The present chapter is organized in two sections. The Section - A attempts to provide a comprehensive understanding of corporate governance by placing various issues that are central to it in the literature of social, management sciences and law. The Section - B aim to assay developments in the field of corporate governance. This explains various stylized models, systems and structures, regulatory measures in the international arena and most importantly contemporary developments in global corporate governance practices. Together, this chapter highlights conceptual issues in corporate governance practice and comparative systems of corporate governance in developed, developing economics of the world. The present chapter also focuses on growing integration of world economics and tries to examine whether this results in convergence or divergence of corporate governance systems worldwide through the lens of political economy perspective.

SECTION – A

Corporate governance has succeeded in attracting a good deal of public interest because of its apparent importance for the economic health of corporations in particular and society in general. However, the concept has poorly defined primarily because it potentially covers a large number of distant economic phenomenon. Hence, given the variety of perspectives and models of corporate governance, different scholars, practitioners have come up with different definitions that essentially reflect their special interest in the field. Moreover it is not surprising that there exist many definitions of corporate governance. Some have a narrow, operational focus and equate corporate governance with working of board of directors, for ensuring accountability of senior management. Similarly, broad definitions of corporate
governance cover the entire network of formal and informal relations in the corporate economy and their consequences for society in general. Thus, the presence of several contending definitions in the field of corporate governance, where in some tends to be narrow and some much broader, an appropriate way for any researcher to define the concept is perhaps to list a few of different definitions (rather than mentioning one) that could possibly enhance or comprehend the concept in a befitting manner.

2.1 Definitions

Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporations, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decision on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance (OECD, 1999).

Cadbury committee (1992) defined corporate governance as a system by which companies are directed and controlled. It is an encompassing system (not individual parts) that envisages the direction by board of directors and control exercised by shareholders of the business corporation.

A notable point with regard to the above mentioned definition is that the former is in consistent with later. To be precise, Cadbury Committee definition of corporate governance has been incorporated in the OECD code on corporate governance for more meaningful explanation.

The World Bank (1999) states that from a corporate perspective, corporate governance is about maximizing value subject to meeting the company’s financial, legal and contractual obligations. From public perspective, corporate governance is about nurturing an enterprise while ensuring accountability in the exercise of power and patronage by firms. The bank’s framework states further that the role of public policy is to provide firms with the incentives and discipline to minimize the divergence between private and social returns and to protect the interests of stake holders.

According to Marry O Sullivan (2000) corporate governance is a system comprising social institutions that influence the process of strategic investment in corporates which revolves
around three major decisions viz. what type of investments or resource allocations are made, who controls this decision and how returns from successful investments are distributed.

Daily et.al, (2003) defines corporate governance as the determination of the broad uses to which organizational resources will be deployed and the resolution of conflicts among the myriad participants in corporate organizations.

Deakin and Huges (1997) states that at a fundamental level, corporate governance is concerned with the relationship between internal governance mechanisms of corporations and society’s conception of the scope of corporate accountability. It is a system that directs how internal procedures can be adapted to a wider social purpose.

Another notable definition by Sundaram & Bradly (2004) contends that corporate governance refers to the top management process that manages and mediates value creation for, and value transference among, various corporate claimants (including the society – at – large), in a context that simultaneously ensure accountability towards these claimants.

According to Blair (1995) corporate governance implicates” the whole set of legal, cultural and institutional arrangements that determine what publicly traded corporations can do, who controls them, how that control is exercised, and how the risks and returns from the activities they undertake are allocated.

These above said definitions reflect a mature, holistic and wider conception of corporate governance. Corporate governance is thus comprised of systems and procedures which ensure the efficient functioning of the firm in a transparent manner for the benefit of all the stakeholders and being accountable to them. Allen (1992) viewed that these definitions essentially envisage social entity model of the corporation that underscores the role of business corporations while holding them accountable to the large society.

However, in sharp contrast to the above definitions that set forth the big picture, stand some focused definitions which are based on property or contractarian conception (Allen, 1992) that rooted in the principal – agent model of corporate governance.

Shleifer and Vishny (1997) states that corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. They argued that how do the suppliers of finance get managers to return some of the profits
to them? How do they make sure that managers do not steal the capital they supply? And how do suppliers of finance control managers?

Another key definition by Oliver Hart (1995) defines that corporate governance is the sum of process by which investors attempt to minimize the transaction and agency cost of doing business which a firm.

According to Mathiesen (2002) corporate governance is a field in economics that investigates how to secure / motivate efficient management of corporations by the use of incentive mechanisms, such as contracts, organizational designs and legislation. This is often limited to the question of improving financial performance, for example, how the corporate owners can secure and motivate that the corporate managers will deliver a competitive state of returns.

Thus one can understand complex magnitude, scale and scope of corporate governance from the foregoing definitions. The inherent complexities of phenomenon pose difficulties for arriving at all encompassing definition of corporate governance. It is primarily because some commentators take too narrow a view and say it is the fancy term for the way in which directors, auditors and management handle their responsibilities towards shareholders. Others use the expression as if it were synonymous with shareholder democracy. Thus corporate governance is a topic recently conceived, as yet ill-defined and consequently blurred at the edges. The corporate governance is a subject, as an objective or as a regime to be followed for the good of shareholders, employees, customers, suppliers, community indeed for the reputation and standing of the nation and its economy.

