REVISED FINAL DRAFT 8 March 2022

COMPARATIVE CORPORATE GOVERNANCE

A Research Overview

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2022

SUMMARY

Corporate governance is intended to maintain the accountability, stability and performance of corporations. Corporate governance is evolving to concern not just the financial health of the company, but the social and environmental impact of the company. There is considerable international institutional diversity in corporate governance. The role and significance of market institutions varies among different governance systems.

In analysing the purpose of the company and the definition of value creation, the hegemony of agency theory and shareholder primacy is challenged. More expansive theoretical explanations are considered which recognise the deeper values companies are built upon, the wider purposes they serve, and the broader set of relationships they depend upon for their success. The growing emergence of the *Social License to Operate*, the open debate on the *Purpose of the Corporation* (a company's fundamental reason for being), and interest around the world in redefining the social and environmental obligations of corporations in the context of the devastating potential impact of climate change is beginning.

The defining impulses of the late 20thC and early 21stC corporate governance have focused upon digital technological transformation. Corporate governance has evolved through a series of competing epoch-making paradigmatic contests. The paradigm shift to corporate sustainability involves the corporate delivery of long-term value in financial, social, environmental and ethical terms.

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Chapter One

Introduction to Corporate Governance

ABSTRACT

Corporate governance is intended to maintain the accountability, stability and performance of corporations. Corporate governance is evolving to concern not just the financial health of the company, but the social and environmental impact of the company. The origins of the corporate form are considered, and the implications of the subsequent separation of ownership and control. As institutional investors increasingly become the majority shareholders in listed corporations across the world their interest in pursuing the link between governance and performance has heightened considerably. However, the question of what constitutes value and how it may be measured continues to be the subject of much controversy. The dominant theoretical framework for understanding corporate governance is agency theory, however as the limitations of this conceptual approach become apparent, more expansive interpretations of the purpose of governance have become prominent. Adopting and synthesising different theoretical perspectives may begin to provide a fuller understanding of the mechanisms and processes of corporate governance.

The Relevance of Corporate Governance

Corporate governance has wide implications and is critical to economic and social well - being, firstly in providing the incentives and performance measures to achieve business success, and secondly in providing the accountability and transparency to ensure the equitable distribution of the resulting wealth. The significance of corporate governance for the stability and equity of society is captured in the definition of the concept offered by Cadbury (2000) and adopted by the World Bank: “Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of

resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society."

The G20/OECD (2015) have endorsed the central importance of corporate governance for the maintenance of economic stability and the performance of corporations: "The purpose of corporate governance is to help build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies." Principles of corporate governance are not an end in themselves, but a framework on which to "develop more detailed mandatory or voluntary provisions that can take into account country-specific economic, legal and cultural differences."

Corporate governance essentially has three elements defining corporate purpose, balancing interests, and measuring performance. Historically these elements have been broadly interpreted with corporate *purpose* related to the wide interests of stakeholders and the community amounting to a *licence to operate.* The governance mechanisms have been understood as providing a sense of accountability, responsibility and fairness regarding the interests of the different participants in the company. Finally, performance measurement also has been widely conceived as contributing value in financial, social and environmental terms (Clarke 2023).

This careful historical calibration of interests was deliberately overturned by the doctrine of shareholder value and imposition of the idea of *shareholder primacy*. We are now entering an era in which the irresponsibility of such narrow estimations of corporate purpose, governance and performance is becoming manifest. The onset of significant, damaging and apparently relentless human and industry induced climate change has demanded a reconceptualization of the business *license to operate* around the principles of sustainability (Klein 2015; Rasche and Waddock 2014).

In the past corporate objectives described as ‘wealth generating’ too frequently have resulted in the loss of well-being to communities and the ecology. But increasingly in the future the *license to operate* will not be given so readily to corporations and other entities. A license to operate will depend on maintaining the highest standards of integrity and practice in corporate behaviour. Corporate governance essentially will involve a sustained and responsible monitoring of not just the financial health of the company, but the social and environmental impact of the company.

