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C. Richard Baker, Bertrand P. Quéré

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LE ROLE DE L'ETAT DANS LA GOUVERNANCE D'ENTREPRISE

C. Richard Baker, School of Business, Adelphi University, Garden City, New York 11530, USA, Tél: (1) 516 877 4628, Courrier electronique: Baker3@adelphi.edu

Bertrand P. Quéré, IAE Grenoble, University Pierre-Mèndes-France, 525 avenue Centrale 38400 - SAINT-MARTIN-D'HERES, Tél. (33) 04 76 82 59 27, Courrier electronique : bertrand.quere@upmf-grenoble.fr

Résumé : Le thème de la gouvernance d'entreprise s'est progressivement imposé dans de nombreux domaines académiques au cours des quinze dernières années. Cet article recense les différentes approches de ce concept en mettant en évidence l'influence historique de l'Etat alors que la vision traditionnelle limite cette notion à la simple et traditionnelle relation entre dirigeants et actionnaires. La crise financière récente montre pourtant que le rôle de l'Etat et celui de la collectivité en général sont des facteurs clefs dans la compréhension de la gouvernance d'entreprise.

Mot Clés : la gouvernance d'entreprise, l'Etat, l'histoire des entreprises, l'idéologie

Abstract: The topic of corporate governance has become increasingly prominent in recent years in many different academic areas in recent years. In this article we address various approaches to corporate governance, with a particular emphasis on the historical role of the State. It seems that certain approaches to corporate governance avoid discussing the role of the State, focusing instead on interactions between corporate managers and shareholders. The changes in corporate governance which have followed various financial crises show that the role of the State and the desires of the larger society are key factors in gaining a better understanding of corporate governance.

Key Words: corporate governance, the State, business history, ideology

INTRODUCTION

The topic of corporate governance has become increasingly important recent years in a number of different areas of academic research. The purpose of this paper is to discuss several different approaches to corporate governance, with a particular emphasis on the historical and in our opinion, necessary, role of the State in systems of corporate governance. Certain theoretical approaches to corporate governance completely avoid discussing the role of the State, focusing instead on interactions between corporate managers, boards of directors and shareholders. The evolutions in the systems of corporate governance which have followed numerous financial crises have demonstrated that the role of the State and the desires of the larger collectivity are key factors in understanding systems of corporate governance. The remainder of this paper is organized as follows. Section 1, discusses the complex dialectical tension which exists between the ideas of legitimacy, performance and ideology in the discussion of systems of corporate governance. Section 2, discusses the historical and necessary role of the State in systems of corporate governance. It should be noted that this paper focuses exclusively on the role of the State with respect to corporate governance and it does not discuss the role of corporate lobbying efforts directed towards restricting the ability of the State to control corporate activity. Section 3, presents a summary of the three primary academic theories of corporate governance and relates these three theories to the three dialectical tensions discussed in Section 1. Section 4 briefly addresses the necessary role of the State in mediating conflicts of interest between theories in periods of financial crisis.

1. THE DIALECTICAL TENSION BETWEEN LEGITIMACY, PERFORMANCE AND IDEOLOGY

Despite the financial logic which forms the basis of power and hierarchy in modern business enterprises, the rise of "corporate governance" as a major topic of interest during the last fifteen or twenty years remains somewhat surprising. The very idea of governance evokes a comparison with a democratic political process in which elected officials seek to form a government. In democratic countries, each citizen, except in those cases where there has been a suspension of civil rights, has the right to vote. The political connotation that predominates in the collective mind with respect to the concept of corporate governance thus risks an

association with the political desire to share in a more or less equal manner the power at the heart of a firm. Following this logic, a true electoral process can only proceed in a context whereby a certain group, feeling themselves in solidarity with a community of values and interests, allows themselves to become subject to a power which they are willing to recognize as legitimate (Giddens, 1984). If this constitutional approach strongly taints the idea that we now have of our formal organizations, the mere existence of an election does not systematically result in equity or justice. All forms of governance rest on the idea of "legitimacy", lacking which the governing authority would not know how to exercise its power without considerable resort to force. If the nation-state is clearly the most prominent example, and equality of voting which is indifferent to class or wealth, the ideal status, it is not generally the mode of operation among the collectivities known as business enterprises. It was in order to avoid these hasty parallelisms that the term "governance" quickly came to be used as a replacement for the ambiguous term "government" which carries with it certain problematic connotations (Charreaux, 2004).

In a general sense, the notion of "legitimacy" can only be conceived of at the level of a particular group joined together by a common set of interests and/or destinies (Dogan, 2004). With respect to corporate governance, this common set of interests has led to a weighting procedure according to the relative sizes of the pecuniary engagements of the participants. If the desire for political equality runs counter to this form of weighting procedure, it is in financial matters often the rule. Contrary to the presumption of human solidarity, pursuant to which a great number of unrelated persons are brought together to advance a given cause, the determination of who votes in a corporate general assembly is proportional to the number of shares held by each shareholder. It is therefore the financially most committed who weigh most on the appointment of directors. This manner by which corporate directors are chosen may facilitate the financing of the company. It also may also appear to constitute a way by which, in defending their own interests, the greatest contributors of capital enhance the value of the corporation. Thus, the "equality of treatment" mandated by the laws of corporate governance does not necessarily correlate with the rights of a "citizen" in a democratic state. While companies rarely follow a democratic model, the election of legal representatives to control the enterprise produces a type of legitimacy without being necessarily egalitarian (Jensen and Meckling, 1976).

