Corporate Governance: Comparative Analysis and Practical Solutions to Face the Emerging Challenges

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Abstract

The evolution characterizing the global economy over the Centuries and across the Countries in the world has inspired a wide variety of studies concerning the relation between company's property and control. This long process produced various theories and models aiming to explain the origin of the issue and trying to present possible solutions. The Agency Theory issued by Jensen and Meckling [1976] has provided irreplaceable basis in this sense, allowing successive scholars to create hypothetical formulations. However, in our humble opinion, this analysis showed only one side of the issue, thus still leaving incomplete the solution to the corporate governance issues. The theories concerning the market-based systems and the bank-based systems are evident demonstrations that other factors should be considered for the analysis (then just not directors' function) in order to obtain serious and definitive conclusions in the matter of company's property and control. In accordance with these presuppositions, we have thought fundamental examining the main principles of corporate governance regulating the market-based systems - then Unites States of America - and those issued by European Union and by OECD.
In order to develop the present analysis we have considered appropriate dividing the paper as follows: in the first part we have elaborated an introduction aimed to explain the status quaestionis. Specifically, we have considered the basic literature that allowed the successive development of the analysis. In the second part, we have developed a comparative analysis between the principles of corporate governance promoted in United States and those disciplining the companies in the Eurozone. In this sense the laws regulating the stock market, the doctrines promoted by important institutes of analysis concerning the corporate governance as well as by international organizations have been deeply analyzed. Specifically in this section we have highlighted a common denominator between the corporate governance doctrines developed in the market-based systems and in the bank-based systems. The third part ends the present work. It consists of practical proposals in the matter of corporate governance.

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1. Introduction to Analysis

Through the analysis of the main theories concerning the corporate governance it is possible to observe remarkable differences between Anglophone Countries and European ones in terms of approach to the corporate governance issue. This is mainly due to the economic development that has characterized these areas, but especially to the different degree of development of semi-public companies. In United States of America, the main doctrines concerning the corporate governance have identified the Board of Directors and the managers as the major contributors to the problems related to the bad company performance and to the problematic relations with the company owners. This particular conviction has led scholars to show more interest in the role performed by directors, how they could be judged (business judgment rule) and what it is necessary in order to avoid conflicts of interest. In this sense the Agency Theory was the doctrines peak. It has opened a debate on the principle of proxy and the various aims that managers and shareholders aspire to. Consequently, over time further doctrines related to Board of Director's role and composition have been developed; we are referring to the independent director's role and his control function on the managers, but also to the efficiency of the reporting system linked to the executive directors and to the importance of the disclosure for the risk identification purposes.

These topics are widely discussed within the American regulatory systems as well as within the large organizations such as ALI [2008], BRT [2010] and NACD [2009]. Berle and Means' studies on ownership and control [1966] had a great influence on the following researches. They were the first two scholars which analyzed accurately the process of development featuring the competitive managerial system of American companies. This development has changed completely the idea of enterprise and entrepreneur just dedicated to a limited production for himself and to a limited market in time and space. (Cantillon R., 1974) The American public companies were a deep transformation of the joint-stock companies already studied widely by Weber M. [1974] and Sombart W. [1967]. More specifically, the spread ownership changed the real essence of the enterprise by transforming it and leading its functions at its most extreme. This unique mechanism has changed completely the roles of the different stakeholders, and in this way the internal balances of governance were reshaped.

As we know, one of the main features of this structure is the myriad of small shareholders - which are often disorganized - that invest in the society for various reasons. The soul of this uncontrolled capitalism - mainly characterized by a financial structure rather than a real productive structure - has developed speculative flows that over time have increasingly distanced the ownership from management. The consequence is that in the specific case of the public companies, the extremely spread ownership has provided a wide space for speculation and profit sharing, omitting the interest in the original productive purpose. Schumpeter's concept of innovative creation [1942] is far from the current public companies' reality where shareholders allow directors to take decisions - sometimes careless - just to achieve profits. This principle of proxy was at the basis of all the doctrines concerning the Agency and the company's control. These were exasperated relationships that led scholars to find out solutions by blaming on and sometimes rendering ineffective the strongest part in the relationship of governance: managers and directors. From our point of view, the solutions should be found out in the system itself by regulating better the enterprises' growth and protecting their aim - the production - from speculation.

