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## The Ideology of Corporate Governance

**Robert I. Tricker**

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The concept of corporate governance from the legal point of view focuses on company law rules, and regulation; it leads to an understanding of directors' roles and responsibilities, of shareholders' rights and of governance processes. The operational perspective, on the other hand, tends to be descriptive, with normative insights based on good practice; it leads to material on board structures, board processes and styles, and the issues that face directors. The additional theoretical focus is essentially ideological and political. It derives insights from the worlds of political science, sociology and philosophy; and leads to insights into the importance of values, beliefs and culture in understanding corporate governance.

The classic paradigm of the corporation, as we have seen throughout our study, is rooted in the power of ownership: he who owns the shares owns the overall right to govern the company. Essentially this is based on an ideological and socio-political view of society. It supports a specific conception of the place of and the relationship between the individual, the enterprise and the state. But such belief systems vary around the world and, indeed, can change over time in a given culture.

Despite our study of the differences between corporate governance practices around the world, the real surprise is that, given the widely divergent ideological, political and cultural distinctions even between industrialised societies, the corporate concept has become so widespread.

Weaver (1988) offers corporatism as part of the answer:

Corporatism is a modern ideology, invented in the nineteenth century and practiced mainly in the twentieth. It rests on the same effort to apply the perspectives of science to social philosophy, the same view of society as a cooperative, hierarchical, scientifically managed organism, the same rejection of individualism and natural rights that guided the founders of the corporation. Corporatism accepts private ownership of business but sees economic life as a mainly institutional activity that occurs under bureaucratic supervision rather than in the free marketplace.... It accepts representative democracy but sees political life as a process dominated by economic, ethnic and other interest groups rather than individual citizens.

... corporatism is the philosophy that guides business in its dealings with society (the state) – broadly, the management of a nation's markets and politics by companies, unions, and other producer groups, backed up where necessary by the power of government.

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The advocates of stakeholder theories of corporate responsibility are advancing corporatist ideas. In discussing research into corporate governance in British companies in 1983 the present writer suggested:

The modern enterprise, in reality, is itself loosely bounded and involves complex and interacting networks of relationships. It is better perceived as a set of dynamic open systems – coalitions of interests between parties. Indeed, a modern public company, operating internationally, may well involve groups of wholly and partially owned subsidiaries and be, itself, enmeshed in joint ventures with other public companies and governments. In these circumstances the concept of the company surrounded by a precisely bounded set of stakeholders is an abstraction at a very high level, and probably unhelpful in practice in thinking through corporate responsibilities.

The Oxford political philosopher Weinstein (1977) has provided a useful insight into the ideology of corporatism:

There is no doubt that industrial societies generally, though still harbouring a plurality of corporate bodies, are dominated more than ever by the idea and the reality of corporatism, by the integration of multitudes within large-scale organisations. The concept of corporatism in society therefore depicts the changed position of the individual, and focuses on the distribution of power and resources within society, and in the case of multinational corporations, across national boundaries. But on its face “corporate state” says nothing about the powers and functions of the state. There might be a powerful array of corporate bodies in society, economic, religious and educational, and a relatively weak and limited state; or a state whose powers permeate and even subjugate the various corporate bodies in society. So whether or not one sees, for example, the modern manager-run, rather than owner-run, business corporation as profit maximising or satisfying, its existence for more than a century has raised controversial issues over the individual’s relation to it, as both employee and consumer, and its relation to other corporate entities as well as the state.

Weinstein’s essay adds further valuable insights into the political philosophies behind state corporatism:

Almost all ideas about state corporatism have roots in one kind of political ideology or another. For example, one important kind of corporate state thinking was inspired by hostility towards late eighteenth and early nineteenth century liberal ideas of free contract, the free market in property, the dependence of wealth production upon the multiplicity of individual and small units as well as political claims to free thought and association, and limited, responsible and representative government. This kind of corporatism dramatised the disunity, fragmentation, selfishness and overt conflict that marked a liberal order. In contrast with liberalism, which sharply distinguished between state and society, and conceived the state merely as an umpire or “nightwatchman”, imposing minimum rules

over social activities while within that loose framework individuals and groups could freely pursue their own good in their own way, corporate state theories often called for an organic unity of society and for consensus expressed in the state's development of central strategy for the whole society. These theories harked back to pre-market, hierarchically ordered societies or looked forward to a policy which developed positive goals untainted by liberalism's skepticism about the validity of any collective goals, especially those which left opaque what kind of good the individual was supposed to derive from them. The state in alliance with either religion or some new social science, was to bring about the organic unity of society – by contrast with the second-rate, mechanical and precarious unity of a free market which left too much to an ill-founded faith in the rationality and goodness of free-wheeling individuals.