In this work the comparison and synthesis of the institutional diversity of corporate governance internationally will be placed in the context of an increasingly resource-constrained environment in which corporations will face new responsibilities and constraints. The re-evaluation of fiduciary duty is presently taking place, and will prove to be profound, as Watchman states, “The concept of fiduciary duty is organic, not static. It will continue to evolve as society changes, not least in response to the urgent need for us to move towards and environmentally, economically and socially sustainable financial system” (UNEP 2015: 9). The fundamental purpose of corporate governance will increasingly become the delivery of corporate social responsibility and sustainability (Clarke 2015; 2016; Clarke, Edwards and Benn 2023).

Origins of Corporate Governance

The business corporation emerged as the dominant form for business association in the early twentieth century, but its antecedents lie eight hundred years earlier in the notion of the corporate entity developed to resolve problems of group relations in religious and social communities. These medieval elements were transformed by the application of corporate ideas and practices of the business enterprises that came later (Redmond 2005a: 28). Among these devices was the idea of the ‘*incorporate person*’ – the interpretation of companies as legal persons with rights and duties. Corporate bodies recognized by common law were applied to business organizations in England and Holland when charters were granted to incorporate trading companies which became joint stock companies. Speculative excesses quickly followed the formation of the early trading companies.

However, the principle of people managing companies being responsible for the investments of others was now well established in business organizations. The resulting concerns regarding corporate governance are not a new thing, and Adam Smith in 1776 in *The Wealth of Nations* made a comment on company management that would echo through the ages:

'Being managers of other people's money than their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private co-partner frequently watch over their own . . .Negligence and profusion, therefore, must always prevail more or less in the management of the affairs of a joint stock company' (Smith 1976: 264–265).

As technological change advanced with the industrial revolution and corporations increased in scale and activity, there occurred a wider diffusion of ownership of many large companies as no individual, family or group of managers could provide sufficient capital to sustain growth. Berle and Means chronicled the profound implications of this *separation of ownership and control:* 'the dissolution of the old atom of ownership into its component parts, control and beneficial ownership' (1933: 8). For Berle and Means it was axiomatic that as the number of shareholders increased, their influence upon corporate enterprise diminished as professional managers took control. As corporations became the dominant vehicles of the US economy, their legal instruments of incorporation – particularly in the state of Delaware which became the most popular jurisdiction in which to incorporate – increasingly reflected the interests not of stockholders, but of the executive management who intended to run the corporation.

Berle and Means identify two distinct functions of the corporate entity, first the commercial operations, and second the business of raising capital, and distributing risks, losses and gains. Whilst managers may reasonably insist on as free a hand as possible in running commercial business activities, it is quite a different thing to allow management power to determine how the financial surplus of the corporation is distributed.

The separation of ownership and control occurs as the ownership of corporations is progressively diluted from complete ownership to minority control, and though there are many devices for working control of a corporation to be retained by those with only a

minority of the shares, eventually the situation is reached when ownership is so widely distributed that no minority interest is large enough to dominate the affairs of the company. At this point even the largest single interest amounts to just a small percentage of the total shareholdings, insufficient to place irresistible pressure upon management. Means (1931) recognizes a range of potential forms of dilution of ownership control:

- control through almost complete ownership
- majority control
- control through a legal device without majority ownership
- minority control
- management control

Different mechanisms are outlined by Means by which managers are able to shift the enterprise profits, and to a considerable degree the underlying assets, among groups of stockholders (including themselves). There are countervailing forces including the need to maintain a reputation for probity if new sources of funds are to be accessed, the influence of the law and state regulation, and the intervention of the financial community. However, vigilance is required to prevent managers acquiring absolute power.

In what became the most influential work on corporate governance in the twentieth century *The Modern Corporation and Private Property* (1933) Berle and Means anticipate the emergence of a new form of social organization, citing Walther Rathenau who commented on similar developments in German corporate life: 'The depersonalisation of ownership, the objectification of enterprise, the detachment of property from the possessor, leads to a point where the enterprise becomes transformed into an institution' (1933: 304). Berle and Means (1933: 306) acknowledge that potentially there are three forms that might emerge to govern this new corporation:

- The first is without regard for the change of character from *active* ownership to *passive* property ownership, to maintain the doctrine of strict property rights, by which the management are placed in a position of trusteeship for the *sole* benefit of

the shareholders, despite the fact that the latter have ceased to have power or accept responsibility for the *active* property in which they have an interest.