2.1.1 Principles of Corporate Governance in U.S.A. and in Europe: A Comparative Analysis

The scientific tradition has largely assumed that English and American Countries are markedly based on the market while European Countries as Germany and Italy but also outside the EU - as Japan - suffer a purely banking influence. The so-called market-based systems are characterized by a predominant presence of publicly-traded companies with share dispersion. This principle - anticipated in A. Berle and G. Means' analysis - has led to a high heterogeneity of shareholders as well as to the concentration of direction in the hands of managers.
This is the reason of the market importance in the companies' life. Through analysis of the market it would be therefore possible to understand the enterprise evolution, then the good or poor management of the same. The second definition of "outsider system" lies in the fact that the financing process of action is primarily identified in the market, then outside. (Velte P. et alter, 2011) However, precisely because of this "uncontrollable" management induced by overwhelming spread of shareholders, in the English-speaking Countries was almost automatic the imposition of strict disciplines in order to be listed [e.g. in the UK was initially adopted the Cadbury Report in 1992 and later the Combined Code in 1998]. More recently different models and theories have arisen in order to highlight the strengths and weaknesses of the market-based system.

These are the cases of the Financial Model considering the direct reflection of company's management on market in light of shares trend (De Luca, 2008: 31), the Myopic Market Model and the strange managerial myopia caused by stock market (Costanzo P. et alt., 2007: 14) and the Stakeholders Theory exalting the stakeholders' role in order to maximize the profit. If in market-based systems the most part of controversial issues is covered by the possible manipulation of company management by directors causing disadvantage for shareholders, that's not the main topic featuring the corporate governance issues in European Countries. In European Continental system - also featuring Japan - the presence of institutional investors plays a predominant role for the corporate governance framework. Indeed, in this particular system investment banks, insurance companies, investment funds or financial holdings - the so-called institutional investors - have increased the number of shares so much as to retain the 66% of equity in the market. (Pichhadze A., 2010: 3) In the case of bank-based systems (also called insider systems) management therefore is not sub iudice of the market in which it operates but from those entities that heavily enter the capital. This approach has also led many scholars to consider cases in which institutional investors could become block holders, with all negative consequences it involves. (Edmans A., 2014: 2427)

2.1.2 Principles of Corporate Governance in United States of America

In America the theme of corporate governance is much debated. As we have seen in the previous paragraphs, United States rely on a system that is predominantly oriented towards the market. For this reason, not only the corporate legislation but also many other codes developed many interesting facets. They differ from the doctrines of the individual European countries but also from those dictated by the OECD. We propose to investigate these differences in order to take an investigation on the contributions that different doctrines have made but also on the processes governing the company's operations. Of course, we can do this always keeping in mind the limits that we've imposed to the present work. On the corporate governance subject, United States of America developed over the years several recommendations of best practices, each with separate propositions.

However, all are based on the guidelines contained in the Federal Act.

In this context and by way of clarification, we should like to emphasize that any new propositions must be in harmony with the provisions from the old Exchange Act of 1934, although several acts on regulation of stock markets have been issued over the years [Gramm-Leach-Bliley Act 1999 - Sarbanes-Oxley Act 2002 - Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010] (SEC, 2003: 35). Among the many tasks covered, the Security Exchange Commission (SEC) is the body in charge of vetting and checking the regularity of new amendments. Due to the huge number of American financial markets, always in the light of the legislation provisions, the two main Stock Markets - the New York Stock Exchange and the Nasdaq - have over time proposed to the SEC two manuals containing precise policies, practices and procedures for company in "listing" phase. They are important because companies desirous to be listed must demonstrate some requirements in step with the corporate governance principles issued by them. Among other provisions it is important to emphasize listed companies need to have a code of ethics or conduct governing internal relationships and corporate governance. Examining the NYSE Manual - originally adopted in 1953 and later updated over the years - in Section 303A. 10 it is possible to observe the following sentence: "listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers." (NYSE, 2014: 112) The code should then treat the important topics concerning the corporate governance without neglecting the themes of:

a) Conflict of interest
b) Opportunity for the enterprise
c) Confidentiality
d) Fair dealing
e) Protection and proper use of corporate assets
f) Harmony with corporate laws in force
g) Communication of prohibited or illegal behaviors

The need to provide for all these important factors has led various associations and bodies to keep alive the analysis on the different corporate governance systems. Hence, the solutions regularly expressed by specialists on the subject of risk management, control, and transparency are innumerable.

