

2003

## Corporate Governance, Culture and Convergence: Corporations American Style or with a European Touch

Jeswald W. Salacuse

---

### Recommended Citation

Jeswald W. Salacuse, *Corporate Governance, Culture and Convergence: Corporations American Style or with a European Touch*, 9 LAW & BUS. REV. AM. 33 (2003)  
<https://scholar.smu.edu/lbra/vol9/iss1/5>

This Symposium Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in Law and Business Review of the Americas by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

# CORPORATE GOVERNANCE, CULTURE AND CONVERGENCE: CORPORATIONS AMERICAN STYLE OR WITH A EUROPEAN TOUCH?

Jeswald W. Salacuse\*

## I. INTRODUCTION

FOR most countries, the behavior of their corporations as key institutions in the generation and allocation of society's resources is a subject of vital concern. Therefore distinct, complex systems of corporate governance to regulate corporate behavior have evolved. Scholars have sought to explain the diversity of these systems on a variety of grounds: the quest for economic efficiency,<sup>1</sup> the existence of political constraints on financial institutions,<sup>2</sup> and the differing nature of legal systems.<sup>3</sup> While each of these factors has certainly been important in shaping systems of corporate governance around the world, one other significant factor that has received relatively little attention is culture. Corporate 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 among countries intensifies, one may ask whether the differing systems for regulating corporations, based as they are on strong cultural preferences, present opportunities for convergence, cooperation, or conflict. Will Europe, for example, eventually have its corporations in the American style? Will the United States come to appreciate corporations with a European touch? The purpose of this paper is to explore the link between culture and cor-

---

\* Henry J. Braker Professor of Commercial Law, The Fletcher School of Law and Diplomacy, Tufts University. Visiting Professor University of London (SOAS & QMW). Fulbright Distinguished Chair in Comparative Law in Italy (2000). Independent director of mutual funds listed on the New York Stock Exchange. This article is a revised version of a paper originally presented at the conference on "Transatlantic Perspectives on US-EU Economic Relations: Convergence, Cooperation, and Conflict," April 11-12, 2002, hosted by the John F. Kennedy School of Government, Harvard University, and later in modified form at a colloquium on Corporate Governance, organized by the British Institute of International and Comparative Law, London, June 6, 2002.

1. Michael E. Porter, *Capital Disadvantage: America's Failing Capital Investment System*, HARV. BUS. REV., Sept.-Oct. 1992, at 65.
2. Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10 (1991).
3. John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 644 (1999).

porate governance, and to speculate on the possibilities for convergence of corporate governance systems in the future.

For the last twenty-five years, American public policy 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 of corporate activity on society—primarily on corporations' obligations to various *external* groups and constituencies. By contrast, corporate governance has primarily concerned the *internal* organization, rules, and relationships of the corporation itself, especially its obligations to its shareholders. 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 collapse of Enron in 2001 and the financial scandals uncovered in other American corporations are seen as failures of corporate governance, provoking widespread demands for governance reform.

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, European countries appear to have devoted relatively more attention to the social role of corporations in the community, and somewhat 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 determine whether corporate governance means the same thing on both sides of Atlantic.

## II. DEFINING CORPORATE GOVERNANCE

The term "corporate governance" appears to have arisen and entered into prominent usage in the mid-to-late 1970s in the United States in the wake of the Watergate scandal and the discovery that major American corporations had engaged in secret political contributions at home and corrupt payments abroad.<sup>4</sup> Eventually it gained currency elsewhere as a subject distinct from corporate management or corporate organization.

Students and practitioners 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>5</sup> and "the organizations and rules that affect expectations about the exercise of control of resources in firms."<sup>6</sup> One noted economist has rather cryptically written that govern-

---

4. E. Norman Veasey, *The Emergence of Corporate Governance as a New Legal Discipline*, 48 *BUS. L.* 1267 (1993).

5. Mary O'Sullivan, *Corporate Governance and Globalization*, 570 *AM. ACAD. POL. & SOC. SCI.* 153, 154 (2000).

6. WORLD BANK, *WORLD BANK DEVELOPMENT REPORT : BUILDING INSTITUTIONS FOR MARKETS* (2002), at 68, available at <http://www.worldbank.org/wdr/2001/fulltext/fm.pdf>

ance is “an institutional framework in which the integrity of the transaction is decided.”<sup>7</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 governmental competition policies.

Corporate managers, investors, policy makers and lawyers, on the other hand, tend to employ a narrower definition. For them, corporate governance is the system of rules and institutions that determine the control and direction of the corporation and define relations among the corporation’s primary participants—shareholders, the board of directors, and company management.<sup>8</sup> This narrower definition focus almost exclusively on the internal structure and operation of the corporation’s decision-making processes. This definition has been central to public policy discussions about corporate governance in the United States and many other countries. For example, the *OECD Principles of Corporate Governance*,<sup>9</sup> aimed at corporations in both Europe and the North America, deal with only five topics: I. The Rights of Shareholders; II. The Equitable Treatment of Shareholders; III. The Role of Stakeholders in Corporate Governance; IV. Disclosure and Transparency; and V. The Responsibility of the Board.

Corporate governance as a public policy issue (though not as a label) 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 1932.<sup>10</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.<sup>11</sup> They also pointed to the increasing dispersion of corporate

---

7. OLIVER E. WILLIAMSON, *THE MECHANISMS OF GOVERNANCE* 11 (1996).

8. See ROBERT A. G. MONKS & NELL MINOW, *CORPORATE GOVERNANCE* 1 (2d ed. 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 CAL. PUB. EMPLOYEES’ RET. SYS., *CORPORATE GOVERNANCE CORE PRINCIPLES & GUIDELINES* (1998), available at <http://www.calpers.org>. (last updated Apr. 13, 1998) [hereinafter Calpers], which explicitly adopts this definition. Similarly, the United Kingdom’s 1992 Cadbury Reports often quoted: “Corporate governance is the system by which businesses are directed and controlled.” Cadbury Comm., *Report of the Committee on the Financial Aspects of Corporate Governance*, para. 2.5 (Dec. 1992), available at <http://www.worldbank.org/html/fpd/privatesector/cg/codes.htm>.

