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A Short Comparative Study of Corporate Governance in European National Legal Systems

Ovidiu Ioan Dumitru, Lecturer PhD

Faculty of Law, Bucharest University of Economic Studies, Romania
ovidiu.dumitru@drept.ase.ro

Nicolae Marius Vavură

Premier Global Council Group, Romania
nicolae.vavura@pgcgroup.ro

Abstract. Corporate Governance has developed immensely in the last decades mainly due to the negative effects on shareholders's of management decisions leading to a continuous conflict to be solved by the policymakers and academics. After the publication of the Cadbury Report, we noticed an increase interest in drafting corporate governance codes, the American and European legislators being the most active, but recent financial crisis reduced confidence in the results of corporate governance quality, some authors asserting even that the poor implementation of the policies in the area have leaded to the crisis. This paper wants to show the diversity of corporate governance standards present today in different national legal systems, by comparing its main elements like protection of shareholders and stakeholders' interests, board structures and operations and control, oversight and reporting.

Keywords. Corporate Governance, Shareholders, Stakeholders, Boards, Managers

1. Introduction. Corporate Governance in EU Member States

The European Union presents perhaps the most variety when it comes to corporate governance standards to be applied. Due to different historical backgrounds and legal system affinities in terms of company law, each EU member state has a different set-up for this type of regulation. Based on distinct levels of restriction and regulatory nature, the systems of corporate governance applied by EU states can be broadly categorized into three: Anglo-Saxon, German and Nordic. These three systems all stem from the same basic set of principles of corporate governance, which boils down to fairness and protection of interests for all stakeholders to a company. The different economic focuses of their respective countries, however, have led to significant enough differences in corporate governance regulations that these three systems can be considered as separate.

Placing them upon a spectrum, the Anglo-Saxon system can be considered the least restrictive. Despite being fairly extensive in nature and coverage, the corporate governance code applied in Britain is not actually directly imposed by the state. Stemming perhaps from a history of free-market economy with low regulatory intervention, the Anglo-Saxon corporate governance remains mainly enforced by the market itself with regard to impositions by the stock exchanges

in order to list companies, rather than regulatory authority. As such, most companies are not legally required to adhere to most of the code recommendations. They are however, as part of the stock market listing rules, required to disclose the way in which they've applied code recommendations and justify why any of the provisions were not applied [1].

On the other side of the spectrum, the German system is, for the most part, hardcoded into the country's legal framework. Most corporate governance provisions are adopted in one form or another into actual pieces of legislation related to company law. Together, they produce a quite clear, but restrictive set of rules for companies to follow in setting up they corporate practices, ranging from employee representation in company leadership, to various procedures required in order to be considered as functioning legally [2].

Coming in as a sort of middle ground between the two, the Nordic system (represented mainly by codes applied in Sweden, Denmark or Finland) presents a combination of elements from the other two systems mentioned above. It is less restrictive than the German one, with many provisions being only applied to listed companies. It does however contain a certain level of additional restrictions compared to the Anglo-Saxon such as ones regarding the independence of company directors or their remuneration. Overall, however, barring provisions imposed by EU-wide legislation with regard to disclosure requirements and financial institutions, the Nordic system is still mainly considered more as a mechanism of self-regulation of the market, managed and imposed mainly through stock-listing requirements [3].

1. Shareholders and Stakeholders

Moving into the specifics of the matter, divergence on the issues of shareholders and stakeholders is something that immediately comes to mind as a key source of heterogeneity in corporate governance from country to country. Here, by stakeholders we're referring in the modern context following the development of stakeholder theory in corporate governance. Unsurprisingly, the main conflict is also the one regarding the main principles of stakeholder theory, which is the amount of involvement that these should have in the management of a company.

This of course does not exclude some debate regarding shareholder involvement either because it is the point of view of managers that they should have full autonomy regarding their actions and no interference even from the owners, as in the end they are the ones that are hired to take care of the company's operations and should be trusted to do so.

1.1. Roles of Shareholders and Stakeholders

As clearly seen by the fact that the European Union is pushing legislative initiatives to encourage more active shareholder involvement in the functioning of their companies, there is an obvious gap in the leadership of European companies which leads to companies functioning sub optimally [4].

What this means is that shareholders, despite the fact that they're the actual owners of the company and the ones most directly affected by the performance of the company, do not actually properly fulfil their role at the head of the company. This role in particular refers to the control of the company but also includes the strategy of the company.

