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Corporate Governance Regulations and Practices in Europe - Comparative Study

Laws and norms of corporate governance (CG thereafter) are important constituents of the framework for thriving market economies. Although CG is defined differently in a variety of national economies, overall it involves (1) the mechanisms by which business is organized, directed and controlled in a limited liability corporate form, and (2) the mechanisms by which corporate managers are held accountable for corporate conduct and performance. It is important to distinguish CG from business management and corporate responsibility, although they are related. Over the past decade, interest in the role of CG has intensified in the academic community as well as among practitioners all over the world due to the competitive pressure of globalization as manifested in the creation of a common economic zone (European Union, EU thereafter) in Europe in 1999. In an attempt to develop a single capital market, the EU adopted common currency, freed the flow of capital, goods, services and people across EU borders. The EU creation was accompanied by the growth and diffusion of shareholdings, and increased merger activity among the largest corporations and largest stock exchanges, which made countries- members of European Union (EUM thereafter) a perfect candidate for mandatory adoption of the International Financial Reporting Standards (IFRS) in 2005, i.e. convergence of financial reporting system. In this respect, an analysis of the commonalities and differences among national CG laws and practices will be instrumental in eliminating any related barriers to the development of a single capital market by streamlining all CG regulations and practices within EU economic zone. Recent developments in this area show that IFRS is becoming a common financial reporting system around the world. In this respect, leading questions in CG include (1) whether CG systems (CGS thereafter) follow financial reporting on the road of harmonization, and (2) whether any particular given CGS (or its component) enjoys relative competitive advantage worthy to be adopted by others. If only the most robust practices can survive globalization, theoretically it plausible to predict that given a long window, national CGS will loosen their systematic differences without political or/and administrative intervention and converge to similar optimum practices due to concerns about local firms' performance in international markets. Practically, however, as literature suggests (Khana et al. 2002) no evidence of similarity in CG practices was identified at a country level despite the latest trends in convergence of CG laws. Overall, an extensive body of study addresses these questions, identifying and evaluating national variations in CG regulations and practices (LaPorta et al. 1998, 1999, 2000; Bushman and Smith 2001; Gugler et al. 2003; Leuz et al. 2003; Gilson 2005; Jackson et. al. 2007; Krivogorsky et al. 2008 a,b). Unfortunately, even as this stream of literature has become broader and more reliable, answers to the upshot questions regarding competitive advantage and the likelihood of evolutionary convergence have also become more elusive. Working hypotheses have been changing rapidly, more in response to external events than to developments in the discourse. American observers in the 1990s looked to Japanese governance practices for guidance to reform the US market governance system, then viewed to be in the middle of a productivity crisis (Kester 1997; Porter 1997). Among the characteristics American observers found most attractive is the Japanese governance system's robust ability to self-correct in the wake of external shocks (Gilson 1998), which relates to its distinctive production methods, such as lean production, as well as both Japanese cross-holdings and shop floor arrangements. The initial excitement, however connected to the likelihood of massive American adoption of Japanese governance methods was deteriorating as the US entered the recession started in the 1990s that tested the resilience of Japanese CG institutions in American business environments. (Boot and Macey 1998). Although some authors still predict full harmonization as an imminent prospect (Kester 1996) many offer a more cautious forecast, or even make a case against it (Roe 1994). Unsurprisingly, in this respect the comparative governance literature offers alternative theoretical frameworks that support conflicting hypotheses. The theoretical approach that commands widest acceptance scrutinizes present national CG regimes and posits suboptimal performance caused by the operation of political forces over time. It thereby dismisses the possibility of evolutionary efficiency in its account of the status quo (Roe 1996). That said, it does not dismiss mandatory convergence (which obviously requires well developed enforcement mechanisms) and presents a brighter future of constructive cross-reference between the two dominating types of clusters: (a) “market-centered" systems found mainly in English-speaking countries and characterized by widely-dispersed shareholding and thick liquid trading markets; and (b) “blockholder” or “relational investor” systems, found in varied form in most capitalist economies and characterized by control by insider coalitions or wealthy families, lack of liquidity, and thin trading of non-controlling stakes. This comparative study contains the analysis of the similarities and distinctions in CG regulations and practices among EUM from both clusters through an examination of CG codes , and to a limited extent relevant elements of the underlying legal framework. The choice to analyze codes is due their distinct nature. They are comprised of the methodology and criteria of CG ratings, and set of principles, standards and best practices and recommendations and codes themselves are neither legally nor contractually bindings; the laws, standards, and regulations, however which serve as the base for best practices described in the codes are legal and contractual documents. Here it is perhaps important to note that many EUM have more than one operational CG code, which makes CGS complicated and sometimes inconsistent. For example, the UK had eleven codes, and in addition two international and two-pan European codes relevant to all EUM companies which affect UK companies as well. The CG codes are being issued by a broad array of groups such as governmental or quasi-governmental entities, and committees (or commissions) organized by stock exchanges, business, industry, academic and directors’ associations, and investor-related groups. As one might therefore expect, compliance mechanisms and the “official” status of the codes vary widely. Some codes advocate listing requirements and mandate disclosure by listed companies together with an explanation of any areas of non-compliance garnered through connection to stock exchanges. “Comply or explain” requirement exert some coercive pressure in creating incentives to comply.2 Note, that even though the CG codes are voluntary in nature given the investment community’s significant economic power, these codes have considerable influence on CG practices and, thus need to be simplified in order to streamline CG practices and increase efficiency in the process as a whole.