9. Organisation for Economic Co-Operation and Development, *OECD Principles of Corporate Governance*, (endorsed by the Ministers at the OECD Meeting, 26-27 May 1999), Paris, OECD, 1999, available at [www.oecd.org](http://www.oecd.org) [hereinafter *OECD Principles of Corporate Governance*]. The American Law Institute’s *Principles of Corporate Governance: Analysis and Recommendations* (St. Paul, Minn.: American Law Institute Publishers, 1994) takes a similarly narrow view of the subject’s scope.

10. ADOLF BERLE, JR. & GARDNER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

11. *Id.*

shares among a growing number of persons who, because they were numerous, widely scattered, and had relatively small interests, were not able to exercise control over the corporation they owned.<sup>12</sup> This divorce of ownership from control in the modern American corporation posed a challenge to the interests of shareholders.<sup>13</sup> 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?<sup>14</sup>

Recently, some scholars have disputed the applicability of the Berle and Means model of the modern publicly traded corporation to countries outside of the United States. Finding that dispersed share ownership is largely an American and British phenomenon, they have argued that because large publicly traded corporations in other countries, for example in Europe, Latin America, and Japan, are to a significant extent run by control groups with substantial equity interests, the basic problem of corporate governance in those countries is to protect minority shareholders from expropriation by controlling parties.<sup>15</sup> The difference in the concentration of shareholder ownership in corporations between the United States and the United Kingdom on the one hand, and the European continent on the other is striking. For example, among 1309 corporations listed on the New York Stock Exchange and 2831 corporations on the NASDAQ, one study found that the median size of block holding by an investor group was less than the minimum required disclosure level of 5 percent.<sup>16</sup> In the United Kingdom, out of 1926 listed companies, less than 3 percent had shareowners with majority control.<sup>17</sup> Another study found that out of 250 listed, non-financial companies in the U.K., the median block holder controlled only 9.9 percent of votes.<sup>18</sup> On the other hand, in 50 percent of non-financial listed companies in Austria, Belgium, Germany, and Italy, a single investor or related group of investors controlled more than 50 percent of voting stock.<sup>19</sup> In 50 percent of listed companies in the Netherlands, France, Spain, and Sweden, a single block holder (an individual or related group of investors) controlled more than 43.5 percent, 20 percent, 34.5 percent, and 34.9 percent respectively of voting rights.<sup>20</sup> Thus, share ownership and therefore voting power in publicly

---

12. *Id.*

13. *Id.*

14. *Id.*

15. Rafael La Porta, et al., *Corporate Ownership Around the World*, 54 J. FIN. 471, 471-517 (1999).

16. Colin Mayer, *Corporate Cultures and Governance: Ownership, Control and Governance of European and U.S. Corporations* (Mar. 31, 2002) (unpublished paper, conference draft), available at [http://www.ksg.harvard.edu/cbg/conferences/us-eu\\_relations/meyer\\_corporate\\_culture\\_governance.pdf](http://www.ksg.harvard.edu/cbg/conferences/us-eu_relations/meyer_corporate_culture_governance.pdf).

17. See THE CONTROL OF CORPORATE EUROPE OXFORD (Fabrizio Baraca & Marco Becht eds., 2001).

18. Mayer, *supra* note 16, at 2.

19. *Id.*

20. *Id.*

traded corporations is more concentrated in Europe than it is in the United States and the United Kingdom. In addition, a larger percentage of the United States population are shareowners compared to European countries. For example, whereas one half of all American adults directly or indirectly own corporate shares, only one in five Germans is a shareowner.<sup>21</sup>

The statistical patterns that emerge with respect to corporate share ownership concentration lead to the conclusion that, in general terms, America and Europe offer two basically different types of publicly traded corporations: the “manager-dominated model,” which prevails in the United States and the United Kingdom, and the “controlling shareholder-dominated model,” which prevails throughout most of the European continent. While this difference in share ownership structure between the United States and the United Kingdom on the one hand, and countries on the European continent on the other, is real, a central problem of corporate governance on both continents arises out of the separation of ownership and control underscored by Berle and Means. That problem is protecting minority shareholders from those in control, whether the controllers are professional managers without substantial ownership interests who would manage the corporation largely in their own interests, or shareholders with a controlling interest who would trample on the rights of the minority.

The corporate governance problem identified by Berle and Means seventy years ago has not diminished in the United States 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 collapse of Enron and the financial scandals at other large American corporations have 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, instead of their own interests. The spectacle of certain Enron top managers emerging from the their bankrupt corporation with substantial financial gains, while investors and employee shareholders sustained large losses, has only served to highlight the problems posed by the divorce of ownership from control in large American corporations and to focus renewed attention on the need to reform corporate governance.<sup>22</sup>

---

21. N.Y. TIMES, Sept. 29, 2002, at WK 4.

22. Enron employees have been injured in two respects: (i) through loss of their jobs and (ii) 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).

Although the fundamental agency problem has not changed, what has changed since the time of Berle and Means is the rise of institutional investors, propelled to a significant extent by the nature of the privately funded U.S. retirement system and the aging of the American population. The dispersion of share ownership, which served to render shareholders powerless, has been countered to some extent by the growing concentration of corporate shares 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.<sup>23</sup> Institutional investors in the United States and the United Kingdom 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>24</sup> Indeed, because 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, with its central preoccupation on protecting shareholder rights and interests, to be too narrow. For those 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>25</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>26</sup> For Americans, corporate governance is about shareholders controlling managers for purposes of shareholder profit (managerial responsibility); whereas 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 at times they may really be talking about two different things.

---

23. 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 Social Investment Forum, *1999 Report on Socially Responsible Investing Trends in the United States* (Nov. 4, 1999), available at <http://www.socialinvest.org/area/research/trends/1999-Trends.htm>.

24. 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." Calpers, *supra* note 8.