2.2 Corporate Governance System

The corporate governance framework within which organizations operate fundamentally concerned with two key questions – whom should organizations serve and how should the direction and purpose of an organization determined? The corporate governance framework relates not only to the powers of key participants but also the process of supervising executive decisions and action and issues of accountability. The framework primarily intends to acknowledge and realize the expectations of shareholders through or appropriate mechanism of internal control by the board of directors. This is illustrated in the following diagram.
2.2.1 Shareholders

Shareholders are often referred to as the owners of the corporation, but the corporation's legal personality raises questions about whether it can be owned in any meaningful and effective way. However, as the owner of a corporation, shareholder 'owns' a certificate representing entitlement to a proportional share of corporation. In reality, the only thing that shareholder has is the stock certificate that entitles him to particular rights and obligations that are set by the laws of the land. The rights of shareholder are classically defined as (i) right to sell the stock, (ii) the right to bring suit for damages if the corporation's directors or managers fail to meet their obligations, (iv) the right to seek certain information from the company and (v) certain residual rights following company's liquidation once creditors and other claimants paid off.
The relationship between shareholders and board of directors is central to the corporate governance framework. As a result of dispersed ownership, relatively small holding the shareholders could not exercise control over management and unable to incur excessive costs for monitoring the self-dealings and appropriation of managers. So, the elected representatives of shareholder i.e. board of directors are expected to assume these fiduciary duties on behalf of real owners of the corporations. Thus shareholders delegate responsibilities as owners of the company to the directors who are responsible for corporate strategy, operations and supervision. According to Raju (2004), Shareholders always expect board of directors to safeguard their interests and create value for their investments.

The relationship between shareholders and executive management is crucial and most sensitive one in the corporate governance framework. Shareholders provide financial investments, and in return, management is responsible for running the company well and delivering timely and accurate financial reports. As suppliers of finance, the shareholders provides capital and obtain certain residual control rights i.e. right to make decisions in critical circumstances like bankruptcy, financial wrongdoings (Grossman and Hart, 1986). Likewise, shareholders along with board are expected to provide oversight over management. Shareholders as owners of the company oversee director’s report, annual accounts and approve nominations for directors at the annual general meetings. Shareholders consent is necessary for mergers and all crucial matters of importance regarding a company’s functioning (Marchi Raju, 2004).

2.2.2 Board of Directors

The board of directors of a company is the center of corporate governance framework. The role and responsibilities have been addressed significantly in several reports and codes of corporate governance. The Board controls, monitor managerial competence, approve resource allocation, decide business policy issues and facilitate development, implement and monitor corporate strategy. Board of directors are entrusted with several responsibilities, where in some of them are entitled by law and some are guaranteed by codes and regulations.

Usually, the board of directors delegates to the top management of the company, and through them to other senior management. The directors assume responsibilities and monitor executive management on behalf of shareholders.
The board of directors selects and plans the succession of chairman or chief executive officer. Board also appoints or approves other members of the senior management. Alongside, board of directors also ensures the integrity of corporations accounting and financial systems (OECD, 1999). The board of directors should maintain an attitude of constructive scepticism and act with integrity and demonstrate commitment to the corporation.

The board of directors understands and review annual operating plans and budgets, review management plans and approve significant corporate actions. In a nutshell board of directors performs all key and strategic functions and tries to balance the power of management, while ensuring accountability and transparency in corporate governance practices.

The corporate boards are charged with the task of approving strategy and budgets and the task of setting compensation. The board is also typically responsible for answering that the firm acts in a legal and socially responsible manner (Sundaram et.al, 2004). The corporate boards generally composed of executive directors (who are members of the managements team); and non-executive directors, who are outsiders. These non – executive directors are often nominee directors (Promoters, institutional investors, banks) or Independent directors. Alongside, boards are organized into various committees like audit committee, remuneration committee, nomination committee, shareholders grievance committee etc. that carry certain key functions.

The relationship between board and shareholders assumes significance in the contemporary corporate governance framework. There have been a number of attempts to reforms the boards so that directors are more accountable to shareholders, who actually elected them. Generally boards of directors are individually responsible to the shareholders (in letter) and entitled with duties that safeguard the interests of owners, who cannot involve in day to day management of business. However, the link between shareholders and board of directors received far less scrutiny than other relationship in the corporate governance framework. This is mainly because, directors are not clearly aware of what shareholders expect and they are in a way distant from shareholders that forbid them to make informed choices to safeguard owners interests. Thus there is an apparent missing link in the relationship between board and shareholder because board is unclear about the preferences of shareholders and shareholders have little say about who represent them. Hence, in the context of prevailing missing link in governance framework a director’s allegiance shifts from shareholders to the nearby board room where fellow directors and management fill the void (Montgomery and
Rhonda, 2003). This movement skews the above governance triangle, move directors closer to management, and sets the stage for cordial, consensus – driven environment for which boards are widely criticized.

The relationship between board and top management is based on information flow to directors and strategic supervision, planning provided by board to management. This relation has been severely criticized and the bone of contention for contemporary corporate governance regulations. The apathy, passive role of board of directors in checking management actions has led to high profile financial scandals and scams.

Thus, in principle, the board has an important role to play, but there are some reasons to doubt its effectiveness in practice. Notably, most of these questions are raised against the efficiency of non-executive directors. It widely believed that in academic literature that outside directors play a larger role in monitoring management than inside directors. Fama (1980), for instance argues that the inclusion of outside directors as professional referees enhance the viability of the board in achieving low – cost internal transfer of control. This also lowers the probability of top management colluding and expropriating shareholders. Outside directors are usually respected leaders from business and academic communities and have incentives to protect and develop their reputation as experts in decision control (Fama and Jensen, 1983).

However, some scholars expressed that the non-executive directors may not do an efficient job of monitoring for several reasons. Hart (1995) opined that they may not have significant financial interest in the company, and they may therefore have little to gain personally from improvements in company performance. Second, non-executive directors are busy people (they may themselves be chief executives or sit on many company boards) and probably have little time to think about the company affairs, or to collect information about the company (Shleifer and Vishny, 1997). Finally, non executives may owe their positions to management, who proposed them as directors in the first place. As well as feeling loyal to management, they may want to stay in managements good graces, so that they can be related and continue to collect their fees.

2.2.3 Top Management

Top – Management is a catch – phase for those who work at the apex, and companies often define their ‘top’ as no more than seven or eight most senior officers. Interestingly, much of
the world beyond the company halls and capital markets, however top management is
personified almost solely by chairman or chief executive. The readers of world’s business
press know that Jack Welsh runs GE, Michael Eisner rules Walt Disney Company, Warren
Buffet is Berkshire Hathaway; Fujio cho drives Toyota, Jurgen Schrempp steers Daimler
Chrysler, Microsoft by Bill Gates and LN Mittal sets the tone for LN Group etc. Davis and
Useem, (2004) noted that the academic research too, had long been drawn to the same
pinnacle of the pyramid, partly on the conceptual premise that the chief executive is the
manager who matters, and partly on the pragmatic ground that little is publicly known about
except CEO or chairman.

