

Corporate Governance and the Importance of Societal and Cultural Factors: An Argument Against Calling Time on UK Boardroom Rules

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I. Introduction

Corporate governance has in recent years been a much discussed topic in economics, management, business ethics, corporate law, and other disciplines. Surprisingly, it has not always been a commonplace term. In fact, two decades ago there was no evidence that it would attract the public interest and dominate the headlines of legal, business and financial newspapers. Its growth can be attributed to the failure of the commercial world to keep up with the pace of corporate development. This failure took the form of financial scandals and corporate collapses in the United States¹ and Western Europe – such as the collapses in the UK of the Bank of Credit and Commerce International,² Polly Peck,³ and the Maxwell empire⁴ – around the turn of the twenty-first century, and the global economic crisis beginning with the sub-prime mortgage scandal in the US. Within the UK, discussion has been dominated by the circumstances surrounding the forced support of mortgage lenders, such as RBS and Northern Rock, and their subsequent ‘public acquisition’ and future commercial viability. On the other side of the Atlantic we have witnessed, amongst others, the forced purchase of financial services firm Bear Sterns by JP Morgan in March 2008, and the collapse of Wall Street investment bank Lehman Brothers in September of the same year. These events have had a deep impact on the psychology of all involved parties, namely, investors, legislators, corporate directors and the general public. Inevitably, corporate governance has attracted a lot of attention and is in the top of every agenda about the best and most efficient regulatory framework repair organisational ills and corporate failures.

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¹ The US has produced a voluminous amount of literature. See, for instance, KF Brickley, ‘From Enron to Worldcom and Beyond: Life and Crime after Sarbanes-Oxley’ 81 Wash. U. L. Q. 357; JC Coffee Jr, ‘Understanding Enron: “It’s About the Gatekeepers, Stupid”’(2002) 57 Bus. Law. 1403. For a representative UK example, see A Walters, ‘Directors’ Duties: the Impact of the Company Directors Disqualification Act 1986’ 21(4) Co. Law., 110.

² *Financial Times*, 9 November 1991, p. 1.

³ *Financial Times*, 2 October 1990, p. 27; and *Financial Times*, 25 October 1990, pp. 1 and 24.

⁴ *Financial Times*, 6 December 1991, p. 21.

The global economic crisis raises many corporate governance issues and the UK government has initiated a review of corporate governance in the banking industry in particular. The Chancellor of the Exchequer commented that “corporate governance should have been far more effective in holding bank executives to account”.⁵ As a result, an independent review to recommend measures to improve the corporate governance of banks, in particular risk management, was announced on February 9, 2009 by the Chancellor of the Exchequer, the Secretary of State for Business, Enterprise and Regulatory Reform and the Financial Services Secretary to the Treasury. The review will examine risk management issues (including the effectiveness of risk and audit committees), incentives to manage risk in bank remuneration policies, the competences needed on bank boards, board practices and structures, and the role played by institutional shareholders.⁶ The final recommendations were published on 26 November 2009.⁷ It parallels calls from the academic and business communities for radical reform of corporate governance structures. Most notably, in a recent interview with *The Times* newspaper,⁸ Sir Richard Greenbury, the chief architect of UK boardroom rules in the 1990s, performed a reversal on what he thinks will cure Britain’s corporate ills. Following the system of board guidelines and rules first crafted by Sir Adrian Cadbury in 1991,⁹ and later built on by his own report in 1995,¹⁰ and the Higgs review in 2003,¹¹ which favoured the non-executive director as the guardian against executive misconduct, he now favours the continental style two-tier board.

The detailed theoretical analysis of corporate governance in the broadest sense goes beyond the scope of this article, so we will focus on the key issues relating to the reform of board structures of UK corporations. It is worthwhile to note at this point that while British corporations are governed by a single unitary board of directors, where executives and non-executives mingle and are equally responsible, many European corporations, such as Germany and France, have a two-tier structure – a supervisory board of non-executive directors to which a management board of executives reports.¹² Now, it is not the intention of this article to engage in a debate over the doctrinal and normative merits of the two styles of board structure, but to address

⁵ HM Treasury, Press Release, 10/09, 9 February 2009, ‘Independent review of corporate governance of UK banking industry by Sir David Walker’.

⁶ <http://www.hm-treasury.gov.uk/press_10_09.htm> [Accessed 29 September 2009].

⁷ Walker Review of Corporate Governance of UK Banking Industry’ and can be accessed at: http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf [Accessed 17 April 2010].

⁸ http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article5983510.ece> [Accessed 29 September 2009].

⁹ The Committee on the Financial Aspects of Corporate Governance, *Report with Code of Best Practice* (London, Gee Publishing, 1992) (Sir Adrian Cadbury, Committee Chair).