- In direct opposition to the doctrine of strict property rights, is the view that corporate developments have created a new set of relationships, giving to the management powers which are absolute and not limited by any implied obligation with respect to their use. This would reflect a significant modification of the principle of private property.
- A third possibility exists however, that passive property rights should yield before the larger interests of society. The management of corporations should develop into a neutral technocracy, balancing the claims of various groups, employees, customers, shareholders and the community, and assigning to each according to a transparent policy.

In the most passionate argument in favour of the merits of the third alternative as the right course for the future development of corporate governance Berle and Means declare:

"Eliminating the sole interest of the passive owner, however, does not necessarily lay a basis for the alternative claim that the new powers should be used in the interest of the controlling groups. The latter have not presented, in acts or words any acceptable defence of the proposition that these powers should be so used. No tradition supports this proposition. The control groups have, rather, cleared the way for the claims of a group far wider than either the owners or the control. They have placed the community in a position to demand that the modern corporation serve not alone the owners or the control but all society. This third alternative offers a wholly new concept of corporate activity. Neither the claims of ownership nor those of control can stand against the paramount interests of the community . . . It only remains for the claims of the community to be put forward with clarity and force." (1933: 309)

Almost a century after Berle and Means expressed these hopes for a different concept of the corporation with much wider accountability to the community, the issue remains one of the most alive and highly contentious dilemmas for corporate governance. The call of Berle and Means for an increase in the recognition and scope of fiduciary duties of those who

controlled corporations continues to influence legal thinking in the context of climate change and the call for more socially and environmentally responsible corporations.

Governance and Performance

Good governance has always been intuitively associated not just with soundly run, but with commercially successful companies. Countries known for their robust governance institutions attract investment capital. This was central to the understanding of corporate governance that informed the work of the Cadbury Committee which insisted on the first page of its pioneering report:

"The country's economy depends on the drive and efficiency of its companies. Thus the effectiveness with which boards discharge their responsibilities determines Britain's competitive position. They must be free to drive their companies forward, but exercise that freedom within a framework of effective accountability. This is the essence of any system of good corporate governance." (1992: 1.1)

There is an increasing realization the higher standards of corporate governance are not only necessary to ensure accountability, but also to positively improve corporate performance. Though the evidence relating governance reforms to performance improvement in the past has proved mixed, more sophisticated methodologies are now being applied with more promising results, with 'an increasing body of finance literature suggesting companies with superior governance offer better relative investment performance or lower investment risk' (Goldman Sachs 2006: 4).

As institutional investors increasingly become the majority shareholders in listed corporations across the world their interest in pursuing the link between governance and performance has heightened considerably. However, the question of what constitutes *value* and how it may be measured continues to be the subject of much controversy. Once company value creation could be measured solely in financial terms: it was simply a question of the company generating a profit. In this narrow view any social costs or environmental impact of business activity could be written off as *externalities* for communities or government to deal with.

This constricted set of values is now unacceptable and encounters direct challenge wherever it is still asserted. There is a strong sense emerging among both the general public and investment community that the wealth-generating activities of corporations do need to be recognized and enhanced within a wider framework of social and environmental responsibility, moving 'sustainability issues from the periphery of corporate strategy to the heart of it' (UNEP 2014a: 5).

Corporate Governance and Sustainability

The definition and appreciation of what constitutes wealth creation is changing in radical ways which corporations and their governance are only just beginning to contemplate (Benn and Dunphy 2006). In the past it was all too easy for corporations to simply externalize their social and environmental costs. However, the realization that social cohesion and ecological integrity represent values as material and valuable as any monetary values, suggests the next great challenge for companies is to bridge the divide between corporate governance and corporate social and environmental responsibility. Corporations increasingly will be held to account for their social and environmental impact. In social terms they will need to demonstrate a commitment to their employees, community and wider society that ensures they do no harm to the health and well-being of people and do everything they can to improve the quality of life. In environmental terms corporations will be made to bear the cost of any impact on the environment, and there will be incentive structures to enable better responses and solutions to environmental problems. This widening of the responsibilities of companies will demand a new conception of corporate governance and business objectives, a new understanding of the corporate mission (UNEP 2014a, 2014b; UNEP/CISL 2014).