There conceptual and pragmatic underpinnings for shining the light solely on CEO however
have eroded in-recent years as companies redefined their operations and researchers re-
convinced their methods. The academic research expanded the field of view from chief
executive to the entire upper echelon that consists of top management of the firms. Thus these
corporate leverage populations in corporate leverage positions have become central tenets of
corporate governance framework. Now, let’s examine the role and responsibilities of top
management that runs the corporations day to day business operations.

First and foremost responsibility of CEO and Top management is to direct and operate the
corporation in an effective and ethical manner. They are primarily accountable to
stockholders, who actually delegated control to them over day – day management of
business. So, they should inform shareholders and other stakeholders periodically about key
strategic decisions or how the resources provided by stakeholders have put into efficient use.

The top management team generally takes lead in strategic planning. They identify and
develop strategic, annual operating plans and budgets. They should identify risks in the
product, capital, labour market and plan appropriate ways to manage overall risk profile of
the corporation. Finally, the top management is responsible for the integrity of corporation’s
financial reporting systems. It is in all senses, the responsibility of management to produce
financial statements that fairly present the corporation’s financial condition and thus permit
investors to understand the business and financial soundness and risks of the corporation. The
top-management thus, plays a significant role in mediating or go-between company and
board of directors, company and shareholders.

The role of top management has been widely criticized in the classical and contemporary
corporate governance literature primarily because of the equivocal relationship between
shareholders and top management. The shareholders provide capital to the firms, delegated decision making to management and expect good returns for the capital they supplied. They are unable to exercise real control due to diverse nature, relatively small proportion of holdings and excessive monitoring costs. These factors by and large bestow management with unchecked control that some time act as an incentive to steal owners money, strip corporations assets and indulge in financial irregularities. The shareholders are always uniformed, unable to understand the magnitude of certain strategic choices and financial reporting procedures even if informed that further adds to their apathy and passive role in determining corporate decisions. Though shareholders, on paper, elect boards to monitor top-management but presented with a fait accompli because boards join with management more often and erode shareholders interests.

The above analysis adds to one’s confusion and questions the credibility of corporate governance framework. A point to bear in mind that the foregoing analysis reflects classical agency problem between shareholders and managers as principals and agents. The contemporary corporate governance literature and regulations essentially aims at solving these issues of ownership and control so that interests of owners and managers can be aligned in one way or other. As Ward., (1997) illustrated that the growing regulations to protect shareholders and activism by institutional investors, mutual funds etc. have relatively controlled the excessive management discretion and attempted to regain some influence that owners had over their firms in the yester years.

Thus, it is clear from the forgoing analysis that balance of power in corporate governance is delicate one and it relies on three critical anchors – shareholders, management and the board of directors. Each of this has important responsibilities of its own, but their interactions are effective corporate governance framework. When they work together as a system, they provide powerful set of checks and balances. But when pieces of the system are missing or not functioning well, the system as a whole can be dangerously unbalanced.

Thus, the above analysis of corporate governance clearly highlights the ensemble nature of this complex phenomenon. The corporate governance is an all-encompassing system with several complementary subsystems such as decision systems, remuneration systems, ownership structure etc. These subsystems or incentive mechanisms primarily acts as internal controls, that enhance efficiency of various actors in the system on the hard, God contributes to the overall effectively of corporate governance structure. These subsystems
notably acts as balancing mechanisms, checks the misuse of power, limits the control exercised by different participants in corporate governance system. For instance, incentive based compensation align the interests of owners and managers, representation of investors on company board monitor the management actions, market for corporate control regulate managers behaviour etc. However, much detailed analysis of internal and external mechanisms would be resorted in the following section.

2.3 External and Internal Mechanisms of Corporate Governance

There are five major elements of the external environment of corporate governance: capital markets, product market, labour market, market for corporate control and regulatory environment.

External capital markets – both equity and debt markets – exercise sizable control over firm both because of the fact that firms have to subject themselves to its scrutiny whenever they wish to raise external funds. The capital markets notably, determine the structure of ownership of the firms, either debit or equity, dispersed or concentrated ownership. As Jensen (1986) argues that capital markets comprises of individual, institutional investors, stock exchanges and other regulatory agencies that exercise discipline over the firm policy with regard to leverage and dividend payments.

The capital markets shape the ownership structure of the firm there by influence several sub systems of the corporate governance system that mentioned above. The concentrated equity ownership by institutional investors, pension funds, insurance companies, banks or large individual owners enable them to monitor and control the management, thereby perhaps contributes to corporate performance and represent their interests effectively (Shleifer and Vishny, 1997). Thus, ownership structures that dominated by capital market players i.e. large block holders, institutional investors occupy key positions in the board and effectively monitor decision systems, incentive system, performance monitoring systems and often encourage market for corporate control i.e. other firms to takeover etc. The capital markets in the contemporary times, at least in advanced economics have become vibrant, dynamic and vigilant on firms, hence become an active external control mechanism of corporate governance.

The discipline imposed by product marks is obvious. In competitive economic systems, firms that cannot consistently produce cheaper, faster, better and innovative products that
consumer demands will not survive in the long run. Sundaram and Bradly, (2004) have noted that the competition will ensure only the fit to survive. The product markets comprises of both a firm’s market and market of other firms who have invested in that. For instance, if firms A is negatively performing in its product markets then firm B,C,D who invested in A (these firms can be institutional investors, pension funds also) cannot hold their investments in firm A for risk, because there firms too have their own product markets. Thus consequently there firms exert control over firm A or threaten to withdraw their investments in it. Shleifer and Vishny (1997) argued in this fashion and agree that product market competition is probably the most powerful force towards economic efficiency in the world. The intense competition in product market may reduce returns on capital because of excessive investments diverted to technological up-gradation, innovation, R&D and hence cut the amount the managers can possibly expropriate. Fama, (1980) also contended that along with product market, the labour markets especially that of managerial labour too ensure that managers from better performing firms will be rewarded and worse performing firms will be penalized in the market place.