¹⁰ The Committee on the Financial Aspects of Corporate Governance, *Study Group on Directors’ Remuneration* (London, Gee Publishing, 1995) (Sir Richard Greenbury, Committee Chair).

¹¹ Derek Higgs, *Review of the Role and Effectiveness of Non-Executive Directors* (2003), and can be accessed at: < <http://www.berr.gov.uk/files/file23012.pdf>> [Accessed 29 September 2009].

¹² Europe represents a wide range of corporate governance practices. States such as France, Switzerland, Austria, Belgium, Hungary, and much of Northern Europe evolved their governance systems along Roman-Germanic, rather than Anglo-American lines.

the issue of how receptive UK corporate governance might be in facilitating a continental type of management rules. The structure of this article is as follows. Part II attempts to provide context to the origins and inter-disciplinary interpretations of the expression corporate governance. Part III provides an outline, albeit a brief one due to time constraints, of the two types of board structure and composition, together with a summary of some significant similarities and differences of the two models. The issues broadly discussed by theory, on which we give some comparative analysis, thus first relate to the issue of the composition of a board (single or dual) and the distribution of powers between non-executive and executive management. The aim of Part IV is to investigate whether it is structurally possible to transfer the German two-tier board, which is obligatory for a relatively small number of German corporations, into the UK corporate legal system. The upshot of this analysis points up the fact that current research into corporate governance has not incorporated cultural and societal elements in a substantial form. Part V concludes by a summary and drawing some key points from the general discussion.

II. Understanding the Notions of Corporate Governance

As one commentator has pointed up, “each generation must conduct the corporate governance debate within the parameters set by the prevailing manifestation of corporatism”.¹³ So far there is a voluminous amount of literature that has been already written, with a view to understand the implications of corporate governance and to formulate recommendations on suitable governance structures and practices. Scholars and academics, governments and legislators, managers and directors are all involved in this on-going discussion, with a view to find the right answer to the questions of what is the most effective corporate governance regulation and also what is the form of regulation that will act as a protective shield for corporations worldwide against fraud, dishonesty, mismanagement and corruption. It is a well settled tenet that it is a complicated task to attempt to define such a wide term as corporate governance,¹⁴ because it potentially covers a large number of distinct legal and economic phenomena. One commentator argues that “[i]t is a fashionable concept but like most fashionable ideas it is remarkably imprecise”.¹⁵ The “absence of any real consensus”¹⁶ or “coherence, either empirically, methodologically or theoretically”,¹⁷ on the definition is indicative of the complexity of the subject

¹³ M Lipton, ‘Corporate Governance in the age of Finance Corporatism’ (1992) 136(1) U. Penn. sylvania L. Rev., 1, 3.

¹⁴ J Du Plessis, ‘Corporate Law and Corporate Governance Lessons from the Past: ebbs and flows, but far from “the end of history...”’: Part 1’ (2009) 30(2) Co. Law.43.

¹⁵ J Farrar, ‘Opinion, Corporate Governance’ (1998) 10(2) Bond Law Review, Special Issue: C.G., 141.

¹⁶ K Keasey, S Thompson, and M Wright, *Corporate Governance: Economic Management and Financial Issues* (Oxford, Oxford University Press, 1997), at 7.

¹⁷ A Pettigrew, ‘On Studying Managerial Elites’ (1992) 13(1) Strategic Management Journal, 163.

matter. Accordingly, economists, organisation theorists, lawyers, sociologists, and even political scientists, laying claim to its meaning, interpretation and applications, have tended to give the expression a wide variety of competing definitions. Each adopted definition essentially reflects the special interest of its creator in the field of corporate governance, because every rigorous analysis needs a good definition as a starting point.

To illustrate this point, Economists and Social Scientists tend to define it broadly as “the structures, processes, cultures and systems that engender the successful operation of the organisation”,¹⁸ and “the organisations and the rules that affect expectations about the exercise of control of resources in firms”.¹⁹ These definitions focus not only on the formal rules and institutions of corporate governance, but also on the informal practices that evolve in the absence of weakness of formal rules.²⁰ Moreover, they encompass not only the internal structure of the corporation but also its external environment, including capital and labour markets, bankruptcy systems and government competition policies. Lawyers, on the other hand, tend to employ a more narrow definition. For them, corporate governance is a system of rules and institutions that determine the control and direction of the corporation and that define relations among the corporation’s primary participants. Thus the United Kingdom’s 1992 Cadbury Report’s often quoted definition is: “Corporate governance is the system by which businesses are directed and controlled”.²¹ As applied in practice, this narrower definition focuses almost exclusively on the internal structure and operation of the corporation’s decision-making processes. It has been this narrower definition that has been central to public policy discussions about corporate governance in most countries,²² and it will provide the focus of attention for this article.