Compare these thoughts, written in the 1970s, with the emergence during the 1980s of the market led, enterprise culture, with Thatcherism in Britain and Reaganomics in the United States. Notice also the emergence of agency theory, with its implicit ideological challenge to stewardship theory, of interests in business ethics, and of the successful prosecution of Wall Street arbitraguers and insider traders who, like Gekko in the film "Wall Street", had applauded greed as the basis of the capitalist system.

Mintzberg (1984) introduced an interesting conceptual horseshoe (see Figure 1) in which he sought to provide a conceptual framework, a portfolio of alternatives, to help to clarify the debate around the question "who should control the corporation?" At the centre is the position which seeks to balance economic with social goals, on the right those positions which favour the exclusive pursuit of economic goals, on the left those ideas which seek to temper economic goals with social ones.

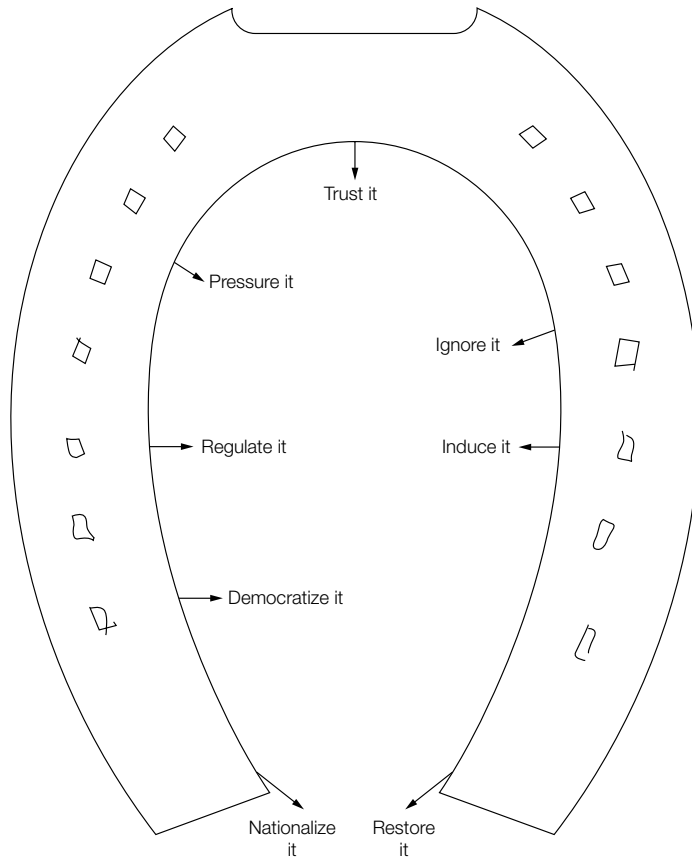
In understanding international corporate governance, and particularly in considering future developments, it is important to be sensitive to the underpinning ideological perspectives, how they differ between cultures, and how they might be changing.

### **Ownership as the Basis of Power**

We can now see that the classical concept of the corporation – of incorporation, the separation of ownership from management, and the limitation of the owners' liability for company debts – is rooted in Western political philosophy and ideology. Developments in the future may have to reflect alternative ideologies around the world.