The regulatory environment can be a strong source of external discipline. Quite apart from the plethora of laws at the state and national levels that controls or circumscribes a firms behaviour directly, regulators intervene in the activities of contemporary corporations through passage and application of numerous provisions relates to governance, accountability, protection of interests etc. The role of regulatory bodies have gained prominence due to number of corporate governance problems, frauds, financial scans, misappropriation of wealth by companies in the recent times. Many countries today have developed efficient regulations on corporate governance. The regulatory developments in corporate will be dealt in section B of present chapter.

The last but not the least is the market for corporate control, commonly referred as takeover mechanism. This is the most widely known external mechanism of governance. Especially in Anglo-American settings, because in other national contexts however an active take over market have yet to develop or still in infancy. This market ensures the under performers will get weeded out through acquisitions and acquiring firms extract higher value from these firms by putting them to more efficient uses (Sundaram and Bradley, 2004). The active market for corporate control ensures that such a threat of takeovers will always be present. The existence of such a threat is sufficient to ensure its disciplinary governance role of the top-management.
A great deal of theory and evidence supports the idea that takeovers address governance problems and acts as an efficient mechanism of corporate governance (Manne, 1965), (Jensen, 1988)). The most important point is that takeovers typically increase the combined value of the target and acquiring firm indicating profits are expected to increase afterwards (Jensen and Ruback, 1983). Moreover takeover targets are often poorly performing firms (Palepu, 1985) and their managers are removed once the takeover succeeds. Takeovers, thus, are widely interpreted as the critical corporate governance mechanism in the US & UK, where large shareholders are less common, thus hostile takeovers has emerged as particulars mechanism for consolidation of ownership, without which managerial discretion cannot be effectively controlled (Jensen and Ruback (1983), Mayers, (1990), Easterbrook and Fischel (1991))

In this connection, a poorly run corporation will suffer a low stock market valuation, which creates an opportunity for outsiders with better management to buy the firms through a tender offer to the dispersed shareholders of the targeted firms. If shareholders accept this offer, acquires control of the target firm and solar replace or at last control, the management (Manne, 1965). Takeovers can thus be viewed as rapid – fire mechanisms for corporate control.

There are also, numerous internal mechanisms of corporate governance, but I will only focus on five of the more immediate and important ones. They are (1) structure and role of the board of directors, (2) role of top management (3) nature of compensation systems (4) nature of employment practices and (5) nature of internal control systems and incentive systems in place to measure and reward performance of employees of the firm.

The role of boards in the corporate governance process is central, as we have already noted. The board of directors are generally elected by shareholders to monitors top management and ratifies major decisions of the company. Precisely, they act on behalf of the shareholders; in extreme cases the board may replace the company’s chief executive and other members of the management team (Hart, 1995).

The corporate boards are charged with the task of approving strategy and budgets and the task of setting compensation. The board is also typically responsible for answering that the firm acts in a legal and socially responsible manner (Sundaram, Bradley, Chipani and Walsh, 2004). The corporate boards generally composed of executive directors (who are members of the managements team); and non-executive directors, who are outsiders. These non –
executive directors are often nominee directors (Promoters, institutional investors, banks) or Independent directors. Alongside, boards are organized into various committees like audit committee, remuneration committee, nomination committee, shareholders grievance committee etc. that carry certain key functions.

In principle, the board has an important role to play, but there are some reasons to doubt its effectiveness in practice. Notably, most of these questions are raised against the efficiency of non-executive directors. It widely believed that in academic literature that outside directors play a larger role in monitoring management than inside directors. Fama (1980), for instance argues that the inclusion of outside directors as professional referees enhance the viability of the board in achieving low – cost internal transfer of control. This also lowers the probability of top management colluding and expropriating shareholders. Outside directors are usually respected leaders from business and academic communities and have incentives to protect and develop their reputation as experts in decision control (Fama and Jensen, 1983).

However, some scholars expressed that the non-executive directors may not do an efficient job of monitoring for several reasons. First, they may not have significant financial interest in the company, and they may therefore have little to gain personally from improvements in company performance (Hart, 1995). Second, non-executive directors are busy people (they may themselves be chief executives or sit on many company boards) and probably have little time to think about the company affairs, or to collect information about the company (Shleifer and Vishny, 1997). Finally, non-executives may owe their positions to management, who proposed them as directors in the first place. As well as feeling loyal to management, they may want to stay in managements good graces, so that they can be related and continue to collect their fees.

Another internal mechanism in corporate governance: the CEO and top management. The role of this corporate leveraged population in corporate leveraged position has been significantly highlighted in the preceding sub section in this present chapter (sec 2.4.3.). This anchor of corporate governance plays a significant role in mediating or go-between Company and board of directors, company and shareholders.

The compensation and control systems are internal mechanisms of corporate governance as they are responsible for aligning the reward (and punishment) systems to the goals of the firm. For instance, are managers paid with fixed salaries and bonus, or they also compensated with stocks and stock options? The later type of compensation would presumably better to
align the managers and shareholders interests if the stated goal of the firm is to create shareholder value (Sundaram et. al, 2004).

The final internal governance issue and perhaps the most important from standpoint of day to day operations of the firm, is the nature of employment practices. These mechanisms address certain typical questions: how are employees hired and promoted? How is their human capital built and retained? How long do they stay with the firm? Does firm have a relationship based contract with employees or provide a lifetime – employment guarantee, or does it hire and fire at will or deal with its employees on an arms-length?

It is clear from the foregoing analysis, that a good corporate governance system depends on how well checks and balances are placed in or efficiency of various internal and external mechanisms to regulate and control the corporate behaviour. Now, we shall move on to second section, that deals with recent developments in corporate governance regulations and codes of best practices, International stylized models of corporate governance and cross national convergence of regulations and models of governance.