Despite this lack of democracy at the heart of the business enterprise, commercial entities have long been controlled or supervised by the State through legal structures which specify the operating parameters of companies to a fine degree (Braudel, 1985). These legal mechanisms have been consistently expanded and reinforced in response to the risks associated with the growth of capital markets and more generally in response to the importance of corporations to the political economy. The modes of election, responsibilities and attributes of corporate directors are a traditional component of these laws. It should therefore be noted that if the topic of corporate governance is of relatively recent origin, its essence has been present in practical terms since the early 19th century in the form of laws dealing with companies and commercial activities (Pierre, 2002). Like the prose of Mr. Jourdain in Molière's "The Bourgeois Gentleman", corporate governance has existed without it being named so.

Any form of conceptualization proceeds from a desire to understand the relationships between observed phenomena using a process of logical reasoning. Following the inductive process which prevails among the social sciences, the logical reasoning process leads to a reconsideration of the previous literature dealing with corporate governance. While company law has been the subject of multiple studies and commentaries, its progressive adaptation to new economic circumstances has provided an abundance of texts which tend to defy overall comprehension. If the technical coherence of the law is hardly in question, few questions have been raised about the law's purpose in operational terms. Company law has therefore been concerned primarily with the validity of various acts and procedures. The rise of corporate governance as a topic of interest has been the result of a reawakening regarding the distance between the technical features of corporate law and the needs of the general public with respect to governance of corporations. It is within the context of financial crises that the analysis of corporate governance has been found to be lacking (Baker and Hayes, 2004).

It is somewhat surprising that the recent increased awareness about the dysfunctions of corporate governance did not emerge out of crises in continental Europe. Rather, it was in the United Kingdom that there first appeared, in 1991, a revelation about the questionable practices of the press baron Robert Maxwell (Bower, 1992, 1996). These revelations produced evidence concerning numerous questionable acts; revelations which were subsequently added to concerns about the collapse of the Bank of Credit and Commerce International (BCCI)(Beaty and Gwynne, 1993). These media thronged events influenced the

work of the committee on *Financial Aspects of Corporate Governance* directed by Sir Adrian Cadbury (Cadbury Report, 1992). The recommendations of this committee were focused on internal control, the functions of boards of directors, and the role of external auditors. While it can be seen from its title that a large place of honor was granted to financial aspects of corporate governance, there was a reinforcement of the argument concerning a need for a more critical examination of managerial decision-making. The increasing popularity of issues related to the functioning and operations of capital markets, which began in the 1990s, undoubtedly explains the quick transposition into various European countries of a questioning attitude towards managerial decision-making. The developments in corporate governance accompany follow in an undeniable fashion the de-regulation of financial markets and more generally the processes of globalization (Giddens and Hutton, 2000).

In a manner similar to the British efforts to improve the system of corporate governance through codes of best practices, in France, the Vienot I (1995) and Vienot II (1999) reports focused on establishing the "correct" balance between the role of managing directors and other directors. The parallelism between the British and French reports did not end merely with recommendations pertaining to a more balanced approach to corporate governance and management control. The reports also demonstrated that the recommendations of professional management associations were assimilated into the white papers issued by governmental authorities. In other words, even if the responsibilities of directors was at the center of the recommendations that the committees put forth, they did not disturb the "legitimacy" of actual corporate governance, because there was no objective other than to reassure shareholders their interests were being cared for (Vienot II, 1999).

While the parameters of corporate governance have been essentially circumscribed by managerial influences in many countries, the idea of corporate governance has been paradoxically conceived of in some different ways in certain continental European countries. A remarkable call for research was issued by the French Government through its General Planning Commission in March 1999. This call included a framework which transcended the relationship between managers and shareholders. While addressing the differences between the interests of large and small shareholders, the document also spoke about "the company, its partners and the environment" as well as the "governance of the company and the role of employees". In other words, far from being narrowly confined to the interests of shareholders, the idea of corporate governance was broadened in a concentric manner. It was

not simply a matter of shareholders and shareholder value, but also “stakeholders” in partnership with the company. Consequently, the idea of corporate governance, which was initially developed under the British neo-liberal framework, was partially “socialized” during its transposition into continental European countries. The recent popularity of corporate governance as a subject undoubtedly therefore explains the opportunism evidenced by many academic researchers who have attempted to address governance issues even at the price of diluting their original purpose and definition. If law, accountancy and finance constitute the most directly related disciplines, strategy and human resource management have quickly followed in the pursuit of academic visibility (Cohen et al., 2002).