25. La Porta, *supra* note 15; see also, Coffee, *supra* note 3, at 644-45.

26. EMPLOYEES AND CORPORATE GOVERNANCE 164 (Margaret M. Blair and Mark J. Roe eds., 1999).

### III. THE SOURCES OF CORPORATE GOVERNANCE

The rules and mechanisms of corporate governance come from a wide variety of sources, both public and private. A primary source is the company or corporation law of the individual countries concerned. This legislation governs the creation, basic structure and primary rules of operation of the company, corporation, *société anonyme*, *aktientgesellschaft*, or other corporate legal form that a firm chooses to take. It also states some of the basic rights of shareholders, including the right to vote, to receive information about company matters, and to challenge management decisions in court. The nature of these rights varies significantly from country to country. Some countries offer stronger protection to shareholders than others.<sup>27</sup>

In the United States, which has a federal system of law, each of the fifty states has its own corporation code.<sup>28</sup> In addition, judicial decisions by state courts have developed important legal doctrines governing corporate behavior, such as “the business judgment rule” and the duties of care and loyalty of corporate officers and directors. American state corporate laws have a high degree of similarity, 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 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 percent the Fortune 500 companies, 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. 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.

A second important source of corporate governance are national rules and regulations with respect to the sale, distribution and trading of securities involving the public. One basic goal of securities regulation in virtually all countries is to assure that investors receive adequate information about the corporation and its activities so that they may make investment decisions and exercise shareholder rights appropriately. As with corporation laws and codes, the extent of protection afforded to shareholders by securities legislation varies from country to country.

---

27. See La Porta, *supra* note 15, at 1141-43 (evaluating the effective of enforcement in forty-nine countries).

28. 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 Bus. L. 1271, 1273 (1993).

Although the United States has no federal corporate law, federal securities laws, principally the 1933 Securities Act and the 1934 Securities Exchange Act, as well as the voluminous regulations issued 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, publicly traded companies must at the same time respect the complex federal rules, on a wide range of governance matters from informing shareholders about corporate activity to conducting audits of corporate accounts. 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, antitrust, and taxation also have important consequence for American systems of corporate governance.

The principal source of corporate governance in Europe is the legislation of the individual European country concerned. Although European Union legislation does have an impact on certain aspects of corporate governance, it has not unified corporate governance practice to the same extent as the combination of U.S. federal law and regulations, and the New York Stock Exchange and NSDAQ rules, have tended to unify American practices. Thus, there is a greater divergence in corporate governance rules among publicly traded European corporations than there is among their American counterparts.

In addition to the nature of the laws and regulations on corporate governance, one must also consider the quality of law enforcement in the countries concerned. The effectiveness of corporate governance legislation and regulation depends of course on the competence, integrity, and forcefulness of the courts and regulatory agencies in each country. On this issue, one also finds significant variations among countries.

The rules and decisions of certain private bodies, such as stock exchanges, professional accounting institutions, and industry organizations, also influence corporate governance. Thus the rules of the New York Stock Exchange address many elements of corporate governance and are obligatory for corporations who have their shares traded on the "Big Board."<sup>29</sup> Invoking that powerful lever, the Sarbanes-Oxley Act of 2002,<sup>30</sup> a major legislative response to the scandals at Enron, Arthur Anderson, and other corporations, compelled the U.S. Securities and Exchange Commission to direct the securities exchanges and national associations of securities dealers to adopt rules, applicable to the corporations which they traded, on a wide range of corporate governance matters including audit committees, independence of directors, and the composition of boards of directors.<sup>31</sup>

---

29. For the rules of the New York Exchange applicable to listed companies, *see* [www.nyse.com](http://www.nyse.com).

30. Sarbanes-Oxley Act of 2002, H.R. 3763, 107th Cong. (2002).

31. *Id.*

Accounting plays a vital role in corporate governance because of its fundamental role in any disclosure regime concerning information about companies' activities. A strong disclosure regime is essential for the exercise of shareholder rights, for monitoring corporate activity, and for imposing discipline on management. Without effective and uniform accounting standards and practices, however, meaningful disclosure cannot take place. For example, the lack of agreement within the American accounting profession as to the need to treat stock option grants to executives as a current expense led to overstatement of earnings of some corporations, thereby inflating valuations of their stock on securities markets. As a result, the accounting rules and practices and professional organizations such as the Financial Accounting Standards Board (FASB) in the United States and the International Accounting Standards Board in Europe (IASB) are yet another important source of corporate governance. Part of the corporate disclosure system, technically outside of the formal institutions of corporate governance but which shareholders rely on and managers try to influence, are financial analysts of broker-dealer firms, credit rating agencies, and the financial press.<sup>32</sup>

Within the limits of law, regulations, and the applicable rules of private regulatory bodies, corporations have 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. The degree of discretion varies from country to country. The traditional legal mobility of American corporations from state to state and the broad discretion afforded to corporate organizers tend to reflect a basic "enabling approach" (i.e., everything is permitted unless it is specifically prohibited) of American corporate law. Conversely, there are 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 order to influence the exercise of this discretion, industry groups and institutional investors' have prepared codes, reports, and statements of corporate governance that they have presented to, or pressed upon the management of corporations. In the United States, the Business Round Table, a leading organization of corporate executives, and institutional investors, such as the California Public Employees' Retirement System

---

32. All U.S. publicly traded corporations are subject to the accounting and auditing standards set forth by the Financial Accounting Standards Board (FASB). At present, Europe has no single, agreed upon set of standards. As part of its efforts to create a single European market in financial services, the European Commission has directed that by 2005 most EU listed companies should prepare their financial statements using international accounting standards that are currently being formulated by the International Accounting Standards Board, a private group based in London. By 2007, all EU listed companies are to use common international standards. David Tweedie, *Tackling A Crisis in Financial Reporting*, 11 EUR. BUS. FORUM 19, 19-21 (2002).

(CalPERS) and TIAA-CREF, have been active participants in this movement.

Europe has also engaged in a similar exercise, primarily at the country, rather than the continental level. During the 1990s, prestigious groups and organizations within individual European countries produced over thirty recommended codes of best practices in corporate governance.<sup>33</sup> They include The Cadbury Report (U.K., 1992), Viénot Reports I and II (France, 1995 and 1999), Peters Report (Netherlands, 1997), and the Mertzanis Report (Greece 1999).<sup>34</sup> And finally, an important multilateral effort to define best practices in corporate governance for both Europe and North America is the Organisation for Economic Co-operation and Development's *Principles of Corporate Governance*, adopted in 1999.<sup>35</sup> None of these codes and reports is binding on corporations, but they have served to heighten awareness of corporate governance issues, to establish goals toward which corporations should work, and to frame and influence policy discussions.