Apart from the academic discipline, the discussion is also particular to the geographical and historical relativity in which it is studied. It is fair to suggest that a common misconception and perhaps assumption about corporate governance is that it is a functional and mechanistic concept. It has been suggested²³ that because corporate governance is a multi-faceted subject, this may help to explain why many governance measures are articulated as ‘principles’ by international organisations like

¹⁸ J Cook, & S Deakin, ‘Stakeholding and Corporate Governance: Theory and Evidence on Economic Performance’ ESRC Centre for Business Research, University of Cambridge, (1999), at 2.

¹⁹ World Bank, ‘*Building Institutions for Markets: World Bank Development Report*’ (2002) and can be accessed at: <<http://www.worldbank.org/wdr/2001/fulltext/fulltext2002.htm>>, 68 [Accessed 29 September 2009].

²⁰ A Dyck, ‘Privatisation and Corporate Governance: Principles, Evidence, and Future Challenges’ (2001) 16(1) World Bank Observer, 59.

²¹ Committee on the Financial Aspects of Corporate Governance, ‘*Report with Code of Best Practice*’ (London, Gee Publishing, 1992), para. 2.5 This document can be accessed at: <<http://www.ecgi.org/codes/documents/cadbury.pdf>> [Accessed 29 September 2009].

²² JW Salacuse, ‘Corporate Governance in the New Century’ (2004) 25(3) Co. Law. 69, 70.

²³ A Young, ‘Rethinking the Fundamentals of Corporate Governance: the relevance of culture in the global age’ (2008) 29(6) Co. Law. 168, 169.

OECD rather than as 'standards'.²⁴ So, if there is no all-inclusive governance regime applicable to every country, this suggests that a given country's corporate governance system will be characterised by specific elements. As discussed later, it is suggested here that from one country to another, considerations like social norms and cultural values will influence how corporations are run and the types of laws being enacted.²⁵ Often historical, political and economic factors also serve as country-specific barriers. To be sure, Anglo-American corporate governance concentrates upon the internal structure of the company. This approach limits the objective of corporate governance to profit maximisation since it prioritises the interests of the shareholders.²⁶ This can be contrasted with the 'stakeholder' approach,²⁷ which has influenced corporate governance developments more strongly in other countries, especially some member states.²⁸ It is potentially a broader definition of corporate governance, since it addresses the 'external' and 'internal' aspects of corporate activity, and recognises the relationship between the company and the community and goes beyond the notion of profit maximisation is the only relevant objective of the enterprise. The upshot of this section is that the priorities in the debate on the management and control of corporations vary, and its intensity and nature are also different depending on the country in which it is taking place.²⁹

²⁴ OECD, *OECD Principles of Corporate Governance* (2004).

²⁵ A Young, 'Rethinking the Fundamentals of Corporate Governance', 168, 170.

²⁶ For a representative sample, see generally H Hansmann, & R Kraakman, 'The End of History for Corporate Law' (2001) 89 Georgetown L. J. 439; M Roe, 'The Shareholder Wealth Maximisation Norm and Industrial Organization' (2001) 149 U. Pennsylvania L. Rev. 2063; A Alcock, 'Corporate Governance: A Defence of Status Quo' (1995) 58(6) M.L.R. 898.

²⁷ A Etzioni, 'A Communitarian Note on Stakeholder Theory' (1998) 8(4) Bus. Ethics Q., 679; T Donaldson, & L Preston, 'The Stakeholder Theory for the Corporation: Concepts, Evidence, Implications' (1995) 20 Academy Management Review 65; R Karmel, 'Implications of the Stakeholder Model' (1993) 61 George Wash. L. Rev. 1156; R Mitchell, 'Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts' (1997) 22 Academy Management Review 853; P Goldenberg, 'IALS Company Law Lecture: Shareholders v Stakeholders: The Bogus Argument' (1998) 19(2) Co. Law. 34.

²⁸ In France, the Viénot Report emphasised that the 'interests of the company may be understood as an overriding claim of the company as a separate economic agent, pursuing its own objectives which are distinct from those of shareholders, employees, creditors including the internal revenue authorities, suppliers and customers. It none the less represents the common interest of all these persons which is for the company to remain in business and prosper'. See *The Boards of Directors of Listed Companies in France*, Report of the Viénot Committee' (July, 1995). Under German law, a management board is required to run the corporation in the interests of the corporation as a whole. Shareholders are regarded as only a part of the differing groups of 'stakeholders'.

²⁹ Centre for European Policy Studies, 'Corporate Governance in Europe: Report of a CEPS Working Party' (1995) CEPS Working Report No. 12, 2.