There is some doubt as to whether existing explanations of corporate existence, activities and objectives are adequate to the task of examining or explaining this new corporate horizon. A great deal of legal and academic thinking on corporate governance and corporate purpose remains trapped within the tight parameters of *agency theory*, assuming the only real issue is *principal/agent* relations, and that delivering *shareholder value* will resolve all problems. The understanding of the responsibilities and objectives of corporate governance needs to be developed to encompass wider concerns and deeper relationships. The corporate licence to operate needs to be negotiated not only with shareholders, but with a much wider constituency of stakeholders representing social and environmental interests. The dominant

theoretical perspective in corporate governance has neglected this wider understanding of the purpose of the corporation and substituted instead a conceptually narrow view. To understand the comparative development of corporate governance, it is useful to consider the theoretical explanations that have sought to explain this phenomena.

Agency Theory

We understand the world through evolving theoretical frameworks, and these theories inform our action. The dominant theoretical framework for understanding corporate governance is undoubtedly agency theory, whatever its evident limitations. Rampant executives running out of control at the shareholders expense is a sharp reminder of the significant and enduring agency dilemmas in corporate governance. Agency theory conceives of the firm as a *nexus of constantly re-negotiated contracts* by individuals each aiming to maximise their own utility (Alchian and Demsetz 1972). Jensen and Meckling (1976) suggest the essence of the agency problem is the separation of finance and management. Investors (principals) need the managers' (agents) specialised human capital to generate returns on their funds.

The principals and agents effectively have an unwritten contract that specifies what managers can do with the funds, and how the returns will be divided between them and the shareholders. A problem is that as future contingencies cannot be anticipated, complete contracts are not feasible. The principals and agents have to allocate *residual control rights*: the rights to make decisions not foreseen in the contract. Managers inevitably acquire considerable residual control rights, providing discretion over how to allocate investors' funds. From this point of view the subject of corporate governance concerns the constraints principals can put on agents to reduce misallocation of investor's funds.

Agency theory claims shareholders have the right to residual claims since they are the residual risk bearers: the only economic actors who make an investment in the corporation without a contractual guarantee of a specific return. As the *residual claimants*, shareholders bear the risk of the company making a profit or a loss, and they have a direct interest in the allocation of corporate resources to make the largest residual possible. As the basis of agency theory is the *self-interested utility-maximising motivation* of individual actors, it is assumed

the relationship between shareholders and managers will be problematic, and there is a single-minded focus on how the principal is able to prevent the agent from maxmising his own utility (Jensen 1994).

For agency theorists efficient *markets in corporate control*, management, and information are the means that militate against the agency problem. However, as *agency dilemmas* are so inherent in the corporate form, the universality of the publicly listed corporation is a phenomenon of enduring concern: 'Why, given the existence of positive costs of the agency relationship, do we find the usual corporate form of organisation with widely diffuse ownership so widely prevalent. If one takes seriously much of the literature regarding the "discretionary" power held by management of large corporations, it is difficult to understand the historical fact of enormous growth in equity in such organisations not only in the United States, but throughout the world' (Jensen and Meckling 1976:330).

The way agency theory has come to dominate so completely the corporate governance literature is explained by Daily, Dalton and Cannella (2003:372) as due to two factors:

"First, it is an extremely simple theory, in which large corporations are reduced to two participants – managers and shareholders – and the interests of each are assumed to be both clear and consistent. Second, the notion of humans as self-interested and generally unwilling to sacrifice personal interests for the interests of others is both age old and widespread … Economists struggled with this problem for centuries until Jensen and Meckling (1976) provided their convincing rationale for how the public corporation could survive and prosper despite the self-interested proclivities of managers. In nearly all modern governance research governance mechanisms are conceptualised as deterrents to managerial self-interest."