While the recent emergence of corporate governance as a topic of concern appears to be in many ways the counterparty to corporate failures and financial crises, it is nevertheless surprising that the response to these dysfunctions has not been purely and simply defined by increased legislation in the countries concerned. Apparently, there is a dialectical logic guiding the evolution of corporate governance regulations intended to prevent and control financial abuses. The promulgation of “codes of best practices” was the first response to the dysfunctions of corporate governance (Cadbury Report, 1992; OECD, 2004). While the urgency of the financial situation might have ordinarily led to strong intervention by the State, it was initially a neo-liberal logic which was pursued. This now seems to be changing as the enormity of the crisis is much larger than anyone anticipated.

One can question the efficacy of an approach in which corporations impose constraints upon themselves in order to permit themselves to be more transparent towards shareholders. Nevertheless, if coercion has not been directly imposed by the State, it has been understood that the power of the State would be exercised in an indirect manner through social pressures. In other words, the diffusion of codes of best practices is a collective requirement sufficiently strong enough so that businesses align themselves in a concurrent manner in order to maintain legitimacy. To whatever extent corporate governance practices are “voluntarily” applied in accordance with codes of best practices, such practices have become a sort of onerous “option” which management is able to “manage”. The free-form aspects of this framework, employing new and somewhat evanescent concepts like the “citizen enterprise”, are undoubtedly at the origin of studies which seek to assess the efficacy of the best practices approach. It is within this context that a number of researchers have attempted to determine, through empirical studies, the impact of corporate governance practices on the “performance”

of business enterprises. The results of these studies have been less than illuminating. Larker, Richardson and Tuna (2004) concluded that the normal indicators of good governance explain very little about the effects of governance on the behavior of management and the performance of corporations concerned. Working with a database provided by Institutional Shareholders Services and certain indices of good corporate governance, Brown and Caylor (2004) reached conclusions which contradict prior studies regarding the importance of good corporate governance.

In fact, few studies of corporate governance focus on the role of the State and the importance of corporate law. It is, however, precisely the State and corporate law which regulate relationships between managing directors, supervising boards and the general assembly of shareholders. Schleifer and Vishny (1997) performed a global review of the basic parameters of the principal systems of corporate governance in advanced capitalism, but they admitted that their study remained at such a level of generality that it revealed little about the specifics of the corporate governance mechanisms: "*Although a lot has been written about law and corporate Governance in the United States, much less is written (in English) about the rest of the world, including other wealthy economies. Yet legal rules appear to play a key role in corporate governance*."

In effect, disciplinary specialization has led to an incoherent understanding of the role and purpose of corporate governance in advanced capitalism. Even if the financial economics approach has had its strengths, the conclusions obtained are often trivial due to the nature of the questions that are asked. A positive correlation among the variables pertaining to good corporate governance and performance variables may demonstrate the usefulness of good corporate governance, but the opposite result would equally be a dismaying sign leading to harsh questions about the level of rigor of the study. Consequently, the demand for greater transparency in corporate governance responds more to social imperatives than effective performance. The cost of social imperatives is one reason why nation states may have initially intervened in ways which allowed a relatively wide margin of freedom to corporations (Baker, 2007).

The neo-liberal view of corporate governance that is evident in the empirical finance literature does not take into account the sociological and legal foundations of governance. Even if the questions of researchers are logically based, they overlook the dialectical tensions

existing between the evolution of corporate governance and the role of the State. The control of managers and the corresponding changes to company law not only facilitate the objective of making firms more transparent vis-à-vis shareholders, they also respond to social requirements for increased legitimacy in the community. No doubt it is this more democratic vision that has caused an expansion of the idea of corporate governance to include all stakeholders of the enterprise. A vision of neo-liberal corporate governance which is anxious about efficiency and performance is therefore contrasted with a vision which is more "consensual" and provides a more democratic image of the firm (Giddens, 2003).

The enactment of this more democratic vision can lead to confusion in a political sense. Effectively, the idea of good corporate governance may be less concerned with improving the economic performance of the firm than with exerting control over corporate activity. This broadened concept of corporate governance may therefore be seen as a resurgence of an idea which was formerly hidden in a world where ideologies were said to have disappeared. In effect, rather than governing relationships between managers and shareholders, corporate governance is seen as a way to govern corporate behavior, especially whatever behavior is considered to be deleterious to the common good. Because the business enterprise is the primary scene of conflict between capital and other interests in society, questions about corporate governance therefore become central to political thought.

To summarize this section of the paper, there are tensions between the concepts of legitimacy, performance and ideology as illustrated in Figure 1. To explicate the manner in which these tensions have evolved through time, in the next section we will discuss the historical and necessary role of the State in constructing and facilitating systems of corporate governance and mediating between the conflicting concepts of legitimacy, performance and ideology.