SECTION B

2.4 International Codes and Regulations on Best Practices in Corporate Governance

Corporate governance codes and regulations proliferated in the 15 years since the Cadbury code of best practices came into effect in the United Kingdom. In the past five years alone, new codes have emerged in every G7 country except Japan. These governance reforms generally emanates from national governments, securities commissions, stock exchanges, investors and investor associations and other supra national organizations. To describe simply, there regulations embody their view of what good governance is all about. The Cadbury code, for instance, made 19 recommendations addressing the structure, independence and responsibilities of boards; effective internal financial controls and remuneration of directors and executives. As, it has mentioned earlier, regulation is an important mechanism in corporate governance and it significantly effect the why corporates
function is the economy. The following paragraphs describe various codes and regulations in corporate governance internationally in a chronological order.

The early regulations in corporate governance initiated in United Kingdom in the year of 1986. The first legislation, the financial services act came into being to effect and broaden the role of stock exchanges. In a year later US published Tread way commission report to essentially deal with fraudulent financial reporting. This report highlighted the need for a proper control environment, independent audit function to avoid misinterpretation of financial report.

The debate on corporate governance received a boost as a series of financial sandal's that unearthed in UK during late eighties and early nineties. Several corporations collapsed and this severely impacted economy and society as a whole. As a result the first organized response has initiated through Cadbury committee set up by London stock exchange that brought out the pioneering Cadbury code as a response to these series of scandals and corporate failures among UK listed companies (Ghosh, 2004).

2.4.1 Cadbury Committee on Financial Aspects of Corporate Governance (1992)

The Cadbury report made 19 recommendations, many of which attempted to address what were seen as recent failures in corporate governance, were board of directors had been dominated by top management and chief executives. The Cadbury committee recommended that boards of public quoted companies should have minimum of three non-executive directors, who should be independent of the company. In addition, Cadbury report recommended that companies should have an audit with minimum of three members, a nomination committee to recommend board appointments and a remuneration committee to recommend remuneration of executive directors. The membership in these key committees should be wholly or mainly non-executive directors (Wearing, 2005).

The Cadbury committee suggested certain important changes especially regarding separation of responsibilities between chairman of the board and chief executive of the company. It argued for clear division of two roles, so that no single individual can have unfettered powers of decision. However, the committee has made certain mandatory provisions specially with regarding to Director’s role and responsibilities in explaining and reporting on effectiveness of the company systems of internal controls that have become controversial subsequently.
Many of the recommendations of Cadbury Committee have been made mandatory by London stock exchange in 1992.

2.4.2 Kings Committee on Corporate Governance (1994)

In South Africa, which has some distracting features in terms of the styles of corporates governance, the main code on corporate governance was produced in 1994 by Mervyn King Committee. This Committee recommended for effective internal audit function, establishment of audit committee, observance of highest level of business and professional ethics and internationally accepted accounting standards. This committee has made several notable suggestion by keeping in view of social ethical, environment and cultural values attached to business in South Africa. Thus, as a matter of fact the committee also covered worker’s participation, affirmative action programmes and a code of ethics in its recommendations.

The development in corporate governance as a result of Cadbury committee report has significantly influenced several nations in Europe to design similar codes in their own economic context. As a result, French equivalent of the Cadbury report, the Vienot report was published in 1995, and its Dutch equivalent, the Peters report was published in 1996.

2.4.3 Greensbury Committee on Characters Remuneration (1995)

The Greensbury Committee was formed after widespread public concern over what were seen as excessive amounts of remuneration paid to directors of quoted companies and newly privatized companies in the United Kingdom. The committee noted that high risk compensation to corporate executives on the basis of performance and stock price has subsequently increased short-termism and led to staff reductions, pay restraint for other staff members (Greensbury, 1995). The Greensbury committee was keen to ensure that director’s remuneration was linked to performance, and the committee however did not seem to see a problem with high levels of pay per se, as long as they were justified on the basis of company’s financial result.

Greensbury committee notably addressed the problem of severance package to departing directors whose performance had not been noticeably successful, but who still managed to leave the company with generous compensation for loss of office. The Greensbury report developed many of its recommendations from the earlier Cadbury report. The committee
recommended for remuneration committee consisted of non-executive directors. These non-
executive directors should have no financial interest in the company.

2.4.4 Hampel Committee and the Combined code 1998.

In the United Kingdom, the early reports such as, Cadbury and Greensbury have intensified
corporate governance regulations and some of their recommendations generated excessive
debates. One such aspect is director’s responsibilities of reporting on the effectiveness of a
company’s system of internal controls. As a result of widespread criticism from various
industry circles, the reporting requirements of directors have restricted only to internal
financial controls as against the effectiveness of the company’s system of internal control
(Marchi Raju, 2004)

The Hampel committee was created in 1995 to review implementation of the findings of the
Cadbury and Greensbury committees. However, it took five years for the committee to
restate the original Cadbury recommendations on internal control reporting. This repot
extended the director’s responsibilities to “all relevant control objectives including business
risk assessment and minimizing the risk of fraud”. Most of the recommendation of the
committee were accepted and published by the London stock exchange as the combined code
principles of good governance and code of best practice.

The stipulations contained in combined code require among other things the board should
maintain sound systems of internal control to safeguard shareholders investment and the
company assets. The directors should at least, annually conduct a review of effectiveness of
the group systems of internal control and should report to shareholders regarding all controls,
including financial, operational and compliance controls and risk management (combined
code, 1999)

2.4.5 Turnbull Committee guidelines on corporate governance 1999

Turnball guidance published in 1999 extended the provisions set out by the combined code.
It stated that board of directors should confirm that there was an on-going process for
identifying, evaluating and managing the key business risks.

The report argued that one common denominator behind past failures in the corporate world
was the lack of effective risk management. It contends therefore that board of directors were
not only responsible but also needed guidance not just reviewing the effectiveness of internal
controls but also for providing assurance that all significant risks had been reviewed and effectively managed.