Double Agency Dilemmas

Agency theory does address some of the central dilemmas associated with the transformation of the simple control structures of the owner entrepreneur company, to the more complex controls required following the separation of ownership and control. However, agency theory underestimates and over-simplifies the complexity of many corporate relationships and

purposes and distills these down to the simple mechanisms of principal/agent tensions. There is to begin with what is in effect a *double agency dilemma*, firstly in the relationship between shareholders and board of directors, and secondly in the relationship between board of directors and management. Yet agency theory concentrates all its attention on the shareholders/directors dilemma, and scarcely ever enter the 'black box' of the firm to consider the relationship between boards of directors and management. Despite this constricted focus it is the fundamental tenets of agency theory that have informed much of corporate governance policy and practice in recent decades:

"The dominant view of boards, a view that had underpinned the majority of reform activity, is that the board acts as a control mechanism to reduce the potential divergence of interests between corporate management and shareholders. Non-executive directors, because of their supposed independence and objectivity, provide an important check and balance to the power of the chief executive and his or her executive team. The notion of 'contestability' in the boardroom has become central, and the model for boards is unmistakably adversarial."
(Stiles and Taylor 2002:1)

The translation of the complexities of the corporate world into a simple set of control relationships neglects the political, organisational and technical dimensions of business activity, that make it less predictable and controllable than it might appear.

"Agency theorists need to assume not only that people are self-seeking economic utility maximisers, but that they are fully competent self-seeking utility maximisers. In other words, they need to assume that, faced with particular choices, people will in fact make the decisions that maximise their utility … Nobody with any knowledge of business would suggest that all managers are equally competent or that any manager can infallibly achieve their objectives, whether these are the objectives set by their shareholders or those dictated by their own self-interest. The world of business is simply not like that. On the contrary, it is confused, uncertain and unpredictable. The information on which decisions have to be based is both insufficient and overwhelming and can be full of contradictions. Implementation of a decision can be wrecked by a host of technical, personal and interpersonal factors quite outside a chief executive's control. The most carefully and competently constructed judgements, whether they be executive judgements of how to run the business, or non-

executive judgements of how the executives are performing, can with hindsight appear fatally flawed" (Hendy 2005:58).

This is not to suggest that the effort to exercise effective control and coherent direction in corporate enterprise is futile, but it does imply that the application of simple rules or the assumption of crude interpretations of motivation is likely to be inappropriate. The effort to understand and to bring into some alignment the interests of shareholders, the activities and aspirations of managers, and the concerns of wider stakeholders, requires more careful analysis and application than agency theory might offer. As Pye and Pettigrew (2005:30) argue "The idea that all managers are self-interested agents who do not bear the full financial effects of their decisions (Jensen and Meckling 1976) has provided an extraordinary edifice around which three decades of agency research has been built, even though these assumptions are simplistic and lead to a reductionist view of business, that is, comprising two participants – managers (agents) and shareholders (principals)." Attempting a deeper understanding of corporate governance relationships requires consideration of wider theoretical perspectives.

More Complex Theories of Corporate Governance

For too long corporate governance has been observed through a single analytical lens of agency theory that offers partial insights but cannot begin to examine the full dimensions of the problem or offer convincing explanations. The complexity and richness of the dynamic phenomena involved in corporate governance requires the application of a range of theoretical critiques to understand more fully the dilemmas involved:

"A multi-theoretic approach to corporate governance is essential for recognising the many mechanisms and structures that might reasonably enhance organisational functioning. For example, the board of directors is perhaps the most central internal governance mechanism. Whereas agency theory is appropriate for conceptualising the control/monitoring role of directors, additional (and perhaps contrasting) theoretical perspectives are needed to explain director's resource, service and strategy roles" (Daily, Dalton and Cannella 2003:372).

Existing theoretical approaches to corporate governance follow a continuum from the narrow focus of agency theory and transaction cost theory inspired by financial economics, through approaches including stewardship, resource dependency, stakeholder and managerialist theories developed by organisational theorists, to more critical analysis originating in sociological and political critiques (Clarke 2004). Each theoretical approach has its own logic and limitations, and though a number of the approaches represent opposing interpretations of the same problem, in some cases the theories serve to illuminate different dimensions of the governance problem.