III. Reform of Corporate Governance Structures

A. *UK Law and Guidelines on the Composition and Structure of the Board*

An important difference between legal systems is whether they require single-tier or two-tier boards.³⁰ The single-tier board remains the norm in the UK,³¹ the United States and the Commonwealth. In large corporations, with numerous and dispersed shareholding bodies, the central management is necessarily in the hands of the board. The board of directors is the most important decision making body with the corporation. Yet English corporate law has traditionally specified very little about how this body should operate. In a corporation with a small number of shareholders, who may also be the directors, the board will generally be actively involved in managing the business of the corporation. In a corporation that is sufficiently large that active management by the board is no longer feasible, the board oversees management rather than managing the company's business itself. In large public corporations, it is customary to find a board made up of executive and non-executive directors. The distinction between executive and non-executive directors has no significance in English corporate law for these are essentially business terms. Executive directors are those directors concerned with the actual management of the corporation. They have considerable discretion in conducting the business of the corporation. They will have extensive management powers delegated to them by the articles of association, and they typically have service contracts with the corporation, which, together with the articles, delimit their powers and responsibilities.³² Further, the executive directors are appointed³³ and removed³⁴ by shareholder democracy. Non-executive directors are directors without executive management responsibilities but who are concerned with general management policy and strategy and the monitoring of the executive directors, although their precise role (particularly with respect to their monitoring responsibilities) is the

³⁰ A third system exists in Belgium, France and, again differently, in Switzerland, where the corporations can choose between either of the structures, the unitary board being much more common. This is referred to as the "conseil d'administration" in French corporations. In France, more and more corporations are making use of the possibility provided by the law to entrust their management to an executive "directoire" and a supervisory "conseil de surveillance".

³¹ However, although the single-tier board is what is normally found in the UK, it is not obvious that the law requires a single board. The Companies Act 2006 does not require the directors to act as a board and so it hardly needs to address the further question of whether the board is to be a one-tier or a two-tier board.

³² See e.g., Art 70 Table A of the Companies Act 1985. Besides authorising the directors to conduct the affairs of the corporation, articles of association also provide that directors are liable in the event that they fail to carry out their duties properly.

³³ The Model Articles' provisions on the appointment of directors are that the board or the general meeting of shareholders can appoint a director.

³⁴ As to removal of directors, a very important provision of the Companies Act 2006 (s. 168) is that any director can be removed by an ordinary resolution of the shareholders.

subject of debate.³⁵ They commonly have letter of appointment setting out their role and responsibilities.

It might be fair to suggest that the executive directors see the non-executive directors as fulfilling managerial and strategic responsibilities while shareholders and the boarder investing public, and, to some extent, the Government tend to focus on their monitoring responsibilities. The focus of the role of non-executive directors received its impetus initially from a series of corporate collapses in the late 1980s which raised concerns as to the effectiveness of the traditional board structure when dominated by powerful executive directors. These concerns prompted the setting up of the Cadbury Committee and later the Hampel Committee³⁶ to address issues surrounding the composition, structure and effectiveness of boards of directors. At around the same time, the Greenbury Committee was asked to consider issues surrounding directors' remuneration. Many commentators believe that non-executive directors can be effective in ensuring that the board of a company acts in the interests of the corporation rather than a member or members of the board. However, *Re Polly Peck International plc (No 2)*³⁷ shows how unrealistic it is to expect non-executive directors to control a determined and powerful managing director. Some scholars have also taken the view that non-executive directors often have only limited time or lack of information,³⁸ lack of influence,³⁹ and are reluctant to act as a whistleblower on errant executive directors,⁴⁰ to perform all the tasks of ensuring the corporation is correctly managed.⁴¹ These failings have, to an extent, been pin-pointed, certainly by Sir Richard Greenbury, as a contributing factor to the UK's experiences during the recent global financial crisis, and led to renewed calls to reconsider the fundamentals of corporate governance. To this end, many critics look to Europe.

³⁵ On non-executive directors generally, see S Kiarie, 'Non-executive Directors in UK Listed Companies: are they effective?' (2007) 18(1) I.C.C.L.R. 17; M Sweeney-Baird, 'The Role of the Non-Executive Director in Modern Corporate Governance' (2006) 27 Co. Law. 67; JE Parkinson, 'Evolution and Policy in Company Law: The non-executive director' in JE Parkinson, A Gamble, and G Kelly, (eds), *The Political Economy of the Company* (Hart Publishing, London, 2000).

³⁶ The Committee on Corporate Governance, (London, Gee Publishing, 1998) (Sir Ronald Hampel, Committee Chair).

³⁷ [1994] 1 BCLC 574.

³⁸ BD Baysinger, & RE Hoskisson, 'The Composition of Boards of Directors and Strategic Control: Effects on Corporate Strategy' (1990) 15(1) Academy of Management Review 72, 76.

³⁹ S Kiarie, 'Non-executive Directors in UK Listed Companies', 17, 20.

⁴⁰ M Sweeney-Baird, 'The Role of the Non-executive Director in Modern Corporate Governance', 67, 70.