We have also seen how the original concept has evolved over the years into myriad different varieties – from the small and simple to the large and vastly complex. The original idea of the joint stock, limited liability company may have outgrown its usefulness. Generalisations about the roles of directors and the governance of companies can no longer cover the enormous diversity. Perhaps we need to reclassify corporate types to reflect adequately the variations between companies, and the fundamental differences between patterns of ownership and

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**Figure 1:** Mintzberg's conceptual horseshoe: who should control the corporation

governance power bases. To put this in perspective, consider the following list of possible ownership structures in public and private companies:

#### Public Companies

- Shares held widely by financial institutions and individual investors: with no dominant holding.
- A majority of the shares with financial institutions and individual investors: but with one or more institutional or individual investors dominant.
- A majority of the shares with financial institutions and individual investors: but with another company holding sufficient voting equity to dominate, which means the company is treated as an associate of that group.
- A minority of the shares with the public: the dominant interest in the hands of one or more financial institutions or individual investors.
- A minority of the shares with the public: the dominant interest in the hands of another company, who treats the company as a subsidiary.

### Private and Proprietary Companies

- Wholly or partly owned by government or a quasi-governmental body, which exercises corporate governance.
- Wholly or partly owned by another company, which treats it as a subsidiary.
- A joint venture owned by a number of companies.
- The private company with shareholders not involved in management.
- Owner-dominated but with some shares in the hands of shareholders not involved in management.
- Owner-directed and -managed (the family company).

To compound such complexity further consider the implications of cross-holdings within pyramids, chains and networks of companies, and cross and interlocking directorships between companies.

An alternative conceptual framework for corporate governance would have to embrace this contemporary diversity and complexity, and reflect more adequately the ideological reality of the power to govern. Research into governance processes are leading in this direction. In the remainder of this chapter we will review some of these ideas, which would provide alternative approaches to governance responsibilities and processes, and new thinking in company law and regulation.

### The Control of the Public Company

There have been a number of initiatives in recent years to change the notion that remote shareholders are able to govern public companies adequately, by increased regulation, separation of powers and wider disclosure. The material on “the corruption of undivided power” in chapter 6, and indeed the entire thrust of agency theory has been to provide alternative governance mechanisms. In chapter 7 we also discussed the apparent erosion of shareholder rights and recent ideas on “re-discovering shareholder democracy” in Tokyo, New York and London.

Other initiatives around the world to improve the effectiveness of governance in public companies include:

In Australia, which had seen some spectacular company collapses in the late 1980s, a group of key organizations – the Australian Securities Commission, the Australian Stock Exchange, the Institute of Chartered Accountants, the Australian Institute of Company Directors and the Business Council – joined together for the first time in 1990 to address issues of corporate governance. They proposed that all public company boards should have a majority of independent non-executive directors, separate Chairman and CEO, audit committees and ethical codes and guidelines. A director should limit the number of boards on which he serves and must be able to act in the interests of the shareholders as a whole. Further a business judgment rule should be introduced to place an obligation on directors to take all reasonable steps to inform themselves, to show that they believed their decisions to be in the best interests of the company as a whole.

In the UK, a group representing institutional investors also produced a recommendation that criticized existing governance practices and sought greater

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accountability from boards and wider shareholder involvement. PRONED, a government and City Institutions body to encourage the wider use of independent non-executive directors, produced a code of practice, and its previous director, Charkham, advocated the establishment of shareholder committees, mainly from institutional investors, to act as intermediaries between the board and the diverse shareholding membership.

Meanwhile throughout the European Community, movement towards company law harmonisation has highlighted ideological as well as practical differences in social policy and the application of corporate governance. In Germany the perception of the large corporation as a sort of partnership between labour and capital, has led to widespread employee participation and worker membership of the second tier supervisory board. Attempts to introduce similar worker involvement, either through mandatory two-tier boards or unitary boards with directors nominated to represent labour or capital remain the subject of intense debate. Works Councils and other alternative forums for employee participation have been suggested as non-statutory alternatives.

In Japan, pressure from other countries to open securities trading and to introduce outsider membership on boards, may produce some changes, although the closely knit and inter-related structure of the powerful *kaibatsu* will resist significant change for as long as it is in their interests to do so.

In the United States, the debate continues about the protection of incumbent management from hostile raiders versus the rights of shareholders to have the underlying value in their companies realised. Also, whilst the debate of the late 1970s and early 1980s about large companies being socially responsible and accountable to a range of stakeholders, including consumers, suppliers, employees and society at large, has died down, the idea of more representative boards is brought up periodically.