*****Insert Figure 1*****

2. THE HISTORICAL AND NECESSARY ROLE OF THE STATE

Entities, the primary goal and purpose of which is the pursuit of profit, have existed throughout human history[1]. Such entities have frequently been created or controlled by the State. Corporations were initially established as special purpose entities endowed with certain rights allowing them to exploit profit making opportunities. These enterprises were joint-ventures between the company and the State, in which the royal charter specified the percentage of profit that would flow to the crown, thus, implicating the State directly in the profit making process (Haurere, 2006).

2.1 The Development of Corporate Governance in Europe

The origins of corporate governance in Europe can be traced to Stora Kopparberg in Sweden, which obtained a charter from King Magnus Eriksson in 1347, allowing the company to exploit certain opportunities in copper mining (2007). In a similar way, the Dutch East India Company (Vereenigde Oostindische Company, VOC), was established by the United Provinces in 1602, and it remained during nearly two centuries one of the pillars of Dutch capitalism (Morineau, 1999). In France, a "Declaration of the King establishing a company for trade in the Eastern Indies" was promulgated by Louis XIV in 1664. The statutes of this company included certain privileges such as an exemption from taxes, an exclusive monopoly in trade with the Eastern hemisphere (to which was added in the 18th century, the West Coast of Africa), a guarantee of its financial obligations by the royal treasury, and the capacity to name ambassadors, to declare war and to conclude treaties. This company had purposes and objectives much broader than its name suggested. It was virtually an arm of the French State in that it provided material support for wars against the English and Dutch; it contributed to the development of a national navy by affirming the French presence on the seas; and it promoted French civilization and the Christian religion (Haudrère, 2006). In other words, its purposes were not merely commercial, but also political, cultural and religious.

Beginning in the 17th century, shares in chartered corporations were traded in organized capital markets in Amsterdam, London and other cities. Irrational expectations about the value of shares often led to speculation and share price collapse, followed by trading reforms

[1] See for example, the numerous laws pertaining to business activity contained the Code of Hammurabi dating to 1950 B.C. (Finet, 2002).

and increased regulation by the State.[2] Revelations of corporate fraud in some countries led to outright prohibitions against any form of corporate activity. During the 18th and 19th centuries, the corporate form was prohibited in most countries, except for the British Empire and the United States of America, where the emergent industrial revolution prompted an enormous need for capital. This demand for capital was increasingly provided through organized capital markets and share exchanges. The intersection of capital and political interests led to cycles of corruption and reform, which were exemplified by the Companies Acts in Great Britain, and the Commercial Code in France (Younkins, 2001). In each instance, there were interventions by the State which sought to control the power and growth of capitalist enterprises while simultaneously being enmeshed in conflicts between proletarian, bourgeois and aristocratic classes over the ownership and control of industrial, financial and commercial enterprises (Cooke, 1950).[3]

In France, the Code du Commerce of 1807 allowed the creation of *sociétés anonymes* (corporations). While "companies made up of shareholders" had existed in the 18th century, they were not widely used. This was, however, the model for companies such as the *La Compagnie français des Indes orientales*. Due to limitations on the liability of the shareholders for the acts of the corporation, the Code du Commerce subjected *sociétés anonymes* to regulation by the State. In contrast, *sociétés en commandite par actions*, which functioned as limited partnerships, were relatively free from regulation because the liability of the managing directors was theoretically unlimited and this was thought to constitute a guarantee of proper conduct with respect to third-parties (Johnston, 2005).

Braudel (1985) has argued that capitalism can only exist where the laws favor its development. He maintained that "there are positive social policies which promote the expansion and success of capitalism". These policies include the maintenance of social stability and the establishment of a favorable environment for commercial activity. The existence of a capitalist economy presupposes certain positive acts on the part of the State, in that it is only the State which can guarantee the right of private property which is essential to capitalist activity. In France, the right to private property was recognized as an inalienable right in the *Déclaration des droits de l'homme et du citoyen* enacted by the French State in

[2] Much like the cycle of de-regulation, speculation, abuse and re-regulation that is taking place today
[3] Gustave Eiffel was both a gifted engineer and an entrepreneur who financed the construction of his tower through political intrigues.

1789 (Braudel, 1985). Jean-Baptiste Say advanced this liberal economic logic in his *Treatise on Political Economy* in 1828, in which he enunciated the principle of measuring economic value based market exchanges of goods and services.

By way of contrast, political liberals, such as de Tocqueville, were often wary of unbridled economic liberalism. The economic crises resulting from unconstrained liberal economic policies often forced the State to intervene in economic activity in order to help workers and to protect certain industries[4]. However, it was precisely during the industrial revolution that capitalist economies passed from being primarily agricultural to urban and industrial. The rural emigration, combined with a demographic explosion, depopulated the country sides and filled the large industrial cities with impoverished workers. Various political actors argued that only intervention by the State could alleviate poverty and improve working condition (Pierre, 2002). Socialist thinkers severely criticized the emergent capitalism of the 19th century; its more radial partisans sought to destroy bourgeois society completely. Others argued for a more moderate approach which included the formation of trade unions, social welfare programs and democratic access to political power. Nevertheless, the period which followed the last vestiges of *Ancien Régime* as incarnated by Louis-Philippe in 1848, and the coup d'état of Louis Napoleon in 1851, supported not only industrial, commercial and banking oligarchies, but also colonial expansion. The commercial treaty of 1860, between Great Britain and France liberalized the exchange of agricultural products and manufactured goods, and lowered taxes and customs duties. The level of economic liberalism, globalization and international trade was greater in the last part of the 19th century than at any time prior to the end of the 20th century (Pierre, 2002).