⁴¹ Although it has been suggested that non-executive directors would be well advised to exercise vigilance and shrewdness in the discharge of their monitoring and supervisory duties. See JL Yap, 'Case Comment: Hear No Evil, See No Evil, Speak No Evil: the total inactivity of non-executive directors' (2009) 20(11) I.C.C.L.R. 412. The author refers to several recent case law decisions that make clear that a director will not be able to rely on their lack of involvement as an excuse to avoid the imposition of liability. Contrast with A Young, 'Regulating Non-Executive Directors in Australia: a socio-legal approach' (2008) 29(11) Co. Law. 323, 327. The author states that in spite of the combination of increased legislative obligations and greater scrutiny of the judiciary on non-executive directors' conduct and behaviour, this does not necessarily translate into higher standards apart from increased levels of legal risk and higher premiums for professional indemnity insurance.

B. Board Structures Outside the UK: The Roman-Germanic Example

In order to determine whether the German two-tier board system can deliver impulses or ideas for the reform of UK corporate law, it is necessary and essential to understand how the system actually works in practice and how the two boards share the responsibility in the corporate decision-making process. The two-tier board structure is mandatory for every stock corporation (Aktien Gesellschaft, AG).⁴² Under German corporate law, unlike in the UK, a stock corporation must have two different boards of directors: a management board ('vorstände'),⁴³ and a supervisory board ('aufsichtsrat'),⁴⁴ which is organised vertically, rather than horizontally.⁴⁵ There is generally a clear division of powers between the two organs of a stock corporation. Each organ has statutory tasks that cannot be delegated to another organ, unless the Aktiengesetz 1965 specifically provides otherwise. The vorstände have similar powers and functions to executive directors of UK public limited corporations. It manages, leads and implements the business affairs of the company.⁴⁶ The main provision concerning the Aktien Gesellschaft's management is s.76(1), which provides: "The management board shall have direct responsibility for the management of the company".⁴⁷ The German text emphasises that the vorstände shall manage the company as a matter of its own responsibility. This is an important provision because it means that the vorstände is not bound by instructions from the company's shareholders.⁴⁸ The freedom under the German system available to corporate directors to consider purposes other than short-term profit maximisation/shareholder value, e.g. employee interest or social interests, arises implicitly from the German legislative framework as a whole and the fact that the German constitution prescribes a "social" market economy.⁴⁹ There is also a duty to inform the supervisory *aufsichtsrat* periodically about the current and future corporate policy (including financial, human resources and investment planning), all major business affairs, revenue numbers, the rate of return, the condition of the corporation in general and all matters which might be of significant importance to the liquidity or future earning power of the corporation.⁵⁰ Normally, the vorstände

⁴² ss 30, 95, and 96 Aktiengesetz 1965.

⁴³ ss 76–94 Aktiengesetz 1965.

⁴⁴ ss 95–117 Aktiengesetz 1965.

⁴⁵ R Kraakman, & H Hansmann, (eds) *The Anatomy of Corporate Law: a comparative and functional approach* (OUP, Oxford, 2004) at 35.

⁴⁶ s 76 Aktiengesetz 1965.

⁴⁷ *Ibid.*

⁴⁸ G Henn, *Handbuch des Aktiengesetz* (7th Ed.) (CF Müller, Heidelberg, 2002) at 271–272 in HC Hirt, 'The Enforcement of Directors' Duties pursuant to the Aktiengesetz: present law and reform in Germany: Part 1' (2005) 16(4) I.C.C.L.R. 179, 181.

⁴⁹ Article 20 of the *Federal Constitution (Grundgesetz)* states: "The Federal Republic of Germany is a democratic and social republic." This is supplemented by Article 14(2) *Federal Constitution (Grundgesetz)*: "Property carries obligations. Its use should simultaneously serve the public good."

⁵⁰ s 90(1) Aktiengesetz (Stock Corporation Act) 1965.

meets on a regular basis (far more often than the supervisory *aufsichtsrat*) in order to comply with its tasks and responsibilities.