About ethics and behavior, in addition to the federal legislation and the above mentioned Stock Exchange provisions, it is possible referring to regulations provided by:

a) "Corporate Governance Codes and Principles" issued by the Council of Institutional Investors;
b) "Principles of Corporate Governance" issued by the Business Roundtable;
c) "Key Agreed Principles to Strengthen Corporate Governance for U.S. publicly Traded Companies" issued by the National Association of Corporate Directors;
d) The Principles of Corporate Governance issued by the American Law Institute. (European Corporate Governance Institute, 2014: 1)

Because of the substantial contribution that such authorities periodically provide, we have made an analysis on the main topics debated in the matter of corporate governance.

Table 1 - Main Debated Topics in the Matter of Corporate Governance

	ALI	**Business Roundtable**	**National Association of Corporate Directors**
MAIN DEBATED TOPICS	Duty of Care	Director orientation and update	Corporate governance guidelines
	Duty of Loyalty	Board size and performance	Risk oversight
		Independent Directors	Strategy
		Interaction with Shareholders, Press and Customers	Execute Compensation
			Transparency

Source: author's elaboration

As we can observe in the table upper showed, the current most debated topics by Associations for corporate governance in United States involve directors' modus operandi and the corporate risk depending from managerial choices. The reason is related to the principle above mentioned that the American system of corporate governance is widely focused on directors' figure. In accordance with this principle they have an exclusive power in the company. The attention is completely captured on managers and on the performance they can obtain on the market, as direct consequence of a widely spread ownership.

2.1.3 Principles of Corporate Governance Issued by OECD and European Commission

As various sources disciplining corporate governance in European Countries, we can clearly identify the "Principles" issued in 2004 by OECD - successively redefined and implemented - but also the "Green Paper" issued by the European Commission in 2011 and considered the peak of previous European Recommendations in the matter of corporate governance. Both institutions have stressed the importance to resolve the problems related to the exercise of leadership and the operational criteria in accordance with the general rules as well as the codes of conduct. Furthermore, these two Institutions have also made various analyses concerning the types of shareholder operating in the current company's framework as well as the related role they can play in order to obtain the performance of the company in which they have invested. The possibility to make financial investments in real time thanks to the intervention of mediators (institutional investors) has greatly changed the idea of shareholder that has characterized and distinguished the public corporation from other corporate forms.
As a result, the roles as well as the principles of corporate governance were upset.

Table 2: Main areas of Common Analysis

BOARD OF DIRECTORS	**SHAREHOLDERS**
Trasparency & Disclosure	Higher partecipation
Improvement of the system for the risk identification and management	The exercise of the right to vote
A greater interaction Shareholders - Stakeholders	Higher protection of minority shareholders
More independence of the Board members	Higher interest on the remuneration systems
Higher control on the managers	Higher control on the Board of Directors

Source: author's elaboration of data from OECD and European Commission

The table above reproduced gives an example of the main themes examined in the Green Paper issued by the European Commission and by OECD. It is evident the importance of developing guidelines able to discipline the classic relation "shareholders-directors" as well as the principle of their operating function. We should also recognize that both OECD Principles and European Commission's Regulations have stressed the features distinguishing the bank-based system from the market-based system. More specifically, the regulations issued by European Union through many Directives have aimed to protect shareholders not only from directors' choices but also from institutional investors' management. (Direttorio Generale per le Politiche Interne, 2012:14)

Table 3: European Directives Related to Corporate Governance

DIRECTIVE 68/151/EC	Requirement to provide information relating to the company to any third party
DIRECTIVE 77/91/EC	Essential requirements for the listed companies
DIRECTIVE 2003/51/EC	Publication of financial and non-financial data
DIRECTIVE 2003/58/EC	About the electronic systems to fulfill reporting obligations; protection against insider dealing and market manipulation
DIRECTIVE 2003/71/EC	Definition of financial securities, transferability of shares and categories of investors
DIRECTIVE 2004/25/EC	Development of control authorities in the stock markets
DIRECTIVE 2004/109/EC	Transparency and remuneration policies
DIRECTIVE 2005/56/EC	Protection of shareholders
DIRECTIVE 2006/43/EC	Rules on auditing matter
DIRECTIVE 2006/46/EC	Birth of the principle “Comply or Explain”
DIRECTIVE 2006/48/EC	About remuneration policies (the remuneration Committee)
DIRECTIVE 2006/68/EC	Protection of minority shareholders
DIRECTIVE 2007/36/EC	About shareholders’ rights
DIRECTIVE 2007/63/EC	The independent expert as a source of information for shareholders
DIRECTIVE 2009/109/EC	Protection of shareholders in case of acquisitions
DIRECTIVE 2010/73/EC	About the possibility of establishing a European authority for the financial supervision
DIRECTIVE 2010/76/EC	About the modernization of corporate governance systems to reduce Shareholders’ risks

Source: author’s elaboration of data from the General Directorate for Internal Policies

At the same time, also guidelines expressed in OECD Principles of 2004 have stressed the great importance to shareholders’ role. In this way, shareholders’ rights are enhanced so that abuse of power by directors cannot take place.