In view of the complexity of the issues and the diversity of sources, a discussion of U.S. and European corporate governance in a short article faces a challenge in determining the precise elements to be covered. Following the approach of the *OECD Principles of Corporate Governance* and the American Law Institute's *Principles of Corporate Governance: Analysis and Recommendations*,<sup>36</sup> it adopts a narrow definition of corporate governance and focuses primarily on the rules governing the corporation's basic internal institutions.<sup>37</sup>

Despite their high degree of complexity and technicality, the rules of corporate governance in both the United States and Europe have not evolved in response to economic and political imperatives alone. The differing cultures of the United States and Europe have also played important roles.

#### IV. THE RELATIONSHIP OF CORPORATE GOVERNANCE TO CULTURE

Rules and institutions are shaped by the culture of the societies in which they function. Definitions of "culture" are as numerous as defini-

---

33. For a comprehensive listing of these codes and reports, see WEIL, GOTSHAL & MANGES, COMPARATIVE STUDY OF CORPORATE GOVERNANCE CODES RELEVANT TO THE EUROPEAN UNION AND ITS MEMBER STATES, 14-16 (Jan. 2002), available at [http://www.europa.eu.int/comm/internal\\_market/en/company/news/corp-gov](http://www.europa.eu.int/comm/internal_market/en/company/news/corp-gov) [hereinafter WEIL, GOTSHAL & MANGES STUDY].

34. *Id.*

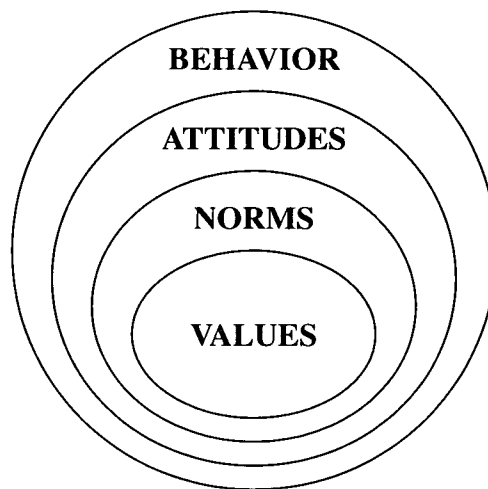
35. *OECD Principles of Corporate Governance*, *supra* note 9.

36. A.L.I. *Principles of Corporate Governance: Analysis and Recommendations* (1994).

37. *Id.* 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 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.

tions of “governance.” For some scholars, culture is “the way in which a group of people solves problems and reconciles dilemmas,”<sup>38</sup> for others culture is “an integrated pattern of basic assumptions, values and artifacts that sets the stage for action, belief, and policy.”<sup>39</sup> For purposes of this article, culture is defined as the socially transmitted behavior patterns, attitudes, norms, and values of a given community.<sup>40</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, as illustrated below.



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 from the culture working within the corporation; for example, the way shareholder meetings are organized and conducted. A second layer consists of the attitudes of persons within a given community toward specific events and phenomena; for example the attitudes about economic competition. 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 and fundamental beliefs; for example, whether an organization or community has a strong attachment to the value of individualism or to communitarianism, a value preference that can profoundly impact a wide range of

---

38. ALFONS TROMPENAARS & CHARLES HAMPDEN-TURNER, *RIDING THE WAVES OF CULTURE: UNDERSTANDING CULTURAL DIVERSITY IN GLOBAL BUSINESS* 6 (2d ed., 1998).

39. WILLIAM C. FREDERICK, *VALUES, NATURE AND CULTURE IN THE AMERICAN CORPORATION* 88 (1995).

40. Jeswald W. Salacuse, *Intercultural Negotiation in International Business*, 8 *GROUP DECISION AND NEGOTIATION* 217, 218-221 (1999).

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>41</sup>

Culture has two basic and crucial social 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>42</sup> Thus a culture can be viewed as a system of survival that a community has developed over time in response to the challenges that it has encountered as a group. As will be seen, the United States and Europe, while holding many values and beliefs in common, also differ with respect to the importance attached to two important cultural values: individualism and communitarianism. Their differing histories may explain the difference in their value preference between the individual and the community.

In addition to national cultures, individual corporations have their own corporate culture. While U.S. law tends to foster a degree of uniformity in corporate governance among publicly traded companies in the United States, corporate culture, driven by the internal dynamics of individual enterprises tends to display much more diversity. For example, the culture of a family-run company differs significantly from that of a public corporation. Conversely, the culture of an established automobile manufacturing company is unlike that of a 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. 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. Thus, the potential for tension and conflict in a particular corporation between its system of governance and its prevailing corporate culture may be great.

## V. 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 their book when they asked: For whom should the corporation be run?<sup>43</sup> They argued that there were only three possible answers: (i) the shareholders, (ii) the man-

---

41. FREDERICK, *supra* note 39.

42. EDGAR H. SCHEIN, *ORGANIZATIONAL CULTURAL AND LEADERSHIP* 50 (1985).

43. BERLE, *supra* note 10, at 356.

agers (whom they referred to as “the control”), or (iii) the community.<sup>44</sup> As between the interests of shareholders and managers, they believed that protection of shareholder interests was to be preferred.<sup>45</sup> 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.<sup>46</sup> 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>47</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. Thus, it is capable of 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>48</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’ idealistic vision of corporate governance and social responsibility never became a reality. Years later, in the mid 1970s 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>49</sup> Numerous proposals were advanced at the federal level in pursuit of this goal. Except for the Foreign Corrupt Practices Act of 1977,<sup>50</sup> which outlawed bribery abroad, none of these proposals actually became law.

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

---

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. BERLE, *supra* note 10, at 356.