Political turmoil during the 20th century led increasingly to arguments regarding the superiority of the socialist system to the capitalist system of economic production. This eventually led to nationalization of many corporations in European countries, including banks, railroads, airlines, telecommunications, electricity, gas, etc. By the mid 1950s major portions of the economies of European countries were controlled directly or indirectly by the State, thus the question of corporate governance did not arise, because the State directly controlled most enterprises of any significance. This was not the case in the United States

[4] As demonstrated by recent financial crises and government bailouts.

where the State did not own or directly control business enterprises, thus the system of corporate governance evolved in quite a different manner.

2.2 The Development of Corporate Governance in the United States

In the early days of the American republic, corporations were individually and specifically created through state legislative action. The chartering of corporations by the states declined during the 19th century because corporate laws were focused on protecting the public interest, and not on the interests of shareholders. Corporate charters were closely regulated by state legislatures. Forming a corporation required an act of the legislature. Investors were given a voice in corporate governance, and corporations were required to confine themselves to the activities specified in their charters. As a consequence, many business enterprises in the 19th century avoided the corporate form entirely (e.g. Andrew Carnegie created United States Steel as a limited partnership, and John D. Rockefeller set up Standard Oil as a trust). Eventually, state governments realized that they could profit by providing more permissive corporation laws. New Jersey was the first state to adopt a corporate law which had the specific purpose of attracting more businesses to incorporate in that state. Delaware soon followed and became known as the most corporation-friendly state in the country (Moye, 2004). See Table 1 for an outline of the key historical developments in corporate governance in the United States.

*****Insert Table 1*****

Beyond the corporate law, there was another type of corporate governance in the United States which took the form of laws against the formation of interlocking corporate ownership (anti-trust), laws against restraints of trade (anti-monopoly), and regulations regarding the production of food and medicine, as well as price controls in industries like telecommunications, electricity and gas production, water, urban railroads, urban lighting, interstate railroads and shipping (Cooke, 1950). By the mid 1950s, many aspects of the US economy were regulated by the federal or state governments through commissions and boards which established prices either according to a fixed rate of allowable return on capital or by a capping mechanism. This system essentially fell apart in the 1980s, when a worldwide trend towards neo-liberalism, fostered in part by the political strategies of Margaret Thatcher in the Great Britain and Ronald Reagan in the United States, led to deregulation in many industries.

This deregulation trend continued through the 1990s and 2000s. Many of the formerly regulated industries in the United States (e.g. banking, electricity, airlines, and telecommunications) were deregulated. Many commentators have argued that the process of deregulation has led to the recent financial crises and that a reconsideration of the deregulation trend is very much needed.

At the same time it must be recognized that State intervention has often proven to be inadequate to protect citizens and stakeholders in a globalized economic environment. Traditional forms of corporate governance, largely dependent on ideas of shareholder democracy have been powerless to meet public demands regarding financial stability, taxation, employment, health and worker safety, product safety, environmental protection, anti-trust law, immigration, unfair tariffs, etc., all of which must be addressed by authorities of the State charged with governing and controlling corporations. The laws pertaining to corporate governance have evolved over the last two hundred years in response to historical and economic events, and for the most part these laws have focused on abuses of corporate power and fraudulent acts. Consequently, the corporate law is inadequate to address the control of corporate activity in an era of globalized capital markets and transnational corporate enterprises. While shareholders may be entitled to certain voting rights by law, the laws of corporate governance do not give adequate power to shareholders to control corporate activity, unless the shareholders own sufficient shares to dictate their wishes.

Furthermore, the interests of shareholders do not necessarily coincide with the interests of other stakeholders such as creditors, employees, customers, and society generally. Shareholders would normally like to see increasing share prices, while employees want to retain their jobs. Consequently, there is an inherent conflict among the different stakeholders which the laws of corporate governance do not address. Employment laws are outside of the laws of corporate governance. Likewise, if the majority of the population of a country believes that certain types of corporate activity are not desirable (e.g. sale of genetically modified crops; arms manufacture; cigarette production; etc.) the laws pertaining to corporate governance do not address these issues. Consequently, while there may be an effort by the State to control corporate activities, the laws of corporate governance are not part of this control mechanism. This leads to a social problem in which the objectives and purposes of corporate governance are confused. While the laws of corporate governance concentrate on shareholders and their interest, there is a significant amount of surveillance of corporate

activity by the State which does not fall under the definition of corporate governance. Moreover, the existing scope of corporate governance is viewed by some members of civil society as insufficient. Non-governmental organizations argue for greater legislation to govern and control corporate activity.