2.4.6 Higgs Review on Effectiveness of Independent Directors 2003

This committee had been commissioned by the UK government to review the role and effectiveness of non-executive directors, following financial scandals including Enron and WorldCom. Public confidence in non-executive directors had been eroded because most of non-executive and independent directors are recruited to company boards primarily due to their personal contacts. The Higgs review made a number of recommendations for the combined code to be revised, for instance enhancing the role of the senior independent director, detailing the role of the non-executive director and the duties of the nomination committee.

2.4.7 Sarbanes – Oxley Act 2002

This act is a radical piece of corporate legislation by the United States congress, regarded by many commentators as the single most important legislation since securities exchange act of 1934. In the USA, corporate crisis associated with high profile companies such as Enron, WorldCom, Global crossing, Tyco etc. seem to have hastened the introduction of the Sarbanes – Oxley legislation.

The Act introduces sweeping corporate law changes relating to financial reporting, internal controls, personal loans from companies to their directors, whistle blowing and destruction of documents. In addition, Sarbanes – Oxley restricts the range of additional services that an audit firm can provide to a client. There are increased penalties for directors and professionals who have conspired to commit fraud. Some examples follow of its provisions.

The Act requires that all periodic reports containing financial statements field with the securities exchange commission must be accompanied by a written statement by CEO of the company. The section 1102 of the act provides that knowing and willful destruction of any record or document with intent to impair an official proceeding carries fines or imprisonment up to 20 years.

The section 806 provides protection to for employees who provide evidence of fraud. The legislation also established a public company accounting oversight board (PCAOB) to be
responsible to the securities exchange regulation of auditing in US companies, inspection of accounting firms and disciplinary proceedings.

However, as a result of the Sarbanes – Oxley legislation, some companies felt that burden of compliance was too high in relation to the perceived benefits. The companies were reporting to spending millions of dollars revamping their internal controls, upgrading compliance regimes, writing codes of ethics, setting up hotlines for internal complaints, writing governance principles and board committee charters (Wearing, 2005).

The above mentioned codes and regulations vary in scope and details, but most tackle four fundamental issues of corporate governance. Fairness to all shareholders, whose rights must be upheld, accountability by the board and management, transparency or accurate and timely financial and non-financial reporting and responsibility for the interests of minority shareholders and other stakeholders and for abiding by the letter and spirit of law. Policy makers around the world increasingly argue that codes embodying these principles not only protect investors against fraud and poor stewardship but also may help to reduce corporates cost of capital.

The proliferation of codes and regulations may be attributed to two reasons. First, inherent flexibility of a code as opposed of a law and second, it is impossible to legislate on every aspect of corporate behaviour in a detailed way and statutory prescriptions may sometimes in appropriate for many governance issues. Some commentators are also apprehensive about the affectivity of codes because of apparent lack of enforcement and statutory validation to codes. However, despite of apparent lack of teeth, codes undoubtedly improved corporate governance practices in various countries. Codes has intensified broader policy debates about regulation of business, educated companies and very often prescribed best practices. Most importantly these codes were drafted by powerful institutional investors, stock exchanges and securities commissions often by national governments, whose importance thus cannot be undermined.

There are several ways through which codes can be made further effective. If codes are combined with mandatory disclosures, a practice known as “Comply or Explain” may leads to effective corporate governance practices. These requirements force companies to think carefully because any depart from code must be publicly justified. The Cadbury code, adopted by London stock exchange demanded that listed companies reveal in their annual accounts whether they were complying with it-and if not way.
Ultimately, corporate governance codes and laws most support each other. All countries have legal statutes covering important areas pertaining to business corporations. Corporate governance codes can encourage best practices in these statutes and also other areas that have not been sufficiently addressed in the laws. Moreover the boundary between laws and codes will shift over time and vary by country.

In spite of enormous success of corporate governance codes and regulations in promoting change some scholars have expressed that certain shortcomings and excessive developments might jeopardize the use of codes. The codes in the first place may leads to ‘Regulation Creep’ (Coombes and Wong, 2004). The regulators may tempted to broader their scope and add more provisions because codes generally improve corporate governance. For example in the UK, Highs review of 2003 recommended 82 provisions as against to 45 provisions in combined code of 1998 and 19 provisions in Cadbury code of 1992.

Secondly, the excessive emphasis in the contemporary times is on complying rather than explaining. The companies’ attempts to show why they have deviated from the code are dismissed without thought and comply or explain approach ultimately interpreted as ‘comply or breach’.

Finally, the progressive convergence of codes around the world might generate a tendency – ‘one size fits all’ among policy makers and practitioners. This might sometimes leads to unintended consequences. For instance, a blind forth adoption of best practices of corporate governance in developed countries by developing countries might not yield favourable results because many issues by the codes are not practically relevant of for them. The corporate governance codes thus, must first embody the prevailing conditions, issues rooted in one’s own country and culture.

2.5 Models of Corporate Governance: the Global Perspective.

An important ingredient in all corporate governance systems is monitoring of managerial activity by various elements of the system. Monitoring can be undertaken by the board of directors, individual shareholders, concentrated holdings of shares such as mutual funds and pension funds, bondholders, books or workers (Harper, 2000).

A nation’s system of corporate governance can be seen as an institutional matrix (North, 1990), that structures the relations among owners, boards, and top-managers, thus determine the goals pursued by the corporation. The nature of this institutional matrix is one of the
principle determinant of the corporate governance structure and economic vitality of a society (Davis and Useem, 2004).