49. Veasey, *supra* note 4.

50. Securities Exchange Act of 1934 § 13(b), amended by Pub. L. No. 95-213, Title I, § 102, 91 Stat. 1494, 1494-95 (codified at 15 U.S.C. § 78m).

shareholder gain.”<sup>51</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 *A.L.I. 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* 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>52</sup> (emphasis added). *A.L.I. 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: “[i]n general the greater the amount of corporate resources that are expended, the stronger should be the nexus.”<sup>53</sup> Despite this concession to social action, *A.L.I. Principles of Corporate Governance* is far from the vision of Berle and Means. Maximization of shareholder value remains the basic objective of the American corporation.

In the United Kingdom, the objective of the corporation is basically the same as it is in the United States. English law makes it clear that the shareholders are the owners of the company and that a company’s board of directors is required to advance the interests of the shareholders as a whole.<sup>54</sup> Because of the centrality of shareholders’ interests to corporate purpose, the prevailing model in both countries, which of course share the common law tradition, is often referred to as the “shareholder model of corporate governance.”

Elsewhere in Europe, in varying degrees both law and policy recognize that corporations also have the objective of advancing the interests of other persons and groups beyond the narrow category of shareholders. Such persons and groups, who may include employees, suppliers, creditors, civic organizations, and the community at large, are usually referred to as “stakeholders.”<sup>55</sup> As a result, these countries are said to have a “stakeholder model” of corporate governance. The prevailing legal tradition in these countries is that of civil law.

---

51. A.L.I., *supra* note 36, § 201.(a), at 55.

52. *Id.* vol. 1, § 2.01(b), at 55.

53. *Id.* vol. 1, at 65.

54. WEIL, GOTSHAL & MANGES STUDY, *supra* note 33, at 36.

55. For example, the Recommendations of the Norby Commission in Denmark stated: “[Corporate governance is] [t]he goals, according to which a company is managed, and the major principles and frameworks which regulate the interaction between the company’s managerial bodies, the owners, as well as other parties who are directly influenced by the company’s dispositions and business (in this context jointly referred to as the company’s stakeholders). Stakeholders include employees, creditors, suppliers, customers, and the local community.” The Norby Commission, *Recommendation for Good Corporate Governance in Denmark*, Introduction, (Dec. 6, 2001), available at <http://www.corporategovernance.dk> (last visited Nov. 14, 2002).

For Europeans and others, such as the Japanese, the American emphasis on the maximization of shareholder value alone 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 also 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 co-determination 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 stakeholders a "voice" in firm management and seeks to accommodate their diverse interests in deciding upon corporate action.<sup>56</sup> Another manifestation of the stakeholder model in European and Japanese 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 any shares they may hold in the firm.<sup>57</sup>

To what extent does national culture in the United States and Europe reflect the value preferences for the shareholder as opposed to the stockholder model of corporate governance? Charles Hampden-Turner and Alfons Trompenaars, in a survey of 15,000 managers and employees from around the world, asked respondents 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 twelve nationalities surveyed, the group with the largest percentage of managers and employees selecting profit as "the only goal" was Americans (40 percent).<sup>58</sup> U.K. respondents were second with 33 percent. One may therefore conclude that among industrialized countries national culture in America is closest to the ideal of shareholder value maximization as a corporate goal.<sup>59</sup> On the other hand, it should be noted, of course, that despite the large percentage in relation to other nationalities, 60 percent of the Americans surveyed nonetheless considered that a corporation had other goals in addition to making a profit.<sup>60</sup> Consequently, it would seem that the prevailing cultural value preference in the United States might not completely accord with the U.S. system's stated goal of corporate governance.

---

56. Sigurt Vitols, *Varieties of Corporate Governance: Comparing Germany and the U.K.*, in *Varieties of Capitalism: the Institutional Foundations of Comparative Advantage* 337 (Peter A. Hall & David Soskice eds., 2001).

57. Alexander Dyck, *Privatization and Corporate Governance: Principles, Evidence and Future Challenges*, 16 *The World Bank Res. Observer* 59, 60 (2000).

58. Charles Hampden-Turner & 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 (1993).

59. *Id.*

60. *Id.*

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. This is a widespread phenomenon throughout American corporate life, a phenomenon that is by no means confined to CEOs and top managers. As a result, management contracts and compensation schemes have become important instruments of governance in the modern American corporation. According to one study, the typical American corporation now allocates 1.4 percent of its equity each year to executives and other employees.<sup>61</sup> In 2000, the value of options granted by America's 325 largest corporations nearly equaled 20 percent of their pre-tax profits.<sup>62</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>63</sup>

European and Japanese 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. Compared to the 40 percent of American respondents who believed that the sole goal of the corporation was to make a profit, only 28 percent of the Italians, 27 percent of the Swedes, 26 percent of the Dutch, 25 percent of the Belgians, 24 percent of the Germans, 16 percent of the French, and just 8 percent of the Japanese had the same preference.<sup>64</sup>

The difference between the American and the European and Japanese models of the corporation is a reflection of, and is driven by, two different cultural value preferences: individualism and to communitarianism. According to Trompenaars and Hampden-Turner, "[t]he 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>65</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>66</sup> In an extensive survey of individualism in fifty-three countries, Geert Hofstede found Americans to be the most individualistic, achieving an individualism rating on his scoring system of ninety-one out of a possible one hundred.<sup>67</sup>

---

61. FIN. TIMES, Aug. 12, 2000.

62. N.Y. TIMES, Mar. 23, 2002.

63. O'Sullivan, *supra* note 5, at 169.

64. Hampden-Turner & Trompenaars, *supra* note 58, at 32.

65. Trompenaars & Hampden-Turner, *supra* note 38, at 59.

66. Hampden-Turner & Trompenaars, *supra* note 58, at 48.

67. Geert Hofstede, *Cultures and Organizations: Software of the Mind* 53 (1997).

The cultural value of individualism, which provides the individual a central role 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. Hofstede’s individualism index gave Great Britain a rating of eighty-nine, ranking it third in individualism behind the United States and Australia.<sup>68</sup>