Thus, it can bee seen that the concept of corporate governance is ambiguous because the laws pertaining to corporate governance often espouse a neo-liberal orientation focused on shareholder democracy, while the general laws seek to restrain the ability of corporations to pursue profit making activities. The general laws are derived from democratic processes, but equally are the laws pertaining to corporate governance. Consequently, there is a sort of schizophrenia among the citizens of advanced capitalist countries in that the citizens may sometimes want market oriented solutions to problems, while at other times they may want to place restrictions on what corporations are permitted to do. Thus, the topic of corporate governance is a sort of balancing act among conflicting perspectives relating to legitimacy, performance and ideology in which the role of the State becomes increasingly important.

To summarize the discussion of section with respect to the historical and necessary role of the State in systems of corporate governance, Figure 2 shows how the laws which seek to govern corporations are effectively form a set of concentric circles in which the formal type of Corporate Law, which many researchers consider to be the totality of corporate governance, is merely one component of the set. In the next section, we will discuss several theories of corporate governance that are prevalent in the academic literature and link these theories back to the ideas of legitimacy, performance and ideology.

*****Insert Figure 2*****

3. CONTRASTING THEORIES OF CORPORATE GOVERNANCE

According to Charreaux (2004), the various theories of corporate governance can be divided into those which focus on "disciplinary" aspects of governance versus those which focus on "cognitive" aspects. In the disciplinary area there are those which focus on shareholders and those which focus on stakeholders.

3.1 The Shareholder Disciplinary Model

The primary theory of corporate governance which underpins most academic research at present, at least in finance, economics and accounting, is the disciplinary shareholder model pursuant to which the purpose of corporate governance is to discipline corporate managers so that their interests are congruent with those of shareholders (Shleifer and Vishny, 1997). This model was defined in the United States by Jensen and Meckling (1976). The primary assumption underlying this model is that shareholders are the residual owners of the enterprise, and as owners, their legal rights are determined by the principles governing the possession, use and transfer of private property. The shareholder disciplinary model, and the legal principles upon which it is based, have led to the conclusion that the primary responsibility of corporate managers to protect the interests of shareholders.

Research relying on the shareholder disciplinary model has focused on the structure of boards of directors, the rights of shareholders, the control of executive compensation, and the audit of financial statements in order to prevent embezzlement and fraudulent behavior both on the part of managers and employees of the enterprise. It is within this logic that the US Sarbanes-Oxley Act increased legal sanctions for misstatements of financial reports and reinforced the independence of both boards of directors and auditors. However, this law did not call into question the notion that a good system of corporate governance is one which guarantees the interests of the shareholders. In Europe, the concept of corporate governance is more recent because its origins are connected to the privatization of companies which were formerly owned or controlled directly by the State. Thus, the European concept of corporate governance integrates not only the idea of protecting the interests of shareholders, but also the manner in which companies are governed by the State.

3.2 The Disciplinary Partnership Model

According to many researchers, the concept of corporate governance should not be limited to relationships between managers and shareholders, but rather should take into account the range of strategic partners who are the source of value creation in an enterprise (Charreaux, 2004). These researchers propose a partnership model of corporate governance according to which there must be incentives for stakeholders to make investments of their time and money which will benefit the enterprise as a whole (Bessire and Meunier, 2005). Such an approach

is based on the assumption that a disciplinary partnership model will be more efficient than a shareholder model (Zingales, 2000). In other words, the compensation paid to employees and other stakeholders will be large enough to motivate stakeholders to increase the economic efficiency of the enterprise. In the United States such incentives have taken the form of bonuses and salaries tied to the performance of the enterprise, as well as other incentives such as paid health insurance and company funded retirement pension schemes. Share option grants have also been an important motivational device used in recent years. The purpose of these incentives is to place stakeholders in position which is congruent with the economic interests of the enterprise as a whole.

Paradoxically the partnership model has been more difficult to implement in European countries because of the existence of social welfare systems created by the laws many countries. Companies are mandated by law to provide paid health insurance, company funded retirement plans and relatively long vacations, thus foregoing the incentive aspect of such incentives. If every employee receives the same benefits there is no incentive to work towards a more efficient mode of operation. Thus, a partnership model cannot prevent the conflicts which often emerge between unsatisfied stakeholders. Ultimately, it is the role of the State to act as a mediator to protect the community as a whole. In a period of increasing globalisation, recipients of benefits are increasingly not in a position to demand a greater share of the economic results because the residual shareholders are able to transfer their investments to enterprises producing a greater return on investment. In this context, the challenge faced by the State is to govern enterprises in a situation where operations may be transferred to countries where labour costs are lower and social protections are weak or non-existent.