After agency theory the most established theoretical approach is transaction cost economics. Ronald Coase (1937) insisted, notwithstanding the assumption of neoclassical theory that the allocation of resources is coordinated through a series of exchange transactions on the market, that in the real world a considerable proportion of economic activity is organised in firms. Coase examines the economic explanation for the existence of firms, and why economic activities take place within firms rather than through markets. He explains the nature of firms in terms of the imperfections of markets, and in terms of the *transaction costs* of market exchange.

New institutional economics differs from agency theory in that the corporate governance problems of firms are perceived to proceed from a number of contractual hazards. This approach is concerned with discovering internal measures and mechanisms which reduce costs associated with contractual hazards to an efficient level: the external discipline of the market cannot be relied on to mitigate these problems, as it has only "limited constitutional powers to conduct audits and has limited access to the firm's incentive and resource allocation machinery" (Williamson 1975:143). Like-neo classical economics though, the locus of attention remains the shareholder-manager relationship, but in this case it is because shareholders are perceived to "face a diffuse but significant risk of expropriation because the assets in question are numerous and ill-defined, and cannot be protected in a well-focused, transaction specific way" (Williamson 1984:1210; Learmount 2002:5). As with agency theory the narrowness of the focus limits the explanatory power of this analysis.

Relationship and Resource Based Theories of Governance

In contrast to agency theory, stewardship theory acknowledges a larger range of human motives of managers including orientations towards achievement, altruism, and the commitment to meaningful work. Stewardship theory maintains there is no inherent conflict of interest between managers and owners, and that optimum governance structures allow coordination of the enterprise to be achieved most effectively. Managers should be authorised to act since according to stewardship theory they are not opportunistic agents but good *stewards* who will act in the best interests of owners. Stewardship theory recognises a strong relationship between managers' pursuit of the objectives of the enterprise, the owners' satisfaction, and other participants in the enterprise reward. Davis, Schoorman and Donaldson (1997) suggest that as managers maximise shareholders' wealth through raising the performance of the firm, they serve their own purposes. Managers balance competing shareholder and stakeholder objectives, making decisions in the best interests of all. However, there is an element of choice in corporate governance arrangements, both managers and owners can choose to have either agency or steward relationships, contingent upon their assessment of the motivations of each other, and the situation of the enterprise. Stewardship theory rescues the integrity of management as a profession, something many managers would recognise and aspire towards.

There is a stream of theoretical approaches that widen the focus beyond internal monitoring, to explore the external challenges of corporate governance in terms of building relationships and securing resources. Resource dependence theory, institutional theory, and network theory all are interested in the external relations of corporations. Resource dependency theory highlights the *interdependencies* of organisations rather than viewing them simply in terms of management intentions. Hillman, Cannella and Paetzold (2000) for example examine how company directors may serve to connect the firm with external resources that help to overcome uncertainty, and provide access to relationships with suppliers, buyers, public policy makers and other social groups. Resource dependency approaches add a vital external dimension to corporate governance relationships.

Stakeholder theory defines organisations as *multilateral* agreements between the enterprise and its multiple stakeholders. The relationship between the company and its *internal stakeholders* (employees, managers, owners) is framed by formal and informal rules

developed through the history of the relationship. This institutional setting constrains and creates the strategic possibilities for the company. While management may receive finance from shareholders, they depend upon employees to fulfil the productive purpose and strategic intentions of the company. *External stakeholders* (customers, suppliers, competitors, special interest groups and the community) are equally important and are constrained also by formal and informal rules that businesses must respect. Stakeholder theory has an intellectual appeal and practical application, however it is argued often that multiple stakeholder responsibilities can leave management with too much freedom of manoeuvre (often by managers who do not wish to be more widely accountable!)