The European continent and Japan, on the other hand, tend to emphasize the role and importance of the community more than the United States. Their special history has caused them to place greater faith in communitarianism than individualism as a set of values. Europe’s emphasis on “social solidarity,” its skepticism about the merits of unfettered competition, and the formal inclusion of labor in corporate management in some European countries all reflect 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 reflection strong individualistic values in contrast with German concepts of “labor rights” and “good faith” in contracting,<sup>69</sup> which reveal strong communitarian values. This difference is also found in attitudes toward competition. For example, in one survey whereas nearly 70 percent of American managers believed that increased competition as opposed to increased cooperation among business would lead to greater benefits for society; only 41 percent of German managers, 45 percent of French managers, 39 percent of Swedish managers, and 24 percent of the Japanese managers had the same view.<sup>70</sup> In Hofstede’s individualism index, France and Sweden ranked tenth with scores of seventy-one, Germany ranked fifteenth with an index rating of sixty-seven, and Spain ranked twentieth with an index of fifty-one. (Japan ranked twenty-third with an index of forty-six).<sup>71</sup>

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

---

68. *Id.*

69. See Steven Casper, *The Legal Framework for Corporate Governance: The Influence of Contract Law on Company Strategies in Germany and the United States*, in VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE 387, 388 (Peter A. Hall & David Soskice eds., 2001).

70. Hampden-Turner & Trompenaars, *supra* note 58, at 71.

71. Hofstede, *supra* note 67, at 53.

of dispersed share ownership among the public in most European countries, as compared to the situation in the United States, may reinforce this view. On the other hand, there is evidence that the stakeholder model, and particularly co-determination, makes it harder for shareholders to control management, and that European managers manipulate the stakeholder model by playing off one set of stakeholders against another in order to advance managerial interests.<sup>72</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>73</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 and elsewhere. Seeing the globalization movement led by American corporations whose declared governance system makes a goal of seeking profits for shareholders without regard to other stakeholders, various groups are protesting against corporations that refuse to accommodate other stakeholder interests. A further point of friction may arise as a result of American institutional investors using their holdings in European and Japanese companies to press American notions of good corporate governance on European and Japanese managers. In November 2001, for example, the California Public Employees Retirement System (CalPERS), America's largest public pension fund, allocated \$1.7 billion of its investments specifically to pursue "active corporate governance strategies" in European and Japanese markets.<sup>74</sup> Good governance for U.S. 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 1990s, 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 don't manage the same way."<sup>75</sup>

---

72. Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities*, in *EMPLOYEES AND CORPORATE GOVERNANCE* 163, 190 (Margaret M. Blair and Mark J. Roe eds., 1999).

73. David E. Weinstein & Yishay Yafeh, *On the Costs of a Bank-Centered Financial System: Evidence from the Changing Main Bank Relations in Japan*, 53 J. FIN. 635 (1998).

74. See Press Release, CalPers, CalPERS Turns Up Corporate Governance Heat (Nov. 15, 2001) at <http://www.calpers.org/whatsnew/press/2001/1115a.htm>.

75. Philippe Haspelspleigh, et al., *Managing for Value: It's Not Just About Numbers*, Harvard Bus. Rev., July-Aug. 2001 at 65, 67-68.

Discussions of corporate governance often stress the differences between the shareholder and stakeholder models, often going so far as to state that the shareholder version is the "Anglo-Saxon model" and the stakeholder variety "the European model." While there are real differences between the two, care should be taken not to over emphasize them for several reasons. First, in countries with a shareholder model, the management and board of directors of the corporation are required to obey the law, and numerous laws (for example labor and environmental legislation) exist to protect persons from adverse corporate actions even though such persons are not technically designated as "stakeholders" and such legislation does not fit within the rubric of "corporate governance." Second, among the countries said to have a stakeholder model of corporate governance, there is a broad variation in the extent to which such stakeholders actually participate in corporate governance. For example, in Austria, Denmark, Germany, Luxembourg, and Sweden, the law gives employees, as a key stakeholder group, in companies of a specified size the right to elect some members of the company's supervisory board. In Finland, on the other hand, employees may be granted such a right within the company's articles of incorporation. In France, when employee shareholding reaches 3 percent, they may nominate one or more directors, with certain exceptions. In all other European Union Member States, again with certain conditions, however, only shareholders elect members of the company's board. Third, there appears to be some convergence in corporate practice between the two models as a result of globalization and the listing by large corporations of their shares on exchanges of other countries in order to widen their access to capital.

The Organisation for Economic Co-operation and Development (OECD), whose Member Countries include proponents of both shareholder and stakeholder models, faced this problem in drafting its *Principles of Corporate Governance*.<sup>76</sup> The *OECD Principles of Corporate Governance* seek to bridge the gap between the shareholder and stakeholder models of corporate governance by stating in articles I and II that corporate governance should protect shareholders' rights and should ensure the equitable treatment of all shareholders. The Principles also state in article III that "[t]he corporate governance framework should recognize the rights of stakeholders as established by law."<sup>77</sup> At the same time, it is important not to overemphasize the process of convergence or to downplay differing cultural values and attitudes that influence and underpin national systems of corporate governance. The differences are real. For the most part, such differences stem from some deeply held cultural beliefs.

Although American systems of corporate governance permit, but do not require, corporate boards and management to take account of social

---

76. OECD: Ad Hoc Task Force on Corporate Governance, *OECD Principles of Corporate Governance* (Apr. 19, 1999), available at <http://www.oecd.org>.

77. *Id.*

welfare issues in their decisions, various internal and external factors, such as pressure from labor unions, environmental groups, and non-governmental organizations, have induced U.S. corporations in individual cases to integrate social considerations in their decisions. This tendency, however, by no means implies the kind of dilution of shareholder rights entailed by the extreme stakeholder model. Noteworthy in this regard is the emergence of "socially responsible investing," by which investors instruct institutions managing their funds to take account of certain social criteria in making investment decisions. As of 2001, it is claimed that \$2 trillion in U.S. investments were subject to social responsibility criteria.<sup>78</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 and Japanese managers may also represent a force for convergence toward increased shareholder rights in Europe and Japan.<sup>79</sup>

## VI. THE INSTITUTIONS OF CORPORATE GOVERNANCE

### A. IN GENERAL

The institutions of corporate governance include both those that are external and those that are internal to the corporation. The external institutions include government regulatory agencies, stock markets where corporations list their shares, and the courts that enforce remedies for violations of corporate governance rules. Thus both the Securities and Exchange Commission in the United States and the European Commission are, in a real sense, institutions of corporate governance. The internal institutions are the mechanisms within the corporation that determine how it is run. Given that the internal mechanisms are to a large extent defined and determined by the external institutions, the external and internal organizations are linked. For example, law and governmental regulations specify the powers of boards of directors and supervisory boards, the rights of shareholders, and the obligations of managers. Thus, participants in a corporate enterprise, particularly those that solicit capital from the public, are not free to organize themselves any way they like, but must follow rules promulgated by legislative bodies, regulatory agencies, and stock exchanges. At the same time, all external systems of corporate governance leave certain governance matters to the discretion of the corporate participants themselves. A fundamental and practical governance question for corporate managers, directors, and lawyers is therefore: what matters of corporate governance are determined by external rules, and what matters are left to the discretion of the internal participants?