3.3. Socio-cognitive Approaches to Corporate Governance

Some researchers have gone beyond the disciplinary models of corporate governance, whether it be the shareholder or partnership model, in order to describe a model known as "socio-cognitive". This model is derived from idea like increasing the competences of all employees through training and reliance on new technologies (Bessiere and Meunier, 2005). Pursuant to this approach, protecting the interests of shareholders, or even addressing the interests of various stakeholders, are not sufficient to guarantee sustainable value creation. It is thus necessary to develop the type of knowledge creation which can create new sources of

investment, with a better coordination of productive capacity, and transferring knowledge acquired in order to solve conflicts of interests among recipients of benefits. This is done through training, knowledge creation and competence building (Charreaux, 2004).

The notion of sustainable value creation, which underlies socio-cognitive theory, focuses on a consideration of the enterprise as a body of knowledge and competencies (Dosi, 1994). A sustainable enterprise needs to be innovative and innovating (Lazonick and O' Sullivan, 2000). In effect, three conditions permit the emergence of innovative enterprises. These include: industrial conditions which favour competitive technologies; organisational strategies which foster cognitive development, and favourable institutional conditions with respect to labour legislation, finance and corporate law. These conditions depend on authorities of the State which are at the origin of the institutions charged with encouraging innovation. According to Charreaux (2004), the socio-cognitive model of corporate governance, centred on the concept of innovation, leads to a distribution of benefits in a manner different from that in the shareholder or partnership models since it privileges those who contribute most to new ideas and new processes. It also leads to a re-analysis of the structures of corporate governance so as to encourage organisational development. Within this logic, the board of directors would include representatives from of all the parts of the enterprise that are likely to create value. Finally, the State would create institutions to facilitate the process of training, knowledge creation and development. While the socio-cognitive approach may be intended to lead to innovation and more sustainable companies, it does not merely constitute a prescriptive and normative theory; it can be a pragmatic approach to corporate governance reconciling the conflicting claims of legitimacy, performance and ideology.

4. CORPORATE GOVERNANCE AND FINANCIAL CRISES

The tensions between legitimacy, performance and ideology are reflected clearly in the three theoretical models of corporate governance discussed above (see Figure 1). In this respect, it remains the necessary and important role of the State to mediate between conflicting models and conflicting theories of corporate governance. Moreover, as was discussed previously, this mediating role of the State has been present throughout the history of business enterprise. Indeed, what now appears to be happening is that the State is reasserting its role with respect to the corporate governance in the face of a significant worldwide financial crisis. The

current crisis reinforces the need for corporate governance by the State. Given that the risk to social stability it is important re-assert the scrutiny and regulation that that has been regularly applied by the State. Without a background of social stability the collectively will suffer. The question, however, is not how to choose between State control and deregulation, but how to identify the points where control is to be appropriately applied, such as in the socio-cognitive model (Williams, 2008).

There is however, a deeper moral issue. Business enterprises are sometimes viewed as if they were individuals, with purposes and strategies, deliberating reasonably about how to achieve objectives. Business enterprises are in fact social constructions. They are sets of practices, habits, and agreements which have arisen through a mixture of choice and chance. This leads to errors in understanding the concepts of corporate governance, leading to the idea that market forces will eventually lead to the common good and that the market will respond to excesses by a through a sort of equilibrium process. The concept of best practices leads to the idea of exhorting business enterprises to acquire public responsibility and moral vision. This idea loses sight of the fact that the market is not an individual consciousness, but rather that is an aggregation of activities carried on by persons who make decisions about priorities. Business enterprises are not philanthropic; seeking a profit is a sanctioned activity. It is also true that reducing regulation and surveillance by the State in order to allow entrepreneurs and innovators to create wealth is necessary in order to draw whole populations out of poverty. However, it is simplistic to say that the neo-liberal view of corporate governance will secure stable and just outcomes everywhere. Thus, the historical and necessary role of the State in the system of corporate governance is to assure stability and to enhance the probability of just outcomes for the greatest number of people (Williams, 2008).

CONCLUSION

In this article we have addressed the issue whether corporate governance is primarily a matter of “legitimacy”, that is, the legitimacy of the business enterprise from a legal perspective, but also the legitimacy of the State which seeks to control transnational corporations in an increasingly globalized environment (a democratic perspective). Alternatively, corporate governance may be considered from the perspective of corporate finance and financial economics as being primarily a matter of the “performance” of the business enterprise in the

face of increasingly competitive capital markets (a neo-liberal perspective). Finally, corporate governance may be seen to be primarily a matter of "ideology", in which the perception of good governance pursuant to codes of best practices masks a more problematic set of underlying political issues (a critical perspective). We have investigated these three perspectives through an analysis of the historical and necessary role of the State in promoting an effective system of corporate governance both from an ideological and a legitimacy perspective. In essence, the role of the State is to reconcile conflicting perspectives in order to promote an effective system of corporate governance. While the advocates of financial economics argue that the role of corporate governance should be focused solely on performance, it appears that this is actually less important in terms of the role of the State which, of necessity, must arbitrate between conflicting perspectives.