Critical Perspectives

From a more critical perspective managerialist theory focuses on the distinctions between the myth and the reality of the relative powers of managers and boards. Mace (1971) for example examines the 1960s ascendancy of corporate executives, when powerful CEOs selected and controlled the boards of directors of the companies they ran. He outlines how CEOs in the US were able to determine board membership, to decide what boards could and could not do, controlled the information and professional advice the board received, and determined the compensation of senior executives, including often themselves. When corporations fail, the question always arises, '*Where were the board of directors*?' However, there is a wide gap between what directors are supposed to do, what people generally assume directors do, and what they are actually allowed to do in practice.

Mace catalogues how dysfunctional boards rather than being exceptional, became normal in the United States, as executives took control. Finally, there are more radical theoretical critiques which suggest that corporations perpetuate the power of an elite, serving to exploit others in the interests of accumulating wealth and power (Mills 1971). Though radical analysis faded after the 1960s, it has enjoyed a new lease of life in the widespread critique of the impact of globalisation which corporations have spearheaded, and in the critique of the sustainability of corporations (Clarke et al 2019; Weinstein 2012, 2013; Baars and Spicer 2017; Fleming and Spicer 2007).

Complementary Theories of Corporate Governance

Adopting and synthesising different theoretical perspectives may begin to provide a fuller understanding of the mechanisms and processes of corporate governance. In a survey of board practice Philip Stiles and Bernard Taylor recommend the explanatory power of a series of theoretical perspectives. The structure of the board, its monitoring of budgets and plans, and its address to performance and targets, all reflect the assumptions of agency theory and transaction cost theory underpinning the control role of the board:

"Consistent with this theme, however, is the finding that boards may actively help companies to unlearn organisational practices that have become dysfunctional (Nystrom and Starbuck 1984). That is, boards may diagnose new opportunities, select new performance measures, and emphasise certain control systems at the expense of others, in order to bring the organisation to a new focus. This supports the stewardship theory of board activity and suggests that, in certain circumstances, both organisational economics and stewardship theories may be complementary. The combination of what Tricker (1994) calls the conformance and performance roles suggests that multiple theoretical lenses are appropriate. Reinforcing the case for complementary theoretical perspectives is the evidence of boundary-spanning activity on the part of non-executive directors but also of the executive directors, providing support for the resource-dependence view of board activity. Our approach is, therefore, in line with greater calls for reconciliation between economic and organisational perspectives (Kosnik 1987; Eisenhardt 1989; Judge and Zeithaml 1992) and shows that seemingly contradictory approaches can coexist as theoretical explanations" (Stiles and Taylor 2002:122–123).

There are many other established and emerging theoretical tools that may enhance the understanding of corporate governance however, and they may prove increasingly necessary given the decisive challenges ahead. The essential and eternal concept of *trust* is a good place to commence. Trust is a vital component of corporate governance, and the absence of trust is deeply corrosive. As Stiles and Taylor (2002:23) note, much of the activity of corporate governance revolves around the building of trust: 'A series of studies by Westphal and Zajac has highlighted how the interpersonal influence processes in the board/chief executive relationship can help trust and cooperation develop within the board and help problem-

solving and decision-making activity (Westphal and Zajac 1995, 1997; Zajac and Westphal 1996)'. In their own research on boards Stiles and Taylor (2002:123–124) indicate how trust and control are not mutually exclusive:

"Underpinning the discussion has been the central role of trust in enhancing both board task performance and board cohesiveness. The model of trust argued for has not been the traditional one of trust and control conceptualised as opposite ends of a continuum. Rather trust and control are interdependent. Because the board operates in complex and uncertain conditions and is often characterised by role conflict the potential for both trust and control to coexist is apparent. Control mechanisms serve to focus members' attention on organisational goals, while trust mechanisms promote decision-making and enhance cohesiveness."

Team Production Theory

Another tributary of ideas has offered a more thoughtful interpretation of the corporate governance dilemma. *Team production* theory, initiated by Alchian and Demsetz, comprehends something of the collaborative basis of business endeavor that was fundamental to earlier theorists. The reformulation of team production theory by Margaret Blair and Lynn Stout presents a recognizable and meaningful explanation of the purpose of the corporation and the duties of directors. Rather than conceiving of the company as a bundle of assets that belong to shareholders, Blair (1995) argues corporations may be conceived as institutional arrangements for governing the relationships between all of the parties that contribute firm-specific assets. This includes not only shareholders, but also long-term employees who develop specialised skills of value to the corporation, and suppliers, customers and others who make specialised investments.