The *aufsichtsrat* is the control or supervisory organ in the two-tier administration. This clear constitutional division between the executive and the supervisors clarifies the role of the particular directors, and, unlike the UK where employees have traditionally been excluded from corporate decision-making, makes provision for the inclusion of labour representation or co-determination on the board.⁵¹ It is a concept that dates back to the 1930s when the idea that the exclusive role of the corporation was to maximise shareholder wealth was questioned, and the theory of the enterprise with a wide range of constituencies with an interest in the corporation came to the fore. From a practical point of view, the *aufsichtsrat*'s main tasks include the supervision of the *vorstände*,⁵² and the representation of the company as against members of the *vorstände*.⁵³ To ensure that these monitoring functions are undertaken correctly, the *vorstände* must inform periodically the *aufsichtsrat* about the current and future corporate policy (including financial, human resources and investment matters), all major business affairs, revenue numbers, the rate of return, the condition of the corporation in general and all matters which might be of significant importance to the liquidity or future earning power of the corporation.⁵⁴ From a legal perspective, the duty of members of the *vorstände* to employ the care of a diligent and conscientious manager⁵⁵ also applies to the members of the *aufsichtsrat*.⁵⁶ Further, the *aufsichtsrat* is empowered to terminate the contract of employment of every executive director, provided there is an important reason to do so.⁵⁷ In addition, the corporation's constitution or the *aufsichtsrat* itself may determine that certain types of board decisions may be entered into (by the *vorstände*) only with the *aufsichtsrat*'s consent.⁵⁸ However, a fundamental principle is that the supervisory board is not empowered to interfere directly with any of the decisions made by the board of executive directors.⁵⁹ Although the executive directors are not bound by direct orders or instructions of the *aufsichtsrat*, effective control is ensured by the fact that the supervisory board generally elects the board of directors.⁶⁰ Given the aforementioned principles that are inher-

⁵¹ s 1(1) *Mitbestimmungsgesetz* (Co-determination Act) 1976. For a useful discussion of the historical development of co-determination and the German two-tier board system, see J Du Plessis, & O Sandrock, 'The Rise and Fall of Supervisory Co-Determination in Germany?' (2005) 16(2) *I.C.C.L.R.* 67.

⁵² s 111 *Aktiengesetz* 1965.

⁵³ s 112 *Aktiengesetz* 1965.

⁵⁴ s 90(1) *Aktiengesetz* 1965. Some have suggested that this will be done in a more detached manner than that employed by the "in-house" relationship, which tends to exist between executive and non-executive directors in the UK. See T Pryce-Brown, 'Shareholder Protection – a Cultural Quagmire' (1995) 16(4) *Co. Law* 114, 115.

⁵⁵ s 93(1) *Aktiengesetz* 1965.

⁵⁶ s 116 *Aktiengesetz* 1965.

⁵⁷ ss 84–87 *Aktiengesetz* 1965.

⁵⁸ s 111(IV 2) *Aktiengesetz* 1965.

⁵⁹ s 111(4) *Aktiengesetz* 1965.

⁶⁰ s 111(3) *Aktiengesetz* 1965.

ent in the structure and composition of the Roman-Germanic management structure, with its clear separation of powers, or a more robust, autonomous supervisory board, and less of a focus on short-term profit maximisation, there are significant points in favour of the two-tier board.

C. The Unitary and Two-Tier Structures Compared

It will be remembered that, as mentioned earlier on, the central thrust of this article is to examine the argument that has been advanced by, amongst others, Sir Richard Greenbury, for a radical reform of corporate governance structures in the UK in favour of the continental-style two-tier board. The discussion above pointed up that there are two types of board structures, namely, the unitary board and the two-tier board. It is, however, not easy currently to make an exact distinction between these two board structures, as most developed countries have moved away from the traditional unitary board structure in the case of large public corporations. In most jurisdictions that have adopted a single-tier system of corporate governance, the management structure for large corporations has some characteristics and objectives that are reminiscent of the more continental two-tier boards. The fact is that the UK's board of directors is increasingly becoming a monitoring and supervisory organ (at least in large corporations) with the representation of most outside and independent members and the delegating of ever more executive functions to independent non-executive directors and other committees. On the other hand, the German supervisory board is, in addition to its supervisory function, strengthening its strategic role within the German corporation. Further, some recent debate has suggested a watering down of the two-tier board and co-determination laws in terms of corporate management,⁶¹ and that Germany is adapting towards a more Anglo-American shareholder-orientated model.⁶² Nonetheless, there are also important differences. To be sure, the similarities between the structure and composition of the board of directors are an important aspect of corporate governance. However, the UK and Germany, due to their different political and social history, approach it differently. This will now be discussed in the following section.

⁶¹ J Du Plessis, & O Sandrock, 'The Rise and Fall of Supervisory Co-Determination in Germany?', at 67; D Otto, 'German Co-Determination Culture Under Attack' (2005) 45 *Euro. Law* 15; R Von Rosen, 'Corporate Governance in Germany' (2007) 15(1) *J Fin. Regulation and Compliance*, 30.

⁶² For a dominant account in corporate law that corporate governance is converging on the shareholder-centric model, see H Hansmann, & R Kraakman, 'The End of History for Corporate Law', (2001) 89 *Georgetown Law Review* 439. For a discussion on the recent reform of shareholders' rights in Germany, see HC Hirt, 'The Enforcement of Directors' Duties pursuant to the *Aktien-gesetz*: Present law and reform in Germany: Part 2' (2005) 16(5) *I.C.C.L.R.* 216; L Miles, & S Zagelmeyer, 'German Takeover Legislation: Implications for the future' (2004) 15(7) *I.C.C.L.R.* 221.