Table 4: Shareholder’s Rights

SHAREHOLDERS’ RIGHTS				
To participation	**To information**	**To dividends**	**To vote**	**Opposition to diluition**
General Meetings	Continous		Directly	Preferential subscription
Extraordinary Meetings	Timely		By Proxy	Guardianship vs controlling shareholders

Source: author’s elaboration

The OECD “Principles” are a series of studies that can be helpful to resolve several questions related to the themes of transparency, agency, shareholders’ powers and minorities, although they do not have an authoritarian value comparable to EU Directives or Recommendations. According to the analysis on the main innovations introduced by the Principles, we consider important to point out:

a) The need for a better relationship between directors and stakeholders;
b) The improvement of the reporting systems and transparency;
c) Board of Directors’ independence and its monitoring function;
d) The role of institutional investors in order to protect shareholders’ rights.

In relation with this last point (d) an extensive research made by OECD has revealed surprising data on the trend regarding the investment funds, pension funds and insurance companies. Already an OECD’s analysis of 2008 showed that in the period 1995-2005 the proportion of revenues from institutional investors (so-called institutionalization) is passed from 110.2% to 162.6%. (OECD, 2008: 3). While the rise of the investment funds was already evident in 2005, overtaking insurance companies with the 35.7% on total assets. The degree of development characterizing the institutional investors is just a small index of their role within the governance systems and expresses very well the particular protection shareholders need.

The comparative analysis made between the system of corporate governance in auge in U.S.A. and the system spread in European Countries stresses the different needs in these two macro areas. As direct consequence - thus - we could define these two systems as substantially different in the matter of corporate governance principles. During time, the bank-based system has been featured by the increasing role of Institutional investors in the company's life. This is due to the relevant importance they play not only for the stock market operation but also for the countless investors' rights. However, as last consideration we would like to affirm that a common denominator between these different systems exists. We are referring to the important figure of shareholder and his relevant function inside the decisional context. It is possible to regulate and to modernize the system of governance only by enhancing shareholder's function - more than director's one - both in the market-based system and the bank-based system. Nonetheless, it is always right to establish a precise regulation concerning directors' number, competences and independence.

3. Practical Solutions to Improve the Corporate Governance

In accordance with the analysis upper made, we would like to present some proposals:

A) Minority shareholders should participate more in the corporate life.

Only through a more active presence, interest and participation in the corporate life, minority shareholders can avoid that their rights are overruled by some risky managerial decisions. Until the speculation or the mere profit sharing achieved by the big corporations will be the predominant elements within the circuit of the international stock exchange, there will be not any improvement in the internal processes of governance and the shareholders will never be able to protect their interests. The desire to participate in the listed companies should be primarily driven by the desire to embrace the original cause of the company itself: the production and the marketing of a good or product. This lack of interest is even more obvious in the case of purchasing shares through institutional investors. Without an external discipline which regulates the voting system, or even more, without the share owners' real interest in receiving detailed and timely information, minority shareholders can be never an active part in the company.

B) Better discipline of control interest to obtain the neutral choice of directors.

In this sense, when we understand the reality that distinguishes the spread ownership public companies, it is also easier to understand the reasons and the circumstances that lead to the creation of share blocks. The obvious consequence is an abuse of the minority shareholders' interests in the choice of administrative team and their influence on it. Also in this case, the responsibility of taking decisions wouldn't fall just on the directive leadership but rather on the part of majority shareholders with the power of control. If the choices taken by the directors were actually expression of a restricted circle of shareholders' interest, it would be difficult just to think of managers' responsibility, but rather of the circle of shareholders who have proposed and nominated them.

C) Appropriate systems for directors' remuneration.

In our humble opinion, the real responsibility of directors' remuneration falls on shareholders' good sense.

The remuneration principles which have been adopted are primarily based on this general principle:

HIGH REMUNERATION = HIGH FIDELITY AND HIGH PERFORMANCE

However, the reality often shows us how this postulate is incorrect.