---

78. See Social Investment Forum, 2001 Report on Socially Responsible Investing Trends in the United States, at <http://www.socialinvest.org/area/research/trends/2001-Trends.htm> (last visited Nov. 28, 2001).

79. O'Sullivan, *supra* note 5, at 153.

The scope of internal corporate discretion varies from country to country. For example, while Germany requires certain members of a corporation's supervisory board to be representatives of labor, American legislation has no such requirement and gives U.S. corporations broader discretion in the selection of directors. The remainder of this article will focus primarily on the internal institutions of corporate governance.

Governance is about power. The purpose of any system of governance is to determine how power is allocated and exercised. Within any publicly traded corporation in Europe or the United States, there are potentially three institutional centers of power: (1) the board of directors or supervisory board; (2) the managers; and (3) the shareholders. Let us examine each of these power centers turn.

## B. THE BOARD OF DIRECTORS AND SUPERVISORY BOARD

In both the United States and Europe, a board of directors, selected by shareholders and acting collectively, exists to make key corporate decisions and to supervise management. It is a central institution of corporate governance. Nonetheless, important differences in structure and composition exist between the two continents. One significant structural element to be noted at the outset is that whereas the United States' and the United Kingdom's laws provide for a single board of directors, certain European countries, notably Germany, Austria, the Netherlands, and Denmark, require corporations of a certain size to have a two-tiered system. This two-tiered system consisting of a management board composed primarily of executives of the corporation, and a supervisory board composed of non-executives elected by the shareholders and in some cases by employees. The supervisory board in most cases selects the members of the management board and assures their accountability to corporate goals and governance regulations. In the other eleven EU countries, the unitary board prevails; however, in five out of the eleven, a two-tiered system is optional.<sup>80</sup> For example, French law provides for such an option, but only about 20 percent the Paris Stock Exchange CAC 40 and less than 4 percent of all French *sociétés anonymes* have chosen to create one.<sup>81</sup> The two-tiered system separates the managerial and supervisory functions that are usually combined within the unitary board system into two distinct organs. The existence of separate supervisory board unconnected to management serves to increase the independence of non-executive directors and to give them additional power in acting as an oversight

---

80. WEIL, GOTSHAL & MANGES STUDY, *supra* note 33, at 43.

81. The Director's Liability Under French Law, Franco British Law Society Lecture, (Nov. 19, 2001), available at [http://www.law.ed.ac.uk/legal\\_connexion/research/societes.htm](http://www.law.ed.ac.uk/legal_connexion/research/societes.htm). With respect to commercial companies, Law no. 66-537 of 24 July 1966, as amended, gives French companies the option to create a two-tiered system consisting of a management boards (*directoire*) and a supervisory board (*conseil de surveillance*). A few large internationally listed companies, such as Peugeot, AXA, and Total Fina, have chosen to adopt the two-tier system.

body over corporate managers. In evaluating the advantages and disadvantages of the two systems, one study concluded:

The one-tier system may result in a closer relation and better information flow between the supervisory and managerial bodies; the two-tier system encompasses a clearer formal separation between the supervisory body and those being supervised. However, with the influence of the corporate governance best practice movement, the distinct benefits traditionally attributed to each system appear to be lessening as practices converge.<sup>82</sup>

In the United States, corporate governance systems rely heavily on the corporation's board of directors. Many state corporate laws provide that "the management" of the corporation is entrusted to or is under the supervision of the board, but in fact no board of director in a publicly traded corporation "manages" as that term is commonly understood. Although the board has certain key managerial tasks, such as selecting and removing the company's chief executive officer, and approving important transactions, the fundamental task of the board in a publicly traded corporation 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>83</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>84</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. Although shareholders elect directors, the process has traditionally resembled an election in a one-party state: management chooses 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 subsequently, through pressure by institutional investors and industry groups, induce corporations to adopt them.

One principle that has found wide spread adoption in practice, though not in law,<sup>85</sup> is that a majority of the board of publicly traded corpora-

---

82. WEIL, GOTSHAL & MANGES STUDY, *supra* note 33, at 43.

83. Ira M. Millstein, *The Responsible Board*, 52 BUS. L. 407, 409 (1997).

84. A.L.I., *supra* note 36, at 77.

85. 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 percent of the board be "interested persons." An interested

tions 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 percent of its directors as non-employees. In Europe also, there appears to be a growing trend to include non-employees in corporate board membership and many of the European codes of best practice stress the importance of a board's "independence" from management. In 2001, 50 percent of the members of an average board of a German DAC 30, 92 percent of the members of the average board of a French CAC 40, 99 percent of the Netherlands Top 21 boards, and 57 percent of the United Kingdom's average FTSE 100 board consisted of non-employees.<sup>86</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 as 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>87</sup> However, independence is a subjective matter. In order to provide some objectivity to the process, one organization has developed a set of criteria to weigh board member's independence from management.<sup>88</sup> 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 percent, in Germany to 50 percent, in the UK to 39 percent, in France to 25 percent, and in the Netherlands to 7 percent.<sup>89</sup> The 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 other mechanisms are needed to assure director independence. The failure of Enron directors to act as "independent watchdogs," however, may have been influenced by the social, political, and other connections that they had with Enron management.