IV. Cultural and Societal Aspects in Corporate Governance

It is important to note from the outset that the author accepts that although it might be desirable that corporations should, as a normative matter, pursue a Roman-Germanic commitment to the neo-corporatist stakeholder conception of the corporation and the social market economy, the cultural and socio-political aspects of the existing legal and regulatory framework in the UK does not, in fact, support these reform initiatives in law and practice. Given that many such measures are now on the table “to fix” the organisational ills and corporate failures that have come to the fore during the most recent global financial crisis, it may be timely to identify the challenges facing UK corporations in implementing a corporate governance regime based on continental standards and values. Every legal system has “many, many characteristics of structure, substance, and culture”.⁶³ It follows that the greater the cultural distance between the host and adopter countries, the more difficult it will be to effectively implement foreign corporate governance strategies in the latter.⁶⁴ It is the contention of this article that the UK has a corporate culture fundamentally different from Roman-Germanic jurisdictions.

The first and most significant point to note is that the German model originated from a neo-stakeholder conception of the corporation during the 1920s, which posits the corporation as “a community of interdependence, mutual trust and reciprocal benefits”.⁶⁵ It is noteworthy the 1937 Stock Corporation Act in fact made explicit the point that management is independent from shareholders, when it prescribed that the management board “must not be as dependent as it has been in the past on *the mass of irresponsible shareholders* [emphasis added], who do not in general have the necessary appreciation of the business situation.”⁶⁶ Further, the German Parliament (*Bundestag*) claimed that the principle of social responsibility was subsumed under the German Basic Law (*Grundgesetz*),⁶⁷ as well as a variety of other regulations. Accordingly, corporations are viewed traditionally as public institutions with public

⁶³ LM Friedman, *Law and Society: An Introduction* (Englewood Cliffs, Aldershot, 1977) at 75.

⁶⁴ L Miles, ‘The Cultural Aspects of Corporate Governance Reform in South Korea’ [2007] J Bus. L. 851, 876.

⁶⁵ D Millon, ‘Communitarianism in Corporate Law: Foundations and law reform strategies’; in LE Mitchell (ed), *Progressive Corporate Law* (Boulder, Westview Press, 1995) at 1.

⁶⁶ See Para. 70 of the Stock Corporation Act 1937. This provision seems to characterise the traditional significance attached to shareholders in the German corporate hierarchy, which is perhaps best viewed in the often quoted statement of a German banker a number of years ago: “Shareholders are dumb when they buy stock and impertinent because they also want a dividend.” See ‘Bündis Für Aufschwung Risikokapital – Der Neue Pflegedienst’, Focus Magazin, 25 Mar 1996 in TJ Andre, ‘Cultural Hegemony: the Exportation of Anglo-Saxon Corporate Governance Ideologies to Germany’ (1998) Tulane L. Rev. 69, 105.

⁶⁷ The Basic Law sets out a catalogue of liberal rights, but differs from the United States Constitution, for example, by explicitly linking private property rights to obligations to support the public interest. Article 14, Para. 2 of the Basic Law states: ‘Property carries obligations. Its use should simultaneously serve the public good.’ The importance of this clause related to the notion of ‘socially limiting’ or embedded classic rights, and giving the State the duty to limit freedoms.

obligations and it is necessary to have mandatory rules to control what they and their managers do. In contrast, it is a well-settled principle of English corporate law that the corporate objective is aligned with shareholder interests or wealth maximisation. In what has become an important and well-known dictum, Evershed MR in the English Court of Appeal in *Greenhalgh v Arderne Cinemas*.⁶⁸ said: “the phrase, ‘the company as a whole does not (at any rate in such a case as the present) mean the company as a commercial entity distinct from the [shareholders]. It means the [shareholders] as a generally body.”⁶⁹ Although it is debatable whether the courts ever, in fact, uniformly embraced the shareholder-orientated principle,⁷⁰ it has now, in effect, been articulated in a statement on directors’ duties in the Companies Act 2006.⁷¹ As things stand, English corporate law, for the most part, other important constituencies that warrant attention from directors, such as creditors, employees, suppliers, and the general community, lack any real substantive rule to provide adequate protection.⁷²

The second aspect relates to the different approach between the two jurisdictions towards regulating corporate decision-making and behaviour. The German corporate governance framework can be characterised as ‘hard law’ with a stricter monitoring role for the supervisory board, and, as discussed above, what, in effect, is a set of established core responsibilities that are enshrined in law, which the management board owes to the former. In the UK, the regulation of corporations has traditionally adopted a more ‘soft law’ approach of “negotiated regulation”⁷³ towards the business community, with an insufficiently defined arrangement between the executives and the relatively recent inclusion of the independent non-executive’s role. Third, in the UK it is the shareholder’s general meeting that is responsible for the appointment and dismissal of executive directors. It follows that the shareholders’ interests are the prime concern of the directors and managers of the corporation. In the German corporate governance structure, this responsibility is vested in the supervisory board, which, inevitably, permits a more powerful position for this administrative organ when compared to its UK counterpart, and means that the management board is accountable to a supervisory board that reflects the notion that people are part of a shared community who inherit the beliefs, values and goals of the community. The fourth point to make is that it is doubtful, due to political inertia, if the UK government even wants to adopt the Roman-Germanic system since it seems quite content to permit the business community to regulate itself.⁷⁴ While the criticism of “allowing

⁶⁸ [1951] Ch. 286, CA.