Another idea to separate functions and provide greater independence, is that public companies should each have a governing body, which would include the directors, as now, but also a set of governors, who would be elected by the shareholders and be totally independent of the company's business (Tricker 1983). The basis for governance would be as shown in Figure 2. The role of Chairman of the Governing Body would be created statutorily and be separate from the CEO.

Of course, in all such developments a balance needs to be struck between the agency benefits of the alternative governance processes and their cost. The discernible trend towards greater regulation and the proliferation of governance mechanisms could, in the longer term, be self-defeating if it inhibited the wealth creation process, or favoured those economies, jurisdictions and stock markets which were less controlled.

### **Other Constitutional Forms**

Of course, each of these ideas continues to rely on the conventional notion of ownership and voting by individual shareholders as the basis of governance power. A more dramatic alternative would be to have a different constitutional foundation.

Mutual societies have provided a successful governance model, such as mutual insurance companies of which there are a number of major examples in Britain and Canada; Savings and Loan Associations in the States and Building Societies



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a situation would, obviously, be – how do those who manage the federation obtain and maintain their power? If the companies are incorporated in various jurisdictions and owners protected by nominee holdings, the answer to such questions may be hard to find in practice.

A rather different concept of a federation of companies, connected by common interests, not joint ownership, is proselytised by the Apple Computer organization which envisages a galaxy of companies, each individually owned and managed, circling around a central mother-ship (Rock 1990).

Then an idea has developed in France – *groupements d'interet economique* (GIEs) – which, unlike joint ventures which need capital, are linkages of common interest which facilitate and develop economic activities of the members. Debts of the GIEs are the responsibility of the members. In a way the GIE provides an economic linkage under the partner firms, rather than an ownership linkage over them. The European Community is endeavouring to extend them to encourage cross-border cooperation between firms. The legal framework has now acquired an English acronym – European Economic Interest Groups (EEIGs).

### **Beyond the Present Frontiers**

In conclusion what might lie beyond the present frontiers of international corporate governance that we have been exploring?

Looking ahead the one thing that seems certain is that the existing diversity and complexity of forms of corporate enterprise and patterns of corporate governance will continue and, very probably, increase. Alternative paradigms of corporate governance will be needed to improve the effectiveness of governance, to influence the healthy development of corporate regulation, and to understand the reality of the political processes by which companies are governed, rather than the structures and mechanisms through which governance is exercised. In any development it will be important to avoid the polar extremities of governance based on an expensive bureaucracy of regulation and the adversarial clash of vested interests. Governance powers and processes need to provide for the many different constitutional bases of modern enterprise and to reflect the reality of power over that entity, balancing independence and objectivity with executive commitment and motivation.

Looking ahead towards the next decade it is possible to foresee a duality in the developing scenarios. On the one hand, we might expect further diversity – new patterns of ownership, new forms of group structure, new types of strategic alliance, leading to yet more alternative approaches to corporate governance. More flexible and adaptive organizational arrangements, entities created for specific projects, business ventures and task forces, are likely to compound the diversity. Sharper differentiation of the various corporate types and the different bases for governance power will be necessary to increase the effectiveness of governance and enable the regulatory processes to respond to reality.

But on the other hand, we might also expect a convergence of governance processes as large, public corporations operating globally, their shares traded through global financial markets, are faced with increasing regulatory convergence in company law, disclosure requirements and international accounting standards, insider trading and securities trading rules, and the exchange of information between the major regulatory bodies around the world.



Governing bodies may well be more diverse and more adaptable in their membership. Toffler (1985) suggests that instead of constructing permanent edifices in their organizational and board structures, the business leaders of the future may have to de-construct their companies to maximize maneuverability. "They must be experts not in bureaucracy but ad-hocracy." Members of those governing bodies are likely to be specifically trained as directors, experienced in board matters through career planning and action learning activities, rather than executives appointed to the board following success in a different capacity. There may well be wider participation in governance matters; and almost certainly a greater acceptance of accountability and more professionalism. Boards are likely to accept responsibilities for ethical issues as readily as economic ones. Individual directors are likely to be more visible to their outside environment, which may over time become less litigious.

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