It has previously been identified that managers are incentivized to have short-term approaches aiming at larger short-term gains due to the fact that their contracts tend to have the larger component of their payment be performance based [5]. This of course is damaging to the company due to the fact that most short-term approaches tend to sacrifice future potential of the company and have large opportunity long-term. Needless to say, this is generally not in the best interest of the shareholders and should be a behaviour which is prevented by them.

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Unfortunately, this situation can most likely be attributed to shareholders tending to neglect applying corporate governance measures in their companies in the absence of legal enforcement to do so. Such measures are meant to allow their direct representatives, the directors of the company, to exert their oversight duties precisely to balance impulses of management which might act in the detriment of the company. In consequence, one might say that the first role of shareholders of a company is proper development and adaptation of the corporate structure and regulations of the company, enabling the fulfilment the earlier mentioned roles of control/oversight of management and strategic decision-making.

Defining the role that stakeholders should have in the company actually stems from similar ideas as for the shareholders, the difference being that stakeholders do not actually have any direct authority to dictate what the company does. As a consequence of their relative lack of power, stakeholders have been traditionally neglected in affairs of corporate governance, being mainly seen as either executants of the will of shareholders and managers in the case of employees, or parties that are indirectly affected and therefore do not merit much attention.

In spite of this, stakeholders, referring in particular to employees, are still part of the company, and actually represent the greater part of the population of a company. As such, some states such as Germany, Austria, Czech Republic and others modelling themselves after the German system of corporate governance, require that employees have their own representatives in the directorate of the company, ensuring their input in the strategy and development of the company.

This introduction of employees as a direct player in the leadership of the company has enabled companies in these states to actually avoid some problems which have plagued companies and other countries and have actually given rise to the practice of Corporate Social Responsibility (strikes, walkouts, employee scandals etc.). The fact remains that a company functions due to its employees and they should be allowed to play a role in the direction that they are going as a whole.

This aspect is gaining ground, with the new version of the UK Corporate Governance Code also adopting a recommendation to include employee representation in the Board of Directors in one form or another, proving that it is becoming acknowledged that employees have valuable input to give for the company's strategic level in order to ensure sustainability [1].

1.2. Shareholder and Stakeholder rights

Talking about the roles, we immediately identify that with regard to employees fulfilling their role in the leadership of the company, they actually have to be awarded the right to have representatives on the board of directors. While they are clearly awarded this right in Germanic system countries, in most other countries, because companies are not specifically required to do so by national legislation, they generally have no say in any strategic development of the company. As such, what most stakeholders benefit from as rights related to companies are actually comprised in general labor laws or liability laws of their respective countries, and in consequence, their role in the strategy of the company is non-existent.

Shareholders on the other hand benefit from a rather large array of legal provisions meant to help them. Most laws aiding shareholders, however, were never required in the first place. The corporate governance requirements guaranteeing shareholders the rights they have today, could have been devised and placed in the company contracts and articles of incorporation of companies without having government intervene.

Given the above, we can actually split shareholder rights into two categories: fundamental and secondary. The fundamental rights of shareholders can be considered those related to the basic idea of forming a company, namely that they cannot be excluded from any decision which

changes the nature of their company in any way, and that they have the right to be rewarded for their contribution to the company capital. These two rights are the ones which have existed from the very beginnings of companies by shares regardless of whether the shareholders also fulfilled roles as managers or are completely uninvolved in company operations.
The secondary rights can be considered all other rights which have been developed over time as derivatives necessary to protect shareholders, their company and their fundamental rights. Among these we can enumerate rights related to the reception of accurate information regarding company activity or the right to conduct examinations and audits of the company. Protection of shareholders from other shareholders can be counted here as well, such as provisions aimed particularly at protecting the interests of minority shareholders across Europe.
These rights of course have significant differences across countries within the EU with some doing more than other to outline and specifically offer provisions in national legislation with regard to every detail of shareholder rights [6]. For example the Anglo-Saxon code does not carry specific provisions regarding justifications for movements by the company in order to prevent hostile takeovers while the German systems requires legally the management board of the company to convene a shareholder assembly in order to discuss takeover offers and options, considering that management should not have any power to restrict shareholders in exercising their ownership rights [7].

2. Board structure and operation

Moving to the more specific way in which shareholders and stakeholders can exert their rights and fulfill their role in the leadership of a company, the directorate represents the embodiment of the shareholders and their interests in the leadership of the company. The directorate itself is usually organized in a board whose composition, duties, requirements, rights and rules of function are generally outlined in the company's articles of incorporation.
In theory, the board of directors represents the will of the shareholders and acts in fulfilling the main shareholder roles, which is to supervise the management of the company as well as setting the strategic direction which the company should take.