There is a wealth of written literature on comparative corporate governance systems with the bulk of it focusing on four major economies – US, UK, Germany and Japan. The literature in all guises emphasized the prevailing systems in these economies and attempted to conceptualize the differences amongst on the basis of several factors that are internal to these individual economies. There systems are classified differently by different scholars: outsider and insider based (Mayers, 1994), market centric and bank based (Cohen, 2000), contractual and communitarian (Sundaram, Bradly, Chipani and Walsh, 2004), high-tension and networking (Charkam, 2000), Market based and blockholder (Becht, Bolton, Roell, 2002) and market based vs relationship based model (Marchi Raju, 2004). The first order in the above categorization refers to corporate governance models in US and UK, whereas second order refers to models prevailing in Germany and Japan. However recent literature on comparative corporate governance envisages another two relevant models prevailing in transitional economies (the newly privatized countries such as Russia and Middle East) and emerging economies (India, Hong Kong, Singapore and Malaysia). Thus, dyadic models are replaced with quadrilateral in the recent times. In the following sections an attempt is made to describe the governance quadrilateral and patterns of governance associated with each model.

2.5.1 Market centric governance model

This model also referred as out-sider model of corporate governance widely practiced in the US and UK. The model postulates classical separation between ownership and control. Since equity ownership is widely dispersed (Barle and Means, 1934) among large number of institutional investors and small shareholders, control thus vests with professional managers. This model also referred to as principal – agent model where shareholders, the principles entrust the management of firm to managers, the agents. The model envisages reducing the agency costs and mitigate classic agency problem that arises as a result of dispersed ownership. The model concerns to align the interests of shareholder and managers prima facie, so that managers can create value for shareholder’s investments.

The capital markets notably strong and liquid in market centric economies because of god investor protection norms. While relying on markets to provide the governance to corporations, this model also stresses on other monitoring arrangements, like incentives and disciplinary techniques designed to achieve strong managerial performance. The unique
aspect of the equity market in the market centered system is the widely held nature of securities and lack of significant inter-corporate, individual / family and bank holdings.

The compensation of management is tied to firms performance is essentially to align the interests of management and shareholders. The board of directors are fundamental to the control of corporations, charged with directing and managing the business of the corporation on behalf of the owners. The board of directors entrusted with the responsibilities like appointing and monitoring management, communicate with shareholders and other stakeholders, ensuring internal controls and management information systems to function effectively etc. In addition, the shareholders too, monitor management and board of directors. They vote for directors at annual meetings, express consent or descent on certain key strategic actions of management etc.

In addition to the monitoring activities of shareholders and board of directors, markets also provide a monitoring and, in some situations a disciplinary faction. The markets here include the securities market, market for corporate control, market for management services, product market. These markets however have devised their own techniques to alleviate corporate governance problems (Bhasa, 2004).

The market for corporate control is an important means to solve the principle – agent problems. In the prototypical case, poor management in a widely held company leads to low stock price. A potential acquirer believing that it can improve the performance of the either by removing management or generating economics of scale will either make a friendly bid for the equity of the firm or if incumbent management is not inclined to transaction make a hostile bid. Takeovers are quite common in this model, and takeover bids are frequently facilitated by the existence of one or more institutional shareholders who tender their shares to the bid and make it successful (Halpern, 2000).

Market for managerial labour is effective in these countries that threaten a poorly performing manager to find a new job. The ready managerial labour market helps in mitigating governance problems to a large extent. Ready supply of competent and qualified managers in the managerial markets acts as a stick for incumbent managers to perform well. Bad performance can be immediately replaced with the surfeit of talent available outside. Hence, the existence of managerial labour market helps in aligning the interests of manager with that of shareholder. Alongside, the product plays a typical role in this mode. If a firm operates
poorly relative to its competitor ultimately will find itself in financial distress and in the extreme bankrupt.

The underlying discussion of market based governance system is based on the assumption that the companies have widely held equity. The model has to be modified if there are concentrated holdings of equity and debt this possibility is considered in depth in the following section.

2.5.2 Relationship Based Governance Model.

This model of governance is characterized by concentrated stock ownership and illiquid capital markets. The shareholders of corporations under such a model are driven by long-term commitment and are in a position to monitor managerial action, thus avoiding the incurring of agency costs. Banks dominates the ownership shares by holding large amounts of equity in corporations. Banks are seen to be directly involved in the operations of the firms in terms of monitoring, decision making etc. Quite unlike market based model firm, where banks or the debt holders withdraw from corporations in crunch situations, in this model banks commit themselves to bailing out corporations that are having bad times. Hence, the governance model is largely understood to be relationship based model. The Japanese, French, German and Korean models are good examples of this governance model.

This model is primarily considered to be the most effective model of governance, despite being characterized by weak and illiquid capital markets. The relationship model is also beset with many problems. The dominance of banks in decision making process steals from the management its professional expertise and the corporation is managed as per the whims and fancies of a few financial analysts. However, since unlike the market based firms, there is no separation of ownership and control, thus problems of managerial expropriation of shareholders money do not arise in these firms. Instead, what is observed mostly is the conflict of interests among multiple stakeholders. While the banks might want to get stable returns, the managers may be interested in personal growth etc. (Bhasa, 2004).

While some differences can be observed in the governance patterns of the relationship based economies, the primary thread that unites them is the centrality of a web of relationships to run a corporation. However many commentators have criticized these firms for being highly concentrated in nature, besmirched with the attendant problems of non-specialization. The promoters double up as managers in most cases and if not excessive intrusion by the majority
shareholders and the banks in the day to day operations may lead to corporate governance problems in the firm where majority shareholders expropriating the value of minority shareholders. However some researchers felt that these firms have, despite their illiquid markets and concentrated ownership structures stayed alongside the Anglo – American firms and also consistently performed better.

2.5.3 Transition Governance Model

Central and eastern European countries and the newly independent states (former Soviet Union) typically constitute the population of economies that have adopted this governance model. Interestingly, this form of governance model has been coerced on their economic systems given their penchant to open their markets for capital requirements (Bhasa, 2004).

This model is characterized by weak, illiquid yet emerging stock markets, transition from a state – led enterprise to gradually seeping diffuse structures; transition in legal systems towards the competitive and functional systems; weak institutional set up to confront governance problems, poor investor protection mechanisms, lack of financial discipline in terms of coercing the government to refinance loss making enterprises (Berglof and Von Thadden, 1999), and weak institutional investors.