The history of the large corporations, or more humbly of the joint-stock companies, has taught us how it is not sure that those managers which are handsomely paid are actually faithful to the intentions of those who has appointed them. Therefore, a proportional remuneration system that pushes managers to receive a good remuneration in relation to the long-term corporate performance is necessary. So, we believe that the OECD statement according to which the shareholders should not show their interest in the Directors' remuneration contracts is absolutely inadmissible. In the same way, we do not accept that the managers and directors' remuneration is competence just of the remuneration committee appointed by the directors themselves. Only recently, big listed corporations have shown a light change of trend, although the general situation is not oriented towards the solution of these problems yet.

D) Creation of special minority shareholders meetings and appointment of specific members among them within the board of directors.

The presence of shareholders within the directive structure is now a more usual practice, especially in presence of block holders. However, it is extremely difficult that there are interests by the minority shareholders. Recently, international organizations have proposed to introduce a person appointed by the Board of Directors which is responsible for the communication and the report to the shareholders during the meetings of the Board of Directors We believe that these transfers of information are extremely dangerous, especially when the interests of many people - that are of substantial value - must be protected. Therefore, we propose that the above-mentioned figure on the management, is replaced by a particular representative directly proposed by an Assembly constituted of the minority shareholders. Then, such Assembly would have the aim to represent all the minority shareholders wishing to participate in the important company issues, but especially to obtain timely information to exercise their voting right. Thanks to his growing played role and his intermediate function between the company and shareholders, the representative could be identified just amongst the institutional investors. Firstly, they should already report on the general information about the company management and trend, but in our humble opinion, their direct presence inside the BOD would be the best solution to solve problems of misunderstanding and bad reporting systems.

E) Improvement of reporting system and better identification of price sensitive information.

About the information and its regular reporting system, we must consider an essential observation that is widely linked to the themes of transparency. Indeed, it is more a national rather than an international custom the adoption of special codes for the appropriate information of the company, but having a special care in dealing with the price sensitive information. This type of information is singular and unique due to their importance to maintain a sort of competitiveness on the market and the company's secrets. However, it is possible that the principle of communication and reporting to shareholders in a timely and functional way gives out in order to avoid leaks.
Such as there's the chance that information of interest useful for future business decisions are not leak out because they are camouflaged as price sensitive.

In our opinion, the identification of price sensitive information should be very clear in accordance with the Statute and accepted by shareholders in such a way that there are no further misunderstandings. In our humble opinion, companies must consider such measures in order to reduce the corporate governance inconveniences and problems. However, we believe that the main solutions should come at international level, by disciplining an economic system which in some debauched cases has piratical features without scruples. That's the current case of large-size corporations attracting capitals both from private shareholders and banks - without responsibility of their decisions - while small and medium-sized companies - listed and not - have to deal not only with a minor access to credit but also with shareholders' distrust as well as with the countless challenges that their modest reality entails.

Conclusions

Although there are deep differences, the theme of spread ownership and its role for the internal balance are common denominators between the American systems of governance and that one featuring European Countries.
Companies with a spread ownership have had a deep development also in Europe, with everything that this entails. The problems related to the control function of directors' work and to managerial transparency are hot topics also for European investigation system, but without they play a key role. As previously observed, the European macro-area is characterized by a bank-based system because of the influence of institutional investors.
This peculiarity has led the international organizations, such as the OECD but also the European Union, to investigate the specific existing connections between companies, institutional investors and shareholders. The research has showed that the principle of proxy, which is at the base of the existence of the institutional investors, can sometimes be a double-edged sword. This postulate - already explained by analyzing the OECD's "Principles" and the EU Directives - gains more strength if we consider how much can be deleterious for shareholders referring their power of proxy to companies of savings management, insurance companies or investment banks. Indeed, the shareholder's protection is threatened whenever the exercise of voting right is practiced without any particular dispositions of the shareholder himself.

This principle is valid also in those Countries operating in a market-based context where directors express an almost absolute power. The management oversight and control through the right to vote is shareholders' key function within a corporation. In our opinion, it is also more important rather than the control performed by the independent directors.

This function was introduced just for avoiding the non-participation of the shareholders in the company's life. Then, it seems logical thinking the issue origin is not caused by directors. It is undeniable that they have a very important function, which is often omitted for searching for personal profit. However, we believe that it is wrong to consider them as demons. If the shareholders will not be first to control the company's trend day by day, it won't be possible leading the managers towards a more ethical conduct, far from unscrupulous decisions that sometimes can be harmful not only for the shareholders but also for the company itself. Otherwise, measures concerning the corporate governance will be always more needed, but they will be far from the sad reality characterizing the economic-productive-financial system.

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