2.1. One-tier vs Two-tier systems

In the European Union, mirroring perhaps the duality between the free-market and social market economic approaches adopted bby the various states, there are generally two distinctly identifiable ways of organizing boards of directors, each with its own particularities. First of all, the single board system, which is also the oldest and most traditional, represents the organizing of the directors of the company within one single layer, comprised usually of an odd number of directors who generally take decisions by a majority vote.
Under this form of organization, the directors who make up the board may also include the executive managers of the company which is generally done in order to make it easier for information to be passed around and strategic decisions and deliberations to be made. However, this aspect immediately brings to attention the potential conflict of interest arising from the fact that the presence of executives on the board of directors cuts into the supervisory power of the representatives of the shareholders. The reason for this is both mathematical, as shareholders simply have fewer seats of the total, as well as mechanical, in the sense that managers can more easily gain influence with other members of the board, in addition to controlling the flow of information that gets released to the other directors.
Essentially what is happening is that with a one-tier system there is no clear separation of powers between the executive branch of the company, which is composed by the executive management, and the oversight/legislative branch of the company. This perhaps benefits the

company in terms of reaction and streamlining of activity and strategic planning, however, at the same time it creates exploitable loopholes for agents of the company to take advantage and maybe hoodwink the shareholders or potential investors one way or another.
Of course, the shareholders may always create additional mechanisms and requirements of the functioning of the board in order to mitigate risks, but the solution which the Germanic social market organization has chosen is to completely separate the two roles of the board, and indeed separate the board itself into two levels. The supervisory board, composed solely of persons which do not have any managerial position, would be the top level, exerting pure control duties over the second level of the board, which is the management board (composed of the executives of the company).
The two-tier board system, while curbing the clear problems with conflict of interest, does produce its own major vulnerability, which is communication and data. Communication in a two-tier board system is much slower that in the one-tier, with information having to be first compiled within the management board and then transmitted to the supervisory board. At the same time, the transmitted information is that much more susceptible to the filtering and management as everything would have to go through them first [8].
Following a long historical analysis, it is quite difficult to say whether one type of organization if better than the other with no particular indication from past performance data putting one above the other [8]. There are however indications that particular vulnerabilities of the one-tier board system, such as the appointment of a CEO to the position of chairman of the board, while bringing short-term gain, represent a loss long-term in company performance, in addition to the fact that most of the time, it actually costs the company more for a single Chairman CEO than with having two separate people in these roles [9].
Indeed, stemming from such considerations is perhaps the reason why we have hybrid systems such as the Nordic system. In this case there is a one-tier board system which however does not generally get involved in the management of the company but does have the power to hire and fire the CEO of the company. There may also be requirements for employee representation in the board which is more typical of the two-tier German system [10].
Outside of the countries adhering strictly to one of the three systems, we also have many countries in Europe that have chosen to allow companies to pick and choose which system works best for them. This is also the case for Romania as well as other countries which do not necessarily have a rich capitalist tradition. In most of these cases there are no accompanying requirements for employee representation on the board of directors even in the case that a company chooses to organize itself in a two-tier system.

2.2. Board composition

Having mentioned several times requirements for presence of employee representatives on the board of directors, we should perhaps mention that there are two basic types of members of a board of directors: executive and non-executive. The difference between the two is that executive directors also occupy management roles within the company. As such, the one-tier system is composed of both executive directors and non-executive directors appointed by the shareholders, while in the two-tier system the supervisory board is composed purely of non-executives and the management board is made up the of the company's senior managers.
This basic split, however, does not fully describe the potential composition of the board. Given the rather wide range of corporate governance codes in Europe we end up with more types of directors, depending upon the interests which they represent.
One major requirement for the board composition in various European countries is that a significant percentage of the board of directors is composed of persons independent of the

company and its interests. Naturally, this aspect varies from country to country in the particular way it's defined, however, independence is generally understood as having no function either in the management of the company, as a shareholder nor have any capacity in a partner or competing firm. Percentage requirements vary from country to country in Europe, ranging from countries like Romania which have no requirement regarding completely independent directors, to countries like the Netherlands (which also has a more Nordic approach to corporate governance despite the option to have a 2-tier board), which can require the entirety of the supervisory board of a company to be composed of independent directors [7]. While one can expect a country like Romania, which is still developing its economy and private enterprise establishment following a long period of communism, to not have many requirements regarding independent directors, perhaps a surprising situation comes from Germany which does not actually impose a particular amount of independent directors, leaving it up to the company to decide how many are appropriate [7]. Of course, if we're being technical, the UK corporate governance code also does not make any impositions regarding this aspect. However, it still recommends that the board of directors should contain enough independent directors so that no individuals or groups may be able to take over the board's decisions, making the traditionally less liberal German system an anomaly in this regard [7].