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Table 1 : Key Points in the Evolution of Corporate Governance in the United States

1632- *Massachusetts Bay Company* is chartered by King Charles I.
1732- *New London Society for Trade and Commerce in Connecticut* was the first profit-seeking corporation organized under a state legislative charter.
1811- New York passed the first law allowing incorporation of manufacturing companies.
1819- United States Supreme Court in *Dartmouth v. Woodward* that a corporation is an artificial being, invisible, intangible and existing only in the contemplation of the law, thus restricting the right to form corporations to the legislatures.
1830- New Jersey granted a monopoly to the *Camden and Amboy Railroad Company* to provide railroads in certain areas.
1830-1880- Corporations in most states could only be formed by law passed by the state legislature and only for a specific purpose.
1886- In *Santa Clara County v. Southern Pacific Railroad* defined corporations as "persons" with legal rights.
1888- *New Jersey Holding Company* act allowed corporations to acquire other companies.
1889- New York brings anti-trust actions against the Sugar Trust.
1890- The Federal *Sherman Anti-Trust Act* allowed the federal government to break up trusts.
1892- *New Jersey Corporation Trust Company* was formed to create hundreds of other corporations. This allowed holding companies to exist despite the Sherman Anti-Trust Act and established legal rights of corporations.
1899- Delaware enacts laws favoring corporations and establishing legal rights similar to those of New Jersey. By the 1920s, Delaware won the "race to the bottom" in favor of corporations.
1911- Federal government breaks up the *Standard Oil Trust*.
1933- US Federal *Securities Act of 1933* requires registration of securities that are traded in public stock markets.
1934- US Federal *Securities Exchange Act of 1934* causes the creation of the Securities Exchange Commission (SEC) and requires annual audited financial statements to be issued to shareholders. Audits must be made by independent accountants (i.e. Certified Public Accountants).
1938- Creation of the *Committee on Accounting Procedure* (CAP) of the *American Institute of Certified Public Accountants*. CAP is designated by the SEC as the accounting standards setting body for the United States.
1959- The AICPA creates the *Accounting Principles Board* (APB) to replace the CAP as the accounting standards setter for the US.
1973- The *Financial Accounting Standards Board* (FASB) is created to replace the APB as the accounting standards setter for the US.
2002- Sarbanes-Oxley Act requires a majority of independent directors and appointment of the auditor by an audit committee of the board consisting solely of independent directors. Prior to this law, there was no legal requirement for independent directors.

Figure 1 : The Dialectical Tension between Concepts of Corporate Governance

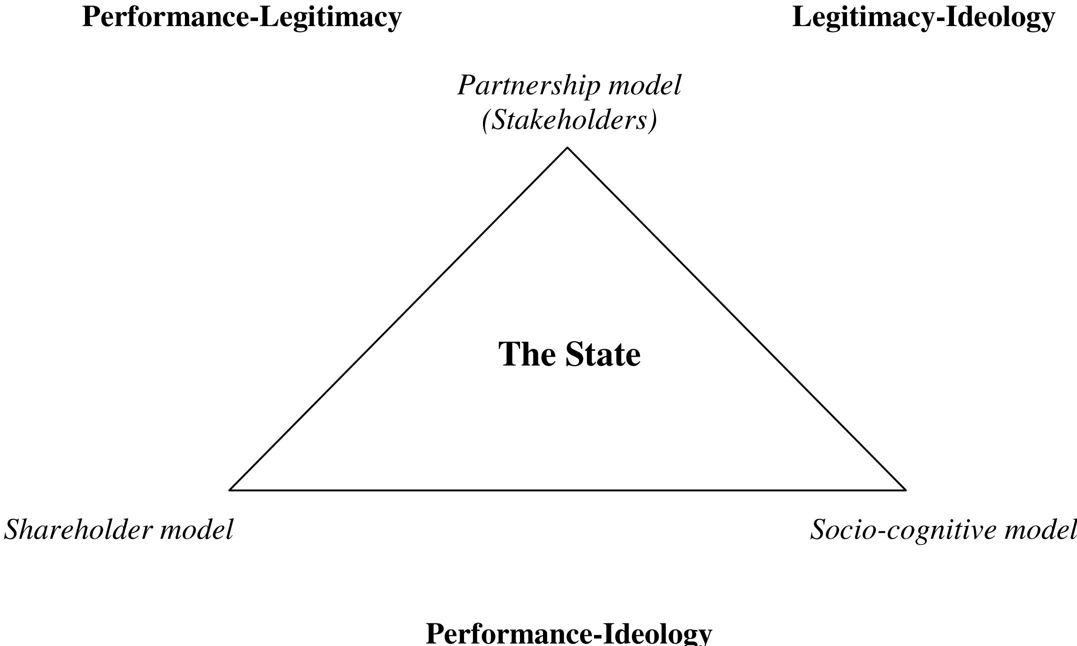

Figure 2 : Corporate Governance as a Set of Concentric Circles