⁶⁹ *Ibid.*

⁷⁰ DJ Attenborough, ‘How Directors Should Act When Owing Duties to the Companies’ Shareholders: Why we need to stop applying *Greenhalgh*’ (2009) 20(10) I.C.C.L.R., 339, 343.

⁷¹ A Keay, ‘Enlightened Shareholder Value, the Reform of the Duties of Company Directors and the Corporate Objective’ [2006] Lloyd’s Maritime and Commercial Law Quarterly 335.

⁷² *Ibid.*

⁷³ A Dignam, ‘Exporting Corporate Governance: UK regulatory systems in a global economy’ (2000) 21(3) Co. Law. 70, 74.

⁷⁴ For a relatively recent review of the development of corporate governance in the UK since 1992, see N Bourne, ‘Corporate Governance in the UK and Overseas’ (2007) 28(11) Bus. L. Rev. 292.

the inmates to run the asylum”⁷⁵ is a fair one to make, for the UK legislature to impose stricter, more prescriptive regulation does not fit in with the *laissez-faire*, free market tenets of English politics or the government’s stated objective to maintain the UK’s position as an attractive location for business.⁷⁶

A final related point concerns the composition of the two supervisory boards. Considering the role of non-executive directors in corporate governance under UK law, it is suggested that the board is compiled of a group of executive and non-executive directors who are largely homogenous in background and sit on the same board. The current practice of recruiting non-executive directors appears to draw on an informal basis based on recommendations from fellow executives. They are a largely “self-perpetuating oligarchy”⁷⁷ drawn from the same social, educational, business and economic background as the executives and might even be former or retired executives. They are therefore unlikely to take a hard line, e.g. as regards excessive remuneration since this will shape their own pay. Evidently, their independence is compromised right from the onset. Further, owing their appointment to their friends and their “cosy relationship with the executives”,⁷⁸ they are unlikely to cause an upset or even ask probing questions. In some cases, this may be the intended outcome as some corporations appoint non-executive directors merely to meet the Combined Code on Corporate Governance’ requirements. This hinders their objectivity and monitoring role. Conversely, the German supervisory board consists of a wider array of actors who represent a range of private interest groups, such as the employees or creditors, i.e. the institutional banks. It is fair to suggest that such actors will be better places to challenge and probe; (2) influencing skills; (3) sound judgment; (4) good corporate governance guidance and communication; and (5) integrity and ethics.

V. Conclusion

Following a series of corporate failures and wrongdoing around the turn of the twenty-first century, and the collapse or bailout rescues from government during the recent global financial crisis, corporate governance has indeed received much attention on an international level in the Post-Enron era. To address what are viewed to be the manifestations of lax corporate governance practices, various institutional measures are now under the microscope, and include issues relating to the management of systematic risk, the role played by institutional shareholders, incentives to manage risk in corporate remuneration policies, the competences needed on corporate boards, and board practices and structures. In the UK, following the global financial crisis, the British government has announced an independent review to recommend measures to improve the corporate governance of UK

⁷⁵ A Dignam, ‘Exporting Corporate Governance’, at 70, 74.

⁷⁶ Company Law Reform White Paper March 2005 (Cm 6456, BERR, 2005), p 8, and can be accessed at: <<http://www.berr.gov.uk/bbf/co-act-2006/white-paper/page22800.html>> [Accessed 29 September 2009].

⁷⁷ S Kiarie, ‘Non-executive Directors in UK Listed Companies’, at 17, 19.

⁷⁸ *Ibid.*

corporations, particularly for the UK banking industry. This will be available by the end of 2009. The review reflects calls from the academic and business communities for a radical reform of corporate governance structures. The focus of this article has thus been to examine how feasible it would be for the UK corporate system to abandon its one-tier management structure in favour of the continental style two-tier board. It has focused on the approaches in the UK and Germany. The structure and composition of the two board structures has been examined in the context of historical, political, economic and social factors, and, although it is accepted that there are some shared global norms, every country tends to approach corporate governance from its own cultural background and hence there are various approaches around the world. It is the contention of this article that unless there is something of a sea change of corporate culture in the UK, then the aforementioned factors will hinder any radical reform of corporate governance structures.