Where the German system ignores independent director requirements, it makes up in terms of employee representation. German companies are required to have employee representation in their supervisory boards when they pass a certain number of employees. This can start at 300 or 500 employees and grow, with the minimum requirement being half the board when the company reaches 2000 employees.

Outside of the Germanic system, Nordic countries have the possibility and some requirements for employee representation in the board of directors. Compared to the Germanic countries which seem clearly in favour of Stakeholder theory in this regard, the Nordic states appear to adhere much more to the Agency Theory perspective, with companies attempting to minimize the influence that employee representatives have on the boards. Finland in particular had left it up to the companies to decide whether they apply the recommendation to include employee representatives on the board. The result was that the vast majority of companies chose against having any such directors. Finally, Finland has actually added a strict requirement for employee representation, although it is still up to the company to decide the manner in which they are included in the company leadership and they can still be isolated into a special supervisory body that may not be given any impactful rights [11].

2.3. Procedures and Evaluation

The way the Board of Directors generally operates is on the basis of committee work and sessions. These committees are usually comprised of several members, who are usually charged with handling a certain type of task on behalf of the board. For example, one type of committee that is generally required by law in most codes is the audit or accounting committee. This committee would be responsible for gathering and reviewing company accounting data and financial information, then compiling reports for the shareholders. Each committee is headed by an appointed chairman, the general recommendation in quite a few cases being to appoint a non-executive or even independent director as chairman, in order to catch and avoid problems due to conflict of interest. Of course, there is also a counter-example wherein Germany actually requires the nominations committee (a committee responsible for nominations for possible directors and their presentation to the General Assembly of shareholders) to be comprised entirely of shareholder representatives [7].

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There is a general freedom for each company's committee organization, however, this general freedom is also where the danger lies. One major aspect which the board usually has to decide is remuneration, which generally falls in the hands of a particular committee. The very existence of this committee is a danger zone, where peddling of influence can easily take place should the wrong persons be in charge. As such it is generally recommended that this committee be comprised of independent members as what they have to do is to actually create a comprehensive analysis of the company situation and of the current economic environment that the company is in. The objective is that the directorate and executive remuneration properly reflects the performance of the company while at the same time also doesn't overburden the company in any way, which is stipulated in this manner in all three corporate governance systems.

Of course, in order to fulfil their duties, directors are actually dependent upon the data provided by the management of the company as well as their recommendations. As such, regardless of system, management has an inordinate amount of influence upon the level of remuneration for the directorate which actually enables them to have an unwarranted say in the decisions of directors.

Even if we're to take the overall functioning of the directorate, their function is dependent upon a flow of information provided by the executives. In addition to the fact that it tends to operate based on scheduled meetings in order to present finding and progress of each committee, the directorate actually can find itself with one arm tied behind its back should a manager choose to delay slightly the reporting of his information at the right time.

2.4. Role and status of managers

As can be gleamed so far discussing the board structure and functions, regardless of which system of corporate governance is used, managers still carry perhaps the heaviest role for the company. A one-tier system definitely amplifies the influence that managers carry within the company, however, the fact remains that being in control of the access that the board of directors has to the company enables them to distort, if necessary, the knowledge that the directorate has in order to influence their decision-making.

In a company, the CEO is traditionally considered the person responsible for the progress of the company. In general, CEOs are brought in to change either the vision of the company or simply its strategy, and as such, they are generally the source of the strategy that a company employs for a long period of time. Given this fact, should they achieve success, their prestige, can grow to the point where they can easily influence the decision making of the directorate. In the German and Nordic systems there are even special provisions preventing former executives of a company from occupying key positions in the board of directors, in order to avoid situations where a single person can directly influence the executive level of the company as well as the board of directors where he's been appointed.

The fact remains that a good CEO can easily gather the favour and trust of shareholders by continuously providing good results and sound decisions. The directorate has to always be careful to not be lulled inadvertently by the executive into acting against the interests of the shareholders simply due to the fact that they end up trusting and relying too much on him/her. This may also explain the level of passiveness of shareholders with regard to their company that the European Union is trying to combat [5].

