corporate*

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<sup>53</sup> John C. Coffee, Jr., *supra* note at 644.

*Governance* is that: “A director or officers has a duty to the corporation to perform the director or officer’s function in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with reasonable care that an ordinarily prudent person would reasonably be expected to exercise in like position and under similar circumstances.” A director or officer is further protected by the so-called business judgment rule: “A director or officer who makes a business judgment in good faith fulfills the duty [of care] ... if the director or officer is 1 not interested in the subject of the business judgment; 2. is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believe appropriate under the circumstances, 3) rationally believe that the business judgment is in the best interests of the corporation...” The ALI makes it clear that in determining what is in the “best interests of the corporation” directors and officers must heed the corporation’s basic objective of enhancing corporate profit and shareholder gain. At the same time, failure to account for social considerations in making decisions that are otherwise legal is not a breach of an officer or director’s duty of care.

The second legal duty imposed on directors and officers is variously called the duty of loyalty, fiduciary duty, or duty of fair dealing. Basically, this duty applies to officers and directors in any corporate transaction or decision in which the officer or director has an “interest.” A complicated principle, it provides that in such transactions, if challenged, the director or officer must prove they are fair to the satisfaction of a court in order for them to avoid liability. Generally, speaking, regulation of self-dealing by officers and directors is more stringent in the Anglo-American system of corporate governance than it is on the European continent, a specific

illustration of the relative value placed on minority shareholder rights in the two systems<sup>54</sup>.

## **VI. Legal Remedies**

The duties of care and of loyalty would have little effect on corporate behavior without the existence of effective enforcement mechanisms. Governmental agencies, like the Securities and Exchange Commission, the U. S. Justice Department, state attorneys general, and state securities regulators, have traditionally pursued enforcement actions against corporations, officers and directors who violate them. But in addition, one must also include another powerful mechanism that probably takes its most vigorous form in the United States and has no exact replica in Europe: the private right of action. Statements about corporate governance rarely mention this phenomenon as an instrument for advancing good corporate governance. Its existence and effectiveness is a product of both American law and culture.

The American system permits shareholders to sue directors and officers for injuries that they have sustained either directly by corporate action or derivatively, on behalf of the corporation, for injuries done to the corporation because of wrongful actions by officers or directors. To facilitate such law suits, specialized law firms have arisen that carry forward the suit while assuming the financial risks entailed by litigation. Their incentive is to recover “attorney’s fees”, a portion of the settlement that the corporation is judged entitled to.

For many institutional investors, the basic remedy and sanction for bad governance is to sell the stock of the offending corporation or not to buy it all. Nonetheless, particularly in the United States where corporate litigation is frequent, the existence of a legal remedy serves as one more factor, along with others, to exert discipline on corporate behavior. If the American style of

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54 Luca Enriques, “The Law on Company Directors’ Self-Dealing: A Comparative Analysis,” 2 *International and Comparative Corporate Law Journal* 297,331 (2000) .

corporate governance is to spread to Europe by reason of the pressure of capital markets and institutional investors, one wonders whether shareholder litigation will be far behind. On the other hand, without a culture that tends to favor private actions by aggrieved individuals, including shareholders, it is unclear that private actions would evolve as effective deterrents to corporate misconduct in certain European cultures.

## **VII Conclusion**

Systems of corporate governance are not mere forms that can be replaced with ease. As John Coffee has argued they are more than just a technology that can be chosen at will by corporations, “a variable that a firm can simply select or contract around.”<sup>55</sup> That is because systems of corporate governance, like a society’s other important institutions, contain its cultural values, values that it has come to believe, rightly or wrongly are essential for social survival. Consequently, one cannot assume that American values of individualism will replace European attachment to community values any time soon.

On the other hand, stressing the dichotomy between the “Anglo-Saxon” shareholder corporate model and the European stakeholder model may exaggerate the differences between the two systems of corporate governance and overlook the impact of forces for convergence such as the activities of institutional shareholders in Europe and the listing of European corporations on American stock exchanges . While a sharp distinction between the two models may satisfy persons with a penchant for dialectic thinking, it may also neglect opportunities to find ways to bridge the differences and fail to notice convergence that may already be taking place. For one thing, the effort to make management, whether American or European, more responsive to other parties outside of management itself can only serve to exert a salutary discipline on managers.

The movement toward more independent directors, whether in Europe or America, is also a step forward, whether one sees the goal of the corporation as shareholder profit or stakeholder benefits. The effort, now well advanced in Europe, to divide the position of chairman from CEO, would probably be seen as beneficial by the shareholders of most American corporations. In this respect at least, Americans might want to have their corporations with a European touch. And finally a middle ground, a point of convergence between the stark shareholder model advanced by Americans and the extreme stakeholder model advocated by Europeans, may reside in the notion of “socially responsible corporate governance,” a concept that seeks to bring together two important themes that really have not been joined thus far: corporate good governance and corporate social responsibility. Rather than force stakeholder advocates to abandon important community rights and shareholder partisans to give up important individual property rights, a dialogue between America and Europe might focus more productively on the meaning of socially responsible good governance and how it might be applied while allowing values demanded by both European and American culture to be preserved.

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<sup>55</sup> John Coffee, *supra* note at 646 .