If the job of management is to maximise the total wealth of the enterprise rather than just the value of the shareholders' stake, then management must take into account the effect of corporate decisions on all stakeholders in the firm. In adapting the *nexus of contracts* theory, Blair and Stout (1999; 2001; Kaufman and Englander 2005) consider shareholders as only one of the parties that make a contribution to the firm, and effectively are not the only residual claimants of the firm. Other groups, including employees, creditors, managers, and

government, make contributions to ensure the enterprise will succeed. The assets created are generally firm specific and, once committed to team production, cannot be withdrawn and sold elsewhere for their full value. Blair and Stout provide an expansive adaption of the original theoretical framework of Alchian and Demsetz (who themselves did not use the concept of "nexus of contract," though it is closely associated with their work).

For Blair and Stout, team production theory with the board of directors serving as a "*mediating hierarchy*" between the different interests provides a sound foundation for conceiving of the corporation in both law and practice:

"We believe, however, that our mediating hierarchy approach, which views public corporation law as a mechanism for filling in the gaps where team members have found explicit contracting difficult or impossible, is consistent with the "nexus of contracts" approach to understanding corporate law. The "nexus of contracts" view of the firm holds that relationships in the firm should be understood as an intertwined set of relationships between parties who agree to work with each other in pursuit of mutual benefit, even though not all the relationships that comprise a firm are necessarily spelled out in complete "contracts." It might perhaps be more informative to think of corporations, and hierarchical governance structures within corporations, as institutional substitutes for contracts, just as property rights are an institutional substitute and necessary precondition for contracts. Nevertheless, we locate the mediating hierarchy model of the public corporation within the nexus of contracts tradition because in the model, team members voluntarily choose to submit themselves to the hierarchy as an efficient arrangement that furthers their own self-interests" (Blair and Stout 1999:254).

Deakin advances further the idea of the corporation as an essentially collaborative institution. He argues the concept of the corporation as a *commons* or shared societal resource is more consistent with its legal nature and offers the possibility of realigning corporate governance (Deakin 2017). "To describe the corporation as an *institutional commons* in the sense identified by Elinor Ostrom (Ostrom, 1990; Poteete, Janssen and Ostrom, 2011) is not to claim that it is completely ownerless. The commons as a whole cannot be owned, but there

are numerous property-type claims in and over the resources contained within it. These are not simply the shareholders' rights of exclusion and alienation identified by corporate law scholarship, but rights of access, withdrawal and management which frequently vest in other stakeholder groups, including employees and creditors, but also fiscal and regulatory bodies. The task of governing the corporation is the same as that of governing all other commons, which is to devise a set of norms which will enable the overlapping and competing claims of the different stakeholder groups to be reconciled, with a view to sustaining the common resource on which they all, in different ways, depend. Company law, as an evolved response to the coordination problems inherent in the business enterprise, very well exemplifies Ostrom's focus on institutional evolution as the basis for effective and sustainable governance arrangements" (Deakin 2017).

Whilst such radical reconceptualization of the corporation are rare, it is likely that to meet the imminent challenge of social and environmental sustainability in a post-carbon economy, further profound rethinking of corporate form, purpose, governance, and directors' duties will be an essential and very practical task.

Other theoretical perspectives may well contribute to a radical reconceptualization of corporate governance around theories such as *social capital* that conceives of value creation arising in social relationships; the *knowledge based theory of the firm* which acknowledges the increasing importance of intellectual capital as the basis of value creation in the knowledge economy; theories that see the firm as a *complex adaptive system* that wrestles with and adapts to its competitive economic environment; theories of *creativity and innovation*; and most important of all the theory of *sustainability*, and whether the corporation can become a sustainable form of economic activity. These approaches all demand that corporate governance can only be understood by going beyond the shareholder/manager relationship, and the immediate mechanisms and institutions of governance, to a deeper understanding of the relationships between corporations and the economies and societies they serve (Clarke 2004).