This may also be the reason why the Nordic system in particular places significant emphasis upon active ownership, and tries to set-up mechanisms that force shareholders and directors to be more involved in supervising and even strategy of their companies [3].

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3. Control, oversight and reporting

The ultimate objective of the directorship of a company according to any corporate governance code, is to ensure proper, effective control over the activity of company management. However, instituting too many control measures, just like any general overregulation, can lead to the hampering of the activity of the company. Given that the main purpose of corporate governance is to ensure the proper functioning and development of companies, states as well as companies have done their best to avoid the installment of cumbersome control systems which not only might affect existing businesses or that may discourage new businesses from developing.

What has been identified in the end as the most critical measure of control, as well as perhaps the most non-disruptive, is transparency. What shareholders and boards require above all else so that the entire system functions properly, is accurate information.

Thus, most corporate governance codes contain provisions regarding disclosure of information at the very least yearly. Moving perhaps counter-intuitively, the German system does not have extremely detailed legal requirements for disclosure of company activity beyond the typical financial reports. It does however require that any analyses, reports and other findings conducted by the companies in order to meet disclosure requirements in other countries, also be delivered to its shareholders [7].

The Anglo-Saxon system on the other hand has extensive requirements for disclosure of reports on several issues such as governance or social responsibility, including detailed justifications for why recommendations by the corporate governance code were not followed in all areas or the ways in which they were achieved. This, of course, tends to only be applied as part of stock exchange listing requirements for companies, especially those participating in the FTSE index [1].

Reporting standards are perhaps the only area where the Nordic system finds itself in an extreme. Stemming perhaps from a continued culture of democracy and transparency in terms of government as identified by other authors, Nordic corporate governance codes tend to have the most extensive requirements regarding issues to be publicly disclosed, including aspects such as detailed company share ownership or independence status of directors [12].

3.1. External control

As a result of the EU's efforts to promote the collection and reporting of accurate and complete information regarding the activity of a company in the member states, as well as the sharing of this information among member states as a means of external control of the companies. As such, regardless of which corporate governance system is applied in a country, all companies are required to disclose their year-end financials.

Outside of this, the classic means of external control, which mainly involve audits, are the most prevalent. Independent audits are required to be conducted on end of the year reports in all codes. In addition, full audits are done upon special events such as listing on the stock market in order to ensure a company's financials as well as compliance to all corporate governance standards required for listing.

These external measures of control unfortunately, do not solve the main problem that shareholders face, which is obtaining real time accurate information regarding the company in order to react immediately to any problems. The fact remains that to call for an external audit of the company is expensive and time consuming, while the annual reports don't really help the board much as they are actually part of the process of approving the end of the year statements and reporting them.

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3.2. Internal control

Given the above, internal control measures are still the most essential regarding any working system of corporate governance. The board of directors, in whichever shape it may take can be considered as an entire body meant to fulfil a controlling role for the business on behalf of the shareholders.

If we're to take the more restrictive meaning of control as the checking of the company activity, then the main internal control system which has been outlined in most corporate governance codes in the EU is represented by the Accounting/Audit committee of the board. The role of this committee, which is generally at least required to have an independent certified auditor, is to keep an eye on the financials produced by the company and be alert for any signs of misrepresentation or improper reporting on the situation of the company. Usually this committee is also involved in the compiling and production of reports to the shareholders, or other stakeholders as the case may be, regarding the situation of the company.

If we're to note particular differences in this aspect, it is rather related more to structural reasons. In the case of the one-tier board system, the accounting committee is responsible for developing, implementing and maintaining internal audit standards as well as the relationship with the external auditor selected by the company. On the other hand, in the German system, it is the supervisory board which carries these responsibilities, being actually one of their main tools in exercising control over the company, but with and audit committee that is solely responsible with evaluating the effectiveness of internal controls [7].

Additional internal controls may be instituted generally in the form of internal corporate governance regulations which may require specific reporting and information flow from the management to the board, or the use of specific tools for storage and transmission of information regarding company activity. For example, Nordic and Anglo-Saxon systems generally require the Board of Directors to also monitor and produce Risk management reports, as well as situation handling reports. The German system on the other hand places the duties of risk management and reporting, squarely upon the management board, while at the same time requiring the supervisory board and the management board to maintain contact at all times, through their chairmen, on issues of strategy, development, sustainability and so on [7].

Unfortunately, despite various internal control recommendations and impositions in the various corporate governance codes, shareholders still seem to avoid implementing many measures on their own unless specifically required by legislation to do so. As such, it appears that passive ownership, rather than active, is the overall trend which corporate governance systems are still trying to combat.

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