---

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-executives outside directors for listed corporations. According to standards adopted by the New York Stock Exchange on August 1, 2002, independent director must comprise a majority of the board of directors of all listed companies other than those in which a shareholder or group of shareholders possess voting control. See The New York Stock Exchange, *available at* <http://www.nyse.com> for text of the standard.

86. Davis Global Advisors, *Leading Corporate Governance Indicators 2001* (2001).

87. *Burks v. Lasker*, 441 U. S. 471, 484 (1979).

88. Davis Global Advisors, *supra* note 86.

89. *Id.* at 35.

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. Practices are also evolving in which most companies have separate nominating and 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 in corporate governance is that a few American 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 CEOs whose performance was unsatisfactory, and to turn aside management proposals judged to be inappropriate.

### C. THE MANAGERS OF THE CORPORATION

If the selection of corporate directors resembles an election in a one-party state, the position the 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 a major American corporation received nearly \$17 million in compensation in 2000 and \$15.5 million in 2001.<sup>90</sup> According to *Business Week*, the average American CEO made forty-two times the average blue-collar worker's pay in 1980, eighty-five times in 1990, and 531 times in 2000.<sup>91</sup> 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.<sup>92</sup>

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.

---

90. See [www.aflcio.org/paywatch/index.htm](http://www.aflcio.org/paywatch/index.htm).

91. *Id.*

92. MGMT. TODAY, Mar. 29, 1999.

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 and Japan, 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 and Japanese cultures with their emphasis on community values and their large number of family companies seem to give the European and Japanese CEO the status of a patriarch or father figure within the corporation instead of the heroic standing that American culture accords its own CEOs.

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. 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 European countries, it is not common in the United States. For example, in 2001 only 19 percent of S&P 500 companies had this type of arrangement, while 100 percent of Germany's Dax 30, 90 percent of the UK's FTSE 100, and 100 percent of Netherlands's top eleven did.<sup>93</sup> The American preference for combining both offices is no doubt strongly influenced by its cultural faith in the heroic individual, as well as claims of efficiency made on behalf of this type of leadership. 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 governance devices.

#### D. SHAREHOLDERS

In both the United States and Europe, shareholder direct participation in corporate governance is limited to (1) electing directors or members of the supervisory board, and (2) approving certain items that require shareholder approval. With respect to the former, the major difference between the United States and Europe concerns those countries, such as Austria, Denmark, Germany, Luxembourg, and Sweden, in which employees elect some members of the board. The effect of this concession

---

93. DAVIS GLOBAL ADVISORS, *supra* note 86, at 38.

to stakeholder participation is to reduce the influence of shareholders in the governance of the corporation in which they own shares.

With respect to items of corporate action subject to shareholder approval, there does not appear to be significant difference between United States and European corporations.<sup>94</sup> Within the United States, individual state laws grant shareholders, as owners of the corporation, the right to make decisions directly about certain key matters affecting fundamental interests of the corporation, such as mergers. The extent of these shareholder rights can vary from state to state and 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 as evidenced by the battle between management and dissident shareholders of Hewlett Packard Corporation in 2002 over approval of a \$12 billion dollar merger between Hewlett Packard and Compaq. This battle 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, including stock options plans, 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.

In general, the Anglo-American system of corporate governance, when compared to systems on the European continent and Japan, has incorporated strong legal protections for minority shareholders. Professor John Coffee has argued that dispersed share ownership in the United States and the United Kingdom is a product of effective legal protections that encourage investors to become minority shareholders, not of political restrictions on financial institutions.<sup>95</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 and Japan. In those regions, 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.

## VII. 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

---

94. See WEIL, GOTSHAL & MANGES STUDY, *supra* note 33, at 38.

95. Coffee, *supra* note 3, at 644.

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 historically U.S. courts have been reluctant to do. The basic duty of care, as set out the *A.L.I. Principles of Corporate Governance* is that:

[a] director or officer has a duty to the corporation to perform the director's 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 the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.<sup>96</sup>

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 (1) is 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 believes to be appropriate under the circumstances, and (3) rationally believes that the business judgment is in the best interests of the corporation.<sup>97</sup>

The ALI *Principles* make clear that in determining what is in the best interest of the corporation, directors and officers must heed the corporation's basic objective of enhancing corporate profit and shareholder gain.<sup>98</sup> 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, a conclusion that might raise objections among some Europeans.

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 that the transactions involved 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.

---

96. A.L.I., *supra* note 36, § 4.01(c), at 139.

97. *Id.*

98. Luca Enriques, *The Law on Company Directors' Self-Dealing: A Comparative Analysis*, 2 INT'L & COMP. CORP. L. J. 297, 331 (2000).

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. 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 or Japan - the private right of action. The existence of the private right of action by shareholders is yet another manifestation of the value of individualism within American culture. 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 "attorneys' fees" and a portion of the settlement to which the corporation is judged entitled.

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 corporate governance is to spread to Europe and Japan 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 countries.

## VIII. CONCLUSION

While sharing a common western civilization, the United States, along with the United Kingdom, differentiates its corporate system from that of most countries on the European continent as a result of several important factors. In very general terms, and while acknowledging exceptions to the pattern on both sides of the Atlantic, one can summarize American style corporations and corporations with a European touch as follows:

AMERICAN MODEL	EUROPEAN MODEL
1. management dominated	1. controlling shareholder dominated
2. shareholder focused	2. stakeholder focused
3. wide public share ownership	3. less wide public share ownership
4. strong shareholder rights	4. less strong shareholder rights
5. unitary board structure	5. two-level board structure
6. single powerful leader	6. consensus or divided leadership
7. shareholder litigation culture	7. less strong litigation culture

Models, of course, are merely intellectual constructs. They do not capture reality in all its complexity. Nonetheless, the seven elements indicated above represent important issues that differentiate and influence the American and the European approaches to corporate governance. Significant and powerful forces, such as the need to access foreign capital markets and the pressure of institutional investors, may tend to foster a certain convergence among corporate governance systems on both sides of the Atlantic. Systems of corporate governance, however, 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>99</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, continually stressing the dichotomy between the American shareholder 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 U.S. institutional investors 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 conver-

99. Coffee, *supra* note 3, at 646.

gence 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: good corporate 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.