Though these firms are trying to adopt best practices of both market – centric and relationship based models in terms of opening up the economy – strengthening capital markets, ensuring relationship based market structures. However, the general apathy that can be found in weak investor protection mechanisms, excessive state intervention and artificial diffusion of ownership has marred their progress.

The state intervention is a significant impediment for this model of governance. These firms in transitional economies made recurrent efforts to emulate market centric model by diffuse ownership structures, but what is commonly observed in these firms that ownership has always been concentrated earlier state owned corporations and now private individuals and business groups held them (Akai and Kim, 1995).

The Primary weakness of this model of governance is that access to external capital is almost choked since investors do not find the transition systems to be convincing (Jackson and Bilser, 1994). The insider bias that could be realized through privatization has weakened the financial system of transitioned economies through misallocation and mis appropriation of assets (Bhasa, 2004).
This model of governance is a recent experiment with the governance adoption models. Much is to be seen and discovered regarding the efficiency had effectively of this model. Whether markets succeed in correcting their governance problems or whether states bolster their financial and legal systems to keep in take with the emerging governance need is a matter of speculation.

2.5.4 Emerging Governance Model

This governance model is much less discussed in literature, on comparative corporate governance unlike the transitional economies model which is an experiment to assimilate the best of market centric and relationship based model. This type of governance system is a fairly successful attempt in replicating governance models of successful economies.

This model is characterized by the existence of vibrant capital markets, successful transition from state held specialty sectors to widely held firms; existence of relationship based models as well as market centric governance mechanisms; emerging managerial labour class; formal and functional legal systems; existence of both family held firm as well as widely dispersed firms. This model of governance is a unique experiment amid the much established insider and outsider models.

The Business groups dominate these economics with family retaining a significant amount of control and ownership, and spread across wider – cross section of industries. These business groups primarily managed and held by the families have modelled their control patterns on the relationship based model of firms. However unlike these firms, the family firms in emerging markets have also embraced the market models of governance by listing themselves on the vibrant stock exchanges.

These economies have enabled a pragmatic shift in understanding of corporate governance mechanisms. While, cross holdings coupled with concentrated and pyramidal ownership structures is one feature of the model. India and Taiwan are the best examples of this model of governance.

However, like all other models of governance this model too besets certain short comings. The existence of business groups often leads to conflicting interests such as transfer pricing, asset stealing, insider trading etc. Some of these attendant problems have relatively solved by the increasing realization of state role in the governance process, gradually emerging market for corporate control and growing activism by investors groups.
This model however, has translated the existing systems into practically feasible mechanisms. But still much needs to be achieved in rationalizing this model of governance. Since justification, for the existence of both insider and outsider oriented models simultaneously in one economy, is governed by practical conversion of the strengths of these models in to new governance paradigms like market – centric and relationship based structures yet to be fully accomplished.

It is clear from the foregoing analysis that corporate governance systems are developed in an institutional matrix that is particular to the country’s economy, society and law concerned. However, we try to enlist the tendencies of convergence among various systems of corporate governance now, by invoking political economy perspective in the era of globalization.

The political economy perspective envisages that the Globalization drive affects different intuitional components of corporate governance regimes in different degrees and among countries the degree of impact varies. It has examined two categories of variables to describe these charging dynamics. One category is composed of the tripartite institutional structure of corporate governance regimes, such as corporate law, financial market regulations and labour law. A second set of variables is constituted by different types of political economic systems like new-liberal, neo – corporatist and statist. The present section combines these sets to construct the governing convergences in systems of corporate governance as a result of globalization. Importantly, to bear in mind the new – liberal economies denote United States and U.K, neo-corporatist implies Germany and statist economies symbolize France and Japan.

The globalization’s primary impact has been the financial system and capital markets which provides the mechanism to influence national economies. As a result of globalization the financial markets are largely affected in neo-liberal, neo-corporate as well as statist economies. However, the neo – liberal and neo – corporate economies are one step ahead than third category to embrace the changes through appropriate regulations.

The financial markets regulations given more powers to investors in US & UK (neo-liberal) and paved the way for enacting several regulations in Germany (neo-corporate) to adopt superior accounting standards, disclosure practices etc. However in France and Japan, little changes have occurred in capital market regulations and states remains to be powerful, even withstand competitive pressures from global capital markets (Halpern, 2000).
The company law reveals a moderate, but surprisingly a variable degree of cross national convergence. The company and corporate law regimes underwent significant change in U.S. incorporating anti-takeover provisions in the federal as well in the state laws. The legal changes pertaining to company law and governance have been increasingly widened in the United Kingdom since 1990s. The UK has enacted several regulations, a few to mention Cadbury code, Greensbury code, Hampel recommendations, Combined code etc. to regulate and enhance governance of UK listed companies.

The new – corporatist economy – Germany and Statist economy like France too underwent significant changes during 1990s to adopt best practices in company law as a result of globalization. However, Japan did not have any major changes in company law regimes except creating on independent securities regulatory body. The changes in corporate and company laws converge to a large extent across these nations. Most of them have adopted best practices of governance and significantly incorporated these provisions in pertinent company laws (Cohen and Cioffi, 2000).

While, the financial market regulations, company laws continue to change across these economies, leaving labour law regimes untouched even at the time of increasing globalization. This is primarily because of sensitivity of labour issue and concerns for political stability of national political economies.

The labour markets remained resilient to the global pressures and on the whole remained stable. There are no significant changes pertaining to labour law in neo-liberal neo – corporatist and static economies of US, UK, Germany, France and Japan. There is absolutely no enhance of evidence in US, UK, France and Japan, whereas in Germany, the courts have opposed attempts to circumvent board co-determination practices (Cohen and Cioffi, 2000).

The above mentioned analysis clearly indicates that there is a growing convergence in corporate governance systems in neo-liberal, neo – corporatist and to a less extent in static economies. The convergence in the realm of capital market regulations, company law can be observed in case of neo- liberal and neo – corporatist economies of US, UK and Germany. However, static economies still holds back in the continuing trend of convergence of corporate governance regime as a result of globalization.